Severn Trent Water Limited

Report and financial statements
For the year ended 31 March 2018

Company number 2366686

Severn Trent Water Limited

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Contents

Strategic report

Governance

Group and Company financial statements

Severn Trent Water Limited
Strategic Report
For the year ended 31 March 2018

Welcome to the Severn Trent Water Annual Report 2018

OUR PURPOSE IS TO SERVE OUR COMMUNITIES AND BUILD A LASTING WATER LEGACY. THIS DRIVES OUR VISION TO BE THE MOST TRUSTED WATER COMPANY BY 2020, DELIVERING AN OUTSTANDING CUSTOMER EXPERIENCE, BEST VALUE SERVICE AND ENVIRONMENTAL LEADERSHIP.

This report highlights the progress we have made over the past year in achieving that vision through our strategic objectives and absolute focus on delivering value for all of our stakeholders.

We're committed to keeping your water flowing clearly and making your waste water clean again, so you can carry on enjoying this force of nature in your very own home, for generations to come.

What we do
We provide clean water and waste water services through our businesses, Severn Trent Water and Dee Valley Water.

The primary markets we focus on

- Wholesale operations and engineering
- Household customer services

About us
We are one of the ten largest regulated ten water and waste water businesses in England and Wales. We provide high quality services to more than 4.3 million households and businesses in the Midlands and Wales.

Where we operate
Our region stretches across the heart of the UK, from the Bristol Channel to the Humber, and from North and mid-Wales to the East Midlands.

Key Facts

Turnover
£1,606.9m

Profit before interest and tax
£525.1m

Underlying profit before interest and tax[1]
£537.7m

Litres of drinking water supplied each day
1.6bn

Litres of waste water treated per day
2.77bn

Employees
5,660
Average during 2017/18

Households and businesses served
4.3 m

1. **Alternative Performance Measures are defined in Note 43 to the financial statements on Page 162**

Our business model

Running an efficient water business

Severn Trent provides clean water every time our customers turn on the tap and removes their waste water in an affordable, sustainable and reliable way.

Critical inputs

Natural resources

Water from reservoirs, rivers and underground aquifers

Read more on page 45

Power

The treatment and distribution of clean and waste water consumes significant energy.

Read more on page 43

The Water Cycle

Water is collected

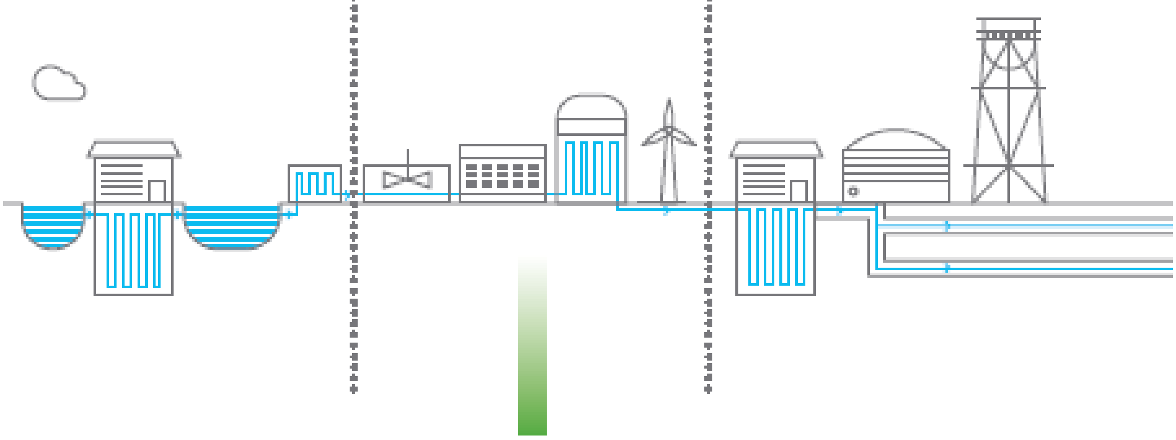
We pay the Environment Agency and Natural Resources Wales for the water we collect from reservoirs, rivers and underground aquifers across our region.

Water is cleaned

Our 116 groundwater and 23 surface water treatment works clean raw water to the highest standards, making it safe to drink.

Clean water is distributed

Our 49,167 km network of pipes and enclosed storage reservoirs bring a continuous supply of clean water right to our customers' taps.



Outcomes

Natural resources

- Clean water for 4.3 million homes and businesses
- Clean gas produced from anaerobic digestion plants, contributing to the decarbonisation of the UK economy

Physical assets

- Efficient and reliable services: 1.6 billion litres of drinking water supplied each day and 2.8 billion litres of wastewater treated each day

Severn Trent Water Limited
Strategic Report (continued)
For the year ended 31 March 2018

Physical assets

A resilient, well maintained network of clean water pipes and reservoirs, sewers and pumping stations

Read more on page 47

Our people

We look to attract, develop and retain talented people, and to bring the next generation of water experts into the industry

Read more on page 48

Relationships

- **Our suppliers and partners**
  Joint ventures and strong supplier relationships
- **Our customers and communities**
  The heart of our business
- **Our regulators**
  Our industry is regulated by Ofwat and several other regulators and public bodies

Read more on page 50

Customers enjoy our services

We serve 4.3 million businesses and households with a safe, reliable supply of water and collect waste water 24 hours a day, 365 days a year.

Waste water is collected

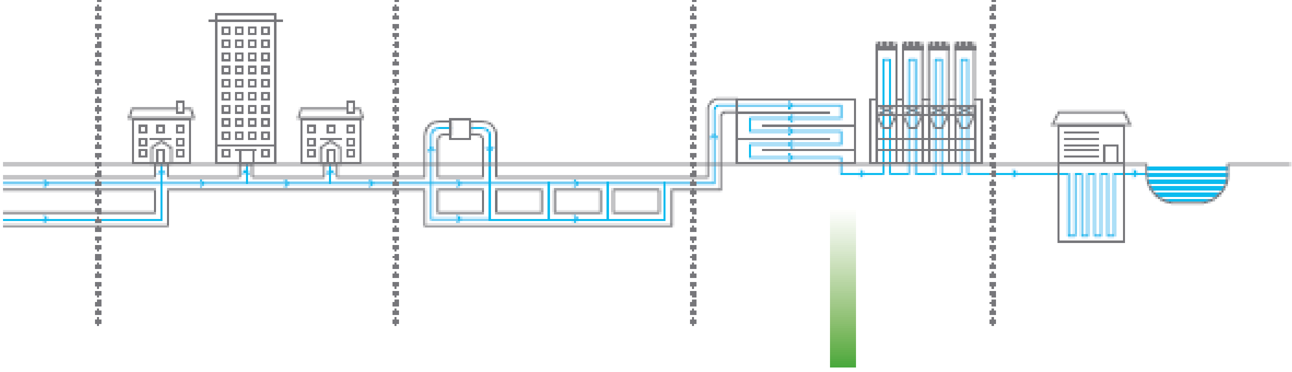
Our 94,027 km of sewers and pumping stations collect waste water from homes and businesses and take it to our treatment works.

Waste water is cleaned

Waste water is carefully screened, filtered and treated in our 1,010 sewage treatment works to meet stringent environmental standards.

Water is recycled to the environment

We pay the Environment Agency and Natural Resources Wales annual consent fees to return the treated water to the water system.



Our people

- An awesome place to work
- A diverse, skilled and talented workforce

Relationships

- **Our suppliers and partners**
  A robust supply chain. We work with partners over the five years of an AMP, which means more competitive pricing
- **Our customers and communities**
  The lowest average combined water and waste water bills in Britain. Educational visits on water efficiency and being sewer savvy
- **Our regulators**
  Positive and constructive relationships and industry-leading ODIs and KPIs

Chairman's statement

Providing responsible leadership

"High levels of customer service create financial rewards. This means we are able to share the benefits of our work with shareholders as well as with our customers and other stakeholders."

Group turnover

£1,606.9m

2017: £1,556.1m

Group profit before interest and tax

£525.1m

2017: £540.4m

This has been a good year for our customers and therefore for Severn Trent. Our operational performance is discussed in detail in our Chief Executive's statement. Here, I want to take the opportunity to look at the bigger picture by highlighting the improvements we have made to customers' lives in the last 25 years – and to underline our commitment to running a responsible business.

Water services in England and Wales have been transformed for the better over the last 25 years – leakage is down by over a third since its peak in 1994/95, service quality is up, as evidenced by a 65% reduction in written complaints since its peak in 2007/08 and environmental performance is unrecognisable from that which we inherited from the nationalised industry in 1989, with an 86% reduction in serious pollution incidents in England and Wales. These changes have not happened by accident; they are the direct result of the near doubling of investment that has been pumped into the sector since privatisation.

At Severn Trent, we have played a major role in this step-change, investing £21 billion in today's money in infrastructure improvements over the last quarter of a century. We are proud of the achievements that this investment has generated for our customers. They drink and wash in cleaner water, experience fewer supply interruptions and floods, and enjoy healthier and more pleasant surroundings, all thanks to our work. At the same time, and despite the huge capital investments we have made, we have been able to keep prices down. This last year, as in the previous seven years, the average price paid by a customer in the Severn Trent region was the lowest anywhere in England or Wales.

Our team is absolutely committed to continuing this good work – and a key aspect of that is demonstrating the highest standards of governance and behaviour. Our values of: putting customers first; creating an awesome place to work; being passionate about what we do; acting with integrity; and protecting our environment sit right at the heart of our decision making. We fully support the governance changes that the regulator and Government wish to see – indeed, as a listed company these standards of transparency and responsible behaviour are already in place at Severn Trent: we are prudent in how we manage financial risk and even-handed in the way we share the returns from our outperformance with customers and shareholders; we pay our taxes in full and on time; pay dividends and executive salaries that are reasonable and sustainable and linked to the delivery of outcomes to customers; avoid complex offshore financial vehicles; and we communicate progress on all of these matters in the Annual Report which we provide to stakeholders and to the public at large on our website every year.

Having strong and transparent corporate governance is the right way to carry out our activities. It will ensure the long term sustainability of our business and reinforce our legitimacy in the eyes of the communities we serve.

Sharing the rewards

Under our industry's regulatory regime, high levels of customer service create financial rewards. This means we are able to share the benefits of our work with shareholders as well as with customers and other stakeholders. In this five year period we are reinvesting £220 million of Totex outperformance back into our business, with a further £120 million of outperformance being shared with customers in the form of lower bills in AMP7. Our investors too have benefited through our base dividend commitment of growth at RPI+4%, and this has all been achieved whilst maintaining a sustainable, resilient financial structure.

