









ANNUAL REPORT AND FINANCIAL STATEMENTS 2015

southwestwater.co.uk

SOUTH WEST WATER

WELCOME TO SOUTH WEST WATER

South West Water Limited is a wholly owned subsidiary of Pennon Group Plc.





Welcome to our Annual Report 2015.

Over the past year we have continued to deliver solid operational and financial performance while preparing the Company for a successful transition into the next regulatory period. With significant industry changes underway I am delighted that the progress we have made places us in such a strong and confident position going forward."



Ken Harvey
Chairman

WHERE WE OPERATE

Since 1989 we have been providing water and sewerage services to Devon, Cornwall and small parts of Dorset and Somerset.

4,170 sq miles
1.7m residents
8m visitors a year

Our region is rural in nature, featuring moors, areas of high ground, a long coastline, and a strong agricultural base.

There are a few large urban centres of which Plymouth, Torbay and Exeter (where we are based) are the largest.

The region's areas of natural beauty and large number of beaches attract high numbers of visitors, particularly during the summer months, placing added seasonal demand on our resources, networks and assets.

ONLINE

southwestwater.co.uk/report2015

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STRATEGIC PRIORITIES

"A Pure Vision."

MORE DETAILS P.12



CHIEF EXECUTIVE'S STATEMENT

"A smooth transition into K6."

MORE DETAILS P.08



OUR PERFORMANCE

"Another year of robust operational and financial performance."

MORE DETAILS P.14

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CONTINUED SUCCESS

South West Water is driven by its 'Pure' vision of 'Pure Water, Pure Service and Pure Environment'. We manage the region's drinking water and wastewater in an integrated way 'from source to sea', delivering high quality services in the most efficient and sustainable way possible.

Revenue

£523.6m

2013/14: £521.5m

Operating profit before exceptional items

£225.4m

2013/14: £226.7m

Profit before tax and exceptional items

£167.9m

2013/14: £162.2m

Capital Investment

£145.1m

2013/14: £141.6m

Excellent drinking water quality

MORE DETAILS P.15

'Business Plan to 2020' assessed as enhanced

MORE DETAILS P.07

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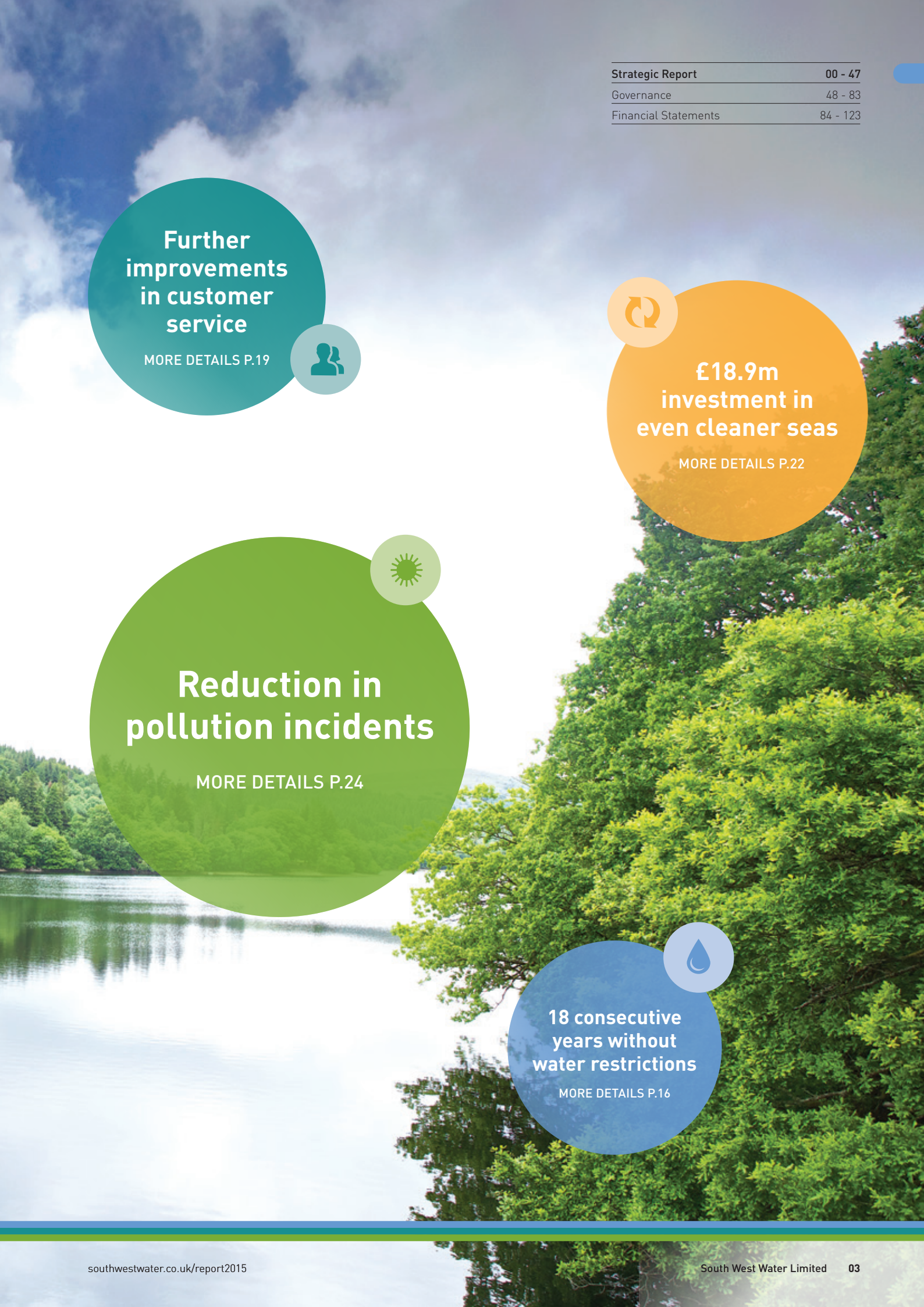


Further improvements in customer service

MORE DETAILS P.19

£18.9m investment in even cleaner seas

MORE DETAILS P.22

Reduction in pollution incidents

MORE DETAILS P.24

18 consecutive years without water restrictions

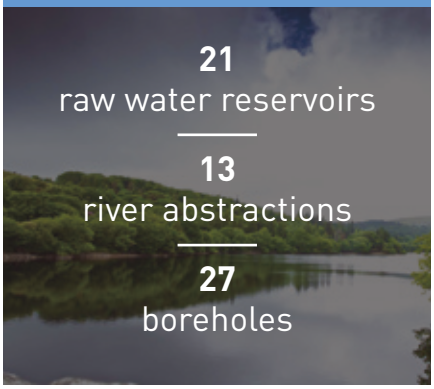
MORE DETAILS P.16

WHAT WE DO

UPSTREAM THINKING ON P.16

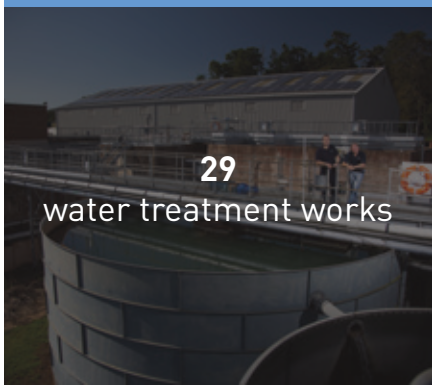
We abstract water from the environment

- maintenance of dams including upgrading spillways
- maintenance and upgrades of pumps and other assets (e.g. pipework)
- generating renewable energy using hydropower technologies.



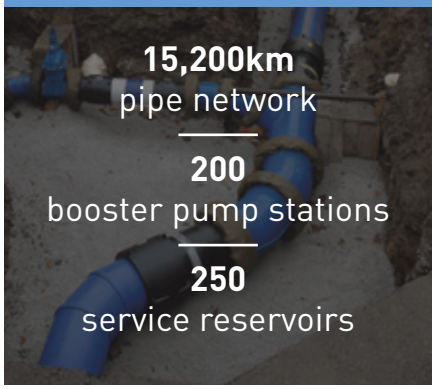
We clean it and make it safe to drink

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



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.



More than 715,000 households and 74,000 businesses and other non-household customers (e.g. public sector organisations, hospitals and schools) rely on us to deliver safe and clean drinking water and safely dispose of wastewater 24 hours a day, 365 days a year. Meeting their needs, along with our environmental and legislative responsibilities and obligations, is the focus of our operational activity.

South West Water is a wholly-owned subsidiary of Pennon Group Plc, a FTSE 250 business which also owns Viridor, one of the UK's leading recycling, renewable energy and waste management companies.

715,000
households

74,000
non-households

24/7
service

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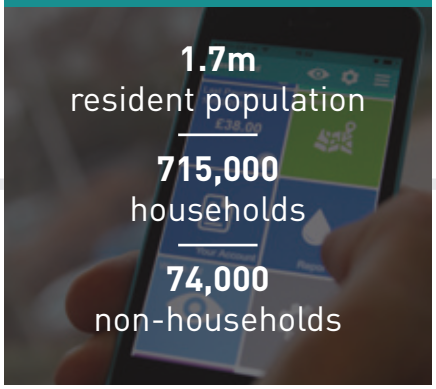
Our customers rely on the services we provide

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



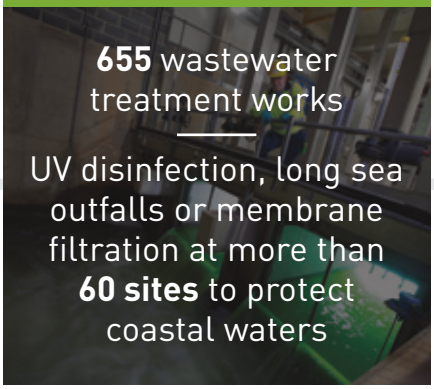
We collect wastewater

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



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
- biosolid recycling
- energy generation from treatment processes through Combined Heat and Power (CHP).



As a regulated business, our investment programme and the charges our customers receive for the services they use is set every five years in agreement with the water industry's economic regulator Ofwat. We are also subject to quality and environmental regulation by the Drinking Water Inspectorate (DWI), the Environment Agency (EA) and Natural England (NE).

The Company strives to deliver the services customers rely on in the most efficient and sustainable way possible. By targeting the outperformance of our efficiency targets, managing our costs in the most effective way and keeping financing costs as low as possible we generate returns for our shareholder and its investors, in addition to those earned through our asset base.

NON-REGULATED BUSINESS

In addition to our regulated services we also invest in a number of non-regulated business areas. These include:

- Source for Searches: a comprehensive range of residential and commercial property services to support the purchase, sale, re-mortgage or development of property or land;
- Laboratory Services: analytical services including water, wastewater, soil and sludge analysis;
- Training: training programmes for various business areas including operational skills such as driver training, health and safety, clerical skills and energy efficiency.

SOURCE FOR BUSINESS

Source for Business, a subsidiary of South West Water, offers a range of additional commercial services for non-household customers including water efficiency advice and support.

SOUTH WEST LAKES TRUST

The South West Lakes Trust (SWLT), an independent charity, manages the access and recreational opportunities available at our reservoir sites (see page 37).

DOWNSTREAM THINKING ON P.27

CONTINUED SUCCESS IN 2015



Ken Harvey
Chairman
3 July 2015

"Over the past year we have continued to deliver solid operational and financial performance while preparing the Company for a successful transition into the next regulatory period."

It is with great pleasure that I welcome you to South West Water's Annual Report for 2015, our final year of reporting for the K5 (2010-15) period and my last as Chairman of the Pennon Group.

Five years ago South West Water embarked on its business plan for 2010-15. Against the backdrop of a troubled economic climate, the Company struck a challenging balance of investment and activity in order to make targeted improvements and protect long-term business value while minimising the impact on customer bills.

It is pleasing to report that through strong leadership, rigorous cost control and a focus on delivering efficiency through innovative and sustainable solutions, that plan has been delivered. Underpinned by the Company's 'Pure' vision' of 'Pure water, Pure service, and a Pure environment', major improvements have been made in many business areas.

The Company has pioneered a catchment focused approach to water and wastewater management, outperformed its efficiency targets for the period, and taken transformative steps to improve customer satisfaction while protecting the region's unique natural environment.

2015 PERFORMANCE SUMMARY

In addition to delivering excellent drinking water quality, an 18th year without water restrictions and further investment in wastewater management and treatment, South West Water's notable successes from the past year include the lowest ever level of contacts received about drinking water discolouration and the lowest number of serious pollution incidents since 2009.

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Challenges remain, particularly in areas such as the prevention of flooding and pollution, however our overall operational performance has been strong and this is reflected in an ongoing trend of increased customer satisfaction.

FINANCIAL PERFORMANCE

Despite the price freeze in customer bills (announced as part of the Business Plan to 2020), South West Water's revenue for 2014/15 was £523.6m (2013/14: £521.5m) – an increase of 0.4% resulting from increased demand and new connections. While operating profit was lower than the previous year, profit before tax was £167.9m (before exceptional items), an increase of £5.7m. This improvement reflects continued strong cost control and favourable interest costs.

DIVIDEND

As a result of South West Water's strong performance against the regulatory contract, dividends of £255.8m were paid in the year, reflecting 169.5p per share and including a special dividend of £155.0m. South West Water remains within Ofwat's optimum range for an efficiently geared company.

GOVERNANCE AND SUCCESSION

The South West Water Board is committed to ensuring that the Company's governance structures and processes reflect best practice and meet the requirements of the UK Corporate Governance Code (to the extent it can be applied to South West Water in the context of the Pennon Group structure). In September 2014 we announced the appointment of two new Non-executive Directors: Steve Johnson, Chief Executive of Electricity North West and former Chairman of the Energy Networks Association; and Duncan Ingram, who has held a variety of commercial and charitable board appointments.

At that time, we also announced that South West Water's Finance and Regulatory Director Susan Davy would be moving into the role of Group Director of Finance for the Pennon Group. She has been succeeded as Finance Director by Louise Rowe, formerly South West Water's Corporate and Central Finance Manager, who was appointed to the South West Water Board in February 2015.

Having announced my own retirement from the Pennon Board effective July 2015, I am delighted the Group has appointed Sir John Parker as my successor. As the former chair of five FTSE 100 companies and CEO, chairman or Non-executive Director in more than twenty major UK and overseas companies, he is widely recognised as one of the most experienced and respected business leaders in the country.

I would like to take this opportunity to thank the South West Water Board members – past and present – for their support and expertise during my eighteen-year tenure. I feel privileged to have played a role in the Company's evolution and am extremely confident of its success in the years to come.

CLARITY FOR THE FUTURE

The progress made in the last five-year period means South West Water is well-placed for the next. It is testament to the calibre of the leadership team which steered our course through 2010-15 that the Company's 'WaterFuture' business plan for K6 (2015-20) was singled out for praise as 'high quality' by Ofwat and subsequently fast-tracked through the price review process in 2014.

As the only water and wastewater company to achieve this 'enhanced' status we have been able to forge ahead with greater clarity and make early headway on delivering further improvements for customers and the region.

A PERIOD OF TRANSITION

Significant changes are underway within the water industry, most notably with the introduction of competition in the non-household retail market in 2017. South West Water is preparing its wholesale and retail business units for the changes and liaising closely with the Government's 'Open Water' programme which is responsible for the architecture of the new market.

Ken Harvey
Chairman
3 July 2015

OUTLOOK

South West Water moves into the K6 period in a position of confidence and strength. Our WaterFuture Business Plan to 2020 has set out ambitious targets and an approach which offers greater rewards for outperformance but also penalties for failure. The task now is to deliver those plans and meet the promises made to customers, whose needs and expectations have been central to the business-planning process.

The Board is committed to the creation of value for shareholder and ensuring the sustainability of the business. A key part of this is ensuring we have the skills and talent necessary for success. On this last point, I would like to thank the staff at South West Water for their hard work to date and their commitment going forward. Together we are working towards a shared vision of service and operational excellence. I am proud of our achievements and wish everyone at South West Water the very best for the future.



Construction of additional storm water storage to protect bathing water quality at Teignmouth, Devon.

A SMOOTH TRANSITION INTO K6



Chris Loughlin
Chief Executive
3 July 2015

"2014/15 has been a landmark year for South West Water."

We successfully concluded the K5 (2010-15) regulatory period, delivering out-performance for the benefit of customers and shareholders, and made a smooth and swift transition into K6 (2015-20). This followed Ofwat's favourable assessment of our 2015-20 Business Plan and our acceleration of a number of key projects.

Operationally, the past year's performance has been strong. Our customers continue to enjoy a safe and high quality supply of drinking water, their number one priority in terms of service provision. As predicted, through careful resource management, we achieved an 18th consecutive year without water restrictions and we once again hit our leakage control target. Regrettably, a small number of large water main bursts resulted in an increase in drinking water supply interruptions during the year. In each case, we did our best to restore service as quickly as possible and we continue to focus on finding ways to prevent and mitigate the impact of such occurrences.

In the wastewater side of the business we continued to invest in improvements to our assets and network in line with the glide-path targets agreed with the Environment Agency.

18
years without water restrictions

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Progress is being made in our compliance with wastewater treatment standards. I am also pleased to report that the number of serious pollutions for the past year was the lowest it has been since 2009.

Recognising the pivotal role we play in protecting our region's unique natural environment we are working towards 'even cleaner seas' through a series of targeted capital investments. 99% of our region's bathing waters continue to meet the EU's mandatory or 'good' standard and we have been focused on making further enhancements in order to meet the revised standards of the Bathing Waters and Shellfish Waters directives which come into force this year.

RESPONDING TO OUR CUSTOMERS

Since the start of the 2010-15 period our operational performance, complemented by the improvements made in how we interact with our customers, has ensured an upward trend in customer satisfaction.

Since 2009/10 written complaints have more than halved and our customer service score* has almost doubled. We recognise that further efforts are required to improve our industry standing. To this end, investment in staff development and process enhancements are supporting our focus on improving the customer experience.

This includes making information and advice more readily available by proactively using a range of platforms including online, social media and SMS texting.

As one of a number of Board 'pledges' from our 2015-20 Business Plan, the price freeze has allowed us to pass savings on to our customers early, in a move which has been widely welcomed by customers, consumer groups and other stakeholders.

While the price freeze has impacted profits for the financial year, the revenues were taken into account in the K6 Final Determination on an NPV neutral basis. Despite the freeze, revenue has increased as a result of higher customer demand and new connections.

Recognising that some customers struggle to pay, we continue to offer a range of affordability schemes and are taking innovative steps to reduce customer debt. Practical advice on water efficiency and free standard meter installations are a key part of our WaterCare+ scheme which has now helped over 13,300 customers. Our social tariff – which was one of the first in the industry – is also helping a further 2,600 customers.

Furthermore, and in partnership with local Citizens Advice Bureaux, we are working in some of the region's most economically deprived areas to engage hard-to-reach and vulnerable customers to ensure they are aware of the advice and support measures available.

WATERFUTURE BUSINESS PLAN TO 2020

South West Water's 2015-20 business plan was singled out as 'high quality' by the industry regulator Ofwat and fast-tracked through the regulatory sign-off process after receiving 'enhanced' status. South West Water was the only water and sewerage company in the UK to receive this accolade. The plan followed South West Water's biggest ever customer consultation.

To view our plan in full, please visit: waterfuture.southwestwater.co.uk/business-plan-2020



£18.9m

Bathing Water Investment

* As measured by the Service Incentive Mechanism (SIM).

"As an employer and a business we continue to grow, investing in training and development and ensuring we have the right skills and the right people to move forwards effectively."

PREPARING FOR MARKET REFORM

A key area of focus for the year has been our preparations for the opening of the non-household retail market in 2017, as outlined in the Water Act 2014.

Our business customer services team continues to build the relationships it has with our 74,000 commercial and other non-household customers while also looking at the opportunities market opening will present outside of the region.

In the past year, and in response to business customer feedback, we have taken a number of steps to improve our offering and help us provide tailored support for individual customer sectors. Furthermore, we have established an internal 'MarketReady' programme designed to ensure the wholesale business is able to operate effectively and in-line with the new market code ahead of 2017.

Market reform will affect all areas of our business and we are acting accordingly to prepare our processes, systems, structures and governance. This includes playing an active role in the Open Water programme which is tasked with the design and implementation of the new market in England and Wales.

GOVERNANCE CHANGES

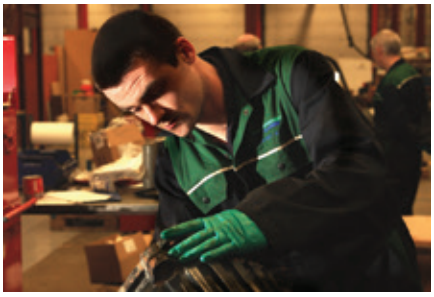
Within the executive team a number of changes have taken place. Following seven years with South West Water, Susan Davy's move from Finance and Regulatory Director of South West Water to Group Director of Finance for Pennon Group Plc. ensures her valuable expertise is retained within the Group.

We have welcomed Louise Rowe's appointment as Susan's replacement as Finance Director. Susan's regulatory responsibilities have been assumed by Iain Vosper, previously Price Review Programme Manager, who has joined the Executive Management Team as Regulatory Director.

MOVING FORWARDS

The high quality of South West Water's Business Plan to 2020 and our acceptance of the Final Determination in December 2014, means the Company has entered the 2015-20 regulatory period in a position of confidence.

We have risen to the challenge of finding even more efficient and innovative ways of working and I am encouraged by the hard work and dedication of our staff, whose efforts are essential to our future success.



100

South West Water selected as a Top 100 Apprenticeship Employer 2014

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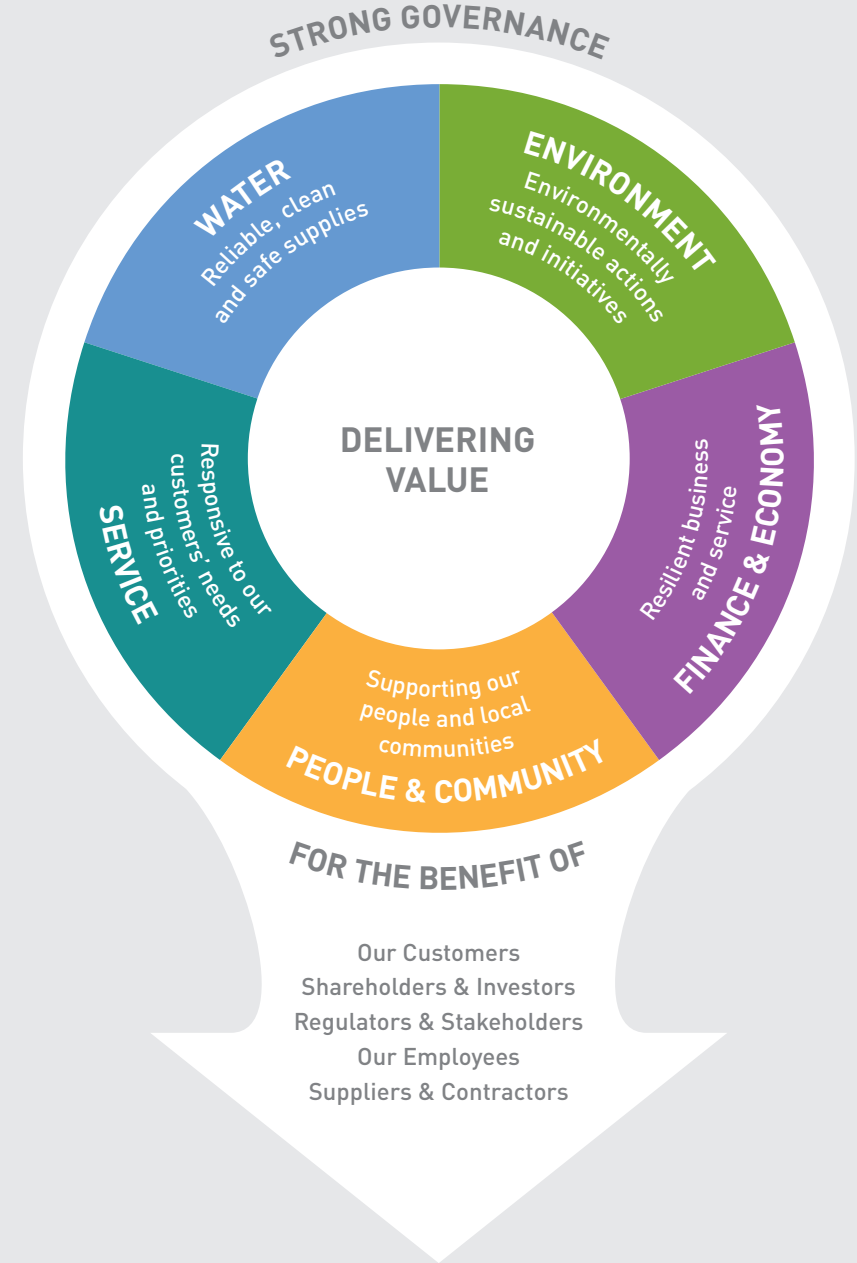
OUR BUSINESS MODEL

As an employer and a business we continue to grow, investing in training and development and ensuring we have the right skills and the right people to move forwards effectively.

We are proud of our successes over the past five years and resolute in our ambition to make further improvements for the benefit of the customers, stakeholders, environment and economy of our region in the years to come.

Chris Loughlin
Chief Executive
3 July 2015



A PURE VISION

OUR GUIDING PRINCIPALS

RELIABILITY

RESPONSIVENESS

SUSTAINABILITY

RESILIENCE

OUR BUSINESS OBJECTIVES

These reflect the South West Water 'Pure' vision and the activities required to deliver it.

WATER

Reliable, clean and safe supplies

SEE P.14

SERVICE

Responsive to our customers' needs and priorities

SEE P.18

ENVIRONMENT

Environmentally sustainable actions and initiatives

SEE P.22

FINANCE AND ECONOMY

Resilient business and service

SEE P.28

PEOPLE AND COMMUNITY

Supporting our people and local communities

SEE P.36

OUR STRATEGY

Innovation, partnership working and the use of new technology are key to delivering reliable, high quality drinking water supplies.

Targeted investments are made to ensure we meet or exceed our regulatory and legislative obligations.

Meeting our customers' needs and ensuring value for money is critical to our success as a business.

We are committed to improving the quality and responsiveness of the services they depend on.

The health of the natural environment is essential.

In every aspect of our operational activity we seek to minimise our impact on the environment while making enhancements to it where possible.

Attracting low-cost financing, maintaining the confidence of our investors, and generating additional returns for outperformance.

Optimising efficiency and prudent investment decisions.

Our people strategy is designed to attract, retain and develop the right people with the right skills.

We are also committed to making a positive contribution to the communities we serve.

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2014/15 PERFORMANCE

- robust drinking water quality
- excellence in leakage and water resource management
- ongoing investment to improve aesthetic qualities (taste, colour, odour)
- further progress for Upstream Thinking catchment management programme
- small number of large mains bursts impacted on figures for interruption prevention.

- customer satisfaction continued to increase
- investments made to improve customer service
- ongoing support for vulnerable customers
- further reduction in written complaints.

- strong bathing water quality results
- reduced floodings
- no major pollution incidents but further work required to reduce total number of pollutions
- reduced greenhouse gas emissions.

- capital efficiencies remain on track
- exceeding operating performance targets with £5.1m efficiencies delivered this year
- cumulative £27.3m efficiencies delivered in K5
- fully funded to the end of 2017.

- company-wide apprentice scheme expanded (14 recruited)
- delivery of employee development and upskilling programmes
- further support for education in the region
- partnership working with regional organisations.

2015-20 OUTCOMES

The following eight outcomes encompass our business operations and provide the framework for the monitoring and incentivisation of performance under our 2015-20 Business Plan.

- Clean, safe and reliable drinking water
- Reliable wastewater services
- Available and sufficient resources
- Resilience in extreme conditions
- Responsive to customers
- Protecting the environment
- Fair charging
- Benefitting the community

KEY PERFORMANCE INDICATORS

Each KPI is presented with a performance status:

- **Green** – performance is in line with expectations or better than expectations
- **Amber** – performance is marginally below expectations
- **Red** – performance is below expectations.

For those KPIs where performance is amber or red, an indication is given as to how the Company is managing the risks in this area and aiming to return performance to target levels.

KEY RISKS

For further information on Principal Risks and Uncertainties please see pages 42 to 47.

How we operate and manage risks

Strong corporate governance and a comprehensive risk management strategy are designed to ensure that South West Water can deliver safe, reliable and sustainable operations.

WATER

INVESTING IN WATER QUALITY

In 2014 we completed a £14.5m project to deliver even better drinking water to customers in Cornwall. The investment upgraded Wendron and Restormel Water Treatment Works, which between them supply around half of the county.

At Wendron, near Helston, five new Granular Activated Carbon (GAC) filters have been installed and the existing rapid gravity filters have been refurbished.

Granular Activated Carbon is a porous material with a large internal surface area – just one teaspoon has the same surface area as a football pitch. Due to its large surface area and specific surface chemistry it can remove large quantities of natural and man-made organic matter sometimes present in rivers and reservoirs supplying water treatment works.

Work started on both sites in 2013 and all the new filters came into use by the end of December 2014.

£14.5m

investment to improve drinking water quality

> "We already have some of the best tap water in the country. This major investment will deliver even better drinking water to our customers in Cornwall."
>
> **Chris Rockey**
> **Science and Water Quality Manager**

Colliford Reservoir, Cornwall.

