Independent auditor's report to the members of Severn Trent Plc

Report on the audit of the financial statements

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2018 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including Financial Reporting Standard 101 "Reduced Disclosure Framework"; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements of Severn Trent Plc (the 'parent company') and its subsidiaries (the 'group') which comprise:

- the consolidated income statement;
- the consolidated and parent company statements of comprehensive income;
- the consolidated and parent company statements of changes in equity;
- the consolidated and parent company balance sheets;
- the consolidated cash flow statement; and
- the related notes to the consolidated financial statements 1 to 47 and the related notes to the parent company financial statements 1 to 18.

The financial reporting framework that has been applied in the preparation of the group financial statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and United Kingdom Accounting Standards, including FRS 101 "Reduced Disclosure Framework" (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the group and the parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the parent company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Summary of our audit approach	
Key audit matters	The key audit matters that we identified in the current year were: • Accuracy of wholesale revenue for non-household customers in the new water market; • Valuation of the provision for trade receivables in Severn Trent Water Limited; • Valuation of the group's retirement benefit obligations; and • Classification and valuation of capital expenditure in Severn Trent Water Limited. Within this report, any new key audit matters are identified with ⮝ and any key audit matters which are the same as the prior year are identified with ⮞.
Materiality	The materiality that we used for the group financial statements was £18 million (2017: £18 million) which was determined on the basis of profit before tax, gains/losses on financial instruments and exceptional items.
Scoping	Our audit scoping has resulted in over 90% of the group's net operating assets and profit before tax being subject to audit testing.
Significant changes in our approach	The group disposed of its Operating Services (US) business on 30 June 2017 and therefore it has not been subject to a component audit for the year ended 31 March 2018. There have been no other significant changes to our scoping approach.

Conclusions relating to going concern, principal risks and viability statement

Going concern

We have reviewed the directors' statement in note 2a to the financial statements and page 59 of the Strategic report about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the group's and company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.

We are required to state whether we have anything material to add or draw attention to in relation to that statement required by Listing Rule 9.8.6R(3) and report if the statement is materially inconsistent with our knowledge obtained in the audit.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

Principal risks and viability statement

Based solely on reading the directors' statements and considering whether they were consistent with the knowledge we obtained in the course of the audit, including the knowledge obtained in the evaluation of the directors' assessment of the group's and the company's ability to continue as a going concern, we are required to state whether we have anything material to add or draw attention to in relation to:

- the disclosures on pages 60 to 65 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation on page 60 that they have carried out a robust assessment of the principal risks facing the group, including those that would threaten its business model, future performance, solvency or liquidity; or
- the directors' explanation on pages 58 and 59 as to how they have assessed the prospects of the group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We are also required to report whether the directors' statement relating to the prospects of the group required by Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

The following key audit matters from the prior year have not been included in the current year:

- revenue recognition in relation to the estimation of unbilled metered revenue in Severn Trent Water Limited on the basis that the difference between the amount accrued and subsequently billed has consistently represented approximately 1% of the accrued income over a number of consecutive years; and
- the valuation of current and deferred tax balances following the settlement of open enquires with HMRC in the prior year.

Accuracy of wholesale revenue for non-household customers in the new water market	
Key audit matter description	On 1 April 2017 the new water retail market opened in England, allowing eligible non-household customers the opportunity to choose their water retailer for the first time. Market Operator Services Limited ("MOSL") was established to facilitate the switching of customers, and also to provide a service to settle accounts between water wholesalers and retailers. Severn Trent Water is a wholesaler. Management have recorded manual adjustments to revenue compared to the information provided by MOSL's Core Market Operating System ("CMOS"). Non-household revenue for the year ended 31 March 2018 is £371.4 million as disclosed on page 85. The key audit matter has been focussed on whether manual adjustments made to revenue are accurate. Due to the high level of judgement involved, we have determined that there was a potential for fraud through possible manipulation of this balance. The Audit Committee also considered this as a significant issue as discussed in the Audit Committee Report on page 85.
How the scope of our audit responded to the key audit matter	We have challenged the assumptions applied and the integrity of management's calculation of the adjustments by performing the following: • evaluated the design and implementation of key controls over the adjustments to revenue; • understood and audited reconciling items between volume and revenue recorded by Severn Trent Water Limited and the information provided by CMOS, specifically recalculating the extrapolation based on settlement reports received; • inquired as to whether any Market Operator disputes or Market Arrangement Code disputes are open at the year end date which could indicate that revenue has been incorrectly recorded; • reviewed and challenged the information used to build up the model by considering the accuracy and completeness of the source data used for calculating the adjustments; • tested the completeness of adjustments by reference to operational data; and • benchmarked the direction of the adjustment across the industry and made direct enquiries of management of the Group's joint venture, WaterPlus, of adjustments being recorded by them.
Key observations	We are satisfied that management's manual adjustments to revenue are appropriate.

Valuation of the provision for trade receivables in Severn Trent Water Limited	
Key audit matter description	A proportion of Severn Trent Water Limited's customers do not or cannot pay their bills which results in the need for provisions to be made for non-payment of the customer balance. Management makes estimates regarding future cash collection when calculating the bad debt provision. The value of the provision for trade receivables in Severn Trent Water at 31 March 2018 is £124.5 million of the total provision of £129.0 million (31 March 2017 £125.4 million of the total provision of £130.5 million) in note 21. Provisions are made against Severn Trent Water Limited's trade receivables based on historical experience of levels of recovery from accounts in particular ageing categories. The key audit matter has been focused on the determination of the ageing of trade receivables balances as this determines the level of provisioning to be recorded and the historical cash collection rates applied to the aged debt. Due to the high level of judgement involved, we have determined that there was a potential for fraud through possible manipulation of this balance. The Audit Committee also considered this as a significant issue as discussed in the Audit Committee Report on page 85.

Independent auditor's report to the members of Severn Trent Plc continued

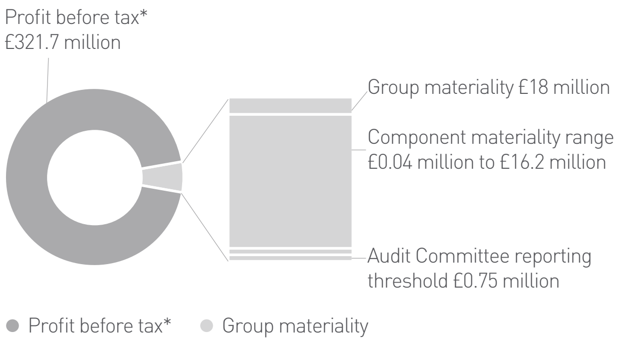
How the scope of our audit responded to the key audit matter	We challenged and tested the information used to determine the bad debt provision by considering cash collection performance against historical trends and the level of bad debt charges over time. Specifically, we analysed the actual experience of slow paying customers in the period using data analytics to consider the collection of debtors that were previously in each aged category. We have also: • evaluated the design and implementation of key management review controls over the bad debt model and management's bad debt paper; • reconciled the debtor ageing for each debt category used in the bad debt provision model using source data from Severn Trent's customer billing system; • audited the information used in calculating the bad debt provision to assess whether it was updated for current cash collection performance; • assessed and audited the rationale for changes to the basis of estimation where changes were made to the bad debt calculation in the current year to reflect historical cash collection patterns for debts with certain characteristics; • compared and assessed the payment profile and level of bad debt provision with those established in previous periods; • considered whether the provision appropriately covered any exposure inherent in the accrued income element of the debtor balance; • deployed our spreadsheet analyser tool to identify anomalies in the bad debt model for further consideration; and • considered whether any of the changes to the estimation in the year represented changes in accounting policy or material error, which required reassessment of the historical position.
Key observations	We are satisfied that the assumptions applied in assessing the impairment of trade receivables and the calculation of the ageing of trade receivable are appropriate and no additional provision was identified from the audit work performed.
Valuation of the group's retirement benefit obligations	
Key audit matter description	This is an area involving significant estimation because the process is complex and requires management after taking advice from their actuarial advisers to make a number of assumptions concerning the discount rate, inflation and pension increases, and the longevity of current pensioners in order to determine the value of the scheme's liabilities. The key audit matter is focused on the valuation of the pension scheme liabilities and the appropriateness of the actuarial assumptions that are used to calculate it, specifically with reference to the discount rate. The group's retirement benefit obligation at 31 March 2018 is £519.8 million (31 March 2017 £574.6 million) as per note 28 Retired Benefit Schemes. The Audit Committee also considered this as a significant issue as discussed in the Audit Committee Report on page 86. Management has included this as a key source of estimation uncertainty in note 4 to the financial statements.
How the scope of our audit responded to the key audit matter	We have challenged the assumptions applied by performing the following procedures: • evaluated the design and implementation of key controls and with support from the pension specialists within our audit team, we challenged the assumptions used in the calculation of the pension scheme deficit as detailed in note 28, specifically challenging the discount rate with reference to comparable market and other third party data; and • assessed whether there had been any changes in the methodology to determine the assumptions since the prior year.
Key observations	We are satisfied that management's assumptions in the valuation of the retirement benefit obligation, including discount rates, are appropriate and within a reasonable range.
Classification and valuation of capital expenditure in Severn Trent Water Limited	
Key audit matter description	Severn Trent Water Limited has a substantial capital programme which has been agreed with the regulator ("Ofwat") and therefore incurs significant expenditure in relation to the development and maintenance of both infrastructure and non-infrastructure assets. Property, plant and equipment ('PPE') additions in Severn Trent Water Limited were £663.2 million of the total additions of £691.2 million disclosed in note 18 (£541.5 million of £583.9 million at 31 March 2017). Expenditure in relation to increasing the capacity or enhancing the network is treated as capital expenditure. Capital projects may contain a combination of enhancement and maintenance activity which are not distinct and therefore there is a key audit matter that PPE is valued incorrectly as a result of items of operating expenditure being misclassified. Due to the level of judgement involved, we have determined that there was a potential for fraud through possible manipulation of this balance. The Audit Committee also considered this a significant issue as discussed in the Audit Committee Report on page 85. Management has included this as a critical judgement in note 4 to the financial statements.
How the scope of our audit responded to the key audit matter	We performed the following procedures to respond to the key audit matter: • we assessed the group's capitalisation policy to determine compliance with relevant accounting standards; • we evaluated the design and implementation and tested the operating effectiveness of controls over the application of the policy to expenditure incurred on projects within the group's capital programme during the year; • for a sample of capital projects, we assessed the application of the capitalisation policy to the costs incurred by understanding the initial business case for the project and ensuring that it had been approved by the relevant capital programme board; and • we agreed a sample of costs to third party invoices and assessed whether the split between capital and operating expenditure was aligned to the original approved business plan.
Key observations	We are satisfied that the valuation and classification of assets capitalised in the year is appropriate.

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Parent company financial statements
Materiality	£18 million (2017: £18 million)	£16.2 million (2017: £16.2 million)
Basis for determining materiality	Approximately 5.6% (2017: approximately 5.7%) of profit before tax, gains/losses on financial instruments and exceptional items.	3.0% of net assets (2017: 3.0%) capped to 90% of group materiality.
Rationale for the benchmark applied	As in 2017, profit before tax, gains/losses on financial instruments and exceptional items has been used in order to focus on the group's underlying trading performance consistent with the group's internal and external reporting.	The parent company does not trade or exist for profit generating purposes so materiality has been determined using net assets.



* Represents profit before tax, gains/losses on financial instruments and exceptional items

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £750,000 (2017: £750,000) for the group, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Our group audit was scoped by obtaining an understanding of the group and its environment, including group-wide controls, and assessing the risks of material misstatement at the group level.

Regulated Water and Waste Water is primarily comprised of Severn Trent Water Limited and Dee Valley Water Limited which were subject to a full scope audit using a materiality of £15m and £0.4m respectively. We have audited a further 10 components using individual statutory materialities which range from £44,000 to £9,000,000. Operating Services US was disposed on 30 June 2017 contributing £42.1 million of revenue and profit before interest and tax of £1.4 million and was subject to analytical review.

This represents over 90% (2017: over 90%) of the group's net operating assets and profit before tax, gains/losses on financial instruments and exceptional items.

We also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to full scope audit procedures.

Our scoping is consistent with the prior year except that Water Plus Limited, Derwent Insurance Limited and Lyra Insurance Guernsey Limited have not been audited by separate component teams in 2018. They are subject to audit procedures performed by the Group audit team.

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

In this context, matters that we are specifically required to report to you as uncorrected material misstatements of the other information include where we conclude that:

- Fair, balanced and understandable – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the group's position and performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- Audit committee reporting – the section describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee; or
- Directors' statement of compliance with the UK Corporate Governance Code – the parts of the directors' statement required under the Listing Rules relating to the company's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

We have nothing to report in respect of these matters.

Independent auditor's report to the members of Severn Trent Plc continued

Responsibilities of directors

As explained more fully in the Directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group's and the parent company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Companies Act 2006

In our opinion the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic report and the Directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the group and of the parent company and their environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made or the part of the Directors' remuneration report to be audited is not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

Other matters

Auditor tenure

We were appointed by the Company at its annual general meeting on 26 July 2005 to audit the financial statements of the Company for the year ending 31 March 2006 and subsequent financial periods. Following a competitive tender process, we were reappointed as auditor of the Company for the year ending 31 March 2016 and subsequent financial periods.

Our total uninterrupted period of engagement is 13 years, covering periods from our initial appointment through to the year ending 31 March 2018.

Consistency of the audit report with the additional report to the audit committee

Our audit opinion is consistent with the additional report to the Audit Committee we are required to provide in accordance with ISAs (UK).

Kari Hale, ACA (Senior statutory auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom

22 May 2018

Consolidated income statement

For the year ended 31 March 2018

	Notes	2018 £m	2017 (restated) £m
Turnover	5, 6	**1,694.1**	1,638.0
Operating costs before exceptional items	7	**(1,153.1)**	(1,117.9)
Exceptional items	8	**(12.6)**	16.6
Total operating costs		**(1,165.7)**	(1,101.3)
Profit before interest, tax and exceptional items	5	**541.0**	520.1
Exceptional items	8	**(12.6)**	16.6
Profit before interest and tax		**528.4**	536.7
Finance income	10	**67.7**	72.2
Finance costs	11	**(287.2)**	(277.3)
Net finance costs		**(219.5)**	(205.1)
Net losses on financial instruments	12	**(6.7)**	(1.8)
Share of net profit/(loss) of joint ventures accounted for using the equity method	19	**0.2**	(1.8)
Profit on ordinary activities before taxation		**302.4**	328.0
Current tax	13	**(32.9)**	(36.3)
Deferred tax	13	**(29.0)**	(22.4)
Exceptional tax	13	**–**	52.2
Taxation on profit on ordinary activities	13	**(61.9)**	(6.5)
Profit for the year from continuing operations		**240.5**	321.5
Profit for the year from discontinued operations	39	**13.2**	21.1
Profit for the year		**253.7**	342.6
Attributable to:			
Owners of the company		**253.7**	342.8
Non-controlling interests		**–**	(0.2)
		253.7	342.6

Earnings per share

		2018 pence	2017 (restated) pence
From continuing operations			
Basic	15	**102.2**	136.8
Diluted	15	**101.9**	136.2
From continuing and discontinued operations			
Basic	15	**107.8**	145.9
Diluted	15	**107.5**	145.3

Consolidated statement of comprehensive income

For the year ended 31 March 2018

	2018 £m	2017 £m
Profit for the year	**253.7**	342.6
Other comprehensive income/(loss)		
Items that will not be reclassified to the income statement:		
Net actuarial gain/(loss)	**29.1**	(311.2)
Tax on net actuarial gain/loss	**(7.6)**	56.3
Deferred tax arising on change of rate	**–**	(3.1)
	21.5	(258.0)
Items that may be reclassified to the income statement:		
Gains/(losses) on cash flow hedges	**5.8**	(8.0)
Deferred tax on gains/losses on cash flow hedges	**(1.0)**	1.3
Amounts on cash flow hedges transferred to the income statement	**8.2**	2.9
Deferred tax on transfer to the income statement	**(1.4)**	(0.4)
Exchange movement on translation of overseas results and net assets	**(1.6)**	5.2
Cumulative exchange gains taken to the income statement	**(29.8)**	(2.8)
	(19.8)	(1.8)
Other comprehensive income/(loss) for the year	**1.7**	(259.8)
Total comprehensive income for the year	**255.4**	82.8
Attributable to:		
Owners of the company	**255.4**	83.1
Non-controlling interests	**–**	(0.3)
	255.4	82.8

Consolidated statement of changes in equity
For the year ended 31 March 2018

	Equity attributable to owners of the company						
	Share capital £m	Share premium £m	Other reserves £m	Retained earnings £m	Total £m	Non-controlling interests £m	Total equity £m
At 1 April 2016	234.3	106.8	116.5	559.8	1,017.4	1.1	1,018.5
Profit for the year	–	–	–	342.8	342.8	(0.2)	342.6
Losses on cash flow hedges	–	–	(8.0)	–	(8.0)	–	(8.0)
Deferred tax on losses on cash flow hedges	–	–	1.3	–	1.3	–	1.3
Amounts on cash flow hedges transferred to the income statement	–	–	2.9	–	2.9	–	2.9
Deferred tax on transfer to the income statement	–	–	(0.4)	–	(0.4)	–	(0.4)
Exchange movement on translation of overseas results and net assets	–	–	5.3	–	5.3	(0.1)	5.2
Cumulative exchange gains transferred to income statement	–	–	(2.8)	–	(2.8)	–	(2.8)
Net actuarial losses	–	–	–	(311.2)	(311.2)	–	(311.2)
Tax on net actuarial losses	–	–	–	56.3	56.3	–	56.3
Deferred tax arising from rate change	–	–	–	(3.1)	(3.1)	–	(3.1)
Transfer net of deferred tax	–	–	7.0	(7.0)	–	–	–
Total comprehensive income/(loss) for the year	–	–	5.3	77.8	83.1	(0.3)	82.8
Share options and LTIPs							
– proceeds from shares issued	0.4	5.7	–	–	6.1	–	6.1
– value of employees' services	–	–	–	6.2	6.2	–	6.2
Current tax on share based payments	–	–	–	0.8	0.8	–	0.8
Deferred tax on share based payments	–	–	–	0.1	0.1	–	0.1
Disposal of non-controlling interest	–	–	–	–	–	(0.8)	(0.8)
Dividends paid	–	–	–	(190.4)	(190.4)	–	(190.4)
At 31 March 2017	234.7	112.5	121.8	454.3	923.3	–	923.3
Profit for the year	–	–	–	253.7	253.7	–	253.7
Gains on cash flow hedges	–	–	5.8	–	5.8	–	5.8
Deferred tax on gains on cash flow hedges	–	–	(1.0)	–	(1.0)	–	(1.0)
Amounts on cash flow hedges transferred to the income statement	–	–	8.2	–	8.2	–	8.2
Deferred tax on transfer to the income statement	–	–	(1.4)	–	(1.4)	–	(1.4)
Exchange movement on translation of overseas results and net assets	–	–	(1.6)	–	(1.6)	–	(1.6)
Cumulative exchange gains transferred to income statement	–	–	(29.8)	–	(29.8)	–	(29.8)
Net actuarial gains	–	–	–	29.1	29.1	–	29.1
Tax on net actuarial gains	–	–	–	(7.6)	(7.6)	–	(7.6)
Transfer between reserves	–	–	(9.0)	9.0	–	–	–
Total comprehensive (loss)/income for the year	–	–	(28.8)	284.2	255.4	–	255.4
Share options and LTIPs							
– proceeds from shares issued	0.4	5.2	–	–	5.6	–	5.6
– value of employees' services	–	–	–	6.9	6.9	–	6.9
Current tax on share based payments	–	–	–	0.8	0.8	–	0.8
Deferred tax on share based payments	–	–	–	(1.3)	(1.3)	–	(1.3)
Dividends paid	–	–	–	(197.0)	(197.0)	–	(197.0)
At 31 March 2018	**235.1**	**117.7**	**93.0**	**547.9**	**993.7**	**–**	**993.7**

Consolidated balance sheet

At 31 March 2018

	Notes	2018 £m	2017 £m
Non-current assets			
Goodwill	16	**62.2**	81.0
Other intangible assets	17	**88.4**	80.9
Property, plant and equipment	18	**8,471.9**	8,116.4
Interests in joint ventures	19	**37.6**	37.4
Derivative financial instruments	20	**36.0**	67.0
Trade and other receivables	21	**181.3**	58.1
Retirement benefit surplus	28	**18.2**	9.8
		8,895.6	8,450.6
Current assets			
Inventory		**18.5**	16.2
Trade and other receivables	21	**456.4**	517.8
Current tax receivable		**–**	7.3
Derivative financial instruments	20	**0.2**	–
Cash and cash equivalents	22	**51.1**	44.6
		526.2	585.9
Current liabilities			
Borrowings	23	**(308.7)**	(559.4)
Derivative financial instruments	25	**–**	(0.6)
Trade and other payables	26	**(462.6)**	(451.9)
Current tax payable		**(8.6)**	–
Provisions for liabilities	29	**(40.6)**	(17.5)
		(820.5)	(1,029.4)
Net current liabilities		**(294.3)**	(443.5)
Non-current liabilities			
Borrowings	23	**(5,259.1)**	(4,719.6)
Derivative financial instruments	25	**(116.0)**	(184.1)
Trade and other payables	26	**(1,009.4)**	(955.7)
Deferred tax	27	**(674.4)**	(623.7)
Retirement benefit obligations	28	**(538.0)**	(584.4)
Provisions for liabilities	29	**(10.7)**	(16.3)
		(7,607.6)	(7,083.8)
Net assets		**993.7**	923.3
Equity			
Called up share capital	30	**235.1**	234.7
Share premium	31	**117.7**	112.5
Other reserves	32	**93.0**	121.8
Retained earnings		**547.9**	454.3
Total equity		**993.7**	923.3

Signed on behalf of the Board who approved the accounts on 22 May 2018.

Andrew Duff
Chairman

James Bowling
Chief Financial Officer

Company Number: 02366619

Consolidated cash flow statement

For the year ended 31 March 2018

	Notes	2018 £m	2017 £m
Cash generated from operations	40	**773.3**	851.0
Tax received	40	**8.0**	20.6
Tax paid	40	**(14.5)**	(42.4)
Net cash generated from operating activities		**766.8**	829.2
Cash flows from investing activities			
Purchase of subsidiaries net of cash acquired		**(0.2)**	(77.7)
Investments in associates and joint ventures		**–**	(13.5)
Purchases of property, plant and equipment		**(608.5)**	(519.2)
Purchases of intangible assets and goodwill		**(27.3)**	(29.1)
Contributions and grants received		**36.8**	39.5
Proceeds on disposal of subsidiaries and other businesses net of cash disposed		**25.1**	5.1
Proceeds on disposal of business to joint venture net of cash disposed		**–**	(10.8)
Proceeds on disposal of property, plant and equipment		**8.0**	7.5
Net loans advanced to joint ventures		**(26.6)**	(109.0)
Proceeds on maturity of forward contract		**–**	4.3
Interest received		**6.4**	1.4
Net cash from investing activities		**(586.3)**	(701.5)
Cash flow from financing activities			
Interest paid		**(183.4)**	(172.6)
Interest element of finance lease payments		**(5.1)**	(5.8)
Dividends paid to shareholders of the parent		**(197.0)**	(190.4)
Repayments of borrowings		**(552.6)**	(276.2)
Repayments of obligations under finance leases		**(1.8)**	(1.5)
New loans raised		**789.2**	498.0
Issues of shares		**5.6**	6.1
Swap termination payment		**(40.0)**	–
Net cash flow from financing activities		**(185.1)**	(142.4)
Net movement in cash and cash equivalents		**(4.6)**	(14.7)
Net cash and cash equivalents at the beginning of the year		**44.6**	55.2
Effect of foreign exchange rates		**(1.5)**	4.1
Net cash and cash equivalents at end of year		**38.5**	44.6
Cash and cash equivalents		**34.7**	25.8
Bank overdrafts		**(12.6)**	–
Short term deposits		**16.4**	18.8
Net cash and cash equivalents at end of year		**38.5**	44.6

Notes to the group financial statements

For the year ended 31 March 2018

1 General information

The Severn Trent group has a number of operations. These are described in the segmental analysis in note 5.

