PENNON GROUP PLC – Annual Report and Annual General Meeting

The Company has today published the following documents on its website www.pennon-group.co.uk

Annual Report and Accounts 2009
Notice of Annual General Meeting
Form of Proxy

In accordance with the Listing Rules, two copies of the above documents have also been submitted to the UK Listing Authority, and will shortly be available for inspection (normally 6 hours after this announcement has been made) at the UK Listing Authority's Document Viewing Facility, which is situated at:

Financial Services Authority
25 The North Colonnade
Canary Wharf
LONDON
E14 5HS

Tel: 0207 066 1000

The Company will hold its 2009 Annual General Meeting at Sandy Park Conference Centre, Sandy Park Way, Exeter, Devon EX2 7NN on Thursday 30 July 2009 at 11.00 a.m.

The following information in the Appendix to this announcement is provided for the purposes of compliance with the Disclosure and Transparency Rules (DTR) of the Financial Services Authority and is as set out in the Company's Annual Report and Accounts 2009. It should be read together with the Company's Preliminary Results announcement released on 2 June 2009 which included a set of consolidated financial statements and a fair review of the development and performance of the business and the position of the Company and its two main trading subsidiary companies, South West Water Limited and Viridor Limited. Together these constitute the information required by DTR 6.3.5 to be communicated to the media in full unedited text.

Appendix

Principal Risks and Uncertainties

A summary of the principal risks and uncertainties that could impact the Group's performance and our mitigating activities which are unchanged from the previous year and new principal risks and uncertainties since the previous annual report are set out below. For further information on how the Group manages risk, see the Business Review and the Corporate Governance and Internal Control sections within the Company's Annual Report and Accounts 2009.

Pennon Group

Risks	Commentary and mitigation
Earnings growth/Shareholder Value	
It may not be possible to continue to sustain the same level of earnings and growth of the Group as in the past	This is dependent upon the correct strategies being pursued by strong and able management within the Group as well

	as on external factors.
There is a risk to shareholder value if the Group is not able to continue to grow its key businesses and produce sustainable earnings growth	The Group has maintained earnings and has successfully grown both South West Water and Viridor and intends to continue to create shareholder value through its strategic focus on water and waste water services and waste management.
<u>Treasury</u>	
The Company may be unable to raise sufficient funds to finance its activities through:	Pennon Group has robust treasury policies in place. These include:
Liquidity risk	Ensuring that the Group has cash and committed loan facilities equivalent to at least one year's forecast requirements at all times. Borrowing repayment commitments are expected to be met as required during the coming period.
Refinancing risk	Ensuring that no more than 20% of Group net debt is permitted to mature in any one financial year. At 31 March 2009 the Group had cash and deposits of £353 million, and undrawn committed bank facilities of £204 million, giving access to total cash resources of £557 million. Loan repayments falling due by 31 March 2010 amount to £235 million, of which £192 million is in the period January to March 2010.
Covenant compliance risk	Pennon Group and South West Water have entered into covenants with lenders. Whilst terms vary, these typically provide for limits on gearing (primarily based on South West Water's Regulatory Capital Value and Viridor's EBITDA) and interest cover. Redemption penalties included in the facility documentation can be invoked if debt facilities are redeemed early. The redemption penalties vary in each facility. The financial covenants included in the Group's debt facilities are monitored on a regular basis. The financial covenants offered by the Group include a provision to re-test the covenants applying frozen GAAP accounting standards. This is to protect the Group from changes in accounting standards which may have a detrimental impact on the financial covenant testing methodology.
Counterparty risk	Surplus funds of the Group are usually placed in short-term fixed interest deposits or the overnight money markets.