We delivered a 3.3% increase in Group turnover to £1,606.9 million, Group PBIT of £525.1 million, down 2.8% from the prior year.

Your Board

Emma FitzGerald stepped down from her position as a Director during the year. On behalf of the Board, I thank her for her insight, professionalism and dedication. It has been a privilege to work alongside her.

We have worked with regulators to successfully realign our English and Welsh licences along national boundaries. From 1 July 2018, all our Welsh interests will sit under a single licence, and we will rebrand Dee Valley Water as Hafren Dyfrdwy after the two main rivers which supply the region. Hafren Dyfrdwy will serve the interests of all our Welsh customers, and we are pleased to have made positive progress to ensure the robust governance of that company through the appointment to its board of three new independent non-executive directors with a wealth of experience in business, public services and Welsh public policy. I am delighted that they all enhance the already diverse make-up of our business.

A diverse team doing great work

Severn Trent's people are a significant asset. We have a fantastic team here who worked tirelessly through the year, often in severe weather conditions, to deliver extraordinary service. They are rightly proud of both their efforts and the outcomes.

It is important that the makeup of our workforce is representative of the communities we serve. So I am pleased to report that 21% of the 124 graduates, placement students and apprentices who joined us during the year came from black or minority ethnic backgrounds. We are also mindful of the role that gender diversity plays in supporting a successful team. The representation of women on our Board led to us again being recognised by the Hampton-Alexander Review in 2017, which placed us second among FTSE 100 companies for representation of women on boards and in leadership. In addition, 40% of the members of our Executive Committee are female and, at 2.4%, our mean hourly pay gap is one of the lowest in the FTSE index.

Looking ahead

We are now working hard to continue to position the business for success during the next regulatory period. Our draft business plans are well advanced and will be submitted to Ofwat in September 2018. We look forward to continuing to outperform against our service commitments through the rest of this AMP and into the next.

Andrew Duff, Chairman

Market and industry overview

Our context and peers
A total of 17 regional businesses supply water services to 50 million household and non-household customers in England and Wales. Ten of these, including our regulated business Severn Trent Water Limited, also provide waste water services. The remaining seven, including our regulated business Dee Valley Water Limited, provide water only.

Over 25 years of continuous improvement...
Water services in England and Wales have been transformed in recent years, with a total investment of around £130 billion driving significant increases in reliability, efficiency and quality.

We’re very proud of our industry’s achievements. For example, whilst adverse weather such as that encountered last winter and spring can skew the picture, customers are still five times less likely to be without water than they were 25 years ago and eight times less likely to be affected by sewer flooding. Leakage has fallen by 35% since the mid-1990s, and 99.6% of drinking water as well as 98.6% of bathing waters now meet EU standards.

As discussed below, our regulatory framework is continuing to evolve. We believe that improving this existing mechanism, for example, by encouraging lower gearing and greater openness and transparency, is a more viable way forwards than embarking on a disruptive course of action that would distract attention from our industry’s core priorities.

...but there’s still more to do
We’re excited about the opportunities to continue the good work the industry has recorded so far. But although we’ve taken huge strides in embedding customers right at the heart of what we do, we recognise that there’s still room for improvement. Customers rightly expect the highest standards of water quality and waste water treatment, 24 hours a day and seven days a week, and while these are continuing to move in the right direction there’s absolutely no room for complacency. We have to target capital investment programmes wisely in order to make sure our network – parts of which originate in the late 19th Century – is equipped to meet the demands of 21st Century living. That’s no easy matter, in light of an increasing population and more housing, as well as all the challenges to water supplies and drainage caused by the droughts and floods associated with climate change. It requires experience, expertise and a great deal of money – in fact Severn Trent alone will have invested some £3,000 million in assets over the five years to March 2020.

Customers also want to be able to contact us whenever and however they want, whether that’s to ask for advice, question a bill or notify us of a leak. Digital technology is playing a major role here at Severn Trent, helping us interact with customers via nine different channels, ensuring we are always there to talk to in person over the phone, or in writing.

And, of course, customers rightly expect all this while enjoying great value for money. Bills matter to everybody – and while we’re pleased that yet again Severn Trent Water’s customers benefited from the lowest bills in England and Wales over the last year, we’re also committed to doing even more to support those vulnerable members of our local communities who struggle to pay.

Water quality... waste water treatment... reliability and efficiency... service and support... all delivered with great value... these are the things our customers expect. We’ve made terrific progress in the last quarter of a century and we know there’s more to do – and we’re committed to working with our peers in the industry and with our regulators to give our customers a service to be proud of.

Our regulatory framework
The Government's approach to our industry is set by the Department for the Environment, Food and Rural Affairs ('Defra') in England and the Welsh Government in Wales. Ofwat is the industry's economic regulator. This means it sets limits on the prices we can charge our customers over five year Asset Management Plan ('AMP') cycles. This financial year was the third of AMP6, which runs from April 2015 to March 2020.

We also work closely with a variety of other regulators and public bodies:

- The Drinking Water Inspectorate ('DWI') independently checks that water supplies in England and Wales are safe and that drinking water quality is acceptable to consumers. Its work includes assuring water quality, ensuring companies make the changes necessary to improve, developing new regulations to further improve water quality, and science and policy.
- The Consumer Council for Water ('CCW') speaks on behalf of water consumers in England and Wales. It advises consumers and takes up complaints on their behalf.
- The Environment Agency ('EA') allows us to collect water from reservoirs, rivers and aquifers and return it to the environment after it's been used by our customers and treated by us.
- Natural Resources Wales is the environmental regulator in Wales. It oversees how the country's natural resources are maintained, improved and used now and in the future.
- Natural England advises the Government on the natural environment in England and helps to protect nature and the landscape, especially for plant and animal life in fresh water and the sea.
- The Health and Safety Executive helps us to reduce the health and safety risks faced by our employees, customers and visitors.

Moving into the next phase of regulation
Every five years, our regulator Ofwat reviews industry pricing. The most recent price review – known as PR14 – was in 2014 and heralded sweeping changes. PR14 gave customers a greater voice in setting our priorities and also introduced a performance-related reward and penalty system, called Outcome Delivery Incentives (ODIs). We welcomed these initiatives and believe they're playing an important part in driving greater efficiency across the industry.

Now we're moving towards the next price review, which will take place in 2019. In December 2017, Ofwat published its methodology for the 2019 price review, known as PR19. This provided us with guidance on expectations for our business plans, which we'll submit in September 2018. In our view, the methodology sets out a challenging environment, but also one where high performing companies can succeed. We're fully supportive of Ofwat's reform agenda, which includes stronger ODIs – and although they're currently still in development, our business plans will lay out our ambitions in four key areas:

Customers
Our preparation work for PR19 has included the most comprehensive customer engagement activity and research programme in our history, in conjunction with insight from our everyday interactions with them. The result is a new level of understanding about the issues that are most important to our customers. In brief, they want us to go beyond just balancing supply and demand, providing clean drinking water and taking waste water away. They see us as key influencers in the everyday lives of their local communities. And they want us to step up and play our role to the full.

So, among other initiatives, we're investing in better communications and also redoubling our efforts around customer education, especially of children – for example on what not to put down their toilets – as well as supporting our people to do more volunteering to benefit the communities which we serve.

Affordability

In 2017, and for the 8th year running, Severn Trent Water's customers had the lowest bills in England and Wales. That's an achievement in its own right, but we're committed to making sure that those bills are affordable for all our customers – including the most vulnerable. Struggling to pay a water bill can be an indication of other issues in a customer's life, so we're working with partners in local communities to identify those who may need some extra help.

Resilience

It goes without saying that reliable supplies and services depend on a reliable infrastructure. But to us 'resilience' is a broader issue than just having good quality pipes, reservoirs and treatment works. It means being operationally resilient, so our people are sufficiently well trained to carry out the tasks we need them to do, both in a steady state and in an emergency. And it means financially resilient, with a stress-tested capital structure to maintain an investment-grade rating for our regulated business and the appropriate equity strength to effectively manage risks. It also means having corporate resilience, with the right governance processes ensuring that we're fair and transparent at all times, and recognised as a responsible and trusted business by society at large. We're rightly regarded as a public service company and we'll do everything in our power to deliver a service that the public can be proud of.

Innovation

You can't deliver outstanding customer service, keep bills affordable or run a resilient business without innovation. We're pleased to see that Ofwat's PR19 methodology embraces the role of markets, not only in bioresources but also in water resources through water trading.

In fact we're working with United Utilities to engage with Thames Water on the evaluation of a project to build a super interconnector that would enable us to transfer and trade water between the Severn and Thames catchment areas.

What happens next?

Ofwat's timetable for PR19 is as follows:

Submission of business plans – 3 September 2018

Initial assessment of plans – late January 2019

Early draft determinations – March/April 2019

Remaining draft determinations – July 2019

Final determinations – December 2019

Playing our part in the debate

We agree with the general direction in which Ofwat is taking the industry and have continued to add our voice to the debate wherever and whenever possible.

For example, in addition to evaluating the possibilities of water trading, we worked with a number of our peers and the Social Market Foundation to publish a report into the likely implications of renationalisation on public sector debt levels.

We've also stepped up our consumer-facing communications, including launching our new brand – 'Wonderful on tap' – to improve understanding of what we do and how we do it. Please see our website for more details.

How our market environment influences our five strategic priorities

Embedding customers at the heart of all we do
we'll continue to anticipate and to meet changing customers' and wider societal needs (see page 16)

Driving operational excellence and continuous innovation
innovation helps us to deliver the services customers need and keep bills affordable (see page 18)

Investing responsibly for sustainable growth
we invest to make sure we continue to benefit from a resilient, well-maintained network that meets the demands of a growing population and a changing climate (see page 19)

Changing the market for the better
we work with the grain of regulation, helping to prepare the industry for the opportunities and challenges of the future (see page 21)

Creating an awesome place to work
we can only succeed if we have the support of inspired, talented, diverse and engaged people (see page 22)

Chief Executive's Review

PBIT
£525.1m
2017: £540.4m

Turnover
£1,606.9m
2017: £1,556.1m

Net ODI outperformance payment
£80.2m
2017: £47.6m

Underlying PBIT
£537.7m
2017: £512.8m

Getting the balance right

"What truly matters is balance.... balance between today and tomorrow, between making improvements where customers value them the most, keeping bills affordable and providing a fair return to our investors."