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KEY PERFORMANCE INDICATORS

Drinking Water Quality*

2014	**99.96**
2013	99.98
2012	99.97
2011	99.99
2010	99.97

STATUS:

Security of Supply Index

2014/15	**100**
2013/14	100
2012/13	100
2011/12	100
2010/11	100

STATUS:

Leakage Ml/d

2014/15	**84.4**
2013/14	84.1
2012/13	84.2
2011/12	81.3
2010/11	83.7

STATUS:

Supply Interruptions hrs/property

2014/15	**0.38**
2013/14	0.25
2012/13	0.27
2011/12	0.62
2010/11	0.82

STATUS:

We aim to provide an uninterrupted supply of fresh clean drinking water which not only meets the highest official drinking water quality standards but is also free from any unwanted taste, smell or colour.

To achieve this we continue to invest in our assets and operations while pioneering new technologies and innovative sustainable solutions in areas such as catchment management.

DRINKING WATER QUALITY

South West Water continued to deliver high quality drinking water in 2014. The Company's performance for Mean Zonal Compliance remained strong, despite a very slight dip in this year's score which largely reflected the tightening of EU standards.

Significant capital schemes were completed during the year. These included the combined £14.5m of investment in water quality improvements (using GAC or Granular Activated Carbon) at the water treatment works of Restormel and Wendron.

UV treatment was also installed at Avon Water Treatment Works, Devon.

We made significant progress in improving our taste, odour and discolouration performance with the number of related customer contacts reaching its lowest level on record.

This has followed a series of targeted investments during 2010-15, including the construction of a new borehole (and the rehabilitation of a further three) to supply an area in East Devon which had previously been an outlier in terms of discolouration contacts.

In preparation for K6 (2015-20) we continue to invest in protecting and enhancing the quality of the drinking water our customers depend on. This includes both bringing forward the delivery, and expanding the scope, of improvements at Tamar Lakes Water Treatment Works in North Cornwall (which will now be complete by 2017 rather than 2020 as originally planned).

* As measured through Mean Zonal Compliance.

WATER CONTINUED

UPSTREAM THINKING

South West Water's award-winning programme of catchment management, 'Upstream Thinking' targets improved raw water quality and storage in the natural landscape using a range of low-cost sustainable techniques.

Delivered in partnership with a number of regional organisations, national park authorities, conservation groups, landowners and the farming community, the programme comprises:

- **Moorland restoration projects on Exmoor and Dartmoor**
  During 2010-15 2,000 hectares of moorland have been successfully restored. Activities such as ditch-blocking have reversed the effect of centuries of peat cutting (which has resulted in dried out eroded moorland areas). The new wetlands are providing benefits in terms of water quality, carbon capture, and natural water storage reducing the likelihood of flash flooding downstream. The projects have also had significant biodiversity and habitat benefits.

- **Agricultural schemes (such as grassland restoration, woodland planting and soil and manure management)**
  Alongside partners including Devon Wildlife Trust and the Westcountry Rivers Trust, we have been working with farmers and landowners to implement effective water management on properties with a potential impact on our region's water courses. Examples include grassland and woodland projects to ease and direct the flow of water, soil and manure management and fencing to prevent livestock from entering streams or rivers. Upstream Thinking is also supporting farmers to access capital grant funding in order to make improvements, comply with legislation and reduce the risk of pollution.

"While many of us have come to believe that looking after nature is a cost we can't afford, South West Water is one among a growing number of businesses who are proving the opposite to be the case. I was very impressed to see the Company's efforts to restore blanket bogs and grasslands in ways that will bring multiple benefits for society, in the process securing clean water at lower cost."

Tony Juniper
Former Friends of the Earth Director, advisor to HRH Prince Charles and author of 'What Nature Does For Britain'.



Changes in vegetation, as evidenced in studies carried out during 2014/15, indicate the degree to which Upstream Thinking is having an effect on water storage in the landscape.

WATER RESOURCES

South West Water is proud of its water resource management record. In 2014 we successfully avoided placing any water usage restrictions on our customers for the 18th consecutive year.

Prior investment in our reservoirs, the use of pumped storage and supply network improvements continue to ensure adequate supplies for the region.

During 2014/15 investment in the maintenance of our reservoirs included the completion of spillway improvements at KTT (Kennick, Trenchford and Tottiford) in Devon. We also completed a £10m 'grouting' scheme at Wimbleball Dam, Devon.

We are confident in having a healthy surplus of water for the foreseeable future. Our Water Resources Management Plan for the next 25 years (published June 2014) can be found at www.southwestwater.co.uk/waterresourcesplan.

LEAKAGE

We continued to control the amount of water lost through leaks and bursts in line with our target of 84Ml or less on average per day.

In addition to improving our response times to any network issues, we have been focusing on using advanced diagnostic tools to help us pre-empt any problems, address them more quickly and improve our water pressure management capabilities.

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To support our 2015-20 plans we are targeting improved leak detection, increasing our use of innovative technologies in the field and providing increased training for South West Water and partner staff.

PREVENTING INTERRUPTIONS

Lives and businesses depend on the reliability of our water service so we do our best to prevent and limit the impact of any network issues. This includes making sure our customers are proactively informed and updated about an interruption when it occurs or is necessary.

During 2010-15 we have continued with mains rehabilitation and focused on improving our operational planning and response processes. We have also been working closely with our customer services team using channels such as text messaging and mobile apps to communicate with customers and alert them to any problems.

In 2014/15 a small number of large mains bursts had an impact on our figures for the average hours of interruption per property. In particular, a burst trunk main at Hayle, Cornwall, in April 2014, affected 3,000 homes.

South West Water is carrying out further investment in equipment such as water supply tankers to help mitigate the impact of bursts when they occur.

OUTLOOK

Recognising that a 'clean, safe and reliable supply of drinking water' is our customers' number one priority, we continue to target high standards of drinking water service provision while also looking at how we can make our drinking water operations more efficient and environmentally benign. Our Business Plan to 2020 highlights some of the investments we plan to make in K6 (2015-20) in support of the following key 'outcome' areas:



CLEAN, SAFE AND RELIABLE SUPPLY OF DRINKING WATER

Investment in our assets and treatment processes will be aimed at maintaining and improving drinking water quality, tackling aesthetic issues (taste, odour, discolouration), and further reducing interruptions. Our drinking water strategy includes plans for a new water treatment works in North Plymouth which will use cutting edge water treatment technologies to improve efficiency. A pilot scheme is currently in place and the preliminary results have been extremely positive.



AVAILABLE AND SUFFICIENT WATER RESOURCES

Given our healthy water resource position, investment in this area is designed to maintain the current supply/demand surplus. In the long-term, we are also aiming to improve our capacity to move water to where it is needed most through the duplication of some sections of network.

Fundamental to our strategy is the ongoing maintenance of our drinking water assets and networks alongside the work we are doing to pioneer advances in drinking water treatment technology and catchment management. Investment in infrastructure is also complemented by identifying and implementing improved communication technologies in order to manage our workforce and operations in an increasingly efficient and customer-focused way.

SERVICE

RESPONDING TO FEEDBACK

South West Water monitors customer satisfaction on an ongoing basis to understand their experience of our services. We compare this to the customer contacts we receive to identify any emerging issues and to inform discussions with stakeholders.

Since we started this survey in 1994 we have seen customer satisfaction with services and value for money significantly improve.

We believe that by communicating with our customers and listening to their feedback we can deliver the best possible service for the region.

90%

highest ever customer satisfaction^



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Our goal is to provide our household and non-household 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 recent years we have taken steps to ensure that they can contact us in a variety of ways and that they can access the right type and level of advice and support depending on their needs and circumstances.

CUSTOMER SATISFACTION

Ensuring we meet or exceed the needs and expectations of our customers is critical to the success of our business.

Over the last five years we have made dramatic improvements to our customer service and customer satisfaction scores, as measured through SIM (Service Incentive Mechanism) and our ongoing customer satisfaction surveys. This reflects improvements made at both an operational level and in the way we interact with our customers and respond to any issues they may have.

A key part of our strategy for improving customer satisfaction is to be proactive in delivering information, advice and support. This includes making the most of digital communications and new media (e.g. Webchat), investing in the training and development of our staff, and ensuring our processes for resolving any issues are as integrated and effective as possible.

Moving into the 2015-20 period we are focused on continuing to enhance our customer service processes and expertise. An important aspect of this is the use of customer analytics to identify how we can further improve the experience they receive and by providing more opportunities for customers to 'self serve' (e.g. through online platforms such as WaterLive and MyAccount).

Ultimately, it is our aim to reduce the likelihood of a customer needing to contact us. If they do so, it is vital that we respond quickly, effectively, and in the format which suits them best.

^ Annually conducted market research.

KEY PERFORMANCE INDICATORS

Service Incentive Mechanism (SIM) Score*

2014/15	**74.8**
2013/14	73.9
2012/13	70.5
2011/12	66.9
2010/11	58.1

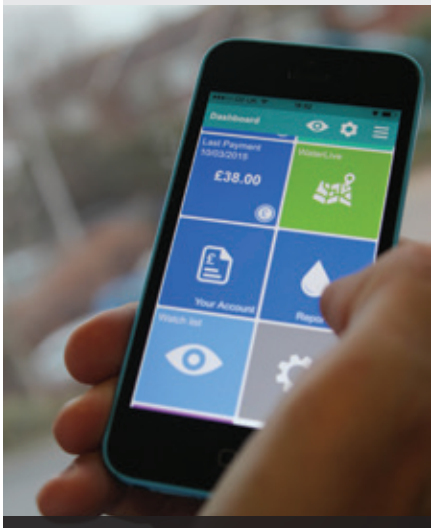
STATUS:

* SIM takes into account a range of measures including written complaints and the results of customer satisfaction surveys.

Written Complaints

2014/15	**4,036**
2013/14	4,477
2012/13	4,246
2011/12	4,518
2010/11	6,091

STATUS:



The updated South West Water App is now available for both Android and Apple devices.

SERVICE CONTINUED



TARIFF FREEZE TO 2015

Announced in November 2013, South West Water froze its standard tariffs and standing charges through to April 2015 for all its household and business customers.

The price freeze was part of our WaterFuture Business Plan to 2020 which also pledged below inflation bill increases to 2020.

AFFORDABILITY

Water and sewerage bills in the South West have historically been higher than the national average, largely due to the scale of environmental investment required to protect our region's coastal waters.

In 2013 the annual £50 Government payment towards every household bill was introduced in acknowledgement of this situation. However, in a region with lower than average wages, relatively high house prices, high energy costs and a large elderly population, many customers still struggle to pay.

In addition to the 2014/15 tariff freeze and to help those with genuine affordability issues, South West Water offers a range of advice and support services. These include:

- **WaterCare+** — involving a benefit entitlement and tariff check, water audit and water efficiency measures (including metering), this scheme has now helped over 13,300 customers
- **ReStart** — by incentivising regular payment this scheme is designed to reduce a customer's water debt. More than 11,500 customers have been helped to date
- **WaterSure** — for those in receipt of means-tested benefit or tax credit
- **Freshstart fund** — delivered in partnership with the Citizens Advice Bureau for one-off hardship cases
- **WaterCare tariff** — our means-tested social tariff, introduced in 2013, has enabled more than 2,600 to pay their bills through a reduction in their standard metered charge
- **Support services delivered alongside social housing providers** — practical advice and assistance targeting low-income tenants in areas of deprivation.

METERING

79% of our customers are now metered with 7,489 installations carried out during the past year. This represents a high level of overall meter penetration when compared with the rest of the industry and helps us achieve one of the lowest consumption per head rates in the industry.

Our customer research indicates that the vast majority of customers believe metering is the fairest way of charging. We continue to promote the benefits of metering and offer free installation of standard meters for those wishing to make the switch.

During 2015-20 we aim to increase household metering coverage to 85%. We are carrying out SMART metering trials at three new housing developments in order to assess the viability and benefit of using such technology.

PRIORITY SERVICES

We are committed to helping our customers, especially those who require additional assistance due to disability, age or illness. Some of the priority services we offer include:

- alternative bill formats (large print or braille, telephone bill reading, sending bills to a helper or carer)
- meter reading and meter relocation (depending on circumstances)
- support during supply interruptions (e.g. providing an alternative water supply)
- information and advice on water fittings for those with disabilities.

We also ensure that the facilities at many of our recreational sites (e.g. those managed through the South West Lakes Trust) are designed to be accessible to everyone.

As at 31 March 2015 there were 9,585 customers on our priority services register.

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BUSINESS CUSTOMERS

South West Water provides dedicated services to our region's 74,000 business and other non-household customers. The Company is currently preparing for the opening of the non-household retail market in 2017. In the past year this has included the introduction of sector-specific business customer specialists and a new series of tariffs for default and enhanced levels of service (which came into effect in April 2015).

The Company's strategy is designed to retain its South West business customer base while also exploring opportunities for out-of-area growth (through our subsidiary 'Source for Business' service which now has licences to operate in Scotland and England and Wales). This is underpinned by a focus on helping individual customers make the best use of the water they pay for and ensuring they are receiving a level of service that is tailored to their needs.



OUTLOOK

Improving the services and experience that our customers receive when interacting with us requires both improvement at operational level and in the way in which we communicate and respond to any issues, queries or requests for information.

It is vital that our services represent value for money and that they are perceived in that way. Ultimately, our goal is to achieve industry-leading customer satisfaction levels, ensuring bills are kept as low as possible and minimising the likelihood that a customer will need to contact us with an issue or complaint.

RESPONSIVE TO CUSTOMERS

We will continue to review and enhance our customer relationship management systems, adapting to new and emerging trends such as the growth in digital media.

FAIR CHARGING

Our business plan included a Board pledge to keep 2015-20 price rises below forecast inflation. We intend to continue developing and promoting our affordability initiatives, offering support and assistance to those who genuinely struggle to pay.

RESILIENCE IN EXTREME CONDITIONS

Making sure the water and wastewater services we provide can withstand the potential impacts of extreme weather and security threats.

ENVIRONMENT

EVEN CLEANER SEAS

South West Water helps to protect around a third of the bathing waters in England and Wales.

Since 1989 the Company has invested more than £2bn to protect and improve coastal water quality.



The picturesque waters around the Cornish coastline help attract millions of visitors every year.

KEY PERFORMANCE INDICATORS

Bathing Waters

Good
Excellent

2014	99.3
2014	86.3
2013	99.3
2013	91.0
2012	91.1
2012	60.3
2011	98.6
2011	95.1
2010	96.5
2010	90.3

STATUS:

99%

bathing waters meeting EU 'good' standard

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Our business depends on the health of the natural ecosystems in which we operate. As environmental stewards, we have a duty to protect and, where possible, enhance the environment as best we can.

A focus on low-impact sustainable schemes and investment in renewable technologies are key aspects of our strategy for environmental protection.

BATHING WATER QUALITY

Out of the 146 designated bathing waters sampled in the South West Water region during the 2014 bathing season, 145 or 99.3% met or exceeded the European Union's good (mandatory) standard and 126 or 86.3% met the excellent (guideline) standard.

The decline in the number of bathing waters reaching the guideline standard can be attributed to the wetter weather during August.

In preparation for the European Union's revised Bathing Water Directive – which came into effect in 2015 – South West Water has already carried out an £18.9m programme of targeted improvements at key beaches around the region. These include Lyme Regis, Teignmouth, Torbay, Mothecombe, Seaton (Cornwall), Looe and Combe Martin.

We plan to spend c.£40m improving bathing water quality between 2015 and 2020. Furthermore, we continue to work with local authorities and other stakeholder groups to tackle the range of issues that can affect bathing water quality (e.g. misconnections, agricultural run-off, bird and animal waste).

WASTEWATER TREATMENT STANDARDS

Wastewater treatment standards are measured by Population Equivalent Sanitary Compliance (the percentage of the population served by compliant wastewater treatment works) and Numeric Compliance (which gives equal weighting to all sizes of works).

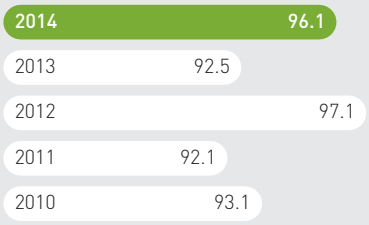
Since 2011, South West Water has been focusing on the delivery of a glide path of improvements at more than 90 wastewater treatment works as agreed with the Environment Agency. Substantial capital investment, together with improved working practices, is delivering progress in this area and in 2014 we exceeded our glide path targets.

Key to our compliance delivery plan are the steps we are taking to predict and prevent potential failure. We continue to review our maintenance and scheduling procedures and are also improving our capacity to monitor sites remotely 24 hours a day.

The enhanced status of South West Water's Business Plan to 2020 has allowed us to accelerate the delivery of a number of key capital schemes. Sites are being prioritised for improvement as appropriate and we continue to work towards our K6 target of 100% numeric compliance by 2020.

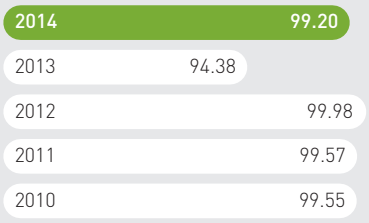
KEY PERFORMANCE INDICATORS

Numeric Compliance (%)



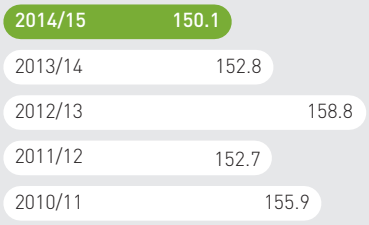
STATUS:

Population Equivalent Sanitary Compliance (%)



STATUS:

KPI: Greenhouse Gas Emissions ($ktCO_2e$)



STATUS:

ENVIRONMENT CONTINUED

POLLUTIONS

South West Water aims to ensure there are no harmful pollution incidents and we continue to invest in the maintenance and upgrades necessary to reduce the likelihood of a pollution incident occurring.

In the past year we have focused on improving our maintenance schedules and procedures while using advanced technologies to improve our capabilities for wastewater network monitoring and analytics. This includes the use of remote sewer monitors to provide early warning of any issues.

Our efforts have been reflected in the 2014 figure for major or significant pollutions (Categories 1&2) which is the lowest it has been in the past five years. While this result is favourable, we recognise that further work is required in order to bring down the overall number of pollution incidents.

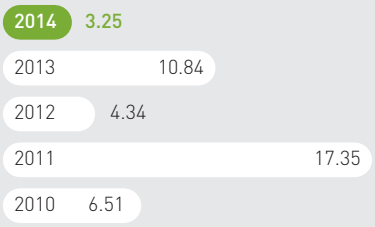
In our Business Plan to 2020 we have outlined plans to eliminate Category 1 and Category 2 pollutions and make a significant reduction in less harmful pollutions (Categories 3 & 4). This will involve further investment in our wastewater treatment processes, pumping stations and network monitoring, complemented by our catchment-focused 'Downstream Thinking' (see page 27) approach to tackling wastewater issues.

FLOODING

2014/15 was a relatively benign year in terms of heavy rainfall events. The number of properties flooded internally was significantly fewer than the previous year and the number of repeat floodings was below the K5 average.

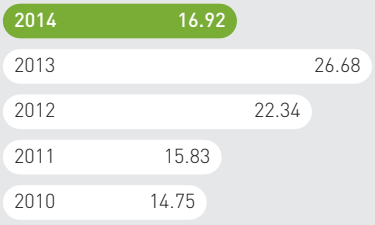
KEY PERFORMANCE INDICATORS

WW Pollutions Cat 1-2 per 10,000km



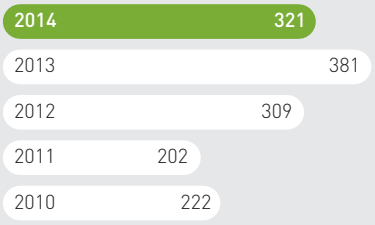
STATUS:

WW Pollutions Cat 1-3 per 1,000km



STATUS:

Total Number of Pollutions



STATUS:

To help prevent sewer flooding South West Water invests in increased sewer capacity, the separation of storm water from the wastewater from properties, and other capital schemes. In 2014/15 the Company completed a £3.5m scheme to upgrade the sewerage network in Truro, Cornwall, and a £2m flood alleviation scheme to protect homes in the Colebrook area of Plymouth (jointly funded by South West Water, the Environment Agency and Plymouth City Council).

South West Water continues to work alongside lead local flood authorities and other stakeholders to identify best practice in the management of excess storm water.

ENERGY & CARBON

We continue to focus on reducing our carbon emissions though a combination of asset optimisation, renewable energy generation and energy-saving initiatives.

Overall energy use of 260.68GWh for 2014/15 was marginally lower than the previous year (2013/14: 264.5GWh). Carbon emissions were also reduced*, despite the drier than average summer in 2014 which increased the need for energy-intensive water pumping.

Renewable energy usage during 2014/15 was 18.5GWh, an increase on the previous year (2013/14: 17.4GWh). South West Water's ongoing investment in renewable technologies means the Company is now able to generate 25GWh – around 10% of its annual energy needs.

Furthermore, South West Water is building links with a number of third party renewable energy providers in order to increase the proportion of energy drawn from renewable sources.

* This KPI only includes emissions from Ofwat-regulated activity.

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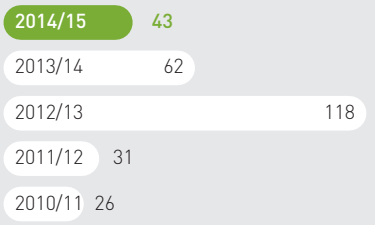
KEY PERFORMANCE INDICATORS

Repeat Floodings

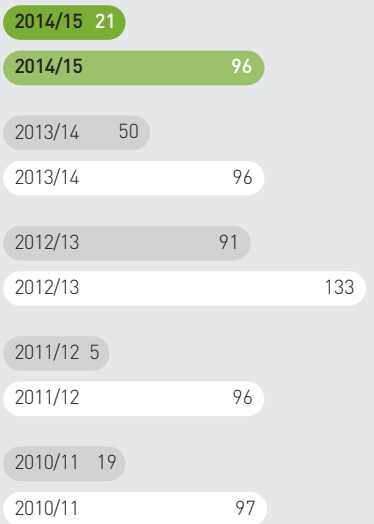


STATUS:

Internal Floodings (excluding private sewers)

Properties flooded caused by sewer capacity

Properties flooded caused by other factors



STATUS:

OUTLOOK

South West Water continues to make major investments in environmental protection, not least through targeted improvements associated with improved bathing and shellfish water quality. In 2015/16, our investment will also include 'Downstream Thinking' – our innovative programme of sustainable measures to reduce the likelihood of flooding and pollution (see page 27).

Our Business Plan to 2020 highlights some of the investments we plan to make in K6 (2015-20) in support of the following key 'outcome' areas:

PROTECTING THE ENVIRONMENT

This includes investment to reduce the likelihood of pollution, improve our wastewater processes to meet all emerging environmental regulations and reduce our carbon footprint.

RELIABLE WASTEWATER SERVICE

It is our aim to reduce internal sewer floodings, collapses and blockages while also tackling odour issues at our operational sites.

BENEFITING THE COMMUNITY

Recognising the economic importance of bathing and shellfish waters to our local economy this includes increased protection for coastal and estuarine areas and our region's rivers through investment in wastewater treatment assets and monitoring and control technologies.

Our strategies are designed to ensure we meet or exceed environmental regulations and legislation as it develops. Furthermore, we remain focused on pioneering new and improved ways of working that reduce our environmental impact.

ENVIRONMENTAL SUSTAINABILITY

The South West is blessed with abundant natural beauty and a wealth of species and habitats ranging from moorland and forest to cascading rivers and idyllic beaches. The health of this unique environment is critical to our region's two largest industries – tourism and agriculture. It is also a key aspect of the quality of life enjoyed by those that live here.

Taking care of the environment is no small task and we do our best to limit the environmental impact of our operations while also looking at ways we can make improvements to it.

This involves a combination of:

- investment in maintenance and improvements of our processes and assets (treatment works, supply network etc.)
- finding ecologically sensitive ways working (in areas such as catchment management)
- managing waste products responsibly (e.g. recycling sludge)
- taking steps to reduce our carbon footprint
- working alongside other agencies and organisations towards the shared goal of environmental protection.

We're dedicated to ensuring that the environment of our region is healthy now and in the future.

AN ECOLOGICALLY SENSITIVE APPROACH: DEVONPORT LEAT RECONSTRUCTION

Dating back to the 1790s, Devonport Leat was built on Dartmoor to supply water to the Plymouth area. A tributary to Burrator Reservoir, the 18 mile leat consists of trenches formed roughly out of Dartmoor granite, effectively creating a miniature grass-lined canal.

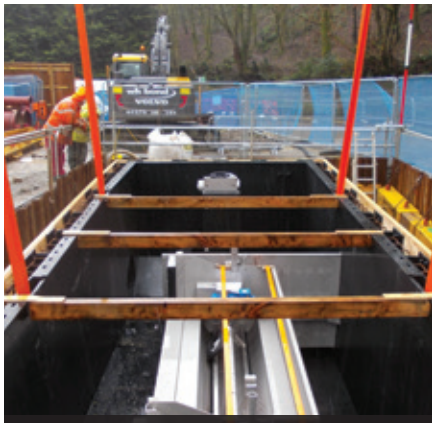
In 2013 South West Water began a project to restore a number of sections of the leat which had deteriorated. As a site of historical importance located in Dartmoor National Park in a remote area of outstanding natural beauty and special scientific interest, the repairs presented a unique challenge.

Following intensive surveying, carried out alongside the Environment Agency, South West Water and its partners carried out excavations by hand in order to expose leaking sections of the leat. Traditional repairs of stone-built walls and bank sections were undertaken, excess vegetation cleared and sluice gates reinstated.

All care was taken to protect the leat as a natural habitat, with wildlife watching briefs, fish rescue monitoring and pollution control procedures put in place.

An example of environmental best practice, the project was completed in 2014, securing the leat's water supply for future generations while protecting a valuable and ecologically sensitive part of the region.





Installation of a storm water tank.

EVEN CLEANER SEAS: BATHING WATER INVESTMENT

The final scheme in South West Water's £18.9m bathing water improvement programme during 2014/15 (see page 23) was completed in Looe, South East Cornwall, in spring 2015.

£5m was invested in underground storage tanks to provide additional storm water capacity, ultraviolet (UV) disinfection (at Menheniot Wastewater Treatment Works) and monitoring devices on sewerage network storm overflows.

The improvements will provide further protection for bathing water quality off the seaside resorts of Looe and Seaton, thereby helping to safeguard the area's valuable tourist economy.

PARTNERSHIPS TO TACKLE WASTEWATER ISSUES: DOWNSTREAM THINKING

In 2014 South West Water completed a £3.5m upgrade to Truro's sewers. The improvements were needed because the sewerage network in parts of the city was no longer able to cope with the demands placed on it.

Population growth, together with extreme wet weather events, means such investment in infrastructure is critical. However, in recent years we have widened our focus to look at how supplementary measures such as sustainable drainage schemes and landscape improvements can reduce the pressures placed on sewers. This programme of work is being piloted in Truro through our 'WaterShed' scheme.

Delivered in partnership with a range of stakeholders including local councils, residents and businesses, WaterShed is designed to manage storm water (such as the run-off from buildings and streets) using low cost sustainable techniques.

The project scope includes:

- the landscaping of a local park to absorb storm water during wet weather events
- disconnecting rainwater downpipes and draining roof water into the ground rather than the drains
- the introduction of 'rain gardens' – areas of ground designed with sand, gravel, a certain type of soil and carefully selected plants which absorb rainwater
- soakaways and rainwater harvesting systems.

As well as helping tackle sewer flooding and pollution, WaterShed will benefit the community through improved water efficiency and enhanced green spaces for recreation.

RESPONSIBLE WASTE MANAGEMENT: SLUDGE RECYCLING

South West Water continues to recycle biosolids (treated sewage sludge) for use on agricultural land. Sludge recycling is a sustainable and well-regulated practice, and the Company has strict quality assurance processes to ensure that regulations and guidance are fully met.

In 2014/15 South West Water recycled 41,300 tonnes of sludge (measured as dried solids). The Company's compliance with environmental requirements remained at 100%.

We completed refurbishments to digestion facilities at Countess Wear and the first phase of a digester refurbishment at Marsh Mills, both in Devon. In order to continue producing renewable energy from sludge treatment, new combined heat and power engines were also installed at Kilmington and Totnes.

41,300

tonnes of sludge recycled

FINANCE AND ECONOMY

As a result of increased revenue, ongoing strength in operational cost control and favourable interest charges, South West Water's profit before tax and exceptional items increased in 2014/15 by £5.7m to £167.9m.

Despite the tariff freeze in the year revenue grew marginally by 0.4% to £523.6m as a result of increased demand, new connections and other sales, partly offset by the effect of customers switching to a metered tariff.

The revenue foregone in the price freeze is recovered over 2015-20 on an NPV neutral basis. An additional £2.8m was generated by c.7,600 new customer connections. Customer demand has increased by 0.9% on last year, reflecting the dry summer in 2014 and relatively benign winter months.

79% of South West Water's customers are now benefitting from a metered supply, with 7,489 customers opting for a meter in 2014/15 (2013/14: 10,070).

£167.9m

profit before tax and exceptional items increased by £5.7m



Excavation work for the Mothecombe Bathing Waters scheme.