	Counterparty risk arises from the investment of surplus funds and from the use of derivative instruments. The Board has agreed a policy for managing such risk, which is controlled through credit limits, counterparty approvals, and rigorous monitoring procedures. All deposits are with counterparties which have a credit rating approved by the Board (A1 Moody's/ AA Standard & Poor's).
Interest rate risk	The Group's exposure to interest rate movements is managed by the use of interest rate derivatives. The Board's policy is that in any one year at least 50% of net debt is fixed. Interest rate swaps are used to manage the mix of fixed and floating rates. The Group has fixed approximately 60% of existing net debt up to 31 March 2010. At 31 March 2009 the Group had interest rate swaps to convert floating rate liabilities to fixed rate, and hedge financial liabilities, with a notional value of £760 million and a weighted average maturity of 2.4 years (2008 £634 million, with 2.1 years). The weighted average interest rate of the swaps for their nominal amount was 4.5% (2008 4.8%). The notional principal amounts of the interest rate swaps are used to determine settlement under those swaps and are not therefore an exposure for the Group. These instruments are analysed in more detail in note 22 to the financial statements. In addition South West Water has index-linked approximately 25% of its current net debt up to 2041 – 2057. South West Water's total index-linked debt of £353 million has an average real interest rate of 1.66%. The interest rate for index-linked debt is based upon an RPI measure which is also used in determining the tariff increase for South West Water customers.
<u>Pensions</u>	
The future costs of defined benefit schemes are subject to a number of risks including:	The Group operates defined benefit schemes for certain existing staff. These schemes closed to new entrants on or before 1 April 2008. New employees have been offered defined contribution arrangements.
• the returns achieved on pension fund investments	Pension trustees keep investment policy under review and use professional

	investment advisers.
• movements in interest rates and inflation	The pension trustees review the investment strategy to improve the match of investments and liabilities. Employee and employer contributions are also kept under review and have been increased. Further employer contributions of £39 million were made in the year.
• pensioner longevity	Independent actuaries have identified scheme-specific mortality experience which is reflected in liabilities.

<u>South West Water</u>

Risk	Commentary and mitigation
Tighter price controls over the revenue of the company's regulated business	South West Water has met Ofwat's efficiency expectations in the last two Periodic Review periods and is on track to meet them in the current period.
Failure to deliver the capital investment programme	The company has a track record of delivering its capital programme in accordance with regulatory requirements. The current capital programme is on track and progress is regularly monitored and reviewed.
The company may be unable to raise sufficient funds to finance its functions	Pennon Group and the company have 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. Treasury policies and risk management are described in more detail on pages 30 to 33.
Failure to deliver operating cost savings implicit in the regulatory review	In line with its track record, the company remains confident of delivering the assumed operating cost savings. A major restructuring programme is currently being implemented.
Environmental regulations and quality standards could increase the company's costs	These issues are addressed through the five year regulatory review mechanism.
Climate change	The company has plans ready and will adapt the way it conducts its business to respond effectively to the hotter, drier summers and wetter winters that are anticipated.
Contamination of water supplies	The company has established procedures and controls in place, as well as contingency plans and incident management procedures. It also maintains insurance policies in relation to these risks, although there can be no assurance that all or any of the costs associated with these risks would be covered or that coverage will continue to be available in the future.
Non-recovery of customer debt	In addition to existing strategies, South

	West Water has implemented new initiatives to improve and secure cash collection, including the use of property charging orders. Stretching debt and collection targets – with incentives – have been agreed with the customer service contractor. The accounts of major customers are kept under close review. Provision was made in the last Periodic Review for companies to make an application for an Interim Determination of K in the event of bad debts being significantly above the amount allowed for by the water regulator.
Energy cost volatility	South West Water mitigates rising energy costs through careful system operation, by maximising renewable energy generation and by purchasing all forms of energy in the most efficient way.
Pension costs may increase due to factors outside the company's control	All defined benefit schemes have been closed to new entrants and replaced by defined contribution arrangements.
Poor investment performance may affect the defined benefit pension scheme assets and increase the pension scheme deficit	Employee and employer contributions are kept under review and have been increased. Further employer contributions of £28.8million were made in the year. Pension trustees keep investment policy under review and use professional investment advisers.
Water resource adequacy	The company has a number of schemes in place to maintain water resources (such as pumped storage for certain reservoirs) and promotes conservation measures. In particular, South West Water prepares a new Water Resources Plan every five years and reviews it annually for a range of climate change and demand scenarios. The draft Water Resource Plan indicates that no new reservoirs are required before the planning horizon of 2035. However, investment is needed to develop the overall trunk main infrastructure, to expand treatment capacity and to enhance certain pumped storage facilities.
Operational failures	The company is able to monitor its significant assets by automated and remote operation and has routine controls and operating procedures in place that are constantly kept under review. Asset management techniques are employed to pre-empt the failure of assets.
Reduced revenue from falling customer demand for water	The reduced demand experienced in the current five-year regulatory period will be taken into account by the regulator in setting a baseline turnover level for the next period. The water regulator is