Times have changed. Today, all of us, across all walks of life expect the companies that serve us to be socially responsible. It's time for leading businesses to step up to the challenges of running a sustainable operation and to embrace all aspects of their performance: social and environmental as well as financial.

Success is not as easy to quantify as it was in the past. Gone are the days when a company was judged purely on its balance sheet and income statement. At Severn Trent, this is a change we welcome wholeheartedly.

That's not to say that financial performance no longer matters. It does, and we're extremely proud of our track record in that respect, as you can see from the figures for 2017/18 that you'll find elsewhere on these pages, notably in James' financial report. What truly matters is balance... balance between today and tomorrow, between making improvements where customers value them the most, keeping bills affordable and providing a fair return to our investors.

We can debate what has caused this shift of opinion well into the early hours; whether it's the financial crisis or global political unrest, government action or the poor behaviour of a handful of companies, or something else entirely. What is undeniable is that this change has happened. And that the new world it's ushered in is here to stay.

So, instead of a traditional CEO review, I want to use these 1,500 words or so to tell you what I'm really proud of and what makes Severn Trent different, through the lens of social responsibility. I want to show you how have we performed when the metrics of success are extended beyond financial returns.

Our environment: everybody's most important priority

Climate change has focused everybody's minds on the need to look after the planet we call home. At Severn Trent we're fortunate that our estate, which is one of the largest corporate land-holdings in the UK at over 53,000 acres, includes several Sites of Special Scientific Interest ('SSSIs') as well as many other areas that are important for plants and wildlife. But with great fortune comes great responsibility – more than most companies, we're in a position to have significant impacts on these wonderful environments.

So we work very hard to make sure that these impacts are as positive as possible. That means encouraging greater biodiversity by working with groups such as The Wildlife Trust and farmers. Over the last year, we improved biodiversity on 9.86 hectares of SSSIs and are targeting many more by 2020. We also encourage and empower our people to focus their volunteering efforts on local rivers and other habitats near their homes. And last year, 40% of our colleagues chose to clean up 50 km of riverbank through our volunteering scheme.

Environmental responsibility also means reducing sewer flooding – where we reduced the number of external flooding events by around 2,000, which is a 49% outperformance against our target – and serious pollution incidents, which came down from seven to two. We continued to improve the quality of water entering our rivers, for example by working in partnership with farmers and rewarding them for using less metaldehyde on their fields. It was great to see all these achievements come together and we believe they will help us regain the mark of exceptional environmental performance in our sector, the coveted 4* status from the Environment Agency.

Looking to the long-term future of the environment, we're continuing to invest heavily in renewable energy – and I was delighted that we generated the equivalent of 38% of the energy we consumed last year, and also sold green gas back into the grid.

Our customers: the reason why we're all here

There are two ways of behaving when you're a natural monopoly. You can simply take advantage of the opportunities your situation presents. Or you can work night and day to create a service that's so good that your customers would still choose you, if they had the choice. We firmly believe that this is vital for any business that wants to still be a business in the years ahead.

So how do we do that? Firstly by striving to give customers what they tell us they want – low bills, less sewer flooding and high quality water at the turn of a tap. Our upper quartile positioning in the UK Customer Service Index and our Customer ODI performance show that we're making good progress.

Affordability is right at the top of our agenda and I'm delighted to report that at an average of £348 in 2018/19, Severn Trent Water's bills will once again be the lowest in England and Wales. That's £57 lower than the average household bill, £35 lower than the next cheapest and – if we look beyond the UK – half those in Berlin and a quarter of those in Copenhagen.

We're also increasing our efforts to support the most vulnerable people in our communities. As well as providing discounts to customers who are struggling to pay their bills, we've started to work more closely with other agencies and use our close relationship with local communities to identify where a little bit of extra understanding and financial help can go a long way to easing pressure on customers facing difficulties. This isn't the best way to improve our bottom line – but it is demonstrably the right thing to do.

As I've already mentioned, the number of sewer floodings are one of a number of measures in which we have outperformed, but it is disappointing when our customers are left with nothing coming out of their taps, as happened too often this year. Our performance on supply interruptions was our worst performance in five years and the first time we've missed our target on that measure during that time. Some of these interruptions to supply can be explained away by the extreme freeze-thaw-freeze cycles of the bitter winter, which also meant that we missed our challenging target on leakage – despite strong performance for 11 months of the year. But the fact remains that we know we have let some of our customers down in an area that really matters to them. Although small succour for these performance failures, customers are rightly compensated for them through compensation when our performance falls below regulatory standards and by virtue of the ODI penalty system, through reductions in future bills.

We're working really hard to improve our ability to cope with extreme weather, as this is a fact of life for us all now, through initiatives like leakage detector robots and other high tech tools that can give us extra 'eyes' on the network.

Customers also tell us that it's important that we're available for them when they need to talk to us. We all lead busy lives, and we all know how frustrating it is when you can't talk to somebody when you need to in the five minute slot that you have in between dealing with more important work or family matters. So we've extended and improved our contact channels. We're now the only water company that customers can contact at any time of day or night, on any issue – not just for emergencies.

We need to help our customers understand what they should and shouldn't put down the loo or the sink, and how to use water more efficiently. While I passionately believe that most people want to do their best for the environment, they don't always have the right knowledge to do so. That's why we spend so much time and effort on education, particularly in schools. If we can get young people to value water and support what we're doing to preserve and supply it, then we will all be in a much better place as well as our children and grandchildren in years to come.

Our people: the assets that make it all happen

Severn Trent is its people. They're the ones on the front line, the ones who talk to customers, the ones who innovate and implement the bright ideas that help us deliver a service you would choose to have.

To be your best, you have to be happy and supported in your workplace. So we're constantly looking for new and better ways to help them thrive, fulfil their potential and show them how much we value their expertise and commitment. Over the last year we've increased our focus on training. Ours is a technical, engineering-led industry where there's absolutely no substitute for the right expertise. Of course, investing in training is good for our business, because it helps us be more technically competent. But it's also good for our colleagues, because it gives them a platform for growth, promotion and more rewarding careers – and it's good for local communities and industry too, because it improves the skills base across the Midlands. This is what businesses like Severn Trent can and should be doing... building our employees' talents and playing our part as members of society to benefit everybody.

As a significant employer in our region and presence in local communities across the Midlands, we can also do a lot to help change general attitudes towards issues that affect individuals everywhere. For example, according to the World Health Organization, one in four people in the world will be impacted by mental or neurological disorders at some point in their lives. So last year we decided that we needed to remove the stigma associated with mental health, particularly for men. We now have over 400 qualified mental health first aiders at Severn Trent, who have undertaken formal training programmes and also listened to first-hand stories of how mental health can affect lives – including personal contributions from my senior team. Now we're turning our attention to the menopause, which is another area that is a bit of a taboo in society at large but which can have a massively detrimental impact on women and their families.

Our employee engagement score rose by a full six percentage points last year, proving that the things we're doing for our people are appreciated, and we are turning Severn Trent into an even better place to work. Our teams respond to the sense of belonging and community that we're trying to create here – and an incredible 40% of them turned out to volunteer their time to improve their local environment during the last 12 months.

Dee Valley Water is now substantially integrated, and the people there are already a vital part of the Severn Trent family. I'm so proud of the fact that they haven't missed a beat in delivering a great year from an operational perspective, with zero coliforms (an important feature of water quality) at their sites probably being the standout achievement. We're learning from each other and adopting each other's best practices in order to provide better services to our customers and the environment.

I'd like to thank all 6,000 of our people for the passion they've applied to all they do over the year, sometimes in difficult circumstances, but always with a smile on their faces. They make it an honour to have my job. Thank you!

Our outlook: lots to look forward to, but more hard work lies ahead

In September, we'll submit our plans to Ofwat for our next five year business plan. Make no mistake, from an industry perspective this is going to be tough.

But for customers, this is the right thing at the right time. Putting the focus fairly and squarely on customer service, affordability and long term resilience is absolutely the correct thing to do and we fully support Ofwat's goals.

We've been working hard over the last few years to make sure we're in good shape to rise to these challenges. As this report highlights, Severn Trent Water's customers again had the lowest bills in England and Wales, and we're making good progress in most other areas of the business. Are we getting it right all the time? No. But we know where and how we can improve – and we have a total determination with our people's support to get there.

Liv Garfield
Chief Executive

How we are doing against our strategic objectives

Embed customers at the heart of all we do

What do we mean by this?

We'll improve the way in which customers engage with us through improved insight and understanding of what's important to them.

What we said we would do in 2017/18

- **Make a step change in customer service.**
- **Continue to deliver on the things that matter most to our customers to achieve a substantial reward of around £23 million in customer ODIs.**
- **Provide a service that is affordable for all and support our financially vulnerable customers by assisting 50,000 customers with their bills.**
- **Be recognised as an upper quartile wholesaler in the new non-household retail market**
- **Provide an industry leading experience for property developers and customers who need new water and waste connections**

Our progress 2017/18

- **Achieved Upper Quartile position in the UK Customer Service Index and reduced customer written complaints by 17%.**
- **Achieved better outcomes for customers on a number of measures including external and internal sewer flooding, and achieved ODI outperformance payments of £80.2 million.**
- **Maintained the lowest bills in England and Wales, and assisted more than 50,000 vulnerable customers with their bills.**
- **Developer Services team recognised by Ofwat as 1st for Water and 2nd for Waste in its SLA compliance comparison tables.**

Areas of focus for 2018/19

- **Build greater capability in incident management focusing on continuous improvement**
- **Develop the use of the 'Wonderful on tap' brand to increase the focus of all colleagues on enhancing the quality of our products and customer service, and make our customers aware of what we do for them and our connection with their daily lives.**
- **Deliver on the things that matter most to our customers as measured in Customer ODIs**
- **Provide a service that is affordable for all and support our financially vulnerable customers by assisting 50,000 customers with their bills**

CASE STUDY

Lowest bills in the land – yet again

Research tells us that with so many competing demands on household budgets, affordability is one of the biggest concerns for our customers. Which is why it was great to see that our efforts to keep water bills down yet again proved so worthwhile.

For the 8th year running, Severn Trent Water's customers have the lowest bills in England and Wales. Our average combined bill for 2018/19 will be £348. That's £57 below the average across the two nations and £35 less than the next cheapest.