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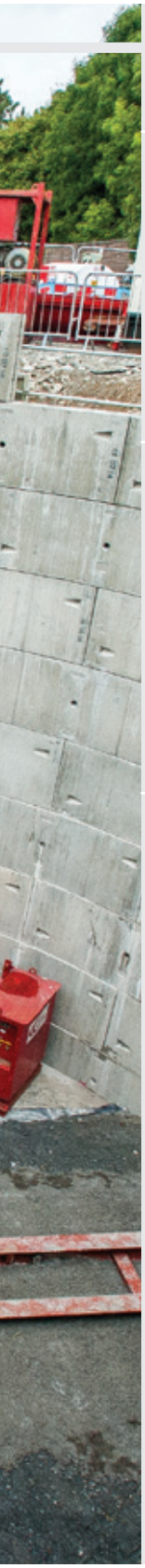


KEY PERFORMANCE INDICATORS

Revenue

2014/15	**£523.6m**
2013/14	£521.5m
2012/13	£500.1m
2011/12	£474.7m
2010/11	£449.1m

Operating Profit (before exceptional items)

2014/15	**£225.4m**
2013/14	£226.7m
2012/13	£214.8m
2011/12	£204.7m
2010/11	£189.7m

Regulatory Capital Value

2014/15	**£2.93bn**
2013/14	£2.96bn
2012/13	£2.92bn
2011/12	£2.83bn
2010/11	£2.70bn

Strong financial policies and prudent investment decisions are critical to ensuring a successful future for our business and the major role we play in the regional economy.

OPERATING COSTS

Our operating costs, including depreciation, rose by £3.4m (1.2%) to £298.2m, below the average inflation levels for the year.

The key movements were:

- cost increases (including power, carbon reduction commitment costs and business rates)
- increased depreciation and costs of capital schemes
- other cost movements including lower property sales and increased costs from other sales activity
- additional efficiencies delivered in the year. Cumulative K5 efficiency to date is 11% ahead of target as a result of early delivery.

Cumulative cost increases over the K5 period to date remain lower than average RPI for the same period.

The bad debt charge is below last year and the increase in revenue reduced the proportion as a percentage of revenue further to 1.7%. Debts totalling £17.7m (2013/14: £7.9m) were written off against the provision during 2014/15, of which £1.5m relates to personal and commercial bankruptcy, and £1.2m related to our ReStart programme, a South West Water customer affordability initiative. The increase from the prior year reflects a detailed review of customers who have moved properties and where debt has been outstanding for a number of years.

NET FINANCE COSTS

Net finance costs have reduced from the prior year at £57.5m (2013/14: £64.5m), predominantly reflecting the lower interest on RPI index-linked debt and reprofiling of lease interest. £2.4m of interest was capitalised on longer term capital schemes.

South West Water has access to overall interest rates that are amongst the lowest in the water industry. Interest cover for 2014/15 is both within the required levels for financial covenants and in line with expectations.

PROFIT BEFORE TAX

Profit before tax was £167.9m, an increase of £5.7m (excluding the exceptional item) from the prior year (£17.5m increase, including net exceptional item in 2014/15).

FINANCE AND ECONOMY CONTINUED

TAXATION

The current tax charge for 2014/15 of £29.8m (2013/14: £28.6m) included £3.3m credit of adjustments for prior year. A deferred tax charge of £8.0m resulted in a net total tax position of a charge of £37.8m (2013/14: credit £1.3m).

The current corporation tax charge which is included within the tax charge, increased by £1.2m on 2013/14. This reflects the increase in profit reported, offset by the decrease in corporation tax rate to 21% and adjustments to the tax charge in respect of prior periods.

Deferred tax for the year was a charge of £8.0m (2013/14: credit £29.9m). The increased charge reflects a one-off credit last year following the enacted 3% reduction in the future rate of UK corporation tax.

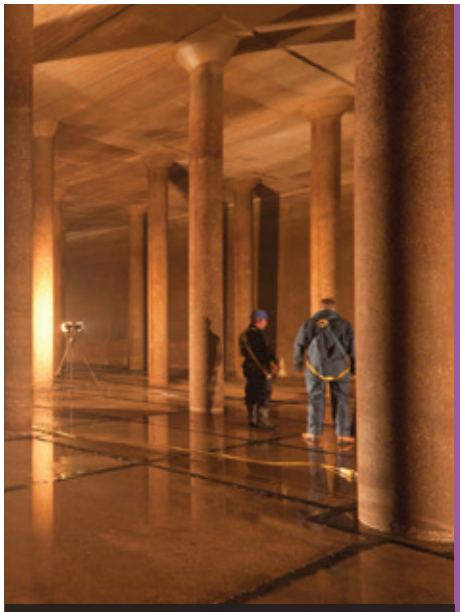
This will continue to change in line with corporation tax rates. The Company will apply relevant tax laws in a reasonable way and only engage in tax planning when it is aligned with the commercial and economic activity of the business.

DIVIDENDS AND RETAINED EARNINGS

The Company has established a dividend policy, which involves 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.



Capel Lane service reservoir, Exmouth.

Payments are also designed to ensure that the ability of the Appointee to finance its Appointed Business is not impaired. Dividends of £255.8m were paid to the parent undertaking (2013/14: £112.0m), representing a base dividend of £66.2m, £34.6m of outperformance dividend based on cumulative performance to 31 March 2015 and £155.0m taking into consideration the balance sheet position and key financial ratios of South West Water.

The dividend was calculated with reference to the projections in the Ofwat 2009 Final Determination and the assumptions for 2014/15 included within the 2015-20 Business Plan.

PROPERTY, PLANT AND EQUIPMENT

The Directors are aware that the value of certain land and buildings in the balance sheet may not be representative of their market value. However, a substantial proportion of land and buildings comprises specialised operational properties and structures for which there is no ready market and it is not therefore practicable to provide a full valuation.

CAPITAL INVESTMENT

Capital additions for the year were £145.1m, an increase from £141.6m in 2013/14.

The key areas of focus remain:

- **water resource and ensuring resilience of our networks**
- **improved drinking water quality**
- **delivering environmental improvements.**

Investments during the year included:

- **investments in assets to improve bathing water quality to meet revised European Guidelines in 2015**
- **completion of the improvements in water quality with treatment upgrades at two key treatment works**
- **delivering additional capacity to meet growth requirements – including supply to two new towns within the region**
- **focusing on compliance at wastewater sites during periods of extreme weather**
- **innovative investments to reduce flooding for those customers previously highlighted as at risk**
- **preparatory work on the new innovative water treatment works at North Plymouth.**

The expenditure included £25m projects advanced from the next regulatory period (2015-20) in order to target strong outcome delivery in the next 5 years.

South West Water continues to deliver capital projects in line with Ofwat, Drinking Water Inspectorate and Environment Agency expectations. Performance cumulatively to date is in line with target for K5.

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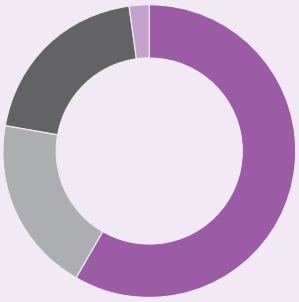
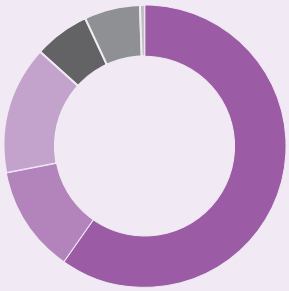
CAPITAL EXPENDITURE



Capital Additions Total £145m

Maintenance	**£83m**
Supply and Demand	**£29m**
Quality	**£30m**
Enhanced Service Levels	**£3m**

MAJOR COMPONENTS OF THE COMPANY'S DEBT FINANCE AT 31 MARCH 2015



Finance Leasing	**£1,238.3m**
Indexed Linked Bond	**£249.7m**
European Investment Bank Loans	**£304.3m**
Pennon Group Loan	**£130.0m**
Bond	**£133.0m**
Other	**£9.1m**

LIQUIDITY AND DEBT PROFILE

The Company has a strong liquidity and funding position with £246.9m cash and deposits at 31 March 2015 (including £195.0m of restricted funds representing deposits with lessors against lease obligations). In addition the Company has £450m of committed undrawn facilities

The Company's financing structure gives scope and flexibility needed to implement our strategic objectives and maximise value.

Funding facilities are in place to cover both medium and long-term requirements, including loans from the European Investment Bank (EIB) and finance leasing arrangements. In addition, short-term facilities exist with a range of financial institutions.

At 31 March 2015 the Company's loans and finance lease obligations totalled £2,064.4m. After the £246.9m held in cash this gives a net debt figure of £1,817.5m (an increase of £171.8m during the year).

The Company's debt has a maturity of up to 42 years with a weighted average maturity of 25 years. The Company has fixed, or put swaps in place to fix the interest rate on at least 50% of its debt for the next regulatory period (K6 2015-20). The average interest rate for 2014/15 was 3.3%. The balance sheet value of net derivative liabilities moved from £11.7m to £38.2m at 31 March 2015.

The movement is taken to reserves through the Statement of Comprehensive Income for effective interest rate swaps, and through the Income Statement for those which were ineffective.

The Company has £249.7m of debt index-linked to 2041-2057 at an overall real rate of 1.99%.

As a result of these initiatives South West Water's cost of finance is amongst the lowest in the industry.

At 31 March 2015 the fair value of the Company's non-current borrowings was £1,747.2m (2014: £1,542.3m) which is less than its book value as detailed in note 21 to the financial statements.

CAPITAL STRUCTURE

Net debt increased by £171.8m during the year, reaching a total of £1,817.5m. The increase primarily reflects the capital spend net of retained profits for the year and the additional dividend payment to maintain an efficient funding level.

Regulatory Capital Value (RCV) is the financial base used by Ofwat to allow a rate of return and set prices at each Periodic Review. At 31 March 2015 RCV equalled £2,928.0m, a decrease of £30.8m (1.0%) in the year driven by the lower RPI at the year end. The RCV at 31 March 2014 was £2,958.8m.

FINANCE AND ECONOMY CONTINUED

As a result, South West Water's net debt to RCV has increased to 62%, remaining in line with Ofwat's optimum range of 55% to 65% and below the notional level assumed within the 2015-20 (K6) Final Determination.

TREASURY POLICIES

South West Water ensures that there is the funding to meet foreseeable needs to maintain reasonable headroom for future contingencies and to manage interest rate risk. The Company enters into certain structured financing transactions that have and are expected to provide an improved return on surplus funds and overall interest rate performance. It operates only within policies approved by the Board and undertakes no speculative trading activity.

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

The Company has considerable financial resources. The Directors therefore believe that it is well placed to manage its business risks despite the ongoing uncertainties of the current economic environment.

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

GOING CONCERN

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.

TAXATION OBJECTIVES AND POLICIES

Our tax strategy, as approved by the Board, is to ensure we do not engage in any practices which avoid paying tax at the appropriate levels. We manage the taxes we pay having regard to the interests of our investors and our long-term relationship with the tax authorities. We will consider bona-fide arrangements which are integral to our business and which qualify for tax exemption or relief.

TAX CONTRIBUTION

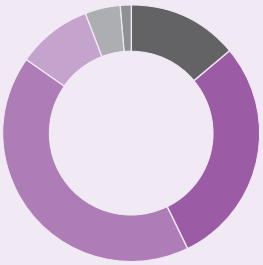
The total current tax charge for the year was £29.8m. A reconciliation between the actual tax charge and the estimated charge at 21% is provided in note 8 to the financial statements.

The Company made a net payment of £36.4m of UK corporation tax in the year (2013/14: £44.1m). The Company's total tax contribution extends significantly beyond the UK corporation tax charge.

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

- Value Added Tax (VAT) of £50m was recovered by the Company from HMRC. The repayment has arisen chiefly as a result of operational and capital expenditure. VAT has no material impact on profit before tax
- business rates of £25m paid to local authorities. This is a direct cost and reduces profit before tax
- employment taxes of £12m including employees' Pay As You Earn (PAYE) and total National Insurance Contributions (NICs).
- Fuel Excise Duty of £1m related to transport costs. This reduces profit before tax
- Carbon Reduction Commitment (CRC) payment for the Company was £2m representing the commitment payments for carbon usage in both 2013/14 and 2014/15 as phase 2 of the CRC mechanism has commenced and payments are now made in advance. This reduces profit before tax.

TAX CONTRIBUTION 2014/15



Employment taxes	£12m
Business Rates	£25m
UK Corporation Tax paid	£36m
Environmental payments	£8m
Carbon Reduction Commitment	£4m
Fuel Duty	£1m

The corporation tax rate for 2014/15 used to calculate the current year's tax is 21% (2013/14: 23%). The corporation tax rate was reduced to 20% from 1 April 2015.

PENSIONS

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

In July 2014 the Pennon Group reviewed the long-term sustainability of the defined benefit pension schemes, of which South West Water represents 80%, and changes in benefits were agreed following extensive employee engagement. As a result an exceptional credit of £11.8m arose from the capping of future pension increases.

At 31 March 2015 the Company's pension schemes showed a deficit (before deferred tax) of £41.5m (2013/14 £60.8m), the decrease primarily reflecting an increase in schemes' asset values and changes in financial assumptions.

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South West Water's regular cash contributions to the schemes remain within Ofwat's Final Determination for the K5 period. During the year South West Water paid £8.7m of deficit recovery payments into the scheme. The triennial actuarial valuation of the main scheme at 31 March 2013 was completed 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 which have good credit ratings.

OUTLOOK

The focus for South West Water during 2015-20 is to deliver strong outcome performance, improve customer service and continue to meet legislative and regulatory requirements. We aim to maximise returns and deliver benefits for customers and investors through efficient total expenditure (Totex), improved services (net ODI rewards) and financing outperformance.

South West Water is already considering the impacts of future legislative changes which include the potential for 'Upstream Reform'. The Company is engaging on key industry consultations on the development of Ofwat's ongoing regulatory reform agenda in order to influence the direction of travel in this area.



Meldon Reservoir, Devon.

ECONOMIC SUSTAINABILITY

South West Water is one of the largest companies in the region and the services we provide are essential for the region's economic sustainability. The major investment we have made to safeguard the environment protects key regional industries such as tourism, while our use of local contractors and suppliers creates a major economic ripple effect.

In all aspects of our activity we strive to be as efficient as possible, ensuring our services represent value for money and that we carry out our business in a responsible way.

USING OUR RESOURCES WISELY: PRESSURE MANAGEMENT

High pressure in the mains network increases the amount of water lost through leaks and bursts. To mitigate this, South West Water continues to invest in maintenance and improvements which reduce water pressure in sections where there is high pressure. This helps to ensure we keep leakage at a rate that is economical while minimising the resources necessary for repairs.

To achieve this we use pressure reducing valves (PRVs). During K5 we have aimed to reduce the average operating pressure across the region by 1 metre head each year. In 2014/15 we exceeded this target – achieving a reduction of 2.1 metres head.

INNOVATION TO IMPROVE EFFICIENCY: PIONEERING DRONE TECHNOLOGY

Innovation and technological advances play a key role in improving our efficiency and ensuring economic sustainability. Examples include our use of remote technologies through the PUROS scheme (Phased Utilisation of Remote Operating Systems) and our pilot use of cutting edge drinking water treatment technology ahead of the construction of a new water treatment works for North Plymouth.

One of the more recent initiatives we are developing is the use of Unmanned Aerial Vehicles (UAVs or 'drones'). In association with the University of Exeter we initially deployed a drone for hydrological monitoring purposes during the Exmoor Mires Project (part of the Upstream Thinking programme). In the past year we have also begun to look at drone application for a wide range of industry purposes including leak detection, flooding, asset inspection, thermal imaging, water quality research, habitat and environmental impact analysis.

South West Water now has its own in-house drone capability with a small team of trained pilots receiving permission to fly from the Civil Aviation Authority.



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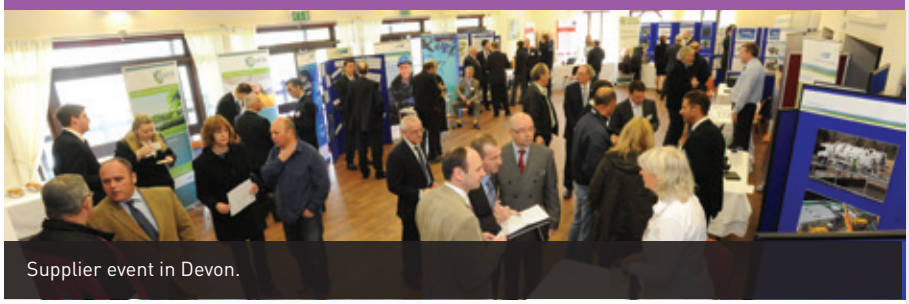
SUPPORTING THE REGIONAL ECONOMY: SUSTAINABLE SUPPLY CHAIN

South West Water annually places approximately £100m of order value with companies which have a base in the region. The Company's procurement process sets standards for our individual suppliers' approaches to economic, financial and environmental sustainability and we take rigorous steps to ensure they meet strict criteria in this regard.

We operate a 'mixed economy' supply chain model which uses smaller specialist companies alongside larger strategic partners. A culture of innovation and the sharing of best practice is encouraged and celebrated, not least through our supplier forum and annual supplier awards.

During the past year we have developed our supplier sustainability programme to identify and deliver environmental benefits in key tenders, record the carbon footprint of key and strategic suppliers and implement the Supplier Code of Conduct.



Supplier event in Devon.

KEEPING COSTS LOW: ENERGY STRATEGY

South West Water is one of the region's largest users of energy. We aim to keep our energy costs as low as possible and reduce carbon emissions through a combination of energy efficiency measures, investment in renewable technologies (see page 24) and the optimisation of our operational assets.

By the end of 2014/15 we generated an above-target saving of 5.18GWh through our energy efficiency measures. These included the refurbishing of existing assets, replacing out-of-date equipment with more efficient products and adjusting the scheduling of equipment in order to make it more effective.

Alongside the steps we are taking to increase our renewable energy generation, the streamlining of our processes, assets and equipment is vital to our long-term economic and environmental sustainability.

SECURING REGIONAL INVESTMENT: £10M BOOST FOR SOUTH WEST BUSINESSES

Plymouth University and SWMAS Ltd, with bidding partner South West Water, received a £10m grant from the £47m of Regional Growth Fund (RGF) funding for the South West.

The funding will be used to develop projects to boost high quality job creation and increase private sector investment.

SUPPLIER CODE OF CONDUCT

Suppliers must:

ENVIRONMENT

- assess and manage key environmental risks
- comply with environmental regulations
- focus on waste reduction and recycling
- measure their carbon footprint and target reductions
- larger companies are expected to have formal environmental management systems accredited to ISO 14001.

ECONOMIC

- be financially sound
- operate a sustainable cost model providing a fair wage for employees and timely payment of suppliers
- support an open book approach to cost, encouraging collaboration and driving sustainable cost reduction
- maximise the benefit for the economy and employment in South West Water's region.

SOCIAL AND ETHICAL

- operate to the highest ethical standards
- accept South West Water's Supplier Code of Conduct
- comply with provisions of the Bribery Act 2010
- declare any personal interests
- comply with international labour standards in accordance with the principles of the International Labour Organisation Conventions
- support sustainable local communities in their areas of activity
- adopt appropriate ethical standards for global trading (ETI, SA 8000, UN Global Compact).

PEOPLE AND COMMUNITY

DOING OUR BIT FOR THE REGION

South West Water supports various organisations, projects and initiatives which benefit the region.

In 2014/15 we become the principal supporter of the South West Coast Path Association which takes care of the region's 630-mile coast path – a major tourist attraction.

South West Water also sponsors the annual Nippers Championships run by Surf Life Saving GB, an organisation we have supported for more than a decade.

Nippers is a junior program which introduces children aged 5 to 13 to surf lifesaving. Through fun water-based activity it helps grow their confidence and teaches them valuable lifesaving skills.

£86k

community sponsorship and charitable donations in 2014/15



The annual Nippers Championships was run in Exmouth during August 2014.

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South West Water's aim is to sustainably improve services and be a good neighbour whilst having a positive impact on the communities it serves and the people it employs.

COMMUNITY AND CHARITY SUPPORT

In 2014/15 we provided over £86,000 worth of community sponsorship and charitable donations. Each year the Company aims to sponsor a variety of projects and initiatives which fall under the themes of water, environmental benefits, and the promotion of youth participation.

Examples in the past year include:

- Devon Wildlife Trust – support for a Wildlife Festival in Barnstaple and educational talks at the Wembury Marine Centre
- Surf Life Saving GB – sponsorship of the annual Nippers Championships
- Cornwall Heritage Trust – for the Millennium Book for Cornwall, a major educational resource for the county to be made available in every school and college in Cornwall
- South West Coast Path Association – which takes care of the 630-mile coast path; one of the region's main tourist attractions.

South West Water also supports the Keep Britain Tidy Beach Care programme and we continue to raise funds and awareness for WaterAid, our industry charity.

ACCESS AND RECREATION

The South West Lakes Trust, an independent charity, manages over 14,000 acres on South West Water's behalf. The Trust is the region's largest combined environmental and recreational charity, taking care of 50 inland water sites which attracted 1.8m visits during 2014/15.

The Trust operates five 'Outdoor & Active' Centres across Devon, Cornwall and West Somerset, where sailing, windsurfing, kayaking and a range of other family friendly and educational activities can all be enjoyed. South West residents and visitors can take advantage of 150km of paths, 30 fisheries for trout and coarse fishing, and waterside camping at five sites. A cable wakeboarding centre is also in operation at Siblyback Reservoir in Cornwall.

South West Water also supports and promotes access and recreation through its Heritage Open Days in which members of the public are invited on guided tours around operational sites. In 2014/15 over 200 people were given a chance to explore behind the scenes at Brokenbury Waste Water Treatment Works in Brixham, Pynes Water Treatment Works in Exeter and at Roadford Dam, Devon.

PEOPLE AND COMMUNITY CONTINUED

> Our People Strategy is designed to attract, develop and retain a high calibre workforce."

EMPLOYEE DEVELOPMENT

South West Water prides itself on being a responsible employer, attaching paramount value to the wellbeing, training, needs and ambitions of its 1,221 employees.

Employee involvement and participation in all aspects of business and organisational change is encouraged and supported through the Company's 'People Strategy' which is designed to attract, develop and retain a high calibre workforce.

In the past year the Company has carried out an upskilling programme for operational employees and also continued to deliver a range of employee development schemes aimed at facilitating personal development and improved leadership skills.

A new Finance Development Programme was implemented in order to build knowledge and experience among new recruits in the finance directorate.

Furthermore, in November 2014 South West Water became the first company in the UK to have secured support from Government, under the Employer Ownership Fund, to help train a new generation of engineers. More than £250,000 is being invested to support 86 staff in developing their engineering skills over the course of a three-year training programme.

APPRENTICESHIPS

During 2014/15 South West Water's apprenticeship scheme grew with 14 new recruits joining the Company. This has brought the total number of apprenticeships to 61, which represents 5% of the full time staff base.

South West Water has been recognised in the prestigious Top 100 Apprenticeship Employers list which is compiled annually by the National Apprenticeship Service to celebrate excellence in businesses that employ apprentices.

SUPPORT FOR EDUCATION

South West Water has a well-established relationship with many of the region's schools, colleges and universities and continues to support education through the provision of educational material, work experience placements, school talks and guest lectures. In 2014/15, through the speaker network, South West Water provided 28 school talks and 11 talks to various community groups and organisations.

The Company has been a key player in the development of a new University Technical College (UTC) for the region. Based in Newton Abbot, Devon, and set to open its doors in autumn 2015, the new college will be a hub for engineering and science. South West Water is also helping to secure a legacy for training and skills in the water industry through its participation in the Energy and Efficiency Industrial Partnership – a Government and employer partnership designed to help strengthen the UK's energy and utility workforce.



5%

of full time staff base made up of apprentices

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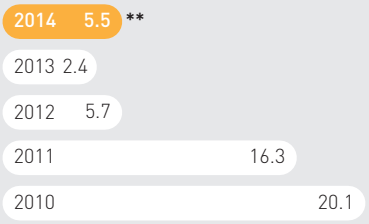
RIDDOR*/1,000 EMPLOYEES



* Reporting of Injuries, Diseases and Dangerous Occurrences Regulations.
** Actual number of reportable incidents: 7.

HEALTH AND SAFETY

The health and safety of employees is paramount and South West Water continually reviews company policies and processes in order to minimise the number of incidents. During 2014/15 we have undertaken a major review of operational sites to risk assess our activities and identify and prevent any potential hazards.

The Company's accident frequency rate (measured per 100,000 manhours) has been successfully reduced over the past twelve months, however there were seven reportable incidents during the year which is above our target threshold.

Work continues to reduce the likelihood and severity of any incident and we remain focused on developing a proactive health and safety culture. This includes in-house initiatives such as T.A.P ('Think, Act, Prevent') and S.E.C ('Safety, Environment, Customer').

Furthermore, we are enhancing South West Water's health and safety management systems to ensure the Company is operating in-line with externally accredited standards of best practice at all times.

South West Water's health and safety strategy continues to be promoted through a steering group comprising a cross section of directors, managers, and employee representatives who are tasked with driving health and safety improvements across the business.

OUTLOOK

South West Water customers attach value to the Company having a positive effect on the community and regional economy.

Our Business Plan to 2020 highlights some of the investments we plan to make in K6 (2015-20) in support of the following key 'outcome' area:

BENEFITING THE COMMUNITY

In addition to our investment in protecting bathing and shellfish waters (see page 23) this also includes new education and apprenticeship opportunities for young people in the region, support for recreational and leisure activities and support for the regional economy through our ongoing service delivery, investment and improvements. Our role in the development of a new University Technical College (UTC) in Devon will bring both economic and social benefits. Health and safety improvements will also be targeted through investment of over £20m.



Visitors to Roadford Dam during a Heritage Open Day in 2014.

SOCIAL SUSTAINABILITY

It is important to us that our activities have a positive social impact and that we understand and respond to our customers' needs. This includes helping those who struggle to pay and communicating with our customers in ways which suit them best.

It also extends to the following areas of community engagement:

- minimising the impact of construction or other operational work on people's lives and businesses
- supporting employment, learning and education in the region
- providing opportunities for access and recreation (e.g. at our reservoirs)
- fundraising and supporting local charities and organisations
- employee volunteering (e.g. for beach cleans and other community-focused activities).

SUSTAINABILITY TARGETS

For the list of 2014/15 sustainability targets and information on the South West Water Sustainability Committee please see page 60.

HELP WHERE IT'S NEEDED: SOCIAL HOUSING PARTNERSHIPS



To help tackle water poverty and make sure those who struggle to pay are given the right level of assistance, South West Water has partnered with a number of the region's social housing providers to raise awareness about the help available.

National statistics show that around 80% of customers with water debt and potential affordability issues live in the rented sector. In our region, of those living in social housing, approximately 38% are deemed to be in water poverty which means they spend more than 3% of their annual income on their water bills. A lower than average percentage of those customers are using a metered supply which means they are not eligible for water affordability scheme assistance or benefitting from the improved water efficiency benefits which metering can bring.

Taking an innovative approach to awareness-raising in areas of economic deprivation, South West Water has been developing its relationships with social housing providers in 2014/15, offering training to frontline staff including housing officers, benefit and support workers. We have also supported a series of community events and taken part in joint marketing campaigns which have targeted around 60,000 homes.

By providing information and advice on ways to save money on water bills in an engaging way, South West Water is helping to improve the financial circumstances for some its most hard-pressed customers while also addressing the related issue of water debt.

"So many of our customers have commented that the help they've received is making a real difference to their daily lives. It has just been a case of finding the right way to get the conversation started which has made all the difference."

Sally Mills, Customer Policy and Relations Manager

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GIVING BACK:
VOLUNTEERING AT CHICKS

CHICKS is a moorland retreat for disadvantaged children located at Brentor on Dartmoor. It provides week long respite breaks for children from a variety of backgrounds – those living in poverty, victims of neglect or abuse, children who have lost parents or are full time young carers.

In 2014/15, South West Water staff, as part of the Company's employee volunteering programme, gave up their time to help with the landscaping of the retreat. Tree-planting, the clearance of scrub in order to provide woodland play areas and the construction of outdoor activity equipment were among the tasks undertaken.

CHICKS aims to support 1,300 children during 2015 and we are proud to support this worthy cause.



Tree planting at the CHICKS retreat.

CREATING NEW EDUCATIONAL OPPORTUNITIES:
SOUTH DEVON UNIVERSITY TECHNICAL COLLEGE

In autumn 2015 the new South Devon University Technical College (SDUTC) will open in Newton Abbot in South Devon, specialising in science, engineering and the environment for 14 to 18 year olds.

South West Water is one of several leading regional employers supporting the college which will ensure vital skills are retained and developed in the region for generations to come.

The Company has played a significant role on the project since the concept of the new college was initially identified. South West Water supported the successful bid which was awarded £10m funding and the Company chairs the Project Steering and Curriculum Groups. South West Water has been involved in the recruitment, induction and mentoring of the Principal Designate, supported assessment centres for future staff and helped promote and deliver a series of Open Days to engage prospective students.

South West Water is actively reporting the progress to a range of industry bodies including other water and wastewater companies in order that they can learn about the new establishment and potentially develop similar colleges across the country.



The UTC aims to inspire a new generation of scientists and engineers.

PRINCIPAL RISKS AND UNCERTAINTIES

The following have been identified from South West Water's risk management process as potentially having a material adverse effect on its business, financial condition, results of operations and reputation. They are managed as described but are not wholly within our control and may still result in a material adverse impact on the Company. Factors beside those listed could also have a material adverse effect on our business activities.

HOW WE MANAGE RISK

We operate a well established and fully embedded risk management process from which we seek to identify significant risks at the earliest possible stage and determine whether they are acceptable risks, which we can manage and mitigate satisfactorily. More detail on our risk management process is set out on page 58.

