

4 June 2020

Full Year Results 2019/20

Strategic value realised through sale of Viridor, well positioned for new regulatory delivery period

Pennon, one of the UK's largest environmental infrastructure groups, is issuing its Full Year Results for the year ended 31 March 2020.

Solid 2019/20 performance

- We continue to do all we can to support our employees, customers and communities through this unprecedented COVID-19 pandemic, with the vast majority of operations continuing as usual
- Pennon is well positioned with strong funding and liquidity of £1.6 billion, prior to receipt of net cash proceeds from Viridor sale, to weather ongoing uncertainty
- Solid financial and operational performance across the Group, in line with management expectations, delivering for all our stakeholders, well positioned for K7 (2020-25)
- South West Water finished K6 (2015-20) with sector leading cumulative RORE¹ of 11.8%
- Viridor has performed well, successfully delivering key priorities and growth investment
- Delivering on dividend commitment for 2019/20, announcing a sustainable 2020-25 dividend policy for the Continuing Group of CPIH² +2% per annum

Financial impact of COVID-19

- Financial impacts for 2019/20 focused on expected credit losses (ECL) – related to customer debt – provision of £9.0 million across the Pennon Group
- Pennon Water Services not requiring deferral of wholesale payments at this stage – a number of other retailers taking advantage of wholesaler regulatory support
- Impact for 2020/21 – assumes a three month lockdown with ramp-up over the remaining year
 - non-household revenue expected to reduce, offset by increased household demand
 - risk from ECL for businesses, retailers and households. Support schemes to mitigate impacts
 - Viridor resilient through ERF contracts

¹ Return on Regulated Equity

² A measure of inflation which includes housing costs

Sale of Viridor on track for early summer completion

- Sale of Viridor to KKR³ for an Enterprise Value of £4.2 billion representing an EV / EBITDA multiple of 18.5x⁴
- Shareholder approval and European Commission merger clearance received, now finalising the last condition precedent
- Net cash proceeds expected to be £3.7 billion⁵, to be used to reduce Pennon company borrowings, reduce the pension deficit, retain headroom for future value creating opportunities, and make a return to shareholders
- Following the sale of Viridor, Pennon will focus on its sector leading water and wastewater businesses and will continue to pursue growth within the UK water industry.

³ Planets UK Bidco Limited (Bidco), a newly formed company established by funds advised by Kohlberg Kravis Roberts & Co. L.P. (KKR)

⁴ Based on Viridor's 2018/19 Adjusted EBITDA of £225.4 million

⁵ Taking into account customary deductions for costs related to the Disposal and assumes a completion date of 31 May 2020 which has been chosen for illustrative purposes only

Financial Highlights

Underlying [^]	Continuing Group		Continuing Group and Viridor		
	2019/20	2018/19	2019/20	2018/19	Change
Revenue	£636.7m	£632.6m	£1,389.9m	£1,478.2m	(6.0%)
EBITDA [^]	£365.3m	£367.3m	£563.4m	£546.2m	+3.1%
Adjusted EBITDA [^]	£365.3m	£367.3m	£619.8m	£592.7m	+4.6%
Operating profit	£245.5m	£250.1m	£361.5m	£351.0m	+3.0%
Profit before tax (PBT)	£183.0m	£191.7m	£287.6m	£280.2m	+2.6%
Non-underlying items before tax ⁶	£10.1m	£9.7m	£13.9m	(£19.9m)	-
Profit before tax	£193.1m	£201.4m	£301.5m	£260.3m	+15.8%
Tax	(£70.6m)	(£32.8m)	(£95.2m)	(£37.7m)	(152.5%)
Discontinued Operations	£83.8m	£54.0m			
Profit for the Year	£206.3m	£222.6m	£206.3m	£222.6m	(7.3%)
Statutory earnings per share	47.7p	51.1p	47.7p	51.1p	(6.7%)
- From continuing operations	27.7p	38.2p			
Adjusted earnings per share⁷	61.7p	57.8p	61.7p	57.8p	+6.7%
Dividend per share ⁸	43.77p	41.06p	43.77p	41.06p	+6.6%

IFRS 16: Leases

From 1 April 2019 the Group adopted the new accounting standard IFRS 16: Leases resulting in a marginal net impact on the income statement. A full reconciliation is included in note 15 on pages 62 to 65 of this announcement.

Continuing Group

On 18 March 2020, the Group entered into a formal sale agreement to dispose of Viridor to Planets UK Bidco Limited (Bidco), a newly formed company established by funds advised by Kohlberg Kravis Roberts & Co. L.P. (KKR). In accordance with IFRS 5 'Non-current assets held for sale and discontinued operations', the operations of Viridor have been classified as discontinued operations in both the current and prior year. The 'Continuing Group' consists of South West Water, Pennon Water Services and Pennon Group (the Company).

The results of the Continuing Group compared to 2018/19 reflect:

- Revenue up marginally, from £632.6 million to £636.7 million as growing retail revenues from Pennon Water Services from outside of South West Water's operational region offsets lower wholesale revenues from South West Water due to weather driven reduced demand

[^] Measures with this symbol ^ are defined in the Alternative Performance Measures (APMs) as outlined on pages 67 to 72

⁶ Non-underlying items are adjusted for by virtue of their size, nature or incidence to enable a full understanding of financial performance

⁷ EPS before deferred tax and non-underlying items

⁸ The RPI rate used is 2.6% as of 31 March 2020.

- EBITDA is marginally lower at £365.3 million from £367.3 million, reflecting the mix of margin on retail and wholesale revenues, with South West Water's wholesale margin reducing as a result of lower customer consumption
- Profit before tax reduces by £8.7 million from £191.7 million to £183.0 million reflecting lower EBITDA, increased depreciation on asset growth and higher absolute interest
- Non-underlying items of £10.1 million reflect the gain from efficient financing, net of COVID-19 related ECL adjustments
- Tax of £70.6 million (increased from £32.8 million) primarily reflects the change in the legislated tax rate from 17% up to 19% which has increased the deferred tax charge
- Discontinued operations of £83.8 million (up from £54.0 million) reflects the delivery of growth and expansion of Energy Recovery Facilities in Viridor
- Adjusted earnings per share up +6.7% to 61.7p, statutory earnings per share down (6.7%) to 47.7p reflecting the deferred tax charge from changes in enacted headline rates
- Dividend per share up +6.6% to 43.77p.

To aid the comparability of reported results year on year, the figures and narrative in this statement will focus primarily on the results of the aggregate Continuing Group and Viridor. A full reconciliation of the statutory reported results is included in Item (i) in the Alternative Performance Measures on pages 67 to 72 of this announcement.

Continuing Group and Viridor

- As expected, Group revenue reduced 6.0% to £1,389.9 million, reflecting the exit from Viridor's Greater Manchester contract and lower demand at South West Water due to weather driven lower volume consumption by customers
- Underlying profit before tax increased +2.6% to £287.6 million, supported by efficiencies across the Group and earnings growth from Energy Recovery Facilities (ERF) at Viridor
- Profit before tax for the year increased +15.8% to £301.5 million, due to efficient financing providing a non-underlying gain
- The increase in the tax charge largely reflects the deferred tax impact of the Government's decision not to go ahead with the planned reduction in corporation tax rate from 19% to 17%
- Adjusted earnings per share up +6.7% to 61.7p, statutory earnings per share down (6.7%) to 47.7p reflecting the deferred tax charge from changes in enacted headline tax rates
- Dividend per share up +6.6% to 43.77p
- Group has £1.6 billion of cash and committed facilities providing strong liquidity and funding
 - £840 million of new or renewed finance was raised in 2019/20, including £245 million of funding through the Sustainable Financing Framework for South West Water.

OUTLOOK

Completion of the Viridor disposal is expected early summer 2020, following which the Continuing Group of South West Water and Pennon Water Services and Pennon Group (the Company) will be a UK focused water infrastructure group.

Entering the new K7 regulatory period (2020-25), South West Water is the only water and wastewater company to have achieved fast-track status for two consecutive price reviews. Work is underway to deliver the commitments in the Business Plan focusing on cost base efficiency, operational performance, customer service and sustainable growth. South West Water is focused on providing services in the most efficient and sustainable way, using innovation and new technologies to serve its customers, communities and the environment.

Chris Loughlin, Pennon Chief Executive, commented:

“We are pleased with the solid operational and financial performance delivered this year. Viridor has continued to drive growth while South West Water has maintained its sector leading returns. In these uncertain and difficult times arising from the COVID-19 pandemic we would like to thank all our employees across the Group for the incredible hard work and dedication that has contributed to this performance. The health, safety and wellbeing of our employees and customers is paramount and continues to be our number one priority.

The performance for 2019/20 underpins the dividend of 43.77p per share.

It has been a landmark year for Pennon, culminating in the announcement in March of the proposed sale of Viridor to KKR for an Enterprise Value of £4.2 billion. Viridor has become a leader in engineering excellence, new technology and tackling environmental challenges, and the transaction recognises the strategic value that has been created over many years, accelerating the realisation of that value for shareholders.

Following the sale, Pennon will be a leading UK-focused water infrastructure group, delivering for customers and providing services in the most efficient and sustainable way possible. We are pleased to announce our Continuing Group dividend policy of CPIH + 2% growth per annum through to 2025, with additional returns to shareholders to come from the sale of Viridor.”

Presentation of Results

A presentation of these results hosted by Chris Loughlin, Chief Executive Officer and Susan Davy, Chief Financial Officer will be available on our website www.pennon-group.co.uk/investor-information at 09.00am BST, today 4 June 2020.

We will be hosting a live Q&A session from 10:00am via conference call. Please [click this link to register for the conference call](#).

For further information, please contact:

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PENNON BUSINESS REVIEW

Notwithstanding the challenging backdrop of the COVID-19 pandemic, Pennon has maintained its positive momentum through 2019/20 delivering solid performance in both water and waste as we enter the new K7 (2020-25) period. On 18 March 2020 we announced the sale of Viridor to KKR for £4.2 billion which the Board unanimously believe realises the full strategic value that Pennon has developed and nurtured in Viridor over many years, and the realisation of that value for shareholders.

COVID-19

Operational impact of COVID-19

In these unprecedented times, arising from the COVID-19 pandemic, the health, safety and wellbeing of our employees and customers is paramount and remains our number one priority. Following the latest Government and Public Health guidance, we have strict precautions in place at our sites including enhanced levels of cleaning, additional hygiene facilities and protective personal equipment, and social distancing. The majority of our employees are designated key workers and are delivering the best possible service to customers during this challenging time. Enhanced precautions and safety checks have been established and only critical customer visits are taking place. We know that this is a difficult time for our customers and we have stepped up our support for those in vulnerable circumstances, including a dedicated COVID-19 priority services register and extending our support schemes for customers who struggle to pay their bills.

Financial impact of COVID-19

The financial impact of COVID-19 on our 2019/20 financial results have been limited to the expected credit losses (ECL) on our customer debt across the Group (£9.0 million provision recognised) with the largest impact for non-household business customers of c.£5.0 million. There has been no significant additional Totex impact as a result of the pandemic to date.

During lockdown South West Water has seen a change in customer demand with a decline in wholesale demand from businesses (c.20%), particularly those within hospitality and retail sectors, net of increased residential demand (c.5%) as people remain at home during this period with c.84% of our customers on a meter. We continue to monitor these impacts closely, however any net shortfall in household and non-household demand would be recovered through existing regulatory mechanisms.

The extent of the impact of COVID-19 on the UK economy remains uncertain with the risk of ECL from business and commercial customers increasing during and following lockdown, although post year end cash collections have remained strong and Pennon Water Services has not taken advantage of wholesaler regulatory support through deferral of any payments at this stage.

The strong collections performance for household customers and use of our social tariff and support schemes has successfully reduced our bad debt costs in recent years. We believe these support measures and our continued focus on collections will help mitigate the financial impacts of COVID-19.

The strong local authority contracted position in Viridor provides resilience to the underlying business, with strong ERF performance mitigating the volume impact from commercial & industrial customers in collections, landfill and recycling.

Solid financial and operational performance

South West Water finished the K6 (2015-20) regulatory period with a sector leading return on regulated equity (RORE) and the successful conclusion of the 2019 Price Review process (PR19). As a result, South West Water began the K7 (2020-25) regulatory period as the only company to have achieved fast-track status for its Business Plan in two consecutive 5-year Price Reviews.

Over K6 South West Water has transformed performance in many key operational areas and is focused on delivering for customers and targeting environmental performance improvements.

Pennon Water Services has sustained its position in the competitive market providing high quality customer services, whilst improving its profitability through growth in value added services and reducing the unit cost to serve through automation, self-service and efficiency.

This has been an important year for Viridor operationally, as the most recent ERFs at Glasgow, Beddington and Dunbar have moved through their ramp-up phases and the construction at Avonmouth ERF has progressed with commissioning underway.

We continue to deliver on our promises to customers, communities and shareholders as our investments drive tangible, positive and sustainable results for all our stakeholders. Over 60% of Pennon's shareholders are UK pension funds, savings, charities, individuals and employees, with over half of South West Water's employees being shareholders.

Crystallising value from the sale of Viridor

Over recent years, the Board has closely monitored the market value of the Group and its component parts. It has been clear for some time that the fundamental value of Viridor was not fully reflected in Pennon's share price. In addition, given the strong financial performance and operational progress of the Group, the Board announced in September 2019 that it was an appropriate time to conduct a review of the strategic focus, growth options and capital allocation policy for the Group.

The sale of Viridor recognises the full strategic value that Pennon has developed and nurtured in Viridor over many years and accelerates the realisation of that value for shareholders. The Board carefully considered the wider implications of the deal and agreed unanimously that the transaction was in the best interests of shareholders and key stakeholders.

The sale of Viridor for an enterprise value of £4.2 billion was approved by Shareholders on 28 May 2020 and European Commission merger clearance has been received. We are finalising the last condition precedent ahead of an expected completion in early summer.

Pennon has strategically invested in Viridor since 1993, creating a de-risked infrastructure model across a complementary portfolio of assets, underpinned by long-term, index linked contracts. Viridor's ability to capitalise on economic and market trends has delivered consistent growth and we look forward to seeing how the business develops through its next phase under new ownership.

Dividend policy

The Board has evaluated the Group's dividend for 2019/20 in light of the COVID-19 pandemic and has concluded that it is appropriate for Pennon to continue to deliver on its dividend commitment. The Group has significant cash and liquidity of £1.6 billion (prior to receipt of net cash proceeds from the sale of Viridor), has not received any Government support measures and continues to progress our WaterShare+ scheme which will see c.£20 million of benefit shared with customers through a customer rebate or a stake in the business through Pennon shares. In addition, the majority of Pennon's shareholders are UK based pension funds, charities, employees, customers and other retail holders who rely on this income.

For 2019/20, the Board has recommended a final dividend of 30.11p, subject to shareholder approval at the Annual General Meeting on 31 July 2020. Together with the interim dividend of 13.66p, this will result in a total dividend of 43.77p, an increase of +6.6% from last year. This is in line with our dividend policy for 2010-2020 of Retail Price Index (RPI) +4% growth per annum, which has been achieved whilst investing more than £3.6 billion in our businesses over the past 10 years. Pennon offers shareholders the opportunity to invest their dividend in a Dividend Reinvestment Plan (DRIP).

The crystallisation of the Viridor sale is equivalent to 22.66p per share of the recommended 2019/20 dividend. This implies a Continuing Group dividend (after excluding Viridor) of 21.11p per share.

The Board intends to use the c.£3.7 billion of net cash proceeds to reduce Pennon's company borrowings and pension deficit, retain some funds for future opportunities, and make a return to shareholders. Details of additional returns to shareholders from the sale of the Viridor business will be announced in due course.

Pennon's dividend policy for 2020-25 for the re-based Continuing Group will be growth of CPIH + 2% per annum, from an implied Continuing Group dividend for 2019/20 of 21.11p per share. The shift from the existing policy of linking the growth in dividend from RPI to CPIH reflects the change in the regulatory model for South West Water, matching allowed revenues.

The re-based dividend reflects the sector leading position of the Continuing Group, with expectations for outperformance on financing and Totex supporting the sustainable dividend growth policy and dividend cover.