Severn Trent Plc is a company incorporated and domiciled in the United Kingdom. The address of its registered office is shown on the back of the cover of the Annual Report and Accounts.

Severn Trent Plc is listed on the London Stock Exchange.

2 Accounting policies

a) Basis of preparation

The financial statements for the group and the parent company have been prepared on the going concern basis (see strategic report on page 59) under the historical cost convention as modified by the revaluation of certain financial assets and liabilities at fair value.

(i) Consolidated financial statements

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRS'), International Accounting Standards ('IAS') and IFRIC interpretations issued and effective and ratified by the European Union as at 31 March 2018.

(ii) Parent company financial statements

The parent company financial statements have been prepared in accordance with United Kingdom Accounting Standards and comply with the Companies Act 2006. The company meets the definition of a qualifying entity as defined in FRS 100 'Application of Financial Reporting Requirements', accordingly the company has elected to apply FRS 101 'Reduced Disclosure Framework'.

Therefore the recognition and measurement requirements of EU-adopted IFRS have been applied, with amendments where necessary in order to comply with Companies Act 2006 and The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410) as the parent company financial statements are Companies Act 2006 accounts.

As permitted by FRS 101, the parent company has taken advantage of the disclosure exemptions available under that standard in relation to statement of cash flows, share based payment, financial instruments, capital management, presentation of comparative information in respect of certain assets, standards not yet effective, impairment of assets and related party transactions. Where required, equivalent disclosures are given in the consolidated financial statements.

As permitted by section 408 of the Companies Act 2006, no profit or loss account or cash flow statement is presented for the parent company. The profit for the year is disclosed in the statement of comprehensive income, the statement of changes in equity and the balance sheet.

Severn Trent Plc is a partner in Severn Trent Limited Partnership ('the partnership'), which is registered in Scotland. As the partnership is included in the consolidated accounts, the parent company has taken advantage of the exemption conferred by Regulation 7 of The Partnership (Accounts) Regulations 2008 from the requirements of Regulations 4 to 6.

The key accounting policies for the group and the parent company are set out below and have been applied consistently. Differences in the accounting policies applied in the consolidated and the parent company financial statements are described below.

(iii) Prior year restatement

Prior year figures in the consolidated income statement, related notes and alternative performance measures in note 46 have been restated to present separately amounts relating to operations classified as discontinued in the current year. For details, see note 39.

b) Basis of consolidation

The consolidated financial statements include the results of Severn Trent Plc and its subsidiaries and joint ventures. Results are included from the date of acquisition or incorporation and excluded from the date of disposal.

Subsidiaries are consolidated where the group has the power to control a subsidiary.

Joint venture undertakings are accounted for on an equity basis where the group exercised joint control under a contractual arrangement.

Non-controlling interests in the net assets of subsidiaries are identified separately from the group's equity. Non-controlling interests consist of the amount of those interests at the date of the original business combination and the non-controlling interests' share of changes in equity since that date.

Transactions between the company and its subsidiaries have been eliminated on consolidation and are not included within the group financial statements.

c) Revenue recognition

Revenue includes turnover and interest income.

Turnover represents the fair value of consideration receivable, excluding value added tax, trade discounts and intercompany sales, in the ordinary course of business for goods and services provided.

Turnover is not recognised until the service has been provided to the customer or the goods to which the sale relates have either been despatched to the customer or, where they are held on the customer's behalf, title has passed to the customer.

Turnover includes an estimate of the amount of mains water and waste water charges unbilled at the year end. The accrual is estimated using a defined methodology based upon a measure of unbilled water consumed by tariff, which is calculated from historical billing information.

Interest income is accrued on a time basis by reference to the principal outstanding and at the effective interest rate applicable.

d) Exceptional items

Exceptional items are income or expenditure, which individually or, if of a similar type, in aggregate should, in the opinion of the directors, be disclosed by virtue of their size or nature if the financial statements are to give a true and fair view. In this context, materiality is assessed at the segment level.

2 Accounting policies continued

e) Taxation

Current tax payable is based on taxable profit for the year and is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred taxation is provided in full on taxable temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred taxation is measured on a non-discounted basis using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred tax liability is settled.

A deferred tax asset is only recognised to the extent it is probable that sufficient taxable profits will be available in the future to utilise it.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities.

f) Goodwill

Goodwill represents the excess of the fair value of purchase consideration over the fair value of the net assets acquired. Goodwill arising on acquisition of subsidiaries is included in intangible assets, whilst goodwill arising on acquisition of associates or joint ventures is included in interests in associates or joint ventures respectively. If an acquisition gives rise to negative goodwill this is credited directly to the income statement. Fair value adjustments based on provisional estimates are amended within one year of the acquisition, if required, with a corresponding adjustment to goodwill.

Goodwill arising on all acquisitions prior to 1 April 1998 was written off to reserves under UK GAAP and remains eliminated against reserves. Following the disposal of the US Operating Services business on 30 June 2017, all acquisitions prior to 1 April 1998 that were included in goodwill have now been sold. Purchased goodwill arising on acquisitions of subsidiaries after 31 March 1998 is treated as an intangible fixed asset.

Goodwill is tested for impairment in accordance with the policy set out in note 2 k) below and carried at cost less accumulated impairment losses. Goodwill is allocated to the cash-generating unit that derives benefit from the goodwill for impairment testing purposes.

Where goodwill forms part of a cash-generating unit and all or part of that unit is disposed of, the associated goodwill is included in the carrying amount of that operation when determining the gain or loss on disposal of the operation.

g) Other intangible non-current assets

Intangible assets acquired separately are capitalised at cost. Following initial recognition, finite life intangible assets are amortised on a straight-line basis over their estimated useful economic lives as follows:

	Years
Software	3 – 10
Other assets	2 – 20

Amortisation charged on intangible assets is taken to the income statement through operating costs.

Finite life intangible assets are reviewed for impairment where indicators of impairment exist (see 2 k) below).

Intangible assets with indefinite useful lives are carried at cost less accumulated impairment losses. Such assets are reviewed for impairment at least annually and where indications of impairment exist in accordance with the policy set out in note 2 k) below.

Development expenditure is capitalised as an intangible asset and written off over its expected useful economic life where the following criteria are met:

- it is technically feasible to create and make the asset available for use or sale;
- there are adequate resources available to complete the development and to use or sell the asset;
- there is the intention and ability to use or sell the asset;
- it is probable that the asset created will generate future economic benefits; and
- the development costs can be measured reliably.

Research expenditure is expensed when it is incurred.

h) Pre-contract costs

Costs incurred in bidding and preparing for contracts are expensed as incurred except where it is probable that the contract will be awarded, in which case they are recognised as a prepayment which is written off to the income statement over the life of the contract.

The group assesses that it is probable that a contract will be awarded when preferred bidder or equivalent status has been achieved and there are no significant impediments to the award of the contract.

i) Property, plant and equipment

Property, plant and equipment is held at cost (or at deemed cost for infrastructure assets on transition to IFRS) less accumulated depreciation and impairment. Expenditure on property, plant and equipment relating to research and development projects is capitalised and depreciated over the expected useful life of those assets.

The costs of like-for-like replacement of infrastructure components are recognised in the income statement as they arise. Expenditure which results in enhancements to the operating capability of the infrastructure networks is capitalised.

Where items of property, plant and equipment are transferred to the group from customers or developers, the fair value of the asset transferred is recognised in the balance sheet. Fair value is determined based on estimated depreciated replacement cost. Where the transfer is in exchange for connection to the network and there is no further obligation, the corresponding credit is recognised immediately in turnover. Where the transfer is considered to be linked to the provision of ongoing services the corresponding credit is recorded in deferred income and released to operating costs over the expected useful lives of the related assets.

Where assets take a substantial period of time to get ready for their intended use, the borrowing costs directly attributable to the acquisition, construction or production of these assets are added to their cost.

Notes to the group financial statements continued

For the year ended 31 March 2018

2 Accounting policies continued

i) Property, plant and equipment continued

Property, plant and equipment is depreciated, using the straight-line method, to its estimated residual value over its estimated useful life, with the exception of freehold land which is not depreciated. Assets in the course of construction are not depreciated until commissioned.

The estimated useful lives are:

	Years
Infrastructure assets	
Impounding reservoirs	250
Raw water aqueducts	250
Mains	80 – 150
Sewers	150 – 200
Other assets	
Buildings	30 – 80
Fixed plant and equipment	20 – 40
Vehicles and mobile plant	2 – 15

j) Leased assets

Leases where the group obtains assets which transfer substantially all the risks and rewards of ownership to the group are treated as finance leases. The lower of the fair value of the leased asset or the present value of the minimum lease payments is capitalised as an asset with a corresponding liability representing the obligation to the lessor. Lease payments are treated as consisting of a capital element and a finance charge; the capital element reduces the obligation to the lessor and the finance charge is written off to the income statement at a constant rate over the period of the lease in proportion to the capital amount outstanding. Depreciation is charged over the shorter of the estimated useful life and the lease period.

Leases where substantially all the risks and rewards of ownership remain with the lessor are classified as operating leases. Rental costs arising under operating leases are expensed on a straight-line basis over the term of the lease. Leases of land are normally treated as operating leases, unless ownership is transferred to the group at the end of the lease.

k) Impairment of non-current assets

If the recoverable amount of goodwill, an item of property, plant and equipment, or any other non-current asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Where the asset does not generate cash flows that are independent from other assets, the group estimates the recoverable amount of the cash-generating unit to which the asset belongs. Recoverable amount is the higher of fair value less costs to sell or estimated value in use at the date the impairment review is undertaken. Fair value less costs to sell represents the amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing third parties, less costs of disposal. Value in use represents the present value of future cash flows expected to be derived from a cash-generating unit, discounted using a pre-tax discount rate that reflects current market assessments of the cost of capital of the cash-generating unit or asset.

The discount rate used is based on the group's cost of capital adjusted for the risk profiles of individual businesses.

Goodwill is tested for impairment annually. Impairment reviews are also carried out if there is an indication that an impairment may have occurred, or, where otherwise required, to ensure that non-current assets are not carried above their estimated recoverable amounts.

Impairments are recognised in the income statement.

l) Grants and contributions

Grants and contributions received in respect of non-current assets, including certain charges made as a result of new connections to the water and sewerage networks, are treated as deferred income and released to operating costs over the useful economic life of those non-current assets.

Grants and contributions which are given in compensation for expenses incurred with no future related costs are recognised in operating costs in the period that they become receivable.

m) Parent company investments

The parent company recognises investments in subsidiary undertakings at historical cost.

After initial recognition at cost (being the fair value of the consideration paid), investments which are classified as held for trading or available for sale are measured at fair value, with changes in fair value recognised in the income statement or equity respectively. When an available for sale investment is disposed of or impaired, the gain or loss previously recognised in reserves is taken to the income statement.

n) Loans receivable

Loans receivable are measured at fair value on initial recognition, less issue fee income received. After initial recognition, loans receivable are subsequently measured at amortised cost using the effective interest rate method whereby interest and issue fee income are credited to the income statement and added to the carrying value of loans receivable at a constant rate in proportion to the loan amount outstanding.

o) Trade receivables

Trade receivables are measured at fair value on initial recognition. If there is objective evidence that the asset is impaired, it is written down to its recoverable amount and the irrecoverable amount is recognised as an expense in operating costs.

Trade receivables that are assessed not to be impaired individually are assessed collectively for impairment by reference to the group's collection experience for receivables of similar age or characteristics.

p) Service concession agreements

Where the group has an unconditional right to receive cash from a government body in exchange for constructing or upgrading a public sector asset, the amounts receivable are recognised as a financial asset in prepayments and accrued income.

Costs of constructing or upgrading the public sector asset are recognised on a straight-line basis, before adjusting for expected inflation, over the life of the contract.

2 Accounting policies continued

q) Retirement benefits

(i) Defined benefit schemes

The difference between the value of defined benefit pension scheme assets and defined benefit pension scheme liabilities is recorded on the balance sheet as a retirement benefit asset or obligation.

Defined benefit pension scheme assets are measured at fair value using bid price for assets with quoted prices. For scheme assets with no quoted price, the fair value is derived by using quotations from independent third parties or by using applicable valuation techniques at the end of each reporting period. Defined benefit pension scheme liabilities are measured at the balance sheet date by an independent actuary using the projected unit method and discounted at the current rate of return on high quality corporate bonds of equivalent term and currency to the liability.

Service cost, representing the cost of employee service in the year, is included in operating costs. Net finance cost is calculated by applying the discount rate used for the scheme liabilities to the net obligation.

Changes in the retirement benefit obligation that arise from:

- differences between the return on scheme assets and interest income included in the income statement;
- actuarial gains and losses from experience adjustments; and
- changes in demographic or financial assumptions,

are classified as remeasurements, charged or credited to other comprehensive income and recorded in the statement of comprehensive income in the period in which they arise.

There is no contractual agreement, or stated policy, for charging the net defined benefit cost to participating group companies. Therefore, the parent recognises a charge in the income statement which is equal to the contributions payable in the year. The net defined benefit cost for these schemes is recognised by the sponsoring employers, Severn Trent Water Limited and Dee Valley Group Limited.

(ii) Defined contribution schemes

Contributions to defined contribution pension schemes are charged to the income statement in the period in which they fall due.

r) Provisions

Provisions are recognised where:

- there is a present obligation as a result of a past event;
- it is probable that there will be an outflow of economic benefits to settle this obligation; and
- a reliable estimate of this amount can be made.

Insurance provisions are recognised for claims notified and for claims incurred but which have not yet been notified, based on advice from the group's independent insurance advisers.

Provisions are discounted to present value using a pre-tax discount rate that reflects the risks specific to the liability where the effect is material.

s) Purchase of own shares

Where market purchases of Severn Trent ordinary shares are made through an obligating contract, a liability for the present value of the redemption amount is recognised and charged to retained earnings. Payments for the purchase of shares are charged to the liability when made.

Shares held by the Severn Trent Employee Share Ownership Trust which have not vested unconditionally by the balance sheet date are deducted from shareholders' funds until such time as they vest.

t) Borrowings

The accounting policy for borrowings that are the hedged item in a fair value hedge is set out in note 2 u).

All other borrowings are initially recognised at fair value less issue costs. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest rate method whereby interest and issue costs are charged to the income statement and added to the carrying value of borrowings at a constant rate in proportion to the capital amount outstanding.

Index-linked debt is adjusted for changes in the relevant inflation index and changes in value are charged to finance costs.

Borrowings denominated in foreign currency are translated to sterling at the spot rate on the balance sheet date. Exchange gains or losses resulting from this are credited or charged to gains/losses on financial instruments.

u) Derivative financial instruments

Derivative financial instruments are stated at fair value, including accrued interest. Fair value is determined using the methodology described in note 34 a). The accounting policy for changes in fair value depends on whether the derivative is designated as a hedging instrument. The various accounting policies are described below.

Interest receivable or payable in respect of derivative financial instruments is included in finance income or costs.

Derivatives not designated as hedging instruments

Gains or losses arising on remeasurement of derivative financial instruments that are not designated as hedging instruments are recognised in gains/losses on financial instruments in the income statement.

Derivatives designated as hedging instruments

The group uses derivative financial instruments such as cross currency swaps, forward currency contracts and interest rate swaps to hedge its risks associated with foreign currency and interest rate fluctuations.

At the inception of each hedge relationship, the group documents:

- the relationship between the hedging instrument and the hedged item;
- its risk management objectives and strategy for undertaking the hedge transaction; and
- the results of tests to determine whether the hedging instrument is expected to be highly effective in offsetting changes in fair values or cash flows (as appropriate) of the hedged item.

The group continues to test and document the effectiveness of the hedge on an ongoing basis.

Hedge accounting is discontinued when the hedging instrument expires, is sold, terminated or exercised, or no longer qualifies for hedge accounting.

Notes to the group financial statements continued

For the year ended 31 March 2018

2 Accounting policies continued

u) Derivative financial instruments continued

Fair value hedges

Where a loan or borrowing is in a fair value hedging relationship it is remeasured for changes in fair value of the hedged risk at the balance sheet date, with gains or losses being recognised in gains/losses on financial instruments in the income statement. The gain or loss on the corresponding hedging instrument is also taken to gains/losses on financial instruments in the income statement so that the effective portion of the hedge will offset the gain or loss on the hedged item.

If hedge accounting is discontinued, the fair value adjustment arising from the hedged risk on the hedged item is amortised to the income statement over the anticipated remaining life of the hedged item.

Cash flow hedges

The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised in equity and the ineffective portion is charged to gains/losses on financial instruments in the income statement. When the gain or loss from the hedged underlying transaction is recognised in the income statement, the gains or losses on the hedging instrument that have previously been recognised in equity are recycled through gains/losses on financial instruments in the income statement.

If hedge accounting is discontinued, any cumulative gain or loss on the hedging instrument previously recognised in equity is held in equity until the forecast transaction occurs, or transferred to gains/losses on financial instruments in the income statement if the forecast transaction is no longer expected to occur. From this point the derivative is accounted for in the same way as derivatives not designated as hedging instruments. If the hedging instrument is terminated, the gains and losses previously recognised in equity are held in equity until either the forecast transaction occurs or the forecast transaction is no longer expected to occur.

Embedded derivatives

Where a contract includes terms that cause some of its cash flows to vary in a similar way to a derivative financial instrument, that part of the contract is considered to be an embedded derivative.

Embedded derivatives are separated from the contract and measured at fair value with gains and losses taken to the income statement if:

- the risks and characteristics of the embedded derivative are not closely related to those of the contract; and
- the contract is not carried at fair value with gains and losses reported in the income statement.

In all other cases embedded derivatives are accounted for in line with the accounting policy for the contract as a whole.

v) Share based payments

The group operates a number of equity settled share based compensation plans for employees. The fair value of the employee services received in exchange for the grant is recognised as an expense over the vesting period of the grant.

The fair value of employee services is determined by reference to the fair value of the awards granted, calculated using an appropriate pricing model, excluding the impact of any non-market vesting conditions. The number of awards that are expected to vest takes into account non-market vesting conditions including, where appropriate, continuing employment by the group. The charge is adjusted to reflect shares that do not vest as a result of failing to meet a non-market condition.

Share based compensation plans are satisfied in shares of the parent company. Where the fair value of the awards is not recharged to participating group companies, the parent company records the fair value of the awards as an increase in its investment in the subsidiary. The investment is adjusted to reflect shares that do not vest as a result of failing to meet a non-market based condition.

w) Cash flow statement

For the purpose of the cash flow statement, cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months maturity from the date of acquisition and include cash and bank balances and investments in liquid funds.

Net cash and cash equivalents include overdrafts repayable on demand.

Interest paid in the cash flow statement includes amounts charged to the income statement and amounts included in the cost of property, plant and equipment.

x) Net debt

Net debt comprises borrowings including remeasurements for changes in fair value of amounts in fair value hedging relationships, cross currency swaps that are used to fix the sterling liability of foreign currency borrowings (whether hedge accounted or not), net cash and cash equivalents, and loans to joint ventures.

y) Foreign currency

The results of overseas subsidiary and associated undertakings are translated into sterling, the presentational currency of the group, using average rates of exchange ruling during the year.

The net investments in overseas subsidiary undertakings are translated into sterling at the rates of exchange ruling at the year end. Exchange differences arising are treated as movements in equity. On disposal of a foreign currency denominated subsidiary, the deferred cumulative amount recognised in equity since 1 April 2004 relating to that entity is recognised in the income statement under the transitional rule of IFRS 1 'First-time Adoption of International Financial Reporting Standards'.

Foreign currency denominated assets and liabilities of the company and its subsidiary undertakings are translated into the relevant functional currency at the rates of exchange ruling at the year end. Any exchange differences so arising are dealt with through the income statement.

2 Accounting policies continued

y) Foreign currency continued

Foreign currency transactions arising during the year are translated into sterling at the rate of exchange ruling on the date of the transaction. All gains and losses on exchange arising during the year are dealt with through the income statement.

z) Discontinued operations and assets held for sale

Where an asset or group of assets (a disposal group) is available for immediate sale and the sale is highly probable and expected to occur within one year then the disposal group is classified as held for sale. The disposal group is measured at the lower of the carrying amount and fair value less costs to sell. Depreciation is not charged on such assets.

Where a group of assets which comprises operations that can be clearly distinguished operationally and for financial reporting purposes, from the rest of the group (a component), has been disposed of or classified as held for sale, and it:

- represents a separate major line of business or geographical area of operations; or
- is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations; or
- is a subsidiary acquired exclusively with a view to resale,

then the component is classified as a discontinued operation.

3 New accounting policies and future requirements

The group has adopted all amendments to standards with an effective date relevant to this year end with no material impact on its results, assets or liabilities. All other accounting policies have been applied consistently.

At the balance sheet date, the following Standards and Interpretations were in issue but not yet effective:

IFRS 9 'Financial Instruments' affects the measurement and disclosure of financial instruments with effect from 1 April 2018. The group does not anticipate that the classification of its financial assets and liabilities will change significantly as a result of the adoption of IFRS 9. The group does not propose to retrospectively apply the hedge accounting criteria of IFRS 9 to hedging relationships established under IAS 39 accounting. Existing hedges that qualify for hedge accounting under IAS 39 are expected to continue to qualify for hedge accounting under IFRS 9. For new hedges established following adoption of IFRS 9, the group will determine on a case-by-case basis whether to apply the hedge accounting provisions of IFRS 9.

Provisions against trade receivables are calculated under the current accounting policy using historical collection information and losses expected as a result of future events are not recognised. Under IFRS 9 the group will recognise a provision for the lifetime expected credit losses for trade receivables. However, the group does not expect the bad debt charge or provision to be materially different as a result.

IFRS 15 'Revenue from contracts with customers' affects the measurement and recognition of revenue with effect from 1 April 2018. The group has performed an impact analysis for each of its business segments and the expected impact on the results and financial position are set out below.

Regulated Water and Waste Water

There will be no change to the timing of recognition of revenue from charges for water or waste water services. This is by far the most significant source of the group's revenue, making up 93% of group turnover in 2017/18.

IFRS 15 requires that revenue is recognised if it is probable that it will be received. The group is under a statutory obligation to maintain water services to domestic properties within the areas defined in its water supply licences. As a result, the group might provide water and/or sewerage services to customers who are unlikely to pay for these services. Under IFRS 15, such revenue is not recognised. However, there is no readily identifiable group of customers where it is not likely, at the point of billing, that the revenue will be collected.

The group also receives income under the Water Industry Act 1991 as a result of providing new connections to its existing network. The group's current treatment for this income is to treat it as a contribution to the related expenditure, recognise it as deferred income on the balance sheet and credit it to the income statement at the same time as the depreciation of the cost. No change to this treatment is anticipated as a result of the adoption of IFRS 15.

Business Services

The Operating Services business operates under a series of bespoke contracts with specific performance obligations. The group has applied the methodology set out in IFRS 15 to each of these contracts in order to identify differences from the current accounting policy. The most significant differences arose in relation to the group's contract to provide water and waste water services to the Ministry of Defence ('MOD'). The group acts as the service provider under the MOD Project Aquatrine Package C – a 25 year contract spanning 1,295 sites across England covering the eastern sea border and from Lancashire in the North West to West Sussex on the South coast.