↔ Unchanged during the year | ↑ Increased during the year | ↓ Decreased during the year

RISK	COMMENTARY	MITIGATION
Regulatory		
Uncertainty arising from Regulatory Reform ↔	PR14, the Price Review for 2015-20 was completed during 2014/15, with South West Water obtaining an 'enhanced' business plan status. The final determination on the business plan was received from Ofwat in December 2014 and was accepted by South West Water. Following the completion of the Price Review, Ofwat has published its forward programme, which focuses on key areas including: • strategy and planning • delivering the reforms in the Water Act 2014, including the market arrangements for retail and other upstream markets • Water 2020, a programme looking at both regulatory and market reforms within the industry • compliance and assurance.	The final determination for 2015-20 was largely in line with the Company's own business plan and draft determination received in April 2014. As Ofwat indicated, a key benefit of enhanced status has been sufficient certainty for the Company to implement the strategies for K6 earlier than may have otherwise been possible. South West Water has been assessed in Ofwat's low risk 'self assurance' category. This reflects the strong Board leadership and governance supported by an integrated risk and assurance framework, which is embedded into the Company.
Legislative & regulatory compliance ↔	As a regulated business South West Water is subject to numerous and changing obligations with which we must comply. The Company pays particular attention to management of risks in these areas. The performance for K6 (2015-20) is focused on the framework of customer outcomes and Outcome Delivery Incentives (ODIs). The ODIs cover a range of measures and include those, which have a financial penalty or reward for changes in performance.	Performance against regulatory outputs and ODIs for the next regulatory period is reported to the Board on a monthly basis and where performance falls short, corrective programmes are developed and implemented to target recovery in a specific area. There are a number of internal monitoring and assurance programmes which are undertaken throughout the year and annual data is supported by external verification through the Company's financial and technical auditors to provide assurance on the Company's compliance with its obligations. South West Water continues to contribute fully to consultations from all our Regulators and seeks to influence emerging changes through strong relationships with our stakeholders. Performance against outcomes and ODIs for 2015-20 will also be considered as part of the 'WaterShare' mechanism in place for the next five years and monitored by an independent panel of key stakeholders.

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RISK	COMMENTARY	MITIGATION
Economic conditions		
Non-recovery of customer debt & affordability 	Customer debt and affordability are key areas of focus given the continued challenging economic conditions. It has been identified that within South West Water's region, the level of deprivation is above the average for the country. In future, further changes to the benefits and Universal Credit system, any significant changes to personal taxation policy implemented by the UK Government as well as macro-economic trends, such as levels of household income relative to the cost of living, may further affect the ability of customers to pay their bills.	In addition to existing strategies, which are kept under review, South West Water continues to implement new initiatives including: • improved processes for managing customer moves targeting previous occupier debt • specific case management and utilising court claims effectively • increasing the use of charging orders to secure debt. South West Water is one of the few companies to have implemented a social tariff. The Company has also continued to fund and promote ways to help customers struggling to pay bills (WaterCare, ReStart, FreshStart Fund) which helps to reduce bad debt exposure.
Finance and funding		
Company may be unable to raise sufficient funds to finance its activities or such funds may be only available at higher cost 	The Company can be impacted by wider economic conditions and availability of finance from banks and other institutions.	South West Water has robust treasury policies in place. These include policies that there are always pre-drawn or committed facilities to cover at least one year's estimated cashflow and that no more than 20% of borrowing matures in any one year. The Company has access to a range of facilities including long and short-term leases, loans and Bonds. For PR14, the Price Review for 2015-20, an extensive business plan exercise was completed including an assessment of sensitivities for changes in key assumptions. The Company is well placed for the funding requirements for the K6 regulatory period.

PRINCIPAL RISKS AND UNCERTAINTIES CONTINUED

RISK	COMMENTARY	MITIGATION
Finance and funding continued		
The Company does not deliver its financial targets 	There are number of areas, which would impact the delivery of South West Water's financial targets including: • revenue – impacted by customer demand and other income streams • operating costs – through cost pressures and not delivering the required efficiencies • capital costs – through pricing pressures and challenging output delivery. In line with its track record, South West Water remains confident of delivering the assumed operating cost savings and has a track record of delivering its capital programme in accordance with regulatory requirements. Progress is regularly monitored and reviewed. Obligations, which arise within a price control period such as Private Sewers and Revised Bathing Water Guidance have been included within our 2015-20 business plan and other obligations could be funded through future adjustments to price limits if they arise.	Changes in customer demand during 2010-15 were adjusted through the Revenue Correction Mechanism at PR14. The residual variation for 2014-15 will be adjusted through revenues in 2016-17. For 2015-20, wholesale revenue controls mean that customer demand changes will be reflected in tariff changes during the period, with a residual adjustment at the next price review. The Company has delivered cumulative operating cost efficiencies and targeted capital efficiencies ahead of K5 targets, and the total expenditure (totex) regulatory framework in place for 2015-20 enables greater flexibility to deliver outcomes efficiently. South West Water continues to manage all cost pressures as they arise, in addition to achieving operating cost efficiencies and managing inflationary increases. Cost outperformance as well as new obligations, which may arise during a price period, will be considered as part of our WaterShare mechanism in K6.
Pension costs may increase and investment performance may increase the net pension scheme deficit 	All defined benefit schemes have been closed to new entrants and replaced by defined contribution arrangements. In addition, following a consultation with employees, the defined benefit pension scheme was restructured.	All defined benefit schemes have been closed to new entrants since April 2008. Employee and employer contributions are kept under review and a formal actuarial valuation as at 31 March 2013 was concluded during the period. Changes to the defined benefit pension scheme rules, capping future pension increases, were implemented in July 2014 and have reduced ongoing pension risk. In addition South West Water paid £8.7m of deficit recovery payments in the year.

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RISK	COMMENTARY	MITIGATION
Operating Performance		
Non-compliance or avoidable health and safety incident occurs 	South West Water is committed to achieving the appropriate level of health and safety compliance.	There are rigorous health and safety policies and procedures in place across South West Water. The number of accidents reportable under RIDDOR (Reporting for Injuries, Diseases and Dangerous Occurrences Regulations) for 2014 increased to seven incidents reported in the year compared to three in 2013. Continuous training is being provided to ensure that appropriate health and safety working practices are embedded. The accident review panel continues to complete thorough investigations of root causes and aims to ensure a consistent approach to RIDDOR management is adopted. Over the past 18 months, a significant review of operational sites has been undertaken to provide up to date risk assessments at all wastewater and drinking water treatment sites. A programme of capital improvements has been delivered reducing site risks further. The Company has also replaced its lone worker procedures and equipment to utilise recent advancements in technology and functionality. The alarm handling arrangements have also been changed as part of the lone worker system review with this service now being managed by an accredited external provider. Senior management and Executive visits are completed during the year across a number of sites. The behavioural safety programme launched in 2012 badged 'TAP' has continued to be publicised.
Significant operational failure or incident occurs 	Due to the nature of South West Water's business there are continued risks arising during the normal course of business, including risk of failure of assets, processes or systems, which could otherwise impact on the health, safety and security of our people or customers, or on our financial position and our reputation. This could include: • contamination of water supplies • pollution and flooding events • water resource restrictions.	South West Water has established procedures and controls in place, as well as contingency plans and incident management procedures. South West Water has a number of schemes in place to maintain water resources (such as pumped storage for certain reservoirs) and promotes conservation measures and customer water efficiency measures. South West Water also considers the longer term resource situation and prepares a new Water Resources Management Plan every five years. This is reviewed annually for a range of climate change and demand scenarios. The Company has identified targeted capital investments to reduce the risk to specific customers in key affected areas. South West Water is working alongside lead local flood authorities, other partner agencies, developers and environmental groups to identify best practice management of extreme rainfall and flooding.

PRINCIPAL RISKS AND UNCERTAINTIES CONTINUED

RISK	COMMENTARY	MITIGATION
Operating Performance continued		
Extreme weather and climate change 	Whilst 2014/15 may have been a relatively benign year of weather for the South West region, the overall expected trend is that extreme weather, which challenges the operations of South West Water, will increase. Warmer summers with more heatwaves and wetter winters are liable to lead to more variable and extreme conditions. Pressures on water resources in summer and the operational impact of flooding and high winds in winter is therefore anticipated to test South West Water's assets.	South West Water is well placed to cope with extreme incidents such as those experienced in recent years. A key mitigation is having detailed contingency plans, sufficient emergency resources and a capital programme that supports ongoing efforts to manage these risks. In the longer term, the impacts of climate change are being considered. The Company has plans ready and will adapt the way it conducts its business to respond effectively to the anticipated hotter, drier summers and wetter winters.
Poor service provided to customers 	Customer service remains paramount to South West Water and the Company focuses on improving customer satisfaction and reducing customer complaints. South West Water could incur a financial penalty under Ofwat's Service Incentive Mechanism (SIM) for below average customer service performance.	The Company has delivered further improvements in customer service demonstrated through a number of measures including: • improved satisfaction including value for money • reduced written complaints • fewer water quality complaints • improvements in SIM score. South West Water has improved its relative industry SIM measure. Whilst South West Water's performance continues to improve, relatively the performance in the period 2010-15 has incurred a modest financial penalty (already incorporated in the 2014 Final Determination). Targeted improvements are underway to further increase the relative score during the period 2015-20.
Market		
Uncertainty arising from market reform 	Whilst the Water Act 2014 recognises an approach to reform that is 'evolutionary' rather than 'revolutionary', the development of greater competition in the water industry could reduce South West Water's revenues.	As part of the risk management and business strategic planning processes, the Company continues to evaluate developments and proposals for competition. Strong progress has been made in developing our approach to retail market opening in 2017 and South West Water's internal project 'MarketReady' programme is aligned and actively engages in the development of central market operations.

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RISK	COMMENTARY	MITIGATION
Market continued		
	In particular, the 'Open Water' project is set to open the non-household retail market for water in England and Wales from 1 April 2017. This project has no direct impact on the household market. Details of upstream reform have yet to be defined and therefore continue to provide a level of uncertainty.	South West Water is prepared for the development of retail competition for non-household customers during the next regulatory period and has developed enhanced services, which it offers to commercial customers through its subsidiary, 'Source for Business'. In addition, South West Water is participating in discussions for the design of upstream reform. Upstream reform will involve a mixture of market and regulatory reforms to deliver services to customers, the environment and society effectively and efficiently.
Reputation		
Loss of key stakeholder support and prolonged negative media campaign ⇔	South West Water has a number of key stakeholders and aims to balance their needs (including our customers) with environmental responsibilities and legislative and regulatory obligations. The loss of key stakeholder support could impact the delivery of South West Water's activities.	The Company is committed to engaging with key stakeholders. Engagement with key stakeholders during the price review period was high and South West Water will maintain these dialogues. In addition, South West Water actively manages communications with customers and stakeholders online (including through social media). During 2015-20, South West Water's innovative 'WaterShare' mechanism (to share rewards of out-performance in a transparent way) will be overseen by an independent panel of key stakeholder representatives.

FORWARD-LOOKING STATEMENTS

The Principal Risks and Uncertainties section contains forward-looking statements regarding the financial position; results of operations; cashflows; 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 Principal Risks and Uncertainties section, 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 'Principal Risks and Uncertainties' section.

By Order of the Board

R C Zmuda
Secretary
Peninsula House
Rydon Lane
Exeter
Devon
EX2 7HR

3 July 2015

CHAIRMAN'S INTRODUCTION

Good governance reduces risk and adds value to our business. As such, the South West Water Board is committed to the highest standards of corporate governance and the principles on Board leadership, transparency and governance as published by Ofwat.

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, are committed to operating to the highest standards of board leadership and governance including transparency of reporting to investors, customers, regulators and other stakeholders.

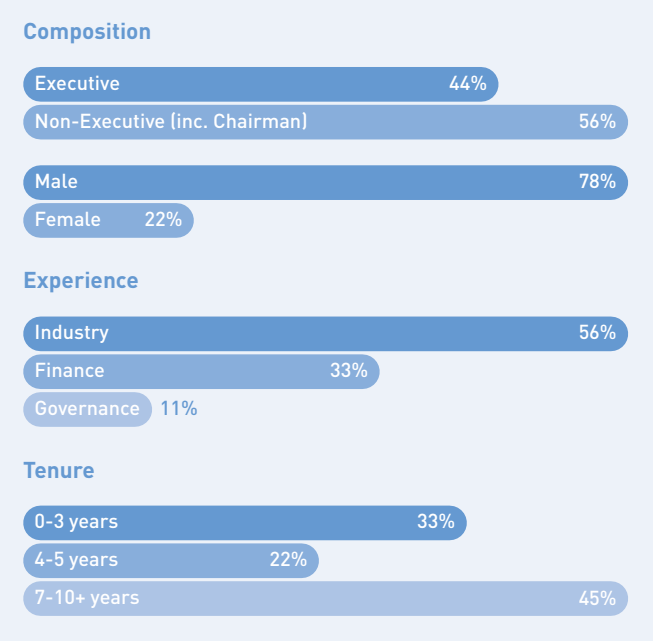
South West Water itself has a fully-functioning and standalone Board. The business of the Board covers a full range of corporate issues including strategy, performance, delivery, compliance and governance. In response to, and in accordance with Ofwat's 'Board leadership, transparency and governance – 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. In order to align the existing governance framework more explicitly with Ofwat's governance principles and the UK Corporate Governance Code, the Board established Audit, Sustainability, Remuneration and Nomination Committees during 2013/14 which have been in operation during 2014/15.

Two additional Non-executive Directors, Duncan Ingram and Steve Johnson have been recruited during the year. They bring extensive expertise and experience from a variety of industries, including regulated industries. Their recruitment results in a Board Composition of five independent Non-executive Directors (including myself) and four Executive Directors.

On 20 March 2015, Pennon Group Plc announced my decision to retire from the Pennon Group Board on 31 July 2015 following the Group's Annual General Meeting. As a consequence I will also be stepping down as Chairman of South West Water with effect from 31 July 2015 and will be succeeded as Chairman of both Pennon Group Plc and South West Water Limited by Sir John Parker.

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.

BOARD COMPOSITION



The South West Water Board of Directors at the end of the 2014/15 financial year comprised myself as Chairman (a Non-executive Director), four Executive Directors, and four Non-executive Directors. The Board considers that the Non-executive Directors were independent throughout the year. They are considered by the Board to have the appropriate skills and experience in their respective disciplines to bring independent and objective judgement to the Board's deliberations and to represent customers' interests.

BOARD EFFECTIVENESS

The Board is committed to remaining effective and recognises that to do so it must ensure that it has the right balance of skills, independence and knowledge of the Company to enable it to discharge its duties and responsibilities. This is particularly important to ensure that the Board is best placed to support the Company's future strategy.

The South West Water Board carried out an internally facilitated Board performance evaluation during the year. The results of the performance evaluation showed that the Board continued to operate effectively. The Board intends to carry out a performance evaluation exercise on an annual basis.

UK CORPORATE GOVERNANCE CODE

During 2014, the Company implemented changes to its Board structure and governance to enable compliance with the South West Water Board leadership, transparency and governance Code. The South West Water Code states that the Company will comply with the UK Corporate Governance Code to the extent it can be applied to the Company in the context of the Pennon Group structure.

The Company has complied fully with the principals and spirit of the Code during the year, subject to the exceptions as described below. Many 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 Corporate Governance Code.

Provision A.4.1. of the Code requires the Board to appoint one independent Non-executive Director to be the Senior Independent Director. However, a Senior Independent Director has not been appointed due to the structure of the Group, as the South West Water Chairman is also the Chairman of the Pennon Group Plc (sole South West Water shareholder). Any shareholder concerns can therefore be communicated to the South West Water Board via the Group Chairman.

Provision B.6.1. of the Code states that the Board should state in the Annual Report how performance evaluation of the Board, its committees and its individual Directors has been conducted. Whilst performance evaluation of the Board and individual Directors has been performed and is explained in the 'Performance Evaluation' section below, South West Water has not yet conducted evaluation exercises for each individual Committee of the Board. As 2014/15 was the first full year of operation for many of these Committees, a performance evaluation exercise for each Committee will be carried out in 2015/16.

Provision B.6.2. of the Code requires that evaluation of the Board should be externally facilitated at least every three years. As this is the first year of South West Water voluntarily complying with the Code, an external evaluation will be carried out in 2015/16. As detailed in the 'Performance Evaluation' (on page 53), an internal evaluation has been performed this year (2014/15).

As the South West Water Chairman is also the Chairman of Pennon Group Plc (South West Water's immediate and ultimate parent company), his performance evaluation is conducted separately by the Non-executive Directors of Pennon Group Plc, led by the Senior Independent Non-executive Director of Pennon Group Plc. Code provision B.6.3. states that the Non-executive Directors (of South West Water) should be responsible for the performance evaluation of the Chairman, however as noted above due to the Group structure the South West Water Chairman's performance evaluation is conducted by the Non-executive Directors of Pennon Group Plc.

Provision C.3.2. of the Code states that the terms of reference of the Audit Committee should include making 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. It also states that the Audit Committee should develop and implement policy on the engagement of the external auditor to supply non-audit services. As the auditor is appointed on a Group basis, the appointment, re-appointment and removal of South West Water's external auditor is a matter for the Pennon Group Audit Committee.

Development and implementation of a policy on the engagement of the external auditor to supply non-audit services is also a responsibility of the Pennon Group Audit Committee as it is more appropriate to consider on a Group wide basis. The Chairman of the South West Water Audit Committee regularly consults with the Chairman of the Pennon Audit Committee in relation to external auditor matters.

Provision C.3.8. of the Code requires a separate section of the Annual Report to 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 the responsibility of the Pennon Group Audit Committee.

Provision D.2.2. of the Code requires that the Remuneration Committee has 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 South West Water Chief Executive, who is also a member of the Pennon Group Plc Board is the responsibility of the Pennon Group Remuneration Committee.



Ken Harvey
Chairman
3 July 2015

BOARD OF DIRECTORS



Name

Ken Harvey

Position

Chairman

Date of appointment

1 March 1997

Experience

Appointed on 1 March 1997, Ken Harvey was formerly Chairman and Chief Executive of Norweb Plc. He held a number of appointments within Southern Electricity and became Engineering Director of London Electricity and then Deputy Chairman.

He has also been chairman of a number of limited and private equity funded companies. Ken will stand down as Chairman on 31 July 2015 and will be succeeded by Sir John Parker.



Name

Chris Loughlin

Position

Chief Executive

Date of appointment

1 August 2006

Experience

Chris was appointed in 2006, having previously held the position of Chief Operating Officer of Lloyds Register, the world's leading quality and safety assurance organisation.

Chris started his career as a consulting engineer. He subsequently worked in a variety of roles including Executive Director of British Nuclear Fuels and Executive Chairman of Magnox Electric. Earlier in his career he was a Diplomat in the British Embassy in Tokyo.



Name

Dr Stephen Bird

Position

Chief Operating Officer for Wholesale Operations

Date of appointment

1 March 2000

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.

Stephen is Director of the Heart of the South West Local Enterprise Partnership and Chairman of the Water UK Marine Waters Group. He is also a Board Member of UK Water Industry Research Limited. He is a Fellow of the Chartered Institute of Environmental Managers, holds an MBA and is a Chartered Director.



Name

Monica Read

Position

Business Services and Sustainability Director

Date of appointment

1 September 2002

Experience

Monica joined South West Water in 1992, having previously worked for accountants Touche Ross & Co., both in the UK and overseas.

At South West Water, she has held a variety of senior positions in operations, finance and customer services. She is a graduate in Environmental Science, a chartered accountant and holds a diploma from the Institute of Directors.

Monica is a Board member of the South West Lakes Trust.



Name

Louise Rowe

Position

Finance Director

Date of appointment

1 February 2015

Experience

Louise has been with South West Water for over six years, holding a range of managerial roles in the Finance Directorate prior to her appointment as Finance Director in February 2015.

She is a physics graduate and qualified as a chartered accountant with KPMG.

In 2014 Louise was Chair of the Prince of Wales' Accounting for Sustainability's Natural and Social Capital Project.



Lord Matthew Taylor

Non-executive Director

1 March 2010

Lord Taylor of Goss Moor is Chairman of the National Housing Federation which represents 1,100 housing associations, and Chairman of the St Austell Eco-Town Eco-community. He has expertise in planning for sustainable communities. He was MP for Truro and St Austell for 23 years from 1987, until he stood down at the 2010 general election.

Matthew is also Non-executive Director of Mayfield Market Towns Ltd., and Chair and Non-executive Director of Bridgehall Real Estate Limited.



Martin Hagen

Non-executive Director

1 September 2010

Martin is an independent member of the Audit and Risk Assurance Committee of the Department for Work and Pensions (DWP), a Non-executive Director of the Bradfords Group and a Governor and Audit Committee Chair of the University of the West of England.

He 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.



Duncan Ingram

Non-executive Director

1 September 2014

Duncan Ingram has held a variety of commercial and charitable board appointments.

He is a member of Ofcom's Advisory Committee for England, Non-executive Director of social housing provider The Hyde Group, Faster Payments Scheme and Paym (Mobile Payments Service) and Chair of the Children's Trust. He is also a Trustee of YMCA England.

Duncan spent much of his career with BT Group, including as Managing Director of Customer Service and as Managing Director of Broadband Services.



Steve Johnson

Non-executive Director

1 September 2014

Steve Johnson is Chief Executive of Electricity North West and former Chairman of the Energy Networks Association.

He has considerable experience across the UK gas, electricity and water supply industries, and was Managing Director of Morrison Plc, the support services business.

BOARD OF DIRECTORS CONTINUED

The Directors on the Board and their attendance at the 11 scheduled meetings of the Board during 2014/15 are as follows:

Board membership		Appointment date	Attendance
Chairman			
Ken Harvey	Chairman of the Nomination Committee	March 1997	10/11
Executive Directors			
Chris Loughlin	Chief Executive	August 2006	11/11
Dr Stephen Bird	Chief Operating Officer for Wholesale Operations	March 2000	11/11
Susan Davy*	Finance and Regulatory Director	August 2007	9/9
Louise Rowe	Finance Director	February 2015	3/3
Monica Read	Business Services and Sustainability Director	September 2002	11/11
Non-executive Directors			
Martin Hagen	Chairman of the Audit and Remuneration Committees	September 2013	11/11
Lord Matthew Taylor	Chairman of the Sustainability Committee	March 2013	11/11
Duncan Ingram	Non-executive Director	September 2014	7/7
Steve Johnson	Non-executive Director	September 2014	6/7

* Resigned 31 January 2015.

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.

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.

HOW THE BOARD OPERATES

The Board has a schedule of matters reserved for its decision and delegates more detailed consideration of certain matters to Board Committees. The matters reserved to the Board include:

- the approval of financial statements including the Annual Report & Accounts
- major items of capital expenditure
- authority levels for other expenditure
- risk management process and monitoring of risks
- approval of the strategic plan and annual operating budgets
- company policies, procedures and delegations.

Written reports are circulated in advance of Board meetings from the Executive Directors on matters within their respective areas of the business. Under the guidance of the Chairman, all matters before the Board are discussed openly and presentations and advice are received frequently from Senior Managers or from external advisors.

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

DEALING WITH DIRECTORS' CONFLICTS OF INTEREST

The Board has in place a procedure for the consideration and authorisation of Directors' conflicts of interest. This is in accordance with the Directors' duty to avoid conflicts of interest under provisions of the Companies Act 2006. The Company's Articles of Association grant Directors authority to approve such conflicts subject to appropriate conditions.

PERFORMANCE EVALUATION

The Board continues to have well developed internal procedures to evaluate the performance of the whole Board, the Chairman, each individual Director and the Company Secretary. This year the Board decided it was appropriate to perform an internally managed evaluation operated by the Company Secretary. All participants' views were sought via a questionnaire on a range of questions, which were specifically designed to ensure objective evaluation of performance. Responses were then summarised and evaluated for the Board to consider and determine whether any changes should be made to be more effective or to improve governance.

The Chairman's performance was evaluated separately by the Non-executive Directors of Pennon Group Plc, led by the Senior Independent Non-executive Director of Pennon Group Plc.

INTERNAL CONTROL

The Board is responsible for maintaining the Company's system of internal control. 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 has been in place throughout 2014/15 and up to the date of the approval of this Annual Report and Accounts.

INTERNAL CONTROL FRAMEWORK

South West Water has a well-established internal control framework, which is operated and applied in relation to the process for preparing the Company's financial statements and Annual Report.

This framework comprises:

- a clearly defined structure which delegates an appropriate level of authority, responsibility and accountability to senior managers and their departments
- a comprehensive budgeting and reporting function, with an annual budget approved by the Board, which also monitors the financial reporting process. Monthly performance and updated forecasts against budget for the full year are also provided.
- documented financial control procedures. As detailed above, senior managers are required to confirm annually that they have adequate financial controls in operation and to report any material financial risks. Compliance with procedures is reviewed and tested by the Pennon Group internal audit functions, internal quality assurance, external auditors and external ISO auditors
- an investment appraisal process for evaluating proposals for all major capital expenditure and acquisitions, with defined levels of approval and a system for monitoring the progress of capital projects
- a post-investment evaluation process for major capital expenditure to assess the success of the project and learn any lessons to be applied to future projects.

INTERNAL CONTROL REVIEW

An evaluation of the effectiveness of overall internal control compliance by South West Water is undertaken in respect of each financial year (and subsequently up to the date of this report) to assist the South West Water audit plan for the forthcoming financial year, and also the completion of the Annual Report. Initial evaluation is carried out by senior managers for consideration and final evaluation by the Board.

In addition the Audit Committee regularly reviews the operation and effectiveness of the internal control framework and annually reviews the scope of work, authority and resources of the Company's internal audit activities. For 2014/15 and up to the date of the approval of the Annual Report and Accounts, both the Audit Committee and the Board were satisfied with the effectiveness of the Company's risk management policy and the internal control framework and their operation within the Company.

SHAREHOLDER ENGAGEMENT

South West Water is a 100% owned subsidiary of Pennon Group Plc. South West Water's Non-executive Directors are invited to attend the Pennon Group strategy away day. The Chairman of the Board is also the Chairman of Pennon Group Plc and the Chief Executive is a member of the Pennon Group Plc Board. Both the Chairman and Chief Executive participate in Pennon's programme of regular dialogue with Pennon's institutional shareholders, which are described in the Pennon Group Plc Annual Report and Accounts.

BOARD COMMITTEES

A range of key matters are delegated to the Board's Governance Committees as set out on pages 54 to 62 of this corporate governance report.

The terms of reference of each of the Board's committees are set out on the Company's website (southwestwater.co.uk) or available upon request from the Company Secretary.

Following appointment of new Non-executive Directors to the Board, the membership of committees has also been expanded.

AUDIT COMMITTEE

"It is vital that business is carried out in a transparent way with detailed and thorough systems in place to ensure accountability for, and scrutiny of, strategic decision-making, risk management and the reporting of performance."



Martin Hagen
3 July 2015

INTRODUCTION

The South West Water Audit Committee provides a key element of the Company's governance structure, with members considered to have the required expertise to challenge and evaluate how well the Company is working towards its strategic goals and how accurately this is communicated. This includes ensuring that the interests of shareholders and other stakeholders are protected and that responsible business practices are adhered to. The Committee's remit is to achieve compliance with best practice in terms of corporate governance and financial reporting, and act as a link between external auditors and Board Directors.

Furthermore, the Audit Committee enables Non-executive Directors to use their individual understandings and experience of the wider business, political and economic spheres to provide objective insight on how the Company is managing both the risks and opportunities afforded to it. The Committee's aim is to ensure that South West Water continues to make sound and informed judgements on its business activities and that the resultant outputs are communicated in a fair and balanced way.

Membership		Attendance
Martin Hagen	Chairman	4/4
Lord Matthew Taylor	Non-executive Director	4/4
Steve Johnson	Non-executive Director	2/2
Duncan Ingram	Non-executive Director	1/1

Martin Hagen
3 July 2015

ROLE OF THE AUDIT COMMITTEE

The Audit Committee is responsible for providing effective oversight and governance over the Company's financial reporting, including the adequacy of related disclosures, the performance of assurance provided during the year, the internal financial control environment and the processes in place to monitor this.

The full terms of reference are available on our website (southwestwater.co.uk).

The members of the Committee receive updates in financial reporting and the Company's regulatory framework in various forms throughout the year. The Chief Executive, Executive Directors, Head of Pennon Group Internal Audit and the external auditors normally attend by invitation, all meetings of the Committee. Other members of senior management are also invited to attend as appropriate. The Committee has an established annual calendar of business, which assists in ensuring that it manages its affairs efficiently and effectively throughout the year concentrating on the key matters, which affect the Company.

The most significant matters which the Committee considered and made decision on during the year are set out below.

Financial reporting	Internal control and compliance	External auditors	Risk management	Governance
Monitored the integrity of the financial statements of the Company and the half year and full year results including reviewing significant financial reporting judgements contained in the statements. Considered and approved a process for confirming and recommending to the Board that the 2014/15 Annual Report & Financial Statements are fair, balanced and understandable.	Reviewed quarterly internal audit reports on audit reviews across the Company during the year. Reviewed the integrated internal control framework for the Company. Considered the outcome of Quality Assurance reviews and ISO accreditations.	Considered the auditor's report on their review of the 2014/15 half year results and key findings. Reviewed and monitored audit/ non-audit expenditure during 2014/15. Considered and approved the 2014/15 audit plan and set performance expectations for the external auditor. Considered the initial results of the 2014/15 external audit.	Reviewed risk management framework and compliance with that framework during 2014/15. Reviewed the assessment of the risks by the Executive Directors. Received as part of the risk management review the Annual Report on any whistleblowing.	Considered and approved new Annual Report disclosure requirements. Held separate meetings with the external auditors and the internal group audit manager without members of management being present.