Final dividend payment information

23 July 2020	Ordinary shares quoted ex-dividend
24 July 2020	Record date for final dividend
10 August 2020*	Final date for receipt of DRIP applications
2 September 2020*	Final dividend payment date

*These dates are provisional and are subject to obtaining shareholder approval at the 2020 Annual General Meeting.

Upcoming Events

Early Summer	Expected completion of Viridor sale
31 July 2020 ⁹	Annual General Meeting
18 September 2020	Capital Markets Day
25 September 2020	Trading Statement
24 November 2020	Half Year Results 2020/21
30 March 2021	Trading Statement
25 May 2021	Full Year Results 2020/21

⁹ Rescheduled from previously published date of 23 July 2020

PENNON FINANCIAL PERFORMANCE

Underlying [^]	Continuing Group		Continuing Group and Viridor		
	2019/20	2018/19	2019/20	2018/19	Change
Revenue	£636.7m	£632.6m	£1,389.9m	£1,478.2m	(6.0%)
EBITDA [^]	£365.3m	£367.3m	£563.4m	£546.2m	+3.1%
Adjusted EBITDA [^]	£365.3m	£367.3m	£619.8m	£592.7m	+4.6%
Depreciation and amortisation	(£119.8m)	(£117.2m)	(£201.9m)	(£195.2m)	(3.4%)
Operating profit	£245.5m	£250.1m	£361.5m	£351.0m	+3.0%
Net interest	(£62.5m)	(£58.4m)	(£88.7m)	(£83.2m)	(6.6%)
Share of JV profit after tax			£14.8m	£12.4m	+19.4%
Profit before tax (PBT)	£183.0m	£191.7m	£287.6m	£280.2m	+2.6%
Non-underlying items before tax ¹⁰	£10.1m	£9.7m	£13.9m	(£19.9m)	-
Profit before tax	£193.1m	£201.4m	£301.5m	£260.3m	+15.8%
Tax	(£70.6m)	(£32.8m)	(£95.2m)	(£37.7m)	(152.5%)
Discontinued Operations	£83.8m	£54.0m			
Profit for the year	£206.3m	£222.6m	£206.3m	£222.6m	(7.3%)
PAT (attributable to holders of hybrid capital)	£7.0m	£8.6m	£7.0m	£8.6m	(18.6%)
PAT (attributable to minority interests)	(£1.1m)	(£0.3m)	(£1.1m)	(£0.3m)	+266.7%
PAT (attributable to shareholders)	£200.4m	£214.3m	£200.4m	£214.3m	(6.5%)
Adjusted earnings per share ¹¹	61.7p	57.8p	61.7p	57.8p	+6.7%
Statutory earnings per share	47.7p	51.1p	47.7p	51.1p	(6.7%)
- From continuing operations	27.7p	38.2p			
Dividend per share ¹²	43.77p	41.06p	43.77p	41.06p	+6.6%
Capital investment ¹³			£339.2m	£395.9m	(14.3%)
South West Water			£161.0m	£154.0m	+4.5%
Viridor ¹³			£177.6m	£241.7m	(26.5%)
Other			£0.6m	£0.2m	+200.0%
			31 March 2020	31 March 2019	Change
Net debt Continuing Group and Viridor			£3,264.0m	£3,079.5m	+6.0%

[^] Measures with this symbol [^] are defined in the Alternative Performance Measures (APMs) as outlined on pages 67 to 72.

¹⁰ Non-underlying items are adjusted for by virtue of their size, nature or incidence to enable a full understanding of financial performance

¹¹ EPS before deferred tax and non-underlying items

¹² The RPI rate used is 2.6% as of 31 March 2020

¹³ Including construction spend related to service concession arrangements net of amounts subject to legal contractual process

IFRS 16: Leases

From 1 April 2019 the Group adopted the new accounting standards IFRS 16: *Leases* resulting in a marginal net impact on the income statement and balance sheet.

Based on the additional lease liability and associated assets recognised at 1 April 2019 for the Continuing Group the impact on profit for the year ended 31 March 2020 was a reduction in profit after tax of £0.6 million, resulting from:

- an increase in EBITDA of £1.9 million
- an increase in depreciation of £1.4 million
- an increase in finance costs of £1.2 million; and
- a reduction in corporation tax of £0.1 million.

A full reconciliation is included in note 15 on pages 60 to 63 of this announcement.

Non-underlying items

The non-underlying items before tax for the Continuing Group and Viridor total a credit £13.9 million and after tax total a charge of £29.3 million, consisting of:

- | | |
|--|----------|
| • The movement in the fair value of long-dated derivatives associated with South West Water's 2040 bond. These derivatives no longer met the Group's accounting hedging requirements and early settlement enabled South West Water to lock in a 'mark to market' gain. This has resulted in the recognition of a pre-tax credit of £18.0 million and cash proceeds on termination of the derivative of £87.2 million | £18.0m |
| • A provision charge for expected credit losses related to the impacts of the COVID-19 pandemic across the Group – c.£5 million Pennon Water Services, c.£3 million South West Water and c.£1 million Viridor | (£9.0m) |
| • Aspects of the closedown of defined benefit pension commitments following the cessation of the Greater Manchester recycling operating contract resulting in a pre-tax credit | £4.9m |
| • A net tax charge on the above items | (£2.6m) |
| • A deferred tax charge resulting from the announced change of headline tax rates from 17% to 19% | (£40.6m) |

Of the total £29.3 million net charge, £22.1 million relates to the Continuing Group with £7.2 million relating to Viridor.

Financial performance from the Continuing Group and Viridor (before non-underlying items)

Given the significant contribution of Viridor to the Group's results for entire financial year, pro forma results for the whole Group including continuing and discontinued operations have been presented alongside the statutory results in the income statement. The commentary on the overall performance of the Group is based on this approach.

Revenue

Group revenue has reduced by 6.0% (£88.3 million) to £1,389.9 million (2018/19 £1,478.2 million). The majority of this reduction was due to the planned cessation of the Greater Manchester recycling operating contract and lower landfill tax receipts in Viridor. South West Water's revenue has reduced marginally due to customer demand falling from the exceptionally hot, dry summer in 2018/19 in comparison with the wetter weather this year. Revenues in Pennon Water Services are broadly in line with the previous financial year with the decrease in South West Water revenues offset by continuing growth in the rest of the market, with a focus customer profitability.

EBITDA

Group EBITDA and adjusted EBITDA were ahead of last year by 3.1% at £563.4 million (2018/19 £546.2 million) and 4.6% to £619.8 million (2018/19 £592.7 million) respectively driven by good operational cost control across the Group and strong performance across Viridor's activities, particularly from the fleet of ERFs.

Net finance costs

Underlying net finance costs of £88.7 million are £5.5 million higher than last year (2018/19 £83.2 million), primarily due to the cessation of capitalising interest on assets in the course of construction as the Beddington, Glasgow and Dunbar ERFs which are now operational.

The Group continues to secure funding at a cost that is efficient with the effective interest rate reducing to 3.5% (2018/19 3.6%), reflecting lower margins on new and renewed financing. The effective interest rate for South West Water is 3.4%, reduced from 3.5% in the prior year.

The effective interest rate is calculated after adjusting for capitalised interest of £11.0 million (2018/19 £15.2 million), notional interest items of £9.0 million (2018/19 12.5 million), interest received from shareholder loans to joint ventures of £5.3 million (2018/19 £5.3 million) and service concession contracts of £15.1 million (2018/19 £14.6 million).

During 2019/20 underlying net finance costs (excluding pensions net interest costs of £0.8 million (2018/19 £1.4 million), discount unwind on provisions of £8.2 million (2018/19 £11.1 million) and interest receivable from service concession contracts of £15.1 million (2018/19 £14.6 million) were covered 3.8 times by Group operating profit (2018/19 4.1 times)).

Profit before tax

Group underlying profit before tax was £287.6 million, an increase of 2.6%, compared with the prior year (2018/19 £280.2 million). Included in profit before tax is our share of joint venture profit after tax of £14.8 million (2018/19 £12.4 million). After non-underlying items, profit before tax was £301.5 million (2018/19 £260.3 million) reflecting a combined non-underlying credit before tax from continuing and discontinued operations of £13.9 million (2018/19 charge of £19.9 million).

Taxation

On an underlying basis the net tax charge of £52.0 million (2018/19 £42.7 million) consists of:

- Current year current tax charge of £28.0 million, reflecting an effective tax rate of 9.7% (2018/19 £32.4 million, 11.6%). The lower effective rate versus the UK's mainstream corporation tax rate of 19% reflects the accelerated level of capital allowance claims available to the Group compared with the depreciation charge and tax relief on accelerated pension deficit recovery payments made during the year
- Current year deferred tax charge of £26.7 million (2018/19 £23.2 million) primarily reflect capital allowances across the Group in excess of depreciation charged
- Following the submission of prior year tax computations:
 - Current tax credit of £9.2 million (2018/19 £3.0 million), reflecting clarification of uncertain tax items
 - Deferred tax charge of £6.5 million (2018/19 £9.9 million credit), reflecting finalisation of capital allowance claims

The 2019/20 non-underlying items result in a £43.2 million¹⁴ tax charge (2018/19 £5.0 million credit), primarily reflecting the impact of the announced change of tax rates from 17% to 19% in March 2020.

Overall, the total tax charge for the year was £95.2 million (2018/19 £37.7 million). The Group's taxes borne and collected (those that are a cost to the Group and those where the business acts as a collector of taxes) results in a total tax contribution of £278 million¹⁵ being paid to the Government.

¹⁴ £15.3 million current tax charge and £27.9 million deferred tax charge

¹⁵ Total tax contribution includes landfill tax collected and borne, VAT, business rates, employment taxes, corporation tax, fuel excise duty, carbon reduction commitment, environmental payments and climate change levy

Earnings per share

Whilst earnings per share on an underlying basis increased by 6.7% to 61.7p (2018/19 57.8p), earnings per share on a statutory basis reduced by 6.7% to 47.7p (2018/19 51.1p) driven by the c.£41 million non-underlying deferred tax charge relating to the change in tax rate from 17% to 19%. From 2019/20 the 2017 perpetual capital securities qualify for tax relief, following a change in legislation. The tax relief for 2019/20 is £1.6 million, increasing earnings per share by 0.4p.

Strong cash inflows from operations, continuing capital investment

The Group's operational cash inflows in 2019/20 were £728.6 million (2018/19 £649.0 million). These funds have been put to use in efficiently financing the Group's capital structure and investing in our capital programmes. This capital investment has resulted in marginally higher Group net debt (before the effects of IFRS 16).

Contributions into the Group's pension schemes were £48.1 million (2018/19 £32.2 million), including a voluntary £17.2 million accelerated deficit recovery payment. Corporation tax payments were £52.6 million (2018/19 £29.2 million) reflecting the changes in legislation for the timing of payments on account. Other tax payments made by the Group in 2019/20 total £147.1 million¹⁶ (2018/19 £137.9 million).

Sustainable funding position

The Group has a strong liquidity and funding position with £1,639 million cash and committed facilities at 31 March 2020. This consists of cash and deposits of £699 million (including £227 million of restricted funds representing deposits with lessors against lease obligations) and undrawn facilities of £940 million. At 31 March 2020 the total Group borrowings were £3,963 million, including £137 million of obligations now classified as leases under IFRS 16. £3,715 million of gross borrowings are in the Continuing Group with £2,520 million at South West Water and £1,195 million at Pennon Group and subsidiaries and £248 million of lease liabilities in Viridor.

The net debt of the Continuing Group including Viridor (before the impact of IFRS 16) was broadly comparable with the prior year. An increase of £137 million has been recognised attributable to lease liabilities in accordance with IFRS 16. As a result, total net debt is £3,264 million compared with £3,080 million in the prior year. The net debt of the Continuing Group as at 31 March 2020 is £3,049 million (£822 million at Pennon Group and £2,227 million at South West Water).

Pennon has pioneered a Sustainable Financing Framework to integrate commitments to environmental and social objectives into a variety of funding opportunities across the Group, with

¹⁶ Total tax includes business rates, employers' national insurance, fuel excise duty, carbon reduction commitment, environmental payments, climate change levy and external landfill tax

£845 million raised since 2018. The framework allows Pennon to access future funding opportunities aligned with the Green Loan Principles, Green Bond Principles and Social Bond Principles. The framework has been certified by DNV GL a leading sustainability verifier. Pennon is committed to continuous annual improvements in sustainability ratings and KPIs which may lead to improved interest rate margins.

During the year, £840 million of new and renewed facilities have been agreed, £500 million in Pennon Group plc and £340 million in South West Water. The total includes a Pennon revolving credit facility (RCF) which provides the Group with flexible, efficient and effective funding during the strategic review. In total, £245 million of the new facilities signed in the year are linked to the sustainable nature of the business. This includes a new £50 million CPI linked sustainable loan, this maintains South West Water's proportion of index linked net debt and supports the industry's transition from RPI to CPIH.

During the year the Group also early settled the fixed to floating rate derivatives associated with the South West Water Finance plc 2040 bond. The settlement locked in the value and removed the future volatility from the income statement, the resulting cash inflow of £87.2 million will be utilised to fund South West Water's capital commitments.

In preparation for the announced abolition of LIBOR in 2021, South West Water has completed the first LIBOR to SONIA amendment for a sustainable RCF. While financial institutions finalise the precise workings of the successor measure to LIBOR, widely expected to be SONIA, this amendment to an existing facility allows the Group to address documentation and early system changes that will be required. Further work continues and later this year it is expected that our financial institutions will no longer provide LIBOR linked financial products.

Efficient long-term financing strategy

The Group has a diversified funding mix of fixed (£1,797 million, 55%), floating (£844 million, 26%) and index-linked borrowings (£623 million, 19%). The Group's debt has a maturity of up to 37 years with a weighted average maturity of c.17 years. Much of the Group's debt is floating rate and derivatives are used to fix the rate on that debt.

Following the K7 (2020-25) South West Water Final Determination the Group has aligned its hedging strategy with the changed regulatory methodology in this area. A proportion of new debt will be hedged in K7 on a rolling ten-year basis while still maintaining flexibility within the overall portfolio. Embedded debt hedging is aligned with the five year regulatory delivery period. Around 60% of South West Water's embedded floating net debt has already been hedged through K7, taking advantage of falling swap rates and assuring the Group transitions smoothly into the new regulatory period.

South West Water's cost of finance, with an effective rate of 3.4%, is among the lowest in the industry. Around two-thirds of South West Water's net debt is from finance leases which provide a long maturity profile. Interest payable benefits from the fixed credit margins which are secured at the inception of each lease. £576 million (c.26%) of South West Water's net debt is index-linked. This is below Ofwat's notional assumption of 33%, giving an advantageous position through regulatory transition from RPI to CPIH.

The overall average effective rate through the K6 regulatory period for South West Water has been 3.3%, being a drop of 0.6% from the average rate achieved in the K5 regulatory period of 3.9%. Expectations are for a similar period on period reduction in the effective interest rate as we move into K7, given the advantageous interest rate hedging that has been undertaken to date.

Net debt position

The net debt of the total Group including Viridor was £3,264 million, an increase of £184 million during the year (2018/19 £3,080 million), which is largely attributable to £137 million of lease liabilities being recognised in accordance with IFRS 16. For the purposes of banking covenants these lease obligations are excluded from net debt. The net debt of the Continuing Group as at 31 March 2020 is £3,049 million, and ongoing covenants are not adversely impacted by the Viridor sale.

In the year, cash inflow from operations was strong at £728.6 million (2018/19 £649.0 million). Cash outflows relating to the capital programme totalled £339.9 million¹⁷ (2018/19 £384.5 million). The gearing ratio at 31 March 2020, being the ratio of net debt to (equity plus net debt) was stable at 64.6%¹⁸ (31 March 2019 64.7%).

The combined South West Water and Bournemouth Water debt to RCV ratio is 63.6%¹⁹ (31 March 2018 58.9%) which is broadly in line with Ofwat's K6 target for efficient gearing of 62.5%. Gearing at South West Water is expected to fall in the coming regulatory period meeting the trajectory of Ofwat's notional structure. During the year South West Water also made a voluntary accelerated pension deficit recovery payment of £17.2 million covering two years of planned payments, adding 0.5% to gearing.