Under the contract, the group maintains and upgrades the MoD infrastructure assets and provides operating services for water and waste water. Both the operating services and maintenance and upgrade services are charged under a volumetric tariff, along with standing charges, which are adjusted with inflation as agreed in the contract.

The current accounting policy for this contract is to recognise revenue billed under the volumetric tariff at the point of billing. The expected costs for the upgrade services are recognised on a straight-line basis, before adjusting for expected inflation, over the life of the contract. The resulting asset is recognised as a financial asset in accordance with IFRIC 12.

Under IFRS 15, the expected revenue over the life of the contract will be allocated to the performance obligations under the following headings:

- operating and maintaining the MOD infrastructure assets;
- upgrading the MOD infrastructure assets;
- administrating the services received from statutory water and sewerage undertakers; and
- administrating billing services of the MOD's commercial and Non Base Dependent ('NBD') customers.

Notes to the group financial statements continued

For the year ended 31 March 2018

3 New accounting policies and future requirements continued

Business Services continued

Costs of upgrade services recognised as a financial asset at 31 March 2017 amounting to approximately £30 million will be written off to reserves on transition to IFRS 15 and revenue that had not been recognised under the existing accounting policy amounting to approximately £35 million will be credited to reserves. If IFRS 15 had been applied in 2017/18 revenue would have been approximately £1 million higher and operating costs would have been approximately £3 million higher.

IFRS 16 'Leases' sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ('lessee') and the supplier ('lessor') and will be effective for the group from 1 April 2019. The impact on the results or net assets of the group or company of the changes to the standard has not yet been quantified in detail but this is not expected to be significant because the group does not hold a significant value of operating leases.

There are no other standards and interpretations in issue but not yet adopted that the directors anticipate will have a material effect on the reported income or net assets of the group.

4 Critical accounting judgements and key sources of estimation uncertainty

In the process of applying the group's accounting policies, the group is required to make certain judgements, estimates and assumptions that it believes are reasonable based on the information available. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results may ultimately differ from those estimates.

During the year, management reassessed the significant estimates and critical judgements and resolved that the following were no longer considered to be critical judgements or significant estimates:

i) Tax provisions

Following the exceptional current tax credit in the prior year arising from agreement with HMRC of tax matters from several prior years, and the group's disposal of almost all of its overseas operating subsidiaries, management no longer considers there to be significant risk of a material adjustment to tax provisions in the next year.

ii) Goodwill arising on acquisition of Dee Valley Water

As set out in note 38, the fair values attributed to the assets and liabilities acquired on the acquisition of Dee Valley Water have been finalised in the year, and therefore there will not be a material adjustment to this balance in the next year.

iii) Unbilled revenue

The estimated consumption for customers with water meters is regularly compared to actual consumption data. The difference between estimated and actual consumption historically has not been material. Hence unbilled revenue is no longer considered to be a key source of estimation uncertainty.

iv) Provision for impairment of trade receivables

Provisions are made against Severn Trent Water's trade receivables based on historical experience of levels of recovery from accounts in a particular ageing category. As the provision and the charge in the income statement have not fluctuated significantly over the past few years, it is unlikely that there would be a change in assumptions that would lead to a material change in the carrying amount of trade receivables. Management has therefore concluded that provision for impairment of trade receivables is no longer considered to be a key source of estimation uncertainty.

v) Provisions for other liabilities and charges

In previous years, this area was disclosed as a significant judgement. Management has taken note of the FRC's thematic review of reporting judgements and estimates, which sets out that this is an estimate rather than a judgement. Management has assessed the risk of material change to this balance in the next year and concluded that it is not significant.

a) Critical accounting judgements

i) Classification of costs between operating expenditure and capital expenditure

Severn Trent Water's business involves significant construction and engineering projects. Assessing the classification of costs incurred on such projects between capital expenditure and operating expenditure requires judgements to be made. The judgements are made based on objective criteria that that group has developed to facilitate the consistent application of its accounting policies.

b) Sources of estimation uncertainty

i) Depreciation and carrying amounts of property, plant and equipment

Calculating the depreciation charge and hence the carrying value for property, plant and equipment requires estimates to be made of the useful lives of the assets. The estimates are based on engineering data and the group's experience of similar assets. Details are set out in note 2 i). A five year change in the average remaining useful lives of property, plant and equipment would result in a £35 million change in the depreciation charge.

ii) Retirement benefit obligations

Determining the amount of the group's retirement benefit obligations and the net costs of providing such benefits requires assumptions to be made concerning long term interest rates, inflation and longevity of current and future pensioners. Changes in these assumptions could significantly impact the amount of the obligations or the cost of providing such benefits. The group makes assumptions concerning these matters with the assistance of advice from independent qualified actuaries. Details of the assumptions made and associated sensitivities are set out in note 28 to the financial statements.

5 Segmental analysis

The group is organised into two main business segments:

Regulated Water and Waste Water includes the wholesale water and waste water activities of Severn Trent Water Limited, its retail services to domestic customers, and Dee Valley Water Limited.

Business Services includes the group's Operating Services businesses in the UK & Ireland and the group's regulated and non-regulated Renewable Energy business.

On 15 February 2017, the group completed the acquisition of Dee Valley Water Group Limited. This business has been included in the Regulated Water and Waste Water segment with effect from that date. Further details of the acquisition are set out in note 38.

The disposals of the group's Operating Services businesses in Italy and the USA were completed on 23 February 2017 and 30 June 2017 respectively. These businesses have been classified as discontinued operations. The prior year segmental results have been restated to present the Italian and US Operating Services businesses as discontinued operations as set out in the stock market announcement dated 19 July 2017.

The disposal of the group's non-household retail business to the newly created Water Plus joint venture with United Utilities was also classified as a discontinued operation in the prior year. This transaction was completed on 1 June 2016.

The Severn Trent Executive Committee ('STEC') is considered to be the group's chief operating decision maker. The reports provided to STEC include segmental information prepared on the basis described above. Details of Regulated Water and Waste Water's operations are described on pages 34 to 41 of the Strategic Review and those of Business Services on pages 42 and 43.

Results from interests in joint ventures are not included in the segmental reports reviewed by STEC.

The measure of profit or loss that is reported to STEC for the segments is underlying PBIT. A segmental analysis of sales and underlying PBIT is presented below.

Transactions between reportable segments are included within segmental results, assets and liabilities in accordance with group accounting policies. These are eliminated on consolidation.

a) Segmental results

	2018		2017 (restated)	
	Regulated Water and Waste Water £m	**Business Services £m**	Regulated Water and Waste Water £m	Business Services £m
External turnover	**1,574.1**	**119.9**	1,527.6	109.8
Inter-segment turnover	**0.5**	**18.8**	1.2	18.6
Total turnover	**1,574.6**	**138.7**	1,528.8	128.4
Profit before interest, tax and exceptional items	**514.9**	**36.0**	494.7	32.2
Exceptional items (see note 8)	**(11.1)**	**(1.8)**	26.4	0.6
Profit before interest and tax	**503.8**	**34.2**	521.1	32.8

Profit before interest, tax and exceptional items is stated after:				
Depreciation of property, plant and equipment	**300.7**	**7.7**	299.4	6.7
Amortisation of intangible assets	**19.8**	**0.7**	17.4	0.3
(Profit)/loss on disposal of fixed assets	**(5.0)**	**–**	0.8	–

Notes to the group financial statements continued

For the year ended 31 March 2018

5 Segmental analysis continued

a) Segmental results continued

The reportable segments' turnover is reconciled to group turnover as follows:

	2018 £m	2017 (restated) £m
Regulated Water and Waste Water	1,574.6	1,528.8
Business Services	138.7	128.4
Corporate and other	9.0	6.2
Consolidation adjustments	(28.2)	(25.4)
	1,694.1	1,638.0

Included in revenues of Regulated Water and Waste Water of £1,574.6 million (2017: £1,528.8 million) is £354.9 million (2017: £317.5 million) which arose from sales to Water Plus Select Limited. No other single customer contributed 10% or more to the group's revenue for either 2018 or 2017.

Segmental underlying PBIT is reconciled to the group's profit before tax as follows:

	2018 £m	2017 (restated) £m
Regulated Water and Waste Water	514.9	494.7
Business Services	36.0	32.2
Corporate and other	(9.7)	(6.0)
Consolidation adjustments	(0.2)	(0.8)
Profit before interest, tax and exceptional items	541.0	520.1
Exceptional items:		
Regulated Water and Waste Water	(11.1)	26.4
Business Services	(1.8)	0.6
Corporate and other	0.3	(10.4)
Net finance costs	(219.5)	(205.1)
Net losses on financial instruments	(6.7)	(1.8)
Share of profit/(loss) of joint ventures	0.2	(1.8)
Profit on ordinary activities before taxation	302.4	328.0

The group's treasury and tax affairs are managed centrally by the Group Treasury and Tax departments. Finance costs are managed on a group basis and hence interest income and costs are not reported at the segmental level. Tax is not reported to STEC on a segmental basis.

b) Segmental capital employed

Separate segmental analyses of assets and liabilities are not reviewed by STEC. The balance sheet measure reviewed by STEC on a segmental basis is capital employed, as shown below:

	2018		2017	
	Regulated Water and Waste Water £m	Business Services £m	Regulated Water and Waste Water £m	Business Services £m
Operating assets	8,900.8	196.6	8,477.1	213.1
Goodwill	63.5	–	67.3	14.9
Interests in joint ventures	–	37.6	–	37.4
Segment assets	8,964.3	234.2	8,544.4	265.4
Segment operating liabilities	(1,957.6)	(41.9)	(1,970.9)	(55.9)
Capital employed	7,006.7	192.3	6,573.5	209.5

Operating assets comprise other intangible assets, property, plant and equipment, retirement benefit surpluses, inventory and trade and other receivables.

Operating liabilities comprise trade and other payables, retirement benefit obligations and provisions.

5 Segmental analysis continued

b) Segmental capital employed continued

The Business Services capital employed at 31 March 2017 includes £31.3 million in respect of Operating Services US, which was sold on 30 June 2017.

The reportable segments' assets are reconciled to the group's total assets as follows:

	2018 £m	2017 £m
Segment assets		
Regulated Water and Waste Water	**8,964.3**	8,544.4
Business Services	**234.2**	265.4
Corporate and other	**60.5**	40.6
Other financial assets	**87.3**	111.6
Loan receivable from joint venture	**135.6**	108.6
Current tax receivable	**–**	7.3
Consolidation adjustments	**(60.1)**	(41.4)
Total assets	**9,421.8**	9,036.5

The consolidation adjustments comprise elimination of intra-group debtors and unrealised profits on fixed assets.

The reportable segments' liabilities are reconciled to the group's total liabilities as follows:

	2018 £m	2017 £m
Segment liabilities		
Regulated Water and Waste Water	**(1,957.6)**	(1,970.9)
Business Services	**(41.9)**	(55.9)
Corporate and other	**(74.6)**	(67.5)
Other financial liabilities	**(5,683.4)**	(5,463.7)
Current tax	**(8.6)**	–
Deferred tax	**(674.3)**	(623.7)
Consolidation adjustments	**12.3**	68.5
Total liabilities	**(8,428.1)**	(8,113.2)

The consolidation adjustments comprise elimination of intra-group creditors.

The following table shows the additions to other intangible assets and property, plant and equipment:

	2018		2017	
	Regulated Water and Waste Water £m	Business Services £m	Regulated Water and Waste Water £m	Business Services £m
Other intangible assets	**25.6**	**2.8**	26.1	4.2
Property, plant and equipment	**680.4**	**10.1**	541.5	41.8

c) Geographical areas

The group's sales from continuing operations were derived from the following countries:

	2018 £m	2017 (restated) £m
UK	**1,689.8**	1,632.1
Other	**4.3**	5.9
	1,694.1	1,638.0

The group's non-current assets (excluding financial instruments, deferred tax assets and post-employment benefit assets) were located in the following countries:

	2018 £m	2017 £m
UK	**8,841.4**	8,345.6
US	**–**	28.2
	8,841.4	8,373.8

Notes to the group financial statements continued

For the year ended 31 March 2018

6 Revenue

	2018 £m	2017 (restated) £m
Water and waste water services	**1,574.1**	1,527.6
Other services	**28.8**	30.5
Service concession arrangements	**49.8**	44.5
Energy sales and related incentive payments	**41.4**	35.4
Turnover	**1,694.1**	1,638.0
Interest receivable	**5.7**	0.4
	1,699.8	1,638.4

7 Net operating costs

	2018			2017 (restated)		
	Before exceptional costs £m	Exceptional costs £m	Total £m	Before exceptional costs £m	Exceptional costs £m	Total £m
Wages and salaries	**237.2**	**0.6**	**237.8**	218.5	–	218.5
Social security costs	**23.2**	**–**	**23.2**	21.6	–	21.6
Pension costs	**20.8**	**(8.3)**	**12.5**	20.9	(16.6)	4.3
Share based payments	**6.9**	**–**	**6.9**	6.1	–	6.1
Total employee costs	**288.1**	**(7.7)**	**280.4**	267.1	(16.6)	250.5
Power	**79.2**	**–**	**79.2**	70.4	–	70.4
Carbon Reduction Commitment	**5.9**	**–**	**5.9**	6.3	–	6.3
Raw materials and consumables	**55.1**	**–**	**55.1**	51.1	–	51.1
Rates	**82.4**	**–**	**82.4**	78.5	–	78.5
Charge for bad and doubtful debts	**25.8**	**–**	**25.8**	21.1	–	21.1
Services charges	**34.3**	**–**	**34.3**	33.1	–	33.1
Depreciation of tangible fixed assets	**308.2**	**16.8**	**325.0**	305.9	–	305.9
Amortisation of intangible fixed assets	**20.5**	**–**	**20.5**	17.8	–	17.8
Hired and contracted services	**227.7**	**3.5**	**231.2**	224.9	–	224.9
Operating lease rentals						
– land and buildings	**0.6**	**–**	**0.6**	0.8	–	0.8
– other	**1.1**	**–**	**1.1**	0.4	–	0.4
Hire of plant and machinery	**5.5**	**–**	**5.5**	3.9	–	3.9
Research and development expenditure	**2.1**	**–**	**2.1**	2.2	–	2.2
Profit on disposal of tangible fixed assets	**(7.3)**	**–**	**(7.3)**	(5.0)	–	(5.0)
Profit on disposal of subsidiary undertaking	**–**	**–**	**–**	(0.6)	–	(0.6)
Exchange losses/(gains)	**1.1**	**–**	**1.1**	(3.1)	–	(3.1)
Infrastructure maintenance expenditure	**135.2**	**–**	**135.2**	136.2	–	136.2
Ofwat licence fees	**3.6**	**–**	**3.6**	3.6	–	3.6
Other operating costs	**44.5**	**–**	**44.5**	40.3	–	40.3
Other operating income	**(3.0)**	**–**	**(3.0)**	(4.1)	–	(4.1)
	1,310.6	**12.6**	**1,323.2**	1,250.8	(16.6)	1,234.2
Release from deferred credits	**(14.3)**	**–**	**(14.3)**	(13.9)	–	(13.9)
Own work capitalised	**(143.2)**	**–**	**(143.2)**	(119.0)	–	(119.0)
	1,153.1	**12.6**	**1,165.7**	1,117.9	(16.6)	1,101.3

Further details of exceptional costs are given in note 8.

7 Net operating costs continued

During the year the following fees were charged by the auditors:

	2018 £m	2017 £m
Fees payable to the company's auditors for:		
– the audit of the company's annual accounts	**0.2**	0.2
– the audit of the company's subsidiary accounts	**0.4**	0.5
Total audit fees	**0.6**	0.7
Fees payable to the company's auditors and their associates for other services to the group:		
– audit related assurance services	**0.1**	0.1
– other services relating to taxation	**–**	0.1
– other assurance services	**0.1**	0.3
Total non-audit fees	**0.2**	0.5

Details of directors' remuneration are set out in the Directors' remuneration report on pages 96 to 128.

Other assurance services include certain agreed upon procedures performed by Deloitte in connection with Severn Trent Water's regulatory reporting requirements to Ofwat.

Details of the group policy on the use of the auditor for non-audit services and how auditor independence and objectivity are safeguarded are set out in the Audit Committee report on pages 87 and 88. No services were provided pursuant to contingent fee arrangements.

8 Exceptional items before tax

	2018 £m	2017 (restated) £m
Regulated Water and Waste Water		
Profit on disposal of fixed assets	**–**	11.0
Gain arising on pension exchange arrangement	**7.7**	15.4
Restructuring costs	**(18.8)**	–
	(11.1)	26.4
Business Services		
Gain arising on pension exchange arrangement	**0.3**	0.6
Restructuring costs	**(2.1)**	–
	(1.8)	0.6
Corporate and other		
Elimination of intra-group profit on disposal of fixed assets	**–**	(11.0)
Gain arising on pension exchange arrangement	**0.3**	0.6
	0.3	(10.4)
	(12.6)	16.6

Exceptional tax is disclosed in note 13.

9 Employee numbers

Average number of employees (including executive directors) during the year:

	2018			2017		
	Continuing operations number	Discontinued operations number	Total number	Continuing operations (restated) number	Discontinued operations (restated) number	Total (restated) number
By type of business						
Regulated Water and Waste Water	**5,660**	**–**	**5,660**	5,273	2	5,275
Business Services	**596**	**368**	**964**	585	1,564	2,149
Corporate and other	**9**	**–**	**9**	11	–	11
	6,265	**368**	**6,633**	5,869	1,566	7,435

Notes to the group financial statements continued

For the year ended 31 March 2018

10 Finance income

	2018 £m	2017 (restated) £m
Interest income earned on bank deposits	**0.5**	0.2
Other financial income	**5.2**	0.2
Total interest receivable	**5.7**	0.4
Interest income on defined benefit scheme assets	**62.0**	71.8
	67.7	72.2

11 Finance costs

	2018 £m	2017 £m
Interest expense charged on:		
Bank loans and overdrafts	**19.2**	22.7
Other loans	**183.4**	167.4
Finance leases	**4.4**	4.2
Total borrowing costs	**207.0**	194.3
Other financial expenses	**2.7**	0.3
Interest cost on defined benefit scheme liabilities	**77.5**	82.7
	287.2	277.3

Borrowing costs of £26.2 million (2017: £18.6 million) incurred funding eligible capital projects have been capitalised at an interest rate of 3.89% (2017: 3.94%). Tax relief of £5.0 million (2017: £3.7 million) was claimed on these costs which was credited to the income statement, offset by a related deferred tax charge of £4.5 million (2017: £3.2 million).

12 Net losses on financial instruments

	2018 £m	2017 £m
(Loss)/gain on swaps used as hedging instruments in fair value hedges	**(1.1)**	17.6
Loss arising on debt in fair value hedges	**–**	(16.9)
Exchange gain/(loss) on other loans	**12.7**	(11.1)
Loss on cash flow hedges transferred from equity	**(8.2)**	(2.9)
Hedge ineffectiveness on cash flow hedges	**1.4**	(0.1)
(Loss)/gain arising on swaps where hedge accounting is not applied	**(12.6)**	11.1
Amortisation of fair value adjustment on debt	**1.1**	0.5
	(6.7)	(1.8)

The group's hedge accounting arrangements are described in note 36.

13 Taxation

a) Analysis of tax charge in the year

	2018 £m	2017 (restated) Before exceptional tax £m	2017 (restated) Exceptional tax £m	2017 (restated) Total £m
Current tax at 19% (2017: 20%)				
Current year	**36.8**	47.3	–	47.3
Prior years	**(3.9)**	(11.0)	(16.4)	(27.4)
Total current tax	**32.9**	36.3	(16.4)	19.9
Deferred tax				
Origination and reversal of temporary differences:				
Current year	**21.4**	16.4	–	16.4
Prior years	**7.6**	6.0	4.0	10.0
Exceptional credit from rate change	**–**	–	(39.8)	(39.8)
Total deferred tax	**29.0**	22.4	(35.8)	(13.4)
	61.9	58.7	(52.2)	6.5

The total tax charge for the year was £61.9 million (2017: £6.5 million).

The current tax charge before exceptional tax was £32.9 million (2017: £36.3 million). In 2017, the exceptional current tax credit of £16.4 million arose primarily from adjustments following agreement with HMRC of tax matters from several prior years.

The deferred tax charge before exceptional tax was £29.0 million (2017: £22.4 million). In 2017, there was an exceptional deferred tax credit of £35.8 million arising from agreeing a number of prior year tax items with HMRC and a reduction in the corporation tax rate, enacted in that year, to 17% with effect from 2020.

b) Factors affecting the tax charge in the year

The tax expense for the year is higher (2017: lower) than the standard rate of corporation tax in the UK of 19% (2017: 20%). The differences are explained below:

	2018 £m	2017 (restated) £m
Profit before taxation	**302.4**	328.0
Tax at standard rate of corporation tax in the UK 19% (2017: 20%)	**57.5**	65.6
Tax effect of depreciation on non-qualifying assets	**1.8**	3.2
Other permanent differences	**1.4**	(1.4)
Current year impact of rate change	**(2.5)**	(3.7)
Adjustments in respect of prior years	**3.7**	(17.4)
Exceptional deferred tax credit arising from rate change	**–**	(39.8)
Total tax charge	**61.9**	6.5

	2018 £m	2017 (restated) £m
Profit before taxation	**302.4**	328.0
Tax at standard rate of corporation tax in the UK 19% (2017: 20%)	**57.5**	65.6
Tax effect of depreciation on non-qualifying assets	**1.8**	3.2
Other permanent differences	**1.4**	(1.4)
Tax effect of accelerated capital allowances	**(19.7)**	(13.2)
Other timing differences	**(4.2)**	(6.9)
Adjustments in respect of prior years	**(3.9)**	(27.4)
Total current tax charge	**32.9**	19.9

Notes to the group financial statements continued

For the year ended 31 March 2018

13 Taxation continued

c) Tax charged/(credited) directly to other comprehensive income or equity

In addition to the amount charged to the income statement, the following amounts of tax have been charged/(credited) to other comprehensive income or equity:

	2018 £m	2017 £m
Current tax		
Tax on share based payments	**(0.8)**	(0.8)
Tax on pension contributions in excess of income statement charge	**(9.3)**	(14.1)
Total current tax credited to other comprehensive income or equity	**(10.1)**	(14.9)
Deferred tax		
Tax on actuarial gain/loss	**16.9**	(42.2)
Tax on cash flow hedges	**1.0**	(1.3)
Tax on share based payments	**1.3**	(0.1)
Tax on transfers to the income statement	**1.4**	0.4
Effect of change in tax rate	**–**	3.1
Total deferred tax charged/(credited) to other comprehensive income or equity	**20.6**	(40.1)

14 Dividends

Amounts recognised as distributions to owners of the company in the period:

	2018		2017	
	pence per share	£m	pence per share	£m
Final dividend for the year ended 31 March 2017 (2016)	**48.90**	**115.2**	48.40	114.0
Interim dividend for the year ended 31 March 2018 (2017)	**34.63**	**81.8**	32.60	76.4
Total dividends paid	**83.53**	**197.0**	81.00	190.4
Proposed final dividend for the year ended 31 March 2018	51.92	122.7		

The proposed final dividend is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements.

15 Earnings per share

a) Basic and diluted earnings per share

Basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year, excluding treasury shares and those held in the Severn Trent Employee Share Ownership Trust, which are treated as cancelled.

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

Basic and diluted earnings per share from continuing and discontinued operations are calculated on the basis of profit from continuing and discontinued operations attributable to the equity holders of the company.