GOING CONCERN

As part of its review of the Annual Report and Financial Statements the committee considered whether the Company had adequate financial resources to continue trading as a going concern.

The Committee has considered, amongst other matters:

- a review of the Company's financial projections
- stress testing of the financial budget and forecasts
- a review of the cash and committed borrowing facilities available as well as consideration of the Company's capital adequacy
- consideration of the Company's strategic business model.

Regulatory reform, and in particular the final price determination for 2015-2020 and Licence change impacts have, to date, followed the Government's evolutionary objective. A number of the existing features of the regulatory regime have been retained which impact long-term financing – not least an RCV based return linked to RPI, with assets remaining 'ring fenced' in the wholesale business, with a 25-year rolling Licence.

The Directors are satisfied that the Final Determination received from Ofwat on 12 December 2014 relating to the business plan to 2020 is financeable and that the business model, strategy and operations are sustainable.

In conclusion, the Directors have a reasonable expectation that the Company has adequate resources available to it to continue in operational existence for the foreseeable future and have therefore continued to adopt the going concern policy in preparing the financial statements.

AUDIT COMMITTEE CONTINUED

ACCOUNTING POLICIES AND CRITICAL ACCOUNTING JUDGEMENTS

As part of its monitoring of the integrity of the financial statements, the Committee reviews whether suitable accounting policies have been adopted, whether management has made appropriate estimates and judgements and also seeks support from the external auditors to assess them.

The Committee looked carefully at those aspects of the financial statements which required significant accounting judgement or where there was estimation uncertainty. These areas are explained in note 4 of the financial statements on pages 100 and 101. The Committee paid particular attention to the following areas in the year ended 31 March 2015:

Provision for doubtful debt	
Throughout the year and particularly at each balance sheet date South West Water evaluates the collectability of trade receivables and records a provision for doubtful debts. This provision is based on segmenting South West Water customer base and including a provision percentage after considering the relative age of accounts, collections history, write-offs and future collectability.	The Audit Committee has considered (previously at South West Water Board – full report in May) the appropriateness of the doubtful debt provisioning at the half and full year results. There have been no changes in the methodology for calculating this provision during 2014/15, though a detailed review of the collections history, write-offs and future collectability has been performed. This exercise has resulted in small changes to the provision percentage for certain categories of debt, however this has not resulted in a significant change to the total provision. At the year end the external auditors reported on the work performed. The Committee discussed the results of this report and asked questions of the Executive Directors. The approach and key assumptions made by management were considered appropriate and accepted by the Audit Committee.
Metered Accrual	
South West Water's billing cycle for measured customers is in arrears and therefore at the balance sheet date an estimate of revenue recognised within the year is required.	The metered accrual is a system driven automated calculation. The accrual is reviewed by management and the assumptions used in the calculation are considered appropriate and consistent with the prior year. A retrospective review of the prior year accrual against the actual amounts billed identified a difference of c.0.8% of revenue, and is not considered to be significant by the Audit Committee.
Fixed asset depreciation charge	
Capital expenditure and asset related charges are a significant balance within South West Water's financial statements. The estimates of asset lives and thus depreciation charges are a significant judgement.	The Audit Committee has considered the appropriateness of the accounting for capital expenditure and the asset lives assumed. There have been no material changes in the process or procedures in the application of depreciation, nor have any asset lives been amended in the past year. The reporting from external auditors has been reviewed, where specific comment and analysis has been made on this judgement. The useful lives applied were within the range applied by others within the sector.

The Committee is satisfied that each of the matters set out above had been fully and adequately addressed by the Executive Directors, appropriately tested and reviewed by the external auditor and that the disclosures made in the Annual Report and Financial Statements are appropriate.

EXTERNAL AUDIT

The Company's Audit Committee is actively engaged with the auditor. Ernst & Young LLP was appointed as auditor in 2014 following a comprehensive competitive tender process.

Annually, the Audit Committee reviews the external auditor's plan and considers the effectiveness as well as their independence, bearing in mind that it is recognised there is an ongoing need to use our auditor's firm for some non-audit services.

PROVISION FOR NON-AUDIT

The Committee applies the Group policy for the engagement of the external auditor's firm for non-audit work. The Committee carefully reviews whether it is necessary for the auditor's firm to carry out such work and will only recommend approval for their appointment if they are satisfied that the auditor's independence and objectivity is fully safeguarded. Also if there is another accounting firm that can be engaged to undertake the non-audit services then such firm would be chosen in preference to the external auditors.

Set out on page 102 is the level of fees paid to the Company's auditor's firm for audit services, audit related services and non-audit services.

The decrease in total fees results from the significant amount of assurance required in 2013/14 over the submission of the 2015-2020 Business Plan and fees for pension advisory services. The only non-audit work performed in 2014/15 by South West Water's external auditor is in respect of assurance on tariffs and charges for 2015/16, which is not considered material work.

The Committee considered that the external auditor was best placed to provide certain review and recommend procedures as well as agreed upon procedures in connection with South West Water's annual submission of charges and tariffs for the forthcoming year because of their knowledge of South West Water's business and the inherent links with revenue reporting in the statutory financial results in 2015/16.

RISK AND ASSURANCE

The Audit Committee is responsible for ensuring appropriate risk management processes are in place and for the assurance undertaken across the Company.

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.

This integrated assurance framework includes the following key components:

1st line of defence Management	• performance reviews • local quality control • annual certification and 'sign-off' of submitted data.
2nd line of defence Policy setting and compliance checking	• business management systems internal audits • policies and culture (e.g. whistle blowing) • Quality Assurance and ISO internal reviews (iii) • Risk Manager Internal Reviews.
3rd line of defence External scrutiny	• Group Independent Internal Audit (i) • financial audit (ii) • technical audit (ii) • quality regulators (including ISO external reviews) (iii) • other external assurance providers.

This integrated assurance approach has been recognised as best practise as South West Water was one of only two companies to be assessed within the 'self assurance' category by Ofwat, for 2015-20 reporting.

(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. This is summarised in an audit plan, approved in September each year, which is approved by the Audit Committee and updated on a rolling basis.

A key input into the agreeing the audit plan is the review of the effectiveness of the Internal Audit function by the Audit Committee.

The Internal Audit function reviews the extent to which systems of internal control:
- are designed and operating effectively
- are adequate to manage South West Water's key risks.

The areas of the business that received attention over the past year included capital expenditure, energy management, property services, transport, credit management and debt collection.

The Head of Pennon Internal Audit is invited to, and attends, South West Water Audit Committee meetings, and is also given the opportunity to discuss privately with the Audit Committee Chairman without any members of management present.

AUDIT COMMITTEE CONTINUED

INTEGRATED ASSURANCE FRAMEWORK CONTINUED

(i) Group independent internal audit continued

The Audit Committee has oversight responsibilities for activities completed by the Pennon Group Internal Audit department within South West Water. The Internal Audit annual plan is reviewed and approved by the South West Water Audit Committee and recommendations and findings arising from these, along with management actions to findings are considered.

(ii) Annual assurance (financial and technical audit)

Alongside the statutory external auditors, 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 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 Quality Assurance Department as part of the Company's ISO 9001:2008 and ISO 14001:2004 certifications.

South West Water also has the following quality accreditations/certifications:

- ISO 9001: 2008 (quality management)
- ISO 14001: 2004 (environmental management)
- ISO 27001: 2005 (information security)
- ISO 17025: 2005 (laboratories and sampling).

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

PROJECT ASSURANCE

Where required, South West Water will consider assurance over key projects and engage external assurance providers were appropriate to review progress and outputs of these projects.

RISK MANAGEMENT AND ASSESSMENT

A full risk and control assessment is undertaken annually, and regularly updated, to identify both financial and non-financial risks. At Audit Committee meetings details of any new high-level risks identified are presented together with how they are to be managed, in addition to details of any changes to existing risks and their management.

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 procedures.

South West Water also has in place and adheres to a whistleblowing policy, and thoroughly investigates any allegations of misconduct and irregularity, whilst considering the implications for our control environment. In the normal course of business, investigations into irregularities may be ongoing as of the date of the approval of the financial statements.

The results of the risk and control assessment will also inform the assurance approach taken (e.g. to perform additional internal reviews in areas of higher risk).

These processes all serve to ensure that South West Water has an embedded culture of effective control and risk management, and is positioned to be able to react appropriately to new risks as they arise. The key risks affecting the Company are detailed in pages 42 to 47.

For the 2015-2020 regulatory period, South West Water will be subject to separate regulatory revenue controls for various types of income streams. Previously there had been a single revenue control for the regulated business of South West Water. The risk management process will be aligned with the new revenue controls.

OFWAT COMPANY MONITORING FRAMEWORK

In February 2015, Ofwat published guidance on the monitoring and assurance requirements for water and sewage companies during the 2015-2020 regulatory period. It includes a framework, which adopts a risk based approach with respect to monitoring and assurance requirements for the water companies.

South West Water are one of only two water companies to have been categorised within the lowest risk 'self assurance' category, which means that it has no additional prescriptive assurance requirements in respect of regulatory performance reporting (including 'Outcome Delivery Incentives') beyond minimum requirements for all companies and can determine itself additional assurance provision.

South West Water will continue to apply the integrated assurance framework across the business to ensure a robust and rigorous approach to assurance.

SUSTAINABILITY COMMITTEE





Lord Matthew Taylor
3 July 2015

Membership		Attendance
Lord Taylor	Chairman	3/3
D G Ingram	Non-executive Director	1/1[1]
S Johnson	Non-executive Director	1/1[1]
M J Hagen	Non-executive Director	2/3
C Loughlin	Chief Executive	3/3
M S Read	Business Services & Sustainability Director	3/3

1 Appointed during financial year therefore only eligible to attend one meeting.

The Sustainability Committee is responsible for reviewing the strategies, policies, management and initiatives in the context of how the Company conducts its business in a responsible and sustainable manner.

It considers the targets and performance of South West Water in the areas of: ethical business practice; community engagement; environmental, economic and workplace sustainability; and the role of the Company in society.

Matters considered during the year included:
- performance against sustainability targets for 2014/15
- target setting for 2015/16
- strategies and progress in relation to community engagement, employee engagement survey results, customers and Supply chain
- Company policies
- reporting and verification.

> "Sustainability encompasses the social, economic and environmental relationships a business has with the wider world."

To operate sustainably is to choose responsible working practices that bring positive long-term benefits. This includes everything from the steps taken to protect the environment through to the way in which a business manages its employees and builds relationships with the communities in which it operates. South West Water's Sustainability Committee was established in 2014 to monitor, challenge and ensure the transparency of reporting in terms of the Company's social, economic and environmental sustainability.

The creation of the Committee has enabled increased focus on sustainability, building on the Company's already very strong track record. In 2014/15, the Committee met on three occasions to provide objective scrutiny on a variety of business matters and activities. The appointment of two new experienced Non-executive Directors during the year has further strengthened the opportunities for the Committee to provide effective challenge and insight.

The Committee has reviewed South West Water's performance against its fourteen sustainability targets for 2014/15 and the setting of further targets for the year ahead. I am pleased to report that South West Water met 12 of the 14 sustainability targets for 2014/15. The targets that were not met were health and safety and finalising the arrangements for Paid Ecosystems Services. Health and safety is an area in which the Company is placing concerted efforts to improve performance, both in terms of hazard reporting and steps to reduce the number of reportable incidents (see page 39). Developing the new and innovative Paid Ecosystems Services terms has made progress during the year and engagement with stakeholders remains a priority for our environmental programme.

Sustainability is one of South West Water's guiding principles. In order to further strengthen the Company's focus on maintaining and developing as a responsible business, the Committee recommended South West Water's membership of Business in the Community (BiTC). BiTC's initial assessment of the Company has been favourable and has provided a useful platform from which to make further improvements in how the Company monitors and communicates its business activities from a sustainability perspective.

Furthermore, the Committee has established an annual programme to review activities and progress regarding issues of sustainability and corporate responsibility. Our aim is to ensure that the Company's decision-making and target-setting reflect best practice, not only in comparison with water industry peers but against a range of best practice businesses and sectors.

Lord Matthew Taylor
3 July 2015

SUSTAINABILITY COMMITTEE CONTINUED

SUSTAINABILITY TARGETS

A summary of South West Water's performance against sustainability targets for 2014/15 is outlined in the following report. Page references are provided for further information.

ENVIRONMENTAL SUSTAINABILITY

The protection of the natural world is an essential aspect of ensuring 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	Page
Aim for less than four category 1 and category 2 incidents as a result of effluent discharge/storm overflow.	MET	24
Develop partnering relationships with the Environment Agency, local authorities and community groups on flooding and integrated urban drainage to prepare for Downstream Thinking pilots.	MET	27
Target greenhouse gas emissions reduction compared with 2009/10.	MET	24
Finalise arrangements for Paid Ecosystems Services agreements on third party land and commence first project on Exmoor.	IN PROGRESS	n/a

SOCIAL 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 the people we serve, those we employ, and the quality of life they enjoy.

Target	Status	Page
Deliver our community engagement programme.	MET	36-41
Extend partnership working with local social housing providers offering targeted financial and practical assistance to tenants.	MET	40
Target a one-year RIDDOR-reportable injury incidence rate of no more than 300 per 100,000 employees within the 2015 calendar year.	NOT MET	39
Continue leadership skills development and productivity focus through the employee development programme.	MET	38
Conduct a whole company employee engagement and satisfaction survey and develop consequential departmental and business action plans.	MET	38

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ECONOMIC SUSTAINABILITY

Through the people we employ and the contractors, suppliers and partner organisations that we work alongside, South West Water plays a significant role in the economy of the region. Our strategies are designed to deliver long-term value to our shareholder and its investors, ensuring we are as efficient as possible while minimising the cost to customers.

Target	Status	Page
Further develop the supplier sustainability programme to identify and deliver environmental benefits.	MET	35
Continue to develop relationships with local universities on innovation and in particular progress partnership with South Devon University Technical College.	MET	41
Increase self generated energy to a level of 15GWh or greater.	MET	24
Achieve a further 3GWh (full year effect) energy saving through the powerdown, pump efficiency and PUROS programmes.	MET	24
Deliver pressure management programme at targeted locations across the water distribution network to deliver a reduction in average pressure of 1 metre head during 2014/15.	MET	34

VERIFICATION

South West Water's sustainability performance and reporting has been audited by South West Water's technical auditors, SMC, an independent management consultancy specialising in regulatory reporting.

NOMINATION COMMITTEE

Membership	Role	Attendance
Ken Harvey	Chairman	1/1
Martin Hagen	Non-executive Director	1/1
Lord Matthew Taylor	Non-executive Director	1/1
Duncan Ingram[1]	Non-executive Director	–
Steve Johnson[1]	Non-executive Director	–

1 Appointed in November/December 2014 to the Committee. Duncan Ingram and Steve Johnson did not attend the Nomination Committee meeting held during 2014/15, which preceded their appointment to the Committee.

The Nomination Committee is responsible for considering and recommending to the Board persons who are appropriate for appointment as Executive and Non-executive Directors and for other senior management roles, so as to maintain an appropriate balance of skills and experience within the Company and on the Board.

This Committee will meet to select and recommend appointments to the Board. The terms of reference of the Nomination Committee are available on our website.

During the year, the Nomination Committee initiated a succession planning process to replace the South West Water Finance & Regulatory Director, Susan Davy following the announcement that she would be taking up the role of Group Director of Finance with Pennon Group Plc.

Following this process, the Board accepted the Committee's recommendation that Louise Rowe should join the South West Water Board as Finance Director with effect from 1 February 2015. Louise is a graduate qualified Chartered Accountant and as Corporate & Central Finance Manager, Louise was extensively involved in the successful Price Review, which led to South West Water being recognised by Ofwat as one of only two water companies attaining an 'enhanced' business plan status. She brings extensive experience both from her time within South West Water and from her previous role within accountants KPMG.

The Committee also led the recruitment process for two new Non-executive Directors which following Board acceptance culminated with the appointment of Duncan Ingram and Steve Johnson as Non-executive Directors on 1 September 2014.

Duncan Ingram and Steve Johnson bring extensive expertise and insight including relevant experience from other regulated businesses. Both will be invaluable as the Board continues to develop South West Water's services under a new regulatory framework and prepare for reform of the non household retail market.

Duncan Ingram and Steve Johnson became members of the Nomination Committee following their initial appointments as Non-executive Directors of South West Water.

REMUNERATION COMMITTEE

Membership	Role	Attendance
Martin Hagen	Chairman	2/2
Lord Matthew Taylor	Non-executive Director	2/2
Duncan Ingram[1]	Non-executive Director	2/2
Steve Johnson[1]	Non-executive Director	2/2

1 Appointed in November/December 2014 to the Committee.

THE DIRECTORS' REMUNERATION REPORT

The Directors' remuneration report for 2014/15 is set out separately on pages 63 to 79.

The Remuneration Committee meets in accordance with an annual calendar to consider remuneration matters in respect of the Company and in particular is responsible for:

- advising the Board on the framework of executive remuneration for the Company
- determining the remuneration and terms of engagement of the Executive Directors (excluding the Chief Executive) and senior management of the Company.

The remuneration of the Chairman, who is also the Chairman of Pennon Group Plc and the Chief Executive, who is also a member of the Pennon Group Plc Board is the responsibility of the Pennon Group Remuneration Committee.

THE COMMITTEE'S ACTIVITIES DURING THE FINANCIAL YEAR

During the year the Committee dealt with the following matters:

- annual executive salary review
- determining performance targets in respect of the annual incentive bonus plan for 2015/16.

The Remuneration Committee's principal function is to support the Company's overall remuneration policy. The terms of reference for the Remuneration committee are available on our website.

GENDER DIVERSITY

The Company has a number of policies embracing workplace matters, including non-discrimination and equal opportunities policies. South West Water is seeking to grow through the diversity of talents and abilities in the Company. South West Water strives to eliminate bias and discrimination in the treatment of people, be they job applicants, employees, or members of the public, including bias and discrimination on grounds of gender.

Membership	Female membership %
The Board	22%
Senior Management	15%
Company	21%

DIRECTORS' REMUNERATION REPORT

INTRODUCTION

In accordance with the remuneration reporting requirements the report is in two parts:

- Directors' remuneration policy – a summary of the policy on Directors' remuneration. This is provided for information only due to no changes being proposed this year which increase or extend any of the elements of remuneration
- annual report on remuneration – contains the remuneration of the Directors for the year 2014/15 including the 'single remuneration figure' table providing a value for each element of remuneration for each Director, together with the details of the link between Company performance and remuneration during the year. It also provides details of how our policy will be applied for 2015/16.

The membership and the role of the Remuneration Committee including how it has operated during the year is set out on page 62.

REMUNERATION DECISIONS FOR THE YEAR

In April 2014 the basic salaries of the Executive Directors increased by 2.5%. The salary increases were generally in line with those across the organisation. During the year an independent benchmarking exercise of Executive Management remuneration was completed. As a result for 2015/16 Director salaries have been individually increased to reflect this review, except for the Finance Director having been appointed towards the end of the 2014/15 year.

The bonus outturns for the Executive Directors for the year were between 67.2% and 78.2% of salary (with half deferred as set out on page 65). This reflects the achievements of the business in the year, the Company's performance against corporate financial targets and the Executive Directors' individual targets.

As regards the long-term incentive plan, the overall estimated outturn for awards vesting at the end of the three year period ending 31 March 2015 is 0% of the maximum 100%. This reflects that Pennon Group's total shareholder return is estimated to be below the comparator index and is expected to rank below the median of the FTSE 250.

BOARD CHANGES

Susan Davy, Finance and Regulatory Director, resigned from the Board on 31 January 2015 to take up her appointment as Group Director of Finance for Pennon Group Plc.

On 1 February 2015 Louise Rowe became Finance Director and joined the South West Water Board. Her remuneration package is in line with those of the other Executive Directors, except that her salary has been set at an initially lower level with a view to providing for scope for increases depending on performance over the next two years. As Mrs Rowe's appointment was a promotion within the Company (from being Corporate and Central Finance Manager of South West Water) her pre-existing awards and contractual commitments have been honoured in accordance with their established terms. This is in accordance with the approved remuneration policy. No cash sign-on payments were made.

LOOKING FORWARD

In accordance with the new provisions of the UK Corporate Governance Code and good remuneration practice we decided to introduce explicit malus and clawback provisions in our Performance and Co-investment Plan for awards from 2015. We introduced similar provisions in our Annual Incentive Plan last year.

For awards from 2015, a further two year holding period has been introduced in respect of any shares which vest at the end of the three year performance period under the Performance and Co-investment Plan. This further aligns the interests of management with the longer term success of the Company.

No other changes have been made to our remuneration package. In particular all maximum opportunities will remain the same in 2015/16.

DIRECTORS' REMUNERATION POLICY

INTRODUCTION

The remuneration policy tables for Executive and Non-executive Directors are set out below. They have been reproduced as approved with the exception of minor and inconsequential changes (for example, updating to reflect Director changes) and the introduction of malus and clawback provisions in the Group's Performance and Co-investment Plan.

The Directors' remuneration policy is available on request from the Company Secretary.

FUTURE POLICY TABLE – EXECUTIVE DIRECTORS

The table below sets out the elements of the total remuneration package for the Executive Directors which are comprised in this Directors' remuneration policy.

How the components support the strategic objectives of the Company	How the component operates (including provisions for recovery or withholding of any payment)	Maximum potential value of the component	Description of framework used to assess performance
Base salary			
Set at a competitive level to attract appropriate candidates to meet the Company's strategic objectives and to aid retention.	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 but there may be exceptions such as where there has been the recruitment of a new Executive Director at an initially lower salary.	When reviewing salaries the Committee has regard to the following factors: • salary increases generally for all employees in the Company and the Pennon Group • market rates • performance of individual and the Company • other factors it considers relevant. There is no overall maximum.	None, although individual and Company performance are factors considered when reviewing salaries.
Benefits			
Benefits are provided that are consistent with the market and level of seniority and which 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. In the event that an Executive Director is required to relocate, relocation benefits may be provided.	The cost of insurance benefits may vary from year to year depending on the individual's circumstances. There is no overall maximum benefit value but the Committee aims to ensure that the total value of benefits remain proportionate.	None.

How the components support the strategic objectives of the Company	How the component operates (including provisions for recovery or withholding of any payment)	Maximum potential value of the component	Description of framework used to assess performance
Annual bonus			
Linked to achievement of key performance objectives aligned to the strategy of the Company.	Annual bonuses are paid following finalisation of the financial results for the year to which they relate and paid usually three months after the end of the financial year. A portion of any bonus is deferred into shares in Pennon Group Plc which are normally released after three years. Normally 50% is deferred. Any dividends on the shares during this period are paid to the Directors. The deferred bonus plan is operated in conjunction with Pennon Group Plc's HMRC approved executive share option scheme (ESOS) on the basis that the pre-tax value of awards under both are the same as if the deferred bonus plan had operated alone. For bonuses awarded in respect of the 2014/15 financial year and going forward malus and clawback provisions apply which permit net cash bonuses and/or deferred bonus shares to be forfeited, repaid or made subject to further conditions where the Committee considers it appropriate in the event of any significant adverse circumstances, including (but not limited to) a material failure of risk management, serious reputational damage, a financial misstatement or misconduct. Clawback may be applied for the period of three years following determination of the cash bonus.	The maximum bonus potential for each Director is: C.Loughlin – 100% of base salary of which 50% is cash and 50% is deferred. S.Bird, M.Read, L.Rowe – 75% of base salary of which 37.5% is cash and 37.5% is deferred.	Performance targets relate to corporate and personal objectives which are reviewed each year. For C Loughlin, 70% and for S C Bird, M S Read and L F Rowe, 60% relates to financial targets or quantitative measures. The measures, weighting and threshold levels may be adjusted for future performance years. Following the financial year end the Committee, with advice from the Chairman of the Board and following consideration of the outturn against target by the Chairman of the Audit Committee, assesses to what extent the targets are met and determines bonus levels accordingly. In doing so the Committee takes into account overall Company performance and may adjust the bonus upwards or downwards for any specific factors such as exceptional out-performance or under-performance.

DIRECTORS' REMUNERATION POLICY CONTINUED

FUTURE POLICY TABLE – EXECUTIVE DIRECTORS CONTINUED

How the components support the strategic objectives of the Company	How the component operates (including provisions for recovery or withholding of any payment)	Maximum potential value of the component	Description of framework used to assess performance
Long-term incentive plan (Performance and co-investment plan)			
Provide alignment to shareholders and to longer term Pennon Group's performance.	Annual grant of conditional shares (or equivalent). Share awards vest dependent upon the achievement of specific performance conditions measured over a performance period of no less than three years. A grant is only made if the Director has acquired or is due to acquire co-investment shares equivalent to one-fifth of the value of the award. Dividend equivalents (including dividend reinvestment) may be paid on vested awards. 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. **Introduced for 2015/16** For grants made from 2015 onwards malus and clawback provisions will apply which permit shares to be forfeited, repaid or made subject to further conditions where the Committee considers it appropriate in certain circumstances. The circumstances in which malus may be applied include (but are not limited to) a material misstatement, serious reputational damage, or the participant's misconduct. The circumstances in which clawback may be applied are material misstatements or serious misconduct. In addition a further 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: C.Loughlin – 100% of base salary. S.Bird, M.Read, L.Rowe – 80% of base salary.	The current performance conditions are based on Total Shareholder Returns (TSR) of the Pennon Group with 50% based on TSR against the peer group index (chosen because these companies are regarded as Pennon Group's key listed comparators) and 50% based on TSR against constituents of the FTSE 250 index (excluding investment trusts) (chosen because this is the FTSE index to which the Pennon Group belongs currently). No more than 30% of maximum vests for minimum performance. The 'underpin' evaluation includes consideration of environmental, social and governance (ESG) factors and safety performance as well as financial performance. The Committee will keep the performance measures under review and may change the performance condition for future awards if this were considered to be aligned with the Pennon Group's interests and strategic objectives.

How the components support the strategic objectives of the Company	How the component operates (including provisions for recovery or withholding of any payment)	Maximum potential value of the component	Description of framework used to assess performance
Pension			
Provides funding for retirement and aids retention of key skills to assist in meeting the Company's strategic objectives.	Defined benefit pension arrangements are closed to new entrants. Defined contribution pension arrangements have been available to new staff since 2008. A cash allowance may be provided as an alternative and/or in addition where pension limits have been reached.	The maximum annual pension contribution or cash allowance is 15% of salary. For Executive Directors appointed prior to April 2013 the maximum annual pension contribution or cash allowance is 30% of salary. Legacy defined benefit pension arrangements will continue to be honoured.	None.
All-employee share plans			
To align interests of all employees with Pennon Group's 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.	None.

DIRECTORS' REMUNERATION POLICY CONTINUED

FUTURE POLICY TABLE – NON-EXECUTIVE DIRECTORS

The table below sets out the Company's policy in respect of the setting of fees for Non-executive Directors.

How the components support the strategic objectives of the Company	How the component operates	Maximum potential value of the component
Fees		
Set at a market level to attract Non-executive Directors who have appropriate experience and skills to assist in determining the Company's strategy.	Fees are set by the Board with the Chairman's fees being set by the Committee. The relevant Directors are not present at the meetings when their fees are being determined. Non-executive Directors normally receive a basic fee. In reviewing the fees the Board, or Committee as appropriate, consider the level of fees payable to Non-executive Directors in other companies of similar scale and complexity.	Total fees paid to Non-executive Directors will remain within the limits stated in the Articles of Association.
Benefits		
Benefits for the Chairman are provided which are consistent with the market and level of seniority.	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 leaving Chairman's benefits include the provision of a company vehicle, fuel and health insurance. Sir John Parker, who will become the Chairman from 1 August 2015, is entitled to expenses on the same basis as for other Non-executive Directors and, when appropriate for the efficient carrying out of his duties, will be provided with a driver and vehicle for travelling purposes.	None.

DIRECTORS SERVICE CONTRACTS/LETTERS OF APPOINTMENT

The policy for Executive Directors' service contracts is to provide for 12 months' notice from either side. The policy for Non-executive Directors' letters of appointment is to contain three months' notice from either side and for the Chairman's letter of appointment to contain a 12 month notice period from either side.

ANNUAL REPORT ON REMUNERATION

INTRODUCTION

This section sets out how the Company has applied its remuneration policy in the year, and details how the policy will be implemented for the year 2015/16.

OPERATION OF THE REMUNERATION POLICY FOR 2015/16

During 2014/15 the Pennon Group Remuneration Committee further reviewed the incentive framework for Executive Directors across the Group. The key changes made were:

- adjustment of the corporate performance objectives for the annual bonus to ensure that they were aligned with the areas of challenge in the strategy
- the introduction of malus and clawback arrangements in the Performance and Co-investment Plan in accordance with best practice
- the introduction of a two year holding period in respect of any shares which vest under the Performance and Co-investment Plan.

