PENNON GROUP PLC

25 May 2016

Full Year Results 2015/16
for the year ended 31 March 2016

Delivering for Customers and Shareholders

Chris Loughlin, Pennon Group Chief Executive said:

"2015/16 has been a transformative year for Pennon. The Group has delivered a strong performance, notwithstanding the financial impact of our commitment to keep South West Water customer bills below inflation to 2020. We have seen significant earnings growth driven by the build-out of Energy Recovery Facilities across the UK. Bournemouth Water has now been integrated into South West Water and the combined water business is outperforming its regulatory contract. This strong performance across the Group underpins our sector-leading dividend policy of 4% growth per annum above RPI inflation to 2020."

Financial Highlights

- 2015/16 results in-line with management expectations
- Profit Before Tax consistent with 2014/15 following South West Water revenue reset, but reflecting +44.9% growth in Energy Recovery Facilities (ERFs) EBITDA
- Return on Regulated Equity at 11.7%, unique WaterShare mechanism benefiting customers
- Sustainable, low cost funding position underpinning capital investment
- Dividend per share +5.6% to 33.58p

Underlying[1]	**2015/16**	**2014/15**	**Change**
Group Revenue	£1,352.3m	£1,357.2m	(0.4%)
Group EBITDA	£448.4m	£411.0m	+9.1%
Group Adjusted EBITDA [2]	£508.4m	£465.9m	+9.1%
Group Operating Profit	£261.8m	£246.6m	+6.2%
Group Profit Before Tax (PBT)	£211.3m	£210.7m	+0.3%
Earnings per share [3]	39.5p	39.8p	(0.8%)
Dividend per share	33.58p	31.80p	+5.6%
Underlying PBT to Statutory Profit After Tax (PAT)			
Non-underlying Items (Profit Before Tax)	(£5.0m)	(£13.7m)	+63.5%
Tax	(£38.0m)	(£54.7m)	+30.5%
PAT (attributable to holders of hybrid capital)	(£16.2m)	(£16.0m)	(1.3%)
PAT (attributable to shareholders)	£152.1m	£126.3m	+20.4%

[1] Before non-underlying items

[2] Statutory EBITDA plus share of Joint Venture EBITDA and IFRIC 12 interest receivable (previously reported as "underlying EBITDA")

[3] Before deferred tax. Basic earnings per share (statutory basis) 37.0p

Operational Highlights

- Water business outperforming the regulatory contract, net ODI reward delivered for 2015/16
    - Well-prepared to take opportunities in a changing regulatory environment
- Eight operational ERFs, ramp-up progressing well at the 6 ERFs brought on-stream between 2014/15 and H2 2015/16
    - Construction of three further ERFs ongoing – Glasgow entering commissioning in H1 2016/17, Dunbar and South London (Beddington) progressing well
- A more homogeneous risk profile, c.80% of ERF portfolio volumes (and associated price) contracted long-term
- Recycling 'self-help' driving margin improvement
- Driving value through efficiency - integrating, sharing best practice, reducing costs
- Capital allocation - optimising Pennon's risk/reward profile

Presentation of Results

A presentation for City audiences will be held today, Wednesday 25 May 2016, at 10am at the London Stock Exchange, 10 Paternoster Square, London, EC4M 7LS.

A live videocast of the presentation can also be accessed using the following link:

www.pennon-group.co.uk/investor-information

For further information, please contact:

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About Pennon Group

As one of the largest environmental infrastructure groups in the UK, Pennon is at the top end of the FTSE 250. Pennon has assets of around £5.7 billion and a workforce of over 4,800 people.

South West Water provides water and wastewater services to a population of c.1.7 million in Cornwall, Devon and parts of Dorset and Somerset. South West Water was awarded enhanced status for its 2015-2020 Business Plan, and has the highest potential returns in the water sector.

Bournemouth Water provides water services to a population of c.0.5 million in parts of Dorset, Hampshire and Wiltshire. Bournemouth Water was acquired in April 2015 and has been substantially integrated into South West Water.

Viridor is a leading UK energy recovery, recycling and waste management company, providing services to more than 150 local authorities and major corporate clients as well as over 32,000 customers across the UK.

Upcoming Events

1 July 2016	Annual General Meeting
6 September 2016	Trading Statement
25 November 2016	Half Year Results 2016/17
9 February 2017	Trading Statement
24 May 2017	Full Year Results 2016/17

Sector-leading dividend policy

Pennon's current dividend policy is 4% year-on-year growth above RPI inflation to 2020. This is underpinned by the highest potential Return on Regulated Equity in the water sector over K6 (2015-2020) and the growth in earnings being delivered by Viridor's ERFs.

For 2015/16, the Board has recommended a final dividend of 23.12p, up 6.0%, subject to shareholder approval at the Annual General Meeting on 1 July 2016. The final dividend will be paid on 2 September 2016 to shareholders on the register on 8 July 2016. Together with the interim dividend of 10.46p, this will result in a total dividend for the year of 33.58p, an increase of 5.6%(4).

The Company will also offer a scrip dividend alternative. The final date for the receipt of Forms of Election/Mandate in respect of the scrip dividend alternative for the final dividend will be 15 August 2016.

Dividend Payment Information*:

7 July 2016	Ex-dividend date
8 July 2016	Record date
15 August 2016	Scrip election date
2 September 2016	Payment date

* These dates are provisional and, in the case of the final dividend subject to obtaining shareholder approval at the 2016 Annual General Meeting.

[4] RPI as at 31 March 2016 was 1.6%

PENNON OUTLOOK

Focused on de-risking and delivering growth

Pennon is focused on UK environmental infrastructure across water and waste. The Group is moving towards a more homogeneous risk profile through long-term, predictable, asset-backed, index-linked revenues. Currently, two thirds of revenues are index-linked and long-term contracted. All eleven committed ERFs in the portfolio will be on-stream by H1 2018/19, driving earnings growth, while the Regulatory Capital Value (RCV) of the water business is expected to grow by 21%. This growth underpins Pennon's sector-leading dividend policy of 4% growth above RPI inflation to 2020.

Pennon will continue to seek and identify further growth opportunities within the UK, assessing the long-term viability of the market and achieving an appropriate risk/reward balance.

Strong water business

The combined water business is well-prepared to take opportunities in a changing regulatory environment, looking at options for future consolidation and growth while continuing to deliver and outperform the business plans.

A new single legally separate company, Pennon Water Services, has been created ahead of the non-household retail market opening, which will move into a period of shadow operation in October 2016 prior to formal opening in April 2017. This business will provide retail and water management services for c.85,000 non-household customers, who will be eligible for this new market. A key part of Pennon's non-household strategy is to capitalise on Viridor's national footprint, focusing on existing customer relationships and exploring the opportunities to provide value-added services.

South West Water is also fully engaged in Water 2020 as it prepares and positions itself for PR19. The company is in a very good position to anticipate and influence future regulatory reforms and is playing its part in shaping the future of the industry.

ERFs delivering growth

Eight out of the eleven committed ERFs are operational and this is expected to rise to nine in 2016/17. ERFs are on track to contribute c.£100m to EBITDA in 2016/17, despite removal of Levy Exemption Certificates and lower energy prices. The option to commit to an additional ERF at Avonmouth in Bristol remains and would take the total portfolio to twelve plants nationwide. Viridor continues to target new long and medium-term commercial and industrial recycling and recovery contracts.

Recycling 'self-help' measures to deliver margin improvement

Viridor remains cautious about future recyclate price growth, but is not relying on a near term price recovery and is instead driving forward self-help measures to deliver margin improvement. This focuses on reducing costs, simplifying the organisation, improving asset utilisation and rationalising the portfolio to improve returns. There is an increasing shift towards sharing commodity risk exposure with customers.

Driving value through efficiency

Pennon has a strong track record on delivering efficiency at South West Water. Pennon expects to deliver c.£27 million of net synergies by 2020 from the integration of South West Water and Bournemouth Water.

Pennon has further cost saving and synergy plans underway to deliver c.£11 million a year of enduring financial benefits by 2017/18. At South West Water, this equates to c.£2 million a year of additional Totex outperformance over and above existing plans. At Viridor this equates to c.£9 million a year. At Viridor, these savings will be driven by reorganisation, restructuring and streamlining overheads. Viridor is also centralising and optimising its sales force, logistics and fleet management.

As part of the evolution in Pennon's structure, a shared services review is underway, assessing where opportunities can be unlocked to create additional value through integrating back office functions, sharing skills and knowledge across Pennon's businesses and reducing costs.

PENNON FINANCIAL PERFORMANCE

Underlying performance in-line with Management Expectations

Group EBITDA and adjusted EBITDA were ahead of 2014/15 up 9.1% at £448.4 million (2014/15 £411.0 million) and £508.4 million (2014/15 £465.9 million) respectively. Underlying profit before tax was broadly in line at £211.3 million (2014/15 £210.7 million). This has been achieved against the backdrop of reduced allowed returns in our water business for the K6 regulatory period (net £13.5m[(5)] impact), mitigated by strong contributions from Viridor's growing portfolio of operational Energy Recovery Facilities and from Bournemouth Water following the acquisition.

Both our water businesses recorded strong performances against their new K6 regulatory contracts, outperforming regulatory assumptions. The water business's underlying profit before tax was marginally down by £2.2 million (1.3%) to £165.7 million (2014/15 £167.9 million) reflecting South West Water's revenue reset, largely offset by the additional earnings from Bournemouth

[5] Cost of capital reset £35.7m net of 2014/15 bill smoothing of £22.2m

Water (acquired in April 2015), good cost control and lower average borrowing rates. With the highest potential returns in the sector for K6, South West Water is outperforming its business plan, resulting in a return on regulated equity of 11.7%[(6)] for the water business.

At Viridor, the portfolio of operational ERFs continues to perform well, with the six most recently delivered ERFs ramping up as Viridor optimises each plant. Peterborough ERF became operational in December 2015, having been delivered on time and below budget, bringing the total number of operational ERFs to eight. As a result, Viridor's adjusted EBITDA increased 30.5% to £176.5 million (2014/15 £135.3 million), driven by the full year effect of its expanded fleet of ERFs. Viridor has three further ERFs under construction with Glasgow ERF expected to enter commissioning in H1 2016/17 and construction progressing well at Dunbar and Beddington (South London).

We have secured funding at a cost that is efficient and effective. The Group interest rate on average net debt reduced to 3.3% (2014/15 3.4%).

The Group's underlying UK corporation current tax charge was £32.9 million (2014/15 £39.2 million) after the release of a prior year credit of £1.4 million (2014/15 credit of £5.5 million).

The £1.4 million prior year credit is a net position (releases of provisions net of additional charges) reflecting our latest assessment of Pennon's uncertain tax positions yet to be agreed with HMRC. The uncertain tax positions relate to the deductibility of financial arrangements, relief for capital expenditure and the outcome of finalising our 2014/15 tax return, which has resulted in a lower tax charge than the original assessment.