Nevertheless, we know that some vulnerable customers still struggle to make ends meet – so over the last 12 months, we used our Big Difference scheme to give discounts of up to 90% to 36,000 people.

CASE STUDY
Protecting the interests of our customers
From investing in robotic leakage detectors to encouraging farmers and fast food chains to be more careful about what they put on fields or down drains, we work tirelessly to make Severn Trent water as clean, available and affordable as possible.

Although customers certainly appreciate what we do – in fact water quality complaints are down 12% year-on-year – not everybody buys into the need to look after this precious resource. We don't enjoy taking people to court, but sometimes it's the only way to protect the interests of all those who pay their bills and play by the rules. Since the start of 2016, we've successfully prosecuted over 50 companies that have been caught illegally using hydrants to access our network. And to prevent future misuse, we've now fitted 30,000 locking caps to hydrants across our network.

CASE STUDY
Improving our performance for developers
Every year, we connect around 20,000 new properties and install and adopt around 100 km of new water and waste water pipes. And whether we're working with an individual doing a self-build, a national housebuilder constructing a new 200-home estate or office block, or a farmer wanting a new water supply for a distant drinking trough for his cattle, we aim to make this process as simple and cost-effective as possible.

By reorganising our Developer Services business around our three main customer segments – small and first time developers, large developers and self-lay providers – we evolved our approach over the last year to meet the needs of our customers more precisely.

The result? The best customer service within our sector – finishing 1st for water and a close 2nd for waste water as measured by the Ofwat customer service KPI. We also saw a 29% reduction in customer complaints compared to the previous year.

Drive operational excellence and continuous innovation

What do we mean by this?

We'll build a smarter water and waste water network, develop our business intelligence and simplify our cross business processes.

What we said we would do in 2017/18

- **On track delivery of our plans to be upper quartile for Retail, Water and Waste.**
- **On track delivery of upper quartile financing performance by the end of 2019.**
- **Continue to provide environmental leadership as evidenced by EA 4* status.**
- **Deliver budgeted benefits from implementing ten innovation projects and ten digital projects, and developing a sustainable pipeline and process for innovation.**
- **Drive innovative developer solutions to deliver a step-change in the new connections service to customers.**
- **Reduce the number of water quality complaints.**

Our progress 2017/18

- **Achieved upper quartile performance in key waste measures including external sewer flooding.**
- **Delivered sector leading environmental performance, which we expect to lead to EA 4* status.**
- **Expanded our search globally for innovative solutions to deliver the highest standards and greatest efficiency for our customers.**
- **Achieved 1st and 2nd place in Ofwat's water and waste rankings respectively for new connections SLA compliance.**
- **Delivered our best water quality performance in five years, reducing water quality complaints by 12%.**
- **Deployed innovative solutions, such as the addition of bio-augmentation to prevent the build-up of fatbergs, to deliver higher standards and greater efficiency.**

Areas of focus for 2018/19

- **Deliver our plans to be Upper Quartile for Retail, Water and Waste**
- **Continue to provide environmental leadership**
- **Collaborate to deliver the budget Regain self-assured status for our English business**
- **Make further progress on the quality of our water as measured by the DWI's Compliance Risk Index**

CASE STUDY

Seeking out best practice, wherever in the world it lives

Our teams are constantly coming up with brilliant ideas on how we can do things better, faster or cheaper for our customers – and the Bike on a Boat project gives them all the support they need to become even more innovative.

Named after a clever idea developed by an America's Cup yacht racing team, Bike on a Boat is all about learning from each other as well as from best practice around the world. Towards the end of 2017, we took Bike on a Boat on tour, holding 64 roadshows at 10 different venues over six weeks and generating over 6,200 ideas from our people.

In October 2017, we launched a £100,000 Bike on Boat fund to enable any of our people to apply to travel anywhere in the world in order to learn more about how other companies are reducing water usage and leakage.

We have received over 30 applications and approved 13 trips as far afield as Australia and Singapore.

Invest responsibly for sustainable growth

What do we mean by this?

We'll develop an effective strategy which optimises our regulated asset base, whilst creating new growth opportunities for the future.

What we said we would do in 2017/18

- **On track to delivering on our PR14 commitments and make appropriate targeted investments for the future.**
- **Integrate and deliver the benefits of the Dee Valley acquisition, combining the strengths of the two companies to create a strong Welsh entity focused on delivering local priorities.**
- **Complete and transition Competing to Win to business as usual .**
- **Generate the equivalent of 38% of our energy needs from renewable sources.**
- **Achieve material improvements in some of our key Enterprise Risk Management risks.**

Our progress 2017/18

- **Embraced Totex, identifying a further £100 million of efficiencies which will be re-invested in the business to further improve customer service and ensure we're in the best possible position for AMP7.**
- **Substantially completed the integration of Dee Valley Water into the Severn Trent Group, allowing the two companies to learn and share best practice with each other for the benefit of their customers.**
- **Well advanced in realigning the boundaries of Severn Trent Water and Dee Valley Water along English and Welsh national borders.**
- **Generated the equivalent of 38% of our energy needs from renewable sources, and made good progress on the construction of new renewable energy plants.**
- **Delivered key milestones in major capital schemes, including the Birmingham Resilience Programme and the Newark waste and water improvement project. Major capital schemes are on track to meet any associated ODI commitments.**

Areas of focus for 2018/19

- **Deliver fully on our PR14 (AMP6) investment commitments, being confident that we are able to deliver against our current plans and make appropriate investments for the future**
- **Achieve material improvements in some of our key ERM risks**
- **Drive a focus on efficiency across all business areas including central functions to support frontline investment**
- **Continue to embed innovation across the company, making it part of every team's way of working**

CASE STUDY
Bringing new resilience to local infrastructure

The market town of Newark in Nottinghamshire has survived everything from the black death to the civil war. But an expanding population coupled with an ageing, inadequate sewer network was challenging the town's resilience. The infrastructure was at breaking point, with 400 properties regularly at risk of sewer flooding – after fire, the worst thing that can happen to a property.

We're currently investing £60 million in a three year project to replace more than 20 km of pipes, including a 2.8 metre diameter tunnel running 15 metres below Newark's streets. Despite short term disruption, the end results will be welcomed by all. The town will have a sewer and water pipe network fit for its future population. And for the 400 households at the heart of the project, a drop of rain will no longer raise the fear of sewage flooding their homes and gardens.

CASE STUDY
The end of an era

Customers in North Wales are now enjoying higher quality water, thanks to the completion of a complex scheme to close an old treatment works and instead supply water from a more resilient and efficient facility.

Constructed in the 1920s, the works at Legacy on the outskirts of Wrexham was licensed to abstract water from nearby former lead mines. This water was then treated through a series of pressure filters and chlorination plants before being held in a 350,000 gallon tank. However, despite regular upgrades, the facility was nearing the end of its useful life and some customers were experiencing occasional discolouration problems.

In March 2018, following several years of hard work by the team at Dee Valley, a project to transfer the raw water to Llywn Onn was completed – including a new distribution water pipe – and the Legacy treatment works was finally closed.

Change the market for the better

What do we mean by this?

We'll embrace market opening in the UK and explore opportunities for growth in new water markets.

What we said we would do in 2017/18

- **Have a clear PR19 outline plan in place that evidences our leading status.**
- **Produce compelling cases for investment that customers want to see, at PR19, that enables strong RCV growth over AMPs 7 and 8.**
- **Design and implement the bio-resources change programme and business model.**
- **Be seen as the water sector's thought leader.**
- **Create a strong Welsh entity focused on delivering local priorities**

Our progress 2017/18

- **Our PR19 plans are coming together well, co-creating them with our largest ever customer engagement programme, and we are in a good position to submit in September 2018.**
- **Restructured our waste business to create a stand-alone Bioresources team, identifying opportunities for operating efficiencies and trading with our companies.**
- **Worked with the Social Market Foundation to assess the likely costs associated with renationalising the water and sewerage industry in England.**
- **Worked with United Utilities to engage with Thames Water on the construction of a super interconnector to transfer and trade water between the Severn and Thames catchment areas.**
- **Integration of Dee Valley Water is well advanced, and plans to realign the boundary of the Company wholly within Wales will take effect in July 2018.**

Areas of focus for 2018/19

- **Produce compelling cases for investment at PR19 that enable strong RCV growth over AMPs 7 & 8**
- **Deliver phase two of the energy and renewables strategy, achieving 50% self-generation**
- **Build a sector leading approach to Bioresources**
- **Finalise the creation of Hafren Dyfrdwy and deliver a great first year**

Create an awesome place to work

What do we mean by this?

We'll create a culture of empowerment and accountability with a focus on skills, talent and career development.

What we said we would do in 2017/18

- **Deliver a step change in our safety performance.**
- **Improve the wellbeing of our colleagues.**
- **Deliver a further uplift in our employee engagement scores.**
- **Progress our talent agenda.**
- **Continue to strive for the most diverse and inclusive business with increasing numbers of Black, Asian and Minority Ethnic ('BAME') talent in our business.**
- **Further improve employee engagement by resolving the top 10 issues identified by our employees.**

Our progress 2017/18

- **Achieved a 23% reduction in lost time injuries, resulting in an LTI rate of 0.17, through an enhanced focus on safety culture, standards compliance and training.**
- **Continued our focus on mental and musculoskeletal health to drive an improvement in employee wellbeing and reduce absences.**
- **Achieved a six percentage points improvement in our employee engagement survey, demonstrating improvement in all areas, and achieving an upper quartile position relative to our peers.**
- **Continued investment both in our graduate and apprentice schemes, as well as innovative investment in the ongoing training and development of our broader employee population.**
- **Focused efforts on further improving social mobility within our region, through targeted recruitment from social mobility cold spots.**
- **Delivered solutions for two of the top ten issues identified by our employees, and made progress to resolve the remaining issues.**

Areas of focus for 2018/19

- **Deliver a further step change in our safety performance and support the wellbeing of our colleagues**
- **Continue to build on our strong volunteering performance and drive the CR agenda**
- **Continue our focus on improving overall Quest engagement scores**
- **Deliver the foundations of the new Academy, to make a positive contribution to technical development**

CASE STUDY

Opportunity and support for all

We're striving to make Severn Trent an awesome place to work – where anybody who wants to reach their potential can thrive.