A summary of the specific remuneration arrangements for Executive Directors in 2015/16 is described below:

Base salary	Following an independent benchmarking exercise, salary increases of between 3.36% for C Loughlin, 7.37% for S C Bird and 16.07%% for M S Read are effective from 1 April 2015. L F Rowe, having been appointed on 1 February 2015, did not receive any increase. 2015/16 salaries are: • Chris Loughlin:£400,000 [1] • Stephen Bird:£185,000 • Monica Read:£130,000 [2] • Louise Rowe:£115,000
Pension and benefits	No changes. Legacy defined benefit pension arrangements. Salary supplement cash allowance of between 15% and 30% from which is deducted the employer's contribution to the Defined Benefit or Contribution pension schemes for the Directors.
Annual bonus	No change to maximum opportunity of: C Loughlin: 100%[1] of salary S C Bird, M S Read and L F Rowe: 75% of salary No change to operation of deferral. Normally 50% of the bonus is delivered as deferred shares. Following a review of the performance measures, annual bonus will be based on the following for 2015/16: C Loughlin: • 30%[1] Pennon Group EPS performance • 30%[1] personal strategic objectives • 40%[1] measures specific South West Water including net debt, South West Water operating profit, SIM performance and serviceability. S C Bird, M S Read and L F Rowe: 75% of salary • 25% South West Water financial performance • 20% defined service improvements • 30% personal strategic objectives. More detail on the measures and weightings is provided on the following page. The objective was to ensure alignment to measures identified as key for each role with an appropriate balance between hard financial measures and objectives aligned to the strategic success of the business. For bonuses from 2014/15 both malus and clawback will apply as described in the summary of the remuneration policy report.

1 80% of this remuneration paid directly by South West Water.
2 Pro-rated for part time service.

ANNUAL REPORT ON REMUNERATION CONTINUED

OPERATION OF THE REMUNERATION POLICY FOR 2015/16 CONTINUED

Performance and Co-Investment Plan (PCP)	No change to maximum performance opportunity of 100% of base salary for C Loughlin and 80% for S C Bird, M S Read and L F Rowe. Awards are subject to co-investment of 20% of the award and performance measures: • 50% Pennon Group Plc's TSR vs FTSE 250 (excluding investment trusts) • 50% Pennon Group Plc's TSR vs a peer group index • 'Underpin' relating to overall Pennon Group performance. For awards from 2015/16 both malus and clawback apply as described in the summary of the remuneration policy. In addition, a further two year holding period will apply in respect of any shares which vest at the end of the three year performance period.
Shareholding guidelines	No change. 100% of salary to be built up in the first five years of joining.

FORWARD-LOOKING PERFORMANCE TARGETS

Details of the annual bonus framework that will apply for each Executive Director for 2015/16 are set out in the table below:

C Loughlin	Pennon Group EPS*	30%
	Average South West Water Directors' performance: (i) operating profit (ii) RORE^ (iii) Net debt (iv) Totex performance (v) Environmental, Customer and Employee Service Improvements	40%
	Personal	30%
S.Bird M S Read L F Rowe	South West Water performance: (i) operating profit (ii) RORE^ (iii) Net debt (iv) Totex (v) Environmental, Customer and Employee Service Improvements	45%
	Personal	30%

* Pennon Group EPS is before deferred tax and exceptional net charges.
^ Return on Regulated Equity.

The specific bonus targets are considered to be commercially sensitive. However the Committee intends to disclose details of the targets set retrospectively to the extent they are not considered commercially sensitive.

For the PCP (long-term incentive plan) the targets are set out below:

	Threshold (30% of maximum vests)	Maximum (100% of maximum vests)
Comparator Index (50% of award)	Equal to index	15% above the index
FTSE 250 (excluding investment trusts) (50% of award)	Above 50th percentile	At or above 75th percentile

The Water/Waste Index will comprise:

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

NON-EXECUTIVE DIRECTOR FEES

Non-executive Director fees for 2015/16 are set out below. Following the establishment of the South West Water Board Committees, the fees for Non-executive Directors were increased by 28% reflecting the significant additional time commitment required. These changes were approved by the Board and effective from 1 September 2014.

Role	Fees £
Chairman	262,400*
Non-executive Director fee	45,000

* 50% of this remuneration is chargeable to South West Water through Group Recharges.

SINGLE TOTAL FIGURE OF REMUNERATION TABLES (AUDITED INFORMATION)

	Base salary/fees (£000)		All taxable benefits (£000)		Annual bonus (cash bonus and deferred shares) (£000)		Performance and co-investment plan (£000)		Pension (£000)		Total remuneration (£000)	
	2014 /15	2013 /14	2014 /15	2013 /14	2014 /15	2013 /14	2014 /15	2013 /14	2014 /15	2013 /14	2014 /15	2013 /14
Executive Directors												
C Loughlin*, Chief Executive	310	302	21	24	242	256	–	109	93	90	666	781
S C Bird, Chief Operating Officer for Wholesale Operations	172	168	16	15	116	106	–	47	74	72	378	408
S J Davy[2], Finance & Regulatory Director	149	174	12	13	104	124	–	49	46	54	311	414
M S Read[1], Business Services and Sustainability Director	112	107	22	22	76	68	–	31	69	41	279	269
L F Rowe[2], Finance Director	19	–	1	–	14	–	–	–	3	–	37	–
Non-executive Directors												
K G Harvey*, Chairman	131	128	12	13	–	–	–	–	–	–	143	141
M J Hagen	41	35	–	–	–	–	–	–	–	–	41	35
D J Ingram	26	–	–	–	–	–	–	–	–	–	26	–
S Johnson	26	–	–	–	–	–	–	–	–	–	26	–
Lord Taylor	41	35	–	–	–	–	–	–	–	–	41	35

1 Pro-rated for part-time service.
2 Actual remuneration reflects respective appointments and resignations.

NOTES TO THE SINGLE TOTAL FIGURE REMUNERATION TABLE

* C Loughlin is an Executive Director of Pennon Group Plc as well as Chief Executive of South West Water. The disclosures above reflect 80% of his full remuneration which is paid directly by South West Water.
* K G Harvey is the Chairman of Pennon Group Plc and South West Water. The disclosures above reflect 50% of his full remuneration which is chargeable to South West Water through Group recharges.

ANNUAL REPORT ON REMUNERATION CONTINUED

ANNUAL BONUS OUTTURN FOR 2014/15

The performance targets set and the performance achieved in respect of the annual bonus for 2014/15 in respect of each Executive Director is set out below.

Chris Loughlin

Measure	Weighting	Threshold	Target	Maximum	Actual outturn	Bonus outturn
Pennon Group EPS^	30%	35.3p	39.3p	45.1p	39.8p	13.65%
South West Water performance	40%	The average of the bonus earned by the other Executive Directors of South West Water which relate to: • out-performance against operating profit • net debt targets • the position the Company achieves in the 'Service Incentive Mechanism' of water and sewerage companies established by Ofwat • the achievement of a range of service standards set for the Company by Ofwat • personal objectives relating to key initiatives, projects and compliance targets for South West Water.*				36.53%
Personal objectives	30%	Implementing South West Waters new strategies and projects and meeting compliance targets.*				28%
Total outturn						78.18%

^ Pennon Group EPS is before deferred tax and exceptional net charges.
* Actual targets considered commercially confidential.

S C Bird, S J Davy, M S Read

Measure	Weighting	Threshold	Target	Maximum	Actual outturn	Bonus outturn
South West Water's performance	50%	Bonus earned by Executive Directors of South West Water relate to: • out-performance against operating profit • net debt targets of the Company • total 'Service Incentive Mechanism' (SIM) score and the position the Company achieves in the 'Service Incentive Mechanism' of water and sewerage companies established by Ofwat • achievement of stable serviceability target. South West Water operating profit targets were £220.1m and were exceeded. Actual South West Water operating profit performance was £225.4m. SIM performance was 74.8, and all areas of serviceability remained stable.				47.2%
Personal objectives	25%	Implementing South West Waters new strategies and projects and meeting compliance targets.*				S C Bird 20% S J Davy 23% M S Read 21%
Total outturn	75%	S C Bird S J Davy M S Read				67.2% 70.2% 68.2%

* Actual targets considered commercially confidential.

L F Rowe

Measure	Weighting	Threshold	Target	Maximum	Actual outturn	Bonus outturn
Personal objectives	75%	Relating to developing role as new Finance Director.				70.9%

PERFORMANCE & CO-INVESTMENT PLAN OUTTURN FOR 2014/15

The PCP awards made on 3 July 2012, which are due to vest on 3 July 2015, are the awards included in the single figure table and currently it is estimated that the outturn will result in zero vesting as set out in the table on the following page.

50% of the awards will vest subject to Pennon Group's TSR performance measured against an index made up of the following six listed water and waste comparator companies. These companies were considered to be the Group's key listed comparators:

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

The remaining 50% of the awards will vest subject to Pennon Group's ranked TSR performance against the constituents of the FTSE 250 (excluding investment trusts).

The calculation of Pennon Group's TSR performance over the three year performance period (being 1 April 2012 to 1 April 2015) for the PCP awards was undertaken by Deloitte LLP for the Pennon Group Remuneration Committee.

Vesting of the award is according to the schedule below:

	Threshold (30% of maximum vests)	Maximum (100% of maximum vests)	Achievement in the period to 1 April 2015*	Vesting outturn*
Comparator Index (50% of award)	Equal to index	15% above the index	-20.0% out performance	0%
FTSE 250 (excluding investment trusts) (50% of award)	Above 50th percentile	At or above 75th percentile	29.5%	0%
TOTAL				0%

Straight line vesting between points. For below threshold performance, 0% vests.

* As the calculation 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 2015 to 30 June 2015) the achievement and the outturn is an estimate at the date of calculation 12 June 2015.

Vesting of the award is also subject to the 'underpin' described on page 66 which the Committee has determined to the date of this report would be satisfied.

ANNUAL REPORT ON REMUNERATION CONTINUED

TOTAL PENSION ENTITLEMENTS (AUDITED INFORMATION)

S C Bird, S J Davy and M S Read were members of the Pennon Group's defined benefit pension arrangements during the year. The value of pension benefits accrued in the year has been included in the single total figure table on page 71.

Total pension entitlements for each Director is shown in the table below:

	Defined benefit pension accrued at 31 March 2015 (1) £000 p.a.	Normal retirement age	Description of additional benefits available to the Director on early retirement
S C Bird	95	60	None
S J Davy	14	65	None
M S Read	64	60	None

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. Chris Loughlin is not a member of any of the Pennon Group's pension schemes and receives a sum in lieu of pension entitlement equivalent to 30% of salary.

No additional benefits will become receivable by a Director in the event that the Director retires early. Chris Loughlin had a normal retirement date of 60 but has an agreement with the Company to continue in office subject to one year's notice on either side.

Stephen Bird's normal retirement age is 60 which will be reached on 14 May 2018. Monica Read's normal retirement age is also 60 which will be reached on 1 January 2022. Louise Rowe's normal retirement age is 65 which will be reached on 15 January 2047.

DIRECTOR CHANGES – ADDITIONAL INFORMATION

Recruitment of Louise Rowe

Louise Rowe joined the Board on 1 February 2015 as an Executive Director and as Finance Director. Her remuneration package is in line with those of the other Executive Directors, except that her salary has been set at an initially lower level with a view to providing for scope for increases depending on performance over the next two years.

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

The Chairman's fee was increased by 2.5% for 2014/15 compared to the previous year. Following the establishment of the South West Water Board Committees, the fees for Non-executive Directors were increased by 28% reflecting the significant additional time commitment required.

The Chairman's benefits comprise of a company vehicle, fuel and private health insurance.

ALL EMPLOYEE, PERFORMANCE AND OTHER CONTEXTUAL INFORMATION

Remuneration of the Chief Executive

	2010/11	2011/12	2012/13	2013/14	2014/15
Chief Executive single figure remuneration	984	834	786	781	666
Annual Bonus payout (% of maximum)	93.1%	86.8%	63.6%	85.1%	78.2%
LTIP (PCP) vesting (% of maximum)	50.0%	79.3%	50.0%	30.2%	0%

COMPARISON OF EXECUTIVE DIRECTOR REMUNERATION TO EMPLOYEE REMUNERATION

The table below shows the percentage change between 2013/14 and 2014/15 in base salary, benefits and annual bonus for the average of the Executive Directors and all employees.

The percentage increase in salary is based on the actual increase received by the Chief Executive and the annual pay award to employees for 2014/15. The benefits available to employees and the Chief Executive have not changed during the year. The average bonus is the total amount paid or payable to the average number of employees 1,221 (2013/14: 1,169) as detailed in note 10 to the financial statements.

	Percentage change in salary	Percentage change in benefits	Percentage change in annual bonus
Chief Executive remuneration	2.6%	0%	-5.8%
All employees	2.4%[1]	0%	-4.3%

1 Annual pay award for 2014/15.

RELATIVE IMPORTANCE OF SPEND ON PAY

	2014/15 (£m)	2013/14 (£m)	Percentage change
Overall expenditure on pay[1]	46.6	46.1	+1.1%
Distributions to Parent Company	255.8	112.0	+128%
Net interest charges	57.5	64.5	-10.9%
Purchase of property, plant and equipment (cash flow)	142.6	146.5	-2.7%

1 Excludes employer's social security costs.

The above table illustrates the relative importance of spend on pay compared with distributions to shareholders and other Group outgoings. The distributions to Parent Company 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 2014/15

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
C Loughlin	PCP	100% of salary	387	30% of maximum	31 March 2017
S C Bird		80 % of salary	138		
S.Davy			143		
M S Read			90		
C Loughlin	Deferred bonus/ ESOS	50% of bonus awarded	161[1]	n/a	26 August 2017
S C Bird			53		
S.Davy			62		
M S Read			34		

1 Reflects 80% of award chargeable to South West Water.

ANNUAL REPORT ON REMUNERATION CONTINUED

SHARE AWARD AND SHAREHOLDING DISCLOSURES (AUDITED INFORMATION) CONTINUED

Share awards granted during 2014/15 continued

PCP awards were calculated using the Pennon Group share price at the date of grant (14 July 2014) which was £7.98 per share. Deferred bonus awards were calculated using the Pennon Group share price at the date of grant (27 August 2014) which was £8.21.

The deferred bonus plan is operated in conjunction with the Pennon Group's HMRC approved executive share option scheme (ESOS). This is on the basis that the aggregate pre-tax value of the awards made under both the annual bonus and the ESOS would be the same as they would have been if the bonus plan had operated alone. This is achieved by requiring that an amount of deferred shares, equal in value to any gain made on the exercise of ESOS options, is forfeited by the Directors at the end of the 3 year deferral period.

DIRECTORS' SHAREHOLDING AND INTEREST IN SHARES

The Remuneration Committee believes that the interests of Executive Directors and senior management should be closely aligned with the interests of shareholders. To support this, the Committee operates shareholding guidelines. The Executive Directors are expected to build up a shareholding in Pennon Group in accordance with the shareholding guideline which amounts to a shareholding interest equivalent to 100% of salary to be built up within the first five years of joining the Company at the rate of at least 20% per year by the end of each year. This level of shareholding is then expected to be maintained by each Director and is revalued each year in accordance with the then prevailing share price and the Executive Director's salary.

The beneficial interests of the Executive Directors in the ordinary shares (40.7p each) of Pennon Group Plc as at 31 March 2015 (or date of cessation, if earlier) and 31 March 2014 together with their shareholding guideline obligation and interest are shown in the table below:

					Unvested awards			
	Share interests (including connected parties) at 31 March 2015	Share interests (including connected parties) at 31 March 2014	Share-holding guideline (100% to be accrued over five years)	Share-holding guideline met?	Performance shares (subject to performance conditions)	SAYE	Deferred Bonus shares	ESOS
C Loughlin	225,045	193,543	100%	Yes	154,420	2,788	57,180	4,329
S C Bird	20,650	20,058	100%	Yes	54,928	1,554	20,510	4,329
S J Davy	38,557	30,085	20%	Yes	56,936	1,530	22,361	4,329
M S Read	59,123	55,711	100%	Yes	35,106	2,316	13,091	4,329
L F Rowe	2,116	–	20%	Yes	–	1,472	–	–

Since 31 March 2015 3,233 additional ordinary shares in Pennon Group have been acquired by Chris Loughlin as a result of participation in the Pennon Group's Scrip Dividend Alternative and the Pennon Group's Share Incentive Plan. Monica Read acquired 232 additional shares as a result of participation in the Pennon Group's Scrip Dividend Alternative and 62 ordinary shares as a result of the Pennon Group's Share Incentive Plan. Louise Rowe acquired 24 ordinary shares as a result of participation in the Pennon Group's Scrip Dividend Alternative.

There have been no other changes in the beneficial interests or the non-beneficial interests of the Directors in the ordinary shares of the Pennon Group between 1 April 2015 and 3 July 2015.

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 2015	Shares held at 31 March 2014
Ken Harvey	26,209	26,209
Martin Hagen	3,600	3,600
Duncan Ingram	–	–
Steve Johnson	–	–
Lord Matthew Taylor	–	–

DETAILS OF SHARE AWARDS

(a) Performance and co-investment plan (long-term incentive plan)

In addition to the above beneficial interests, the following Directors have or had a contingent interest in the number of ordinary shares (40.7p each) of 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 2014	Conditional awards made in year	Market price upon award in year	Vesting in year	Value of shares upon vesting (before tax) £000	Conditional awards held at 31 March 2015	Date of end of period for qualifying conditions to be fulfilled
C Loughlin							
1/7/11	51,432	–	698.00p	17,434	140	–	30/6/14
3/7/12	48,145	–	768.50p	–	–	48,145	2/7/15
2/7/13	57,810	–	653.00p	–	–	57,810	1/7/16
14/7/14	–	48,465	798.50p	–	–	48,465	13/7/17
S C Bird							
1/7/11	17,650	–	698.00p	5,982	48	–	30/6/14
3/7/12	17,072	–	768.50p	–	–	17,072	2/7/15
2/7/13	20,594	–	653.00p	–	–	20,594	1/7/16
14/7/14	–	17,262	798.50p	–	–	17,262	13/7/17
S J Davy							
1/7/11	18,338	–	698.00p	6,216	50	–	30/6/14
3/7/12	17,696	–	768.50p	–	–	17,696	2/7/15
2/7/13	21,347	–	653.00p	–	–	21,347	1/7/16
14/7/14	–	17,893	798.50p	–	–	17,893	13/7/17
M S Read							
1/7/11	11,507	–	698.00p	3,900	31	–	30/6/14
3/7/12	10,826	–	768.50p	–	–	10,826	2/7/15
2/7/13	13,059	–	653.00p	–	–	13,059	1/7/16
14/7/14	–	11,221	798.50p	–	–	11,221	13/7/17

(i) 30.2% of the July 2011 award shares vested on 29 August 2014 at a market price of 804.96p per share. The total number of shares that vested included additional shares equivalent in value to such number of shares as could have been acquired by reinvesting the dividends which would otherwise have been received on the vested shares during the restricted period of three years. The balance of the award lapsed.

ANNUAL REPORT ON REMUNERATION CONTINUED

DETAILS OF SHARE AWARDS CONTINUED

(b) Annual incentive bonus plan – deferred bonus shares (long- term incentive element)

The following Directors had or have a contingent interest in the number of ordinary shares (40.7p each) of 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 2014	Conditional awards made in year	Market price upon award in year	Vesting in year[2]	Value of shares upon vesting (before tax) £000	Conditional awards held at 31 March 2015	Date of end of period for qualifying conditions to be fulfilled
C Loughlin							
27/7/11	22,141	–	725.00p	22,141	177	–	26/7/14
27/7/12	20,650	–	754.50p	–	–	20,650	26/7/15
5/8/13[1]	16,978	–	693.00p	–	–	16,978	4/8/16
27/8/14	–	19,552	821.50p	–	–	19,552	26/8/17
S C Bird							
27/7/11	6,681	–	725.00p	6,681	53	–	26/7/14
27/7/12	6,949	–	754.50p	–	–	6,949	26/7/15
5/8/13[1]	7,052	–	693.00p	–	–	7,052	4/8/16
27/8/14	–	6,509	821.50p	–	–	6,509	26/8/17
S J Davy							
27/7/11	6,078	–	725.00p	6,078	49	–	26/7/14
27/7/12	7,263	–	754.50p	–	–	7,263	26/7/15
5/8/13[1]	7,555	–	693.00p	–	–	7,555	4/8/16
27/8/14	–	7,543	821.50p	–	–	7,543	26/8/17
M S Read							
27/7/11	4,261	–	725.00p	4,261	34	–	26/7/14
27/7/12	4,491	–	754.50p	–	–	4,491	26/7/15
5/8/13[1]	4,472	–	693.00p	–	–	4,472	4/8/16
27/8/14	–	4,128	821.50p	–	–	4,128	26/8/17

1 In addition to the awards made on 25 August 2013 the Directors also received options pursuant to the Pennon Group's executive share option scheme (ESOS), details of which are set out on page 79. These awards were made in conjunction with the operation of the bonus plan, details of which are set out on page 65.
2 These shares vested on 18 August 2014 at 798.91p per share.

During the year the Directors received dividends on the above shares in accordance with the conditions of the bonus plan as follows: Chris Loughlin £18,116*; Stephen Bird £6,268; S J Davy £6,334; Monica Read £4,008.

* Chris Loughlin received his dividend in the form of ordinary shares (40.7p each) in Pennon Group Plc as a result of participation in the Pennon Group's Scrip Dividend Alternative and these shares are included in the figure given for the additional ordinary shares (40.7p each) in the Company that he acquired since 31 March 2015 given on page 76.

(c) Executive Share Option Scheme (ESOS)

The following Directors had a contingent interest in the number of options shown in the ordinary shares (40.7p each) of the Company pursuant to the Company's ESOS. Further details relating to the operation of the scheme are set out on page 76.

Director and date of Award	Options held at 1 April 2014	Granted in year	Exercised in year	Exercise price per share	Market price of each share on exercising	Market value of each share at 31 March 2015	Options held at 31 March 2015^	Maturity date
C Loughlin								
5/8/13	4,329	–	–	693.00p	–	826.00p	4,329	5/8/16
S C Bird								
5/8/13	4,329	–	–	693.00p	–	826.00p	4,329	5/8/16
S J Davy								
5/8/13	4,329	–	–	693.00p	–	826.00p	4,329^	5/8/16
M S Read								
5/8/13	4,329	–	–	693.00p	–	826.00p	4,329	5/8/16

^ Or at date of resignation.

(d) 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 2014	Granted in year	Exercised in year	Exercise price per share	Market price of each share on exercising	Market value of each share at 31 March 2015	Options held at 31 March 2015^	Exercise period/ maturity date
C Loughlin								
3/7/13	2,788	–	–	538.00p	–	826.00p	2,788	1/9/18 – 28/2/19
S C Bird								
29/6/12	612	–	–	588.00p	–	826.00p	612	1/9/15 – 28/2/16
3/7/13	501	–	–	538.00p	–	826.00p	501	1/9/16 – 28/2/17
14/7/14	–	441	–	611.00p	–	826.00p	441	1/9/17 – 28/2/18
S J Davy								
29/6/12	1,530	–	–	588.00p	–	826.00p	1,530^	1/9/15 – 28/2/16
M S Read								
6/7/09	2,417	–	2,417	386.00p	813.50p	826.00p	–	1/9/14 – 28/2/15
28/6/10	1,433	–	–	431.00p	–	826.00p	1,433	1/9/15 – 28/2/16
14/7/14	–	883	–	611.00p	–	826.00p	883	1/9/17 – 28/2/18
L F Rowe*	–	1,472	–	611.00p	–	826.00p	1,472	1/9/17 – 28/2/18

^ Or at date of resignation.
* L F Rowe's share options are those she received in her previous position of Corporate and Central Finance Manager at South West Water, which she will retain an interest in following her appointment as Finance Director on 1 February 2015.

BOARD OF DIRECTORS AND COMPANY INFORMATION

Chairman	K G Harvey
Chief Executive	C Loughlin
Chief Operating Officer for Wholesale Operations	S C Bird
Finance and Regulatory Director	S J Davy (resigned 31 January 2015)
Finance Director	L F Rowe (appointed 1 February 2015)
Business Services and Sustainability Director	M S Read
Non-executive Directors	Lord Taylor of Goss Moor M J Hagen D G Ingram (appointed 1 September 2014) S Johnson (appointed 1 September 2014)
Company secretaries	K D Woodier R C Zmuda M Heeley (resigned 28 July 2014) K Gale (appointed 10 February 2015)
Registered office	Peninsula House Rydon Lane Exeter Devon EX2 7HR
Independent auditors	Ernst & Young LLP Apex Plaza Forbury Road Reading RG1 1YE
The 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.

DIRECTORS' REPORT
OTHER STATUTORY INFORMATION

INTRODUCTION

This Directors' report is prepared in accordance with the provisions of the Companies Act 2006 and regulations made thereunder. It comprises the following two pages and the following matters disclosed elsewhere in this Annual Report as follows:

- list of Directors during the year as set out on page 52
- risk management objectives and policies (page 42)
- likely future developments of the Company (outlook sections of the strategic report)
- inclusion and gender diversity (page 62 of the corporate governance report)
- carbon emissions (see page 24)
- Directors' responsibilities statements (page 83)
- financial instruments (page 109 of the financial statements).

FINANCIAL RESULTS AND DIVIDEND

A total dividend for the year of £255.8m was paid during the year (2013/14: £112.0m). The 'Finance and Economy' section of the Strategic report on pages 28 to 35 analyses the Company's financial results in more detail and sets out other financial information.

DIRECTORS

No Director has, or has had, a material interest, directly or indirectly, at any time during the year under review in any contract significant to the Company's business.

A list of all the Directors during the year is set out on page 52. Further details relating to the Directors and their service agreements or contracts for services are set out on page 68 and details of the Directors' interests in shares of Pennon Group Plc are given on pages 76 to 79.

DIRECTORS' INSURANCE AND INDEMNITIES

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

EMPLOYMENT POLICIES AND EMPLOYEE INVOLVEMENT

South West Water is an equal opportunities employer and we recognise the importance and benefits of a diverse workforce. South West Water's employment policies are non-discriminatory and we make every effort to ensure that no current or future employee is disadvantaged because of age, gender, religion, ethnic origin, marital status, sexual orientation or disability.

This commitment to diversity and equality is demonstrated in all its employment activities including recruitment, training, career development and promotion and ensuring there is no bias or discrimination in the treatment of people. In particular, applications for employment are welcomed from persons with disabilities, and special arrangements and adjustments as necessary are made to ensure that applicants are treated fairly when attending for interview or for pre-employment aptitude tests. Wherever possible the opportunity is taken to retrain people who become disabled during their employment in order to maintain their employment within the Group. The Board also has a diversity policy and encourages gender diversity in particular. Further details are set out on page 62.

Employees are consulted regularly about changes which may affect them either through their trade union-appointed representatives or by means of the elected staff council.

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 South West Water and the Pennon Group. The Group also cascades information monthly to all employees to provide them with important and up to date information about key events and to obtain feedback from them. Further information about employment matters relating to South West Water are set out on pages 38 to 39.

South West Water encourages share ownership among its employees by operating an HM Revenue & Customs approved Sharesave Scheme and Share Incentive Plan which are, subject to shareholder approval at this year's Pennon Group AGM, being amended to provide for the increased savings limits approved by Government. At 31 March 2015 around one-third of South West Water's employees were participating in these plans.

KEY RELATIONSHIPS

Regulators and others

South West Water actively engages with a wide variety of environmental and regulatory stakeholders. We take steps to ensure that communication is handled in the most appropriate way and that the information we provide is high quality and consistent.

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

DIRECTORS' REPORT
OTHER STATUTORY INFORMATION CONTINUED

KEY RELATIONSHIPS CONTINUED

Procurement and suppliers

Our procurement strategy is focused on strategic alliances with 60 key suppliers who account for the large majority of expenditure.

With the start of the K5 regulatory period we introduced an innovative 'mixed economy' model to source our capital programme. This means using a significant number of smaller local contractors to provide specialised services as well as developing long-term relationships with more major supply chain partners.

South West Water sources all its purchases from competitive markets.

It is the Company's payment policy for the year ending 31 March 2015 to follow the Code of The Better Payment Practice Group on supplier payments.

The Company will agree payment terms with individual suppliers in advance and abide by such terms. Information about the Code may be obtained from The Better Payment Practice Group's website at www.payontime.co.uk. Trade creditors at 31 March 2015 represented 25 days of the amount invoiced by suppliers during the year (2014: 20).

POLITICAL DONATIONS

No political donations were made or political expenditure incurred and no contributions were made to a non-EU political party (2013/14: nil).

INCIDENTS AND PROSECUTIONS

In 2014/15 the Company was the subject of seven prosecution cases brought by the Environment Agency (2013/14: seven). These cases resulted in South West Water being convicted of 12 offences with a total fine of £395,500 (2013/14: 12 offences with a total fine of £134,000).

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.

ANNUAL GENERAL MEETING

The Annual General Meeting of South West Water Limited will be held at Peninsula House, Rydon Lane, Exeter on 30 July 2015 for the transaction of the following business:

Resolution 1

To receive the Report of the Directors and the audited financial statements for the year ended 31 March 2015.

Resolution 2

To re-appoint Ernst & Young LLP as auditors of the Company to hold office until the conclusion of the next general meeting at which the Financial Statements are laid before the Company and to authorise the Directors to fix their remuneration.

A member of the Company is entitled to attend and vote at the meeting or may appoint one or more proxies to attend and, on a poll, vote instead of her or him. A proxy need not be a member of the Company.

By Order of the Board

R C Zmuda
Secretary
Peninsula House
Rydon Lane
Exeter
Devon
EX2 7HR

3 July 2015

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT AND THE FINANCIAL STATEMENTS

The Directors are responsible for preparing the strategic report, a Directors' 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 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 that period.

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;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

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.

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

Finally, in accordance with reporting requirements, the Board confirms that the Annual Report and Financial Statements taken as a whole are fair, balanced and understandable and provide the information necessary to assess the Company's performance, business model, and strategy as set out on pages 11 to 13.