Underlying deferred tax for the year was a charge of £39.2 million (2014/15 £18.2 million). The higher charge this year reflects higher ERF capital allowances. In addition there is a non-underlying £33.1 million deferred tax credit relating to the enacted reduction in the UK rate of corporation tax and a £1.0 million deferred tax credit relating to other non-underlying items.

This resulted in a total tax charge for the year of £38.0 million (2014/15 £54.7 million).

Earnings per share before deferred tax and non-underlying items was comparable with the prior year, down 0.8% to 39.5p (2014/15 39.8p). Overall, weighted average shares in issue increased by c.20 million to 410.9 million, reflecting the placing of c.12 million new shares. These were issued to replenish cash resources following the acquisition of Bournemouth Water and partly mitigated by ERF profit growth from Viridor ERFs and a first time contribution from Bournemouth Water.

Dividend per share increased by 5.6% on a sustainable basis to 33.58p.

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[6] RoRE reflects the Ofwat regulatory guidance of Base RoRE plus Outperformance. It is calculated using actual results before non-underlying items (deflated into 2012/13 prices) and compared against the Final Determination allowances sourced from Ofwat published models and based on notional gearing and annual average RCV.

Water business financial results reflect Bournemouth Water contribution

	2015/16	2014/15	Change
Revenue	**£547.0m**	**£522.2m**	**+4.7%**
South West Water	£505.1m	£522.2m	(3.3%)
Bournemouth Water	£41.9m	-	-
EBITDA[7]	**£335.2m**	**£331.3m**	**+1.2%**
South West Water	£317.8m	£331.3m	(4.1%)
Bournemouth Water	£17.4m	-	-
Operating Profit[7]	**£224.5m**	**£225.4m**	**(0.4%)**
South West Water	£215.0m	£225.4m	(4.6%)
Bournemouth Water	£9.5m	-	-
Profit Before Tax[7]	**£165.7m**	**£167.9m**	**(1.3%)**
South West Water	£159.7m	£167.9m	(4.9%)
Bournemouth Water	£6.0m	-	-
Non-underlying items before tax[8]	**(£5.2m)**	**£11.8m**	**(144.1%)**
Capital Expenditure	**£134.1m**	**£145.1m**	**(7.6%)**
South West Water	£126.3m	£145.1m	(13.0%)
Bournemouth Water	£7.8m	-	-

Viridor financial growth driven by ERFs

	2015/16	2014/15	Change
Revenue[9]	**£806.2m**	**£835.9m**	**(3.6%)**
EBITDA[7]	**£116.5m**	**£80.4m**	**+44.9%**
ERFs	£89.7m	£33.7m	+166.2%
Landfill	£6.3m	£15.4m	(59.1%)
Landfill Gas	£31.5m	£35.8m	(12.0%)
Recycling	£13.1m	£11.5m	+13.9%
Contracts, Collections & Other	£36.5m	£37.5m	(2.7%)
Indirect Costs	(£60.6m)	(£53.5m)	+13.3%
Share of JV EBITDA	£43.3m	£41.4m	+4.6%
IFRIC 12 Interest Receivable	£16.7m	£13.5m	+23.7%
Adjusted EBITDA[7][10]	**£176.5m**	**£135.3m**	**+30.5%**
Profit Before Tax[7]	**£30.7m**	**£27.7m**	**+10.8%**
Non-underlying items before tax[11]	**(£5.0m)**	**(£26.7m)**	**+81.3%**
Capital Investment[12]	**£182.8m**	**£262.2m**	**(30.3%)**

[7] Before non-underlying items
[8] £5.2m restructuring charge in 2015/16
[9] Including landfill tax and construction spend on service concession arrangements
[10] Statutory EBITDA plus share of Joint Venture EBITDA and IFRIC 12 interest receivable (previously reported as "underlying EBITDA"
[11] £5.0m restructuring charge in 2015/16
[12] Including construction spend on service concession arrangements

Revenue comparable with prior year

Group revenue was broadly in line with last year at £1,352.3 million. Revenue from the water business was up by 4.7% to £547.0 million as a result of the Bournemouth Water acquisition, offset by the revenue reset and the reduction in revenue as a result of customers switching from unmeasured to metered charges net of new customers connecting to the network. Viridor's revenue decreased by 3.6% to £806.2 million due to the expected decrease in construction spend on service concession arrangements as plants come on stream and lower landfill volumes, partly offset by the full-year contribution of operational ERFs.

EBITDA[(13)] increased through growth

Group adjusted EBITDA, which consists of EBITDA of £448.4 million, IFRIC 12 interest receivable of £16.7 million and our share of joint venture EBITDA of £43.3 million, increased by 9.1% to £508.4 million (2014/15 £465.9 million), with the water businesses up by 1.2% to £335.2 million (2014/15 £331.3 million) and Viridor up by 30.5% to £176.5 million (2014/15 £135.3 million).

Our water business EBITDA was boosted by the acquisition of Bournemouth Water which contributed £17.4 million, offsetting the reduction in South West Water's allowed returns. While average RPI rose 1.1%, both South West Water's and Bournemouth Water's operating costs in 2015/16 fell compared to the previous year, with significant savings in operational maintenance, as well as targeted efficiencies contributing to cost performance. In addition, South West Water's bad debt charges also fell to 1.5% as a percentage of revenues from 1.7% in 2014/15, and Bournemouth Water's bad debt charges fell to 0.4% from 0.8% in 2014/15. This was driven by strong collections as we work with our customers to manage their debt. Total operating costs for the water business were £211.8m for the year (£322.5m including depreciation), comprising £187.3m from South West Water and £24.5m from Bournemouth Water. This compares with South West Water costs in 2014/15 of £190.9m (£296.8 million including depreciation).

Viridor's EBITDA was ahead of last year predominantly due to the full year impact of operational ERFs, net of anticipated declines in landfill volumes. Our ERF activities delivered EBITDA of £89.7 million (2014/15 £33.7 million), a significant increase compared to 2014/15. We remain on track to deliver our target of c.£100 million of EBITDA from ERFs by 2016/17 (before IFRIC 12 interest receivable and our share of joint venture EBITDA). Joint venture EBITDA increased to £43.3 million (2014/15 £41.4 million) due to continuing strong EBITDA from Lakeside and higher EBITDA from Runcorn I reflecting a full year of operations, despite the Lakeside maintenance shutdown taking place as planned this year. This resulted in a share of Joint Venture profit after tax of £3.6 million (2014/15 £4.9 million).

[13] Before non-underlying items

Recycling and resources EBITDA, comprising recycling, collection and contracts and other[14], was broadly in line with last year at £49.6 million (2014/15 £49.0 million), despite lower recyclate prices and therefore lower average revenues at £85 per tonne (recyclate sales plus gate fees) (2014/15 £86 per tonne). Average costs fell by £2 per tonne to £77 per tonne (2014/15 £79 per tonne) as a result of self-help measures including the Input, Throughput and Output Optimisation (ITOO) programme, and therefore the recycling EBITDA margin increased by £1 per tonne to £8 per tonne (2014/15 £7 per tonne). Although the short term outlook for recyclate prices is relatively stable, we remain cautious about future recyclate price growth and are not relying on a near term recovery. We are instead focusing on 'self-help' measures to drive margin improvement.

Landfill gas power generation EBITDA of £31.5 million (2014/15 £35.8 million) was impacted by the removal of Levy Exemption Certificates (LECs) and lower volumes. As expected landfill EBITDA was down to £6.3 million (2014/15 £15.4 million) due to the continuing planned wind-down and aftercare programme.

Through the Group's portfolio management approach to energy hedging, c.90% of energy (generation net of internal usage of electricity) is hedged into 2016/17 and over 50% is hedged out to 2019/20.

Underlying Profit Before Tax in-line with prior year

Underlying profit before tax was £211.3 million, an increase of 0.3%, comparable with prior year (2014/15 £210.7 million). On a statutory basis, profit before tax was £206.3 million (2014/15 £197.0 million) reflecting non-underlying items of £5.0 million.

Non-underlying Items

Net non-underlying items totalling a charge before tax of £5.0 million have been recognised. The net charge includes a £10.2 million charge for restructuring provisions and a £5.2 million credit relating to the non-cash fair value movement on our long-dated derivatives, with the commercial hedged position unchanged. In addition there is a £33.1 million deferred tax credit relating to the enacted reduction in the UK rate of corporation tax and a £1.0 million deferred tax credit relating to non-underlying items noted above.

During the year the Group reviewed the allocation of Viridor's long-lived assets to cash generating units (CGUs) to ensure they remained consistent with Viridor's operations and the waste market it serves. This review concluded the need for updated allocations with assets now considered part of integrated regional CGUs, which resulted in a £60.9 million impairment of non-strategic landfill

[14] Includes £2.4m operating profit on disposal of Whitehead landfill site

sites and a £60.9 million reversal of previous impairments, with the net result of our review having no impact on the income statement.

The non-underlying items total a credit of £29.1 million net of tax.

Strong funding position underpinning capital investment

The Group has a strong liquidity and funding position with £1,707 million cash and facilities at 31 March 2016. This includes cash and deposits of £632 million (including £227 million of restricted funds representing deposits with lessors against lease obligations) and undrawn facilities of £1,075 million. A total of £470 million in new or renewed debt facilities was arranged during the year, being:

- £130 million new European Investment Bank facility
- £100 million new 20-year facility with deferred drawdown
- £100 million of new finance leases in South West Water
- £140 million of term loans and revolving credit facilities.

At 31 March 2016 the Group's loans and finance lease obligations totalled £3,116 million.

Net debt position

The Group's net debt has increased by £287 million to £2,484 million, with the increase reflecting capital investment and the net debt assumed in the acquisition of Bournemouth Water. The Group's gearing ratio at 31 March 2016, being the ratio of net debt to (equity plus net debt), was 62.5% (2015 61.9%).

South West Water's RCV, plus Bournemouth Water's RCV of £152.9m, rose 7.6% to £3,150 million at 31 March 2016. This resulted in a combined debt to RCV ratio of 59.7% (2015 62.1%[(15)]), of which South West Water was 59.8% and Bournemouth Water was 56.7% which compares to Ofwat's K6 target for efficient gearing of 62.5%.

Group net debt includes £971 million of funding for wholly-owned ERFs (Runcorn II, Oxford, Exeter, Cardiff, Glasgow, Dunbar and South London) and £81 million of funding for investments in joint ventures through shareholder loans (which together represents 40% of Group net debt). In addition the joint ventures have non-recourse net debt from third parties (excluding shareholder loans) of which Pennon's share is £215 million. Therefore, 83% of ERF and joint venture funding is from corporate finance.

[15] This relates to South West Water only, Bournemouth Water was acquired in April 2015

Strong cash inflow from operations, reflecting continuing investment

The Group had operational cash inflows in 2015/16 of £418 million (2014/15 £412m). These funds have been put to use in efficiently financing the Group's capital structure and investing in future growth, through our substantial continuing capital investment programme. This investment together with non-cash movements, associated with assuming the fair value of Bournemouth Water's debt, has resulted in higher Group net debt. In April 2015, Pennon acquired Bournemouth Water for a cash consideration of £100.3 million. An equity placing was undertaken to replenish the Group's cash resources in respect of the acquisition and ensure funding flexibility.