Graduates already recognise the opportunities we offer – and apprentices are continuing to follow suit, with another increase in their numbers over the last year. We're also succeeding in attracting a more diverse workforce – BAME employees on our graduate programmes were up 12.74% during the year. Now we're redoubling our efforts to encourage people from less socially mobile populations to join us, removing artificial barriers to entry and working with more schools in disadvantaged areas. For example, for the year ahead we've ring fenced 25 work experience opportunities at five schools across five social mobility 'cold spots' in our region.

Once they're part of our team, we provide all our people with a range of training programmes. We've committed to invest in technical skills and will create a new Severn Trent Training Academy, focused on delivering tailored programmes for staff across our region, with the aim of making our workforce the most technically skilled in the industry.

We recognise the importance of supporting people in all aspects of their lives. During the year, we continued our major programme to improve our employees' understanding of mental health issues, as well as encouraging greater awareness of cancer and menopause. In April 2018, we also signed up to the TUC's Dying to Work charter which aims to protect employees with a terminal diagnosis.

CASE STUDY

Supporting clean, safe water and sanitation

As a founding member and long term supporters of WaterAid, we've raised over £450,000 for the charity over the last two years. We believe that our continued support can help WaterAid realise our shared ambition for clean water, decent toilets and hygiene for everyone everywhere by 2030.

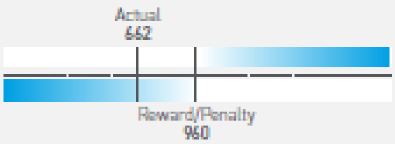
ODIs and KPIs

We continue to make progress against our customer ODIs and financial KPIs

Progress against our Outcome Delivery Incentives[2]

1. Embed customers at the heart of all we do

Internal sewer flooding



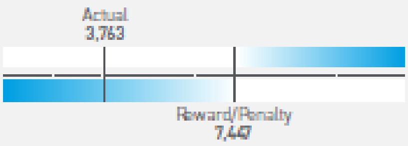
Rate of Reward/Penalty (per incident)

£42,820[1]

Why we measure it
To ensure we do everything we can to prevent flooding of customers' homes or businesses. It is one of our customers' most important priorities.

Progress in the year
We are reporting a performance of 662 internal incidents, ahead of our committed performance level of 960 incidents.

External sewer flooding



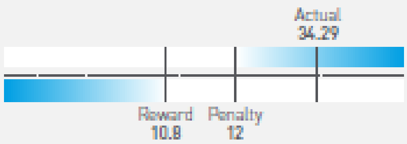
Rate of Reward/Penalty (per incident)

£19,779[1]

Why we measure it
To ensure we do everything we can to prevent flooding of customers' homes or businesses. It is one of our customers' most important priorities.

Progress in the year
We are reporting a performance of 3,763 external incidents, ahead of our committed performance level of 7,447 incidents.

Minutes without supply



Rate of Reward/Penalty (per minute)

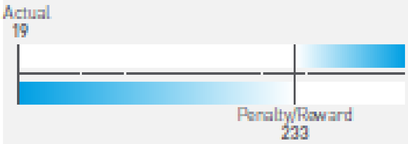
£1.10m[1]

Why we measure it
Our customers value water being there when they need it. This performance commitment ensures we are driving down the impact of any interruptions to supply across our network to minimise the impact on customers.

Progress in the year
We interrupted customers' supplies for an average of 34.29 minutes in 2017/18, well behind our performance commitment of 10.8 minutes.

2. Drive operational excellence and continuous innovation

Improvements to river water quality



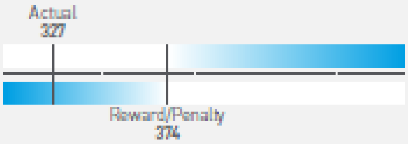
Rate of Penalty/Reward (per unit)

£150,000[1]

Why we measure it
We have statutory obligations to deliver, but our customers told us that we should do more where we can. This performance commitment ensures we meet our obligations and drives us to deliver more where it is possible.

Progress in the year
There were 19 individual points completed in 2017/18, bringing our cumulative total to 34 points, and we are on track for our end of AMP target.

Number of category 3 pollution incidents



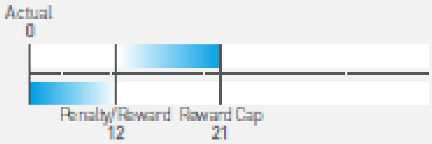
Rate of Reward/Penalty (per incident)

£53,900[1]

Why we measure it
Minimising the impact our activity has on the environment is a key concern for our customers. This performance commitment ensures we drive to improve performance in this area.

Progress in the year
We are reporting 327 category 3 incidents against a committed performance level of 374; this is 47 ahead of target and our reward dead-band.

Successful catchment management schemes



Rate of Penalty/Reward (per scheme)

£1.03m[1]

Why we measure it
Our customers want us to look for new and innovative ways to improve water quality, whilst working in partnership with others stakeholders to deliver wider benefits. This performance commitment focuses on how our approaches are encouraging farmers and land owners to change their behaviour and practices.

Progress in the year
Over the last year, we have undertaken a review of our schemes and processes and optimised our approach based on previous years' experience. We are on track to deliver more than our performance commitment of 12 catchments in 2018/19.

3. Invest responsibly for sustainable growth

See our Regulated Water and Waste Water performance review on pages 34 to 41.

4. Create an awesome place to work

Lost time incidents per 100,000 hrs worked

Severn Trent Water Limited

0.17 2016/17: 0.22

Severn Trent Water Limited
Strategic Report (continued)
For the year ended 31 March 2018

SIM – Customer experience

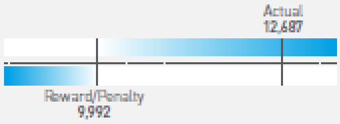
Not yet defined by Ofwat

83.2SIM score

Why we measure it
Providing good quality service to our customers is key and the Service Incentive Mechanism ('SIM') provides us with a regular opportunity to understand our performance and implement initiatives to improve the quality of service we provide, but also deliver value for money.

Progress in the year
We have seen a slight decline in our quantitative areas of our business and maintained our qualitative scores which has meant that we have reported a SIM score of 83.2 for 2017/18, behind our original upper quartile target.

Complaints about water quality



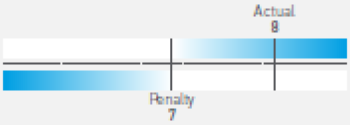
Rate of Reward/Penalty (per complaint)

£900[1]

Why we measure it
Customers value the aesthetic quality of their water. This performance commitment is designed to ensure we manage our network to minimise the number of events that cause discolouration, taste or odour problems.

Progress in the year
In 2017, the number of drinking water quality complaints decreased from 14,461, to 12,687, but we did not achieve our committed performance level of 9,992.

Asset Stewardship – coliform failures



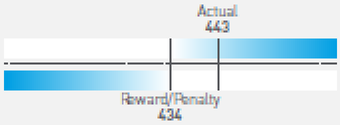
Rate of Penalty

£463,000[1]

Why we measure it
The presence of coliforms in our drinking water is unacceptable as it is an indicator of poor quality so we continually monitor our works to ensure they are not being detected.

Progress in the year
During 2017, we detected coliforms at eight water treatment works sites, which is worse than our committed performance level of seven or fewer works with coliform detections.

Leakage



Rate of Reward/Penalty (per megalitre per day)

£123,000[1]

Why we measure it
Customers see leakage as a waste of a key resource; our customers want us to reduce our level of leakage as a priority.

Progress in the year
Our outturn position for 2017/18 was a total of 443 Ml/day, which was behind our committed performance level of 434 Ml/day.

Severn Trent engagement score improvement[3]

6 percentage points

Progress against our financial KPIs

Group Turnover
£1,606.9.6m
2016/17: £1,556.1m

Group Underlying PBIT[4]
£537.7m
2016/17: £512.8m

Notes

1 In 2012/13 prices after tax.

2 These are also key measurements used to assess our Corporate Responsibility performance.

3 Engagement index used for the Group since 2015/16 to support benchmarking and gain better insight about us as an employer.

4 Alternative Performance Measures are defined in Note 46 to the Group Financial Statements on pages 192 to 194.

Key
Actual
| Severn Trent Actual Performance 2017/18

Performance Review

Our Regulated Water and Waste Water business performed well during the year, as we continued to deliver our five strategic priorities.

Here, we provide greater detail on the achievements and challenges we encountered while delivering our five strategic priorities over the last 12 months – and also identify some of the areas where there's still more to do.

Embedding customers at the heart of all we do

Serving our 4.3 million customers and doing our best for their local communities sits right at the very centre of everything we do.

During the year, we carried out the most intensive customer engagement activity in our history. This included a range of in-depth, deliberative sessions with customers to get right to the heart of their needs, and close collaboration to explore how those needs – and our service – could evolve in the future.

The customer engagement confirmed that the priorities for our customers are consistent and simple – including less sewer flooding and lower bills. Simple to understand, of course, but not so simple to achieve. So it's extremely pleasing to report that this was the third consecutive year where we outperformed on the measures that our customers care most about.

Less sewer flooding

An improved record on sewer flooding sits right at the top of our list of achievements. There's been a 35% reduction in the number of customers affected by external sewer flooding, largely due to our continued focus on prevention.

With many blockages caused by wipes and other non-degradable items, we've continued to use a wide range of initiatives to educate our customers about what they can and can't put down toilets and drains. Among households, wipes are the main culprits and during the year we interacted with 200,536 customers to help them to improve their understanding of how sewers work and to be careful around how much water is consumed. We're paying particular attention to the customers of the future, and engaged with 156,102 schoolchildren during the year. We aim to educate and inspire an entire generation, not just about water conservation and environmental protection, but also by emphasising the importance of hydration to their health and wellbeing.

In the non-household sector, we followed up last year's pioneering agreement with McDonald's by engaging with more fast food restaurants. In Gloucestershire, for example, we worked with companies including YO! Sushi, J D Wetherspoon and The Mayflower to help prevent fatbergs by educating staff about what they shouldn't be pouring down sinks and drains, and advising them on what grease containment and treatment is needed.