The calculation of basic and diluted earnings per share is based on the following data:

(i) Earnings for the purpose of basic and diluted earnings per share from continuing operations

	2018 £m	2017 (restated) £m
Profit for the period attributable to owners of the company	**253.7**	342.8
Adjusted for profit from discontinued operations attributable to owners of the company (see note 39)	**(13.2)**	(21.3)
Profit for the period from continuing operations attributable to owners of the company	**240.5**	321.5

(ii) Number of shares

	2018 m	2017 m
Weighted average number of ordinary shares for the purpose of basic earnings per share	**235.3**	235.0
Effect of dilutive potential ordinary shares:		
– share options and LTIPs	**0.8**	1.0
Weighted average number of ordinary shares for the purpose of diluted earnings per share	**236.1**	236.0

15 Earnings per share continued

b) Underlying earnings per share

	2018 pence	2017 (restated) pence
Underlying basic earnings per share	**121.0**	115.7
Underlying diluted earnings per share	**120.6**	115.2

Underlying earnings per share figures are presented for continuing operations. These exclude the effects of deferred tax, exceptional tax, losses on financial instruments, current tax related to losses on financial instruments, exceptional items and current tax related to exceptional items. The directors consider that the adjusted figures provide a useful additional indicator of performance. The denominators used in the calculations of adjusted basic and diluted earnings per share are the same as those used in the unadjusted figures set out above.

The adjustments to earnings that are made in calculating underlying earnings per share are as follows:

	2018 £m	2017 (restated) £m
Earnings for the purpose of basic and diluted earnings per share from continuing operations	**240.5**	321.5
Adjustments for:		
– exceptional items before tax	**12.6**	(16.6)
– current tax related to exceptional items	**(0.7)**	(0.1)
– net losses on financial instruments	**6.7**	1.8
– current tax on net losses on financial instruments	**(3.3)**	(4.9)
– exceptional current tax	**–**	(16.4)
– deferred tax	**29.0**	(13.4)
Earnings for the purpose of underlying basic and diluted earnings per share	**284.8**	271.9

16 Goodwill

	2018 £m	2017 £m
Cost		
At 1 April	**81.0**	18.2
Acquisition of subsidiary	**–**	66.0
Disposal of subsidiaries	**(14.4)**	(5.4)
Exchange adjustments	**(0.6)**	2.2
Additional consideration in respect of acquisition	**0.2**	–
Adjustment to provisional fair values on acquisition (note 38)	**(4.0)**	–
At 31 March	**62.2**	81.0

Goodwill is allocated to the group's cash-generating units (CGUs) identified according to country of operation and business segment.

A summary of the goodwill allocation by CGU is presented below.

	2018 £m	2017 £m
Dee Valley Water	**62.2**	66.0
Operating Services US	**–**	15.0
	62.2	81.0

Dee Valley Water also has an intangible asset with indefinite useful life amounting to £4.3 million (2017: nil).

The group has reviewed the carrying value of goodwill for impairment in accordance with the policy stated in note 2 k). The carrying value of the Dee Valley Water CGU was determined on the basis of value in use in the current and prior years. The Operating Services US CGU was sold on 30 June 2017.

The value in use calculation for the Dee Valley Water CGU is based on the most recent financial projections available for the business, which cover the remainder of the current AMP period to 2020 and the following AMP period, which runs to 31 March 2025. As a regulated water company, Dee Valley Water's revenues and costs are significantly influenced by the regulatory settlement for each AMP period so management considers it appropriate for the detailed projections to be coterminous with the AMP period.

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16 Goodwill continued

The net cash flows for the current AMP period are based on existing operations and Dee Valley Water's business plan, adjusted for the synergies arising from the acquisition by Severn Trent, to the extent that they will be realised in Dee Valley Water. The net cash flows in the following AMP period have been reduced to reflect the lower weighted average cost of capital proposed by Ofwat in its PR19 methodology.

The key assumptions underlying these projections are:

Key assumption	%
Discount rate	6.3
RPI inflation	3.0
CPI inflation	2.0
Growth rate in the period beyond the detailed projections	2.5

The discount rate was an estimate for the weighted average cost of capital at the year end date based on the market rate for the cost of debt and the cost of equity included in the Dee Valley Water Final Determination for AMP6 adjusted to take account of risks already reflected in the cash flows for AMP7 and beyond. This post-tax rate was converted to the equivalent pre-tax rate discount rate above.

Inflation has been included in the detailed projections at 3% and 2% for RPI and CPI respectively based on the Bank of England's target rate for CPI.

Cash flows beyond the end of the seven year period are extrapolated using an assumption of zero real growth and an estimate of 2.5% for long-term inflation (combination of CPI and RPI).

The value in use for the CGU exceeded its carrying value by £15.6 million. The value in use is most sensitive to the assumption relating to the growth rate outside the five year period. If the growth rate assumption were reduced to 2.2% this would cause the CGU's carrying amount to exceed its recoverable amount under the revised assumption.

17 Other intangible assets

	Computer software				
	Internally generated £m	Purchased £m	Capitalised development costs and patents £m	Instrument of appointment £m	Total £m
Cost					
At 1 April 2016	188.9	104.5	13.5	–	306.9
Additions	14.7	14.5	1.1	–	30.3
Disposals	(1.1)	(1.2)	(0.7)	–	(3.0)
Disposals of subsidiaries	–	(5.0)	–	–	(5.0)
Exchange adjustments	0.2	1.0	–	–	1.2
At 1 April 2017	202.7	113.8	13.9	–	330.4
Additions	9.8	18.2	0.4	–	28.4
Disposals	(0.7)	–	(1.5)	–	(2.2)
Adjustment to provisional fair values (note 38)	–	–	–	4.3	4.3
Disposals of subsidiaries	–	(7.2)	–	–	(7.2)
Exchange adjustments	(0.1)	(0.1)	–	–	(0.2)
At 31 March 2018	**211.7**	**124.7**	**12.8**	**4.3**	**353.5**
Amortisation					
At 1 April 2016	(159.1)	(63.0)	(12.6)	–	(234.7)
Amortisation for the year	(7.7)	(10.8)	(0.8)	–	(19.3)
Disposals	0.7	0.3	0.7	–	1.7
Disposals of subsidiaries	–	3.6	–	–	3.6
Exchange adjustments	(0.1)	(0.7)	–	–	(0.8)
At 1 April 2017	(166.2)	(70.6)	(12.7)	–	(249.5)
Amortisation for the year	(8.0)	(12.6)	(0.1)	–	(20.7)
Disposals	0.6	–	–	–	0.6
Disposals of subsidiaries	–	4.3	–	–	4.3
Exchange adjustments	–	0.2	–	–	0.2
At 31 March 2018	**(173.6)**	**(78.7)**	**(12.8)**	**–**	**(265.1)**
Net book value					
At 31 March 2018	**38.1**	**46.0**	**–**	**4.3**	**88.4**
At 31 March 2017	36.5	43.2	1.2	–	80.9

18 Property, plant and equipment

	Land and buildings £m	Infrastructure assets £m	Fixed plant and equipment £m	Moveable plant £m	Assets under construction £m	Total £m
Cost						
At 1 April 2016	3,168.0	4,939.9	3,788.1	67.0	545.2	12,508.2
Additions	15.5	73.7	12.4	1.7	480.6	583.9
Transfers on commissioning	134.4	39.9	214.7	6.3	(395.3)	–
Disposals	(5.7)	(0.7)	(24.7)	(3.8)	–	(34.9)
Acquisition of subsidiary undertaking	0.8	61.4	64.3	–	–	126.5
Disposal of subsidiary undertaking	–	–	(4.7)	–	–	(4.7)
Exchange adjustments	–	–	2.2	2.7	–	4.9
At 1 April 2017	3,313.0	5,114.2	4,052.3	73.9	630.5	13,183.9
Additions	9.1	60.5	16.4	0.9	604.3	691.2
Transfers on commissioning	69.4	52.2	136.5	4.4	(262.5)	–
Disposals	(2.0)	(0.3)	(12.4)	(2.9)	(0.8)	(18.4)
Adjustment to provisional fair values (note 38)	–	0.8	–	–	–	0.8
Disposal of subsidiary undertaking	–	–	(15.2)	(19.2)	–	(34.4)
Reclassifications	(3.0)	6.5	(10.7)	(0.3)	7.5	–
Exchange adjustments	–	–	(0.9)	(1.2)	–	(2.1)
At 31 March 2018	**3,386.5**	**5,233.9**	**4,166.0**	**55.6**	**979.0**	**13,821.0**
Depreciation						
At 1 April 2016	(1,119.5)	(1,256.5)	(2,368.0)	(45.6)	–	(4,789.6)
Charge for the year	(81.2)	(42.6)	(178.1)	(6.9)	–	(308.8)
Disposals	3.7	0.2	23.4	3.5	–	30.8
Disposal of subsidiary undertaking	–	–	3.5	–	–	3.5
Exchange adjustments	–	–	(1.4)	(2.0)	–	(3.4)
At 1 April 2017	(1,197.0)	(1,298.9)	(2,520.6)	(51.0)	–	(5,067.5)
Charge for the year	(84.5)	(31.5)	(188.0)	(4.8)	–	(308.8)
Disposals	1.7	–	12.9	2.7	–	17.3
Disposal of subsidiary undertaking	–	–	10.2	14.8	–	25.0
Reclassifications	4.1	(1.5)	(3.0)	0.4	–	–
Exceptional depreciation	(10.1)	–	(6.7)	–	–	(16.8)
Exchange adjustments	–	–	0.7	1.0	–	1.7
At 31 March 2018	**(1,285.8)**	**(1,331.9)**	**(2,694.5)**	**(36.9)**	**–**	**(5,349.1)**
Net book value						
At 31 March 2018	**2,100.7**	**3,902.0**	**1,471.5**	**18.7**	**979.0**	**8,471.9**
At 31 March 2017	2,116.0	3,815.3	1,531.7	22.9	630.5	8,116.4

The carrying amount of property, plant and equipment includes the following amounts in respect of assets held under finance leases:

	Infrastructure assets £m	Fixed plant and equipment £m	Total £m
Net book value			
At 31 March 2018	**115.8**	**6.4**	**122.2**
At 31 March 2017	118.8	10.2	129.0

The depreciation charge for 2018 includes £16.8 million (2017: £5.0 million) in respect of the write off of redundant plant and equipment.

Notes to the group financial statements continued

For the year ended 31 March 2018

19 Interests in joint ventures

Particulars of the group's principal joint venture undertaking at 31 March 2018 were:

Name	Type	Country of incorporation	Class of share capital held	Proportion of ownership interest
Water Plus Limited	Joint venture	Great Britain	Ordinary B	50%

The results and net assets of the principal joint venture are shown below:

	Interests in joint venture	
	2018 £m	2017 £m
Group's share of carrying value	37.6	37.4
Group's share of profit and comprehensive income	0.2	(1.8)

All results are from continuing operations in both the current and preceding year.

As at 31 March 2018 and 2017 the joint venture did not have any significant contingent liabilities to which the group was exposed and the group did not have any significant contingent liabilities in relation to its interests in the joint venture. The group had no capital commitments in relation to its interests in the joint venture at 31 March 2018 or 2017.

The company has given guarantees in favour of Water Plus Limited in respect of the joint venture's liabilities to wholesalers in the Open Water market and its loan from Severn Trent Water Limited. The guarantee in respect of liabilities to wholesalers is capped at £42.5 million (2017: £42.5 million) and the guarantees for the Severn Trent Water loan is for the amount due.

The registered office of Water Plus is Two Smithfield, Leonard Coates Way, Stoke-on-Trent, ST1 4FD.

20 Categories of financial assets

	Notes	2018 £m	2017 £m
Fair value through profit and loss			
Cross currency swaps – not hedge accounted		5.8	23.6
Interest rate swaps – not hedge accounted		11.4	23.6
		17.2	47.2
Derivatives designated as hedging instruments			
Cross currency swaps – fair value hedges		18.7	19.8
Energy hedges – cash flow hedges		0.3	–
		19.0	19.8
Total derivative financial assets		36.2	67.0
Loans and receivables (including cash and cash equivalents)			
Trade receivables	21	191.0	214.2
Loan receivable from joint venture	21	135.6	108.6
Short term deposits	22	16.4	18.8
Cash at bank and in hand	22	34.7	25.8
Total loans and receivables		377.7	367.4
Total financial assets		413.9	434.4
Disclosed in the balance sheet as:			
Non-current assets			
Derivative financial assets		36.0	67.0
Loan receivable from joint venture		135.6	9.0
		171.6	76.0
Current assets			
Derivative financial assets		0.2	–
Trade and other receivables		191.0	214.2
Loan receivable from joint venture		–	99.6
Cash and cash equivalents		51.1	44.6
		242.3	358.4
		413.9	434.4

21 Trade and other receivables

	2018 £m	2017 £m
Current assets		
Trade receivables	**320.0**	344.7
Bad debt provision	**(129.0)**	(130.5)
Net trade receivables	**191.0**	214.2
Other amounts receivable	**38.7**	38.5
Prepayments	**15.5**	5.7
Accrued income	**211.2**	159.8
Loan receivable from joint venture	**–**	99.6
	456.4	517.8
Non-current assets		
Other amounts receivable	**1.5**	–
Prepayments	**13.1**	21.4
Amounts receivable from service concession arrangements	**31.1**	27.7
Loan receivable from joint venture	**135.6**	9.0
	181.3	58.1
	637.7	575.9

The carrying values of trade and other receivables are reasonable approximations of their fair values.

Doubtful debts provision

Movements on the doubtful debts provision were as follows:

	2018 £m	2017 £m
At 1 April	**130.5**	126.9
Charge for bad and doubtful debts (continuing and discontinued operations)	**27.3**	21.9
Acquisition of Dee Valley Water	**–**	2.8
Disposal of subsidiary undertaking	**(1.2)**	–
Amounts written off during the year	**(27.6)**	(21.1)
At 31 March	**129.0**	130.5

The aged analysis of receivables that are specifically provided for is as follows:

	2018 £m	2017 £m
Up to 90 days	**0.5**	1.0
91 – 365 days	**1.2**	6.3
1 – 2 years	**5.2**	2.8
2 – 3 years	**2.5**	3.9
More than 3 years	**5.6**	6.9
	15.0	20.9

A collective provision is recorded against assets which are past due but for which no specific provision has been made. This is calculated based on historical experience of levels of recovery.

Notes to the group financial statements continued

For the year ended 31 March 2018

21 Trade and other receivables continued

The aged analysis of receivables that were overdue at the reporting date but not individually provided for is as follows:

	2018 £m	2017 £m
Up to 90 days	43.6	56.6
91 – 365 days	80.0	85.8
1 – 2 years	57.5	57.2
2 – 3 years	40.7	35.1
More than 3 years	77.4	68.0
	299.2	302.7

The amounts above are reconciled to gross and net debtors in the table below:

	2018			2017		
	Gross £m	Provision £m	Net £m	Gross £m	Provision £m	Net £m
Not due	5.8	–	5.8	21.1	–	21.1
Overdue not specifically provided	299.2	(114.0)	185.2	302.7	(109.6)	193.1
Overdue and specifically provided	15.0	(15.0)	–	20.9	(20.9)	–
	320.0	(129.0)	191.0	344.7	(130.5)	214.2

Credit risk

Trade receivables

Credit control policies and procedures are determined at the individual business unit level. By far the most significant business unit of the group is Severn Trent Water Limited, which represents 93% of group turnover and 91% of net trade receivables. Severn Trent Water has a statutory obligation to provide water and waste water services to customers within its region. Therefore there is no concentration of credit risk with respect to its trade receivables from these services and the credit quality of its customer base reflects the wealth and prosperity of all of the domestic households within its region.

Water Plus

In the current and prior year, the group's joint venture, Water Plus, was the largest retailer for non-domestic customers in the Severn Trent region. The trade receivables and amounts shown as loans receivable from joint ventures are disclosed within the related parties note 45.

22 Cash and cash equivalents

	2018 £m	2017 £m
Cash at bank and in hand	34.7	25.8
Short term deposits	16.4	18.8
	51.1	44.6

Short term bank deposits are held as security deposits for insurance obligations, which are not available for use by the group. In addition, £9.8 million (2017: £10.0 million) of cash at bank and in hand is restricted for use on the Ministry of Defence contract and is not available for use by the group.

23 Borrowings

	2018 £m	2017 £m
Current liabilities		
Bank overdraft	**12.6**	–
Bank loans	**287.9**	151.2
Other loans	**5.3**	406.1
Finance leases	**2.9**	2.1
	308.7	559.4
Non-current liabilities		
Bank loans	**929.5**	922.1
Other loans	**4,218.6**	3,683.9
Finance leases	**111.0**	113.6
	5,259.1	4,719.6
	5,567.8	5,279.0

24 Finance leases

Obligations under finance leases are as follows:

	2018 £m	2017 £m
Within 1 year	**6.5**	6.1
1 – 2 years	**7.0**	6.5
2 – 5 years	**24.3**	22.6
After more than 5 years	**113.1**	121.9
Gross obligations under finance leases	**150.9**	157.1
Less future finance charges	**(37.0)**	(41.4)
Present value of lease obligations	**113.9**	115.7

Net obligations under finance leases fall due as follows:

	2018 £m	2017 £m
Within 1 year	**2.9**	2.1
1 – 2 years	**3.2**	2.6
2 – 5 years	**13.7**	11.5
After more than 5 years	**94.1**	99.5
Included in non-current liabilities	**111.0**	113.6
	113.9	115.7

The remaining terms of finance leases ranged from 1 to 14 years at 31 March 2018. Interest terms are set at the inception of the leases. The leases bear fixed interest at a weighted average rate of 5.34% (2017: 5.34%). The lease obligations are secured against the related assets.

There were no contingent rents, escalation clauses or material renewal or purchase options. The terms of the finance leases do not impose restriction on dividend payments, additional debt or further leasing.

Notes to the group financial statements continued

For the year ended 31 March 2018

25 Categories of financial liabilities

	Notes	2018 £m	2017 £m
Fair value through profit and loss			
Interest rate swaps – not hedge accounted		98.8	163.2
Inflation swaps – not hedge accounted		2.8	–
		101.6	163.2
Derivatives designated as hedging instruments			
Interest rate swaps – cash flow hedges		13.6	20.7
Energy hedges – cash flow hedges		0.8	0.8
		14.4	21.5
Total derivative financial liabilities		116.0	184.7
Other financial liabilities			
Borrowings	23	5,567.8	5,279.0
Trade payables	26	18.9	24.0
Total other financial liabilities		5,586.7	5,303.0
Total financial liabilities		5,702.7	5,487.7
Disclosed in the balance sheet as:			
Non-current liabilities			
Derivative financial liabilities		116.0	184.1
Borrowings		5,259.1	4,719.6
		5,375.1	4,903.7
Current liabilities			
Derivative financial liabilities		–	0.6
Borrowings		308.7	559.4
Trade payables		18.9	24.0
		327.6	584.0
		5,702.7	5,487.7

26 Trade and other payables

	2018 £m	2017 £m
Current liabilities		
Trade payables	18.9	24.0
Social security and other taxes	6.9	5.8
Other payables	21.6	13.5
Deferred income	14.9	12.2
Accruals	400.3	396.4
	462.6	451.9
Non-current liabilities		
Accruals	0.4	2.1
Deferred income	1,009.0	953.6
	1,009.4	955.7
	1,472.0	1,407.6

27 Deferred tax

An analysis of the movements in the major deferred tax liabilities and assets recognised by the group is set out below:

	Accelerated tax depreciation £m	Retirement benefit obligations £m	Fair value of financial instruments £m	Other £m	Total £m
At 1 April 2016	766.2	(55.8)	(51.6)	5.9	664.7
Reclassification	–	15.5	–	(15.5)	–
Charge/(credit) to income	23.3	–	3.2	(0.1)	26.4
(Credit)/charge to income arising from rate change	(42.5)	–	2.2	0.5	(39.8)
Acquired through business combination	11.9	1.7	–	(1.1)	12.5
Credit to equity	–	(42.2)	(0.9)	(0.1)	(43.2)
Charge to equity arising from rate change	–	2.1	1.0	–	3.1
At 1 April 2017	758.9	(78.7)	(46.1)	(10.4)	623.7
Charge/(credit) to income	24.5	(0.3)	1.6	3.2	29.0
Charge for adjustments to provisional fair values	0.1	–	–	1.0	1.1
Charge to equity	–	16.9	2.4	1.3	20.6
At 31 March 2018	**783.5**	**(62.1)**	**(42.1)**	**(4.9)**	**674.4**

Deferred tax assets and liabilities have been offset. The offset amounts, which are to be recovered/settled after more than 12 months, are as follows:

	2018 £m	2017 £m
Deferred tax asset	**(109.1)**	(135.2)
Deferred tax liability	**783.5**	758.9
	674.4	623.7

28 Retirement benefit schemes

a) Defined benefit pension schemes

(i) Background

The group operates a number of defined benefit pension schemes in the UK. The Severn Trent Pension Scheme and the Severn Trent Mirror Image Pension Scheme closed to future accrual on 31 March 2015, while the Dee Valley Water Limited Section of the Water Companies Pension Scheme, which is a sectionalised scheme, currently remains open to accrual. The defined benefit pension schemes cover increases in accrued benefits arising from inflation and pension increases. Their assets are held in separate funds administered by trustees. The trustees are required to act in the best interests of the schemes' beneficiaries. A formal actuarial valuation of each scheme is carried out on behalf of the trustees at triennial intervals by an independent professionally qualified actuary. Under the defined benefit pension schemes, members are entitled to retirement benefits calculated by reference to their pensionable service and pensionable salary history, with inflationary pension increases applying in line with the scheme rules.

The UK defined benefit pension schemes and the dates of their last completed formal actuarial valuations as at the accounting date are as follows:

	Date of last formal actuarial valuation
Severn Trent Pension Scheme (STPS)*	31 March 2016
Severn Trent Mirror Image Pension Scheme (STMIPS)	31 March 2016
Water Companies Pension Scheme – Dee Valley Water Limited Section (DVWS)	31 March 2017

* The STPS is by far the largest of the group's UK defined benefit schemes, comprising over 90% of the group's overall defined benefit obligations.

Notes to the group financial statements continued

For the year ended 31 March 2018

28 Retirement benefit schemes continued

a) Defined benefit pension schemes continued

(ii) Amount included in the balance sheet arising from the group's obligations under the defined benefit pension schemes

	2018 £m	2017 £m
Fair value of assets	**2,339.8**	2,352.8
Present value of the defined benefit obligations	**(2,859.6)**	(2,927.4)
	(519.8)	(574.6)
Presented on the balance sheet as:		
Retirement benefit obligation – funded schemes in surplus	**18.2**	9.8
Retirement benefit obligation – funded schemes in deficit	**(529.3)**	(573.9)
Retirement benefit obligation – unfunded schemes	**(8.7)**	(10.5)
Retirement benefit obligation – total	**(538.0)**	(584.4)
Net retirement benefit obligation	**(519.8)**	(574.6)

STPS, STMIPS, and DVWS	2018 £m	2017 £m
Fair value of scheme assets		
Equities	**360.4**	914.3
Diversified growth funds	**5.3**	5.3
Gilts	**–**	412.6
Corporate bonds	**825.7**	670.8
Liability driven investment funds (LDI)	**783.1**	42.6
Property	**180.7**	174.9
Emerging markets multi-assets funds	**3.9**	3.3
High-yield bonds	**3.4**	3.3
Hedge funds	**0.6**	1.2
Cash	**176.7**	124.5
	2,339.8	2,352.8

The majority of the assets have quoted prices in active markets, but there are a small proportion of the equity and LDI investments which are unquoted.

