PENNON GROUP PLC

PUBLICATION OF ANNUAL REPORT AND ACCOUNTS 2018
AND NOTICE OF ANNUAL GENERAL MEETING

In compliance with Listing Rule 9.6.1 Pennon Group Plc (the "Company") announces that the following documents have been submitted to the Financial Conduct Authority electronically via the National Storage Mechanism and will shortly be available for inspection at www.morningstar.co.uk/uk/NSM

- Annual Report and Accounts 2018
- Notice of Annual General Meeting
- Form of Proxy

The Annual Report and Accounts 2018 and Notice of Annual General Meeting may also be viewed on the Company's website at www.pennon-group.co.uk

The Company will hold its 2018 Annual General Meeting at Sandy Park Conference Centre, Sandy Park Way, Exeter, Devon, EX2 7NN on Thursday 5 July 2018 at 11.00am.

The following information in the Appendix to this announcement is as set out in the Company's Annual Report and Accounts 2018. It should be read in conjunction with the Company's Full Year Results announcement released on 25 May 2018 which included a set of consolidated financial statements, a fair review of the development and performance of the business and the position of the Company and its main trading subsidiary companies. Together these documents constitute the information required by Disclosure and Transparency Rule 6.3.5.

Helen Barrett-Hague
Group General Counsel & Company Secretary

5 June 2018

APPENDIX

PRINCIPAL RISKS AND UNCERTAINTIES

Strategic impact – long-term priorities affected

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

Risk level

Green	Amber	Red	↑	↔	↓
Low	**Medium**	**High**	**Increasing**	**Stable**	**Decreasing**

The low, medium and high risk level is our estimate of the net risk to the Group after mitigation. It is important to note that risk is difficult to estimate with accuracy and therefore may be more or less than indicated.

Current assessment of direction of travel of risk level.

Law, regulation and finance

Principal risks	Strategic impact	Mitigation	Net risk	Direction	Risk appetite
Changes in Government policy	Long-term priorities affected: 1,2 Changes in Government policy may fundamentally impact our ability to deliver the Group's strategic priorities, impacting shareholder value.	(i) The renationalisation of the water industry continues to be a central policy of the Opposition and remains a possibility in the event of a change of Government. We recognise, however the existing Government is supportive of the existing regulatory model. We engage regularly with all political parties as well as customers and stakeholders demonstrating the value they receive based on our operational performance and continued investment in the network infrastructure.	**Red**	↔	We recognise that Government policy evolves and seek to minimising potential risk and maximising opportunities through regular communication and robust scenario planning.
		(ii) The Government is considering legislating on the use of specific single-use plastics to reduce the environmental impact and improve recycling rates. Viridor is well positioned to leverage this opportunity in the event that legislation is introduced and continue to invest in its sorting and reprocessing technology. Viridor is also a founding signatory to the UK Plastic Pact.	**Green**	↔	

Principal risks	Strategic impact	Mitigation	Net risk	Direction	Risk appetite
Regulatory reform	Long-term priorities affected: 1,2 Reform of the regulatory framework may result in changes to the Group's priorities and the service we provide to our customers. It may have a significant impact on our performance which can impact shareholder value.	During the year Ofwat finalised their price review methodology for 2020-25. There has also been a focus by the Government and Ofwat on the governance of companies in the water sector. We are well positioned for the new regulatory period with a dedicated, experienced PR19 project team, supported by external consultants, which is monitored through a robust governance framework. We are broadly supportive of Ofwat's proposed reforms and engage fully with the regulator during each consultation. South West Water already carries out its business in line with the improvements set out.	**Amber**	↑	We accept that regulatory reform occurs and seek to leverage the opportunities this creates while mitigating the associated risk.
Compliance with laws and regulations	Long-term priorities affected: 1,2 The Group is required to comply with an ever increasing range of regulated and non-regulated laws and regulation across our water and waste businesses. Non-compliance with one or a number of these may result in financial penalties, a negative impact on our ability to operate effectively and reputational damage which could affect shareholder value.	Our robust regulatory framework ensures compliance with Ofwat, Environment Agency and other relevant requirements. Employees, contractors and partners receive a rolling programme of training and guidance. Additionally, during the year we have launched our 'Speak Up' whistleblowing policy. We have been proactive in reviewing our policies and processes in preparation for the introduction of the General Data Protection Regulation and have appointed a dedicated Data Protection Officer.	**Green**	↔	The Group has the highest standards of compliance and has no appetite for legal or regulatory breaches. We aim to minimise the impact of regulatory reform by targeting changes which are NPV neutral over the longer term to protect customer affordability and shareholder value.
Maintaining sufficient finance and funding, within our debt covenants, to meet ongoing commitments	Long-term priorities affected: 1,3 Failure to maintain funding requirements could lead to additional finance costs and put our growth agenda at risk. Breach of covenants could result in the requirement to repay certain debt.	The Group have mature treasury, funding and cash flow policies in place. We regularly consider how political, economic and regulatory risks may impact on the Group's financing commitments and cashflow. The Group operates with strong liquidity position and diversified funding mix. South West Water is funded to March 2020 while the Viridor committed energy recovery facility (ERF) programme is also fully funded. The successful refinancing of the £300 million hybrid in September 2017has also strengthened our investment capacity and covenant position.	**Green**	↔	We operate a prudent approach to our financing strategy in order to ensure our funding requirements are fully met.