Lower bills

For the 8th consecutive year, Severn Trent Water's customers paid the lowest bills in England and Wales, with our average combined bill for the year being £341. We're proud of this record – but we're even more proud of our continuing efforts to do more every year to help vulnerable customers who are struggling to make ends meet. In its third year, our Big Difference scheme helped 36,000 customers access discounts of between 10% and 90%, which is a critical part, along with other tailored schemes, to ensure we deliver on our commitment to help at least 50,000 customers with bills every year. Experience tells us that financial difficulties can often indicate issues in other areas of a customer's life, so we've expanded our care and assistance team to give us the capacity to engage with agencies such as housing associations, the NHS, Citizens Advice and charities including MIND, Samaritans and local food banks, as well as other utility companies. By working together, sharing appropriate information and adopting a holistic approach to vulnerable people, we believe we'll be able to do even more to play a key role at the heart of local communities.

More ways to contact us

It's important to our customers that they can get in touch with us how they want, when they want. We now maintain nine different customer communication channels, including webchat which saw an increase in traffic during the year. We're the first water company to provide a 24/7 service for non-emergencies, so customers can contact us to discuss anything they want in the middle of the night, if that's what fits in with their lives. The value of round-the-clock availability can be seen in the fact that on most nights, more people contact us with questions about payment of their bills and other issues than about emergencies.

Although our customer Service Incentive Mechanism ('SIM') score – which Ofwat uses to measure how well and how quickly we put things right when our service fails to meet customers' expectations – is disappointing, we are working hard to improve the consistency of our customer experience. There's still more to do, and we're going to focus extra effort in areas such as the time we take to respond when customers inform us of a leak. But it's encouraging to see that our drive to embed customers at the centre of all we do is paying off where it matters most – in the hearts and minds of customers themselves. Customer written complaints for the year are down 17%.

We continued to perform well on the Institute of Customer Service's UK index, which measures customer satisfaction across the utilities sector, achieving upper quartile position for customer satisfaction, equivalent to fourth position in the Utilities sector. We look forward to the introduction of Ofwat's new C-MeX measure; currently in development, we believe that this measure will provide a truer reflection of our relative performance.

Driving operational excellence and continued innovation

We're fully supportive of the incentive environment that Ofwat has created. The clear linkage between performance and reward has encouraged us to think differently about how we work and to develop a sharper focus than ever on improving customer service. The result has been a good performance which has generated significant ODI outperformance payments of £80.2 million. We've decided to defer these earnings and access them in the years to come, when they'll help us to smooth future customer bills.

Nowhere is our performance better demonstrated than on our waste measures, including sewer flooding. As reported above, we achieved a significant reduction in the number of customers affected by such incidents over the last year. In fact we've outperformed our internal sewer flooding regulatory target by 31% and our external target by 49%. How have we achieved this? By continuous investment supported by leading edge technology. At a macro level, we're using sophisticated data and analytics to predict the areas at greatest risk and then addressing these with targeted capital investment. At a more micro level, we're carrying out root cause analysis of incidents when they do occur and putting measures in place to prevent reoccurrence – whether caused by geographic factors or customer behaviours.

Regaining 4* status

Pollution is an area where the investments made since privatisation are really paying off – and we're delighted to report that our environmental performance should enable us to regain coveted 4* status from the Environment Agency.

Our number of serious pollution incidents (categories 1 and 2) decreased to two from seven the previous year while category 3 performance again improved, with 327 incidents against a regulatory target of 374. At the same time, we worked hard to improve the quality of the water entering our rivers and reservoirs. Metaldehyde is an effective pesticide against slugs, snails, and other gastropods – but once it runs off fields and enters the watercourse, it's extremely expensive to remove. We continued to use financial incentives to encourage farmers to pursue different and less environmentally damaging alternatives, with considerable success.

The Drinking Water Inspectorate ('DWI') plays a key role in our regulatory environment, and we continued to fulfil our commitment to carry out diagnostics at our 16 largest sites. Our performance is measured by a metric known as mean zonal compliance, and during 2017/18 we improved our performance compared with the prior year at 99.96% (2016/17: 99.94%).

Scope for improvement

Unfortunately, our performance on supply interruptions was less pleasing, with a two-fold year-on-year deterioration. Due to a number of significant bursts some of our customers were left without water. The major burst at Tewkesbury in December, which affected many thousands of people, was challenging both to locate and isolate. Although we worked tirelessly to reconnect our customers and provided 100,000 litres of bottled drinking water, we recognise that our performance was unacceptable.

Then, in March 2018 the very rapid thaw following 'The Beast from the East' led to a substantial increase over a seven day period in the number of burst pipe notifications we would typically receive during that period, followed by complications caused by airlocks, further snowfall and then further bursts. We were incredibly disappointed that homes and communities were left without water as a result of the unprecedented weather. We know how difficult everyday life was for our customers until we could restore supplies – and we decided immediately to pay £30 compensation, roughly equivalent to our average monthly combined bill for water and waste, to any who were without water for more than 12 continuous hours, or experienced intermittent supply for more than 15 hours. We also worked with business customers and their retailers who were affected. With around 70% of issues occurring on private property, we know we need to do more to advise customers better on how to prepare for winter.

The quality of our drinking water is constantly monitored and strictly regulated. Our strategy for the year was to focus more efforts on our surface water treatment works – and while this generated good results it was accompanied by a slight dip in performance at our ground water sites. For example, the number of sites where coliforms were detected rose from five to eight. While coliforms are harmless bacteria, their presence can be an indication that water quality is not as high as it should be.

Overall, we received 12,687 complaints about water quality during the year, down by 12%. This was our best performance for six years, and sustained the prior year's improvements. We're committed to further improvement and acknowledge that the number of complaints in 2017/18 is still significantly above our regulatory target of 9,992. We're targeting improvements in many ways, including adopting the water flushing programme initiatives in place at Dee Valley Water which helped the team there achieve 100% compliance during the year.

One of the Dee Valley Water teams is currently leading the Severn Trent water quality improvement programme – a good example of how we're sharing best practice and learning from each other's experiences.

Investing in innovation

We continue to seek out innovative ideas that can transform our performance, no matter where they originate. For example, our commitment to remove phosphorus from our sewage treatment works has seen our innovation team evaluate technologies from across the world. Following intensive £2 million trials at our Packington site over the last two years, we're now commencing the roll-out of five different and highly advanced technologies. These include a magnetite ballasted coagulation process pioneered in the US. At one site this technology has replaced our original solution, which was costed at £21.1 million. The new solution reduced the cost to £12.5 million and will lead to a total expenditure (Totex) saving of £8.7 million – a return on investment of 218% on one scheme alone.

We're also seeking to improve our performance on leaks through innovative projects, such as the introduction of detector robots into the pipe network. This innovative solution uses small touch sensors to spot the nature and exact location of leaks rather than the current visual and acoustic techniques. Based on technology first used in North America, we were the first test case in Europe and only the third test case globally with very encouraging early results.

Investing responsibly for sustainable growth

At Severn Trent, we've been responsible for £21 billion of the £130 billion invested by our industry since privatisation – and our capital programme continued at pace through 2017/18, as we invested £855 million across our estate. Last year, we committed to investing a further £120 million in AMP6 in order to make sure we're in the best possible shape for AMP7, and we've increased our forecast Totex efficiencies by £100 million. These now stand at £870 million. This additional £100 million of Totex efficiencies, which is in addition to the £120 million previously announced, will also be reinvested in our business, for the benefit of customers.

Delivering our capital programme

Looking at our major capital projects, we started work on a £60 million project to protect 400 homes and businesses at Newark in Nottinghamshire from sewer flooding, and provide the town with a more reliable water supply. On track for completion in 2019, the project will see us install 4 km of new sewers and 10 km of new water mains, and also build a 3 km, 2.8 metre diameter tunnel 15 metres below Newark.

The £300 million Birmingham Resilience Project is the largest capital project undertaken in the industry during AMP6. Due to be completed in 2020, this will create a second major source of water for Birmingham. Progress during the year included preparatory works for the Lickhill to Frankley pipeline comprising the laying of 17 km of pipework and major tunnelling operations.

Meanwhile, the £40 million investment to replace an ageing reservoir with two new ones at Ambergate was completed a year early in February 2018. This project will lower the risk to drinking water quality while improving our storage capacity resilience at the same time.

Our capital programme is delivering rewards in many areas of the business. We've retained our upper quartile position in waste and are moving in that direction on water. In terms of ODIs, we've significantly outperformed our targets and our ODI outperformance payments have exceeded £80 million.

Building a sustainable business

It's important to balance capacity-building projects with the need to create a sustainable business that's able to deliver customer benefits in the long term – not just next year but over the coming decade and beyond.

For example, we carried out 15,367 home water efficiency checks during the year. These help customers save money by using water more efficiently – and that means less pressure on water resources in the future. We're now using demographic data such as socioeconomic profiling, to target customers who we believe stand to gain most from a visit by our team. In total, our education programmes helped over 171,469 customers use water more wisely in 2017/18.

We're fortunate that the Severn Trent estate is home to a diverse array of species of plants and animals. During the year, we improved biodiversity at Sites of Special Scientific Interest ('SSSIs') covering 9.86 hectares, representing good progress against our 2020 target of 75 hectares – and we also improved almost 120 km of rivers as part of the Water Framework Directive. We continue to focus on exploring innovative ways to generate renewable energy from waste, and last year self-generated the equivalent of 38% of our energy needs.

On a more negative note, our emissions performance was disappointing as we failed to achieve our Water carbon ODI due to higher than expected energy use. In response, we've introduced new energy management initiatives for the coming year. We've also agreed to help the National Grid balance energy supply and demand by turning some of our operational sites off at certain times.

We know that our own efforts to become more sustainable become even more effective when we're joined by others – and in May 2017, we were delighted to see our supply chain partners stepping up to support our ambitions. At an event in Coventry, senior delegates from our top suppliers engaged with our management team to explore opportunities to work together for mutual benefit. The outcome included a series of pledges from these influential suppliers to work on improving sustainability in areas relevant to their business. For example, embedding carbon and water reductions in their processes and pledging to work closely with us on mitigating the risks of modern slavery.

Closer to home, we are working with PwC and Hope for Justice to provide our people with bespoke training on modern slavery. This programme raised awareness of the issue and how to identify it, particularly among our suppliers – and it's encouraged our people to become advocates of our zero tolerance approach to modern slavery.

Changing the market for the better

Severn Trent Water and Dee Valley Water are very active players in the water industry across England and Wales. We're keen to play our part to the full – promoting the industry and the positive influence it has had on life in the UK since privatisation, and encouraging greater awareness among regulators and others of the issues we face.