Movements in the fair value of the scheme assets were as follows:

	2018 £m	2017 £m
Fair value at 1 April	**2,352.8**	2,039.8
Interest income on scheme assets	**62.0**	71.8
Contributions from the sponsoring companies	**35.2**	33.2
Contributions from scheme members	**0.1**	–
Return on plan assets (excluding amounts included in finance income)	**(1.3)**	227.6
Scheme administration costs	**(1.8)**	(3.3)
Benefits paid	**(107.2)**	(87.2)
Acquisition of Dee Valley Water	**–**	70.9
Fair value at 31 March	**2,339.8**	2,352.8

28 Retirement benefit schemes continued

a) Defined benefit pension schemes continued

(ii) Amount included in the balance sheet arising from the group's obligations under the defined benefit pension schemes continued

Movements in the present value of the defined benefit obligations were as follows:

	2018 £m	2017 £m
Present value at 1 April	(2,927.4)	(2,349.3)
Service cost	(0.5)	–
Exceptional past service credit	8.3	17.3
Interest cost	(77.5)	(82.7)
Contributions from scheme members	(0.1)	–
Actuarial gains arising from changes in demographic assumptions	21.6	16.6
Actuarial gains/(losses) arising from changes in financial assumptions	6.9	(470.6)
Actuarial gains/(losses) arising from experience adjustments	1.9	(84.8)
Benefits paid	107.2	87.2
Acquisition of Dee Valley Water	–	(61.1)
Present value at 31 March	**(2,859.6)**	(2,927.4)

The group has an obligation to pay pensions to a number of former employees, whose benefits would otherwise have been restricted by the Finance Act 1989 earnings cap. Provision for such benefits amounting to £8.7 million (2017: £10.5 million) is included as an unfunded scheme within the retirement benefit obligation.

The group has assessed that is has an unconditional right to a refund of any surplus assets in each of the Schemes following settlement of all obligations to scheme members and therefore the surplus in DVWS has been recognised in full.

(iii) Amounts recognised in the income statement in respect of these defined benefit pension schemes

	2018 £m	2017 £m
Amounts credited to operating costs		
Current service cost	(0.5)	–
Exceptional past service credit	8.3	17.3
Scheme administration costs	(1.8)	(3.3)
	6.0	14.0
Amounts charged to finance costs		
Interest cost	(77.5)	(82.7)
Amounts credited to finance income		
Interest income on scheme assets	62.0	71.8
Total amount (charged)/credited to the income statement	**(9.5)**	3.1

The actual return on scheme assets was a gain of £60.7 million (2017: gain of £299.4 million).

Actuarial gains and losses have been reported in the statement of comprehensive income.

(iv) Actuarial risk factors

The Schemes typically expose the group to actuarial risks such as investment risk, inflation risk and longevity risk.

Investment risk

The group's contributions to the Schemes are based on actuarial calculations which make assumptions about the returns expected from the Schemes' investments. If the investments underperform these assumptions in the long term then the group may need to make additional contributions to the Schemes in order to fund the payment of accrued benefits.

Each plan's investment strategy seeks to balance the level of investment return sought with the aim of reducing volatility and risk. In undertaking this approach, reference is made to both the maturity of liabilities and the funding level of that plan. A number of further strategies are employed to manage underlying risks, including liability matching asset strategies, diversification of asset portfolios and interest rate hedging.

Currently the plan has a balanced approach to investment in equity securities, debt instruments and real estates. Due to the long term nature of the plan liabilities, the Trustees consider it appropriate to invest a portion of the plan assets in equity securities and in real estate to leverage the return generated by the fund.

Notes to the group financial statements continued

For the year ended 31 March 2018

28 Retirement benefit schemes continued

a) Defined benefit pension schemes continued

(iv) Actuarial risk factors continued

Inflation risk

The benefits payable to members of the Schemes are linked to inflation measured by the RPI or CPI , subject to caps. The group's contributions to the Schemes are based on assumptions about the future level of inflation. If inflation is higher than the levels assumed in the actuarial calculations then the group may need to make additional contributions to the Schemes in order to fund the payment of accrued benefits.

The Schemes use Liability Driven Investment ('LDI') within the asset portfolios to hedge against the value of liabilities changing as a result of movements in long-term interest rate and inflation expectations. This structure allows the Schemes to both hedge against these risks and retain capital investment in assets that are expected to generate higher returns.

Longevity risk

The group's contributions to the Schemes are based on assumptions about the life expectancy of Scheme members after retirement. If Scheme members live longer than assumed in the actuarial calculations then the group may need to make additional contributions to the Schemes in order to fund the payment of accrued benefits.

(v) Actuarial assumptions

The major financial assumptions used in the accounting valuation of the obligations for the STPS, which represents by far the largest defined benefit obligation for the group, were as follows:

	2018 %	2017 %
Price inflation – RPI	**3.1**	3.1
Price inflation – CPI	**2.1**	2.1
Discount rate	**2.7**	2.7
Pension increases in payment	**3.1**	3.1
Pension increases in deferment	**3.1**	3.1

The assumption for price inflation is derived from the difference between the yields on longer term fixed rate gilts and on index-linked gilts.

In setting our discount rate, we construct a yield curve. Short-dated yields are taken from market rates for AA corporate bonds. Long-dated yields for the curve are based on the average yield available on all long-dated AA corporate bonds. We project the expected cash flows of the schemes and adopt a single equivalent cash flow weighted discount rate based on this constructed yield curve.

The mortality assumptions are based on those used in the latest triennial funding valuations. The mortality assumptions adopted at the year end for accounting purposes and the life expectancies at age 65 implied by the assumptions are as follows for the STPS:

	2018		2017	
	Men	Women	Men	Women
Mortality table used	**S2NMA**	**S2NFA**	S2NMA	S2NFA
Mortality table compared with standard table	**95%**	**99%**	95%	99%
Mortality projections	**CMI 2017**	**CMI 2017**	CMI 2016	CMI 2016
Future improvement per annum	**1.0%**	**1.0%**	1.0%	1.0%
Remaining life expectancy for members currently aged 65 (years)	**22.4**	**24.1**	22.5	24.1
Remaining life expectancy at age 65 for members currently aged 45 (years)	**23.4**	**25.3**	23.6	25.3

The calculation of the scheme obligations is sensitive to the actuarial assumptions and in particular to the assumptions relating to discount rate, price inflation (capped, where relevant) and mortality. The following table summarises the estimated impact on the group's obligations from changes to key actuarial assumptions whilst holding all other assumptions constant.

28 Retirement benefit schemes continued

a) Defined benefit pension schemes continued

(v) Actuarial assumptions continued

Assumption	Change in assumption	Impact on disclosed obligations
Discount rate[1]	Increase/decrease by 0.1% p.a.	Decrease/increase by £48 million
Price inflation[2]	Increase/decrease by 0.1% p.a.	Increase/decrease by £43 million
Mortality[3]	Increase in life expectancy by 1 year	Increase by £107 million

1 A change in discount rate is likely to occur as a result of changes in bond yield and as such would be expected to be offset to a significant degree by a change in the value of the bond assets held by the plans.

2 The projected impact resulting from a change in RPI reflects the underlying effect on pensions in payment, pensions in deferment and resultant increases in salary assumptions.

3 The change in assumption is based on triennial valuations and reflect the fact that life expectancy rates are expected to increase.

In reality, interrelationships exist between the assumptions, particularly between the discount rate and price inflation. The above analysis does not take into account the effect of these interrelationships. Also, in practice any movement in obligations arising from assumption changes are likely to be accompanied by movements in asset values – and so the impact on the accounting deficit may be lower than the impact on the obligations shown above.

In presenting the above sensitivity analysis, the present value of the defined benefit obligation has been calculated using the projected unit credit method at the end of the reporting period, which is the same as that applied in calculating the defined benefit obligation liability recognised in the balance sheet.

(vi) Effect on future cash flows

Contribution rates are set in consultation with the trustees for each scheme and each participating employer.

The average duration of the benefit obligation at the end of the year is 17 years for STPS and STMIPS (2017: 20 years) and 16 years for DVWS (2017: 17 years).

The most recent completed formal triennial actuarial valuations and funding agreements were carried out as at 31 March 2016 for the STPS and STMIPS schemes and 31 March 2017 for DVWS. As a result of the STPS and STMIPS actuarial valuations, deficit reduction contributions of £25 million were paid in the year ended 31 March 2017 and £10 million for each of the subsequent financial years ending 31 March 2019 were agreed. Payments of £8 million per annum through an asset-backed funding arrangement will continue to 31 March 2032. Further inflation-linked payments of £15 million per annum are being made through an additional asset-backed funding arrangement, with payments having started in the financial year ended 31 March 2018 and continuing to 31 March 2031. These contributions will cease earlier should a subsequent valuation of the STPS show that these contributions are no longer needed.

b) Defined contribution pension schemes

The group also operates the Severn Trent Group Personal Pension, a defined contribution scheme, for certain of its UK employees.

Dee Valley Water operates two defined contribution pension schemes, neither of which were material in either the current or prior year.

The total cost charged to operating costs of £20.3 million (2017 restated: £20.9 million) represents contributions payable to these schemes by the group at rates specified in the rules of the scheme. As at 31 March 2018, no contributions (2017: £2.2 million) in respect of the current reporting period were owed to the schemes.

Notes to the group financial statements continued

For the year ended 31 March 2018

29 Provisions

	Restructuring £m	Insurance £m	Other £m	Total £m
At 1 April 2017	–	21.6	12.2	33.8
Charged to income statement	0.8	6.4	14.6	21.8
Utilisation of provision	–	(4.7)	(0.7)	(5.4)
Unwinding of discount	–	–	1.1	1.1
At 31 March 2018	**0.8**	**23.3**	**27.2**	**51.3**

	2018 £m	2017 £m
Included in:		
Current liabilities	**40.6**	17.5
Non-current liabilities	**10.7**	16.3
	51.3	33.8

The restructuring provision reflects costs to be incurred in respect of committed restructuring programmes. The associated outflows are estimated to arise over a period of up to two years from the balance sheet date.

Insurance includes provisions in respect of Derwent Insurance Limited and Lyra Insurance Guernsey Limited, captive insurance companies, which are wholly-owned subsidiaries of the group, and insurance deductions in Severn Trent Water Limited. The associated outflows are estimated to arise over a period of up to five years from the balance sheet date.

Other provisions include provisions for dilapidations, commercial disputes, either from continuing or discontinued operations, and potential environmental claims. The associated outflows are estimated to arise over a period up to 10 years from the balance sheet date.

30 Share capital

	2018 £m	2017 £m
Total issued and fully paid share capital		
240,222,617 ordinary shares of 97$^{17}/_{19}$p (2017: 239,793,915)	**235.1**	234.7

At 31 March 2018, treasury shares of 3,948,599 were held (2017: 4,080,964).

Changes in share capital were as follows:

	Number	£m
Ordinary shares of 97$^{17}/_{19}$p		
At 1 April 2016	239,344,614	234.3
Shares issued under the Employee Sharesave Scheme	449,301	0.4
At 1 April 2017	239,793,915	234.7
Shares issued under the Employee Sharesave Scheme	428,702	0.4
At 31 March 2018	**240,222,617**	**235.1**

31 Share premium

	2018 £m	2017 £m
At 1 April	**112.5**	106.8
Share premium arising on issue of shares for Employee Sharesave Scheme	**5.2**	5.7
At 31 March	**117.7**	112.5

32 Other reserves

	Capital redemption reserve £m	Translation reserve £m	Hedging reserve £m	Total £m
At 1 April 2016	157.1	37.9	(78.5)	116.5
Total comprehensive income for the year	–	2.5	2.8	5.3
At 1 April 2017	157.1	40.4	(75.7)	121.8
Total comprehensive (loss)/income for the year	–	(31.4)	11.6	(19.8)
Transfer to retained earnings	–	(9.0)	–	(9.0)
At 31 March 2018	**157.1**	**–**	**(64.1)**	**93.0**

The capital redemption reserve arose on the redemption of B shares.

The translation reserve arises from exchange differences on translation of the results and financial position of foreign subsidiaries.

The hedging reserve arises from gains or losses on interest rate swaps taken directly to equity under the hedge accounting provisions of IAS 39 and the transition rules of IFRS 1.

33 Capital management

The group's principal objectives in managing capital are:

- to access a broad range of sources of finance to obtain both the quantum required and lowest cost compatible with the need for continued availability;
- to manage exposure to movements in interest rates to provide an appropriate degree of certainty as to its cost of funds;
- to minimise exposure to counterparty credit risk;
- to provide the group with an appropriate degree of certainty as to its foreign exchange exposure;
- to maintain an investment grade credit rating; and
- to maintain a flexible and sustainable balance sheet structure.

The group seeks to achieve a balance of long-term funding or commitment of funds across a range of funding sources at the best possible economic cost. The group monitors future funding requirements and credit market conditions to ensure continued availability of funds.

The group has continued to maintain exposure to low floating interest rates, which comprises 26% of our gross debt portfolio at the balance sheet date, with a further 26% of index-linked debt and 48% of fixed rate debt.

The group's dividend policy is a key tool in achieving its capital management objectives. This policy is reviewed and updated in line with Severn Trent Water's five year price control cycle and takes into account, inter alia, the planned investment programme, the appropriate gearing level achieving a balance between an efficient cost of capital and retaining an investment grade credit rating and delivering an attractive and sustainable return to shareholders. The board has decided to set the 2017/18 dividend at 86.55 pence, an increase of 6.2% compared to the total dividend for 2016/17 of 81.50 pence. Our policy is to grow the dividend annually at no less than RPI plus 4% until March 2020.

The group's capital at 31 March was:

	2018 £m	2017 £m
Net cash and cash equivalents	**38.5**	44.6
Bank loans	**(1,217.4)**	(1,073.3)
Other loans	**(4,223.9)**	(4,090.0)
Finance leases	**(113.9)**	(115.7)
Cross currency swaps	**24.5**	43.4
Loans due from joint ventures	**135.6**	108.6
Net debt	**(5,356.6)**	(5,082.4)
Equity attributable to owners of the company	**(993.7)**	(923.3)
Total capital	**(6,350.3)**	(6,005.7)

Notes to the group financial statements continued

For the year ended 31 March 2018

34 Fair values of financial instruments

a) Fair value measurements

The valuation techniques that the group applies in determining the fair values of its financial instruments on a recurring basis are described below. The techniques are classified under the hierarchy defined in IFRS 13 which categorises valuation techniques into Levels 1 – 3 based on the degree to which the fair value is observable. The group's valuation techniques include Levels 2 and 3 given the wide range of financial instruments below:

	2018 £m	2017 £m	Valuation techniques and key inputs
Cross currency swaps			Discounted cash flow
Assets	**24.5**	43.4	Future cash flows are estimated based on forward interest rates from observable yield curves at the year end and contract interest rates discounted at a rate that reflects the credit risk of counterparties. The currency cash flows are translated at spot rate.
Interest rate swaps			Discounted cash flow
Assets	**11.4**	23.6	Future cash flows are estimated based on forward interest rates from observable yield curves at the year end and contract interest rates discounted at a rate that reflects the credit risk of counterparties.
Liabilities	**(112.4)**	(183.9)	
Energy swaps			Discounted cash flow
Assets	**0.3**	–	Future cash flows are estimated based on forward electricity prices from observable indices at the year end and contract prices discounted at a rate that reflects the credit risk of counterparties.
Liabilities	**(0.8)**	(0.8)	
Inflation swaps			Discounted cash flow
Liabilities	**(2.8)**	–	Future cash flows on the RPI leg of the instruments are estimated based on observable forward inflation indices. Future cash flows on the CPI leg of the instruments are estimated based on the future expected differential between RPI and CPI. Both legs are discounted using observable swap rates at the year end, at a rate that reflects the credit risk of counterparties. This is considered to be a Level 3 valuation technique.

34 Fair values of financial instruments continued

b) Comparison of fair values of financial instruments with their carrying amounts

The directors consider that the carrying amounts of cash and short term deposits, bank overdrafts, loans receivable from joint ventures, trade receivables and trade payables approximate their fair values. The carrying values and estimated fair values of other financial instruments are set out below:

	2018 Carrying value £m	2018 Fair value £m	2017 Carrying value £m	2017 Fair value £m
Floating rate debt				
Bank loans	**917.1**	**918.6**	776.3	782.0
Currency bonds	**38.2**	**38.2**	40.1	40.1
Floating rate notes	**147.7**	**153.0**	147.7	156.4
	1,103.0	**1,109.8**	964.1	978.5
Fixed rate debt				
Bank loans	**185.3**	**185.0**	186.4	186.6
Sterling bonds	**2,357.0**	**2,700.2**	2,257.2	2,746.2
Fixed rate notes	**343.4**	**347.6**	355.2	397.4
Other loans	**5.3**	**5.3**	6.7	6.7
Finance leases	**113.9**	**122.5**	115.7	130.5
	3,004.9	**3,360.6**	2,921.2	3,467.4
Index-linked debt				
Bank loans	**115.0**	**124.9**	110.6	126.7
Sterling bonds	**1,244.1**	**2,057.1**	1,195.8	2,063.1
Other loans	**88.2**	**87.1**	87.3	87.3
	1,447.3	**2,269.1**	1,393.7	2,277.1
	5,555.2	**6,739.5**	5,279.0	6,723.0

The above classification does not take into account the impact of unhedged interest rate swaps or cross currency swaps.

Fixed rate sterling and currency bonds are valued using market prices, which is a Level 2 valuation technique.

Index-linked bonds are rarely traded and therefore quoted prices are not considered to be a reliable indicator of fair value. Therefore, these bonds are valued using discounted cash flow models with discount rates derived from observed market prices for a sample of bonds, which is a Level 2 valuation technique.

Fair values of the other debt instruments are also calculated using discounted cash flow models, which is a Level 2 valuation technique.

35 Risks arising from financial instruments

The group's activities expose it to a variety of financial risks:

- market risk (including interest rate risk, exchange rate risk and other price risk);
- credit risk;
- liquidity risk; and
- inflation risk.

The group's overall risk management programme addresses the unpredictability of financial markets and seeks to reduce potential adverse effects on the group's financial performance or position.

Financial risks are managed by a central treasury department ('Group Treasury') under policies approved by the board of directors. The board has established a Treasury Committee to monitor treasury activities and to facilitate timely responses to changes in market conditions when necessary. Group Treasury identifies, evaluates and hedges financial risks in close cooperation with the group's operating units. The board defines written principles for overall risk management, as well as written policies covering specific areas such as exchange rate risk, interest rate risk, credit risk and the use of derivative and non-derivative financial instruments. The group's policy is that derivative financial instruments are not held for trading but may be used to mitigate the group's exposure to financial risk. The types of derivative instruments held and the related risks are described below.

Interest rate swaps are held to manage the group's exposure to changes in market interest rates. Further details are set out in section a) (i) and note 36 b) (i).

Cross currency swaps are held to mitigate the group's exposure to exchange rate movements on amounts borrowed in foreign currencies. Further details are set out in section a) (ii) and 36 a) (i).

Notes to the group financial statements continued

For the year ended 31 March 2018

35 Risks arising from financial instruments continued

Energy swaps are held to mitigate the group's exposure to changes in electricity prices. Further details are provided in note 36 b) (ii) below.

Severn Trent Water, the group's most significant business unit, operates under a regulatory environment where its prices are linked to inflation measured by RPI. In order to mitigate the risks to cash flow and earnings arising from fluctuations in RPI, the group holds debt instruments where the principal repayable and interest cost is linked to RPI.

a) Market risk

The group is exposed to fluctuations in interest rates and, to a lesser extent, exchange rates. The nature of these risks and the steps that the group has taken to manage them are described below.

(i) Interest rate risk

The group's income and its operating cash flows are substantially independent of changes in market interest rates. The group's interest rate risk arises from long-term borrowings.

Borrowings issued at variable rates expose the group to the risk of adverse cash flow impacts from increases in interest rates.

Borrowings issued at fixed rates expose the group to the risk of interest costs above the market rate when interest rates decrease.

The group's policy is to maintain 40% to 70% of its interest bearing liabilities in fixed rate instruments during AMP6. In measuring this metric, management makes adjustments to the carrying value of debt to better reflect the amount that interest is calculated on. Details of the adjustments made are set out below:

	2018 £m	2017 £m
Net debt (note 40)	**5,356.6**	5,082.4
Cash and cash equivalents	**51.1**	44.6
Loan receivable from joint venture	**135.6**	108.6
Cross currency swaps included in net debt at fair value	**24.5**	43.4
Fair value hedge accounting adjustments	**(30.4)**	(31.5)
Exchange on currency debt not hedge accounted	**(8.5)**	(21.2)
Interest-bearing financial liabilities	**5,528.9**	5,226.3

The group manages its cash flow interest rate risk by borrowing at fixed or index-linked rates or by using interest rate swaps. Under these swaps the group receives variable rate interest and pays fixed rate interest calculated by reference to the agreed notional principal amounts. In practice the swaps are settled by transferring the net amount. These swaps have the economic effect of converting borrowings from variable rates to fixed rates. The group has entered into a series of these interest rate swaps to hedge future interest payments beyond 2030.

The following tables show analyses of the group's interest bearing financial liabilities by type of interest. Debt which is hedged by interest rate swaps or cross currency swaps is included in the category after taking account of the impact of the swap. Debt raised in foreign currencies has been included at the notional sterling value of the payable leg of the corresponding cross currency swap since this is the amount that is exposed to changes in interest rates.

Valuation adjustments that do not impact the amount on which interest is calculated, such as fair value hedge accounting adjustments, are excluded from this analysis.

The net principal amount of unhedged swaps is shown as an adjustment to floating rate and fixed rate debt to demonstrate the impact of the swaps on the amount of liabilities bearing fixed interest.

2018	Floating rate £m	Fixed rate £m	Index-linked £m	Total £m
Overdrafts	(12.6)	–	–	(12.6)
Bank loans	(917.1)	(185.3)	(115.0)	(1,217.4)
Other loans	(167.6)	(2,685.0)	(1,332.3)	(4,184.9)
Finance leases	–	(113.9)	–	(113.9)
	(1,097.3)	**(2,984.2)**	**(1,447.3)**	**(5,528.9)**
Impact of swaps not matched against specific debt instruments	(349.6)	349.6	–	–
Interest bearing financial liabilities	**(1,446.9)**	**(2,634.6)**	**(1,447.3)**	**(5,528.9)**
Proportion of interest bearing financial liabilities that are fixed		**48%**		
Weighted average interest rate of fixed debt		**4.30%**		
Weighted average period for which interest is fixed (years)		**8.8**		

35 Risks arising from financial instruments continued

a) Market risk continued

(i) Interest rate risk continued

2017	Floating rate £m	Fixed rate £m	Index-linked £m	Total £m
Bank loans	(776.3)	(186.4)	(110.6)	(1,073.3)
Other loans	(167.6)	(2,586.4)	(1,283.3)	(4,037.3)
Finance leases	–	(115.7)	–	(115.7)
	(943.9)	(2,888.5)	(1,393.9)	(5,226.3)
Impact of swaps not matched against specific debt instruments	(205.3)	205.3	–	–
Interest bearing financial liabilities	(1,149.2)	(2,683.2)	(1,393.9)	(5,226.3)
Proportion of interest bearing financial liabilities that are fixed		51%		
Weighted average interest rate of fixed debt		5.16%		
Weighted average period for which interest is fixed (years)		9.2		

Interest rate swaps not hedge accounted

The group has a number of interest rate swaps which are not accounted for as cash flow or fair value hedges. This has led to a credit of £7.9 million (2017: charge of £3.3 million) in the income statement.