Principal risks	Strategic impact	Mitigation	Net risk	Direction	Risk appetite
Non-compliance or occurrence of avoidable health and safety incident	Long-term priorities affected: 1,2,3 A breach of health and safety law could lead to financial penalties, significant legal costs and damage to the Group's reputation.	The effective management of health and safety related risks continue to be a priority for the Board and Pennon Executive. The HomeSafe programme was successfully piloted in Viridor's materials recycling facility site in Plymouth, nationwide rollout commenced in April 2018. This is supported by a programme of capital investment for existing assets. The Group has also invested in people, processes and systems within its HSSA function during the year which will assist in driving consistency and monitoring compliance with the Group's health and safety standards.	**Amber**	↑	The Group has no appetite for health and safety related incidents and has the highest standards of compliance within the Group and third parties.

Market and economic conditions

Principal risks	Strategic impact	Mitigation	Net risk	Direction	Risk appetite
Non-recovery of customer debt	Long-term priorities affected: 1,2 Potential impact on revenue as a result of reduced customer debt collection, particularly with regards to vulnerable customers and affordability.	Mature and embedded debt collection strategies are in place for the recovery of South West Water domestic customer debt. This is supplemented by affordability tariffs such as Restart, WaterCare and Freshstart to help reduce our bad debt exposure for those customers who are struggling to pay. Within the non-household market there has been renewed focus on the collection of older debt which has proved effective. Due to high proportion of public sector contracts, Viridor's debt collection risk is lower, however, customer debt is regularly reviewed and proactively managed.	**Amber**	↓	While seeking to minimise non-recoverable debt, we recognise customer affordability challenges and the inability to disconnect domestic customers, some risk of uncollectable debt remains.

Principal risks	Strategic impact	Mitigation	Net risk	Direction	Risk appetite
Macroeconomic risks arising from a downturn in the global and UK economy and commodity and power prices	Long-term priorities affected: 3 Challenges such as continued local authority, reduced global demand for our recycled commodities and decreases in power prices have a direct impact on the revenues generated by our recycling business.	We work closely in partnership with our local authority customers in the delivery of our services, while Viridor remains well positioned across the waste hierarchy, with long term contracts supporting the ERF segment. We have secured new markets for our paper and plastic recyclate in response to changes in quality requirements announced by China. We continue to invest in our assets and are working with our supply chain to improve the quality of paper recycling, we are also implementing self-help measures to drive operational efficiencies. Energy risk management at a Group level acts as a natural hedge between South West Water and Viridor, offsetting any drop in power prices. Existing investments that qualified for Renewable Obligation Certificates are protected by the 'grandfathering' principle.	**Red**	↔	We seek to take well-judged and informed decisions while ensuring plans are in place to mitigate the potential impact of macroeconomic risks.

Operating performance

Principal risks	Strategic impact	Mitigation	Net risk	Direction	Risk appetite
Poor customer service/ increased competition leading to loss of customer base	Long-term priorities affected: 1, 3 Poor customer service has a direct impact on South West Water's delivery of the PR14 business plan and the ability of both Viridor and Pennon Water Services to retain and grow market share.	Targeted improvements have been made to continually improve customer service within South West Water has contributed to the achievement of the ServiceMark accreditation during the year and we continue to secure high service incentive mechanism (SIM) scores. There has been a significant focus within Viridor on our customer experience during the year and the reorganisation of the marketing and sales, service delivery and customer service functions has improved this further, alongside the launch of an annual customer survey. Both Viridor and Pennon Water Services have a large and diverse customer base and are not materially exposed to the loss of any one customer.	**Amber**	↑	We continually seek to increase customer satisfaction and maximise customer retention while taking well-informed risk to develop further markets.