In addition, during the year the Company continued to benefit from offering a scrip dividend alternative. £6.3 million of potential cash dividend was retained in the business (2015 £48.0 million) and resulted in issuing 760,626 shares.

Efficient long-term financing strategy

The Group has a diversified funding mix of fixed, floating and index-linked borrowings. The Group's debt has a maturity of up to 41 years with a weighted average maturity of 22 years matching the asset base. Much of the Group's debt is floating rate and derivatives are used to fix the rate on that debt. The Group has fixed, or put swaps in place to fix, the interest rate on a substantial portion of the existing water business debt for the entire K6 period.

£395.7 million of South West Water's debt is index-linked at an overall real rate of 1.7%. As a result of the aforementioned initiatives, South West Water's cost of finance is among the lowest in the industry. Two thirds of the water business debt is finance leases giving us a long maturity profile. Interest payable benefits from the fixed credit margins were secured at the inception of each lease. Bournemouth Water's RPI index-linked Artesian financing structure assumed on acquisition has been de-securitised and transferred to South West Water. Including Bournemouth Water's net debt, a quarter of the gross funding for the water business is RPI-linked.

The Group's interest rate on average net debt for the year to 31 March 2016 is 3.3% (after adjusting for capitalised interest of £9.4 million, notional interest items totalling £5.5 million and interest received from shareholder loans to joint ventures of £10.7 million). For South West Water this figure was 3.1%.

At 31 March 2016 the fair value of the Group's non-current borrowings was £114 million less than its book value (2015 £74 million). This reflects the benefit of securing interest rates below the current market rate.

Net finance costs of £54.1 million were £13.3 million higher than last year, reflecting a £13.1 million decrease in capitalised interest following a number of ERFs becoming operational towards the end of 2014/15, together with higher borrowings associated with the ongoing ERF capital expenditure programme, partly offset by lower average borrowing rates and £3.2 million higher IFRIC 12 interest receivable.

Interest receivable (before non-underlying items, IFRIC 12 interest receivable and interest receivable from joint ventures) of £14.7 million (2014/15 £19.1 million) has been achieved from the objective of enhancing returns on the Group's substantial pre-funding of £632 million.

During the year underlying net finance costs (excluding pensions net interest, discount unwind on provisions and IFRIC 12 contract interest receivable) were £59.6 million (2014/15 £41.1 million), covered 4.4 times (2014/15 6.0 times) by Group operating profit.

Capital expenditure focused on regulatory expenditure and ERF build out

Group capital investment was £316.9 million in 2015/16 compared to £407.3 million in 2014/15.

South West Water and Bournemouth Water capital expenditure was £134.1 million compared to £145.1 million for South West Water in 2014/15. The beginning of the new regulatory period reflects a change in the nature and extent of capital activity. South West Water has also delivered efficiency savings through innovative planning and scoping of schemes, and maximising benefits during construction and through the supply chain. For example, South West Water has used advanced hydrological modelling to understand how its assets impact on the region's bathing water quality. Through this it has been established that changes in the network will reduce the volume of storm water storage required, significantly reducing the cost to deliver the planned improvements.

South West Water's spending has focused on preparations for the innovative Mayflower water treatment works at North Plymouth, schemes to improve water quality and investment in digital infrastructure. Bournemouth Water has focused on continued pressure management and commissioning two ultraviolet treatment plants at Beaulieu and Knapp Mill. Both South West Water and Bournemouth Water have made a good start to delivering their K6 capital programme.

Viridor's capital investment was £182.8 million compared to £262.2 million in 2014/15, predominantly driven by expenditure on ERFs. This reduction reflected reduced capital expenditure on ERFs as eight of the eleven plants in the portfolio are now on-stream and reduced capital investment in recycling as 2014/15 included expenditure on the Scottish Newhouse glass recycling facility in North Lanarkshire, which came on-stream during 2015/16. Before capitalised interest, cumulative ERF expenditure to date is £910 million, excluding the £72 million spent on Peterborough ERF, which was local authority financed. This leaves c.£295 million left to invest in the ERF programme; c.£185 million in 2016/17, c.£100 million in 2017/18 and c.£10 million in

2018/19. So far, Viridor has realised £22 million of efficiencies across the ERF capital investment programme.

Pensions

The Group operates defined benefit pension schemes for certain employees of Pennon Group. The main schemes were closed to new entrants on or before 1 April 2008.

At 31 March 2016 the Group's pension schemes showed an aggregate deficit (before deferred tax) of £40.9 million (2014/15 £59.6 million). The decrease primarily reflects an acceleration of deficit recovery payments totalling £22.6 million and the addition of the Bournemouth Water's defined benefit scheme, which is in surplus, offsetting adverse movements in asset market conditions and continuing low bond rates used in the discounting of the schemes' liabilities.

Net liabilities of £33 million (after deferred tax) represented around 1% of the Group's market capitalisation at 31 March 2016.

The last actuarial valuation of the main scheme was as at 31 March 2013. The 31 March 2016 valuation is underway.

OPERATIONAL PERFORMANCE

Pennon – evolving for the future

Board structures streamlined

During the year, the Board structures were reviewed and the Chairman and Non-Executive Directors identified opportunities to streamline the Group's governance framework and decision-making processes. Changes were implemented in agreement with Ofwat in respect of South West Water and Bournemouth Water governance arrangements. This has involved simplifying the subsidiary board structure to achieve more efficient governance whilst preserving the regulatory ring fence around the water and wastewater business.

Driving synergies and sharing best practice

Pennon is focused on driving greater synergies and savings across the Group, sharing best practice and ensuring it is well placed to capitalise on emerging opportunities. Both Viridor and South West Water have a breadth and depth of experience in managing large asset bases and in using engineering excellence, technology and innovation to deliver efficiency and effectiveness. By sharing knowledge across the Group and harnessing our combined skills we can provide even better services to our extensive customer base of local authorities, major corporate clients and household customers.

Furthermore, as part of the evolution in Pennon's structure, a shared services review is underway, assessing where we can unlock opportunities to create additional value through integrating back office functions, working more closely together to share best practice and reducing costs.

Pennon Water Services leveraging Viridor expertise

Preparations are being made to maximise the opportunities presented by the opening of the non-household retail market in 2017 while continuing to improve the services provided to our business and commercial customers.

A separate legal entity has been created, Pennon Water Services, which operates from Bournemouth. This company will provide retail and water management services to our c.85,000 non-household customers, who will be eligible for the water retail market in 2017, through our existing brands – South West Water Business Services, Source for Business, Avon Valley Water, Bournemouth Water Business Services and Aquacare.

A key part of our non-household strategy will be to capitalise on Viridor's national footprint, focusing on existing customer relationships and exploring the opportunities to provide value-added services.

Pennon "Portfolio Management" strategy in place

We have developed a portfolio management strategy to help realise the full potential of this growth, with a team of experienced energy market professionals to actively manage our market position. We have also implemented framework contracts to enable us to 'hedge out' market risk where appropriate in the longer term. Through the Group's portfolio management approach to energy hedging, Pennon now has the ability to hedge its market position for periods up to five years ahead, further helping to protect revenues.

c.90% of energy (generation net of internal usage of electricity) is hedged into 2016/17 and over 50% is hedged out to 2019/20. Pennon's hedging was largely completed in Q4 2015, with further trading in early Q2 2016. In addition, the Group has a natural hedging opportunity which represents one third of Viridor's energy generation, as South West Water is a net user of electricity.

Strong performance in Water

Key Performance Indicators	2015/16	2014/15
Drinking Water Quality[16]		
South West Water	99.97%	99.96%
Bournemouth Water	100.00%	-
Customer Service[17]		
South West Water	78.6	74.8
Bournemouth Water	86.2	-
Bathing Water Compliance[18]		
South West Water	97.2%	99.3%

We are focused on providing water and wastewater services in the most efficient and sustainable way possible. Innovation, new technologies, and the pioneering of a holistic approach to water and wastewater management are playing a key role in delivering service improvements and long-term value.

Outperforming our Final Determination Return on Regulated Equity (RoRE) range

South West Water has the highest potential rewards in the sector for K6. At 31 March 2016 the combined water business (South West Water and Bournemouth Water) has delivered an 11.7% Return on Regulated Equity (RoRE)[19] arising from base, financing and operational returns. Of the 11.7%, 6.0% is the base return, 3.0%[20] reflects the difference between actual and assumed financing costs, 2.5% reflects Totex savings and efficiencies, and 0.2% reflects Outcome Delivery Incentives (ODIs).

Totex strategy - securing outperformance

South West Water is striving for ever greater efficiency in K6, building on a strong track record from K5. The company was deemed to be at the frontier of cost efficiency when it was awarded an enhanced Business Plan assessment with the largest element of potential operational outperformance over K6 coming from Totex savings and efficiencies. Bournemouth Water is one of the top performing water only companies and was deemed to be mid-table for efficiency. The combined water business is 'front-end-loading' efficiencies and savings to allow early and more

[16] As measured by mean zonal compliance, the recognised industry measure for overall drinking water quality

[17] As measured by the industry-wide Service Incentive Mechanism (SIM)

[18] New standards introduced in 2015 under the EU's revised Bathing Water Directive. The classifications are 'poor quality', 'sufficient quality' (the new minimum standard), 'good quality' and 'excellent quality' (the new guideline standard). Prior years not restated.

[19] RoRE reflects the Ofwat regulatory guidance of Base RoRE plus Outperformance. It is calculated using actual results before non-underlying items (deflated into 2012/13 prices) and compared against the Final Determination allowances sourced from Ofwat published models and based on notional gearing and annual average RCV.

[20] Interest outperformance is based on the outturn effective interest rate (aligned with Regulatory Accounting Guidelines and adjusted for one-off credits) using the expected K6 RPI of 2.8%, aligned with the 2014 Final Determination cost of capital assumptions, notional debt gearing of 62.5%, and a notional tax impact of 20%.

certain delivery of outperformance. £56 million of Totex savings[(21)] have been delivered in 2015/16, despite costs of delivering growth. These Totex savings reflect changes in the timing of delivery from those planned in each of the determinations.

This outperformance reflects base Totex efficiencies of c.13.8% per annum with further initiatives of c.0.4% per annum (c.£2 million per annum)[(22)] being targeted.

Delivering net ODI reward for 2015/16

South West Water has 23 ODIs, including SIM, which have potential financial rewards or penalties. Incentives for performance are recognised in the year of delivery, whether the measure is recovered in period or as a regulatory true-up at the end of the period. Operational performance for the year has resulted in an ODI reward. The water business had good asset reliability with stable serviceability across all areas. Rewards were secured across bathing water quality, odour complaints and water restrictions. Improved performance is being targeted in areas where penalties were received such as pollutions and interruptions to supply. Bournemouth Water has 10 ODIs, including SIM, which have financial rewards and penalties. Rewards were achieved in leakage and reducing large scale interruptions. Combined ODI rewards result in a £2.1 million benefit and reflects RoRE outperformance of 0.2%.