	Average contract fixed interest rate		Notional principal amount		Fair value	
	2018 %	2017 %	**2018 £m**	2017 £m	**2018 £m**	2017 £m
Pay fixed rate interest						
5 – 10 years	**5.06**	5.06	**(300.0)**	(450.0)	**(65.6)**	(125.3)
10 – 20 years	**5.46**	5.45	**(73.7)**	(68.1)	**(32.6)**	(37.8)
	5.16	5.11	**(373.7)**	(518.1)	**(98.2)**	(163.1)
Receive fixed rate interest						
5 – 10 years	**3.36**	3.34	**225.0**	75.0	**11.4**	5.8
10 – 20 years	**2.75**	2.92	**400.0**	550.0	**(0.6)**	17.8
	3.01	2.97	**625.0**	625.0	**10.8**	23.6
			251.3	106.9	**(87.4)**	(139.5)

Interest rate sensitivity analysis

The sensitivity after tax of the group's profits, cash flow and equity, including the impact on derivative financial instruments, to changes in interest rates at 31 March is as follows:

	2018		2017	
	1.0% £m	**–1.0% £m**	1.0% £m	–1.0% £m
Profit or loss	**(47.7)**	**53.9**	(36.1)	54.3
Cash flow	**(11.5)**	**11.5**	8.8	(8.8)
Equity	**(47.7)**	**53.9**	(36.1)	54.3

(ii) Exchange rate risk

Except for debt raised in foreign currency, which is hedged, the group's business does not involve significant exposure to foreign exchange transactions. Substantially all of the group's profits and net assets arise from Severn Trent Water, which has very limited and indirect exposure to changes in exchange rates, and therefore the sensitivity of the group's results to changes in exchange rates is not material.

Certain of the group's subsidiaries enter into transactions in currencies other than the functional currency of the operation. Exchange risks relating to such operations are not material but are managed centrally by Group Treasury through forward exchange contracts to buy or sell currency. These contracts led to a charge of £nil (2017: charge of £0.1 million) in the income statement.

In order to meet its objective of accessing a broad range of sources of finance, the group has raised debt denominated in currencies other than sterling. In order to mitigate the group's exposure to exchange rate fluctuations, cross currency swaps were entered into at the time that the debt was drawn down to swap the proceeds into sterling debt bearing interest based on LIBOR.

Notes to the group financial statements continued

For the year ended 31 March 2018

35 Risks arising from financial instruments continued

a) Market risk continued

(ii) Exchange rate risk continued

Where the terms of the receivable leg of the swap closely match the terms of the underlying debt, the swaps are expected to be effective hedges, hence the swaps have been accounted for as fair value hedges. The notional value and fair value of these swaps is shown in note 36 a).

The group also has cross currency swaps with a sterling value of £98.3 million (2017: £98.3 million) which are not accounted for as fair value hedges. Economically these swaps act to mitigate the exchange rate risk of debt within the group which is denominated in foreign currency, but they do not achieve hedge accounting under the strict criteria of IAS 39. This has led to a charge of £17.7 million (2017: credit of £13.1 million) in the income statement which is partly offset by the exchange gain of £12.7 million (2017: exchange loss of £15.4 million) on the underlying debt.

The group's gross and net currency exposures arising from currency borrowings are summarised in the tables below. These show, in the relevant currency, the amount borrowed and the notional principal of the related swap or forward contract. The net position shows the group's exposure to exchange rate risk in relation to its currency borrowings.

2018	**Euro €m**	**US dollar $m**	**Yen ¥bn**
Borrowings by currency	(20.2)	(150.0)	(2.0)
Cross currency swaps – hedge accounted	19.9	–	2.0
Cross currency swaps – not hedge accounted	–	150.0	–
Net currency exposure	**(0.3)**	**–**	**–**

2017	Euro €m	US dollar $m	Yen ¥bn
Borrowings by currency	(20.1)	(150.0)	(2.0)
Cross currency swaps – hedge accounted	19.9	–	2.0
Cross currency swaps – not hedge accounted	–	150.0	–
Net currency exposure	(0.2)	–	–

b) Credit risk

Operationally the group has no significant concentrations of credit risk. It has policies in place to ensure that sales of products are made to customers with an appropriate credit history, other than in Severn Trent Water Limited and Dee Valley Water Limited, whose operating licences oblige them to supply domestic customers even in cases where bills are not paid. Amounts provided against accounts receivable and movements on the provision during the year are disclosed in note 21.

Cash deposits and derivative contracts are only placed with high credit quality financial institutions, which have been approved by the board. Group Treasury monitors the credit quality of the approved financial institutions and the list of financial institutions that may be used is approved annually by the board. The group has policies that limit the amount of credit exposure to any one financial institution.

Credit risk analysis

At 31 March the aggregate credit limits of authorised counterparties and the amounts held on short term deposits were as follows:

	Credit limit		**Amount deposited**	
	2018 £m	2017 £m	**2018 £m**	2017 £m
AAA	**–**	5.0	**–**	1.2
Double A range	**105.0**	100.0	**–**	1.8
Single A range	**650.0**	625.0	**11.1**	13.8
Triple B range	**10.0**	10.0	**5.3**	2.0
	765.0	740.0	**16.4**	18.8

The fair values of derivative assets analysed by credit ratings of counterparties were as follows:

	Derivative assets	
	2018 £m	2017 £m
Double A range	**–**	0.8
Single A range	**36.2**	66.2
	36.2	67.0

35 Risks arising from financial instruments continued

c) Liquidity risk

(i) Committed facilities

Prudent liquidity management requires sufficient cash balances to be maintained; adequate committed facilities to be available; and the ability to close out market positions. Group Treasury manages liquidity and flexibility in funding by monitoring forecast and actual cash flows and the maturity profile of financial assets and liabilities, and by keeping committed credit lines available.

At the balance sheet date the group had committed undrawn borrowing facilities expiring as follows:

	2018 £m	2017 £m
2 – 5 years	**710.0**	1,000.0

(ii) Cash flows from non-derivative financial instruments

The following tables show the estimated cash flows that will arise from the group's non-derivative net financial liabilities. The information presented is based on the earliest date on which the group can be required to pay and represents the undiscounted cash flows including principal and interest.

Interest and inflation assumptions are based on prevailing market conditions at the year end date.

2018 Undiscounted amounts payable:	Floating rate £m	Fixed rate £m	Index-linked £m	Trade payables £m	Payments on financial liabilities £m
Within 1 year	(311.4)	(136.0)	(27.8)	(18.9)	**(494.1)**
1 – 2 years	(10.3)	(116.1)	(29.4)	–	**(155.8)**
2 – 5 years	(41.3)	(982.6)	(325.7)	–	**(1,349.6)**
5 – 10 years	(785.3)	(1,333.6)	(199.9)	–	**(2,318.8)**
10 – 15 years	(52.7)	(1,056.0)	(436.2)	–	**(1,544.9)**
15 – 20 years	–	(60.9)	(139.0)	–	**(199.9)**
20 – 25 years	–	(298.8)	(167.7)	–	**(466.5)**
25 – 30 years	–	–	(199.2)	–	**(199.2)**
30 – 35 years	–	–	(649.7)	–	**(649.7)**
35 – 40 years	–	–	(2,273.6)	–	**(2,273.6)**
40 – 45 years	–	–	(1,068.1)	–	**(1,068.1)**
45 – 50 years	–	–	(374.2)	–	**(374.2)**
Total	**(1,201.0)**	**(3,984.0)**	**(5,890.5)**	**(18.9)**	**(11,094.4)**

Undiscounted amounts receivable:	Loans due from joint ventures £m	Trade receivables £m	Cash and short term deposits £m	Receipts from financial assets £m
Within 1 year	–	191.0	51.1	**242.1**
1 – 2 years	126.3	–	–	**126.3**
5 – 10 years	12.5	–	–	**12.5**
Total	**138.8**	**191.0**	**51.1**	**380.9**

Notes to the group financial statements continued

For the year ended 31 March 2018

35 Risks arising from financial instruments continued

c) Liquidity risk continued

(ii) Cash flows from non-derivative financial instruments continued

2017 Undiscounted amounts payable:	Floating rate £m	Fixed rate £m	Index-linked £m	Trade payables £m	Payments on financial liabilities £m
Within 1 year	(160.7)	(538.7)	(25.4)	(24.0)	(748.8)
1 – 2 years	(11.6)	(108.7)	(26.6)	–	(146.9)
2 – 5 years	(42.1)	(469.8)	(84.6)	–	(596.5)
5 – 10 years	(750.2)	(1,383.4)	(440.2)	–	(2,573.8)
10 – 15 years	(112.3)	(1,110.0)	(347.1)	–	(1,569.4)
15 – 20 years	–	(60.9)	(221.3)	–	(282.2)
20 – 25 years	–	(310.9)	(160.3)	–	(471.2)
25 – 30 years	–	–	(190.1)	–	(190.1)
30 – 35 years	–	–	(643.2)	–	(643.2)
35 – 40 years	–	–	(1,226.5)	–	(1,226.5)
40 – 45 years	–	–	(2,089.7)	–	(2,089.7)
45 – 50 years	–	–	(365.0)	–	(365.0)
Total	(1,076.9)	(3,982.4)	(5,820.0)	(24.0)	(10,903.3)

Undiscounted amounts receivable:	Loans due from joint ventures £m	Trade receivables £m	Cash and short term deposits £m	Receipts from financial assets £m
Within 1 year	99.6	214.2	44.6	358.4
5 – 10 years	12.5	–	–	12.5
Total	112.1	214.2	44.6	370.9

Index-linked debt includes loans with maturities up to 50 years. The principal is revalued at fixed intervals and is linked to movements in the RPI. Interest payments are made biannually based on the revalued principal. The principal repayment equals the revalued amount at maturity. The payments included in the table above are estimates based on the forward inflation rates published by the Bank of England at the balance sheet date.

(iii) Cash flows from derivative financial instruments

The following tables show the estimated cash flows that will arise from the group's derivative financial instruments. The tables are based on the undiscounted net cash inflows/(outflows) on the derivative financial instruments that settle on a net basis and the undiscounted gross inflows/(outflows) on those derivatives that require gross settlement. When the amount payable or receivable is not fixed, the amount disclosed has been determined by reference to the projected interest and foreign currency rates derived from the forward curves existing at the balance sheet date. Actual amounts may be significantly different from those indicated below.

	Derivative liabilities			Derivative assets				
						Cross currency swaps		
2018	**Interest rate swaps £m**	**Energy swaps £m**	**Inflation swaps £m**	**Interest rate swaps £m**	**Energy swaps £m**	**Cash receipts £m**	**Cash payments £m**	**Total £m**
Within 1 year	(14.9)	–	–	5.1	0.2	1.1	(0.2)	(8.7)
1 – 2 years	(14.3)	–	–	1.7	–	1.1	(0.3)	(11.8)
2 – 5 years	(47.5)	(0.8)	0.2	3.5	0.1	3.4	(1.1)	(42.2)
5 – 10 Years	(35.8)	–	0.8	3.9	–	23.3	(13.0)	(20.8)
10 – 15 Years	(13.0)	–	1.6	–	–	17.5	(8.8)	(2.7)
15 – 20 years	–	–	(6.7)	–	–	–	–	(6.7)
	(125.5)	**(0.8)**	**(4.1)**	**14.2**	**0.3**	**46.4**	**(23.4)**	**(92.9)**

35 Risks arising from financial instruments continued

c) Liquidity risk continued

(iii) Cash flows from derivative financial instruments continued

	Derivative liabilities		Derivative assets			
				Cross currency swaps		
2017	Interest rate swaps £m	Energy swaps £m	Interest rate swaps £m	Cash receipts £m	Cash payments £m	Total £m
Within 1 year	(25.4)	(0.2)	6.9	1.1	(0.2)	(17.8)
1 – 2 years	(24.9)	(0.5)	6.2	1.1	(0.2)	(18.3)
2 – 5 years	(73.4)	(0.3)	13.1	3.4	(0.8)	(58.0)
5 – 10 Years	(61.6)	–	4.3	23.9	(13.1)	(46.5)
10 – 15 Years	(11.6)	–	(6.4)	18.1	(9.0)	(8.9)
	(196.9)	(1.0)	24.1	47.6	(23.3)	(149.5)

d) Inflation risk

The group's principal operating subsidiary, Severn Trent Water, operates under a regulatory environment where its prices are linked to inflation measured by RPI. Its operating profits and cash flows are therefore exposed to changes in RPI. In order to mitigate and partially offset this risk, Severn Trent Water has raised debt which pays interest at a fixed coupon based on a principal amount that is adjusted for the change in RPI during the life of the debt instrument ('index-linked debt'). The amount of index-linked debt at the balance sheet date is shown in section a) (i) Interest rate risk, and the estimated future cash flows relating to this debt are shown in section c) (ii) Cash flows from non-derivative financial instruments.

Ofwat has announced its plans to move towards an economic regulatory model linked to inflation measured on the CPIH index over a period of time. In anticipation of this the group has entered into CPI/RPI swaps with a notional value of £150 million at 31 March 2018 in order to mitigate the risk of divergence between inflation measured by CPIH and that measured by RPI.

Inflation rate sensitivity analysis

The finance cost of the group's index-linked debt instruments varies with changes in RPI rather than interest rates. The sensitivity at 31 March of the group's profit and equity to changes in RPI is set out in the following table. This analysis relates to financial instruments only and excludes any RPI impact on Severn Trent Water's revenues and Regulatory Capital Value, or accounting for defined benefit pension schemes.

	2018		2017	
	+1.0% £m	-1.0% £m	+1.0% £m	-1.0% £m
Profit or loss	**(11.7)**	**11.7**	(11.2)	11.2
Equity	**(11.7)**	**11.7**	(11.2)	11.2

36 Hedge accounting

The group uses derivative financial instruments to hedge exposures to changes in exchange rates and interest rates. Hedge accounting is adopted for such instruments where the criteria set out in IAS 39 are met.

a) Fair value hedges

(i) Cross currency swaps

The group raises debt denominated in currencies other than sterling. Cross currency swaps are entered into at the time that the debt is drawn down to swap the proceeds into sterling debt bearing interest based on LIBOR in order to mitigate the group's exposure to exchange rate fluctuations. Where the terms of the receivable leg of the swap closely match the terms of the underlying debt, the swaps are expected to be effective hedges.

At the year end the amounts of cross currency swaps designated as fair value hedges were as follows:

	Notional principal amount		Fair value	
	2018 £m	2017 £m	2018 £m	2017 £m
Euro	**11.4**	11.4	**10.4**	10.4
Yen	**8.5**	8.5	**8.3**	9.4
	19.9	19.9	**18.7**	19.8

Notes to the group financial statements continued

For the year ended 31 March 2018

36 Hedge accounting continued

b) Cash flow hedges

(i) Interest rate swaps

The group has entered into interest rate swaps under which it has agreed to exchange the difference between fixed and floating interest rate amounts calculated on agreed notional principal amounts. Such contracts enable the group to mitigate the risk of changing interest rates on future cash flow exposures arising from issued variable rate debt. Where the hedge is expected to be highly effective these interest rate swaps are accounted for as cash flow hedges.

Details of interest rate swaps that have been accounted for as cash flow hedges are summarised below:

	Average contract fixed interest rate		Notional principal amount		Fair value	
Period to maturity	2018 %	2017 %	2018 £m	2017 £m	2018 £m	2017 £m
5 – 10 years	**2.63**	1.70	**135.2**	50.0	**(8.6)**	(1.1)
10 – 20 years	**1.83**	2.14	**298.0**	384.4	**(5.0)**	(19.6)
	2.08	2.09	**433.2**	434.4	**(13.6)**	(20.7)

(ii) Energy swaps

The group has entered into a series of energy swaps under which it has agreed to exchange the difference between fixed and market prices of electricity at six-monthly intervals up to March 2020.

Details of energy swaps that have been accounted for as cash flow hedges are summarised below:

	Average contract price		Notional contracted amount		Fair value	
Period to maturity	2018 £/MWh	2017 £/MWh	2018 MWh	2017 MWh	2018 £m	2017 £m
Less than 1 year	**47.6**	43.6	**43,680**	66,272	**0.2**	(0.2)
1 – 2 years	**48.6**	48.5	**21,955**	205,296	**–**	(0.5)
2 – 5 years	**40.5**	48.6	**547,460**	21,955	**(0.7)**	(0.1)
	41.3	47.4	**613,095**	293,523	**(0.5)**	(0.8)

37 Share based payments

The group operates a number of share based remuneration schemes for employees. During the period, the group recognised total expenses of £6.9 million (2017: £6.1 million) related to equity settled share based payment transactions.

The weighted average share price during the period was £21.25 (2017: £22.98).

At 31 March 2018, there were no options exercisable (2017: none) under any of the share based remuneration schemes.

a) Long Term Incentive Plans ('LTIPs')

Under the Long Term Incentive Plan ('LTIP'), conditional awards of shares may be made to executive directors and senior staff. Awards are subject to performance conditions and continued employment throughout the vesting period. Awards have been previously made on different bases to Severn Trent Plc and Severn Trent Water employees (the 'LTIP') and to Severn Trent Services employees (the 'Services LTIP').

Awards made under the LTIP

The 2014 LTIP awards were subject to Severn Trent Water's achievement of Return on Regulated Capital Value in excess of the level included in the Severn Trent Water AMP5 business plan over a three year vesting period. The 2015, 2016 and 2017 LTIP awards are subject to Severn Trent Water's achievement of Return on Regulated Equity in excess of the level included in the Severn Trent Water AMP6 business plan over a three year vesting period. It has been assumed that performance against the LTIP non-market conditions will be 100% (2017: 100%).

Awards made under the Services LTIP

Awards were subject to achievement of turnover and profit targets over the three year period from the financial year that the awards were granted. In 2017 it was assumed that performance against the Services LTIP would be 0%.

37 Share based payments continued

a) Long Term Incentive Plans ('LTIPs') continued

Awards outstanding

Details of changes in the number of awards outstanding during the year are set out below:

	Number of awards	
	LTIP	Services LTIP
Opening at 1 April 2016	475,878	33,864
Granted during the year	195,415	–
Vested during the year	(132,697)	–
Lapsed during the year	(21,122)	(33,864)
Outstanding at 1 April 2017	517,474	–
Granted during the year	203,035	–
Vested during the year	(139,829)	–
Lapsed during the year	(31,906)	–
Outstanding at 31 March 2018	**548,774**	**–**

Details of LTIP and Services LTIP awards outstanding at 31 March were as follows:

Date of grant	Normal date of vesting	Number of awards 2018	2017
July 2014	2017	**–**	153,724
July 2015	2018	**160,028**	168,335
July 2016	2019	**188,131**	195,415
July 2017	2020	**200,615**	–
		548,774	517,474

Details of the basis of the LTIP scheme are set out in the Directors' remuneration report on pages 96 to 128.

b) Employee Sharesave Scheme

Under the terms of the Sharesave Scheme, the board may grant the right to purchase ordinary shares in the company to those employees who have entered into an HMRC approved Save As You Earn contract for a period of three or five years.

Options outstanding

Details of changes in the number of options outstanding during the year are set out below:

	Number of share options	Weighted average exercise price
Outstanding at 1 April 2016	2,858,611	1,492p
Granted during the year	868,766	1,663p
Forfeited during the year	(71,133)	1,579p
Cancelled during the year	(92,095)	1,636p
Exercised during the year	(449,301)	1,226p
Lapsed during the year	(8,241)	1,396p
Outstanding at 1 April 2017	3,106,607	1,572p
Granted during the year	1,087,376	1,652p
Forfeited during the year	(46,715)	1,636p
Cancelled during the year	(134,768)	1,665p
Exercised during the year	(428,702)	1,306p
Lapsed during the year	(8,867)	1,367p
Outstanding at 31 March 2018	**3,574,931**	**1,625p**

Notes to the group financial statements continued

For the year ended 31 March 2018

37 Share based payments continued

b) Employee Sharesave Scheme continued

Options outstanding continued

Sharesave options outstanding at 31 March were as follows:

Date of grant	Normal date of exercise	Option price	Number of awards 2018	Number of awards 2017
January 2012	2017	1,177p	–	88,346
January 2013	2016 or 2018	1,241p	**110,447**	112,860
January 2014	2017 or 2019	1,331p	**151,528**	489,937
January 2015	2018 or 2020	1,584p	**846,002**	883,839
January 2016	2019 or 2021	1,724p	**621,971**	668,413
January 2017	2020 or 2022	1,663p	**781,782**	863,212
January 2018	2021 or 2023	1,652p	**1,063,201**	–
			3,574,931	3,106,607

c) Share Matching Plan ('SMP')

Under the SMP members of STEC may receive matching share awards over those shares which had been acquired under the deferred share component of the annual bonus scheme. Matching shares may be awarded at a maximum ratio of one matching share for every deferred share and are subject to a three year vesting period. No matching shares have been awarded in the current year.

Matching shares are subject to total shareholder return over three years measured relative to the companies ranked 51 – 150 by market capitalisation in the FTSE Index (excluding investment trusts).

The number of shares subject to an award will increase to reflect dividends paid through the performance period on the basis of such notional dividends being reinvested at the then prevailing share price. Awards will normally vest as soon as the Remuneration Committee determines that the performance conditions have been met provided that the participant remains in employment at the end of the performance period.

Details of changes in the number of awards outstanding during the year are set out below:

	Number of awards
Outstanding at 1 April 2016	27,613
Cancelled during the year	(24,682)
Vested during the year	(2,931)
Outstanding at 31 March 2017 and 2018	**–**

d) Fair value calculations

The fair values of the share awards made and share options granted during the year were calculated using the Black Scholes method. The principal assumptions and data are set out below:

	2018 LTIP	2018 SAYE 3 year scheme	2018 SAYE 5 year scheme	2017 LTIP	2017 SAYE 3 year scheme	2017 SAYE 5 year scheme
Share price at grant date (pence)	**2,341**	**2,138**	**2,138**	2,236	2,222	2,222
Option life (years)	**3**	**3.5**	**5.5**	3	3.5	5.5
Vesting period (years)	**3**	**3**	**5**	3	3	5
Expected volatility (%)	**18.2**	**18.2**	**18.2**	18.2	18.2	18.2
Expected dividend yield (%)	**4.1**	**4.1**	**4.1**	3.7	3.7	3.7
Risk free rate (%)	**n/a**	**0.5**	**0.8**	n/a	0.1	0.5
Fair value per share (pence)	**2,328**	**375**	**351**	2,224	407	429

Expected volatility is measured over the three years prior to the date of grant of the awards or share options.

Volatility has been calculated based on historical share price movements.

The risk free rate is derived from yields at the grant date of gilts of similar duration to the awards or share options.

The dividend yield is calculated using the expected dividend for the year divided by the share price at the date of grant.

38 Acquisitions

On 15 February 2017, Severn Trent Water Limited acquired 100% of the issued share capital of Dee Valley Group Limited comprising all subsidiaries including the regulated water company Dee Valley Water Limited. This acquisition was made through a scheme of arrangement including cash consideration of £79.0 million and the issue of loan notes with a value of £5.2 million.

The acquisition was accounted for using the acquisition method. Goodwill of £66.0 million was capitalised attributable to the anticipated future synergies and outperformance arising as a result of the acquisition. The goodwill valuation was based on management's best estimates of the fair values of the assets and liabilities acquired. Given the proximity to the year end, full detailed fair value exercises were not able to be completed before the approval of the financial statements for the year ended 31 March 2017.

The fair value exercises were completed in the current year and resulted in the revisions to the provisional fair values as set out in the following table.

	£m
Goodwill recognised at 1 April 2017 based on provisional fair values	**66.0**
Additional consideration in respect of acquisition	**0.2**
Adjustments to provisional fair values for:	
– Recognition of Dee Valley Water Limited's Instrument of Appointment	**(4.3)**
– Revisions to estimated fair value of property, plant and equipment	**(0.8)**
– Deferred tax on changes in fair value	**1.1**
Goodwill recognised at 31 March 2018 based on final fair values	**62.2**

Details of the adjustments made to the provisional fair values are set out below.