	proposing a form of revenue cap regulation from 2010, which would allow water companies to recover a shortfall in income for a five-year regulatory period in the next period.
Meter option take-up greater than forecast, resulting in reduced revenues	An Interim Determination of K may be used to fully or partially recover revenue losses if they exceed the prescribed materiality threshold.
Financial loss arising from the insolvency of a major supplier or contractor	The company does not have material exposure to making payments before receipt of goods and services. The company uses a third party credit monitoring service for changes to suppliers' financial status and creditworthiness to supplement an annual risk review of key and strategic suppliers.
Impact of competition in the industry	South West Water is assessing the implications of the Cave Report published in April 2009 in order to prepare for an extension of competition for non-household customers in the water industry. Legislation will be required for any further extension of competition in the water and sewerage services markets.

<u>Viridor</u>

Risk	Commentary and mitigation
<u>Risks associated with current UK and world economic conditions</u>	Current UK and world economic conditions are highly uncertain. Though less affected than many companies, Viridor is by no means immune to general economic conditions. A full assessment of the key risks to Viridor's business arising from current economic uncertainties has been conducted, including the following:
Landfill volumes may decline due to contraction in economy	The majority of inputs are from long-term local authority contracts or Viridor's own collection fleet. This risk is most pertinent to the 40% of Viridor's volumes which are not either domestic landfill or landfill collected by Viridor's own fleet. These volumes have remained steady to date.
Landfill prices	To date, landfill prices in general have proved robust. In a prolonged recession such prices may be impacted by increased price competition.
Recyclate prices	Recyclate prices are, like any commodity, volatile and are directly impacted by world economic conditions. The effect is most significant on the 35% of Viridor's recycling volumes of internationally traded commodities such as paper, card, plastics and metals.

Collection volumes (particularly industrial customers) are subject to economic conditions	Currently margins are holding up, helped by lower fuel prices. Aggressive price competition has been avoided to date.
Bad debt collection more challenging in an economic downturn	Viridor's record of bad debts has been, and remains, good based on tight management controls and the ability to put customers 'on stop' and, for example, refusing to accept waste at its landfills if debts are not being paid.
Increases in landfill costs may not be recovered through price increases	The raising of environmental standards is leading to a gradual increase in landfill costs in general, including engineering (results in increased depreciation) and restoration and aftercare costs. Viridor, with landfills engineered to modern standards with good environmental control systems, should incur lower than average increases in costs.
Aftercare costs levels	Costs which are assessed over 30 years are best estimates based on Viridor's own experience and are updated at each stage of the capital expenditure programme.
Estimated compaction rates (tonnes per cubic metre)	These are best estimates, based on current information, which are reviewed every year based on actual compaction rates assessed by external consultants.
Recovery of costs of legislative change	Municipal contracts typically last for up to seven years. They usually have provision for price increases under set formulae related to inflation and some include legislative or technical changes. Prices for other types of waste depend more on local markets and competitive conditions. Prices, as a long-term trend, have risen fast enough at least to cover cost increases.
The UK Government's Waste Strategy, stemming from the Landfill Directive, will lead to a reduction in volumes of waste being disposed to landfill	Government initiatives are having an impact and the amount of municipal waste being disposed of to landfill is declining. Assuming Landfill Directive targets are met, the total amount of municipal solid waste which will be landfilled from 2020 will be five to 10 million tonnes per annum. If there is no change in other waste streams, this would still leave a substantial total landfill market in 2020. Scarcity of landfill will ensure available voidspace remains a valuable asset. Generally, Viridor has seen its underlying landfill volumes holding steady, with a small increase in 2007/08, probably reflecting a greater share of the landfill market.
Not all landfills may meet the standards of the Integrated Pollution Prevention and Control Directive and the Landfill Directive and/or requirements may be imposed	Any existing landfills that fail to obtain an Environmental Permit would need to be subject to a closure plan with the EA or SEPA. All but one of Viridor's operational