Group net debt includes £2,227 million for South West Water and £215 million for Viridor, with £822 million implied for Pennon the Company.

¹⁷ Includes net proceeds from sale of property, plant and equipment and spend on service concession arrangements (before amounts subject to legal contractual process)

¹⁸ Before the impact of IFRS 16. Group Gearing including the impact of IFRS 16 is 65.6% (64.7% at 31 March 2019)

¹⁹ Based on regulatory capital value (RCV) at 31 March 2019 and South West Water group net debt (excluding the impact of IFRS 16). Regulatory South West Water Limited gearing including IFRS 16 is 64.6% at 31 March 2020 (58.9% at 31 March 2019)

Reducing capital investment as ERF build out progresses

Group capital investment from continuing and discontinued operations decreased to £339.2 million in 2019/20 from £395.9 million in 2018/19.

South West Water

South West Water's capital expenditure in the year was £161.0 million, compared to £154.0 million in 2018/19 with the profile aligned with the K6 capital plan, in addition to expenditure accelerated to make an early start on key K7 initiatives focused on ODI²⁰ delivery.

Key areas of investment and activity during 2019/20 included:

- Further investments in our drinking water quality programme including installation of granular activated carbon (GAC) treatment at College water treatment works in Cornwall. This £10 million project will improve the resilience of our water quality for c.35,000 customers
- Continued investment in the network to drive leakage reduction to support pledges made in the next regulatory period
- Investment in the Plymouth region to improve resilience of water supplies with the completion and commissioning of the Mayflower water treatment works and upgrades to the network and pumping stations
- Schemes to deliver National Environment Programme (NEP) commitments, including phosphorus and ammonia discharge reductions
- Continued improvements at wastewater treatment works, including flood resilience and at pumping stations to reduce pollution incidents
- Investment for growth to meet increases in supply and demand
- Early preparations for the new water treatment works in Bournemouth, building on the innovative investment at Mayflower.

Pennon Water Services

Capital investment during the year was focused on improving service and driving efficiency within our systems and processes.

Viridor

Viridor's capital spend in the year was £177.6 million (2018/19 £241.7 million), a reduction of £64.1 million over 2018/19 as the ERF assets have become operational.

The majority of the expenditure continues to relate to the ERF portfolio, principally the continued development of Avonmouth ERF where commissioning is underway. Other larger projects in the

²⁰ Outcome Delivery Incentives - ODIs

year include the commencement of construction of the £65.0 million Avonmouth plastics recycling facility and upgrade of Masons Materials Recycling Facility (MRF).

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 2020, the Group's pension schemes showed an aggregate deficit (before deferred tax) of £8.5 million (March 2019 £60.8 million), a reduction of £52.3 million as a result of:

- £32.6 million contributions over and above the ongoing service and net interest charges following the Group's decision to voluntarily accelerate £17.2 million of the planned deficit recovery payments
- Greater Manchester recycling operating contract cessation decreasing liabilities by £2.0 million
- Reduction in liabilities of £51.9 million due to lower long term inflation rates reducing liabilities
- £25.1 million reduction in asset values caused by the financial market uncertainty arising from the COVID-19 pandemic
- Changes in other actuarial assumptions increasing the net deficit by £9.1 million.

The net aggregate liabilities of c.£7 million (after deferred tax) represents less than 0.2% of the Group's market capitalisation at 31 March 2020.

Of these liabilities a surplus of £6.6 million relates to Continuing Group and a deficit of £15.1 million relates to Viridor. On completion of the Viridor sale, expected early summer 2020, the Continuing Group will assume responsibility for near all of Viridor's defined benefit obligations.

For the Group's principal scheme, of which South West Water accounts for around 82%, Viridor 12% and 6% for Pennon company, the 2019 triennial valuation has been finalised, recording an actuarial technical provisions deficit of c.£53 million. In agreeing to the valuation, the Group committed to deficit recovery contributions in line with those agreed at the 2016 triennial actuarial valuation to 2022, noting the significant acceleration of contributions during the year.

In addition to the principal scheme, the Group has further pension liabilities (£20.9 million at March 2019 calculated on an actuarial technical provisions basis), that relate to schemes in which the Group participates in connection with Viridor's Greater Manchester recycling operating contract which ceased in May 2019. Following the planned exit from the Greater Manchester recycling operating contract, it is expected that the assets and liabilities associated with all active members of these schemes at 31 May 2019 will transfer to the new operator's pension fund. A non-underlying credit of £4.9 million has been recognised in the income statement in connection with active employees moving to deferred status in these schemes.

The Group is in the process of consulting with all employees on plans to modernise its pension arrangements. The proposals which are being consulted on include the closure of the main defined benefit scheme to future accrual with all employees transitioning to a new defined contribution scheme offered through a master trust arrangement. The outcome of the consultation is expected to be announced in June 2020.

Energy hedging

Pennon has adopted a Group portfolio management approach to energy hedging. The Group has continued to trade over the last 12 months to maintain its net hedged position in accordance with Group policy. Forward hedges for South West Water not already under long-term contracts have been put in place in the liquid market with 100% of the energy requirements hedged until March 2021 and c.92% until March 2022.

SOUTH WEST WATER PERFORMANCE

	2019/20	2018/19	Change
Underlying			
Revenue ²¹	£570.3m	£581.0m	(1.8%)
Operating Costs	(£206.1m)	(£213.9m)	+3.6%
EBITDA	£364.2m	£367.1m	(0.8%)
Depreciation and amortisation	(£118.8m)	(£116.0m)	(2.4%)
Operating profit	£245.4m	£251.1m	(2.3%)
Net interest	(£71.4m)	(£70.5m)	(1.3%)
Profit before tax	£174.0m	£180.6m	(3.7%)

Revenue

South West Water revenue for 2019/20 has reduced by 1.8% (£10.7 million) compared with the prior year. Noting our c.84% metered customer base, tariff rises of 0.6%²² have been offset by lower customer demand (down 3.7%) from the wetter weather experienced this year. Revenue from new customer connections (c.9,000) has been offset by meter switchers and assessed charges. Year on year changes in revenues (compared with the Final Determination) are subject to a revenue ‘true-up’ mechanism.

EBITDA & operating profit

As a result of lower revenue in 2019/20, South West Water’s EBITDA and operating profit reduced by 0.8% and 2.3%, respectively. The ongoing focus on strong cost control and efficiency delivery, as well as extreme weather costs in the prior year which have not been repeated, resulted in operating costs decreasing by 3.6%. South West Water’s bad debt performance remains strong with a charge of 0.5% as a percentage of revenue excluding the impact of COVID-19 (1.0% including COVID-19 impact). This reflects the continuation of efficient cash collections, with the annual charge below the levels assumed in our K6 Final Determination.

COVID-19 resilient delivery of critical services

Focus on safety and supporting our employees and customers

Our focus has been on the safety of our employees and we have prioritised their mental, physical and financial wellbeing. Our swift response to the emerging challenges of the COVID-19 pandemic

²¹ Includes wholesale revenue for non-household customers

²² Net tariff increase reflects the net position post Wholesale Revenue Forecast Incentive Mechanism (WRFIM) pass back of £17.5 million for 2019/20

ensured we have a continuing supply of personal protective equipment (PPE) and we have committed to paying our staff in full without Government support. Our technology infrastructure was resilient and supported the swift changes in working locations and practices allowing staff to work from home wherever possible. We have implemented an extensive staff engagement programme with a dedicated online COVID-19 facility providing up to date information and guidance to support both individuals and their families.

Delivering a robust service safely

During these unprecedented times the health and safety of our staff and customers has been paramount whilst continuing deliver a robust service to the communities we serve. We responded rapidly to the emerging developments and we have maintained the vast majority of our services – particularly those critical to operations and customer needs with over 90% of our staff either at sites, out in the communities they serve or continuing to operate by working from home. We have continued to deliver our key capital schemes, working effectively with our partners to ensure safe working practices. In addition to maintaining services, South West Water successfully completed the expansion into the Isles of Scilly despite the restrictions in place.

Supporting vulnerable customers and maintaining customer service

A key part of our pandemic response has been focused on supporting all our customers through these difficult times, especially those in vulnerable circumstances. We continued to operate our call centre ensuring we maintained our operational support whilst providing reassurance to customers who were concerned about paying their bills.

South West Water was the first company to launch a COVID-19 Priority Services Register where customers could register that they were in a high-risk, vulnerable group and would need ongoing support or if they were self-isolating for a short period due to potential symptoms in their household. Around 21,000 customers have registered over this period and in the unfortunate event of an operational incident these customers will receive support directly to their property.

Like many companies we have limited our visits to customer properties (unless for a critical incident). Despite this we have continued to deliver our support schemes to those customers who struggle to pay their bills and for those on a social tariff or other support scheme. We have extended the period for renewals and lessened the requirements for applications in the short term to provide greater support to those who need it.

We have also supported our communities, providing a mobile incident support vehicle which is being used as a COVID-19 temporary GP medical consultation room in Cornwall.

Well established support for vulnerable customers

South West Water is leading the industry in providing support for customers in vulnerable circumstances or who struggle to pay their bills, with c.60,000 customers benefiting through our range of support programmes. This includes:

- **Social tariff** – continued to develop since its introduction in 2013/14 with over 25,500 customers supported through this scheme
- **WaterCare+ programme** – supporting customers to ensure they are receiving all their eligible benefits (£2.8 million of benefits income realised through this programme since 2015)
- **Restart** – which incentivises customers into regular payment plans (£5.2 million over K6)
- **Freshstart** – a dedicated fund which supports customers who find themselves in temporary hardship (£1.0 million contributed into the scheme over K6)
- **Dual billing pilot** – K7 programme already underway focused on water efficiency and reducing bills.

Our K7 plans continue to focus on this area and we have committed to eliminating water poverty within our regions.

Strong delivery and performance throughout K6 regulatory period

South West Water is committed to delivering outstanding customer service and environmental performance, recognising the substantial role we have within our communities, alongside keeping bills as low as possible.

Customer service improvements over K6

Improving customer service is at the heart of our delivery plans. Since 2015 South West Water has delivered a step change in our SIM score with the highest improvement across the sector²³, ranked third in both the South West and Bournemouth regions and second for the quality of customer service.

Our continued performance improvements since 2015 has seen written complaints more than halve, customer wait times of less than a minute, unwanted contacts reduce c.40%, and complaints to CCW²⁴ have fallen by almost two thirds. In addition, our positive operational response to customer issues and targeted investment has resulted in 96% of operational contacts resolved the first time a customer contacts us.

²³ Based on 2018/19 reported Service Incentive Mechanism (SIM)

²⁴ CCW – previously Consumer Council for Water – ombudsman for customers

Ofwat has ceased publishing comparable SIM score results as it prepares to introduce a new customer experience metric (CMex) in the next regulatory period, and we have been focused on these changes in our delivery plans this year. C-Mex consists of two customer surveys which obtain feedback from those customers who have contacted the company along with a perception survey to a random selection of customers who may not have had any previous interaction with the company.

Exceeded and transformed performance in key operational areas

Whilst a small number of ODIs are in penalty in 2019/20, South West Water is forecasting to deliver net ODI rewards again this year of £2.0 million. This brings the total net reward position for K6 to £13.3 million.

- *Bathing water quality – c.99% achieving sufficient quality, c.83% excellent*

Our legacy of major investment to protect bathing waters continues to be reflected in extremely positive results for the 2019 bathing water season. Of the 151 bathing waters tested in the South West Water region, 149 (c.99%) were classified 'sufficient' or better, with more than c.83% classified as 'excellent'. Neither of the two bathing waters rated as 'poor' were attributed to any failure of South West Water's assets.

- *Leakage – targets met every year*

The leakage target in the South West region was met again this year and has been met every year since targets began. Bournemouth Water K6 leakage target was exceeded, resulting in an ODI reward this year. We continue to focus on new techniques to deliver the stretching commitments for K7, which target a 15% reduction in leakage by 2025.

- *Supply interruptions – maintaining strong performance*

Average duration of supply interruptions per property for South West Water continued to outperform the targeted performance commitment in 2019/20, despite a significant interruption caused by a third-party developer. Excluding this impact, interruptions have more than halved over K6. For the Bournemouth region, the number of properties at reduced risk of large-scale interruptions over K6 outperformed the target resulting in an ODI reward for the year.

- *Water resources – 23rd consecutive year without water restrictions*

Throughout K6 South West Water has achieved zero water restrictions in both regions, again resulting in an ODI reward this year despite the impact of the very dry weather in Summer 2019 placing challenges on specific reservoirs.

- *Flooding – wet weather impacted performance*

The wet weather in 2019/20, including the extreme storms in February 2020, resulted in an increase in internal sewer flooding incidents which exceeded the target for the year, however no penalty was incurred. Over the K6 period the focus on delivering solutions to reduce flooding has been successful with a 12% reduction in internal and 9% reduction external flooding incidents, which outperformed the target in 2019/20.

- *Customer contacts – reduced in both water and wastewater*

Our customers want water that is free from taste, smell and colour and to ensure the odours from our wastewater treatments works are kept at a minimum. We monitor the number of contacts we have in both areas and for 2019/20 outperformed our targets recognising a reward in the year. As well as outperforming our target, over K6 water taste, smell and colour contacts have reduced by 44%, with wastewater odour contacts falling by 27%.

Environmental performance – remains a key area of focus

- *Pollution incidents – serious pollution incidents reducing*

The number of serious pollution incidents (Category 1&2) has reduced with one Category 2 incident in the year (7 incidents in 2015), therefore no penalty has been incurred.

Disappointingly the number of minor pollution incidents (Category 3 & 4) has increased compared to last year. In February 2020 South West Water published a consultation on our plans to tackle wastewater pollution incidents with significant focus to improve this performance with stretching targets for the next regulatory period. The metrics have a key impact on the Environment Agency's Environmental Performance Assessment (EPA).

Delivered sector leading outperformance

South West Water has performed consistently well throughout K6 delivering strong operational and financial performance which underpins our sector leading cumulative RORE²⁵ of 11.8% over K6. We have delivered the highest RORE outperformance in every year.

²⁵ RORE reflects base plus outperformance. It is calculated using actual results before non-underlying items (deflated into 2012/13 prices) and compared against the Final Determination allowances and based on notional gearing, annual average RCV and reflecting the value of tax impacts at the actual annual effective tax rate for the year

	2019/20	K6
Base return	6.0%	6.0%
Totex outperformance	2.9%	2.6%
ODI outperformance	0.2%	0.3%
Financing outperformance	3.0%	2.9%
WaterShare RORE ²⁶	12.1%	11.8%
<i>Ofwat RORE²⁷</i>	11.9%	11.7%

Totex efficiency reducing customer bills

Totex outperformance has achieved cumulative savings of £297 million over 5 years delivering our target of c.£300 million totex savings which is shared with customers, reducing future bills. This represents c.15% outperformance compared to regulatory allowances.

These savings have been delivered across all areas of water, wastewater and retail activities. The key efficiencies have been driven by:

- Managing upward cost pressures across the 5 years, with actual net price rises being below annual average inflation rates again this year
- Reducing customer debt through enhanced collections activities and increasing our affordability schemes (such as social tariffs), with the cost of bad debt now below the level assumed within the K6 Final Determination
- Taking advantages from our strategic alliances, driving efficiency from our procurement processes, and supporting innovation in our capital programme delivery
- Efficiencies from the Bournemouth Water integration, including delivery of key capital schemes in the region, realising c.£27 million of net synergies which were secured early in the integration.

ODIs continue to deliver net reward for K6

Outperformance in ODIs for 2019/20 include those relating to Bournemouth Water where performance (and rewards) were measured at the end of the 5 year period. This has resulted in a

²⁶ WaterShare RORE financing outperformance is based on the outturn effective interest rate on net debt, translated into an effective real interest rate using cumulative K6 forecast RPI of 2.8%.