Watershare sharing efficiency benefits with customers

South West Water has in place a unique WaterShare framework as part of which performance against the business plan is reported to both shareholders and customers.

For 2015/16, WaterShare has realised £25.5 million for shareholders and £21.0 million for customers in respect of Totex efficiencies, with an additional £1.8 million of shareholder value created from ODI performance with enhanced services delivered for customers.

A further £3.1 million of benefits were realised for customers from other items including market movements on new financing net of the costs resulting from new legislation.

Following discussions with our independent WaterShare customer panel it has been decided that these benefits will be reinvested to improve services. The value of benefits to be reinvested equates to a 0.3% RoRE.

[21] £53m from South West Water, £3m from Bournemouth Water including integration synergies already delivered. Phasing of actual expenditure compared to the planned programme has been reflected. Outperformance includes a reduction in the RCV run-off for the RCV element of Totex outperformance calculated based on the Final Determination PAYG. Tax impacts reflect actual effective tax rates.

[22] Exceptional Group restructuring costs of c.£10m recognised in 2015/16 to implement changes, with a two year payback

Drinking Water Quality expected to be in upper quartile

South West Water continued to deliver high quality drinking water in 2015, achieving 99.97%[23], a slight improvement on the previous year. Bournemouth Water achieved a perfect score for drinking water quality, with 100% of compliance tests[24] carried out meeting the required standard. The Drinking Water Inspectorate's (DWI) report will be published in July 2016, with South West Water expected to be in the top quartile, and Bournemouth Water expected to be top of the table.

There was a 14% reduction in South West Water customer contacts regarding taste, odour or discolouration issues. The number of Bournemouth Water customer contacts regarding taste, odour or discolouration issues was well within the target threshold and less than 1% of customers experienced an interruption to their water supply lasting three hours or more.

Leakage was kept within target levels and has been every year since privatisation. There was a further substantial reduction in the amount of water lost through leaks and bursts at Bournemouth Water. Water resources were unrestricted for a nineteenth consecutive year at South West Water, and Bournemouth Water has not had a water restriction since privatisation.

The average duration of supply interruptions per property for South West Water regrettably was up by 2 minutes to 25 minutes in 2015/16. This was largely due to two large trunk main bursts affecting customers' supplies; at St Blazey in Cornwall in October 2015 and in Plymouth in December 2015. In each case we took immediate steps to restore supplies as quickly as possible and keep customers informed.

We have further developed our strategies to prevent and mitigate the impact of such occurrences in future. These are being supported by the use of innovative techniques for network pressure management and monitoring, together with investment in advanced repair technologies.

Significant Investment in Drinking Water

Recognising that customers regard a clean and safe supply of drinking water as their top service priority, key areas of investment and activity during 2015/16 included:

South West Water:

- Development expenditure for a new £60 million state-of-the-art North Plymouth water treatment works

[23] As measured by mean zonal compliance, the recognised industry measure for overall drinking water quality

- Detailed design of improved water treatment processes such as granular activated carbon (GAC) filtration and ultraviolet (UV) disinfection at five water treatment works across the region
- Mains rehabilitation and flushing
- Pressure management and network modelling
- Investment in digital infrastructure, including improvements in retail engagement targeting a proactive and positive customer experience.

Bournemouth Water

- Mains replacement schemes and new mains development
- Water treatment upgrades including GAC replacement and the addition of UV treatment at three sites
- Improvements to the disinfection process at Alderney water treatment works.

Innovative use of catchment management schemes

Furthermore, improved drinking water quality and drinking water treatment efficiency continue to be targeted through South West Water's award-winning 'Upstream Thinking' programme of catchment management. Delivered in partnership with a range of stakeholder groups including wildlife trusts and river authorities, Upstream Thinking's combination of moorland restoration initiatives and agricultural improvement schemes seeks to reduce the level of man-made and natural contaminants in the region's watercourses.

Building on the programme's success in K5 (2010-2015), South West Water is investing around £10 million between 2015 and 2020 to deliver improvements in 11 additional catchment areas. This will include 700 farm improvement plans and the restoration of c.1,300 hectares of moorland.

At Bournemouth Water catchment management work has commenced with our partner Natural England and Catchment Sensitive Farming, working with farmers in the River Stour catchment area to educate them about the effects of their activity on raw water quality.

SIM improving, sharing best practice between South West Water and Bournemouth Water

Pennon's water businesses maintained their previous high levels of customer satisfaction during the year. South West Water's overall customer satisfaction remained broadly stable at 89% (2014/15 90%), with satisfaction regarding value for money at 59%, 1% higher than last year. For 16 years Bournemouth Water has retained the biennial Customer Service Excellence Award, which it last received in 2014. This national award recognises service excellence across the measures of timeliness, quality of information, professionalism and employee attitude.

A key indicator of customer service performance for the water businesses is the service incentive mechanism (SIM), which Ofwat uses to compare the performance of water companies. The SIM score is calculated against a qualitative element (based on a customer survey) and a quantitative element that takes into account, among other things, the number of complaints received in writing or by phone. South West Water's SIM score for the year was 78.6 (continuing the improving trend of recent years), and Bournemouth Water's SIM score at 86.2 remains at the frontier as one of the highest in the industry. We are now sharing best practice between South West Water and Bournemouth Water to continue the year-on-year improvements at South West Water.

Waste water improvements

We aim to ensure the safe and efficient removal and disposal of wastewater while minimising the likelihood of sewer flooding or pollution affecting homes, businesses or the environment.

During K5 (2010-2015) South West Water focused on a targeted programme of wastewater treatment improvements while also working to prevent potential failure through increased monitoring. We are continuing and accelerating our improving trend on compliance. In 2015 the company's score for numeric compliance (the percentage of wastewater treatment works deemed compliant) at 95.8% remained above the K5 average but was slightly below that of the previous year (2014 96.1%). This highlights the need for further enhancements as we strive to achieve 100% compliance by 2020.

Bathing water improvement, despite tougher EU standard

Our legacy of major investment to protect bathing waters, in addition to accelerated bathing water quality schemes implemented during 2014/15, was reflected in extremely positive results for the 2015 bathing water season, which was assessed under tougher new EU standards. Of the 145 bathing waters tested in the South West Water region, 141 (97.2%) were classified 'sufficient' or better, with more than 70% classified as 'excellent'.

Four bathing waters were rated as 'poor'; however this was not attributed to any failure of South West Water's assets. We recognise that bathing water quality is dependent on a wide range of factors and work continues, alongside partners including local councils, community groups, landowners and conservationists, to tackle bathing water quality issues in a holistic and sustainable way.

Overall Pollution Incidents Reduced

South West Water had zero 'serious' (Category 1) pollution incidents in 2015 and made a substantial reduction in the number of pollution incidents overall (Categories 1-4). However, there were seven 'significant' (Category 2) incidents compared with three in 2014.

A comprehensive performance review was undertaken that identified blockages on the network as the largest pollution risk. To improve the robustness of the wastewater network and assets, a strategy is being implemented to increase monitoring and maintenance. We also continue to raise customer awareness about sewer misuse.

Targeting investment to reduce sewer flooding

These improvements will also help to reduce the risk of sewer flooding. While the annual level of rainfall was relatively normal for the year, the number of internal and external sewer floodings was higher than the previous year as a result of extended periods of heavy rainfall in the winter of 2015/16.

In addition to capital maintenance and improvement schemes, we are working to improve our response times to flooding incidents. In the longer term, a reduction in sewer flooding is also being sought through our 'Downstream Thinking' programme of work to improve urban drainage using low-cost sustainable techniques including landscaping and sustainable drainage systems (SuDS). In 2015/16 this included:

- Aveton Gifford, Devon – tackling sewer flooding in a joint project alongside the parish council, the school, county council and householders to reduce the amount of surface water entering combined sewers
- Exmouth, Devon – locations have been identified where SuDS would be most beneficial. Community engagement and initial designs are planned for 2016/17
- Kingsbridge, Devon – the development of an Integrated Urban Drainage Model in partnership with the Environment Agency and Devon County Council.

Furthermore, we continue to work with organisations including the Environment Agency and local councils on flood alleviation projects. In 2015/16 this included the completion of a £2 million scheme to protect homes in the Colebrook area of Plymouth and support for the proposed Environment Agency and Cornwall Council-led £20 million flood alleviation and regeneration scheme around St Austell (for which a funding bid has been submitted to the EU). South West Water is also providing financial support for the Exeter Flood Defence Scheme.

Using technology to improve sewer network monitoring

The use of new technologies is a key part of South West Water's approach to improve both efficiency and sustainability. During 2015/16 the use of SewerBatt was trialled – innovative pipe inspection technology which uses sound to assess the condition of sewers. It is hoped that the roll-out of SewerBatt will allow for improved sewer cleansing by identifying blockages and other potential causes of pollution much more quickly than traditional methods.

Combined business well-prepared for Non-Household Retail market liberalisation

The combined water business is well-prepared, well-positioned and fully engaged in discussions with Ofwat and its peers on the evolving shape of the industry. South West Water has had a separate customer service and contact centre for over ten years, giving the company an advantage in its preparation for market liberalisation in April 2017. South West Water Business Services has been established, tasked with retaining existing business customers, and Source for Business is focused on winning new customers outside the region. By integrating Bournemouth Water, South West Water will continue to deliver economies of scale.

Non-Household Retail Strategy

Preparations are being made to maximise the opportunities presented by the opening of the non-household retail market in 2017 while continuing to improve the services provided to our business and commercial customers.

A separate legal entity has been created, Pennon Water Services, which operates from Bournemouth. This company will provide retail services for our existing non-household retail functions – South West Water Business Services, Source for Business, Avon Valley Water, Bournemouth Water Business Services, and Aquacare. These businesses currently provide services to c.85,000 non-household customers combined, who will be eligible for the market in 2017.

A key part of our non-household strategy will be to capitalise on Viridor's national footprint, its commercial culture, order book, expertise and existing customer relationships. Using this base knowledge, we will explore the opportunities to provide value-added services.

Preparing for Water 2020

South West Water is fully engaged in Water 2020 as we prepare and position ourselves for PR19. The company is in a very good position to anticipate and influence future regulatory reforms and is working hard to play its part in shaping the future of the industry.

Monitoring developments in Household Retail competition

Ofwat is currently gathering information for a report it will submit to the government in September. South West Water is fully engaged with Ofwat, helping in their assessment of costs and benefits through customer research and the Water UK "Market Place for Ideas".

The government is expected to make a decision in late 2016 and this will influence the Water 2020 approach to retail.