which would impact adversely on the economics of landfill	landfills have achieved PPC permits, though in some cases Viridor is appealing against certain of the conditions proposed, which might have cost or other implications for the landfills. The operational landfill which had not yet received a PPC permit closed in May 2009 as planned.
Residual contamination	Viridor's landfill aftercare management includes restoration, maintenance, supervision, monitoring and management of gas and leachate levels after the landfilling activities have ceased. The EA or SEPA will only grant a full or partial permit surrender of the permit once it is satisfied that the landfill no longer poses any environmental risk.
Pricing and other risks relating to renewable energy:	
Fluctuating 'brown energy' prices	Viridor's 'brown energy' prices have been fixed through to the end of March 2010. Brown energy prices will continue to be determined by the world and UK energy market and may go down as well as up.
Impact of oil prices	Viridor's power generation business may be positively affected by increases in oil prices, other parts of the business (in particular collection) may be adversely affected.
Changes in ROC pricing mechanism	The Government has made a strong commitment to renewables which are key to meeting the long-term carbon reduction strategy set out in the energy white paper and the UK's targets for carbon dioxide reductions under the Kyoto Protocol. To date, the Government has stressed its commitment to 'grandfather' rights under current ROC schemes, which are not subject to retrospective changes. Renewables are also important in minimising the UK's increasing reliance on imported energy.
UK renewable energy generating capacity & licensed electricity suppliers	The value of ROCs is increased by the sharing of the buy-out price monies among holders of ROCs. The value of a ROC depends on the supply of renewable electricity relative to the UK's annual increasing targets. It is also dependent on the financial strength of those suppliers who opt to pay the buy-out price. The insolvency of a licensed electricity supplier could lead to a drop in the value of the ROCs which Viridor sells.
Volume of gas generated	Current and future waste composition (including BMW diversion due to Landfill Directive and calorific value) is assessed against costs on each landfill gas project.

<u>Lakeside Energy from Waste (EfW) construction and technical risks</u>	The plant is a modern conventional waste to energy facility. As a result of a competitive procurement procedure it is being supplied by the Japanese consortium Itochu/Takuma on a fixed price basis. 86% of the project is funded by non-recourse bank debt which also limits the risk to the Group. The remainder is funded by the joint venture, of which Viridor has 50% of the equity.
Mix of waste throughput	Efficiencies and output of the plant will be affected by the precise calorific value of the waste throughput. The plant is well proven and it is a robust conventional technology designed to take the currently projected waste mix.
<u>The current planning regime may restrict the availability of future waste treatment facilities</u>	Achievement of the Government's targets for waste management is critically dependent on the planning system delivering sufficient waste treatment facilities. Viridor employs best practice throughout the planning process.
<u>Risks associated with long-term integrated contracts (risk transfer is a key part of Government PFI procurement guidelines)</u>	Risks include waste volumes and mix, planning, technology, input costs and recyclate prices. A careful assessment of the risks and apportionment of them between client, main contractor, technology and equipment suppliers, and sub-contractors is a key part of the process of bidding and finalising a contract. Extensive due diligence conducted so that risks are correctly identified. Viridor will then seek to protect itself through contractual documentation with its client, sub-contractors and sub-suppliers. Viridor takes a robust approach on this issue. If it cannot mitigate the risks satisfactorily or cannot get a reasonable commercial return for taking such risks, its policy is to accept the loss of such a contract rather than win it on unsatisfactory terms.
<u>Recyclate Price Risks</u>	Recyclate prices are driven by global supply/demand trends among manufacturing reprocessors who wish to use the recyclate and national and European legislation setting targets for landfill diversion, recovery and use based on 'polluter pays' principles. Reprocessing capacity in the UK is finite with limited growth forecast, whilst increasing amounts of recyclate are being sought by, and exported to, the rapidly expanding major

	manufacturing locations in China and elsewhere.
World economic conditions impact	As with any commodity, recyclate prices are very sensitive to world economic conditions. Prices in the first half of 2008/09 were well above historical trends for recyclate prices but, in the second half of 2008/09, have fallen significantly below historical trend levels for recyclate prices.
Currency impact (Non-European export prices and freight costs for recyclate are set in US dollars)	Costs are expected to vary with world and regional economic cycles and with the environmental impact and increasing cost of sourcing and processing raw materials. Costs also expected to adjust over time for movements in the value of the US dollar. Viridor may mitigate any recyclate price risk by sharing downsides/upsides with both its clients and customers. Viridor Resource Management is implementing a long-term national and international materials marketing and sales strategy through volatile market conditions.

Directors' Responsibilities Statement

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 (IFRS) as adopted by the European Union. The financial statements are required by law to give a true and fair view of the state of affairs of the Group and the Company and of their profits and cash flows 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 estimates which are reasonable and prudent

• state that the financial statements comply with IFRS as adopted by the European Union.

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

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and the Company and to enable them to ensure that the financial statements and the Directors' remuneration report comply with the Companies Act 1985 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.

1 July 2009

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End transmission