During the year, we supported the Social Market Foundation in publishing a report into the likely implications of renationalising the water industry on public sector debt levels. With some commentators estimating the cost of such a development to be in excess of £90 billion, our view is that the public should be fully aware of the facts around all aspects of renationalisation. We also collaborated with Thames Water and United Utilities to publish a thought leadership document on how water companies could create and manage a systems operator for water trading in order to drive greater efficiency.

Encouraging new ideas

We have a track record of embracing markets where we believe we can create value for our customers. For example, our Water Plus joint venture with United Utilities is enabling us to take advantage of the opportunities presented by the opening of the non-household retail market in April 2017.

We continued to engage with our industry peers on a wide range of issues throughout 2017/18, in order to identify and evaluate new and better ways of working. Our draft Water Resources Management Plan outlines a range of potential trading options to help meet future demand pressures and to secure supplies for the long term. We've already worked with Thames Water and United Utilities to investigate the benefits that a super interconnector could bring to our respective regions, by enabling us to move and trade water. Additional future options include bio-resources trading – and we've taken part in trials to make sure we're ready for the opportunity when it arises.

We also worked closely with the Water Forum, which not only gave us valuable customer insights but also helped guide the new and deeper approach we're taking to supporting vulnerable members of our local communities.

Acquired in 2017, Dee Valley Water has now been substantially integrated into the Group, and we've been busy sharing ideas between the businesses. The acquisition gave us the opportunity to realign both Dee Valley Water and Severn Trent Water around national boundaries. Once the realignment is complete in July 2018, Dee Valley Water will be answerable to the government in Wales, while Severn Trent Water will be answerable to the government in England.

We recognise the importance of leading by example, and aim to help our industry regain public trust and legitimacy by demonstrating the highest standards of governance. Our Board leads from the front and is responsible for the oversight of all aspects of the business, including culture. During the year, the Directors continued to evaluate a broad set of cultural indicators – such as exit interviews and external stakeholders' perceptions – in order to ensure that our values remain central to everything we do.

Creating an awesome place to work

Our people are key to the success of our business – and we want to make sure we motivate, reward and support them accordingly. It was very encouraging to see our efforts reflected by a six percentage points improvement in our annual employee engagement survey in 2017. The increased score builds on the positive momentum of recent years as our culture matures, and was achieved across the board – people in every part of the business support what we're doing.

We're creating an awesome place to work by focusing on a broad set of projects and initiatives. Recruitment and career paths clearly play an important role – graduates continue to be attracted to the challenges and opportunities we offer, and our apprentice intake increased yet again. In fact during 2017/18 we were delighted to see four experienced employees start on our first ever Masters level apprentice programme.

Helping people progress

We invest in skills and development at all levels of the business, doing all we can to provide people with progressive, successful careers. A number of our current senior managers started in junior positions. We aim to provide great opportunities for all, regardless of gender, race or background. We continually strive to be a diverse, inclusive business that reflects the demographics of our region, and achieved a 13% increase in the numbers of Black, Asian and Minority Ethnic ('BAME') employees on our graduate programmes during the year. The population in the East and West Midlands is among the least socially mobile groups in the UK – but as a major employer we can help change that and enable people to realise their potential. To this end, we've removed barriers to entry such as the requirement to have a degree for some of our programmes and we have changed our selection process to focus on potential rather than experience.

Our gender diversity performance improved during the year and we now have a mean gender pay gap of just 2.4%. However, we're working hard to reduce it still further. We benefit from high female representation at executive level and were pleased to be placed second among FTSE 100 companies for representation of women on boards and in senior leadership roles by the 2017 Hampton-Alexander Review. The last year also saw the creation of our first LGBT+ inclusion group. The mission of this team was to create a proud and inclusive culture for our LGBT+ community, supporting our colleagues' ongoing commitment to being recognised as a diverse and inclusive business.

We encourage all our people, across all roles and age ranges, to be creative and put forward their ideas for innovations that can improve customer service. We repeated the all-employee staff roadshow, following its success in 2015. The 'Bike on a Boat' tour, inspired by the innovative approach of the New Zealand America's Cup-winning team of 2017, captured and shared a wide range of brilliant ideas. Since its launch we have funded 13 ideas, including sending employees to evaluate initiatives in Singapore, Australia, Denmark and USA that could be adopted in our business.

We also restructured the business during the year. This brought a renewed emphasis on our core work in water and waste water, it's also improved our customer focus and, crucially, brought a new level of clarity to our employees on roles and responsibilities. We all know what's expected of us, and we all know that the business will do its best to support us by giving us the tools we need – whether that's a robot leakage detector, an innovative agreement with a farmer or a day of intensive management training.

Pay and conditions are high on everybody's list of priorities, and we've made good progress here too. We provide jobs that are well paid and with excellent pensions. Our bonus scheme also embraces everybody, ensuring that the rewards of a good year's work are shared among us all. The annual employee engagement survey identified pay transparency and relativity as two of the top 10 issues where our people thought we could improve. We're now addressing this by clarifying pay rates and being more thorough in the way we explain career opportunities.

Promoting health, safety and wellbeing

We pay particular attention to the health, safety and wellbeing of our teams, and in 2017/18 continued our major initiative around mental health. Our aim is to remove the stigma around mental health, for example by creating a workplace where people can talk about problems with depression or stress. To date, we've trained over 400 mental health first aiders to spot the signs of a possible issue, while a number of senior managers have brought mental health more into the open by talking frankly about their own experiences. During the year, we held an initiative on the menopause and other areas that people can be uncomfortable discussing, including cancer, and we signed up to Dying to Work, which supports employees with a terminal diagnosis.

We're committed to the highest standards of behaviour at all times, not only in our own business but also among our suppliers, who are required to sign up to our Code of Conduct, anti-corruption and bribery policy and our sustainable supply chain charter to illustrate that they share our values and are committed to helping us achieve our goals. We audit suppliers as part of our tendering process for large contracts, and they must demonstrate full compliance with our standards at all times.

During the year, we worked with Hope for Justice to develop a training package, including upskilling our contract managers on how to spot the signs of slavery and human trafficking and the steps they should take if any concerns are raised. We have clear policies and training in place – and these are supported by an independent and confidential whistleblowing service which we actively promote via communications such as messages on payslips. Every report of possible corruption or bribery, from any source, is investigated and reported to both the Corporate Responsibility and Audit Committees of the Board.

We want our people to feel part of a progressive company that plays its part to the full – and the record level of employee volunteering is another positive sign of this. Over 40% of employees volunteered during the year, a huge increase on the 11% that took part in 2016/17. Most volunteering was through our new Community Champions programme, working alongside key partners such as The Wildlife Trust to improve 50 km of riverside environments in our regions. Our volunteers also helped our corporate charities, Comic Relief, Sport Relief and Children in Need, as well as continuing our long term support for WaterAid. In addition to raising nearly £300,000 during the year, our people also drew on specific industry skills to give practical help to WaterAid, for example by supporting the charity’s campaign to improve water quality in Cambodia.

Managing our Critical Resources and Relationships

Every day, we rely on six key resources and relationships to support the long-term sustainability of our business.

On these pages we explain these resources and relationships in detail, and showcase a number of practical examples of how we managed them over the last year.

This year we have integrated our corporate responsibility metrics into our discussion on managing our critical resources and relationships.

Positive engagement with land managers
85%
2017: 44%

Water Framework Directive classification improvement points
19
2017: 15

Hectares improved from unfavourable or deteriorating condition using Natural England's database of SSSIs
9.86
2017: 29.74

Expected EA rating
4*
2017: 3*

Number of Environment Agency Category 1 & 2 incidents (calendar year metric)
2
2017: 7

Reduction in Group carbon emissions
4.4%
(scope 1 and 2) – our direct emissions and those from the energy we use
2017: 8.3%

Our natural resources

Maintaining our reservoirs, rivers and underground aquifers

We're fortunate to be responsible for some of the UK's most impressive natural resources. From the chain of man-made lakes created by damming the Elan and Claerwen rivers in Wales, which provide clean water to Birmingham, to stunning stretches of rivers such as the Severn, the Dee and the Trent, these wonderful resources provide the raw materials for our services.

Despite the relatively dry winter, our reservoirs were full at the end of the financial year, and we're in a strong position to ensure a reliable supply to customers during the year ahead.

Working with landowners...
Prevention is better than cure, so we work hard to make sure that the water entering our watercourses is as clean as possible. Supported by the skills of a dedicated team of agricultural advisers, the Severn Trent Environmental Protection Scheme ('STEPS') aims to improve watercourses and the wider environment.

STEPS provides grants of up to £5,000 for infrastructure improvement and land management changes in our target areas. This is part of our plan to invest £21 million by 2020 to help farmers improve water quality – an investment that will pay off several times over by protecting the environment and reducing treatment costs.

For example, we continued to recompense farmers prepared to switch from metaldehyde to less invasive alternatives for the control of slugs. Once in the watercourse via field run-off, metaldehyde is extremely expensive to remove – and the scheme has again delivered excellent value while helping us achieve our catchment management target.

We improved biodiversity on 9.86 hectares of Sites of Special Scientific Interest ('SSSIs') during the year, and have a target of improving 75 hectares of SSSIs by 2020.

...and ensuring long-term supply

As the financial year closed, we published our draft Water Resources Management Plans ('WRMP'). Our long term view on supply availability, the WRMP articulates the need to make significant investments in water supply and demand management schemes, particularly in light of the Government's requirements for the industry to reduce levels of water abstraction. For example, Severn Trent Water has targeted a 15% reduction in leakage over the next five years, and we plan to increase the use of water meters, in addition to stepping up our home water efficiency checks. We carried out 15,367 checks during the year – helping customers save money and protect future supplies by using water more efficiently.

Helping farmers step up to the challenge

Prevention can be more cost-effective than treatment, particularly when it comes to pesticides which can enter our rivers from surrounding fields. Through the Severn Trent Environmental Protection Scheme (STEPS) we offer farmers grants of up to £5,000 per year to undertake works which will help reduce pollution.

Retaining the Carbon Trust Standard

We were proud to once again be reaccredited with the Carbon Trust Standard during the year. This achievement verifies that we have sound carbon management processes in place and are reducing absolute carbon emissions year-on-year. In fact, we've reduced our GHG emissions by 17% since 2014.