Viridor performing well – Key Performance Indicators

	2015/16	2014/15
Total Waste Inputs (MT)	7.8	7.5
ERFs	2.1	1.2
Landfill	2.0	2.5
Recycling and Other	3.7	3.8
Recycling Volumes Traded	1.8	1.7

ERFs driving growth

We are successfully establishing a significant asset base of ERFs, with eight plants, representing more than two-thirds of the committed portfolio capacity, now in operation. The process of ramping up towards operational optimisation is progressing well at the five ERFs brought on-stream in 2014/15, Peterborough ERF was completed and became operational in December 2015.

2.1 million tonnes of waste inputs were processed in 2015/16 and 142 megawatts (MW) of renewable energy capacity was on-stream including our share of joint ventures, and the Greater Manchester and Walpole anaerobic digestion (AD) plants.

Construction of three further ERFs progressing and to budget

Nine of the eleven ERFs in the committed portfolio are expected to be operational in 2016/17, and are on track to deliver c.£100 million of EBITDA in 2016/17. We expect to have c.18% ERF market share by 2020, with a network of strategic facilities driving Viridor’s longer-term profit growth.

Of the three ERFs under construction, the Glasgow gasification plant is expected to enter commissioning in H1 2016/17 and construction of Dunbar and Beddington ERFs is progressing as planned. All three remain on budget.

De-risking ERF portfolio through significant contracted position

The ERF portfolio is being progressively de-risked with demand expected to exceed capacity over the long term. Approximately 80% of the total ERF portfolio volumes (and associated price) have been secured under long-term, index-linked contracts with short and medium-term contracts in place for the remaining c.20%. Contracts have risk mitigation built-in.

Growing Energy Generation

Viridor’s total energy capacity is changing in scale and across its energy division; currently we have 277MW of operating capacity from ERFs, AD and landfill gas and expect to export over one terawatt hour (TWh) of power to the national grid in 2016/17. Once the total committed ERF portfolio is completed in 2018/19, ERFs alone will provide 242MW of energy generation capacity.

Regulatory Changes

During the period, Levy Exemption Certificates (LECs) were discontinued with a modest impact on Viridor. There have also been changes to the Renewable Obligation Certificates (ROCs) regime. However, Viridor's ROC accreditations are unaffected by these changes. Energy generation continues to be a profitable business for us.

Opportunities for decentralised energy and heat utilisation (combined heat and power) at selective ERF and landfill gas power generation sites are being developed.

Optimising landfill gas output

Our landfill energy business is being managed to maximise the value of landfill gas power generation, whilst exploring alternative commercial development opportunities and other energy uses such as photovoltaics (PV) and energy storage at our landfill sites.

At present we have 99MW of landfill gas capacity (excluding 3MW capacity at sub-contract sites in Suffolk). Gas volumes reached peak production in 2012/13 and have been reducing gradually, partially offset by improved gas capture efficiency. In 2015/16 the landfill gas power generation output was only marginally down to 562 gigawatt hours (GWh) (2014/15 602GWh), reflecting a continued successful output optimisation programme.

Average revenue per megawatt hour (MWh) was 2.2% lower at £90.72 (2014/15 £92.72), reflecting the withdrawal of LECs. The switch from legacy Non Fossil Fuel Obligation (NFFO) contracts to ROCs continues with 94% of energy now sold under the higher value ROCs. The remaining 6% NFFO component will migrate to ROCs in 2016/17. Average costs increased slightly to £34.76 per MWh (2014/15 £33.19).

Landfill sites being managed for cash and alternative use

We have a strategy in place for landfill that will see the business reduce the number of sites taking new waste inputs from 18 at the end of 2014/15 to a small number of strategic sites by 2020. Three landfills closed during the year with a fourth site closing just after the year end. This is in line with legislative moves and economic drivers to divert waste away from landfill.

While sites are being wound down to closure and aftercare, our emphasis remains on maximising the value of electricity generation from landfill gas, reducing costs and developing opportunities for alternative uses for sites, or divestment. We completed the divestment of Whitehead landfill and its associated environmental liability, generating an operating profit on disposal of £2.4 million (recorded within asset sales), and continue to promote similar opportunities for other sites with development potential.

The business continues to be cash generative as the wind-down and aftercare programme accelerates. Viridor's average gate fees increased by 1% to £20.14 per tonne. Consented landfill capacity reduced from 51.7 million cubic metres (mcm) at 31 March 2015 to 47.4 mcm, reflecting usage during the period and a disposal. As previously provided for, c.34mcm of Viridor's consented landfill capacity is not expected to be used.

Landfill tax continues to increase in line with inflation and rose to £84.40 per tonne on 1 April 2016.

Recycling self-help measures delivering

During the year, recycling volumes traded increased by 7.3%, 121,000 tonnes to 1.8 million tonnes. Recyclate prices were lower compared to 2014/15. Prices have now stabilised to some degree for most commodities but remain under pressure, reflecting world economic conditions and competitive markets.

Through the Input, Throughput and Output Optimisation (ITOO) programme, we are targeting improvements in source material quality (involving contract renegotiation where required), rationalisation of sites to improve returns, increased asset utilisation and specific quality control of outputs. A number of input contracts have been successfully renegotiated enhancing value and quality of inputs. Where new recycling contracts have been secured, better gate fees reflect the sharing of recyclate price risks with customers and secure a better specified quality of inputs. These self-help measures have resulted in marginal increases in gate fees compared to the prior year.

We continue to operate the most extensive Material Recycling Facility (MRF) capacity in the UK. Viridor is established as a quality brand in the UK, European and Asian markets including China, where it holds accreditations for export. There are clear long-term regulatory drivers for recycling from the EU and UK Government, alongside expectations from clients, including local authorities, leading corporates and the business community.

Contracts and Collections securing waste inputs and ERF fuel

Performance across our major local authority contracts around the UK (the more significant contracts include Greater Manchester, Glasgow, Lancashire, Somerset and West Sussex) and the Thames Water contract remains broadly in line with last year.

Our large-scale contract successes in 2015/16 include a 25-year contracted service for Tomorrow's Valley in Wales (where four local authorities have come together to create a £190 million residual waste contract for 90,000 tonnes per annum), a 10-year contract with South Lanarkshire Council (with a potential 5-year extension) for treatment of 80,000 tonnes per annum of residual waste via Dunbar ERF, and Clyde Valley in Scotland (where five local authorities have come together to create a £450 million residual waste contract for 190,000 tonnes per annum over 25 years).

The solid performance of the collection business reflected the benefits of sustained management action. Collection remains a key focus in securing increased input tonnages for the business.

Joint Ventures

All three of Viridor's joint ventures continue to perform well. Viridor Laing Greater Manchester (VLGM), a joint venture between Viridor and John Laing Infrastructure, is delivering the 25-year Greater Manchester Waste PFI. Now in its eighth year, this remains the UK's largest ever combined waste and energy project. The recycling, recovery and waste management facilities serving the contract, handle in excess of one million tonnes of material per annum, are operated by Viridor on a sub-contract basis.

Solid recovered fuel produced from the residual waste from Greater Manchester is used to generate heat and power at Runcorn 1 ERF (TPSCo, a joint venture between Viridor, John Laing Infrastructure and Inovyn) which has operated well since it came on line in 2015.

The third joint venture at Lakeside ERF (a 50/50 joint venture with Grundon Waste Management) is in its sixth year of operation and continues to outperform its original power generation and waste processing targets.

Board matters

The year saw the retirements of Ken Harvey, the previous Chairman, and Gerard Connell, the previous Senior Independent Director, who had served for 18 years and 12 years respectively. Both retirements took effect at the end of July 2015, following which Sir John Parker became the Chairman and Gill Rider was appointed as the new Senior Independent Director.

As reported above, Chris Loughlin was appointed to the new role of Group Chief Executive Officer on 1 January 2016. Prior to that, he served as an Executive Director of Pennon Group Plc in his capacity as Chief Executive of South West Water. Stephen Bird was promoted to the position of Managing Director of South West Water with effect from the same date. As at 1 April 2016, Susan Davy's title was also changed from Group Director of Finance to Chief Financial Officer.

Changes to the governance structure, which were implemented on 1 April 2016, saw our existing independent Non-executive Directors, Martin Angle, Neil Cooper and Gill Rider, additionally being appointed as non-executive directors of South West Water Limited. Sir John Parker continues to serve as chairman of South West Water, an office to which he was appointed on 31 July 2015. In addition, the Board has been pleased to welcome three non-executive directors of South West Water, Martin Hagen, Steve Johnson and Lord Matthew Taylor, to participate in plenary sessions of the Pennon Group Board and its Committees, whilst continuing to be non-executive directors of South West Water. Steve Johnson resigned subsequent to the year-end due to taking up another appointment.

These changes represent an important step forward for Pennon Group as it looks towards the future. In his role as Group Chief Executive Officer, Chris Loughlin will oversee the delivery and development of Pennon's strategy whilst driving greater synergies and looking at opportunities across the Group.

Sir John Parker
Chairman

Financial Timetable

(YEAR ENDED 31 MARCH 2016 AND UPCOMING EVENTS)

25 May 2016	Full Year Results 2015/16
Early June 2016	Annual Report & Accounts published
1 July 2016	Annual General Meeting
7 July 2016 *	Ordinary shares quoted ex-dividend
8 July 2016 *	Record date for final cash dividend
15 August 2016 *	Scrip election date for final dividend
6 September 2016	Trading Statement
2 September 2016 *	Final cash dividend paid and Scrip shares issued
25 November 2016	Half Year Results 2016/17
9 February 2017	Trading Statement
24 May 2017	Full Year Results 2016/17

* These dates are provisional and, in the case of the final dividend subject to obtaining shareholder approval at the 2016 Annual General Meeting.

CAUTIONARY STATEMENT IN RESPECT OF FORWARD-LOOKING STATEMENTS

This Report contains forward-looking statements relating to the Pennon Group's operations, performance and financial position based on current expectations of, and assumptions and forecasts made by, Pennon Group management. Forward-looking statements are identified in this Report by words such as "anticipate", "aim", "believe", "continue", "could", "due", "estimate", "expect", "forecast", "goal", "intend", "may", "plan", "project", “remain”, "seek", "should", "target", "will" and related and similar expressions, as well as statements in the future tense. Various known and unknown risks, uncertainties and other factors could lead to substantial differences between the actual future results, financial situation development or performance of the Group and the estimates and historical results given herein. Undue reliance should not be placed on forward-looking statements which are made only as of the date of this document. Important risks, uncertainties and other factors that could cause actual results, performance or achievements of Pennon Group to differ materially from any outcomes or results expressed or implied by such forward-looking statements include, among other things, compliance with law, regulation or decisions by Government and regulators, including water industry reform; maintaining sufficient finance and funding to meet ongoing commitments; non-compliance or occurrence of avoidable Health and Safety incidents; uncertainty arising from open tax computations where liabilities remain to be agreed; non-recovery of customer debt; poor operating performance due to extreme weather and climate change; macro-economic risks arising from the Global and UK economic downturn impacting commodity and power prices; poor customer service/increased competition leading to loss of customer base; business interruption or significant operational failures/incidents; talent management and succession planning in place to meet business requirements; failure or increased cost of capital projects/exposure to contract failures and information technology systems, management and protection including cyber risks. These risks will be described in greater detail in the Pennon Group Annual Report to be published at the beginning of June 2016. Such forward looking statements should therefore be construed in light of such risks, uncertainties and other factors and undue reliance should not be placed on them. Nothing in this report should be construed as a profit forecast.