²⁷ Ofwat's definition of financing outperformance is calculated based on average RPI of 1.1% for 2015/16, 2.1% for 2016/17, 3.7% for 2017/18 and 3.1% for 2018/19, and 2.6% for 2019/20

net ODI reward of £2.0 million²⁸ (£13.3 million²⁹ cumulatively for K6) reflecting RORE outperformance of 0.3% on average over the period through operational improvements, good asset reliability with stable serviceability across all water and wastewater areas and delivering the service customers want. The cumulative net reward of £13.3 million comprises £22.3 million of total rewards and £9.0 million of total penalties.

Financing investment efficiently

South West Water's efficient and effective financing strategy has delivered one of the lowest effective interest rates across the industry consistently over the 5 years. This has resulted in cumulative financing outperformance of £164 million. South West Water's diverse and flexible financing structure has reduced the effective interest rate this year to 3.4% (2018/19 3.5%).

Sharing outperformance between customers and shareholders

South West Water is sharing the benefits of outperformance between customers and shareholders through our unique WaterShare mechanism. Since 2015 £139 million of cumulative benefits have been identified to share with customers through future bill reductions, ODI service improvements and reinvestment in services. This reflects £103 million of totex savings, £13 million of net ODI benefits and £23 million of other benefits (including financing and tax). South West Water was the only company to voluntarily share financing and tax outperformance with customers – an approach which has now been adopted by Ofwat for K7.

The total other savings provide the basis for the c.£20 million³⁰ WaterShare+ scheme in 2020. This scheme will give customers a choice of how to receive these benefits including a reduction in their bill or the option of receiving Pennon shares.

Looking forward – delivering the fast-track K7 plan

Performance transition to K7 (2020-25)

As we transition to K7 the potential return on regulatory equity (RORE) is impacted by the base returns and the change in approach to K7 outperformance. Base returns (through the allowed cost of equity) have reduced to 3.9% compared with 6.0% during K6. Gearing has also reduced to 60% and the wholesale totex sharing rate has been lowered to 50% for fast-track companies compared to the 55% allowed for South West Water (as an enhanced company) in the last regulatory period. In addition, the cost of debt allowed reduced to a nominal cost of debt of 4.2% from 5.5% in K6, reducing the potential for financing outperformance despite lower expected effective interest rates.

²⁸ £2.0 million (£13.3 million cumulatively) net ODI reward; £3.0 million (£17.4 million cumulatively) net reward will be recognised at the end of the regulatory period and £1.0 million (£4.1 million cumulatively) net penalty which will be reflected during the regulatory period

²⁹ ODI net rewards excluding the impact of SIM penalty confirmed in South West Water Final Determination of £2.9 million

³⁰ £3.1m of benefits in 2015/16 previously reinvested for customers

Applying these changes rebased the 11.8% cumulative outperformance delivered during K6 to 9.0%. Overall the Final Determination noted a potential RORE of 8.5% with increased potential and scale for ODIs offset by more challenging cost efficiency allowances resulting in the potential doubling of base returns.

	K6 Average 6.0%	K7 Rebased 3.9%	K7 Final Determination 3.9%
Base return			
Totex outperformance	2.6%		1.2%
ODI outperformance	0.3%		2.2%
Financing outperformance	2.9%		1.2%
Total Outperformance	5.8%		5.1%
WaterShare RORE	11.8%	9.0%	8.5%

South West Water is confident that it will deliver outperformance in each area and is targeting delivery in every year, with financing outperformance locked-in through favourable swap rates (c.60 bps lower than K6) and a focus on delivering substantial cost savings alongside increased targeted ODI rewards.

Strong track record of improvements

In February 2020 South West Water accepted the Final Determination for the K7 business plan which targets continued improvements for our customers and the environment alongside a significant investment programme. Whilst the plan includes stretching performance targets we have a strong track record of delivering improvements across the regulatory period. During 2019/20 we made an early start on our investment plans, including targeting areas for ODI delivery and performance.

Isles of Scilly expansion completed

On 1 April South West Water completed the expansion into the Isles of Scilly with assets transferred and operational teams already working well to deliver essential water and wastewater services. A first for the industry, we collaborated with all our regulators and key stakeholders on the islands to ensure a smooth transition and our plans over the next 5 years include significant investment in critical infrastructure and improvements for both customers and the environment.

Significant enhancement programme of investment

Alongside stretching operational targets and maintaining resilient services to our customers our plan includes a significant enhancement programme of investment. Delivering safe, reliable drinking water is a primary focus and development of our two new water treatment works in the Bournemouth region is underway. These works will build on the technology and experience gained from delivering

the Mayflower water treatment works in Plymouth which uses innovative ceramic membrane technology to improve the resilience of water quality – a first of its kind in the UK. Work is due to begin on testing a pilot plant at our Alderney site this summer.

Protecting the environment is key to our plans which include improvements to bathing water quality, through investments at 8 sites across the region and our pollutions enhancement strategy is focused of reducing both the number of incidents and the impact, with a target of zero serious pollution incidents.

PENNON WATER SERVICES PERFORMANCE

Underlying	2019/20	2018/19	Change
Revenue	£173.5m	£173.7m	(0.1%)
<i>SWW wholesale elimination</i>	<i>(£106.4m)</i>	<i>(£119.3m)</i>	<i>(10.8%)</i>
<i>Revenue – external to the Group</i>	<i>£67.1m</i>	<i>£54.4m</i>	<i>+23.3%</i>
Operating Costs ³¹	(£171.6m)	(£172.7m)	+0.6%
<i>SWW wholesale elimination</i>	<i>£106.4m</i>	<i>£119.3m</i>	<i>+10.8%</i>
<i>Operating Costs – external to the Group</i>	<i>(£65.2m)</i>	<i>(£53.4m)</i>	<i>(22.1%)</i>
EBITDA	£1.9m	£1.0m	+90.0%
Depreciation and amortisation	(£0.7m)	(£0.7m)	-
Operating profit	£1.2m	£0.3m	+300.0%
Net interest	(£1.6m)	(£1.9m)	+15.8%
Loss before tax	(£0.4m)	(£1.6m)	+75.0%

Financial Performance

Pennon Water Services performance has been driven through stable revenues and a focus on reducing operating costs. Revenue has remained stable with a focus on value added services to large national customers and winning dual tariff customers offsetting the attrition from businesses switching retailer, primarily in South West Water's wholesale region. Operating costs have reduced through automation, increased self-service and overhead efficiencies which has resulted in EBITDA almost doubling on last year. Increasing cash collections has reduced the level of debt, further reducing net interest costs. The focus continues to be on improving services whilst driving efficiency to reduce the cost to serve our customers.

High quality business services delivering value and positive environmental impact

High quality customer service in a competitive market

Our customer centred approach has underpinned our focus on excellent service, with our Trustpilot score achieving 9.1 out of 10 during the year. Written complaints are down 41% from the prior year and Pennon Water Services was placed within the top three in the regulatory market performance standards. This strong and resilient performance ensures we are well placed to deliver our long-term strategic objectives once the business market 'normalises' following the impact of COVID-19.

Delivering operating cost efficiencies

Our focus has been on reducing operating costs through investment in our people, processes and technology, increasing the automation of our systems and offering greater self-service to customers.

³¹ Includes wholesale costs for non-household customers

Strong operational delivery focused on increasing cash collections has reduced the bad debt costs to <0.5% of revenue before the impact of COVID-19 (3.0% of revenue post COVID-19).

Further growth and cost efficiencies are targeted through offering added value, non-retail services including support to address private leakage and compliance with environmental standards.

COVID-19 impacting the Non-household retail market

The largest impact of COVID-19 has been on businesses and commercial customers. During lockdown we have seen a decline in non-household demand and numerous customers being identified as temporarily vacant within the market.

Our customer service operations and contact centre have continued to operate effectively through this period and we continue to focus on cash collections, whilst supporting those customers who find themselves in financial difficulty.

We have engaged with our regulators to ensure the regulatory interventions put in place to support the non-household market are appropriate. The liquidity support from the wholesaler provides a safety net for the whole market, however, Pennon Water Services has not required to take advantage of this support to date as a result of our focused operations and collections. The future mechanism to recover any additional risk from bad debt (above 2% of revenue) will ensure retailers can provide additional support to business customers where needed.

VIRIDOR PERFORMANCE – Discontinued Operations

Underlying	2018/19		Change
	2019/20		
Revenue ³²	£757.8m	£852.7m	(11.1%)
EBITDA	£198.1m	£178.9m	+10.7%
<i>ERFs</i>	<i>£165.6m</i>	<i>£154.8m</i>	+7.0%
<i>Landfill</i>	<i>£5.2m</i>	<i>£4.8m</i>	+8.3%
<i>Landfill Gas</i>	<i>£26.8m</i>	<i>£20.6m</i>	+30.1%
<i>Recycling</i>	<i>£14.2m</i>	<i>£14.9m</i>	(4.7%)
<i>Contracts, Collections & Other</i>	<i>£36.0m</i>	<i>£39.0m</i>	(7.7%)
<i>Indirect Costs</i>	<i>(£49.7m)</i>	<i>(£55.2m)</i>	+10.0%
Depreciation and Amortisation	(£82.1m)	(£78.0m)	(5.3%)
Profit Before Tax	£104.6m	£88.5m	+18.2%
<i>Share of JV EBITDA</i>	<i>£41.3m</i>	<i>£31.9m</i>	+29.5%
<i>IFRIC 12 Interest Receivable</i>	<i>£15.1m</i>	<i>£14.6m</i>	+3.4%
<i>Adjusted EBITDA</i>	<i>£254.5m</i>	<i>£225.4m</i>	+12.9%

Revenue

In line with expectations, following the successful exit from the Greater Manchester recycling operating contract at the end of May 2019, and activities to optimise the landfill portfolio last year, Viridor revenues reduced by (11.1%) to £757.8 million (2018/19 £852.7 million). After taking into account overhead savings in relation to the Greater Manchester recycling operating contract exit, these lower revenues had a minimal impact on profits.

EBITDA

In 2019/20, Viridor's EBITDA increased by 10.7% to £198.1 million, underpinned by growth from the ERF business.

The ERF portfolio has performed strongly over the year. Ramp up of operations continue at Glasgow, Beddington and Dunbar, all three having commenced operation towards the end of last year, and Avonmouth generated its first financial contribution³³ this year. It is currently under commissioning

³² Including landfill tax and construction spend on service concession arrangements

³³ Contractual compensation of £4.1 million received in the form of liquidated damages arising where construction is completed post the original contractual compensation date

and on track for operational ramp up during 2020/21. ERF availability achieved c.90%³⁴ for the fourth successive year. ERF EBITDA has increased 7.0% to £165.6 million for the year.

Landfill EBITDA has remained consistent with 2018/19 at £5.2 million (2018/19 £4.8 million). Pricing has held up well, with volumes down but in line with expectations following the closure of two sites last year. We continue to operate from eight locations to meet the market demand for the provision of a landfill solution. Cost savings have helped increase the level of EBITDA per tonne above the prior year.

Landfill Gas has performed strongly in the period with EBITDA up 30.1% to £26.8 million (2018/19 £20.6 million). Investment in gas collection infrastructure has improved collection volumes, and investment in engines has improved availability and reliability. These factors have contributed to gas volumes declining at slower rates than previously experienced. Coupled with improved hedged pricing and higher renewable pricing this has resulted in a strong performance for the year.

We have maintained a continued focus on quality through the year in order to ensure continuation of supply, however, recycling performance has been impacted by global recycle price headwinds in H2 2019/20 in particular, resulting in a 4.7% decrease to £14.2 million for the year (2018/19 £14.9 million). The market for high grade export paper recycle has effectively closed with product now being sold as mixed grade paper.

Contracts, collections and other has seen a reduction in EBITDA of 7.7% to £36.0 million (2018/19 £39.0 million). This was in line with management expectations following the successful transition of the Manchester contract to Suez at the end of May 2019, and timing of the disposal of surplus assets. The closed landfill site at Norlands was also disposed of in the year. This has been sold to developers for repurposing following the completion of high-quality restoration and remediation.

We have continued our focus on indirect costs, which have fallen to £49.7 million following the exit from the Greater Manchester contract and delivery of further efficiencies. This reduction of £5.5 million represents a 10.0% saving over the same period last year (2018/19 £55.2 million).

Share of JV EBITDA has increased by 30.4% to £41.3 million (2018/19 £31.9 million). This reflects an improved contribution from both Lakeside and TPSCo joint ventures based on strong operational performance in the year, and the increase in contribution from the additional investment in TPSCo in December 2018. We received a £6.0 million dividend from Lakeside during the year.

COVID-19 – Resilient operations in unprecedented times

Viridor is well positioned to manage the impact of COVID-19 through the unprecedented lockdown period. The strong local authority contracted position provides resilience to the underlying business,

³⁴ Availability is an average weighted by site capacity, including 100% of joint ventures and excluding Glasgow due to different technology

with strong ERF performance mitigating the volume impact from Commercial & Industrial customers in Collections, Landfill and Recycling.

Operational sites have largely remained open throughout the period. Household Waste Recycling Centres which were closed for a period have now reopened in conjunction with our Local Authority customers.

We are supporting our staff across the business, with a strong emphasis on the health & wellbeing of our people. Remote working has been facilitated across the business where possible, and guidelines on social distancing are being adhered to at operational sites. We have managed our supply chain to ensure that personal protective equipment has remained available across our operations.

Successful delivery of key priorities for 2019/20

	2019/20	2018/19
Total Waste Inputs (MT)	6.7	6.8
ERFs	2.9	2.3
Landfill	1.2	1.5
Recycling and Other	2.6	3.0
Recycling Volumes Traded	1.0	1.2
ERF availability ³⁵	90%	91%

This year Viridor has delivered robust operational performance across a complementary portfolio of assets. We are delivering continued progress in our targeted growth areas, with increasing contribution from contract backed infrastructure assets.

Viridor has seen strong growth in energy recovery with the ramp up and optimisation of existing plants being augmented by the first financial contribution from Avonmouth ERF. We are mitigating near term challenges in recycle markets and we remain confident in the UK residual waste and recycling sector fundamentals. Construction is progressing at the Avonmouth Plastics Processing Facility.

³⁵ Availability is an average weighted by site capacity, including 100% of joint ventures and excluding Glasgow due to different technology

Strong growth from ERF portfolio

For 2019/20 our ERFs have performed strongly with availability c.90%³⁶ for the fourth consecutive year.

Glasgow, Beddington and Dunbar, which were all taken over towards the end of H2 2018/19, have been progressing through their ramp up stage towards optimisation. The Glasgow Recycling & Renewables Energy Centre (GRREC) is our first ERF to utilise Advanced Conversion Facility (ACF) technology. Unlike our existing ERF fleet this produces a synthetic gas which is then controlled and converted to provide energy. This innovative technology has required the development and adoption of new skill sets to fully optimise the plant.

Avonmouth ERF has now entered the commissioning stage with the facility on track for operational ramp up during 2020/21. This now takes our ERF portfolio to 11 facilities.

The ERF joint venture with Grundon Waste Management at Ford (announced in H1 2019/20) is progressing through project design with our technical advisors. Further ERF capacity is essential to meet longer term demand and Viridor continues to progress a pipeline of opportunities to deliver two further ERFs.

Efficiently managed landfill sites with demand into the long term

Overall landfill volumes have decreased in the year reflecting the closure of Beddington and Rigmuir to active waste in the prior year, in line with management expectations. Heathfield has been reopened and Broadpath closed, as planned, leaving 8 sites in operation.

High quality restoration and remediation of our landfill sites remains the cornerstone of our land stewardship responsibilities. We have disposed of one former site (Norlands) in the year which will now be repurposed for other activities.

Landfill gas has shown a robust operational performance reflecting the benefits from investment undertaken in our generation equipment and infrastructure. Investment in new engines has reduced both maintenance downtime and costs, and improvements to the efficiency of our gas collection systems has improved overall engine output. This has led to electricity volumes declining at a lower rate than experienced in previous years which allied to higher pricing, including the renewable energy value, has resulted in improved performance year on year.

We have continued to invest in our engine optimisation strategy this year installing eleven new engines to enhance future availability and better gas outputs.

³⁶ Availability is an average weighted by site capacity, including 100% of joint ventures and excluding Glasgow due to different technology

Over time the decline in Landfill gas volumes has created surplus grid connection capacity at some sites. We are currently seeking to capitalise on this opportunity by the installation of gas peaking engines.