Principal risks	Strategic impact	Mitigation	Net risk	Direction	Risk appetite
Business interruption or significant operational failures/ incidents	Long-term priorities affected: 1,3 Operational failure in our water business could mean that we are not able to supply clean water to our customers or provide safe wastewater services. This has a direct impact on the successful delivery of the PR14 business plan. Additionally, business interruption caused by defects, outage or fire could impact the availability and optimisation of our ERFs and recycling facilities.	A continued reduction in the number of pollution events in wastewater has been identified as a priority and a programme of targeted action is currently underway to address these risks. Both South West Water and Viridor maintain detailed contingency plans and incident management procedures which are regularly reviewed. Equipment failure is managed through a programme of sophisticated planned and preventive maintenance regime and effective management of stores. The focus on the effective optimisation of ERFs in particular has resulted in availability exceeding the Group's original forecasts. The Group also maintains comprehensive insurance across its asset base in the event of an incident occurring.	**Amber**	↑	We operate a low tolerance for significant operational failure or incidents and seek to mitigate these risks where possible.
Difficulty in recruitment, retention and development of appropriate skills, which are required to deliver the Group's strategy	Long-term priorities affected: 1,2,3 Failure to have a workforce of skilled and motivated individuals will detrimentally impact all of our strategic priorities. We need the right people in the right places to share best practice, deliver synergies and move the Group forward in the new shared services structure.	The people strategy, underpinned by six threads, has been rolled out across the Group and is designed to ensure we have the workforce necessary to deliver our strategic priorities. This has included our refreshed Vision, increased workforce engagement, continued commitment to training and development and the introduction of a Pennon Code of Conduct. Succession plans remain in place for senior and other key positions. Challenges remain, however, in sourcing skills and expertise externally for specific senior and operational roles with the implications of Brexit continuing to add additional uncertainty.	**Amber**	↑	While turnover does occur, we ensure the appropriate skills and experience is in place with succession plans to provide resilience in mitigating the impact of this.

Business systems and capital investment

Principal risks	Strategic impact	Mitigation	Net risk	Direction	Risk appetite
Failure or increased cost of capital projects/ exposure to contract failures	Long-term priorities affected: 1,3 Inability to successfully deliver our capital programme may result in increased costs and delays and detrimentally impacts our ability to provide top class customer service and achieve our growth agenda.	All capital projects are subject to a robust business case process and skilled project management resource and senior oversight is utilised to provide additional rigour in the delivery of major projects. Robust due diligence is undertaken on key suppliers, technologies and acquisitions. Back to back agreements and supplier guarantees also provide additional protection. Commissioning at Beddington, Dunbar and Glasgow Recycling and Renewable Energy Facility (GRREC) continued through the year, with financial contributions from Dunbar ERF protected by contractual mechanisms. Expenditure at GRREC is above initial expectations. Viridor is contractually entitled to recover incremental costs under certain circumstances. Avonmouth ERF and Mayflower water treatment works remain on schedule and on budget.	**Red**	↔	Pennon's investment activities are taken on an informed basis with risks weighed against appropriate returns.
Failure of information technology systems, management and protection, including cyber risks	Long-term priorities affected: 1 Failure of our information technology systems, due to inadequate internal processes or external cyber threats could result in the business being unable to operate effectively and the corruption or loss of data. This would have a detrimental impact on our customers and result in financial penalties and reputational damage for the Group.	The Group operates a mature and embedded governance framework over the business as usual IT environment and major project implementations. This is aligned to ISO27001 standards and regular internal and external assessments are undertaken to maintain this accreditation. Disaster recovery plans are in place for corporate and operational technology and these are regularly reviewed and tested. Cyber risks are mitigated by a strong information security framework. This is aligned with guidance issued by the National Cyber Security Centre (NCSC). Awareness campaigns have been undertaken during the year aligned with preparations for GDPR. A variety of internal and external assessments are also undertaken, including annual penetration testing, to test the robustness of our controls.	**Amber**	↑	We seek to minimise the risk of informational technology failure and cyber security threats to the lowest level without detrimentally impacting on business operations

DIRECTORS' RESPONSIBILITIES STATEMENTS

(This statement is extracted from the governance section of the Annual Report 2018 and page numbers referred to are those in the Annual Report 2018.)

The Directors are responsible for preparing the annual report, the Directors' remuneration report and the financial statements in accordance with applicable law and regulations. Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the Group and Company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for the year.