Any forward-looking statements are made only as of the date of this document and no representation, assurance, guarantee or warranty is given in relation to them including as to their accuracy, completeness, or the basis on which they are made. The Group accepts no obligation to revise or update publicly these forward-looking statements or adjust them as a result of new information or for future events or developments, except to the extent legally required.

UNSOLICITED COMMUNICATIONS WITH SHAREHOLDERS

A number of companies, including Pennon Group Plc, continue to be aware that their shareholders have received unsolicited telephone calls or correspondence concerning investment matters which imply a connection to the company concerned. If shareholders have any concerns about any contact they have received then please refer to the Financial Conduct Authority's website www.fca.org.uk/scamsmart. Details of any share dealing facilities that the Company endorses will be included in Company mailings.

PENNON GROUP PLC

Consolidated income statement for the year ended 31 March 2016

	Notes	**Before non-underlying items 2016 £m**	**Non-underlying items (note 5) 2016 £m**	**Total 2016 £m**	Before non-underlying items 2015 £m	Non-underlying items (note 5) 2015 £m	Total 2015 £m
Revenue	4	**1,352.3**	**-**	**1,352.3**	1,357.2	-	1,357.2
Operating costs							
Employment costs		**(180.0)**	**(8.6)**	**(188.6)**	(164.3)	14.9	(149.4)
Raw materials and consumables used		**(114.7)**	**-**	**(114.7)**	(103.8)	-	(103.8)
Other operating expenses		**(609.2)**	**(1.6)**	**(610.8)**	(678.1)	(4.3)	(682.4)
Earnings before interest, tax, depreciation and amortisation	4	**448.4**	**(10.2)**	**438.2**	411.0	10.6	421.6
Depreciation, amortisation and impairment		**(186.6)**	**-**	**(186.6)**	(164.4)	(24.3)	(188.7)
Operating profit	4	**261.8**	**(10.2)**	**251.6**	246.6	(13.7)	232.9
Finance income	6	**42.1**	**5.2**	**47.3**	44.0	-	44.0
Finance costs	6	**(96.2)**	**-**	**(96.2)**	(84.8)	-	(84.8)
Net finance costs	6	**(54.1)**	**5.2**	**(48.9)**	(40.8)	-	(40.8)
Share of post-tax profit from joint ventures		**3.6**	**-**	**3.6**	4.9	-	4.9
Profit before tax	4	**211.3**	**(5.0)**	**206.3**	210.7	(13.7)	197.0
Taxation	7	**(72.1)**	**34.1**	**(38.0)**	(57.4)	2.7	(54.7)
Profit for the year		**139.2**	**29.1**	**168.3**	153.3	(11.0)	142.3
Attributable to:							
Ordinary shareholders of the parent		**123.0**	**29.1**	**152.1**	137.3	(11.0)	126.3
Perpetual capital security holders		**16.2**	**-**	**16.2**	16.0	-	16.0
Earnings per ordinary share (pence per share)	8						
- Basic				**37.0**			32.3
- Diluted				**36.9**			32.2
- Before non underlying items and deferred tax				**39.5**			39.8

PENNON GROUP PLC

PENNON GROUP PLC

Consolidated statement of comprehensive income for the year ended 31 March 2016

	Before non-underlying items 2016 £m	**Non-underlying items (note 5) 2016 £m**	**Total 2016 £m**	Before non-underlying items 2015 £m	Non-underlying items (note 5) 2015 £m	Total 2015 £m
Profit for the year	**139.2**	**29.1**	**168.3**	153.3	(11.0)	142.3
Other comprehensive Income / (loss)						
Items that will not be reclassified to profit or loss						
Remeasurement of defined benefit obligations	**(2.6)**	**-**	**(2.6)**	(2.1)	-	(2.1)
Income tax on items that will not be reclassified	**0.6**	**(3.0)**	**(2.4)**	0.4	-	0.4
Total items that will not be reclassified to profit or loss	**(2.0)**	**(3.0)**	**(5.0)**	(1.7)	-	(1.7)
Items that may be reclassified subsequently to profit or loss						
Share of other comprehensive income from joint ventures	**2.4**	**-**	**2.4**	1.1	-	1.1
Cash flow hedges	**5.0**	**-**	**5.0**	(36.8)	-	(36.8)
Income tax on items that may be reclassified	**(1.0)**	**(0.8)**	**(1.8)**	5.7	-	5.7
Total items that may be reclassified subsequently to profit or loss	**6.4**	**(0.8)**	**5.6**	(30.0)	-	(30.0)
Other comprehensive income / (loss) for the year net of tax	**4.4**	**(3.8)**	**0.6**	(31.7)	-	(31.7)
Total comprehensive income for the year	**143.6**	**25.3**	**168.9**	121.6	(11.0)	110.6
Total comprehensive income attributable to:						
Ordinary shareholders of the parent	**127.4**	**25.3**	**152.7**	105.6	(11.0)	94.6
Perpetual capital security holders	**16.2**	**-**	**16.2**	16.0	-	16.0

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Consolidated balance sheet at 31 March 2016

	Notes	**2016 £m**	2015 £m
ASSETS			
Non-current assets			
Goodwill		**385.0**	339.3
Other intangible assets		**63.8**	56.4
Property, plant and equipment		**3,897.3**	3,578.8
Other non-current assets		**267.8**	291.1
Derivative financial instruments		**62.7**	60.2
Investments in joint ventures		**0.1**	0.1
		4,676.7	4,325.9
Current assets			
Inventories		**20.6**	15.0
Trade and other receivables		**323.5**	287.7
Derivative financial instruments		**9.5**	8.1
Financial assets at fair value through profit		**-**	0.1
Cash and cash deposits	13	**632.2**	771.0
		985.8	1,081.9
LIABILITIES			
Current liabilities			
Borrowings	13	**(65.0)**	(113.6)
Derivative financial instruments		**(17.4)**	(19.5)
Financial liabilities at fair value through profit		**(2.2)**	-
Trade and other payables		**(264.6)**	(277.7)
Current tax liabilities		**(37.1)**	(52.2)
Provisions		**(50.4)**	(32.9)
		(436.7)	(495.9)
Net current assets		**549.1**	586.0
Non-current liabilities			
Borrowings	13	**(3,051.6)**	(2,854.5)
Other non-current liabilities		**(113.2)**	(110.1)
Financial liabilities at fair value through profit		**(51.0)**	(57.3)
Derivative financial instruments		**(38.5)**	(46.0)
Retirement benefit obligations		**(40.9)**	(59.6)
Deferred tax liabilities		**(272.0)**	(235.9)
Provisions		**(171.0)**	(194.4)
		(3,738.2)	(3,557.8)
Net assets		**1,487.6**	1,354.1
Shareholders' Equity			
Share capital	10	**167.8**	162.4
Share premium account		**213.3**	118.6
Capital redemption reserve		**144.2**	144.2
Retained earnings and other reserves		**667.5**	634.1
Total shareholders' equity		**1,192.8**	1,059.3
Perpetual capital securities	11	**294.8**	294.8
Total equity		**1,487.6**	1,354.1

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Consolidated statement of changes in equity for the year ended 31 March 2016

	Share capital (note 10) £m	Share premium account £m	Capital redemption reserve £m	Retained earnings and other reserves £m	Perpetual capital securities (note 11) £m	Total Equity £m
At 1 April 2014	151.3	4.9	144.2	602.4	294.8	1,197.6
Profit for the year	-	-	-	126.3	16.0	142.3
Other comprehensive loss for the year	-	-	-	(31.7)	-	(31.7)
Total comprehensive income for the year	-	-	-	94.6	16.0	110.6
Transactions with equity shareholders						
Dividends paid or approved	-	-	-	(117.0)	-	(117.0)
Adjustment for shares issued under the scrip dividend alternative	2.6	(2.6)	-	48.0	-	48.0
Convertible bond - equity issuance	8.5	116.3	-	(0.5)	-	124.3
Adjustment in respect of share-based payments (net of tax)	-	-	-	3.5	-	3.5
Distributions due to perpetual capital security holders	-	-	-	-	(20.3)	(20.3)
Current tax relief on distributions to perpetual capital security holders	-	-	-	-	4.3	4.3
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	-	-	-	(0.8)	-	(0.8)
Proceeds from treasury shares re-issued	-	-	-	3.9	-	3.9
	11.1	113.7	-	(62.9)	(16.0)	45.9
At 31 March 2015	162.4	118.6	144.2	634.1	294.8	1,354.1
Profit for the year	-	-	-	152.1	16.2	168.3
Other comprehensive income for the year	-	-	-	0.6	-	0.6
Total comprehensive income for the year	-	-	-	152.7	16.2	168.9
Transactions with equity shareholders						
Dividends paid or approved	-	-	-	(129.5)	-	(129.5)
Adjustment for shares issued under the scrip dividend alternative	0.3	(0.3)	-	6.3	-	6.3
Equity issuance	4.9	95.4	-	-	-	100.3
Equity issuance related costs	-	(2.3)	-	-	-	(2.3)
Adjustment in respect of share-based payments (net of tax)	-	-	-	2.5	-	2.5
Distributions due to perpetual capital security holders	-	-	-	-	(20.3)	(20.3)
Current tax relief on distributions to perpetual capital security holders	-	-	-	-	4.1	4.1
Own shares acquired by the Pennon Employee Share Trust in respect of share options granted	-	-	-	(1.1)	-	(1.1)
Proceeds from treasury shares re-issued	-	-	-	2.5	-	2.5
Proceeds from shares issued under the Sharesave Scheme	0.2	1.9	-	-	-	2.1
	5.4	94.7	-	(119.3)	(16.2)	(35.4)
At 31 March 2016	**167.8**	**213.3**	**144.2**	**667.5**	**294.8**	**1,487.6**

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Consolidated statement of cash flows for the year ended 31 March 2016

	Notes	**2016 £m**	2015 £m
Cash flows from operating activities			
Cash generated from operations	12	**371.3**	310.9
Interest paid		**(79.1)**	(62.0)
Tax paid		**(45.0)**	(21.0)
Net cash generated from operating activities		**247.2**	227.9
Cash flows from investing activities			
Interest received		**14.9**	20.3
Loan repayments received from joint ventures		**27.5**	0.3
Dividends received from joint ventures		**6.0**	6.0
Acquisitions, net of cash acquired		**(91.0)**	-
Purchase of property, plant and equipment		**(283.7)**	(298.1)
Proceeds from sale of property, plant and equipment		**6.8**	5.7
Net cash used in investing activities		**(319.5)**	(265.8)
Cash flows from financing activities			
Proceeds from treasury shares re-issued	10	**2.5**	3.9
Proceeds from issuance of ordinary shares		**100.1**	-
Deposit of restricted funds		**(30.3)**	(23.0)
Purchase of ordinary shares by the Pennon Employee Share Trust		**(1.1)**	(0.8)
Proceeds from new borrowing		**80.0**	345.0
Repayment of borrowings		**(96.5)**	(123.6)
Finance lease sale and leaseback		**30.4**	160.1
Finance lease principal repayments		**(38.4)**	(99.5)
Dividends paid		**(123.2)**	(69.0)
Perpetual capital securities periodic return		**(20.3)**	(20.3)
Net cash (used)/ generated from financing activities		**(96.8)**	172.8
Net (decrease) / increase in cash and cash equivalents		**(169.1)**	134.9
Cash and cash equivalents at beginning of year	13	**574.8**	439.9
Cash and cash equivalents at end of year	13	**405.7**	574.8

PENNON GROUP PLC
Notes

1. **General information**

Pennon Group Plc is a company registered in the United Kingdom under the Companies Act 2006. The address of the registered office is given on page 46. During 2015/16 Pennon Group's business was operated through three main subsidiaries. South West Water provides water and wastewater services for Devon, Cornwall and parts of Dorset and Somerset. Bournemouth Water provides water services for parts of Dorset, Hampshire and Wiltshire. Viridor business is waste recycling and recovery.