Recycling – long term fundamentals remain strong despite short term paper headwinds

The construction of our £65 million plastics processing facility at Avonmouth continues to progress. To fill the predicted UK plastics reprocessing capacity gap by 2025 would require the construction of c.14 Avonmouth sized facilities. We continue to progress plans for two further plastic processing plants co-located with Ardley and Dunbar ERFs and have held regional events to engage stakeholders ahead of submitting formal planning applications. Through investment in UK based plastics processing we are reducing exposure to international markets and moving recycle production higher up the value chain. This reflects our continued focus on quality and driving value from the Circular Economy.

The impact of global paper markets has adversely affected the H2 2019/20 recycling performance. We have seen a fall of c.£50 per tonne in paper pricing, with negative paper pricing on mixed paper and the market for high grade export paper effectively closed. These downside issues have been somewhat mitigated by the risk share mechanisms in place with our customers.

Technical Guidance 2019/20

Pennon Group		2019/20	Change
Revenue	<ul style="list-style-type: none"> Impact of lower tariffs based on K7 Final Determination (c.£20m) Reduced non household demand (c.£15m including impact from customers outside of the South West Water region) partially offset by increased household demand (c.£5m) as a result of COVID-19 Non-underlying sharing of outperformance with customers through WaterShare+ of c.£20m 	£636.7m ³⁷	▼
Net debt	<ul style="list-style-type: none"> Expectation of reduced Pennon company debt levels following Viridor sale completion 	£1,122 ³⁸	▼
Tax rate	<ul style="list-style-type: none"> Underlying effective tax rate lower than UK headline rate of 19% reflecting capital allowances 	9.7%	▲
South West Water – transition to new regulatory period		2019/20	Change
Operating costs	<ul style="list-style-type: none"> Increased costs reflecting inflation, expansion into the Isles of Scilly, net of continued efficiency 	£206.1m	▲
Net interest	<ul style="list-style-type: none"> Efficient financing reflecting lower interest rate swaps – effective rate reduction 	£71.4m	▼
Capex	<ul style="list-style-type: none"> Capital expenditure reflects K7 profile of investment – 2019/20 included advancement of investment from 2020/21 	£161.0m	▼
RORE	<ul style="list-style-type: none"> Continued outperformance targeted in all areas 	9.0%	(rebased) ³⁹
RCV	<ul style="list-style-type: none"> Reduction due to impact of K7 Final Determination reflecting midnight adjustments of c.£200m driven by the significant totex outperformance in K6 Potential impact of COVID-19 on future inflation rates 	£3,573m	▼
Pennon Water Services		2019/20	Change
Operating costs	<ul style="list-style-type: none"> Reduction in operating costs due to lower wholesale charges due to COVID-19 	£171.6m	▼
EBITDA	<ul style="list-style-type: none"> Focus on continued cost efficiency with strong collections offsetting potential bad debt impact of COVID-19 	£1.9m	◆
Viridor – completion of transaction expected early summer		2019/20	Change
Profit after tax	<ul style="list-style-type: none"> Continues to contribute to Group earnings up until the point of completion 	£83.8m	▼

COVID-19 assumptions are based on Government current position and timeframe of lockdown, successful exist of lockdown and no second wave of the pandemic supporting a recovery in economic activity over the year.

³⁷ 2019/20 revenue for the Continuing Group

³⁸ £822m net debt as at 31 March 2020 plus £300m in perpetual securities, repaid May 2020

³⁹ Re-based to reflect changes in returns and approach in K7

Board Matters

We were pleased to welcome Claire Ighodaro to the Board in September 2019. Claire's extensive range of Boardroom experience and her background in finance, across both regulated and non-regulated industries, is a great asset to the Group and complements the broad range of skills on the current Board. We ensure that our Board has a broad skill set and deep experience.

Sadly, we will say our farewells to both Lord Matthew Taylor and Martin Hagen who have both served on the Board of South West Water for some 10 years in order to provide continuity through to the K7 regulatory period. Both have rendered exemplary service to the South West Water Board and deserve our heartfelt thanks.

Chris Loughlin
Group Chief Executive Officer
4 June 2020

Financial Timetable

4 June 2020	Full Year Results 2019/20
June 2020	Annual Report & Accounts published
Early summer	Expected completion of Viridor sale
23 July 2020	Ordinary shares quoted ex-dividend
24 July 2020	Record date for final dividend
31 July 2020 ⁴⁰	Annual General Meeting
10 August 2020*	Final date for receipt of DRIP applications
2 September 2020*	Final dividend paid
25 September 2020	Trading Statement
24 November 2020	Half Year Results 2020/21
30 March 2021	Trading Statement
25 May 2021	Full Year Results 2020/21

* Subject to obtaining shareholder approval at the 2020 Annual General Meeting.

⁴⁰ Rescheduled from previously published date of 23 July 2020

PRINCIPAL RISKS AND UNCERTAINTIES

COVID-19

The Board recognise the significant impact that COVID-19 has had globally and within the UK. In response to the current situation the UK Government has designated keyworker status to our front line operational water and waste activities.

In order to continue delivering the expected levels of service to our stakeholders we have reviewed our processes and ways of working and drawn on our resilience and continuity plans, while continuing to prioritise the health, safety and wellbeing of our employees and customers which remains paramount during this period. We also continue to work closely with our key stakeholders and peers including local resilience forums, Water UK, Ofwat and Defra ensuring a joined up and collaborative response. Both the Pennon Executive and the Pennon Board continue to receive regular updates on the Group's response.

To date, our business has remained broadly resilient to the immediate risks that have been presented by COVID-19. It is likely, however, that there will be ongoing restrictions in place during 2020/21, which could provide continued challenges to the delivery of our key operational activities.

Medium-term response planning has been undertaken to establish strategies to mitigate these risks where possible, which has considered a range of potential scenarios and been informed by actions taken by other countries impacted by the pandemic. These plans will continue to be reviewed and updated as further Government and public health guidance is provided.

Britain's Exit from the European Union

Prior to Britain's exit from the EU detailed contingency plans had been established and tested to mitigate against potential issues that may have occurred in the event of a no-deal scenario. Negotiations on a future trading agreement between Britain and the EU is ongoing and continues to be closely monitored.

The impact of any agreement on the Group's operations and processes will be fully evaluated as further detail is confirmed. In the event that no agreement is reached, and trade arrangements revert to World Trade Organization (WTO) rules, existing contingency plans will ensure that the Group is well prepared to mitigate against any short-term impact that is likely to arise from this scenario.

Principal Risks

The Board considers the principal risks to be:

Law, Regulation and Finance

1. Changes in Government Policy
2. Regulatory reform
3. Compliance with laws and regulations
4. Maintaining sufficient finance and funding within our debt covenant to meet ongoing commitments
5. Non-compliance or occurrence of avoidable health and safety incidents
6. Tax compliance and contribution
7. Failure to pay all pension obligations as they fall due & increased costs to the Group should the defined benefit pension scheme deficit increase

Market and Economic Conditions

- 8. Non-recovery of customer debt
- 9. Macro-economic risks arising from the downturn impacting inflation commodity and power prices

Operating Performance

- 10. Poor operating performance due to extreme weather or climate change
- 11. Poor service and/or increased competition leading to loss of customer base
- 12. Business interruption or significant operational failures/ incidents
- 13. Difficulty in recruitment, retention and development of skills required to deliver the Group's strategy
- 14. Non-delivery of Regulatory Outcomes and performance commitments

Business Systems and Capital Investment

- 15. Failure or increased cost of capital projects and/or exposure to contract failures
- 16. Failure of IT systems, management and protection including cyber risks

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 which may constitute "forward-looking statements" within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements are identified in this Report by words such as "anticipate", "aim", "believe", "continue", "could", "due", "estimate", "expect", "forecast", "goal", "intend", "may", "outlook", "plan", "probably", "project", "remain", "seek", "should", "target", "will", "would" and related and similar expressions, as well as statements in the future tense. All statements other than of historical fact may be forward-looking statements and represent the Group's belief regarding future events, many of which, by their nature, are inherently uncertain and outside the Group's control. 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. 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, changes in Government policy; regulatory and legal reform; compliance with laws and regulations; maintaining sufficient finance and funding to meet ongoing commitments; non-compliance or occurrence of avoidable health and safety incidents; tax compliance and contribution; failure to pay all pension obligations as they fall due and increased costs to the Group should the defined benefit pension scheme deficit increase; non-recovery of customer debt; poor operating performance due to extreme weather or climate change; macro-economic risks impacting commodity and power prices and other matters; poor customer service and/or increased competition leading to loss of customer base; business interruption or significant operational failure/incidents; difficulty in recruitment, retention and development of skills; non-delivery of regulatory outcomes and performance commitments; failure or increased cost of capital projects/exposure to contract failures; failure of 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 in June 2020. Such forward looking statements should therefore be construed in light of all risks, uncertainties and other factors, including without limitation those identified above, 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 2020

	Notes	Statutory 2020 £m	Discontinued operations (note 16) 2020 £m	Pro Forma Total ¹ 2020 £m	Statutory 2019 (Restated ²) £m	Discontinued operations (note 16) 2019 (Restated ²) £m	Pro Forma Total 2019 ¹ £m
Revenue	4	636.7	753.2	1,389.9	632.6	845.6	1,478.2
Operating costs							
Employment costs		(70.0)	(130.4)	(200.4)	(67.2)	(138.6)	(205.8)
Raw materials and consumables used		(14.9)	(87.2)	(102.1)	(15.0)	(94.3)	(109.3)
Other operating expenses		(186.5)	(337.5)	(524.0)	(183.1)	(433.8)	(616.9)
Underlying Earnings before interest, tax, depreciation and amortisation	4	365.3	198.1	563.4	367.3	178.9	546.2
Operating non-underlying items	5	(7.9)	3.8	(4.1)	3.9	(29.6)	(25.7)
Depreciation and amortisation		(119.8)	(82.1)	(201.9)	(117.2)	(78.0)	(195.2)
Operating profit		237.6	119.8	357.4	254.0	71.3	325.3
Finance income	6	4.1	22.5	26.6	3.5	20.0	23.5
Finance costs: Underlying	6	(66.6)	(48.7)	(115.3)	(61.9)	(44.8)	(106.7)
Finance costs: Non-underlying	5	18.0	-	18.0	5.8	-	5.8
Finance costs		(48.6)	(48.7)	(97.3)	(56.1)	(44.8)	(100.9)
Net finance costs	6	(44.5)	(26.2)	(70.7)	(52.6)	(24.8)	(77.4)
Share of post-tax profit from joint ventures		-	14.8	14.8	-	12.4	12.4
Underlying profit before tax		183.0	104.6	287.6	191.7	88.5	280.2
Non-underlying operating and finance costs	5	10.1	3.8	13.9	9.7	(29.6)	(19.9)
Profit before tax	4	193.1	108.4	301.5	201.4	58.9	260.3
Taxation (charge)/credit	7	(70.6)	(24.6)	(95.2)	(32.8)	(4.9)	(37.7)
Profit from continuing operations		122.5	83.8	206.3	168.6	54.0	222.6
Profit from discontinued operations	16	83.8			54.0		
Profit for the year		206.3			222.6		
Attributable to:							
Ordinary shareholders of the parent		200.4			214.3		
Non-controlling interests		(1.1)			(0.3)		
Perpetual capital security holders		7.0			8.6		
Earnings per ordinary share (pence per share)	8						
From Continuing operations							
- Basic		27.7			38.2		
- Diluted		27.6			38.1		
From Continuing and discontinued operations							
- Basic		47.7			51.1		
- Diluted		47.5			50.9		

- 1 Pro forma results represent non-GAAP measures presented to provide sufficient detail to enable certain users of the financial statements to assess the combined results of the continuing and discontinued operations of the Group during the current and prior financial years.
- 2 The prior year income statement has been restated to reflect the impact of classifying our waste management activities provided by Viridor as a discontinued operation (see note 16).

Consolidated statement of comprehensive income

For the year ended 31 March 2020

	2020 £m	2019 £m
Profit for the year	206.3	222.6
Other comprehensive income/(loss)		
<i>Items that will not be reclassified to profit or loss</i>		
Remeasurement of defined benefit obligations	17.7	(17.2)
Income tax on items that will not be reclassified	0.1	3.2
Total items that will not be reclassified to profit or loss	17.8	(14.0)
<i>Items that may be reclassified subsequently to profit or loss</i>		
Share of other comprehensive income from joint ventures	0.2	0.5
Cash flow hedges	(14.3)	(6.4)
Income tax on items that may be reclassified	3.1	0.6
Total items that may be reclassified subsequently to profit or loss	(11.0)	(5.3)
Other comprehensive income/(loss) for the year net of tax net of tax	6.8	(19.3)
Total comprehensive income for the year	213.1	203.3
Total comprehensive income attributable to:		
Ordinary shareholders of the parent	207.2	195.0
Non-controlling interests	(1.1)	(0.3)
Perpetual capital security holders	7.0	8.6

Balance sheets

At 31 March 2020

	Notes	2020 £m	2019 £m
ASSETS			
Non-current assets			
Goodwill		42.3	385.0
Other intangible assets		1.2	92.1
Property, plant and equipment		3,171.8	4,509.4
Other non-current assets		–	256.4
Derivative financial instruments		4.1	70.5
Investments in joint ventures		–	51.1
Retirement benefit obligations		6.6	–
		3,226.0	5,364.5
Current assets			
Inventories		4.9	28.8
Trade and other receivables		185.8	484.8
Current tax receivable		1.9	–
Derivative financial instruments		2.7	11.8
Cash and cash deposits	13	665.9	569.6
		861.2	1,095.0
Assets held for sale	16	2,675.3	–
		3,536.5	1,095.0
LIABILITIES			
Current liabilities			
Borrowings	13	(59.9)	(150.4)
Financial liabilities at fair value through profit		(1.5)	(3.8)
Derivative financial instruments		(7.1)	(11.1)
Trade and other payables		(115.3)	(298.0)
Current tax liabilities		–	(19.1)
Provisions		(0.6)	(28.7)
		(184.4)	(511.1)
Liabilities directly associated with assets classified as held for sale		(756.3)	–
Net current assets		2,595.8	583.9
Non-current liabilities			
Borrowings	13	(3,654.9)	(3,498.7)
Other non-current liabilities		(122.9)	(147.9)
Financial liabilities at fair value through profit		(43.1)	(43.1)
Derivative financial instruments		(27.2)	(9.9)
Retirement benefit obligations		–	(60.8)
Deferred tax liabilities		(261.6)	(305.1)
Provisions		–	(203.1)
		(4,109.7)	(4,268.6)
Net assets		1,712.1	1,679.8
Shareholders' Equity			
Share Capital	10	171.3	171.1
Share premium account		227.0	223.6
Capital redemption reserve		144.2	144.2
Retained earnings and other reserves		872.8	843.0
Total shareholders' equity		1,415.3	1,381.9
Non-controlling interests		0.1	1.2
Perpetual capital securities	11	296.7	296.7
Total equity		1,712.1	1,679.8

PENNON GROUP PLC
Consolidated statement of changes in equity for the year ended 31 March 2020