Dee Valley Water Limited holds an Instrument of Appointment as a water undertaker under the Water Act 1989 issued by the Secretary of State for Wales (the Licence). The Licence has no fixed term and requires 25 years notice of termination. Under the Licence, Dee Valley Water Limited has an exclusive right to supply water to household and non-household customers within a geographic area defined in the Licence. On 23 March 2018 Ofwat announced that it had agreed to vary the terms of the Licence with effect from 1 July 2018 to amend the geographic area to include those parts of Wales previously served by Severn Trent Water and to exclude certain parts of England previously served by Dee Valley Water.

Water undertakers are subject to a framework of economic regulation operated by the Water Services Regulation Authority (Ofwat). Under this framework, water undertakers are permitted to set wholesale tariffs that would enable an efficient company to earn a post-tax return on a notional amount known as the Regulatory Capital Value (RCV). They are also allowed to earn a net margin on their retail costs. Ofwat sets the post-tax return at a rate that it considers to be the weighted average cost of capital for companies operating in the sector based on an assumed gearing level. Therefore the Licence, together with the net operating assets, enables Dee Valley Water Limited to earn post-tax returns with a net present value equivalent to the RCV plus a net return on retail activities.

To determine the fair value of the licence we have taken the RCV at 31 March 2017 from Ofwat's Final Price Control Determination published in December 2014 adjusted to current prices at the acquisition date, added an allowance for the value of the Retail business and compared this with the fair value of the operating assets acquired. This resulted in a valuation of £4.3 million for the Licence.

The goodwill acquired represents future outperformance of the regulatory settlement and synergies arising from the combination of the group's regulated water businesses.

See note 16 for the reconciliation of goodwill recognised for the group.

39 Discontinued operations

Operating Services US and Italy

The disposal of the group's US business (Operating Services, US), which formed part of the Business Services segment, to US investors PPC Enterprises LLC and Alston Capital Partners LLC was completed on 30 June 2017. The group disposed of the Operating Services business in Italy, which formed part of the Business Services segment, on 23 February 2017 to Acea S.P.A.

The classification of these businesses as discontinued operations requires judgements as to whether they represent a separate major line of business or geographical area. The Operating Services Italy business was sold on 23 February 2017. At that point the process to dispose of the Operating Services US business was underway, as part of a single coordinated plan to exit the overseas Operating Services businesses. However, at that point the disposal of the Operating Services US business was not considered to be highly probable because the sale process was not sufficiently advanced.

On its own, Operating Services Italy was not considered to be a major line of business or geographical area and so it was not classified as a discontinued operation in the financial statements for the year ended 31 March 2017.

Following the disposal of Operating Services US on 30 June 2017, the group had completed its plan to exit the overseas Operating Services business. It reassessed the classification of these businesses and reclassified them as discontinued operations.

Prior period figures in the consolidated income statement and related notes have been restated to present separately amounts relating to discontinued operations.

Notes to the group financial statements continued

For the year ended 31 March 2018

39 Discontinued operations continued

Water Plus joint venture

On 1 March 2016 the group announced its intention, subject to approval from the Competition and Markets Authority ('CMA'), to enter into a joint venture with United Utilities PLC to compete in the non-household water and waste water retail markets in England and Scotland. On 3 May 2016 the CMA announced approval of the joint venture. On this date the group determined that completion of the proposed transaction became highly probable and the non-household retail business was classified as a disposal group and a discontinued operation with effect from this date. On 31 May 2016 the group transferred Severn Trent Water's non-household retail business to Severn Trent Select Limited and on 1 June it exchanged the entire share capital of Severn Trent Select Limited for 50% of the share capital of Water Plus Limited.

During the year, the remaining balance on the non-household retail receivable amounts that were retained when that business was transferred to Water Plus were written off. An additional £1.5 million was charged to operating costs in discontinued operations in respect of this.

The results of discontinued operations are disclosed separately in the income statement and comprise:

			2018				2017 (restated)
	Operating Services US (3 months) £m	**Non-household retail £m**	**Total £m**	Operating Services US (12 months) £m	Operating Services Italy (10 months) £m	Non-household retail (2 months) £m	Total £m
Turnover	**42.1**	**–**	**42.1**	160.4	20.8	66.0	247.2
Total operating costs	**(40.7)**	**(1.5)**	**(42.2)**	(156.0)	(20.2)	(67.3)	(243.5)
(Loss)/profit before interest and tax	**1.4**	**(1.5)**	**(0.1)**	4.4	0.6	(1.3)	3.7
Net finance income	**–**		**–**	0.9	0.2	–	1.1
(Loss)/profit before tax	**1.4**	**(1.5)**	**(0.1)**	5.3	0.8	(1.3)	4.8
Attributable tax expense	**–**	**0.3**	**0.3**	(0.6)	–	0.3	(0.3)
Gain on disposal of discontinued operations	**13.0**	**–**	**13.0**	–	2.0	14.6	16.6
Profit/(loss) for the year	**14.4**	**(1.2)**	**13.2**	4.7	2.8	13.6	21.1
Attributable to:							
Owners of the company	**14.4**	**(1.2)**	**13.2**	4.7	3.0	13.6	21.3
Non-controlling interests	**–**	**–**	**–**	–	(0.2)	–	(0.2)
	14.4	**(1.2)**	**13.2**	4.7	2.8	13.6	21.1

Basic and diluted earnings per share from discontinued operations are as follows:

			2018			2017 (restated)
	Profit attributable to owners of the company £m	**Weighted average number of shares m**	**Per share amount pence**	Profit attributable to owners of the company £m	Weighted average number of shares m	Per share amount pence
Basic earnings per share	**13.2**	**235.3**	**5.6**	21.3	235.0	9.1
Diluted earnings per share	**13.2**	**236.1**	**5.6**	21.3	236.0	9.0

39 Discontinued operations continued

The net assets of the business at the date of disposal were:

	2018	2017	
	Operating Services US £m	Operating Services Italy £m	Non-household retail £m
Goodwill	14.4	2.0	–
Other intangible assets	2.9	1.4	–
Property, plant and equipment	9.4	1.2	–
Investments	–	4.2	–
Inventories	0.6	7.5	–
Trade and other receivables	28.2	11.3	0.6
Cash and bank balances	9.9	1.5	3.5
Trade and other payables	(19.9)	(15.0)	(0.5)
Borrowings	–	(3.9)	–
Provisions for liabilities	–	(2.3)	–
	45.5	7.9	3.6
Attributable to:			
Owners of the company	45.5	7.1	3.6
Non-controlling interest	–	0.8	–
	45.5	7.9	3.6

The net gain on disposals is calculated as follows:

	Operating Services US £m	Operating Services Italy £m	Non-household retail £m
Consideration	47.8	7.9	25.5
Net assets attributable to owners of the company	(45.5)	(7.1)	(3.6)
	2.3	0.8	21.9
Tax on gain on disposal	(0.7)	–	–
Disposal costs and provisions on disposal	(18.4)	(1.6)	(7.3)
Foreign exchange gain recycled from reserves	29.8	2.8	–
Net gain on disposal	13.0	2.0	14.6

The net cash flows arising from the disposal groups were as follows:

	2018	2017 (restated)			
	Operating Services US (3 months) £m	Operating Services US (12 months) £m	Operating Services Italy (10 months) £m	Non-household retail (2 months) £m	Total £m
Net cash flows attributable to:					
– Operating activities	1.9	5.1	(0.7)	2.9	7.3
– Investing activities	(0.6)	(3.7)	0.4	–	(3.3)
– Financing activities	–	(1.1)	1.1	(3.5)	(3.5)
	1.3	0.3	0.8	(0.6)	0.5

The net cash flows arising from disposals were:

	Operating Services US £m	Operating Services Italy £m	Non-household retail £m
Consideration received in cash and cash equivalents	39.3	0.3	–
Settlement of intercompany loans	–	7.6	–
Disposal costs paid in cash and cash equivalents	(4.6)	(1.6)	(7.3)
Cash and bank balances disposed of	(9.9)	(1.5)	(3.5)
	24.8	4.8	(10.8)

Notes to the group financial statements continued

For the year ended 31 March 2018

40 Cash flow statement

a) Reconciliation of operating profit to operating cash flows

	2018 £m	2017 (restated) £m
Profit before interest and tax from continuing operations	**528.4**	536.7
Profit before interest and tax from discontinued operations	**13.6**	20.6
Profit before interest and tax	**542.0**	557.3
Depreciation of property, plant and equipment	**308.8**	308.8
Amortisation of intangible assets	**20.8**	19.3
Pension service credit	**(7.8)**	(17.3)
Defined benefit pension scheme administration costs	**1.8**	3.3
Defined benefit pension scheme contributions	**(35.2)**	(33.2)
Share based payment charge	**6.9**	6.1
Profit on sale of property, plant and equipment and intangible assets	**(7.3)**	(5.0)
Exceptional depreciation – property, plant and equipment	**16.8**	–
Profit on disposal of businesses	**(13.7)**	(17.2)
Deferred income movement	**(14.3)**	(13.9)
Provisions charged to the income statement	**13.8**	16.5
Utilisation of provisions for liabilities	**(5.4)**	(10.5)
Operating cash flows before movements in working capital	**827.2**	814.2
Increase in inventory	**(2.9)**	(1.3)
(Increase)/decrease in amounts receivable	**(58.4)**	60.3
Increase/(decrease) in amounts payable	**7.4**	(22.2)
Cash generated from operations	**773.3**	851.0
Tax received	**8.0**	20.6
Tax paid	**(14.5)**	(42.4)
Net cash generated from operating activities	**766.8**	829.2

b) Non-cash transactions

No additions to property, plant and equipment during the year were financed by new finance leases (2017: nil). Assets transferred from developers at no cost were recognised at their fair value of £35.6 million (2017: £51.4 million).

c) Exceptional cash flows

The following cash flows arose from items classified as exceptional in the income statement:

	2018 £m	2017 £m
Costs of Pension Exchange Arrangement	**–**	(0.7)

d) Reconciliation of movement in cash and cash equivalents to movement in net debt

	Net cash and cash equivalents £m	Bank loans £m	Other loans £m	Finance leases £m	Cross currency swaps £m	Loans due from joint ventures £m	Net debt £m
At 1 April 2017	44.6	(1,073.3)	(4,090.0)	(115.7)	43.4	108.6	(5,082.4)
Cash flow	(4.6)	(138.5)	(98.1)	1.8	–	26.6	(212.8)
Fair value adjustments	–	–	2.0	–	(18.9)	–	(16.9)
RPI uplift on index-linked debt	–	(4.4)	(49.7)	–	–	–	(54.1)
Foreign exchange	(1.5)	–	12.7	–	–	–	11.2
Other non-cash movements	–	(1.2)	(0.8)	–	–	0.4	(1.6)
At 31 March 2018	**38.5**	**(1,217.4)**	**(4,223.9)**	**(113.9)**	**24.5**	**135.6**	**(5,356.6)**

Liabilities from financing activities comprise bank loans, other loans and finance leases.

41 Contingent liabilities

Bonds and guarantees

Group undertakings have entered into bonds and guarantees in the normal course of business. No liability (2017: £nil) is expected to arise in respect of either bonds or guarantees.

42 Service concession arrangements

The group's contract to provide water and waste water services to the Ministry of Defence ('MOD') is a service concession arrangement under the definition set out in IFRIC 12. The group acts as the service provider under the MOD Project Aquatrine Package C – a 25 year contract spanning 1,295 sites across England covering the eastern sea border and from Lancashire in the North West to West Sussex on the South coast.

Under the contract the group maintains and upgrades the MOD infrastructure assets and provides operating services for water and waste water. Both the operating services and maintenance and upgrade services are charged under a volumetric tariff, along with standard charges, which are adjusted with inflation as agreed in the contract.

Since the group has an unconditional right to receive cash in exchange for the maintenance and upgrade services, the amounts receivable are recognised as a financial asset within prepayments and accrued income. At 31 March 2018 the amounts receivable were £31.1 million (2017: £27.7 million).

There have been no significant changes to the arrangement during the year.

43 Financial and other commitments

a) Investment expenditure commitments

	2018 £m	2017 £m
Contracted for but not authorised in the financial statements	**395.0**	221.0

In addition to these contractual commitments, Severn Trent Water Limited has longer term expenditure plans which include investments to achieve improvements in performance mandated by the Director General of Water Services (Ofwat) and to provide for growth in demand for water and waste water services.

b) Leasing commitments

At the balance sheet date the group had outstanding operating commitments for future minimum operating lease payments under non-cancellable operating leases, which fall due as follows:

	2018 £m	2017 £m
Within 1 year	**1.1**	3.2
1 – 5 years	**2.4**	7.6
After more than 5 years	**4.8**	7.0
	8.3	17.8

Operating lease payments represent rentals by the group for certain of its office property, plant and equipment.

44 Post balance sheet events

Sale of land in Nottinghamshire

On 30 April 2018, the sale of land from Midlands Land Portfolio Limited, a subsidiary of Severn Trent Plc, to Persimmon Homes was completed. The sale values the land at £21.8 million, realising a group profit of £18.2 million in the year ending 31 March 2019.

Payments will be made in cash and phased over the life of the project with £2.3 million payable on 30 April 2018 and the remainder phased evenly over five further yearly payments of £3.9 million each ending on 30 April 2023.

Dividends

Following the year end the board of directors have proposed a final dividend of 51.92 pence per share. Further details of this are shown in note 14.

Notes to the group financial statements continued

For the year ended 31 March 2018

45 Related party transactions

Transactions between the company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not included in this note. Trading transactions between the group and its joint venture, Water Plus, are disclosed below.

	Water Plus	
	2018 £m	2017 £m
Sale of services	**354.9**	317.5
Net interest income	**2.4**	1.3
	357.3	318.8

Outstanding balances between the group and the joint venture as at 31 March were as follows:

	Water Plus	
	2018 £m	2017 £m
Trade and other receivables due from related parties	**44.9**	37.6
Amounts due to related parties	**–**	(8.8)
Loans receivable from joint ventures	**135.6**	108.6
	180.5	137.4

The retirement benefit schemes operated by the group are considered to be related parties. Details of transactions and balances with the retirement benefit schemes are disclosed in note 28.

Remuneration of key management personnel

Key management personnel comprise the members of STEC during the year.

The remuneration of the directors is included within the amounts disclosed below. Further information about the remuneration of individual directors is provided in the audited part of the Directors' remuneration report on pages 110 to 119.

	2018 £m	2017 £m
Short term employee benefits	**6.4**	7.2
Post employment benefits	**–**	–
Share based payments	**3.5**	3.1
	9.9	10.3

46 Alternative performance measures ('APMs')

Financial measures or metrics used in this report that are not defined by IFRS are alternative performance measures. The group uses such measures for performance analysis because they provide additional useful information on the performance and position of the group. Since the group defines its own alternative performance measures, these might not be directly comparable to other companies' alternative performance measures. These measures are not intended to be a substitute for, or superior to, IFRS measurements.

a) Underlying PBIT

Underlying profit before interest and tax is profit before interest and tax excluding exceptional items as recorded in the income statement and restated for discontinued operations. This provides a consistent measure of operating performance excluding distortions caused by exceptional items. The calculation of this APM is shown on the face of the income statement and in note 5 for reportable segments.

b) Underlying earnings per share

Underlying earnings per share figures are presented for continuing operations. These exclude the effects of exceptional items, net gains/(losses) on financial instruments, current tax on exceptional items and on net gains/(losses) on financial instruments, exceptional current tax and deferred tax. The directors consider that the underlying figures provide a useful additional indicator of performance and remove non-performance related distortions. See note 15.

46 Alternative performance measures ('APMs') continued

c) Effective interest rate

The effective interest rate is calculated as net finance costs, excluding net finance costs from pensions, plus capitalised finance costs divided by the monthly average net debt during the year.

$$\frac{\textit{(net finance costs – net finance costs from pensions + capitalised finance costs)}}{\textit{(monthly average net debt)}}$$

	2018 £m	2017 (restated) £m
Net finance costs	**219.5**	205.1
Net finance costs from pensions	**(15.5)**	(10.9)
Capitalised interest	**26.2**	18.6
	230.2	212.8
Average net debt	**5,134.4**	4,812.5
Effective interest rate	**4.5%**	4.4%

This APM is used as it shows the average interest rate that is attributable to the net debt of the business.

d) Effective cash cost of interest

The effective cash cost of interest is calculated on the same basis as the effective interest rate except that it excludes finance costs that are not paid in cash but are accreted to the carrying value of the debt (principally RPI adjustments on index-linked debt).

$$\frac{\textit{(net finance costs – net finance costs from pensions – RPI interest + capitalised finance costs)}}{\textit{(monthly average net debt)}}$$

	2018 £m	2017 (restated) £m
Net finance costs	**219.5**	205.1
Net finance costs from pensions	**(15.5)**	(10.9)
RPI interest	**(54.1)**	(30.2)
Capitalised interest	**26.2**	18.6
	176.1	182.6
Average net debt	**5,134.4**	4,812.5
Effective cash cost of interest	**3.4%**	3.8%

This APM is used as it shows the average cash interest rate based on the net debt of the business.

e) PBIT interest cover

The ratio of profit from continuing operations before interest, tax and exceptional items to net finance costs excluding net finance costs from pensions.

$$\frac{\textit{Underlying PBIT}}{\textit{(net finance costs – net finance costs from pensions)}}$$

	2018 £m	2017 (restated) £m
Underlying PBIT	**541.0**	520.1
Net finance costs	**219.5**	205.1
Net finance costs from pensions	**(15.5)**	(10.9)
Net finance costs excluding finance costs from pensions	**204.0**	194.2
	ratio	ratio
PBIT interest cover ratio	**2.7**	2.7

This APM is used to show how the underlying PBIT of the business covers the financing costs associated only with net debt on a consistent basis.

Notes to the group financial statements continued

For the year ended 31 March 2018

46 Alternative performance measures (APMs) continued

f) EBITDA and EBITDA interest cover

EBITDA is a commonly used proxy for cash flow, for example by ratings agencies and in debt covenants. EBITDA interest cover is the ratio of EBITDA. It is calculated as profit from continuing operations before interest, tax, exceptional items, depreciation and amortisation.

$$\frac{\text{(underlying PBIT + depreciation + amortisation)}}{\text{(net finance costs – net finance costs from pensions)}}$$

	2018 £m	2017 (restated) £m
Underlying PBIT	**541.0**	520.1
Depreciation	**308.2**	305.9
Amortisation	**20.5**	17.8
EBITDA	**869.7**	843.8
Net finance costs	**219.5**	205.1
Net finance costs from pensions	**(15.5)**	(10.9)
Net finance costs excluding finance costs from pensions	**204.0**	194.2
	ratio	ratio
EBITDA interest cover ratio	**4.3**	4.3

This APM is used to show how the EBITDA of the business covers the financing costs associated only with net debt on a consistent basis.

g) Underlying effective current tax rate

Current tax charge for the year on continuing operations, excluding prior year charges, exceptional current tax, and current tax on exceptional items and on financial instruments, divided by profit from continuing operations before tax, net gains/losses on financial instruments, exceptional items and share of net profit of joint ventures accounted for using the equity method.

$$\frac{\text{(Current year current tax charge in the income statement – tax on exceptional items – tax on financial instruments)}}{\text{(PBT – share of net profit of JVs – exceptional items – net losses on financial instruments)}}$$

	2018		2017 (restated)	
	£m	Current tax thereon £m	£m	Current tax thereon £m
Profit before tax	**302.4**	**(36.8)**	328.0	(47.3)
Adjustments:				
Share of net (profit)/loss of joint ventures	**(0.2)**	**–**	1.8	–
Exceptional items	**12.6**	**(0.7)**	(16.6)	(0.1)
Net losses on financial instruments	**6.7**	**(3.3)**	1.8	(4.9)
	321.5	**(40.8)**	315.0	(52.3)
Underlying effective current tax rate		**12.7%**		16.6%

This APM is used to remove distortions in the underlying tax charge and create a metric consistent with the calculation of underlying earnings per share in note 15. Share of net profit/loss of joint ventures is excluded from the calculation because this is included after tax and the tax on joint venture profits is therefore not included in the current tax charge.

47 Subsidiary undertakings

Details of all subsidiary undertakings as at 31 March 2018 are given below. Details of the joint venture are set out in note 19. All subsidiary undertakings have been included in the consolidation.

Owned directly by Severn Trent Plc	Country of operation and incorporation	Percentage of share capital held	Class of share capital held
Severn Trent Investment Holdings Limited	United Kingdom	100%	Ordinary

The following subsidiary undertakings all operate and are incorporated in the United Kingdom. The percentage of share capital held is 100% and the class of share capital held is ordinary.

All subsidiary undertakings	
Aqua Deva Limited	Severn Trent Leasing Limited
Biogas Generation Limited	Severn Trent MIS Trustees Limited
Charles Haswell and Partners Limited	Severn Trent Metering Services Limited
Chester Water Limited	Severn Trent Overseas Holdings Limited
City Analytical Services Limited	Severn Trent Pension Scheme Trustees Limited
Debeo Debt Recovery Limited	Severn Trent PIF Trustees Limited
Dee Valley Group Limited	Severn Trent Power Generation Limited
Dee Valley Limited	Severn Trent Property Solutions Limited
Dee Valley Services Limited	Severn Trent QUEST Limited
Dee Valley Water (Holdings) Limited	Severn Trent Reservoirs Limited
Dee Valley Water Limited	Severn Trent Retail and Utility Services Limited
East Worcester Water Limited	Severn Trent Services (Water and Sewerage) Limited
Etwall Land Limited	Severn Trent Services Defence Holdings Limited
Gunthorpe Fields Limited	Severn Trent Services Defence Limited
Midlands Land Portfolio Limited	Severn Trent Services Finance Limited
North Wales Gas Limited	Severn Trent Services Holdings Limited
Northern Gas Supplies Limited	Severn Trent Services International (Overseas Holdings) Limited
Severn Trent (W&S) Limited	Severn Trent Services International Limited
Severn Trent Corporate Holdings Limited	Severn Trent Services Operations UK Limited
Severn Trent Data Portal Limited	Severn Trent Services Purification Limited
Severn Trent Draycote Limited	Severn Trent Services UK Limited
Severn Trent Enterprises Limited	Severn Trent SSPS Trustees Limited
Severn Trent Finance Holdings Limited	Severn Trent Systems Limited
Severn Trent Finance Limited	Severn Trent Trimpley Limited
Severn Trent Financing and Investments Limited	Severn Trent US Funding Management Limited
Severn Trent Funding Limited	Severn Trent Utilities Finance Plc
Severn Trent General Partnership Limited	Severn Trent Utility Services Limited
Severn Trent Green Power Limited	Severn Trent Water Limited
Severn Trent Holdings Limited	Severn Trent Wind Power Limited
Severn Trent Home Services Limited	UKTalks Limited
Severn Trent LCP Limited	Wrexham Water Limited

All subsidiary undertakings	Country of operation and incorporation	Percentage of share capital held	Class of share capital held
Derwent Insurance Limited	Gibraltar	100%	Ordinary
Energy Supplies UK Limited	United Kingdom	100%	A and B Ordinary
Lyra Insurance Guernsey Limited	Guernsey	100%	Ordinary
Procis Software Limited	United Kingdom	100%	A and B Ordinary and Ordinary
Severn Trent Africa (Pty) Ltd	South Africa	100%	Ordinary
Severn Trent Carsington Limited	United Kingdom	100%	A and B Ordinary
Severn Trent Holdings SA	Belgium	100%	Ordinary
Severn Trent Response Limited	Ireland	60%	Ordinary
ST Delta Limited	United Kingdom	100%	A and B Ordinary

Notes to the group financial statements continued

For the year ended 31 March 2018

47 Subsidiary undertakings continued

Unless stated below, the registered office of the aforementioned entities is Severn Trent Centre, 2 St John's Street, Coventry, CV1 2LZ, United Kingdom.