The financial information for the years ended 31 March 2016 and 31 March 2015 does not constitute statutory accounts within the meaning of section 434 of the Companies Act 2006. The Annual Report and Accounts for the year ended 31 March 2016, including the financial statements from which this financial information is derived, will be delivered to the Registrar of Companies following the Company's Annual General Meeting on 1 July 2016. The auditor's report on the 2016 financial statements was unqualified and did not contain a statement under section 498 of the Companies Act 2006.

The full financial statements for the year ended 31 March 2015 were approved by the Board of Directors on 22 June 2015 and have been delivered to the Registrar of Companies. The independent auditor's report on those financial statements was unqualified and did not contain a statement under section 498 of the Companies Act 2006. This final results announcement and the results for the year ended 31 March 2016 were approved by the Board of Directors on 24 May 2016.

2. **Basis of preparation**

The financial information in this announcement has been prepared on the historical cost accounting basis (except for fair value items as set out in the 2015 Annual Report and Accounts) and in accordance with International Financial Reporting Standards (IFRS) and interpretations of the IFRS Interpretations Committee as adopted by the European Union, and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. The accounting policies adopted are consistent with those followed in the preparation of the Group's 2016 Annual Report and Accounts which have not changed significantly from those adopted in the Group's 2015 Annual Report and Accounts (which are available on the Company website www.pennon-group.co.uk), except as described in note 3.

3. **Accounting policies**

The new standards or interpretations in issue, but not yet effective, are not expected to have a material effect on the Group's net assets or results, except for those set out below:

- IFRS 15 'Revenue from contracts with customers' relates to revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The standard will replace IAS 18 'Revenue' and IAS 11 'Construction contracts' and related interpretations. The standard is effective for annual periods beginning on or after 1 January 2018 and is subject to EU endorsement.

  The Group continues to assess the impact of the new standard on the Group's financial statements. The Group will make more detailed assessments of the impact over the next twelve months.

- IFRS 16 'Leases' no longer distinguish between an on the balance sheet finance lease and an off the balance sheet operating lease. Instead, for virtually all lease contracts the lessee recognises a lease liability reflecting future lease payments and a 'right-of-use' asset. The standard is effective for annual periods beginning on or after 1 January 2019 and is subject to EU endorsement.

  The Directors anticipate that the adoption of IFRS 16 on 1 April 2019 will reduce operating costs, increase depreciation charges and increase finance costs. In addition, c.£100 million of property, plant and equipment will be recognised, with a corresponding increase in borrowings and group net debt. Existing borrowing covenants are not impacted by changes in accounting standards.

The accounting policy for non-underlying items, previously referred to as exceptional items, has been refined to include items which due to their nature in the view of the Directors should be separately disclosed to enable a full understanding of the Group's financial performance.

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Notes (continued)

4. **Segmental information**

Operating segments are reported in a manner consistent with internal reporting provided to the Chief Operating Decision-Maker, which has been identified as the Pennon Group Plc Board. The water business comprises the regulated water and wastewater services undertaken by South West Water and the regulated water services undertaken by Bournemouth Water. The waste management business is the waste recycling and recovery services provided by Viridor.

	2016	2015
	£m	£m
Revenue		
Water	**547.0**	522.2
Waste management	**806.2**	835.9
Other	**12.0**	10.9
Less intra-segment trading *	**(12.9)**	(11.8)
	1,352.3	1,357.2
Segment result		
Operating profit/ (loss) before depreciation, amortisation and non-underlying items (EBITDA)		
Water	**335.2**	331.3
Waste management	**116.5**	80.4
Other	**(3.3)**	(0.7)
	448.4	411.0
Operating profit/ (loss) before non-underlying items		
Water	**224.5**	225.4
Waste management	**40.9**	21.6
Other	**(3.6)**	(0.4)
	261.8	246.6
Profit before tax and non-underlying items		
Water	**165.7**	167.9
Waste management	**30.7**	27.7
Other	**14.9**	15.1
	211.3	210.7
Profit before tax		
Water	**160.5**	179.7
Waste management	**25.7**	1.0
Other	**20.1**	16.3
	206.3	197.0

* Intra-segment trading between and to different segments is under normal market based commercial terms and conditions. Intra-segment revenue of the other segment is at cost.

Geographic analysis of revenue based on location of customers

	2016	2015
	£m	£m
UK	**1,296.1**	1,317.6
Rest of European Union	**10.5**	10.4
China	**38.8**	25.3
Rest of World	**6.9**	3.9
	1,352.3	1,357.2

The UK is the Group's country of domicile and generates the majority of its revenue from external customers in the UK. The Group's non-current assets are all located in the UK.

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Notes (continued)

5. **Non-underlying items**

Non-underlying items are those that in the Directors' view are required to be separately disclosed by virtue of their size, nature or incidence to enable a full understanding of the Group's financial performance.

	2016 £m	2015 £m
Operating (costs)/ credits		
Restructuring costs (a)	**(10.2)**	-
Pension costs – past service (b)	**-**	14.9
Environmental provisions (c)	**-**	6.7
Underperforming contracts (d)	**-**	(11.0)
Impairment of property, plant and equipment (e)	**-**	(24.3)
Total net operating costs	**(10.2)**	(13.7)
Remeasurement of fair value movement in derivatives (f)	**5.2**	-
Deferred tax change in rate (g)	**33.1**	-
Tax credit arising on non-underlying items	**1.0**	2.7
Net non-underlying credit / (charge)	**29.1**	(11.0)

(a) During the year a one-off charge of £10.2m was made to the restructuring provision reflecting announced reorganisations across the Group.

(b) Last year a non-underlying credit was recognised relating to changes made to the Group's defined benefit scheme. Changes implemented last year capped pensionable pay for active members, reducing past service cost.

(c) Last year landfill environmental provisioning was reassessed £6.7m lower reflecting lower expected restoration and aftercare costs, partly offset by a reduction in discount rate.

(d) A small number of contracts last year were assessed as underperforming. On this basis a provision of £11.0m was established.

(e) Following a detailed review of the allocation of non-financial assets to cash generating units, an impairment of £60.9m has been recognised in relation to Viridor's non-strategic landfill assets and a £60.9m reversal of impairment has been recognised in the newly aggregated regional cash generating units.

In 2014/15 the profitability of a small number of landfill energy sites was impacted by higher than anticipated site costs and lower than expected volumes due to site specific circumstances. This resulted in a net non-underlying impairment charge of £24.3m to write-down the carrying value of landfill energy property, plant and equipment. Included in the net charge was impairment reversals of £9.2m.

(f) For certain derivative financial investments, where market volatility and counterparty credit risk result in hedge accounting becoming less certain, hedge accounting is discontinued and non-cash fair value movements are recognised in the income statement as non-underlying items.

(g) Following the enactment during the year the rate of corporation tax reduced from 20% to 19% from April 2017 and reduces further to 18% from April 2020, a one-off credit of £33.1m has been recognised in the income statement. In addition, a charge of £3.8m has been recognised in the statement of comprehensive income and a charge of £0.1m has been recognised directly in equity.

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Notes (continued)

6. **Net finance costs**

	2016			2015		
	Finance cost £m	**Finance income £m**	**Total £m**	Finance cost £m	Finance income £m	Total £m
Cost of servicing debt						
Bank borrowings and overdrafts	**(48.7)**	**-**	**(48.7)**	(32.2)	-	(32.2)
Interest element of finance lease rentals	**(33.5)**	**-**	**(33.5)**	(32.9)	-	(32.9)
Other finance costs	**(2.8)**	**-**	**(2.8)**	(6.5)	-	(6.5)
Interest receivable	**-**	**6.3**	**6.3**	-	11.3	11.3
Interest receivable on shareholder loans to joint ventures	**-**	**10.7**	**10.7**	-	11.4	11.4
	(85.0)	**17.0**	**(68.0)**	(71.6)	22.7	(48.9)
Notional interest						
Interest receivable on service concession arrangements	**-**	**16.7**	**16.7**	-	13.5	13.5
Retirement benefit obligations	**(1.8)**	**-**	**(1.8)**	(2.7)	-	(2.7)
Unwinding of discounts on provisions	**(9.4)**	**-**	**(9.4)**	(10.5)	-	(10.5)
	(11.2)	**16.7**	**5.5**	(13.2)	13.5	0.3
Net gains on derivative financial instruments arising from the combination of non-derivative instruments	**-**	**8.4**	**8.4**	-	7.8	7.8
Net finance costs before non-underlying items	**(96.2)**	**42.1**	**(54.1)**	(84.8)	44.0	(40.8)
Non-underlying items (note 5)						
Fair value remeasurement of non-designated derivative financial instruments, providing commercial hedges	**-**	**5.2**	**5.2**	-	-	-
Net finance costs after non-underlying items	**(96.2)**	**47.3**	**(48.9)**	(84.8)	44.0	(40.8)

In addition to the above, finance costs of £9.4m (2015 £22.5m) have been capitalised on qualifying assets included in property, plant and equipment, and other intangible assets.

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Notes (continued)

7. **Taxation**

	Before Non-underlying items 2016 £m	Non-underlying items (note 5) 2016 £m	Total 2016 £m	Before Non-underlying items 2015 £m	Non-underlying items (note 5) 2015 £m	Total 2015 £m
Analysis of charge						
Current tax charge	**32.9**	**(1.7)**	**31.2**	39.2	0.6	39.8
Deferred tax - other	**39.2**	**0.7**	**39.9**	18.2	(3.3)	14.9
Deferred tax – arising on change of rate of corporation tax	**-**	**(33.1)**	**(33.1)**	-	-	-
Tax charge for the year	**72.1**	**(34.1)**	**38.0**	57.4	(2.7)	54.7

UK corporation tax is calculated at 20% (2015 21%) of the estimated assessable profit for the year.