STATEMENT AS TO DISCLOSURE OF INFORMATION TO AUDITORS

a) so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware; and
b) he has taken all the steps that he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

By Order of the Board

R C Zmuda
Secretary
Peninsula House
Rydon Lane
Exeter
Devon
EX2 7HR

3 July 2015

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

OPINION ON FINANCIAL STATEMENTS

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 March 2015 and of its profit for the year then ended; and
- 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.

WHAT WE HAVE AUDITED

We have audited the financial statements of South West Water Limited for the year ended 31 March 2015 which comprise the Income Statement, Statement of Comprehensive Income, Balance Sheet, Statement of Changes in Equity, Cash Flow Statement and the related notes 1 to 35. 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.

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 and the terms of our engagement letter date 8 June 2015. 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.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITOR

As explained more fully in the Directors' Responsibilities Statement set out on page 83, the Directors are responsible for the preparation of the Group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the Group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

The Directors of South West Water Limited have voluntarily decided to comply with the UK corporate Governance code and have engaged us to provide an opinion on:

- the Directors' statement, set out on page 83, in relation to going concern; and
- the part of the Corporate Governance Statement relating to the Company's compliance with ten provisions of the UK Corporate Governance Code specified for our review.

Report to you if, in our opinion information in the Annual Report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
- is otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the Annual Report is fair, balanced and understandable and whether the Annual Report appropriately discloses those matters that we communicated to the Audit Committee which we consider should have been disclosed.

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

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

OUR ASSESSMENT OF RISKS OF MATERIAL MISSTATEMENT AND AN OVERVIEW OF THE SCOPE OF OUR AUDIT

The Company's operations are based solely in the South West of England and therefore all audit procedures are completed by one audit team at the Company's headquarters.

We identified the following risks that have had the greatest effect on the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. For each risk identified, we have documented our response and audit procedures below:

Risk of material misstatement	Our response to the risks of material misstatement included the following procedures
Revenue recognition across the Company's operations The material income streams for the Company relate to the provision of measured and unmeasured water and wastewater services. Unmeasured services are based on an annual charge and therefore do not present an area of significant management judgement in terms of revenue recognition at the year end. In respect of measured services, meter readings are taken of the volumes used for customers on a periodic basis. An estimate is therefore required at the year end of the amount of income to accrue for volume used by customers up to the year end, since the last actual meter read. The accrued income balance at 31 March 2015 is £61.0m. This is calculated using a combination of system generated information, based on previous customer volume usage, together with management judgements as to the likely impact on usage of factors such as recent weather patterns.	• We challenged the key assumptions and estimates made by management in recognising revenue in respect of measured services. • We understood the process for the supply of measured services, meter reading and related billing in order to challenge the completeness of adjustments to reflect the accrual or deferral of measured revenue. This included considering whether contract terms and conditions were met and revenue recognised at the correct time. • We tested controls within the Company's billing system over the integrity of data and the report utilised to generate the estimate of accrued income made based on the usage by customers since the date of the last meter reading. • We tested whether the assumptions used by management in respect of volume usage were reasonable, by comparing the accrued income to bills raised post year end for a sample of customers. • We also compared management's history of estimating the accrued income balance to bills raised in the subsequent year, to determine the level of historical accuracy and to consider whether there was any evidence of management bias in the assumptions and estimates. • We assessed whether the revenue recognition policies adopted complied with IFRSs. • We performed analytical procedures by comparing turnover and accrued income for the year to prior year, budget and tariff setting models and obtained documentation for significant variances. • In performing our journal testing, we paid increased attention to entries impacting revenue.
Adequacy of the provision for doubtful debts As shown in note 17, there is a provision of £81.0m at the year end against gross trade debtors of £181.0m. The provision is calculated using a combination of system generated information on historic debt recovery rates and management's estimate of the future likely recovery rates.	• We tested controls within the Company's billing system over the integrity of data and the report utilised to generate the ageing and categorisation of debt. • We tested historic data on collection rates and how this data was used in the preparation of the bad debt provision. • We challenged the assumptions used by management in determining the amounts provided for, against the different categories and aging of debt, by comparing these assumptions to historic collection rates and by considering the impact of changes in the method's adopted by management to collect debt.

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

OUR ASSESSMENT OF RISKS OF MATERIAL MISSTATEMENT AND AN OVERVIEW OF THE SCOPE OF OUR AUDIT CONTINUED

Risk of material misstatement	Our response to the risks of material misstatement included the following procedures
Fixed asset accounting There are two key areas of focus in fixed accounting, the first relating to classification of expenditure between capital and operating and the second the asset lives used in the calculation of depreciation. As shown in note 12, during the year there were fixed asset additions totalled £145.1m and depreciation totalled £108.1m.	• We tested controls within the Company's procurement and capital approval process. • We selected a sample of projects included within additions for the year and 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'. This included testing of internal costs capitalised on the projects in our sample. • We challenged the asset lives utilised in the depreciation calculation, based on latest surveys performed of significant assets, latest disposals and replacement plans. This included evidence prepared by internal experts and external surveyors. • We re-performed the calculation of depreciation.
Uncertain taxation liabilities The Company's current tax liability of £27.5m shown in the balance sheet, includes £10.5m in respect of open tax computations relating to prior years, where liabilities are yet to be agreed with HM Customs & Revenue. The Company establishes provisions for individual tax items where the tax position is uncertain.	• We discussed the potential tax exposure with senior company management, including the basis and evidence for their positions with the Company's in-house tax specialists. • The audit team was supported by EY experts who independently assessed the provision for items where the tax position is uncertain, in order to challenge the reasonableness of the provisions recorded. • We requested and read the latest correspondence between the Company and HM Revenue and Customs. • We tested whether the tax accounting and disclosures in note 8 complied with the requirements of IAS12 'Income Taxes'.

OUR APPLICATION OF MATERIALITY

We apply the concept of materiality both in planning and performing our audit, and in evaluating the effect of misstatements on our audit and on the financial statements. For the purposes of determining whether the financial statements are free from material misstatement we define materiality as the magnitude of misstatement that makes it probable that the economic decisions of a reasonably knowledgeable person, relaying on the financial statements, would be changed or influenced. We also determine a level of performance materiality which we use to determine the extent of testing needed to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole. We determined materiality for the Company to be £4.91m, which is approximately 5 per cent of profit before exceptional items and taxation. The rationale for using profit before exceptional items and taxation as our basis for materiality is that it provides a consistent year on year approach excluding one off gains, and is considered to be the most relevant performance measure to the Company's stakeholders. This provided the basis for determining the nature, timing and extent of risk assessment procedures, identifying and assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures.

On the basis of our risk assessments, together with our assessment of the Company's overall control environment, our judgement is that overall performance materiality for the Company should be 50 per cent of materiality, namely £2.46m.

We agreed with the Audit Committee that we would report to the Committee all adjusted and unadjusted audit differences in excess of £0.24m. We also agreed to report differences below those thresholds 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.

OPINION ON OTHER MATTERS PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion 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.

MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

We have nothing to report in respect of the following matters where 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.

OPINION ON OTHER MATTER PRESCRIBED BY THE TERMS OF OUR ENGAGEMENT LETTER

Under the ISAs (UK and Ireland), for companies voluntarily applying the UK Corporate Governance Code, we are required to report to you if, in our opinion information in the Annual Report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
- is otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the Directors' statement that they consider the Annual Report is fair, balanced and understandable and whether the Annual Report appropriately discloses those matters that we communicated to the Audit Committee which we consider should have been disclosed.

Where the Company has voluntarily complied with items specified for review by the Listing Rules of the Financial Services Authority for premium listed UK incorporated companies and instructed us to review such items:

- the Directors' statement, set out on page 83, in relation to going concern; and
- the part of the Corporate Governance Statement relating to the Company's compliance with the ten provisions of the UK Corporate Governance Code specified for our review.

Debbie O'Hanlon (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
Reading
3 July 2015

Notes:
1. The maintenance and integrity of the South West Water Limited website 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 website.
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 2015

	Notes	Before exceptional items 2015 £m	Exceptional items (note 5) 2015 £m	Total 2015 £m	Total 2014 £m
Revenue		**523.6**	**–**	**523.6**	521.5
Operating costs	6				
Manpower costs		**(39.8)**	**11.8**	**(28.0)**	(39.9)
Raw materials and consumables used		**(16.1)**	**–**	**(16.1)**	(16.1)
Other operating expenses		**(136.4)**	**–**	**(136.4)**	(134.9)
Depreciation		**(105.9)**	**–**	**(105.9)**	(103.9)
Operating profit		**225.4**	**11.8**	**237.2**	226.7
Finance costs	7	**(60.3)**	**–**	**(60.3)**	(67.6)
Finance income	7	**2.8**	**–**	**2.8**	3.1
Net finance costs		**(57.5)**	**–**	**(57.5)**	(64.5)
Profit before tax		**167.9**	**11.8**	**179.7**	162.2
Current tax charge	8	**(29.8)**	**–**	**(29.8)**	(28.6)
Deferred tax (charge)/credit	8	**(5.6)**	**(2.4)**	**(8.0)**	29.9
Taxation		**(35.4)**	**(2.4)**	**(37.8)**	1.3
Profit for the year		**132.5**	**9.4**	**141.9**	163.5

The notes on pages 92 to 123 form part of these financial statements.

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 MARCH 2015

	Notes	Before exceptional items 2015 £m	Exceptional items (note 5) 2015 £m	Total 2015 £m	Total 2014 £m
Profit for the year		**132.5**	**9.4**	**141.9**	163.5
Other comprehensive income/(loss)					
Items which will not be reclassified to profit or loss					
Remeasurement of defined benefit obligations	23	**1.7**	**–**	**1.7**	22.8
Income tax on items that will not be reclassified	24	**(0.4)**	**–**	**(0.4)**	(6.7)
Total items that will not be reclassified to profit or loss		**1.3**	**–**	**1.3**	16.1
Items that may be reclassified subsequently to profit or loss					
Cash flow hedges:					
Net fair value (losses)/gains		**(23.5)**	**–**	**(23.5)**	37.8
Income tax on items that may be reclassified	24	**4.1**	**–**	**4.1**	(6.4)
Total items that may be reclassified subsequently to profit or loss		**(19.4)**	**–**	**(19.4)**	31.4
Other comprehensive (loss)/income for the year net of tax		**(18.1)**	**–**	**(18.1)**	47.5
Total comprehensive income for the year		**114.4**	**9.4**	**123.8**	211.0

The notes on pages 92 to 123 form part of these financial statements.

BALANCE SHEET

AT 31 MARCH 2015

	Notes	2015 £m	2014 £m
Assets			
Non–current assets			
Property, plant and equipment	12	**2,636.9**	2,595.0
Derivative financial instruments	18	**0.2**	6.6
Investment in subsidiary undertakings	15	**3.3**	3.3
Trade and other receivables	14	**–**	0.3
		2,640.4	2,605.2
Current assets			
Inventories	16	**5.2**	4.4
Trade and other receivables	17	**119.2**	111.1
Derivative financial instruments	18	**0.1**	1.8
Cash and cash deposits	19	**246.9**	315.8
		371.4	433.1
Liabilities			
Current liabilities			
Borrowings	21	**(183.8)**	(142.5)
Derivative financial instruments	18	**(12.7)**	(16.5)
Trade and other payables	20	**(75.1)**	(76.0)
Current tax liabilities		**(27.5)**	(34.1)
Provisions for liabilities and charges	25	**(2.0)**	(2.4)
		(301.1)	(271.5)
Net current assets		**70.3**	161.6
Non–current liabilities			
Borrowings	21	**(1,880.6)**	(1,819.0)
Other non–current liabilities	22	**(74.3)**	(68.6)
Derivative financial instruments	18	**(25.8)**	(3.6)
Retirement benefit obligations	23	**(41.5)**	(60.8)
Deferred tax liabilities	24	**(232.2)**	(227.9)
		(2,254.4)	(2,179.9)
Net assets		**456.3**	586.9
Equity			
Called up share capital	26	**150.9**	150.9
Retained earnings and other reserves	28	**305.4**	436.0
Total Equity		**456.3**	586.9

The notes on pages 92 to 123 form part of these financial statements. The financial statements on pages 88 to 123 were approved and authorised for issue by the Board of Directors on 3 July 2015 and were signed on its behalf by:



C Loughlin
Chief Executive

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

STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 MARCH 2015

	Called up share capital (note 26) £m	Retained earnings and other reserves (note 28) £m	**Total Equity £m**
At 1 April 2013	150.9	335.5	**486.4**
Profit for the year	–	163.5	**163.5**
Other comprehensive income for the year	–	47.5	**47.5**
Total comprehensive income for the year	–	211.0	**211.0**
Transactions with owners			
Dividends paid	–	(112.0)	**(112.0)**
Share based payments	–	1.5	**1.5**
Total transactions with owners	–	(110.5)	**(110.5)**
At 31 March 2014	150.9	436.0	**586.9**
Profit for the year	–	141.9	**141.9**
Other comprehensive loss for the year	–	(18.1)	**(18.1)**
Total comprehensive income for the year	–	123.8	**123.8**
Transactions with owners			
Dividends paid	–	(255.8)	**(255.8)**
Share based payments	–	1.4	**1.4**
Total transactions with owners	–	(254.4)	**(254.4)**
At 31 March 2015	150.9	305.4	**456.3**

The notes on pages 92 to 123 form part of these financial statements.

CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 MARCH 2015

	Notes	2015 £m	2014 £m
Cash flows from operating activities			
Cash generated from operations	29	**315.5**	313.7
Interest paid		**(49.2)**	(60.1)
Tax paid		**(36.4)**	(44.1)
Net cash generated from operating activities		**229.9**	209.5
Cash flows from investing activities			
Interest received		**0.9**	1.3
Receipt of grants and contributions		**3.4**	2.4
Purchase of property, plant and equipment		**(142.6)**	(146.5)
Proceeds from sale of property, plant and equipment		**1.4**	1.9
Net cash used in investing activities		**(136.9)**	(140.9)
Cash flows from financing activities			
Deposit of restricted funds		**(29.1)**	(26.8)
Proceeds from new borrowing		**–**	125.0
Repayment of borrowings		**(31.1)**	(21.1)
Proceeds from intercompany – borrowings		**130.0**	–
Finance lease sale and lease back		**85.6**	40.7
Finance lease principal repayments		**(92.3)**	(21.3)
Dividends paid		**(255.8)**	(112.0)
Net cash used in financing activities		**(192.7)**	(15.5)
Net (decrease)/increase in cash and cash equivalents		**(99.7)**	53.1
Cash and cash equivalents at beginning of the year	19	**151.6**	98.5
Cash and cash equivalents at end of the year	19	**51.9**	151.6

The notes on pages 92 to 123 form part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1. NOTES TO THE FINANCIAL STATEMENTS

South West Water Limited is a company registered in the United Kingdom under the Companies Act 2006. The address of the registered office is given on page 80. The nature of the Company's operations and its principal activities are set out on page 80.

2. PRINCIPAL ACCOUNTING POLICIES

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

(a) Basis of preparation

These financial statements have been prepared on the historical cost accounting basis (except for fair value items, principally transfers of assets from customers and certain financial instruments as described in accounting policy note (s) and (r) 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 for preparing the financial statements as stated by the Directors on page 55.

No standards or interpretations which were mandatory for the first time in the year beginning 1 April 2014 have a material impact on the net assets or results of the Company.

Standards and interpretations in issue, but not yet effective, are not expected to have a material effect on the Company's net assets or results.

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions which affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best assessment of the amounts, actual events or actions and results may ultimately differ from those estimates.

The financial statements are presented in Sterling and all values are rounded to the nearest one hundred thousand (£0.1m) except when otherwise indicated.

(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 represents the fair value of consideration receivable, excluding value added tax, trade discounts, in the ordinary course of business for services provided.

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

Revenue from main water and wastewater charges includes billed amounts for estimated usage and also an estimation of the amount of unbilled charges at the year end based upon a defined methodology reflecting historical consumption, estimated demand trends and current tariffs. Revenue for unmeasured charges is recognised on a time apportioned basis.

Revenue is recognised to the extent that it is probable that economic benefits will flow to the Company and revenue can be reliably measured.

2. PRINCIPAL ACCOUNTING POLICIES CONTINUED

(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.

(e) 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.

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

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

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

ii) 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 economic lives to their residual value and are principally:

Freehold buildings	30 – 60 years
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 (s).

The assets' residual values and useful lives are reviewed, and adjusted if appropriate.

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

2. PRINCIPAL ACCOUNTING POLICIES CONTINUED

(f) Leased assets

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

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

(g) Impairment of non-financial assets

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

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

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

(h) 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.

(i) 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.

(j) Inventories

Inventories are stated at the lower of cost and net realisable value.

(k) 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.

2. PRINCIPAL ACCOUNTING POLICIES CONTINUED

(l) Derivatives and other financial instruments

The Company classifies its financial instruments in the following categories:

i) Loans and receivables

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

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

Borrowings are classified as current liabilities unless the 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 impairment. A provision for impairment of trade receivables is established by applying expected recovery rates to debts outstanding at the end of the accounting period. The expected recovery rate takes into account age of the debt and payment history.

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 remeasurement 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.

In order 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.

v) Financial instruments at fair value through profit

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

2. PRINCIPAL ACCOUNTING POLICIES CONTINUED

(m) Taxation including deferred tax

The tax (charge)/credit 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.

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

The Company is part of the Pennon Group for tax purposes and accordingly may use the tax group relief provisions whereby current tax liabilities can be offset by current tax losses arising in other companies within the same tax group. Payment for group relief is made equal to the tax benefit and amounts are included within the current tax disclosures.

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

(n) 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.

(o) 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.

(p) Dividend distributions

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

(q) 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. 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 Group's defined benefit pension schemes, expected to arise from employee service in the year, is charged against operating profit.

The movement in the fair value of scheme assets and the present value of scheme liabilities are shown in notional interest within finance income and cost. Changes in benefits granted by the employer are recognised immediately as past service cost in the income statement.

2. PRINCIPAL ACCOUNTING POLICIES CONTINUED

(q) Employee benefits continued

i) Retirement benefit obligations continued

Defined benefit pension schemes continued

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.

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 required in exchange for the grant is recognised as an expense over the vesting period of the grant.

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

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.

(r) Fair values

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

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

(s) Transfers of assets from customers

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

(t) Exceptional items

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

3. FINANCIAL RISK MANAGEMENT CONTINUED

(a) Financial risk factors continued

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 50% of interest bearing liabilities at fixed rates. At the year end 63% (2014: 64%) of net borrowings were at fixed rates and 22% (2014: 24%) 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 18.

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 29) are independent of changes in market interest rates.

At 31 March 2015, if interest rates on net borrowings at that date had been 0.5% higher/lower with all other variables held constant, post-tax profit for the year would have been decreased/increased by £0.2m (2014: £0.2m).

If RPI on index linked borrowings had been on average 0.5% higher/lower with all other variables held constant, post-tax profit for the year would have decreased/increased by £1.5m (2014: £1.5m)

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 21.

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

31 March 2015	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	31.1	38.7	234.5	1,239.0	**1,543.3**
Interest payments on borrowings	17.2	22.8	51.5	611.7	**703.2**
Finance lease liabilities including interest	34.5	35.9	172.3	2,105.3	**2,348.0**
Derivative financial liabilities					
Derivative contracts – net payments	10.6	9.3	15.9	–	**35.8**

31 March 2014	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	31.1	31.1	111.8	1,377.2	**1,551.2**
Interest payments on borrowings	10.3	11.4	36.3	623.2	**681.2**
Finance lease liabilities including interest	55.4	67.0	210.8	2,034.8	**2,368.0**
Derivative financial liabilities					
Derivative contracts – net payments/(receipts)	19.3	8.1	12.5	(7.9)	**32.0**

3. FINANCIAL RISK MANAGEMENT CONTINUED

(a) Financial risk factors continued

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 17.

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 credit rating threshold set by the Board of P1 (Moody's) or A1 (Standard and Poor's).

(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 2015 the Company had cash and facilities excluding restricted funds of almost £502m, 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 are analysed in note 30 and is calculated as total borrowings less cash and cash deposits. Total capital is calculated as equity plus net borrowings.

The gearing ratios at the balance sheet date were:

	2015 £m	2014 £m
Net Borrowings (note 30)	**1,817.5**	1,645.7
Total equity	**456.3**	586.9
Total capital	**2,273.8**	2,232.6
Gearing Ratio	**79.9%**	73.7%

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). Ofwat's optimum range for the K5 (2010-2015) regulatory period for gearing was 55% – 65% and for K6 (2015-2020) Ofwat's optimum gearing is set at 62.5%.

	2015 £m	2014 £m
Regulatory Capital Value	**2,928.0**	2,958.8
Net borrowings (note 30)	**1,817.5**	1,645.7
Net borrowings/Regulatory Capital Value	**62%**	56%

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 18.

3. FINANCIAL RISK MANAGEMENT CONTINUED

(c) Determination of fair values continued

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. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Company for similar financial instruments.

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 at the time of delivery of services. Payments received in advance of services delivered are recorded as a 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; actual results could differ from these estimates which would result in operating revenue being adjusted in the period in which the revision of the estimates is determined. Revenue for unmeasured charges is recognised on a time apportioned basis.

(b) Provision for doubtful debts

At the balance sheet date the Company evaluates the collectability of trade receivables and records provisions for doubtful debts based on experience including comparisons of the relative age of accounts and consideration of actual write-off history.

The actual level of debt collected may differ from the estimated levels of recovery. As at 31 March 2015 the Company's current trade receivables were £181.0m, against which £81.0m had been provided for impairment (note 17).

(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 2013.

The pension cost and liabilities under IAS 19 (revised), 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 2013 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 23 of the financial statements.

(d) Taxation

The Company's current tax provision of £27.5m reflects the management's judgement of the amount of tax payable for fiscal years with open tax computations where liabilities remain to be agreed with HM Revenue & Customs. Management periodically evaluates items detailed in tax returns where the tax treatment is subject to interpretation. The Company establishes provisions on a full basis for individual tax items where the tax position is uncertain.

4. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES CONTINUED

(e) Property, plant and equipment

The Company's accounting policy for property, plant and equipment is detailed in note 2 (e) of the financial statements. The carrying value of property, plant and equipment as at 31 March 2015 was £2,636.9m. In the year ended 31 March 2015 additions to property, plant and equipment totalled £145.1m and the depreciation charge was £108.1m. 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.

5. EXCEPTIONAL ITEMS

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

	2015 £m	2014 £m
Operating credit:		
Pension costs – past service	**11.8**	–
Profit on exceptional item before tax	**11.8**	–
Tax arising on exceptional item:		
Deferred tax	**(2.4)**	–
Profit after tax on exceptional item	**9.4**	–

During the year an exceptional credit before tax of £11.8m was recognised relating to changes made to the Group's defined benefit pension scheme. Changes implemented during the period capped pensionable pay for active members, reducing past service cost.

6. OPERATING COSTS

	2015 £m	2014 £m
Manpower costs (note 10)	**39.8**	39.9
Raw materials and consumables	**16.1**	16.1
Other operating expenses include		
Profit on disposal of property, plant and equipment	**(1.2)**	(1.7)
Operating lease rentals payable:		
Plant and machinery	**1.2**	0.9
Property	**1.4**	1.4
Research and development expenditure	**0.1**	0.1
Trade receivables impairment (note 17)	**9.1**	9.5
Depreciation of property, plant and equipment:		
Owned assets	**72.6**	71.6
Under finance leases	**33.3**	32.3
	105.9	103.9

6. OPERATING COSTS CONTINUED

	2015 £000	2014 £000
Fees payable for the audit of the financial statements	**175**	143
Fees payable to the Company's auditor for other services:		
Audit related assurance services	**–**	210
Tax advisory services	**–**	56
All other services	**7**	362
Total fees	**182**	771

Expenses reimbursed to the auditors in relation to the audit of the Company were £12,000 (2014: £14,000).

A description of the work of the Audit Committee is set out in its report on page 56 which included an explanation of how the auditor's objectivity and independence are safeguarded when non-audit services are provided by the auditor's firm.

7. NET FINANCE COSTS

	2015			2014		
	Finance cost £m	Finance income £m	Total £m	Finance cost £m	Finance income £m	Total £m
Cost of servicing debt						
Bank borrowings and overdrafts	**(8.3)**	**–**	**(8.3)**	(10.0)	–	(10.0)
Interest element of finance lease rentals	**(31.6)**	**–**	**(31.6)**	(34.9)	–	(34.9)
Other finance costs	**(5.3)**	**–**	**(5.3)**	(4.1)	–	(4.1)
Interest receivable	**–**	**2.8**	**2.8**	–	3.1	3.1
Intercompany interest to subsidiaries	**(13.0)**	**–**	**(13.0)**	(15.2)	–	(15.2)
Working capital adjustment	**(58.2)**	**2.8**	**(55.4)**	(64.2)	3.1	(61.1)
Notional interest						
Retirement benefit obligations (note 23)	**(2.1)**	**–**	**(2.1)**	(3.4)	–	(3.4)
Finance (costs)/income	**(60.3)**	**2.8**	**(57.5)**	(67.6)	3.1	(64.5)

In addition to the above, finance costs of £2.4m (2014: £nil) have been capitalised on qualifying assets included in property, plant and equipment.

8. TAXATION

	Before exceptional items 2015 £m	Exceptional items (note 5) 2015 £m	Total 2015 £m	Total 2014 £m
Analysis of charge/(credit) in year				
Current tax charge	**29.8**	**–**	**29.8**	28.6
Deferred tax arising on change of rate of corporation tax (note 24)	**–**	**–**	**–**	(37.7)
Deferred tax – other	**5.6**	**2.4**	**8.0**	7.8
Total deferred tax charge/(credit)	**5.6**	**2.4**	**8.0**	(29.9)
Total charge/(credit) for the year	**35.4**	**2.4**	**37.8**	(1.3)

Current tax is calculated at 21% (2014: 23%) of the estimated assessable profit for the year.

The deferred tax arising on the change of rate of corporation tax resulted from the enactment of the Finance Act 2013 which implemented a reduction in the rate of corporation tax from 23% to 21% with effect from 1 April 2014 and then to 20% with effect from 1 April 2015.

The tax for the year differs from the theoretical amount that would arise using the standard rate of corporation tax in the UK of 21% (2014: 23%). The differences are explained below:

	2015 £m	2014 £m
Profit before tax	**179.7**	162.2
Profit before tax multiplied by the standard rate of corporation tax in the UK of 21% (2014: 23%)	**37.7**	37.3
Effects of:		
Expenses not deductible for tax purposes	**2.5**	2.2
Adjustments to tax charge in respect of prior year	**(2.1)**	(3.0)
Change in rate of corporation tax	**–**	(37.7)
Other	**(0.3)**	(0.1)
Tax charge for year	**37.8**	(1.3)

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

The average effective current tax rate for the year was 17% (2014: 18%).

The Company reimburses other Group companies for losses claimed by way of group relief at an amount equal to the tax benefit received.

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

	2015 £m	2014 £m
Amounts recognised directly in other comprehensive income		
Deferred tax charge on defined benefit pension schemes	**0.4**	8.4
Deferred tax (credit)/charge on cash flow hedges	**(4.1)**	4.7
Amounts recognised directly in equity		
Deferred tax credit on share based payments	**–**	(0.2)

NOTES TO THE FINANCIAL STATEMENTS
CONTINUED

9. DIVIDENDS

	2015 £m	2014 £m
Amounts recognised as distributions to equity holders in the year:		
Base dividend of 43.1p per ordinary share in respect of 2013/14 paid 26 September 2013	–	65.0
Dividend of 11.3p per ordinary share in respect of outperformance for 2013/13 and 2013/14 paid 26 September 2013	–	17.0
Special dividend of 19.9p per ordinary share in respect of outperformance for 2013/14 paid 31 March 2014	–	30.0
Base dividend of 43.9p per ordinary share in respect of 2014/15 paid 26 September 2014	**66.2**	–
Dividend of 22.9p per ordinary share in respect of outperformance for 2013/14 and 2014/15 paid 26 September 2014	**34.6**	–
Special dividend of 102.7p per ordinary share in respect of outperformance for 2014/15 paid 13 March 2015	**155.0**	–
	255.8	112.0

10. EMPLOYMENT COSTS

The average number of persons (including Executive Directors) employed by the Company was 1,221 (2014: 1,169).

	Note	2015 £m	2014 £m
Wages and salaries		**38.7**	35.4
Social security costs		**3.3**	3.0
Pension costs	23	**6.7**	9.4
Share-based payments		**1.2**	1.3
Total employment costs		**49.9**	49.1
Charged as follows:			
Manpower costs		**39.8**	39.9
Capital schemes		**10.1**	9.2
Total employment costs		**49.9**	49.1

Details of Directors' emoluments are set out in note 11. 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.

11. DIRECTORS' EMOLUMENTS

	2015 £000	2014 £000
Executive Directors:		
Salary	**762**	751
Performance-related bonus paid or payable	**276**	277
Share-based payments	**603**	629
Other emoluments, including payments in lieu of pension provision	**357**	331
Non-executive Directors (including Chairman)	**277**	211
Total emoluments	**2,275**	2,199

More detailed information concerning Directors' emoluments (including pensions and the highest paid Director) and share interests is shown in the Directors' remuneration report on pages 63 to 79. 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 27.

11. DIRECTORS' EMOLUMENTS CONTINUED

The aggregate gains on vesting of Directors' share-based awards amounted to a total of £519,000.

Total gains made by Directors on the exercise of share options were £nil (2013/14: £3,000).