	Share capital (note 10)	Share premium account	Capital redemption reserve	Retained earnings and other reserves	Non- controlling interests	Perpetual capital securities (note 11)	Total Equity
	£m	£m	£m	£m	£m	£m	£m
At 1 April 2018	170.8	218.8	144.2	807.1	1.5	296.7	1,639.1
Profit for the year	-	-	-	214.3	(0.3)	8.6	222.6
Other comprehensive loss for the year	-	-	-	(19.3)	-	-	(19.3)
Total comprehensive income for the year	-	-	-	195.0	(0.3)	8.6	203.3
<i>Transactions with equity shareholders:</i>							
Dividends paid	-	-	-	(162.0)	-	-	(162.0)
Adjustment in respect of share-based payments (net tax)	-	-	-	4.4	-	-	4.4
Distributions to perpetual capital security holders	-	-	-	-	-	(8.6)	(8.6)
Own shares acquired by the Pennon Employee Share Trust in respect of Share options granted	-	-	-	(1.5)	-	-	(1.5)
Proceeds from shares issued under the Sharesave Scheme	0.3	4.8	-	-	-	-	5.1
Total transactions with equity shareholders	0.3	4.8	-	(159.1)	-	(8.6)	(162.6)
At 31 March 2019	171.1	223.6	144.2	843.0	1.2	296.7	1,679.8
IFRS 16 leases opening adjustment	-	-	-	(8.0)	-	-	(8.0)
At 1 April 2019 (adjusted for IFRS 16)	171.1	223.6	144.2	835.0	1.2	296.7	1671.8
Profit for the year	-	-	-	200.4	(1.1)	7.0	206.3
Other comprehensive income for the year	-	-	-	6.8	-	-	6.8
Total comprehensive income for the year	-	-	-	207.2	(1.1)	7.0	213.1
<i>Transactions with equity shareholders:</i>							
Dividends paid	-	-	-	(172.6)	-	-	(172.6)
Adjustment in respect of share-based payments (net of tax)	-	-	-	4.8	-	-	4.8
Distributions to perpetual capital security holders	-	-	-	-	-	(8.6)	(8.6)
Current tax relief on distributions to perpetual capital security holders	-	-	-	-	-	1.6	1.6
Own shares acquired by the Pennon Employee Share Trust in respect of Share options granted	-	-	-	(1.6)	-	-	(1.6)
Proceeds from shares issued under the Sharesave Scheme	0.2	3.4	-	-	-	-	3.6
Total transactions with equity shareholders	0.2	3.4	-	(169.4)	-	(7.0)	(172.8)
At 31 March 2020	171.3	227.0	144.2	872.8	0.1	296.7	1,712.1

PENNON GROUP PLC
Consolidated statement of cash flows for the year ended 31 March 2020

	Notes	2020 £m	2019 £m
Cash flows from operating activities			
Cash generated from operations	12	516.3	399.8
Interest paid		(97.7)	(83.9)
Tax paid		(52.6)	(29.2)
Net cash generated from operating activities		366.0	286.7
Cash flows from investing activities			
Interest received		3.4	10.3
Dividends received		6.0	5.5
Investment in joint venture		-	(54.8)
Loan repayments received from joint ventures		13.4	0.5
Deposit of restricted deposits		(23.3)	(21.6)
Purchase of property, plant and equipment		(332.8)	(356.0)
Purchase of intangible assets		(0.6)	-
Proceeds from sale of property, plant and equipment		10.6	6.3
Net cash used in investing activities		(323.3)	(409.8)
Cash flows from financing activities			
Proceeds from issuance of ordinary shares		3.6	5.1
Proceeds from derivatives early settlement		87.2	-
Purchase of ordinary shares by the Pennon Employee Share Trust		(1.6)	(1.5)
Proceeds from new borrowing		268.2	384.5
Repayment of borrowings		(84.8)	(181.6)
Cash inflows from lease financing arrangements		115.0	74.9
Lease principal repayments (2019: Finance lease principal repayments)		(142.8)	(27.8)
Dividends paid	9	(172.6)	(162.0)
Perpetual capital securities periodic return	11	(8.6)	(5.8)
Net cash generated from financing activities		63.6	85.8
Net increase/(decrease) in cash and cash equivalents			
		106.3	(37.3)
Cash and cash equivalents at beginning of year	13	365.7	403.0
Cash and cash equivalents at end of year	13	472.0	365.7

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 66. Through the year, Pennon Group's business has been operated through two main subsidiaries. South West Water Limited includes the integrated water businesses of South West Water and Bournemouth Water, providing water and wastewater services in Devon, Cornwall and parts of Dorset and Somerset and water only services in parts of Dorset, Hampshire and Wiltshire. Viridor Limited is a recycling and residual waste processing and transformation business. Pennon Group is also the majority shareholder of Pennon Water Services Limited, a company providing water and wastewater retail services to non-household customer accounts across Great Britain. On 18 March 2020 Pennon agreed to sell Viridor Limited for £3.7 billion, subject to a number of conditions. The sale is expected to complete in early summer 2020 (see note 16).

The financial information for the years ended 31 March 2020 and 31 March 2019 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 2020, including the financial statements from which this financial information is derived, will be delivered to the Registrar of Companies after the AGM on 31 July 2020. The auditor's report on the 2020 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 2019 were approved by the Board of Directors on 24 May 2019 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 2020 were approved by the Board of Directors on 3 June 2020.

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 2019 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 2020 Annual Report and Accounts which have not changed significantly from those adopted in the Group's 2019 Annual Report and Accounts (which are available on the Company website www.pennon-group.co.uk), except as described in note 3 below.

3. Accounting policies

IFRS 16 'Leases'

The impact of the new leasing standard, which was adopted by the Group from the 1 April 2020, is provided in detail in note 15 below.

Other than the adoption of IFRS 16, new standards or interpretations which were mandatory for the first time in the year beginning 1 April 2019 did not have a material impact on the net assets or results of the Group.

New standards or interpretations due to be adopted from 1 April 2020 are not expected to have a material impact on the Group's net assets or results. Existing borrowing covenants are not impacted by changes in accounting standards.

PENNON GROUP PLC
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. The non-household retail business comprises the services provided by Pennon Water Services in the non-household water and wastewater retail market which, while regulated, is open to competition. Following the Group entering into a formal sale agreement on 18 March 2020 to dispose of Viridor, the waste management business has been accounted for as a discontinued operation.

	2020	2019
	£m	(restated)
	£m	£m
Revenue from continuing operations		
Water	570.3	581.0
Non-household retail	173.5	173.7
Other	10.1	10.5
Less intra-segment trading *	(117.2)	(132.6)
	636.7	632.6
Revenue from discontinued operations		
Waste management	757.8	852.7
Other	9.4	10.9
Less intra-segment trading	(14.0)	(18.0)
	753.2	845.6
Pro forma total revenue	1,389.9	1,478.2
Operating profit before depreciation, amortisation and non-underlying items (EBITDA) from continuing operations		
Water	364.2	367.1
Non-household retail	1.9	1.0
Other	(0.8)	(0.8)
	365.3	367.3
EBITDA from discontinued operations – Waste management	198.1	178.9
	563.4	546.2
Operating profit before non-underlying items from continuing operations		
Water	245.4	251.1
Non-household retail	1.2	0.3
Other	(1.1)	(1.3)
	245.5	250.1
Operating profit from discontinued operations – Waste management	116.0	100.9
	361.5	351.0

PENNON GROUP PLC
Notes (continued)
4. Segmental information (continued)

	2020 £m	2019 £m
Profit before tax and non-underlying items from continuing operations		
Water	174.0	180.6
Non-household retail	(0.4)	(1.6)
Other	9.4	12.7
	183.0	191.7
Profit before tax from discontinued operations – Waste management	104.6	88.5
	287.6	280.2
Profit before tax from continuing operations		
Water	189.0	184.6
Non-household retail	(5.4)	(1.6)
Other	9.5	18.4
	193.1	201.4
Profit before tax from discontinued operations – Waste management	108.4	58.9
	301.5	260.3

* 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.

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 in the year and business trends over time.

	Continuing operations 2020 £m	Discontinued operations 2020 £m	Pro forma total 2020 £m	Continuing operations 2019 £m	Discontinued operations 2019 £m	Pro forma total 2019 £m
Operating costs						
Pension past service credit ⁽¹⁾	-	4.9	4.9	-	-	-
COVID-19 provision for expected credit losses ⁽²⁾	(7.9)	(1.1)	(9.0)	-	-	-
Pension past service cost (GMP equalisation impact) ⁽³⁾	-	-	-	(2.1)	(0.9)	(3.0)
Provision for receivable (due from Interserve in respect of Glasgow Recycling Renewable Energy Centre) ⁽⁴⁾	-	-	-	6.0	(28.7)	(22.7)
Earnings before interest, tax, depreciation and amortisation	(7.9)	3.8	(4.1)	3.9	(29.6)	(25.7)
Remeasurement of fair value movement in derivatives ⁽⁵⁾	18.0	-	18.0	5.8	-	5.8
Net tax credit arising on non-underlying items above	(1.9)	(0.7)	(2.6)	(0.7)	5.7	5.0
Deferred tax change in rate ⁽⁶⁾	(30.3)	(10.3)	(40.6)	-	-	-
Net non-underlying (charge)/credit	(22.1)	(7.2)	(29.3)	9.0	(23.9)	(14.9)

PENNON GROUP PLC
Notes (continued)
5. Non-underlying items (continued)

- (1) Upon cessation of the Greater Manchester contract, Viridor employees delivering this contract transferred to the new contract provider. Accordingly, defined benefit pension commitments for these employees are in the process of being transferred. The past service credit of £4.9 million (2019 £nil) reflects curtailment and other gains resulting from transferring employees moving from an active to deferred status in these schemes.
- (2) In response to the COVID-19 pandemic a detailed expected credit loss review has been undertaken. Economic and credit conditions are worsening, however the UK government continue to implement economic measures to support the wider economy, as a result of the review a Group provision of £9.0 million has been recognised. The charge is considered non-underlying due to its size and non-recurring nature.
- (3) On 26 October 2019, the High Court of Justice of England and Wales issued a judgment in a claim regarding the rights of female members of certain pension schemes to equality of treatment in relation to pension benefits (Guaranteed Minimum Payment (GMP) equalisation). The judgment concluded that the claimant is under a duty to amend the schemes in order to equalise benefits for men and woman in relation to GMP benefits. The issues determined by the judgment arise in relation to many other occupational pension schemes.

The Group estimates, with advice from the Group's corporate actuary, that scheme liabilities will increase by an estimated £3.0 million as a result of the judgment. The cost has been recognised as a past service cost in the income statement for the year ended 31 March 2019. The charge is considered non-underlying due to size and non-recurring nature.

- (4) The financial statements recognise a gross receivable of £72.0 million from Interserve Construction Limited in relation to rectifications and completion costs for Glasgow Recycling Renewable Energy Centre (GRREC). During the financial year ended 31 March 2019, Interserve Plc (holding company of Interserve Construction Limited) entered into administration. The operating company, Interserve Construction Limited with whom we contracted, is currently continuing to trade. As a result of the lack of certainty around the future of Interserve's business, and in accordance with IFRS 9, we have sought to make an appropriate market-based credit assessment using the latest public information available. Consequently, a provision of £22.7 million was recognised in 2018/19 against the receivable, resulting in a total cumulative provision at 31 March 2019 of £28.7 million. The charge is considered non-underlying due to its size and non-recurring nature. The financial stability of Interserve Construction Limited is judged to be outside the control of Pennon Group.
- (5) In the year a gain of £18.0 million has been recognised relating to non-cash derivative fair value movements associated with derivatives that are not designated as being party to an accounting hedge relationship (2019 gain of £5.8 million). In the year these instruments were early settled, as the instruments no longer met the Group's accounting hedging requirements, and this has locked in the mark to market gain. These movements are non-underlying due to the nature of the item being market dependent and potentially can be significant in value (size).
- (6) Following the Chancellor's Budget on 11 March 2020, the UK headline corporation tax rate will remain at 19%. It was previously set to reduce to 17% from 1 April 2020 and that change has now been cancelled. All deferred tax assets and liabilities have therefore been recalculated to crystallise at 19%, resulting in a non-underlying deferred tax charge in the year of £40.6 million. The change was substantively enacted on 17 March 2020.

PENNON GROUP PLC
Notes (continued)
6. Net finance costs

	2020			2019 (restated)		
	Finance cost £m	Finance income £m	Total £m	Finance cost £m	Finance income £m	Total £m
Cost of servicing debt						
Bank borrowings and overdrafts	(28.1)	-	(28.1)	(23.1)	-	(23.1)
Interest element of finance lease rentals	(35.6)	-	(35.6)	(35.4)	-	(35.4)
Other finance costs	(2.7)	-	(2.7)	(2.4)	-	(2.4)
Interest receivable	-	4.1	4.1	-	3.5	3.5
	(66.4)	4.1	(62.3)	(60.9)	3.5	(57.4)
Notional interest						
Retirement benefit obligations	(0.2)	-	(0.2)	(1.0)	-	(1.0)
	(0.2)	-	(0.2)	(1.0)	-	(1.0)
Net finance costs before non-underlying items	(66.6)	4.1	(62.5)	(61.9)	3.5	(58.4)
Non-underlying items (note 5)						
Fair value remeasurement of non-designated derivative financial instruments, providing commercial hedges	18.0	-	18.0	5.8	-	5.8
Net finance costs after non-underlying items	(48.6)	4.1	(44.5)	(56.1)	3.5	(52.6)

In addition to the above, finance costs of £2 million have been capitalised on qualifying assets included in property, plant and equipment (2019 restated £2.9 million).

Excluded from the amounts above are net finance costs relating to discontinued operations of £26.2 million (2019 £24.8 million), consisting of finance income of £22.5 million (2019 £20.0 million) and finance costs of £48.7 million (2019 £44.8 million).

PENNON GROUP PLC

Notes (continued)

7. Taxation

	Before non- underlying items 2020 £m	Non- underlying items (note 5) 2020 £m	Total 2020 £m	Before non- underlying items 2019 £m	Non- underlying items (note 5) 2019 £m	Total 2019 £m
Analysis of charge						
Current tax charge/(credit)	18.8	15.3	34.1	29.4	(5.5)	23.9
Deferred tax charge	33.2	27.9	61.1	13.3	0.5	13.8
Tax charge/(credit) for the year	52.0	43.2	95.2	42.7	(5.0)	37.7

	Continuing operations 2020 £m	Discontinued operations 2020 £m	Proforma Total 2020 £m	Continuing operations 2019 £m	Discontinued operations 2019 £m	Proforma Total 2019 £m
Current tax charge/(credit)	43.8	(9.7)	34.1	29.6	(5.7)	23.9
Deferred tax charge	26.8	34.3	61.1	3.2	10.6	13.8
Tax charge for the year	70.6	24.6	95.2	32.8	4.9	37.7

UK corporation tax is calculated at 19% (2019 19%) of the estimated assessable profit for the year.

UK corporation tax is stated after a credit relating to prior year current tax of £9.2 million (2019 credit of £3.0 million) and a prior year deferred tax charge of £6.5 million (2019 credit of £9.9 million).

PENNON GROUP PLC

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:

	2020	2019
Number of shares (millions)		
For basic earnings per share	420.2	419.6
Effect of dilutive potential ordinary shares from share options	1.9	1.3
For diluted earnings per share	422.1	420.9

Adjusted basic and diluted earnings per ordinary share

Earnings per ordinary share before non-underlying items, deferred tax and adjusted to annualise depreciation and amortisation in the Disposal Group are presented as the Directors believe that this measure provides a more useful year on year comparison on business trends and performance. Deferred tax is excluded as the Directors believe it reflects a distortive effect of changes in corporation tax rates and the level of long-term capital investment. Following the announcement of the sale of Viridor on 18 March 2020, the assets and liabilities of the Disposal Group have been transferred to assets held for sale and in accordance with IFRS 5, the property plant and equipment and intangible assets have not been depreciated or amortised from that date. The Directors believe that to aid comparison of earnings year on year, it is appropriate to reflect a full year's depreciation and amortisation consistent with all other revenues and costs recognised for the full year in the Disposal Group. Earnings per share have been calculated as follows:

Continuing and discontinued operations	2020			2019		
	Profit after tax £m	Earnings per share		Profit after tax £m	Earnings per share	
		Basic p	Diluted p		Basic p	Diluted p
Statutory earnings	200.4	47.7	47.5	214.3	51.1	50.9
Deferred tax before non-underlying items	33.2	7.9	7.8	13.3	3.1	3.1
Non-underlying items (net of tax)	29.3	6.9	6.9	14.9	3.6	3.6
Non-controlling interests' share of non-underlying items	(1.0)	(0.2)	(0.2)	-	-	-
Adjustment for full year depreciation charge in the Disposal Group	(2.6)	(0.6)	(0.6)	-	-	-
Adjusted earnings	259.3	61.7	61.4	242.5	57.8	57.6

PENNON GROUP PLC

Notes (continued)

8. Earnings per share (continued)

Continuing operations	2020			2019		
	Profit after tax £m	<u>Earnings per share</u>		Profit after tax £m	<u>Earnings per share</u>	
		Basic p	Diluted p		Basic p	Diluted p
Statutory earnings	116.6	27.7	27.6	160.3	38.2	38.1
Deferred tax before non-underlying items	10.1	2.4	2.4	2.5	0.6	0.6
Non-underlying items (net of tax)	22.1	5.3	5.2	(9.0)	(2.1)	(2.2)
Non-controlling interests' share of non-underlying items	(1.0)	(0.2)	(0.2)	-	-	-
Adjusted earnings	147.8	35.2	35.0	153.8	36.7	36.5

9. Dividends

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

	2020 £m	2019 £m
Interim dividend paid for the year ended 31 March 2019: 12.84p (2018 11.97p) per share	54.0	50.2
Final dividend paid for the year ended 31 March 2019: 28.22p (2018 26.62p) per share	118.6	111.8
	172.6	162.0
Proposed dividends		
Proposed interim dividend for the year ended 31 March 2020: 13.66p per share	57.5	54.0
Proposed final dividend for the year ended 31 March 2020: 30.11p per share	126.8	118.7
	184.3	172.7

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

The proposed interim dividend for 2020 was paid on 3 April 2020 and the proposed final dividend is subject to approval by shareholders at the Annual General Meeting.