Company	Registered office
Dee Valley Limited	Packsaddle, Wrexham Road, Rhostyllen, Wrexham, LL14 4EH
Dee Valley Water Limited	Packsaddle, Wrexham Road, Rhostyllen, Wrexham, LL14 4EH
Derwent Insurance Limited	6A Queensway, PO Box 64, Gibraltar
Lyra Insurance Guernsey Limited	St Martin's House, Le Bordage, St Peter Port, GY1 4AU, Guernsey
Severn Trent Africa (Pty) Ltd	2 Elgin Road, Sunninghill, Johannesburg, South Africa
Severn Trent General Partnership Limited	50 Lothian Road, Festival Square, Edinburgh, EH3 9WJ
Severn Trent Holdings SA	Rond Point Schuman 6 box 5, 1040 Brussels, Belgium
Severn Trent Response Limited	6th Floor, 2 Grand Canal Square, Dublin 2, Ireland

Subsidiary audit exemptions

Severn Trent Plc has issued guarantees over the liabilities of the following companies at 31 March 2018 under section 479C of Companies Act 2006 and these entities are exempt from the requirements of the Act relating to the audit of individual accounts by virtue of section 479A of the Act.

Company	Company Number
Charles Haswell and Partners Limited	2416605
Chester Water Limited	2888872
City Analytical Services Limited	2050581
Dee Valley Group Limited	4316684
Dee Valley Limited	2902525
Dee Valley Water (Holdings) Limited	4421854
East Worcester Water Limited	2757948
Gunthorpe Fields Limited	4240764
Severn Trent (W&S) Limited	3995023
Severn Trent Carsington Limited	7570384
Severn Trent Corporate Holdings Limited	4395566
Severn Trent Data Portal Limited	8181048
Severn Trent Draycote Limited	7681784
Severn Trent Finance Holdings Limited	6044159
Severn Trent Finance Limited	6294618
Severn Trent Financing and Investments Limited	6312635
Severn Trent General Partnership Limited	SC416614
Severn Trent Holdings Limited	5656363
Severn Trent Investment Holdings Limited	7560050
Severn Trent LCP Limited	7943556
Severn Trent Metering Services Limited	2569703
Severn Trent Overseas Holdings Limited	2455508
Severn Trent Power Generation Limited	2651131
Severn Trent Reservoirs Limited	3115315
Severn Trent Services Holdings Limited	4395572
Severn Trent Services International (Overseas Holdings) Limited	3125131
Severn Trent Services International Limited	2387816
Severn Trent Services Purification Limited	2409826
Severn Trent Services UK Limited	8120387
Severn Trent Systems Limited	2394552
Severn Trent Utility Services Limited	4125386

Company statement of comprehensive income

For the year ended 31 March 2018

	2018 £m	2017 £m
Profit for the year	**182.4**	173.0
Other comprehensive loss		
Items that will not be reclassified to the income statement:		
Net actuarial losses	**(9.1)**	–
Tax on net actuarial losses	**1.5**	–
Deferred tax arising on change of rate	**–**	(0.1)
Other comprehensive loss for the year	**(7.6)**	(0.1)
Total comprehensive income for the year	**174.8**	172.9

Company statement of changes in equity

For the year ended 31 March 2018

	Share capital £m	Share premium £m	Other reserves £m	Retained earnings £m	Total £m
At 1 April 2016	234.3	106.8	160.7	2,985.0	3,486.8
Profit for the year	–	–	–	173.0	173.0
Deferred tax arising from rate change	–	–	–	(0.1)	(0.1)
Total comprehensive income for the year	–	–	–	172.9	172.9
Share options and LTIPs					
– proceeds from shares issued	0.4	5.7	–	–	6.1
– value of employees' services	–	–	–	6.2	6.2
Dividends paid	–	–	–	(190.4)	(190.4)
At 31 March 2017	234.7	112.5	160.7	2,973.7	3,481.6
Profit for the year	–	–	–	182.4	182.4
Net actuarial losses	–	–	–	(9.1)	(9.1)
Tax on net actuarial losses	–	–	–	1.5	1.5
Total comprehensive income for the year	–	–	–	174.8	174.8
Share options and LTIPs					
– proceeds from shares issued	0.4	5.2	–	–	5.6
– value of employees' services	–	–	–	6.9	6.9
Dividends paid	–	–	–	(197.0)	(197.0)
At 31 March 2018	**235.1**	**117.7**	**160.7**	**2,958.4**	**3,471.9**

Included in retained earnings are profits of £1,221.2 million that arose from group restructuring arrangements in previous years and are therefore not distributable.

Company balance sheet

At 31 March 2018

	Notes	2018 £m	2017 £m
Non-current assets			
Intangible fixed assets	2	**0.2**	0.3
Tangible fixed assets	3	**0.2**	0.3
Investments in subsidiaries	4	**3,330.0**	3,325.1
Deferred tax asset	6	**1.5**	0.1
Trade and other receivables	5	**527.6**	1.0
		3,859.5	3,326.8
Current assets			
Trade and other receivables	5	**44.3**	493.6
Current tax receivable		**15.9**	21.4
		60.2	515.0
Current liabilities			
Borrowings	7	**(17.2)**	(5.6)
Trade and other payables	8	**(137.0)**	(265.2)
Provisions for liabilities and charges	9	**(6.0)**	(2.4)
		(160.2)	(273.2)
Net current (liabilities)/assets		**(100.0)**	241.8
Total assets less current liabilities		**3,759.5**	3,568.6
Non-current liabilities			
Borrowings	7	**(85.4)**	(82.3)
Trade and other payables	8	**(189.0)**	(3.0)
Retirement benefit obligations	14	**(8.7)**	–
Provisions for liabilities and charges	9	**(4.5)**	(1.7)
		(287.6)	(87.0)
Net assets		**3,471.9**	3,481.6
Capital and reserves			
Called up share capital	10	**235.1**	234.7
Share premium account	11	**117.7**	112.5
Other reserves	12	**160.7**	160.7
Retained earnings		**2,958.4**	2,973.7
Total capital and reserves		**3,471.9**	3,481.6

The profit for the year is £182.4 million (2017: £173.0 million).

Signed on behalf of the Board who approved the accounts on 22 May 2018.

Andrew Duff
Chairman

James Bowling
Chief Financial Officer

Company number: 02366619

Notes to the parent company financial statements

For the year ended 31 March 2018

1 Employee numbers

The average number of employees during the year was 9 (2017: 12).

2 Intangible fixed assets

	Purchased software £m
Cost	
At 31 March 2017 and 31 March 2018	**1.1**
Amortisation	
At 1 April 2017	(0.8)
Amortisation for the year	(0.1)
At 31 March 2018	**(0.9)**
Net book value	
At 31 March 2018	**0.2**
At 31 March 2017	0.3

3 Tangible fixed assets

	Land and buildings £m	Office fixtures and equipment £m	Total £m
Cost			
At 31 March 2017 and 31 March 2018	**0.1**	**0.6**	**0.7**
Depreciation			
At 1 April 2017	–	(0.4)	(0.4)
Charge for the year	–	(0.1)	(0.1)
At 31 March 2017 and 31 March 2018	**–**	**(0.5)**	**(0.5)**
Net book value			
At 31 March 2018	**0.1**	**0.1**	**0.2**
At 31 March 2017	0.1	0.2	0.3

4 Investments in subsidiaries

	£m
At 1 April 2017	3,325.1
Additions	6.9
Impairment	(2.0)
At 31 March 2018	**3,330.0**

Details of principal subsidiaries of the company are given in note 47 to the group financial statements.

5 Trade and other receivables

	2018 £m	2017 £m
Current assets		
Other amounts receivable	**4.4**	3.0
Prepayments	**0.5**	0.5
Amounts owed by group undertakings under loan agreements	**–**	467.7
Amounts owed by group undertakings	**39.4**	22.4
	44.3	493.6
Non-current assets		
Other amounts receivable	**1.6**	–
Loan receivable	**26.4**	–
Amounts owed by group undertakings under loan agreements	**499.6**	1.0
	527.6	1.0
	571.9	494.6

6 Deferred tax

	Accelerated tax depreciation £m	Retirement benefit obligations £m	Fair value of financial instruments £m	Other £m	Total £m
At 1 April 2016	0.1	–	0.1	0.5	0.7
Charge to income	–	–	–	(0.6)	(0.6)
Credit to income arising from rate change	–	–	0.1	–	0.1
Charge to equity arising from rate change	–	–	(0.1)	–	(0.1)
At 1 April 2017	0.1	–	0.1	(0.1)	0.1
Charge/(credit) to income	(0.1)	–	(0.1)	0.1	(0.1)
Credit to equity	–	1.5	–	–	1.5
At 31 March 2018	**–**	**1.5**	**–**	**–**	**1.5**

7 Borrowings

	2018 £m	2017 £m
Current liabilities		
Bank overdraft	**17.2**	5.6
Non-current liabilities		
Other loans	**85.4**	82.3
	102.6	87.9

Non-current borrowings comprises the company's RPI linked retail bond issued in July 2012. The bond carries a coupon of 1.3% on the principal amount which is uplifted by RPI. The bond is repayable in July 2022.

At the balance sheet date the company had £100 million (2017: £100 million) undrawn borrowing facilities.

8 Trade payables

	2018 £m	2017 £m
Current liabilities		
Trade payables	**0.5**	0.2
Social security and other taxes	**0.5**	0.1
Other payables	**2.8**	2.8
Accruals	**4.0**	1.1
Amounts due to group undertakings	**129.2**	261.0
	137.0	265.2
Non-current liabilities		
Amounts due to group undertakings	**189.0**	3.0
	326.0	268.2

Notes to the parent company financial statements continued

For the year ended 31 March 2018

9 Provisions

	Insurance £m	Other £m	Total £m
At 1 April 2017	–	4.1	4.1
Charged to income statement	–	0.9	0.9
Utilisation of provision	–	(0.1)	(0.1)
Transfer from group company	5.6	–	5.6
At 31 March 2018	**5.6**	**4.9**	**10.5**

	2018 £m	2017 £m
Included in:		
Current liabilities	**6.0**	2.4
Non-current liabilities	**4.5**	1.7
	10.5	4.1

Insurance includes provisions transferred from Derwent Insurance Limited, a captive insurance company, which is a wholly owned subsidiary of the group. The associated claims outflows are estimated to arise over a period of up to five years from the balance sheet date.

Other provisions include provisions for dilapidations and commercial disputes. The associated outflows are estimated to arise over a period up to five years from the balance sheet date.

10 Share capital

	2018 £m	2017 £m
Total issued and fully paid share capital		
240,222,617 ordinary shares of 97 17/19p (2017: 239,793,915)	**235.1**	234.7

At 31 March 2018, treasury shares of 3,948,599 were held (2017: 4,080,964).

Changes in share capital were as follows:

	Number	£m
Ordinary shares of 97 17/19p		
At 1 April 2016	239,344,614	234.3
Shares issued under the Employee Sharesave Scheme	449,301	0.4
At 1 April 2017	239,793,915	234.7
Shares issued under the Employee Sharesave Scheme	428,702	0.4
At 31 March 2018	**240,222,617**	**235.1**

11 Share premium

	2018 £m	2017 £m
At 1 April	**112.5**	106.8
Share premium arising on issue of shares for Employee Sharesave Scheme	**5.2**	5.7
At 31 March	**117.7**	112.5

12 Other reserves

	Capital redemption reserve £m	Hedging reserve £m	Total £m
At 1 April 2016, 31 March 2017 and 2018	**157.1**	**3.6**	**160.7**

The capital redemption reserve arose on the redemption of B shares.

The hedging reserve arises from gains or losses on interest rate swaps taken directly to equity under the hedge accounting provisions of IAS 39 and the transition rules of IFRS 1.

13 Share based payments

For details of employee share schemes and options granted over the shares of the company, see note 37 of the group financial statements. Details of options exercised and awards vesting during the year and of the weighted average share price of the company during the year are also disclosed in that note.

14 Pensions

Defined benefit schemes

The group operates defined benefit pension schemes, of which some employees of the company are members. There is no contractual agreement for charging the net defined benefit cost of these schemes between the companies that participate in the schemes. As a result, the net defined benefit cost of the scheme is recognised in the financial statements of the sponsoring employer, Severn Trent Water Limited. The scheme closed to future accrual on 31 March 2015. The cost of contributions to the group schemes amount to £0.6 million (2017: nil). There were no amounts outstanding for contributions to the defined benefit schemes (2017: nil).

The company has an obligation to pay pensions to a number of former employees, whose benefits would otherwise have been restricted by the Finance Act 1989 earnings cap. This unfunded scheme is part of the Severn Trent Pension Scheme. In prior years, the unfunded pension scheme was recorded in Severn Trent Water Limited. As the obligations under the scheme are borne by Severn Trent Plc, the unfunded pension scheme obligation and corresponding deferred tax asset are now held within Severn Trent Plc.

Information about the plans as a whole is disclosed in note 28 to the group financial statements.

15 Related party transactions

The retirement benefit schemes operated by the company are considered to be related parties. Details of transactions and balances with the retirement benefit schemes are disclosed in note 14.

The company has given guarantees in favour of Water Plus Limited in respect of the joint venture's liabilities to wholesalers in the Open Water market and its loan from Severn Trent Water Limited. The guarantee in respect of liabilities to wholesalers is capped at £42.5 million (2017: £42.5 million) and the guarantee for the Severn Trent Water loan is for the amount due.

16 Contingent liabilities

a) Bonds and guarantees

The company has entered into bonds and guarantees in the normal course of business. No liabilities are expected to arise in respect of either the bonds or guarantees.

b) Bank offset arrangements

The banking arrangements of the company operate on a pooled basis with certain of its subsidiary undertakings. Under these arrangements participating companies guarantee each others' overdrawn balances to the extent of their credit balances, which can be offset against balances of participating companies. As at 31 March 2018, the company had no contingent liabilities (2017: nil).

17 Post balance sheet events

Following the year end the board of directors has proposed a final dividend of 51.92 pence per share.

18 Dividends

For details of the dividends paid in the years ended 31 March 2018 and 31 March 2017 see note 14 in the group financial statements.

Five year summary

	2018 £m	2017 (restated)[1] £m	2016 £m	2015 £m	2014 £m
Turnover	**1,694.1**	1,638.0	1,753.7	1,801.3	1,756.7
Profit before interest, tax and exceptional items	**541.0**	520.1	503.4	540.3	523.8
Net exceptional items before tax	**(12.6)**	16.6	1.0	(18.7)	(15.2)
Net interest payable before (losses)/gains on financial instruments and exceptional finance costs	**(219.5)**	(205.1)	(209.3)	(240.0)	(247.9)
(Losses)/gains on financial instruments	**(6.7)**	(1.8)	7.7	(133.5)	58.0
Results of joint ventures	**0.2**	(1.8)	0.1	0.1	0.2
Profit on ordinary activities before taxation	**302.4**	328.0	302.9	148.2	318.9
Current taxation on profit on ordinary activities	**(32.9)**	(36.3)	(51.3)	(37.8)	(55.8)
Deferred taxation	**(29.0)**	(22.4)	(13.7)	5.1	(21.5)
Exceptional tax	**–**	52.2	78.6	–	230.2
Profit on ordinary activities after taxation	**240.5**	321.5	316.5	115.5	471.8
Results from discontinued operations	**13.2**	21.1	14.8	4.7	–
Profit for the year	**253.7**	342.6	331.3	120.2	471.8
Net assets employed					
Fixed assets	**8,660.1**	8,315.7	7,810.8	7,620.0	7,418.3
Other net liabilities excluding net debt, retirement benefit obligation, provisions and deferred tax	**(960.0)**	(916.8)	(798.4)	(799.0)	(631.1)
Derivative financial instruments[2]	**(104.3)**	(161.1)	(166.3)	(177.7)	(197.1)
Net retirement benefit obligation	**(519.8)**	(574.6)	(309.5)	(468.9)	(348.3)
Provisions for liabilities and charges and deferred tax	**(725.7)**	(657.5)	(694.7)	(725.4)	(758.5)
Net assets held for sale	**–**	–	–	72.6	–
	6,350.3	6,005.7	5,841.9	5,521.6	5,483.3
Financed by					
Called up share capital	**235.1**	234.7	234.3	233.7	233.9
Reserves	**758.6**	688.6	783.1	521.9	789.4
Total shareholders' funds	**993.7**	923.3	1,017.4	755.6	1,023.3
Non-controlling interests	**–**	–	1.1	13.4	12.5
Net debt[3]	**5,356.6**	5,082.4	4,823.4	4,752.6	4,447.5
	6,350.3	6,005.7	5,841.9	5,521.6	5,483.3
Statistics					
Earnings per share (continuing) – pence	**102.2**	136.8	133.5	48.3	198.5
Underlying basic earnings per share – pence	**121.0**	115.7	102.1	107.2	92.5
Dividends per share (excluding special dividend) – pence	**86.6**	81.5	80.7	84.9	80.4
Dividend cover (before exceptional items and deferred tax)	**1.4**	1.4	1.3	1.3	1.2
Gearing[4]	**84.4%**	84.6%	82.6%	86.1%	81.1%
Ordinary share price at 31 March – pounds	**18.44**	23.82	21.73	20.59	18.23
Average number of employees					
– Regulated Water and Waste Water	**5,660**	5,273	5,236	5,532	5,634
– Other	**605**	596	2,122	1,910	1,914

1 Restated as set out in note 2 to the group financial statements.

2 Excludes instruments hedging foreign currency debt.

3 Includes instruments hedging foreign currency debt.

4 Gearing has been calculated as net debt divided by the sum of equity and net debt.

Information for shareholders

Severn Trent shareholder helpline

The Company's registrar is Equiniti. Equiniti's main responsibilities include maintaining the shareholder register and making dividend payments.

If you have any queries relating to your Severn Trent Plc shareholding you should contact Equiniti.

Registrar contact details:

Online: www.shareview.co.uk from here you will be able to securely email Equiniti with your query.

Telephone: 0371 384 2967*

Overseas enquiries: +44 121 415 7044

Text phone: 0371 384 2255*

By post: Equiniti, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6DA

Corporate website

Shareholders are encouraged to visit our website www.severntrent.com which provides:

- Company news and information;
- links to our operational businesses' websites;
- details of our governance arrangements;
- details of our strategy;
- details of the Group's business models and business plan; and
- the Company's approach to operating responsibly.

There is also a dedicated investors' section on the website which contains up to date information for shareholders including:

- comprehensive share price information;
- financial results;
- a history of dividend payment dates and amounts; and
- access to current and historical shareholder documents such as the Annual Report and Accounts.

Electronic communications

By registering to receive shareholder documentation from Severn Trent Plc electronically shareholders can benefit from being able to:

- view the Annual Report and Accounts on the day it is published;
- receive an email alert when shareholder documents are available;
- cast their AGM vote electronically; and
- manage their shareholding quickly and securely online, through Shareview.

Electronic shareholder communications also enable the Company to reduce its impact on the environment and benefit from savings associated with reduced printing and mailing costs.

For further information and to register for electronic shareholder communications visit www.shareview.co.uk

Dividend payments

Bank mandates

Dividends can be paid automatically into your bank or building society account.

The benefits of doing this are that you will:

- receive cleared funds in your bank account on the payment date;
- avoid postal delays; and
- remove the risk of your cheques getting lost in the post.

To take advantage of this service or for further details contact Equiniti or visit www.shareview.co.uk

Dividend reinvestment plan ('DRIP')

The DRIP gives shareholders the option of using their dividend payments to buy more Severn Trent Plc shares instead of receiving cash. If you would like to participate in the DRIP, please request a dividend reinvestment plan mandate from Equiniti Financial Services Limited.

Telephone: 0371 384 2268*

Telephone number from outside the UK: +44 121 415 7173

Information for shareholders continued

Buying and selling shares in the UK

If you wish to buy or sell certificated Severn Trent Plc shares, you may need to use a stockbroker or high street bank which trades on the London Stock Exchange. There are also many telephone and online services available to you.

If you are selling, you will need to present your share certificate at the time of sale. Details of low cost dealing services may be obtained from www.shareview.co.uk or 0345 603 7037**.

Share price information

Shareholders can find share price information on our website and in most national newspapers. For a real time buying or selling price, you should contact a stockbroker.

Shareholder security

Fraudsters use persuasive and high pressure tactics to lure investors into scams. They may offer to sell shares that turn out to be worthless or non-existent, or to buy shares at an inflated price in return for an upfront payment. While high profits are promised, if you buy or sell shares in this way you will probably lose your money.

How to avoid share fraud:

- Keep in mind that firms authorised by the Financial Conduct Authority ('FCA') are unlikely to contact you out of the blue with an offer to buy or sell shares.
- Do not get into a conversation, note the name of the person and firm contacting you and then end the call.
- Check the Financial Services Register at www.fca.org.uk to see if the person and firm contacting you is authorised by the FCA.
- Beware of fraudsters claiming to be from an authorised firm, copying its website or giving you false contact details.
- Use the firm's contact details listed on the Register if you want to call it back.
- Call the FCA on 0800 111 6768 if the firm does not have contact details on the Register or you are told they are out of date.
- Search the list of unauthorised firms to avoid at www.fca.org.uk/scams
- Consider that if you buy or sell shares from an unauthorised firm you will not have access to the Financial Ombudsman Service or Financial Services Compensation Scheme.
- Think about getting independent financial and professional advice before you hand over any money.
- Remember, if it sounds too good to be true, it probably is.

If you are approached by fraudsters please tell the FCA using the share fraud reporting form at www.fca.org.uk/scams, where you can find out more about investment scams.

You can also call the FCA Consumer Helpline on 0800 111 6768.

If you have already paid money to share fraudsters you should contact Action Fraud on 0300 123 2040.

Unsolicited mail

The Company is legally obliged to make its share register available to the general public. Consequently some shareholders may receive unsolicited mail. If you wish to limit the amount of unsolicited mail you receive please contact:

The Mailing Preference Service ('MPS'), Freepost 29 LON20771, London W1E 0ZT

Alternatively, register online at www.mpsonline.org.uk or call the MPS Registration line on 0845 703 4599.

American Depositary Receipts ('ADRs')

Severn Trent has a sponsored Level 1 American Depositary Receipt ('ADR') programme, for which The Bank of New York Mellon acts as Depositary.

The Level 1 ADR programme trades on OTCQX which is the premier tier of the US over the counter ('OTC') market under the symbol STRNY (it is not listed on a US stock exchange). Each ADR represents 1 Severn Trent Ordinary Share.

If you have any enquiries regarding Severn Trent ADRs please contact The Bank of New York Mellon.

By post: BNY Mellon Shareowners Services, PO Box 30170, College Station, TX 77842-3170, US

By telephone:
If calling from within the US: (888) 269 2377 (toll-free)

If calling from outside the US: +1 201 680 6825

By email: shrrelations@cpushareownerservices.com

Website: www.mybnymdr.com

* Lines are open 8.30am to 5.30pm Monday to Friday (excluding public holidays in England and Wales).

** Lines are open Monday to Friday, 8:00am to 4:30pm for dealing, and until 6:00pm for enquiries.

Financial calendar

Ex dividend date – final dividend	14 June 2018
Record date to be eligible for the final dividend	15 June 2018
AGM	18 July 2018
Interim management statement – Q1 year ending 31 March 2019	18 July 2018
Final dividend payment date	20 July 2018
Interim results announcement – year ending 31 March 2019	22 November 2018
Ex dividend date – interim dividend	29 November 2018
Record date to be eligible for the interim dividend	30 November 2018
Interim dividend payment date	4 January 2019

All dates are indicative and may be subject to change.