At 31 March 2015 there were two Directors accruing retirement benefits under defined benefit pension schemes (2014: three Directors). At 31 March 2015 there was one Director accruing retirement benefits under defined contribution pension schemes (2014: none) with contributions of £2,000 made during the year (2013/14: nil).

12. 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 1 April 2013	23.4	1,559.0	641.1	1,253.1	112.7	**3,589.3**
Additions	–	13.8	1.2	30.7	95.9	**141.6**
Assets adopted at fair value	–	5.9	–	0.1	–	**6.0**
Grants & contributions	–	(1.6)	–	–	–	**(1.6)**
Disposals	–	(1.2)	(0.4)	(16.6)	–	**(18.2)**
Transfers/reclassifications	1.0	21.1	7.5	53.9	(83.5)	**–**
At 31 March 2014	24.4	1,597.0	649.4	1,321.2	125.1	**3,717.1**
Additions	0.4	11.5	3.5	34.7	95.0	**145.1**
Assets adopted at fair value	–	6.8	0.1	0.1	–	**7.0**
Grants & contributions	–	(1.9)	–	–	–	**(1.9)**
Disposals	–	(1.2)	(0.1)	(10.4)	–	**(11.7)**
Transfers/reclassifications	2.6	17.5	4.8	40.3	(65.2)	**–**
At 31 March 2015	27.4	1,629.7	657.7	1,385.9	154.9	**3,855.6**
Accumulated depreciation:						
At 1 April 2013	5.8	144.5	196.3	687.4	–	**1,034.0**
Charge for year	0.5	23.8	12.3	69.5	–	**106.1**
Disposals	–	(1.2)	(0.4)	(16.4)	–	**(18.0)**
At 31 March 2014	6.3	167.1	208.2	740.5	–	**1,122.1**
Charge for year	0.6	23.8	11.8	71.9	–	**108.1**
Disposals	–	(1.2)	(0.1)	(10.2)	–	**(11.5)**
At 31 March 2015	6.9	189.7	219.9	802.2	–	**1,218.7**
Net book value:						
At 31 March 2013	17.6	1,414.5	444.8	565.7	112.7	**2,555.3**
At 31 March 2014	18.1	1,429.9	441.2	580.7	125.1	**2,595.0**
At 31 March 2015	20.5	1,440.0	437.8	583.7	154.9	**2,636.9**

Out of the total depreciation charge for the Company of £108.1m (2014: £106.1m), the sum of £1.3m (2014: £1.3m) has been charged to capital projects, £0.9m (2014: £0.9m) has been offset by deferred income and £105.9m (2014: £103.9m) against profits.

Asset lives and residual values are reviewed annually.

The amount of borrowing costs capitalised during the year ended 31 March 2015 was £2.4m (2014: £nil). The rate used to determine the amount of borrowing costs eligible for capitalisation was 3.7% which is the effective rate of the borrowing used to finance the construction.

12. PROPERTY, PLANT AND EQUIPMENT CONTINUED

Assets held under finance leases included above were:

	Land & 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 2014	–	357.0	465.2	411.1	0.2	**1,233.5**
At 31 March 2015	–	398.0	422.3	414.0	1.1	**1,235.4**
Accumulated depreciation:						
At 31 March 2014	–	41.9	112.8	175.6	–	**330.3**
At 31 March 2015	–	47.4	96.9	183.2	–	**327.5**
Net book amount:						
At 31 March 2014	–	315.1	352.4	235.5	0.2	**903.2**
At 31 March 2015	–	350.6	325.4	230.8	1.1	**907.9**

13. FINANCIAL INSTRUMENTS BY CATEGORY

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

		Fair value	Amortised cost		
	Note	Derivatives used for cash flow hedging £m	Loans and receivables £m	Trade receivables and trade payables £m	**Total £m**
31 March 2015					
Financial assets					
Trade and other receivables	14 & 17	–	10.9	100.0	**110.9**
Derivative financial instruments	18	0.3	–	–	**0.3**
Cash and cash deposits	19	–	246.9	–	**246.9**
		0.3	257.8	100.0	**358.1**
Financial liabilities					
Borrowings	21	–	(2,064.4)	–	**(2,064.4)**
Derivative financial instruments	18	(38.5)	–	–	**(38.5)**
Trade and other payables	20	–	(2.2)	(43.5)	**(45.7)**
		(38.5)	(2,066.6)	(43.5)	**(2,148.6)**

13. FINANCIAL INSTRUMENTS BY CATEGORY CONTINUED

	Note	Fair value	Amortised cost		**Total £m**
		Derivatives used for cash flow hedging £m	Loans and receivables £m	Trade receivables and trade payables £m	
31 March 2014					
Financial assets					
Trade and other receivables	14 & 17	–	18.0	85.7	**103.7**
Derivative financial instruments	18	8.4	–	–	**8.4**
Cash and cash deposits	19	–	315.8	–	**315.8**
		8.4	333.8	85.7	**427.9**
Financial liabilities					
Borrowings	21	–	(1,961.5)	–	**(1,961.5)**
Derivative financial instruments	18	(20.1)	–	–	**(20.1)**
Trade and other payables	20	–	(4.4)	(40.8)	**(45.2)**
		(20.1)	(1,965.9)	(40.8)	**(2,026.8)**

14. NON-CURRENT TRADE AND OTHER RECEIVABLES

	2015 £m	2014 £m
Amounts owed by subsidiary company	**–**	0.3

The effective interest rate on amounts owed by subsidiary is 1.7% (2014:2.3%).

15. INVESTMENTS

	2015 £m	2014 £m
At 31 March:		
Subsidiary undertakings	**3.3**	3.3

The Company has five wholly-owned subsidiaries, Peninsula Properties (Exeter) Limited, South West Water Finance Plc, Source Contact Management Limited, Source for Business Limited and Source Collections Limited. All companies are incorporated, registered and operate in England.

The Company disposed of its £1 share holding in Peninsula Leasing Limited, to Pennon Group Plc on 31 March 2015.

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.

16. INVENTORIES

	2015 £m	2014 £m
Raw materials and consumables	**5.2**	4.4

17. TRADE AND OTHER RECEIVABLES – CURRENT

	2015 £m	2014 £m
Amounts receivable from customers	**181.0**	167.8
Less: provision for impairment of receivables	**(81.0)**	(82.1)
Net trade receivables	**100.0**	85.7
Amounts owed by subsidiary companies	**–**	0.4
Amounts owed by fellow subsidiary companies	**1.4**	1.2
Amounts owed by parent undertaking	**0.1**	–
Other receivables	**9.4**	16.1
Prepayments and accrued income	**8.3**	7.7
	119.2	111.1

Amounts receivable from customers includes trade receivables and accrued income relating to customers with metered budget plans.

The Directors consider that the carrying amount 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 has created IAS 39 portfolio provisions, but cannot practicably identify which receivables specifically are the ones impaired. It is company policy to consider a receivable in a portfolio to which an impairment has been allocated on a collective basis as not being impaired for the purposes of IFRS 7 disclosures until the loss can be specifically identified with the receivable.

The ageing of gross trade receivables past due but not specifically impaired was:

	2015 £m	2014 £m
Past due 1 – 30 days	**12.9**	13.0
Past due 31 – 120 days	**15.5**	12.3
More than 120 days	**131.6**	124.4

The aged trade receivables above are taken directly from the Company's aged debt datamart and sales ledger records before the deduction of credit balances and other adjustments. The figures are therefore higher than the trade receivables balance stated above.

The Company has a duty under legislation to continue to provide domestic customers with services regardless of payment. The Company specifically reviews separate categories of debt to identify an appropriate provision for impairment.

The movement in the allowance for impairment in respect of trade receivables was:

	2015 £m	2014 £m
At 1 April	**82.1**	72.5
Provision for receivables impairment	**9.1**	9.6
Receivables written off during the year as uncollectable	**(17.3)**	(7.9)
Cumulative amounts previously excluded from debt	**7.1**	7.9
At 31 March	**81.0**	82.1

18. DERIVATIVE FINANCIAL INSTRUMENTS

	2015 £m	2014 £m
Derivatives used for cash flow hedging:		
Current assets	**0.1**	1.8
Non-current assets	**0.2**	6.6
Current liabilities	**(12.7)**	(16.5)
Non-current liabilities	**(25.8)**	(3.6)
Derivatives deemed held for trading:		
Current liabilities	**–**	–
Non-current liabilities	**–**	–

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 (2014: £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 2015, 63% (2014: 64%) of net borrowings was at fixed rate.

At 31 March 2015 interest rate swaps to swap from floating to fixed rate and hedge financial liabilities with a notional value of £1,003.0m existed, with a weighted average maturity of 4.4 years (2014: £1,313.0m, with 3.6 years). The weighted average interest rate of the swaps was 2.2% (2014: 2.7%).

Valuation hierarchy

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

	2015 £m	2014 £m
Level 2 inputs		
Assets		
Derivatives used for cash flow hedging	**0.3**	8.4
Liabilities		
Derivatives used for cash flow hedging	**(38.5)**	(20.1)
Derivatives deemed held for trading	**–**	–

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.

19. CASH AND CASH DEPOSITS

	2015 £m	2014 £m
Cash at bank and in hand	**16.8**	41.6
Overnight deposits	**–**	55.0
Other short–term bank deposits	**35.1**	55.0
Other deposits	**195.0**	164.2
	246.9	315.8

Overnight deposits have an average maturity of one day.

Other short-term bank deposits have an average maturity of 73 days.

Other deposits include £195.0m (2014: £164.2m) of restricted funds to settle long–term lease liabilities (note 21).

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

	2015 £m	2014 £m
Cash and cash deposits as above	**246.9**	315.8
Less: deposits with a maturity of three months or more (restricted funds)	**(195.0)**	(164.2)
Cash and cash equivalents	**51.9**	151.6

20. TRADE AND OTHER PAYABLES – CURRENT

	2015 £m	2014 £m
Trade payables	**43.5**	40.8
Amounts owed to parent undertaking	**–**	1.2
Amounts owed to subsidiary companies	**2.2**	3.2
Other tax and social security	**1.3**	1.2
Other payables	**7.8**	10.2
Accruals	**19.2**	18.5
Deferred income	**1.1**	0.9
	75.1	76.0

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

21. BORROWINGS

	2015 £m	2014 £m
Current		
Loan from parent company	**130.0**	–
European Investment Bank	**31.1**	31.1
	161.1	31.1
Obligations under finance leases	**22.7**	111.4
Total current borrowings	**183.8**	142.5
Non-current		
European Investment Bank	**273.2**	304.3
Loan from subsidiary company (note 34)	**391.8**	386.5
	665.0	690.8
Obligations under finance leases	**1,215.6**	1,128.2
	1,880.6	1,819.0
Total borrowings	**2,064.4**	1,961.5

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:

	2015		2014	
	Book value £m	**Fair value £m**	Book value £m	Fair value £m
European Investment Bank	**273.2**	**250.6**	304.3	260.1
Loan from subsidiary company	**391.8**	**403.3**	386.5	326.6
	665.0	**653.9**	690.8	586.7
Obligations under finance leases	**1,215.6**	**1,093.3**	1,128.2	955.6
	1,880.6	**1,747.2**	1,819.0	1,542.3

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:

	2015 £m	2014 £m
Between 1 and 2 years	**55.4**	55.2
Over 2 and less than 5 years	**197.6**	190.0
Over 5 years	**1,627.6**	1,573.8
	1,880.6	1,819.0

The weighted average maturity of non-current borrowings was 25 years (2014: 25 years).

21. BORROWINGS CONTINUED

Finance lease liabilities – minimum lease payments:

	2015 £m	2014 £m
Within 1 year	**40.0**	55.4
Over 1 year and less than 5 years	**209.0**	277.8
Over 5 years	**2,105.3**	2,034.8
	2,354.3	2,368.0
Less: future finance charges	**(1,116.0)**	(1,128.5)
Present value of finance lease liabilities	**1,238.3**	1,239.5

The maturity of finance lease liabilities was:

	2015 £m	2014 £m
Within 1 year	**22.7**	111.4
Over 1 year and less than 5 years	**114.2**	102.3
Over 5 years	**1,101.4**	1,025.8
	1,238.3	1,239.5

Included above are accrued finance charges arising on obligations under finance leases totalling £132.8m (2014: £127.3m), of which £2.9m (2014: £6.9m) is repayable within one year.

Included above is £0.6m (2014: £0.6m) due to Peninsula Leasing Limited, under finance lease agreements of which £0.3m (2014: £0.4m) is repayable within one year.

Within obligations under finance leases, the Company has utilised finance lease facilities of £180.0m for certain water and sewerage business property, plant and equipment which are secured by bank letters of credit issued by United Kingdom financial institutions. These letters of credit, covering the full period of the finance leases, are renewable between the financial institutions and the Company at five-yearly intervals, the next being March 2016.

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 £70.7m at 31 March 2015 (2014: £60.1m) 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 2015 of £124.3m (2014: £104.1m) 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.

Undrawn committed borrowing facilities at the balance sheet date were:

	2015 £m	2014 £m
Floating rate:		
Expiring within one year	**25.0**	30.0
Expiring after one year	**425.3**	245.0
	450.3	275.0

In addition, the Company has undrawn uncommitted short-term bank facilities of £25.0m (2014: £25.0m).

22. OTHER NON-CURRENT LIABILITIES

	2015 £m	2014 £m
Deferred income	**74.3**	68.6

Deferred income results from the adoption at fair value of assets transferred from customers.

23. RETIREMENT BENEFIT OBLIGATIONS

The Company's employees are eligible to participate in defined benefit pension schemes and also a defined contribution section within the main scheme, operated by the parent company, Pennon Group Plc.

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 £0.9m (2014: £0.5m).

Defined benefit schemes

The principal actuarial assumptions at 31 March 2015 were:

	2015 %	2014 %	2013 %
Rate of increase in pensionable pay	**2.9**	3.4	3.4
Rate of increase for current and future pensions	**2.9**	3.2	3.4
Rate used to discount schemes' liabilities and expected return on scheme assets	**3.35**	4.30	4.35
Inflation	**2.9**	3.4	3.4

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 2013 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:

	2015	2014	2013
Male	**25.0**	24.9	25.0
Female	**27.2**	27.1	27.0

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

	2015	2014	2013
Male	**26.4**	26.3	25.9
Female	**29.5**	29.4	28.3

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

	Change in assumption	Impact on schemes' liabilities
Rate of increase in pensionable pay	**+/- 0.5%**	+/- 0.2%
Rate of increase in current and future pensions	**+/- 0.5%**	+/- 6.1%
Rate used to discount schemes' liabilities	**+/- 0.5%**	+/- 9.2%
Inflation	**+/- 0.5%**	+/- 6.3%
Life expectancy	**+/- 1 year**	+/- 3.6%

23. RETIREMENT BENEFIT OBLIGATIONS CONTINUED

Defined benefit schemes continued

The amounts recognised in the balance sheet were:

	2015 £m	2014 £m
Present value of funded obligations	**(501.8)**	(465.5)
Fair value of plan assets	**460.3**	404.7
Net liability recognised in the balance sheet	**(41.5)**	(60.8)

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

	2015			2014		
	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	**(465.5)**	**404.7**	**(60.8)**	(472.4)	394.0	(78.4)
Current service cost	**(5.7)**	**–**	**(5.7)**	(8.7)	–	(8.7)
Interest (expense)/income	**(19.3)**	**17.2**	**(2.1)**	(20.4)	17.0	(3.4)
Past service cost and gains and losses on settlements	**11.5**	**–**	**11.5**	(0.2)	–	(0.2)
	(13.5)	**17.2**	**3.7**	(29.3)	17.0	(12.3)
Remeasurements:						
Return on plan on assets excluding amounts included in interest expense	**–**	**42.6**	**42.6**	–	1.6	1.6
Gain/(loss) from change in demographic assumptions	**13.3**	**–**	**13.3**	(3.2)	–	(3.2)
(Loss)/Gain from change in financial assumptions	**(57.2)**	**–**	**(57.2)**	8.7	–	8.7
Experience gains	**3.0**	**–**	**3.0**	15.7	–	15.7
	(40.9)	**42.6**	**1.7**	21.2	1.6	22.8
Contributions:						
Employers	**–**	**13.9**	**13.9**	–	7.1	7.1
Plan participants	**(0.1)**	**0.1**	**–**	(0.1)	0.1	–
Payments from plans:						
Benefit payments	**18.2**	**(18.2)**	**–**	15.1	(15.1)	–
	18.1	**(4.2)**	**13.9**	15.0	(7.9)	7.1
At 31 March	**(501.8)**	**460.3**	**(41.5)**	(465.5)	404.7	(60.8)

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 35).

23. RETIREMENT BENEFIT OBLIGATIONS CONTINUED

Defined benefit schemes continued

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

	2015		2014	
	Quoted prices in active market £m	**Fund %**	Quoted prices in active market £m	Fund %
Equities	**152.0**	**33**	194.0	48
Property	**35.4**	**8**	30.0	7
Bonds	**143.8**	**31**	124.6	31
Diversified Growth Fund	**56.2**	**12**	54.8	14
Other	**72.9**	**16**	1.3	–
	460.3	**100**	404.7	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 schemes hold a significant proportion of growth assets (equities and diversified growth funds) which are expected to outperform corporate bonds in the long term but can give rise to volatility and risk in the short term. The allocation to growth assets is monitored such that it is suitable with the scheme's long-term objectives.

Changes in bond yields: A decrease in corporate bond yields will increase the scheme's liabilities, 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 majority of the assets are either unaffected by or loosely correlated with inflation, meaning that an increase in inflation will also increase the deficit.

Life expectancy: The majority of the 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 bonds which is expected to be less volatile than most other asset classes and reflects the scheme's liabilities
- a proportion of equities, with fund managers having freedom in making investment decisions to maximise returns
- investment of a relatively small proportion of the 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 2013. The Company has made a deficit recovery contribution to the main scheme during the year of £8.7m (2014: £nil). The Pennon Group monitors funding levels on an annual basis and South West Water expects to pay total contributions of around £5.5m during the year ended 31 March 2016.

Deficit recovery contributions are made as agreed and by dates in the recovery plan, split between South West Water and other companies within the Pennon Group based upon the number of scheme members from each company.

24. DEFERRED TAX LIABILITIES

Deferred tax is provided in full on temporary differences under the liability method using a tax rate of 20% (2014: 20%).

The movements on deferred tax were:

	2015 £m	2014 £m
At 1 April	**227.9**	244.9
Impact of change of corporation tax rate credited to the income statement	**–**	(37.7)
Impact of change of corporation tax rate charged to equity	**–**	3.5
Other deferred tax charged to the income statement	**8.0**	7.8
(Credited)/charged to equity	**(3.7)**	9.4
At 31 March	**232.2**	227.9

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 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		
	Owned Assets £m	Leased Assets £m	**Total £m**
At 1 April 2013	257.7	15.8	**273.5**
Impact of change of rate	(34.6)	(2.1)	**(36.7)**
Charged to the income statement	7.5	0.7	**8.2**
At 31 March 2014	230.6	14.4	**245.0**
Impact of change of rate	–	–	**–**
Charged/(credited) to the income statement	4.5	(0.6)	**3.9**
At 31 March 2015	235.1	13.8	**248.9**

24. DEFERRED TAX LIABILITIES CONTINUED

Deferred tax assets

	Provisions £m	Retirement benefit obligations £m	Other £m	**Total £m**
At 1 April 2013	–	(18.0)	(10.6)	**(28.6)**
(Credited)/charged to the income statement	(0.2)	(1.3)	1.1	**(0.4)**
Charged to equity	–	5.3	4.1	**9.4**
Impact of change in rate	–	1.8	0.7	**2.5**
At 31 March 2014	(0.2)	(12.2)	(4.7)	**(17.1)**
Charged to the income statement	–	3.5	0.6	**4.1**
Charged/(credited) to equity	–	0.4	(4.1)	**(3.7)**
Impact of change in rate	–	–	–	**–**
At 31 March 2015	(0.2)	(8.3)	(8.2)	**(16.7)**

Net deferred tax liability

	£m
At 31 March 2014	227.9
At 31 March 2015	**232.2**

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

	2015 £m	2014 £m
Actuarial gains on defined benefit schemes	**0.4**	5.3
Actuarial gains on defined benefit schemes (change of rate)	**–**	3.1
Share-based payments	**–**	(0.2)
Share-based payments (change of rate)	**–**	–
Cash-flow hedges	**(4.1)**	4.3
Cash flow hedges (change in rate)	**–**	0.4
	(3.7)	12.9

25. PROVISIONS

Restructuring	**2015 £m**	2014 £m
At 1 April	**2.4**	3.2
Charged to the income statement	**0.5**	0.5
Utilised during year	**(0.9)**	(1.3)
At 31 March	**2.0**	2.4

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

26. CALLED UP SHARE CAPITAL

	2015 £m	2014 £m
Authorised		
500,000,000 (2014: 500,000,000) ordinary shares of £1 each	**500.0**	500.0
Allotted and fully paid		
150,950,000 (2014: 150,950,000) ordinary shares of £1 each	**150.9**	150.9

27. 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 £250 per month for three or five years. These savings can then be used to buy ordinary shares, at a price set at a 20% discount to the market value at the start of the savings period, at the third, fifth or seventh year anniversary of the option being granted. Options expire six months following the exercise date and, except for certain specific circumstances such as redundancy, lapse if the employee leaves the 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 2015	2014
3 July 2007	522p	2010 – 2014	**–**	5
8 July 2008	517p	2011 – 2015	**5**	7
6 July 2009	386p	2012 – 2016	**23**	218
28 June 2010	431p	2013 – 2017	**108**	114
29 June 2011	536p	2014 – 2018	**70**	200
29 June 2012	588p	2015 – 2017	**279**	299
3 July 2013	538p	2016 – 2018	**283**	297
14 July 2014	611p	2017 – 2019	**312**	–
			1,080	1,140

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

	2015		2014	
	Number of Ordinary shares (thousands)	**Weighted average exercise price per share (p)**	Number of Ordinary shares (thousands)	Weighted average exercise price per share (p)
At 1 April	**1,140**	**511**	1,139	494
Granted	**319**	**611**	306	538
Exercised	**(307)**	**454**	(212)	437
Expired	**(72)**	**492**	(93)	567
At 31 March	**1,080**	**558**	1,140	511

The weighted average price at the date of exercise of Sharesave options during the year was 811p (2014: 703p). The options outstanding at 31 March 2015 had a weighted average exercise price of 558p (2014: 511p) and a weighted average remaining contractual life of 1.8 years (2014: 1.7 years).

27. EMPLOYEE SHARE SCHEMES CONTINUED

i) Sharesave Scheme continued

The aggregate fair value of Sharesave options granted during the year was £0.3m (2014: £0.3m), determined using the Black-Scholes valuation model. The significant inputs into the valuation model, at the date of issue of the options, were:

	2015 £m	2014 £m
Weighted average share price	**764p**	673p
Weighted average exercise price	**611p**	538p
Expected volatility	**17.0%**	18.0%
Expected life	**3.4 years**	3.4 years
Risk-free rate	**1.4%**	0.7%
Expected dividend yield	**4.0%**	4.2%

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 share holding 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.

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

	2015		2014	
	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	**357**	**703**	353	663
Granted	**113**	**799**	135	653
Vested	**(34)**	**698**	(73)	546
Lapsed	**(79)**	**698**	(58)	546
At 31 March	**357**	**735**	357	703

The awards outstanding at 31 March 2015 had a weighted average exercise price of 735p (2014: 703p) and a weighted average remaining contractual life of 1.3 years (2014: 1.3 years).

The aggregate fair value of awards granted during the year was £0.5m (2014: £0.5m), determined using a Monte-Carlo simulation model. The significant inputs into the valuation model at the date of the share awards were:

	2015 £m	2014 £m
Weighted average share price	**795p**	653p
Expected volatility	**17.0%**	18.0%
Risk-free rate	**1.4%**	0.7%

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

27. EMPLOYEE SHARE SCHEMES CONTINUED

iii) 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:

	2015		2014	
	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	**148**	**698**	159	677
Granted	**51**	**822**	47	754
Vested	**(50)**	**573**	(58)	569
At 31 March	**149**	**758**	148	698

The awards outstanding at 31 March 2015 had a weighted average price of 758p (2014: 698p) and a weighted average remaining contractual life of 1.3 years (2014: 1.0 years). The Group's share price at the date of the awards ranged from 693p to 822p.

The aggregate fair value of awards granted during the year was £0.4m (2014: £0.3m), 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.

28. RETAINED EARNINGS AND OTHER RESERVES

	Hedging reserve £m	Retained earnings £m	**Total £m**
At 1 April 2013	(39.3)	374.8	**335.5**
Profit for the year	–	163.5	**163.5**
Other comprehensive profit for the year	31.4	16.1	**47.5**
Dividends paid	–	(112.0)	**(112.0)**
Share-based payments (including tax)	–	1.4	**1.4**
Pennon shares disposed on vesting of options	–	(0.3)	**(0.3)**
Pennon shares acquired by the Employee Share Trust in respect of share options granted	–	0.4	**0.4**
At 31 March 2014	(7.9)	443.9	**436.0**
Profit for the year	–	141.9	**141.9**
Other comprehensive loss for the year	(19.4)	1.3	**(18.1)**
Dividends paid	–	(255.8)	**(255.8)**
Share-based payments (including tax)	–	1.2	**1.2**
Pennon shares disposed on vesting of options	–	(0.3)	**(0.3)**
Pennon shares acquired by the Employee Share Trust in respect of share options granted	–	0.5	**0.5**
At 31 March 2015	(27.3)	332.7	**305.4**

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.

29. CASH FLOW FROM OPERATING ACTIVITIES

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

	2015 £m	2014 £m
Continuing operations		
Profit for the year	**141.9**	163.5
Adjustments for:		
Share based payments	**1.2**	1.3
Deferred income released to profits	**(0.2)**	(0.2)
Profit on disposal of property, plant and equipment	**(1.1)**	(1.7)
Depreciation charge	**105.9**	103.9
Interest payable and similar charges	**60.4**	67.6
Interest receivable	**(2.8)**	(3.1)
Taxation	**37.8**	(1.3)
Exceptional item	**(11.8)**	–
Changes in working capital:		
Increase in inventories	**(0.8)**	(0.6)
Increase in trade and other receivables	**(7.8)**	(9.1)
Increase/(decrease) in trade and other payables	**1.1**	(7.6)
(Decrease)/increase in retirement benefit obligations	**(7.9)**	1.8
Decrease in provisions	**(0.4)**	(0.8)
Cash generated from operations	**315.5**	313.7

30. NET BORROWINGS

	2015 £m	2014 £m
Cash and cash deposits	**246.9**	315.8
Borrowings – current		
Loan from parent company	**(130.0)**	–
Other current borrowings	**(31.1)**	(31.1)
Finance lease obligations	**(22.7)**	(111.4)
Total current borrowings	**(183.8)**	(142.5)
Borrowings – non-current		
Other non-current borrowings	**(665.0)**	(690.8)
Finance lease obligations	**(1,215.6)**	(1,128.2)
Total non-current borrowings	**(1,880.6)**	(1,819.0)
Total net borrowings	**(1,817.5)**	(1,645.7)

31. OPERATING LEASE COMMITMENTS

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

	2015 £m	2014 £m
Within 1 year	**1.5**	1.5
Over 1 year and less than 5 years	**5.4**	5.4
Over 5 years	**18.9**	20.2
	25.8	27.1

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CONTINUED

32. CONTINGENT LIABILITIES

	2015 £m	2014 £m
Guarantee of borrowings of subsidiary undertaking	**382.6**	377.5

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

The Company is subject to litigation from time to time as a result of its activities. The Company establishes provisions in connection with litigation where it has a present legal or constructive obligation as a result of past events and where it is more likely than not an outflow of resources will be required to settle the obligation and the amount can be reliably estimated.

33. CAPITAL COMMITMENTS

	2015 £m	2014 £m
Contracted but not provided	**65.6**	77.7

34. RELATED PARTY TRANSACTIONS

	2015 £m	2014 £m
Parent company		
Purchase of goods and services		
– Group expenses	**4.5**	4.2
Payment for provision of finance		
– Loan interest	**0.1**	–
Sale of goods and services		
– Administrative services	**0.5**	0.5
Dividends paid	**255.8**	112.0

	2015 £m	2014 £m
Subsidiaries of the Company		
Purchase of goods and services		
– Property consultancy	**0.2**	0.5
– Billing and collection services	**9.3**	9.3
Payment for provision of finance		
– Loan interest	**12.9**	15.2
– Finance lease charges: vehicles	**0.1**	0.1
Sale of goods and services (administrative services)	**1.5**	1.5

	2015 £m	2014 £m
Fellow subsidiaries of the Pennon Group		
Purchase of goods and services		
– Waste disposal	**–**	–
– Insurance premia	**0.3**	0.3
Sale of goods and services		
– Tankered waste and trade effluent charges	**–**	0.6

34. RELATED PARTY TRANSACTIONS CONTINUED

	2015 £m	2014 £m
Year end balances		
Borrowings		
– Loan from parent	**130.0**	–
– Loan from subsidiary	**391.8**	386.5
– Finance lease balances with subsidiary	**0.7**	0.7
Receivables		
– Parent company	**0.1**	–
– Subsidiaries	**–**	0.8
– Fellow subsidiaries	**0.1**	1.2
Payables		
– Parent company	**–**	1.2
– Subsidiaries	**2.3**	3.2

Details of the £130.0m loan from the parent Company, Pennon Group Plc, are included in note 21.

35. 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.

NOTES

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