PENNON GROUP PLC

Notes (continued)

10. Share capital

Allotted, called up and fully paid

	Number of shares		£m
	Treasury shares	Ordinary shares	
At 1 April 2018 Ordinary shares of 40.7p each	8,443	419,743,183	170.8
For consideration of £5.1m, shares issued in respect of the Company's Sharesave Scheme	-	777,415	0.3
At 31 March 2019 ordinary shares of 40.7p each	8,443	420,520,598	171.1
For consideration of £3.6m, shares issued in respect of the Company's Sharesave Scheme	-	515,959	0.2
At 31 March 2020 ordinary shares of 40.7p each	8,443	421,036,557	171.3

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

	2020	2019
	£m	£m
11. Perpetual capital securities		
GBP 300m 2.875% perpetual subordinated capital securities	296.7	296.7
	296.7	296.7

On 22 September 2017 the Company issued £300 million 2.875% perpetual capital securities. Costs directly associated with the issue of £3.3 million were set off against the value of the issuance. They had no fixed redemption date but the Company could at its sole discretion redeem all, but not part, of these securities at their principal amount on 22 May 2020 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 22 May 2020, a periodic return of £8.6 million (2019 £8.6 million) has been recognised as a financial liability at the year end.

PENNON GROUP PLC

Notes (continued)

12. Cash flow from operating activities

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

	2020	2019
	£m	£m
Cash generated from operations		
Profit for the year	206.3	222.6
Adjustments for:		
Share-based payments	3.4	3.6
Profit on disposal of property, plant and equipment	(2.5)	(3.9)
Depreciation charge	197.2	190.0
Amortisation of intangible assets	4.7	5.2
Non-underlying increase in customer debt provisions	9.0	-
Non-underlying past service credit	(4.9)	-
Non-underlying remeasurement of fair value movement in derivatives	(18.0)	(5.8)
Share of post-tax profit from joint ventures	(14.8)	(12.4)
Finance income (before non-underlying items)	(26.6)	(23.5)
Finance costs (before non-underlying items)	115.3	106.7
Taxation charge	95.2	37.7
Changes in working capital:		
Increase in inventories	(6.0)	(4.2)
Decrease/(increase) in trade and other receivables	32.6	(46.4)
(Increase)/decrease in service concession arrangements receivable	(17.4)	6.8
Decrease in trade and other payables	(19.2)	(47.7)
Decrease in retirement benefit obligations from contributions	(30.8)	(7.3)
Decrease in provisions	(7.2)	(21.6)
Cash generated from operations	516.3	399.8
	2020	2019
	£m	£m
Total interest paid		
Interest paid in operating activities	97.7	83.9
Interest paid in investing activities	10.6	15.2
Total interest paid	108.3	99.1

The above includes the entire Group, including cash flows relating to the discontinued operations business. Disaggregated information relating to the discontinued operations business is provided in note 16.

During the year, the Group completed a number of sale and leaseback transactions in respect of its infrastructure assets as part of its ongoing financing arrangements. Cash proceeds of £115.0 million were received and a gain of £nil was recognised. These assets are primarily being leased back over an initial term of 10-year lease term at market rentals.

PENNON GROUP PLC
Notes (continued)

13.	Net borrowings	2020 £m	2019 £m
	Cash and cash deposits	665.9	569.6
	<i>Borrowings – current</i>		
	Bank and other loans	(13.7)	(59.8)
	Other current borrowings	(27.0)	(27.0)
	Lease obligations (IAS17 finance)	(18.2)	(63.6)
	Lease obligations (IAS17 operating)	(1.0)	-
	Total current borrowings	(59.9)	(150.4)
	<i>Borrowings – non-current</i>		
	Bank and other loans	(1,894.8)	(1,628.0)
	Other non-current borrowings	(340.8)	(373.9)
	Lease obligations (IAS17 finance)	(1,384.2)	(1,496.8)
	Lease obligations (IAS17 operating)	(35.1)	-
	Total non-current borrowings	(3,654.9)	(3,498.7)
	Total net borrowings	(3,048.9)	(3,079.5)
	Net borrowings in Disposal Group	(215.1)	-
	Total borrowings in total Group	(3,264.0)	(3,079.5)

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

	2020 £m	2019 £m
Cash and cash deposits as above	665.9	569.6
Cash and cash deposits held in the Disposal Group	33.3	-
Less: deposits with a maturity of three months or more (restricted funds)	(227.2)	(203.9)
	472.0	365.7

PENNON GROUP PLC

Notes (continued)

14. **Contingencies**

	2020	2019
	£m	£m
Contingent liabilities		
Performance bonds	197.1	201.7
	197.1	201.7

Guarantees in respect of performance bonds are entered into in the normal course of business. No liability is expected to arise in respect of the guarantees. All of the performance bonds relate to the Disposal Group.

In connection with the application of the audit exemption under Section 479A of the Companies Act 2006 the Company has guaranteed all the outstanding liabilities as at 31 March 2020 of Viridor Waste 2 Limited since this company qualifies for the exemption.

Other contractual and litigation uncertainties

The Group establishes provisions in connection with contracts and litigation where it has a present legal or constructive obligation as a result of past events and where it is more likely than not an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Matters where it is uncertain that these conditions are met include potential prosecutions from the Health and Safety Executive.

15. **Change in accounting policy on leases**

Adjustments recognised on the adoption of IFRS 16

This note explains the impact of the adoption of IFRS 16 'Leases' on the Group's financial statements, and it discloses the new accounting policies that have been adopted from 1 April 2019, where they are different from those applied in earlier periods.

On adoption of IFRS 16, the Group recognised lease liabilities in relation to leases which had previously been classified as 'operating leases' under the principles of IAS 17 'leases'. These liabilities were measured at the present value of the remaining leases payments, discounted using the Group's weighted average incremental borrowing rate (IBR).

Following adoption of IFRS 16, the Group no longer distinguishes between an on the balance sheet finance lease and an off the balance sheet operating lease. For leases previously classified as finance leases, the Group recognised the carrying amount of leased assets and lease liabilities immediately prior to transition as the carrying amount of the right-of-use asset and lease liability at the date of initial application. The measurement principles of IFRS 16 only apply after this date.

As permitted under IFRS 16, the Group will present right-of-use assets and lease liabilities within property, plant and equipment and borrowings respectively. This approach is consistent with the Group's previous presentation of finance leases under IAS 17.

At 31 March 2019, the Group had non-cancellable operating lease commitments of £195.7 million. These predominantly relate to leases of properties occupied by the Group in the course of carrying out its businesses.

On transition on 1 April 2019, the Group recognised the following items in the balance sheet:

- right-of-use assets – increase by £132.2 million
- prepayments – decrease by £0.5 million
- lease liabilities – increase by £145.7 million
- accruals – decrease by £4.2 million
- deferred tax liabilities – increase by £1.8 million
- retained earnings – decrease by £8.0 million

PENNON GROUP PLC

Notes (continued)

15. Change in accounting policy on leases (continued)

The discount rate used in the calculation of the lease liability involves estimation. The discount rate is calculated on a lease by lease basis. For vehicle leases, which account for less than 1% of the present value of future lease payments, the discount rate is determined by the implicit rate within the lease. For all other leases, where implicit rates are not available, discount rates are calculated using the Group's estimated IBR for each lease. The IBR is determined with reference to applicable reference rate borrowing curves (e.g. LIBOR or its successor), credit margins for the different business segments and lease terms. At the commencement of new leases discount rates are updated to ensure the Group applies the IBR that reflects current market conditions. At 1 April 2019, the date of transition to IFRS 16, the range of rates used was between 2.43% and 4.5% and the weighted average IBR across all leases was 3.6%. If the weighted average rate used was increased by 10bps, this would result in a c.0.9% reduction in the present value of lease liabilities recognised at 1 April 2019.

A reconciliation of the lease liability recognised at 1 April 2019 to operating lease commitments at 31 March 2019 is shown below:

	£m
IAS 17 operating lease commitments	195.7
Less: contracts to which the short-term leases exemption has been applied	(0.1)
Less: contracts to which the low-value leases exemption has been applied	(1.6)
Add: adjustment due to different assessment of lease term	0.5
Less: Impact of discounting at weighted average discount rate of 3.6%	(48.8)
Operating Lease liabilities recognised at 31 March 2019	145.7
Add: finance lease liabilities recognised at 31 March 2019	1,560.4
IFRS 16 lease liability as at 1 April 2019	1,706.1
Of which:	
Current lease liabilities	19.4
Non-current lease liabilities	1,686.7
	1,706.1

Associated right-of-use assets for selected land and building leases were measured on a retrospective basis as if IFRS 16 had always applied from lease inception. All remaining right-of-use assets were measured at the amount equal to the lease liability, adjusted by prepaid or accrued lease payments under IFRS 16 transition provisions relating to leases recognised on the balance sheet at 31 March 2019.

A reconciliation between the opening lease liabilities and right-of-use assets at 1 April 2019 is shown below:

	£m
Lease liabilities following first application of IFRS 16	145.7
Less: adjustment for onerous lease accruals	(1.5)
Less: adjustment for other accruals	(2.9)
Add: adjustment for prepaid lease rentals	0.5
Less: adjustment due to application of IFRS 16 at lease inception	(9.6)
Right-of-use assets on first application of IFRS 16	132.2

In applying IFRS 16 for the first time, the Group has used the following practical expedients and made the following elections permitted by the standard:

- the use of single discount rates to portfolios of leases with similar characteristics
- reliance on previous onerous lease assessments
- accounting for operating leases with terms less than 12 months as at 1 April 2019 as short-term leases
- the application of hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease
- applying the modified retrospective approach: the cumulative effect of initially applying IFRS 16 has been calculated as a reduction to retained profits at 1 April 2019 of £8.0 million. Under this election no restatement of comparative figures will be made
- electing to apply the standard to contracts that were previously identified as leases when applying IAS 17

Cash outflows in respect of leasing relate to principal repayments of £142.8 million and interest repayments of £37.7 million, in addition to inflows from lease financing arrangements of £115.0 million.

PENNON GROUP PLC

Notes (continued)

15. Change in accounting policy on leases (continued)

A summary of opening and closing right-of-use assets are shown below:

	2020	As at 1 April 2019
	£m	£m
Land and buildings	112.6	119.7
Infrastructure assets	326.6	360.2
Operational properties	346.5	344.4
Fixed and mobile plant, vehicles and computers	365.9	373.0
Construction in progress	-	5.2
Transferred to assets held for sale	(207.5)	-
Total	944.1	1,202.5

The total value of right-of-use assets at 1 April 2019 and 31 March 2020 includes £1,070.7 million and £1,029.1 million respectively of assets previously classified as 'held under finance leases' within property, plant and equipment in accordance with IAS 17.

Based on the additional lease liability and associated assets recognised at 1 April 2019 for the Continuing Group the impact on profit for the year ended 31 March 2020 was a reduction in profit after tax of £0.6 million, resulting from:

- an increase in EBITDA of £1.9 million
- an increase in depreciation of £1.4 million
- an increase in finance costs of £1.2 million; and
- a reduction in corporation tax of £0.1 million.

EBITDA increased as operating lease costs previously charged against EBITDA under IAS 17 has been replaced under IFRS 16 with charges for depreciation and interest which are excluded from EBITDA (albeit included in earnings). Short-term and low value leasing costs continue to be charged against EBITDA.

Net operating cash flows increased under IFRS 16 as the element of cash paid attributable to the repayment of principal is included in financing cash flows. The net increase/decrease in cash and cash equivalents remains unchanged.

Lease accounting policy

All are accounted for by recognising a right-of use-asset and a lease liability except for:

- Low value assets; and
- Leases with a duration of 12 months or less.

Contracts previously classified as 'operating leases' under IAS 17 are measured at the present value of contractual payments due to the lessor over the lease term, with the discount rate determined by reference to the rate inherent in the lease unless this is not readily determinable, in which case the Group's incremental borrowing rate on commencement of the lease is used. After initial measurement, lease payments are allocated between the liability and finance cost. The finance cost is charged to profit and loss over the lease period to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The interest element of cash payments in respect of these leases is included within interest payments in determining net cash generated from operating activities. The capital element of the cash payment is included within cash flows from financing activities. Right-of-use assets are amortised on a straight-line basis over the remaining term of the lease or the remaining economic life of the asset if shorter. When the Group revisits its estimate of lease term (because, for example, it reassesses an extension option), it adjusts the carrying amount of the lease liability to reflect the payments to make over the revised term, which is discounted at the same discount rate that applied on lease commencement. In these circumstances an equivalent adjustment is

PENNON GROUP PLC**Notes (continued)****15. Change in accounting policy on leases (continued)**

made to the carrying value of the right-of-use asset, with the revised carrying amount being amortised over the remaining (revised) lease term.

Measurement and recognition of assets and liabilities previously accounted for as 'finance leases' under IAS 17 continue to apply following the adoption of IFRS 16. Assets continue to be included as property, plant and equipment as right-of-use assets at the lower of their fair value at commencement or the present value of the minimum lease payments and are depreciated over their estimated economic lives or the finance lease period, whichever is the shorter. The corresponding liability is recorded as borrowings. The interest element of the rental costs is charged against profits using the actuarial method over the period of the lease.

The Group regularly uses sale and lease back transactions to finance its capital programme. A sale and leaseback transaction is where the Group sells an asset and immediately reacquires the use of the asset by entering into a lease with the buyer. Each transaction is assessed as to whether it meets the criteria within IFRS 15 'Revenue from contracts with customers' for a sale to have occurred. As a result, a lease liability is recognised, the associated property, plant and equipment asset is derecognised, and a right-of-use asset is recognised at the proportion of the carrying value relating to the right retained. Any gain or loss arising relates to the rights transferred to the buyer.

PENNON GROUP PLC

Notes (continued)

16. Discontinued operations and non-current assets held for resale

On 18 March 2020, the Group entered into a formal sale agreement to dispose of Viridor Limited to Planets UK Bidco Limited (Bidco), a newly formed company established by funds advised by Kohlberg Kravis Roberts & Co. L.P. (KKR). In accordance with IFRS 5 'Non-current assets held for sale and discontinued operations', the assets and liabilities related to Viridor were classified as a Disposal Group held for sale at 31 March 2020. The sale is conditional on approval by the Group's shareholders, merger control clearance from the European Commission and certain other conditions and is expected to complete in the summer 2020.

The £3.7 billion estimated fair value less costs to sell exceeds the carrying value of Viridor's net assets, and accordingly no impairment losses have been recognised on reclassification as a Disposal Group.

The tables below show the results of the discontinued operations which are included in the Group income statement and cash flow statement for the year ended 31 March 2020, together with the classes of assets and liabilities comprising the operations held for sale in the Group balance sheet as at 31 March 2019.