The tax charge is stated after release of prior year current tax credits of £1.4m (2015 credit of £5.5m) and a prior year deferred tax charge of £15.9m (2015 charge of £9.7m).

Tax on amounts included in the consolidated statement of comprehensive income, or directly in equity, is included in those statements respectively.

The 2016 deferred tax charge includes a credit of £33.1m reflecting a reduction in the rate of UK corporation tax.

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Notes (continued)

8. **Earnings per share**

Basic earnings per share are calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year, excluding those held in the employee share trust which are treated as cancelled.

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to include all dilutive potential ordinary shares.

The weighted average number of shares and earnings used in the calculations were:

	2016	2015
Number of shares (millions)		
For basic earnings per share	**410.9**	390.9
Effect of dilutive potential ordinary shares from share options	**1.8**	1.8
For diluted earnings per share	**412.7**	392.7

Basic and diluted earnings per ordinary share before non-underlying items and deferred tax

Earnings per ordinary share before non-underlying items and deferred tax are presented as the Directors believe that this measure provides a more useful comparison of business trends and performance, since deferred tax reflects distortive effects of changes in corporation tax rates and the level of long-term investment. Earnings per share have been calculated:

	2016			2015		
	Profit after tax £m	**Earnings per share Basic p**	**Diluted p**	Profit after tax £m	Earnings per share Basic p	Diluted p
Statutory earnings	**152.1**	**37.0**	**36.9**	126.3	32.3	32.2
Deferred tax before non-underlying items	**39.2**	**9.5**	**9.5**	18.2	4.7	4.6
Non-underlying items (net of tax)	**(29.1)**	**(7.0)**	**(7.1)**	11.0	2.8	2.8
Earnings before non-underlying items and deferred tax	**162.2**	**39.5**	**39.3**	155.5	39.8	39.6

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Notes (continued)

9. **Dividends**

Amounts recognised as distributions to ordinary equity holders in the year:

	2016 £m	2015 £m
Interim dividend paid for the year ended 31 March 2015 : 9.98p (2014 9.39p) per share	**39.8**	34.8
Final dividend paid for the year ended 31 March 2015 : 21.82p (2014 20.92p) per share	**89.7**	82.2
	129.5	117.0

Proposed dividends

	2016 £m
Proposed interim dividend for the year ended 31 March 2016 : 10.46p per share	**43.1**
Proposed final dividend for the year ended 31 March 2016 : 23.12p per share	**95.4**
	138.5

The proposed interim and final dividends have not been included as liabilities in these financial statements.

The proposed interim dividend for 2016 was paid on 1 April 2016 and the proposed final dividend is subject to approval by shareholders at the Annual General Meeting on 1 July 2016.

If approved at the Annual General Meeting the final dividend of 23.12p per share will be paid on 2 September 2016 to shareholders on the register on 8 July 2016.

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Notes (continued)

10. **Share capital**

Allotted, called up and fully paid

	Number of shares		
	Treasury shares	Ordinary shares	£m
At 1 April 2014 Ordinary shares of 40.7p each	1,282,690	370,552,276	151.3
Shares issued in respect of the £125m convertible bond	-	20,909,635	8.5
Shares issued under the Scrip Dividend Alternative	-	6,365,622	2.6
Shares re-issued under the Company's Performance and Co-investment Plan	(131,685)	131,685	-
For consideration of £0.8m, shares re-issued to the Pennon Employee Share Trust	(99,455)	99,455	-
For consideration of £3.0m, shares re-issued under the Company's Sharesave Scheme	(657,008)	657,008	-
For consideration of £0.1m, shares re-issued under the Executive Share Option Scheme	(5,027)	5,027	-
At 31 March 2015 ordinary shares of 40.7p each	389,515	398,720,708	162.4
Shares issued in respect of the equity issuance	-	12,084,337	4.9
Shares issued under the Scrip Dividend Alternative	-	760,626	0.3
For consideration of £1.1m, shares re-issued to the Pennon Employee Share Trust	(143,538)	143,538	-
For consideration of £1.3m, shares re-issued under the Company's Sharesave Scheme	(227,316)	227,316	-
For consideration of £0.1m, shares re-issued under the Executive Share Option Scheme	(8,305)	8,305	-
For consideration of £2.1m, shares issued under the Company's Sharesave Scheme	-	395,767	0.2
At 31 March 2016 ordinary shares of 40.7p each	**10,356**	**412,340,597**	**167.8**

Shares held as treasury shares may be sold, re-issued for any of the Company's share schemes, or cancelled.

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Notes (continued)

		2016	2015
		£m	£m
11.	**Perpetual capital securities**		
	GBP 300m 6.75% perpetual subordinated capital securities	**294.8**	294.8

On 8 March 2013 the Company issued £300m perpetual capital securities. Costs directly associated with the issue of £5.2m are set off against the value of the issuance. They have no fixed redemption date but the Company may, at its sole discretion, redeem all, but not part, of these securities at their principal amount on 8 March 2018 or any subsequent periodic return payment date after this.

The Company has the option to defer periodic returns on any relevant payment date, as long as a dividend on the Ordinary Shares has not been paid or declared in the previous 12 months. Deferred periodic returns shall be satisfied only on redemption or payment of dividend on Ordinary Shares, all of which only occur at the sole discretion of the Company.

As the Company paid a dividend in the 12 months prior to the periodic return date of 8 March 2016, a periodic return of £20.3m was paid during the year.

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Notes (continued)

12. **Cash flow from operating activities**

Reconciliation of profit for the year to net cash inflow from operations:

	2016 £m	2015 £m
Cash generated from operations		
Profit for the year	**168.3**	142.3
Adjustments for:		
Share-based payments	**2.8**	3.5
Profit on disposal of property, plant and equipment	**(4.3)**	(3.7)
Depreciation charge	**182.9**	161.7
Amortisation of intangible assets	**3.7**	2.7
Non-underlying movement in derivatives	**(5.2)**	-
Non-underlying impairment of property, plant and equipment	**-**	24.3
Non-underlying provision charge	**10.2**	4.3
Non-underlying defined benefit pension credit	**-**	(14.9)
Share of post-tax profit from joint ventures	**(3.6)**	(4.9)
Finance income	**(42.1)**	(44.0)
Finance costs	**96.2**	84.8
Taxation charge	**38.0**	54.7
Changes in working capital:		
Increase in inventories	**(5.5)**	(2.9)
Decrease / (increase) in trade and other receivables	**10.5**	(17.1)
Increase in service concession arrangements receivable	**(15.6)**	(71.9)
(Decrease) / increase in trade and other payables	**(27.0)**	5.7
Decrease in retirement benefit obligations	**(21.2)**	(9.6)
Decrease in provisions	**(16.8)**	(4.1)
Cash generated from operations	**371.3**	310.9

	2016 £m	2015 £m
Total interest paid		
Interest paid in operating activities	**79.1**	62.0
Interest paid in investing activities	**9.4**	22.5
Total interest paid	**88.5**	84.5

PENNON GROUP PLC

Notes (continued)

13. **Net borrowings**

	2016 £m	2015 £m
Cash and cash deposits	**632.2**	771.0
Borrowings – current		
Other current borrowings	**(39.0)**	(82.0)
Finance lease obligations	**(26.0)**	(31.6)
Total current borrowings	**(65.0)**	(113.6)
Borrowings – non-current		
Bank and other loans	**(1,502.5)**	(1,277.2)
Other non-current borrowings	**(234.5)**	(273.2)
Finance lease obligations	**(1,314.6)**	(1,304.1)
Total non-current borrowings	**(3,051.6)**	(2,854.5)
Total net borrowings	**(2,484.4)**	(2,197.1)

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

	2016 £m	2015 £m
Cash and cash deposits as above	**632.2**	771.0
Less : deposits with a maturity of three months or more (restricted funds)	**(226.5)**	(196.2)
	405.7	574.8

14. **Acquisitions**

On 15 April 2015 Pennon Group Plc acquired 100% of the issued share capital of Sembcorp Bournemouth Water Investments Limited (renamed 'Bournemouth Water Investments Limited') including its non-regulated subsidiaries from Sembcorp Holdings Limited for a cash consideration of £100.3m. Sembcorp Bournemouth Water Investments Limited is the holding company for Sembcorp Bournemouth Water Limited (renamed 'Bournemouth Water Limited').

The acquisition was in line with the Group's strategy to increase shareholder returns from the anticipated future synergies and outperformance arising from the merger into South West Water.

The acquisition has been accounted for using the acquisition method. Goodwill of £42.3m has been capitalised attributable to the anticipated future synergies and outperformance arising from the merger into South West Water.

On 1 June 2015 Viridor Waste Management Limited acquired Commercial Recycling Limited's waste collection division in Dorset and Somerset for an initial £4.5m. An additional payment of up to £1.0m could be made in the future depending upon certain performance-related criteria. The acquisition has been accounted for using the acquisition method.

Goodwill of £3.4m has been capitalised attributable to the profitability of the acquired business.

No amount of goodwill related to these acquisitions is expected to be deductible for tax purposes.

The residual excesses over the net assets acquired in each business combination has been recognised as goodwill.

PENNON GROUP PLC

Notes (continued)

14. **Acquisition note (continued)**

Fair values on acquisition	**Bournemouth Water £m**	**Waste Collection Division £m**
Intangible assets	2.3	1.6
Property, plant and equipment	228.5	0.5
Inventories	0.1	-
Trade and other receivables	23.8	-
Cash and cash deposits	13.8	-
Retirement benefit surplus	1.9	-
Borrowings	(160.2)	-
Trade and other payables	(19.7)	-
Other liabilities	(0.5)	-
Taxation - current	(2.7)	-
Deferred tax liabilities	(24.8)	-
Provisions	(0.2)	-
Net assets acquired	**62.3**	**2.1**
Goodwill	42.3	3.4
Total consideration	**104.6**	**5.5**
Satisfied by:		
Cash	100.3	4.5
Transfer of amounts due to Bournemouth Water	4.3	-
Deferred consideration	-	1.0
	104.6	5.5
Net cash outflow arising on acquisition:		
Cash consideration	100.3	4.5
Cash and cash deposits acquired	(13.8)	-
	86.5	4.5
Revenue for the period since acquisition to 31 March 2016	41.9	4.6
Profit before tax for the period since acquisition to 31 March 2016	6.0	0.7
Directly attributable costs included in other operating expenses	2.9	0.2

The fair value of acquired trade and other receivables in Bournemouth Water Investments Limited on acquisition was £23.8m. This included gross contracted amounts receivable of £21.8m, of which cash flows of £1.0m were not expected to be collected.

Goodwill movement	**£m**
At 1 April 2015	339.3
Acquisition of Bournemouth Water Investments Limited	42.3
Acquisition of the waste collection division of Commercial Recycling Limited	3.4
At 31 March 2016	385.0

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