In preparing these financial statements the Directors are required to:

- select suitable accounting policies and then apply them consistently
- make judgements and accounting estimates which are reasonable and prudent
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements.

The Directors confirm that they have complied with the above requirements in preparing the financial statements.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions, and disclose with reasonable accuracy at any time the financial position of the Group and the Company; and enable them to ensure that the financial statements and the Directors' remuneration report comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the International Accounting Standards (IAS) Regulation. They are also responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Each of the Directors, whose names and functions are listed on pages 66 and 67, confirms that, to the best of his or her knowledge:

i) The financial statements, which have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit of the Group and of the Company.
ii) The strategic report (pages 1 to 61) and the Directors' report (pages 102 to 105) include a fair review of the development and performance of the business during the year and the position of the Company and the Group at the year end, together with a description of the principal risks and uncertainties they face.
iii) Following receipt of advice from the Audit Committee, that the annual report, taken as a whole, is fair, balanced and understandable, and provides the information necessary for the shareholders to assess the Group's performance, business model and strategy.

The Directors are responsible for the maintenance and integrity of the Company's website **www.pennon-group.co.uk**.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

RELATED PARTY TRANSACTIONS

(The following is Note 45 to the Financial Statements set out in the Annual Report 2018.)

During the year Group companies entered into the following transactions with joint ventures and associate related parties who are not members of the Group:

	2018 £m	2017 £m
Sales of goods and services		
Viridor Laing (Greater Manchester) Limited	**38.4**	80.1
INEOS Runcorn (TPS) Limited	**15.9**	15.8
Purchase of goods and services		
Lakeside Energy from Waste Limited	**12.0**	10.4
INEOS Runcorn (TPS) Limited	**6.0**	6.6
Dividends received		
Lakeside Energy from Waste Holdings Limited	**6.5**	4.5

Year-end balances

	2018 £m	2017 £m
Receivables due from related parties		
Viridor Laing (Greater Manchester) Limited (loan balance)	**-**	40.2
Lakeside Energy from Waste Limited (loan balance)	**8.2**	8.6
INEOS Runcorn (TPS) Limited (loan balance)	**32.5**	37.8
	40.7	86.6
Viridor Laing (Greater Manchester) Limited (trading balance)	**-**	15.3
Lakeside Energy from Waste Limited (trading balance)	**1.0**	1.0
INEOS Runcorn (TPS) Limited (trading balance)	**2.0**	1.3
	3.0	17.6
Payables due to related parties		
Lakeside Energy for Waste Limited (trading balance)	**1.2**	2.7
INEOS Runcorn (TPS) Limited (trading balance)	**2.5**	1.5
	3.7	4.2

The £40.8 million (2017 £86.6 million) receivable relates to loans to related parties included within receivables and due for repayment in instalments between 2017 and 2033. Interest is charged at an average of 13.0% (2017 13.0%).

Company
The following transactions with subsidiary undertakings occurred in the year:

	2018 £m	2017 £m
Sales of goods and services (management fees)	**12.2**	11.2
Purchase of goods and services (support services)	**1.5**	0.5
Interest receivable	**39.9**	39.6
Interest payable	**0.1**	0.1

Dividends received	**202.3**	247.0

Sales of goods and services to subsidiary undertakings are at cost. Purchases of goods and services from subsidiary undertakings are under normal commercial terms and conditions which would also be available to unrelated third parties.

Year-end balances

	2018 £m	2017 £m
Receivables due from subsidiary undertakings		
Loans	**870.8**	1,124.3
Trading balances	**16.2**	13.4

Interest on £425.3 million of the loans has been charged at a fixed rate of 5.0%, on £20.3 million at a fixed rate of 6.0% (2017 £70.0 million at 4.5%, £428.0 million nil at 5.0% and £28.0 million at 6.0%). Interest on £411.8 million of the loans is charged at 12 month LIBOR +1.0% (2017 £497.8 million) and on £13.4 million at 12 month LIBOR + 3.0% (2017 nil). These loans are due for repayment in instalments over the period 2018 to 2056.

Loans of £100.0 million at 1 month LIBOR + 1.0% and £0.5 million at base rate +1.0% were repaid during the year.

During the year there were no provisions (2017 nil) in respect of loans to subsidiaries not expected to be repaid.

	2018 £m	2017 £m
Payables due to subsidiary undertakings		
Loans	**283.6**	322.0
Trading balances	**14.4**	9.5

The loans from subsidiary undertakings are unsecured and interest-free without any terms for repayment.

5 June 2018

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End transmission