	Notes	Before non-underlying items 2020 £m	Non-underlying items (note 5) 2020 £m	Total 2020 £m	Before non-underlying items 2019 £m	Non-underlying items (note 5) 2019 £m	Total 2019 £m
Discontinued operations							
Revenue	4	753.2	–	753.2	845.6	–	845.6
Operating costs							
Employment costs		(130.4)	4.9	(125.5)	(138.6)	(0.9)	(139.5)
Raw materials and consumables used		(87.2)	–	(87.2)	(94.3)	–	(94.3)
Other operating expenses		(337.5)	(1.1)	(338.6)	(433.8)	(28.7)	(462.5)
Earnings before interest, tax, depreciation and amortisation	4	198.1	3.8	201.9	178.9	(29.6)	149.3
Depreciation and amortisation		(82.1)	–	(82.1)	(78.0)	–	(78.0)
Operating profit	4	116.0	3.8	119.8	100.9	(29.6)	71.3
Finance income	6	22.5	–	22.5	20.0	–	20.0
Finance costs	6	(48.7)	–	(48.7)	(44.8)	–	(44.8)
Net finance costs	6	(26.2)	–	(26.2)	(24.8)	–	(24.8)
Share of post-tax profit from joint ventures		14.8	–	14.8	12.4	–	12.4
Profit before tax	4	104.6	3.8	108.4	88.5	(29.6)	58.9
Taxation (charge)/credit	7	(13.6)	(11.0)	(24.6)	(10.6)	5.7	(4.9)
Profit for the year		91.0	(7.2)	83.8	77.9	(23.9)	54.0
Attributable to:							
Ordinary shareholders of the parent				83.8			54.0

PENNON GROUP PLC

Notes (continued)

16. **Discontinued operations and non-current assets held for resale (continued)**

	2020 £m	2019 £m
Cashflows from operating activities	149.1	69.2
Cashflows from investing activities	(133.0)	(255.6)
Cashflows from financing activities	(23.1)	(73.1)
Net cash flows from discontinued operations, net of intercompany	(7.0)	(259.5)

The net assets relating to the Disposal Group at 31 March 2020 in the Group balance sheet are shown below:

	2020 £m
Assets of the Disposal Group	
Goodwill	340.8
Other intangible assets	86.9
Property, plant and equipment	1,584.9
Other non-current assets	261.5
Investments in joint ventures	60.1
Inventories	29.9
Trade and other receivables	277.9
Cash and cash deposits	33.3
Total assets	2,675.3
Liabilities of the Disposal Group	
Borrowings	(248.4)
Trade and other payables	(141.7)
Current tax liabilities	(1.0)
Provisions	(237.6)
Other non-current liabilities	(14.3)
Retirement benefit obligations	(15.1)
Deferred tax liabilities	(98.2)
Total liabilities	(756.3)
Net assets	1919.0

At 31 March 2020 trade and other receivables include a net other receivable of £43.7 million (2019 £43.3 million) relating to gross contractual compensation amounts due totalling £72.0 million (2019 £72.0 million) arising from additional costs incurred in the construction of the Glasgow Recycling and Renewable Energy Centre (GRREC). A full credit risk appraisal has been carried out on this receivable and a provision of £28.3 million (2019 £28.7 million) has been recognised for expected credit losses.

PENNON GROUP PLC

Notes (continued)

16. **Discontinued operations and non-current assets held for resale (continued)**

Provisions include environmental and landfill restoration provisions relating to landfill sites totalling £201.2 million at 31 March 2020.

Included in other provisions are amounts provided by the Group in relation to the expected economic outflow of resources required to settle claims associated with ongoing litigation. These amounts are considered by the Directors and the management of the Group to be the best estimate of the amounts that might be finally settled. Further disclosures have not been provided in accordance with IAS 37 paragraph 92, as the Group believes they are commercially sensitive and doing so would be seriously prejudicial to the Group's position.

17. **Events after the reporting period**

Repayment of perpetual capital securities

On 6 May 2020, the Company exercised its sole discretionary right to redeem all of the £300 million perpetual capital securities at their principal amount on 22 May 2020, this being the first available date to exercise this right.

Disposal of Viridor

On 18 March 2020 the Group announced the sale of Viridor to KKR subject to shareholder, competition authority approval and other conditions. The first two of these conditions have now been met and the final condition can be waived at Pennon's discretion, giving the Group control of the timetable to complete the transition during early summer 2020.

Impact of COVID-19

The World Health Organization (WHO) announced that COVID-19 was a global pandemic on 11 March 2020 and the UK Government announced its wide-ranging lockdown restrictions on 23 March 2020. Given these events took place prior to the Group and Company's financial year end of 31 March 2020, the Directors have taken the impact of these events into account when making its key judgements and estimates at the balance sheet date, up to the date of approving the annual report and accounts.

The Group's operational response to COVID-19 is set out in on page 6 of this document.

In assessing its going concern and viability the impacts of COVID-19 on these assessments has been considered in full.

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Alternative Performance Measures

Alternative performance measures (APMs) are financial measures used in this report that are not defined by International Financial Reporting Standards (IFRS). The Directors believe that these APMs assist in providing additional useful information on the underlying trends, performance and position of the Group as well as enhancing the comparability of information between reporting periods. As the Group defines the APMs they might not be directly comparable to other companies' APMs. They are not intended to be a substitute for, or superior to, IFRS measurements.

(i) **Underlying earnings**

Underlying earnings are presented alongside statutory results as the Directors believe they provide a more useful comparison on business trends and performance. Note 6 in the Annual Report and Accounts provides more detail on non-underlying items, and a reconciliation of underlying earnings for the current year and the prior year is as follows:

Underlying earnings reconciliation 2020					
£m	Total Group underlying (incl discontinued operations)	Underlying discontinued operations	Non- underlying items from continuing operations	Statutory results	Earnings per share (p)
EBITDA (see below)	563.4	198.1	(7.9)	357.4	
Operating profit	361.5	116.0	(7.9)	237.6	
Profit before tax	287.6	104.6	10.1	193.1	
Taxation	(52.0)	(13.6)	(32.2)	(70.6)	
Profit after tax from continuing operations				122.5	
Profit after tax from discontinued operations				83.8	
Profit after tax (PAT)				206.3	
PAT attributable to perpetual capital holders				(7.0)	
Non-controlling interests				1.1	
PAT attributable to shareholders				200.4	47.7
Deferred tax before non-underlying items				33.2	7.9
Non-underlying items post tax				29.3	6.9
Non-controlling interests' share of non-underlying items				(1.0)	(0.2)
Adjustment for full year depreciation charge in Disposal Group				(2.6)	(0.6)
Underlying earnings				259.3	61.7

PENNON GROUP PLC

Alternative Performance Measures (continued)

(i) **Underlying earnings (continued)**

Underlying earnings reconciliation 2019 £m	Total Group underlying (incl discontinued operations)	Underlying discontinued operations	Non- underlying items from continuing operations	Statutory results	Earnings per share (p)
EBITDA (see below)	546.2	178.9	3.9	371.2	
Operating profit	351.0	100.9	3.9	254.0	
Profit before tax	280.2	88.9	9.7	201.4	
Taxation	(42.7)	(10.6)	(0.7)	(37.7)	
Profit after tax from continuing operations				168.6	
Profit after tax from discontinued operations				54.0	
Profit after tax (PAT)				222.6	
PAT attributable to perpetual capital holders				(8.6)	
Non-controlling interests				0.3	
PAT attributable to shareholders				214.3	51.1
Deferred tax before non-underlying items				13.3	3.1
Non-underlying items post tax				14.9	3.6
Underlying earnings				242.5	57.8

(ii) **EBITDA**

EBITDA (earnings before interest, tax, depreciation and amortisation) is used to assess and monitor operational underlying performance. An adjusted EBITDA is also presented that includes Viridor's share of EBITDA from its joint ventures and finance income on service concession arrangements. This measure is presented to aggregate earnings from all the Viridor ERFs which are accounted for differently depending upon the contractual relationships, as shown in the reconciliation below.

Adjusted EBITDA reconciliation

£m	2020			2019		
	Total Group underlying (incl. discontinued operations)	Discontinued operations	Continuing operations	Total Group underlying (incl. discontinued operations)	Discontinued operations	Continuing operations
Statutory EBITDA	559.3	201.9	357.4	520.5	149.3	371.2
Non-underlying items	4.1	(3.8)	7.9	25.7	29.6	(3.9)
Underlying EBITDA	563.4	198.1	365.3	546.2	178.9	367.3
IFRIC 12 interest	15.1	15.1	-	14.6	14.6	-
Joint venture EBITDA ⁽¹⁾	41.3	41.3	-	31.9	31.9	-
Adjusted EBITDA	619.8	254.5	365.3	592.7	225.4	367.3

(1) These adjustments relate to the waste management business, resulting in adjusted waste management EBITDA of £254.5 million (2019 £225.4 million).

PENNON GROUP PLC

Alternative Performance Measures (continued)

(iii) **Total Group Effective interest rate**

A measure of the mean average interest rate payable on the Group's net debt, which excludes interest costs not directly associated with Group net debt. This measure is presented to assess and monitor the relative cost of financing for the Group.

	2020	2019
	£m	£m
Net finance costs after non-underlying items	70.7	77.4
Non-underlying net finance costs	18.0	5.8
Interest receivable on shareholder loans to joint ventures	5.3	5.3
Net interest on retirement benefit obligations	(0.8)	(1.4)
Unwinding of discounts on provisions	(8.2)	(11.1)
Interest receivable on service concession arrangements	15.1	14.6
Capitalised interest	11.0	15.2
Net finance costs for effective interest rate calculation	111.1	105.8
Opening net debt	3,079.5	2,801.5
Closing net debt	3,264.0	3,079.5
Average net debt (opening net debt + closing net debt divided by 2)	3,171.8	2,940.5
Effective interest rate	3.5%	3.6%

(iv) **Total Group Interest cover**

Underlying net finance costs (excluding pensions net interest cost, discount unwind on provisions and IFRIC 12 interest receivable on service concession arrangements) divided by Group operating profit before non-underlying items.

	2020	2019
	£m	£m
Net finance costs after non-underlying items	70.7	77.4
Non-underlying net finance costs	18.0	5.8
Net interest on retirement benefit obligations	(0.8)	(1.4)
Unwinding of discounts in provisions	(8.2)	(11.1)
Interest receivable on service concession arrangements	15.1	14.6
Net finance costs for interest cover calculation	94.8	85.3
Operating profit before non-underlying items	361.5	351.0
Interest cover (times)	3.8	4.1

PENNON GROUP PLC

Alternative Performance Measures (continued)

(v) **Total Group Dividend cover**

Proposed dividends divided by profit for the year before non-underlying items and deferred tax.

	2020	2019
	£m	£m
Proposed dividends	184.3	172.7
Profit for the year attributable to ordinary shareholders	200.4	214.3
Deferred tax charge before non-underlying items	33.2	13.3
Non-underlying items after tax in profit for the year	29.3	14.9
Non-controlling interests' share of non-underlying items	(1.0)	-
Adjustment for full year depreciation charge in the Disposal Group	(2.6)	-
Adjusted profit for dividend cover calculation	259.3	242.5
Dividend cover (times)	1.4	1.4

(vi) **Total Group Capital investment**

Property, plant and equipment additions plus IFRIC 12 service concession expenditure (ERFs) less landfill restoration asset (spend accounted for through provisions). The measure is presented to assess and monitor the total capital investment by the Group.

	2020	2019
	£m	£m
Additions to property, plant and equipment	326.8	387.2
Additions to intangible assets	0.6	-
Landfill restoration asset	(5.3)	(22.8)
IFRIC 12 additions to other intangible assets – service concession arrangements	-	24.7
IFRIC 12 additions to other non-current assets – service concession arrangements	17.1	6.8
IFRIC 12 additions to current trade and other receivables – prepayments and accrued income	-	3.3
Less IFRIC 12 additions subject to legal contractual process	-	(3.3)
Capital investment	339.2	395.9

Following the adoption of IFRS 16 Property, plant and equipment additions in 2020 including right-of-use assets £6.2 million (2019 £nil million). These assets are directly associated with leases previously classified as operating leases under IAS 17. In 2019, operating leases and associated assets were not held on the balance sheet.

(vii) **Total Group Capital payments**

Payments for property, plant and equipment additions net of proceeds from sale of property, plant and equipment plus IFRIC 12 service concession expenditure (ERFs). The measure is presented to assess and monitor the net cash spend on property, plant and equipment.

	2020	2019
	£m	£m
Cash flow statements: purchase of property, plant and equipment	332.8	356.0
Cash flow statements: purchase of intangible assets	0.6	-
Cash flow statements: proceeds from sale of property, plant and equipment	(10.6)	(6.3)
IFRIC 12 additions to other intangible assets – service concession arrangements	-	24.7
IFRIC 12 additions to non-current assets – service concession arrangements	17.1	6.8
IFRIC 12 additions to current trade and other receivables – prepayments and accrued income	-	3.3
Capital payments	339.9	384.5

PENNON GROUP PLC

Alternative Performance Measures (continued)

(viii) **Total Group Return on capital employed**

The total of underlying operating profit, joint venture profit after tax and joint venture interest receivable divided by capital employed (net debt plus total equity invested). An average value for this metric is part of the long-term incentive plan for Directors.

	2020	2019
	£m	£m
Underlying operating profit	361.5	351.0
Underlying joint venture profit after tax	14.8	12.4
Joint venture interest receivable	5.3	5.3
Adjusted profit for return on capital employed calculation	381.6	368.7
Values at year end:		
Net debt	3,264.0	3,079.5
Share capital	171.3	171.1
Share premium account	227.0	223.6
Capital redemption reserve	144.2	144.2
Perpetual capital securities	296.7	296.7
Capital employed for return on capital employed calculation	4,103.2	3,915.1
Return on capital employed	9.3%	9.4%

(ix) **Total Group Operating cash inflows**

Cash generated from operations before construction spend on service concession arrangements, pension contributions and other tax payments. Other taxes include business rates, employer's national insurance, fuel excise duty, carbon reduction commitment, environmental payments, climate change levy and external landfill tax.

	2020	2019
	£m	£m
Cash generated from operations per cash flow statements	516.3	399.8
IFRIC 12 additions to other intangible assets - service concession arrangements	-	24.7
IFRIC 12 additions to non-current assets - service concession arrangements	17.1	6.8
IFRIC 12 additions to current trade and other receivables - prepayments and accrued income	-	3.3
Pension contributions	48.1	32.2
Other tax payments	147.1	137.9
Payment in respect of terminated synthetic derivative, related to a prior period non-underlying charge	-	44.3
Operational cash inflows	728.6	649.0

PENNON GROUP PLC

Alternative Performance Measures (continued)

(x) **RoRE**
This is a key regulatory metric which represents the returns to shareholders expressed as a percentage of regulated equity.

Returns are made up of a base return (set by Ofwat, the water business regulator, at c.6.0% for 2015-20) plus totex outperformance, financing outperformance and ODI outperformance. Returns are calculated post tax and post sharing (only a proportion of returns are attributed to shareholders and shown within RoRE). The three different types of return calculated and added to the base return are:

- Totex outperformance – totex is defined below and outperformance is the difference between actual reported results for the regulated business compared to the Final Determination (Ofwat published document at the start of a regulatory period), in a constant price base
- Financing outperformance – is based on the difference between a company's actual effective interest rate compared with Ofwat's allowed cost of debt
- ODI outperformance – the net reward or penalty a company earns based on a number of different key performance indicators, again set in the Final Determination

Regulated equity is a notional proportion of regulated capital value (RCV which is set by Ofwat at the start of every five-year regulatory period, adjusted for actual inflation). For 2015-20, the notional equity proportion is 37.5%

Further information on this metric can be found in South West Water's annual performance report and regulatory reporting, published in July each year. The most recent can be found at: www.southwestwater.co.uk/about-us/how-are-we-performing.

(xi) **Totex**
Operating costs and capital expenditure of the regulated water and wastewater business (based on the Regulated Accounting Guidelines).

(xii) **ODI**
ODIs are designed to incentivise companies to deliver improvements to service and outcomes based on customers' priorities and preferences. If a company exceeds these targets a reward can be earned through future higher revenues. If a company fails to meet them, they can incur a penalty through lower future allowed revenues.