Cleaning our rivers

Under the EU Water Framework Directive ('WFD'), we're charged with achieving 'good status' for all watercourses. We continued to support the aims of the WFD during 2017/18 and again made significant progress towards achieving our ambitious target of improving the health of 1,800 km of river by 2020. We completed 10 WFD sewage treatment projects during the year which improved almost 120 km of river – an increase of around 650% over the previous year – and we're now approximately 15% of the way to reaching our objective. River health is assessed by the Environment Agency and measured against a set of criteria including oxygen levels and the presence of fish and invertebrates.

Managing our environmental impact

During 2017/18, we outperformed our internal sewer flooding regulatory target by 31% and our external target by 49% – and these have been key factors that should help us regain a 4* rating from the Environment Agency.

We also achieved all of our regulatory targets relating to pollution incidents, reducing serious category 1 and 2 pollutions to two events during 2017/18, down from seven in the prior year.

We failed to reach our Water ODI carbon emissions target for 2017/18, primarily due to greater energy consumption as we need to meet increases in demand for water production. Efficiency measures now in place are expected to drive the required reduction in the coming 12 months. Meanwhile, we continue to increase the amount of renewable energy we generate. During the year, we produced the equivalent of 38% of Severn Trent Water Limited's energy needs and are on track to increase this to 50% by 2020.

CASE STUDY
Using technology to prevent pollution
Combined sewer overflows ('CSOs') are susceptible to pollution if they block or stop working properly. So over the last year we've invested in monitors at over 70% of our CSOs. We're also installing over 1,000 monitors in manholes where there's a high risk of internal flooding or pollution.

CASE STUDY
40% of employees volunteer to clear 50km of rivers
Our volunteering scheme continues to go from strength to strength. During the year, over 40% of our people worked with partners such as local Wildlife Trusts to help clean up the environment alongside 40km of rivers in England and a further 10km in Wales.

Our physical assets

Ensuring a resilient and well-maintained network

Our physical assets include over 49,000 km of water mains, 27 dams, 139 water treatment works and a vast range of equipment, sites, offices and other structures across an estate that covers more than 53,000 acres. While a significant number of these assets are over 100 years old and of historic importance, many are among the most technologically advanced examples of their type in the water industry – not only in the UK but worldwide.

We're committed to ensuring that our assets are in optimum condition at all times, able to deliver the high quality services that our customers depend on. At dams and reservoirs, for example, we carry out regular checks to identify any remedial actions that need to be undertaken – and every year, the Board receives a full report on the condition of each dam and reservoir in our portfolio.

Security is an increasingly important issue for all key UK infrastructure. Mindful of our role and responsibilities, we co-operate closely with the Government on potential terrorist targets and provide physical security at all major sites. At the same time, our cyber security team constantly monitors our IT assets, identifying and addressing any vulnerabilities in order to protect our data and that of our customers.

Improving our portfolio to improve efficiency...

Since privatisation, the water industry has invested some £130 billion in assets to improve services for customers, with our own capital programme involving an investment of around £3 billion over the five years to March 2020.

The major projects currently underway include the £300 million Birmingham Resilience Project – the largest ongoing capital project in the industry – and a £60 million scheme to improve sewers and water mains at Newark in Nottinghamshire. We also have a continuous investment programme to improve the effectiveness of our sewage treatment works, including a £12.5 million project to remove phosphorus.

...and reduce interruptions and leakage

While our capital programme is delivering rewards in many areas of the business, we recognise that our customers experienced too many supply interruptions during the year. Some of these caused major hardships, notably at Tewkesbury in December 2017, when we took too long to locate, isolate and rectify a burst main, and in March 2018 when the countrywide freeze and subsequent thaw contributed to some customers being left without water or with only intermittent water supplies for extended periods of time.

We're working hard to improve our performance, including investing in robot leakage detector technology which we believe would have been invaluable at bursts such as the one at Tewkesbury.

The time we take to respond when customers tell us about a leak is another area where we need to improve. However, this is not as clear cut as it appears. Our performance commitment target is to respond within 24 hours, but, this may not be the most operationally effective way to provide a good service to customers or manage our network efficiently. We're currently evaluating our response capabilities in order to assure ourselves and our customers that our current approach is appropriate.

Our people

Creating a place where people enjoy coming to work – where they're safe, well rewarded and treated with respect

The Group employs around 6,000 people at locations primarily across the East and West Midlands as well as in North and mid-Wales. We know that we're only as good as our people. So we strive to create a workplace that's welcoming, safe and well-rewarded – and where they're treated with respect. This year's employee survey showed a six percentage points increase in engagement, clearly demonstrating that we're on the right path to making the Group an awesome place to work.

Health, safety and wellbeing

The health and safety of our people is a core aspect of how we work, and we ensure that they're provided with the training and resources to follow our safety rules. Our Lost Time Injury ('LTI') frequency rate for the year was 0.17 per 100,000 hours worked, a significant decrease of 23% over the previous year. Our rigorous approach to safety has led to this improvement over the last three years, from 0.21 in 2015. However, there's no room for complacency and we'll continue to promote safe working practices through initiatives including training and regular communications.

We also made good progress in ensuring our people's wellbeing during the year. We continued our mental health programme and now have over 400 trained mental health first aiders across the Group. This is part of our drive to promote greater awareness of some of the more challenging issues that people can face in their everyday lives – for the year ahead we're continuing to focus on the menopause and cancer.

Pay and career paths

We aim to provide people with careers, not just jobs. Pay scales are relatively high for our Midlands heartlands, and we work hard to make sure that our people can see how and where they can progress up through our organisation – regardless of their starting point.

Attracting high quality people is a challenge for all employers, so we're pleased to see the high numbers of graduates that apply to Severn Trent. Our apprentice programme expanded yet again during the year and for the first time included a Masters level option.
Over the next 12 months we're going to respond to issues raised in the employee survey, including greater clarification on pay rates and extra focus on how we explain career opportunities.

Diversity and inclusion

We're already a diverse, inclusive business – but we know there are opportunities to do even more to reflect the demographics of our region.

The year saw a 13% increase in the numbers of Black, Asian and Minority Ethnic ('BAME') employees on our graduate programmes, and we've introduced new ways of working designed to drive a further increase in future years. These include removing barriers to entry such as the requirement to have a degree for some of our programmes and improving the way we target recruitment activities at schools.

Gender diversity is another area where we're performing well. Our mean gender pay gap for the year was 2.4% – and we're committed to reducing it still further. Our executive team has particularly high female representation, which is why we were placed second among FTSE 100 companies by the 2017 Hampton-Alexander Review.

CASE STUDY
Signing up to help those with a terminal illness
We were proud to sign up to the TUC's Dying to Work charter during the year, which aims to protect employees with a terminal illness. We believe that nobody should have to worry about keeping their job if they have a terminal diagnosis.

CASE STUDY
Raising awareness of mental health
Since 2015, 19% of our employees have taken part in mental health awareness training. We're going to continue to focus on this issue during the year ahead - while also expanding our efforts to embrace other aspects of wellbeing such as physical health, nutrition, exercise and sleep.

Our suppliers and partners

Building strong relationships that provide mutual benefit

We rely on a pool of suppliers that use their expertise and resources to maintain and improve our infrastructure. Through the One Supply Chain programme, we agree long term contracts that give suppliers greater certainty of workflow and revenue, while the benefit to Severn Trent lies in the opportunity to negotiate more competitive prices. The long term nature of the contracts also enables both parties to build stronger relationships, work more closely together and explore more efficient ways of working.

In addition to achieving operational excellence and meeting our efficiency targets, our contracts also stipulate that suppliers must adhere to our own high safety standards and sign up to our policy on bribery and corruption and our sustainable supply chain charter. We ensure compliance with these requirements through a comprehensive audit during the tendering process, and through regular communications and meetings. For example, a number of our suppliers have signed up to corporate responsibility targets agreed with us, and we review progress against these monthly. Through our supplier events, we have set out our plans and expectations, and have invited delegates to contribute their own ideas on how we could work better together. We also took the opportunity to underline the role that safety and ethics play in creating enduring supplier relationships.

Partnering with others

We're keen to work with partner organisations from both inside and outside our industry, combining their specialist knowledge with our own in order to address some of the challenges and opportunities we face.

For example, during the year we extended our drive to support vulnerable customers – and have now formed deeper relationships with bodies including MIND, Samaritans, Citizens Advice, local food banks, the NHS and other utility firms. By sharing our knowledge, we aim to build a holistic view of people who are potentially vulnerable and to put measures in place to help them at an earlier stage.

We've continued to collaborate with our peers in the industry. We engaged with Thames Water to evaluate a project to build a super interconnector that would enable water trading, and with the Social Market Foundation to publish a report into the possible financial implications of renationalisation. In partnership with Thames Water and United Utilities, we also published our joint ideas on how the creation of a systems operator could support greater efficiency.

Suppliers signed up to sustainable supply chain charter

211

Introduced in May 2017

Suppliers paid on time

96%

2017: 97%

Our customers and communities

Improving the customer experience

We're responsible for meeting the needs of 4.3 million household and business customers, across an area stretching from the Bristol Channel to the Humber, and from North and mid-Wales to the East Midlands. We provide these customers with around 1.6 billion litres of high quality drinking water every day and treat around 2.77 billion litres of waste water, which we clean and return to the system.

Everything we do is to the benefit of our customers and their communities – and during the year we carried out our most extensive research project ever, to make sure that we're addressing the issues that matter most to them.

Making a difference
Communication is the key to managing expectations, and we work hard to keep customers and communities informed and to minimise disruption when we carry out planned work on our network. Through our education programme, we help people save water and prevent blockages in our sewers and drains, supporting the long term integrity of the network and protecting water supplies for future generations.

The scale of our operations and the nature of our assets means we have a great opportunity to be a positive influence on the environment in local communities. We're continuing to implement initiatives – and working with local businesses, including farmers – to improve important habitats such as rivers, for the ultimate enjoyment of all. Our 17 visitor sites host a total of 4 million visits a year, and provide access to water for a range of leisure facilities, as well as customer education facilities.

Many of our people continued to play their part in the lives of their local communities during 2017/18. In fact more of our people than ever before took the chance to join in some form of volunteering or fundraising activity.

Regulators

Working with the authorities to shape our industry

We maintain positive and constructive relationships with Ofwat and other regulatory bodies. Complying with their requirements at all times isn't just the right thing to do – it's essential to our licence to operate and our ability to meet our commitments to our customers and other stakeholders.

We engage with regulators on a regular basis in order to share our knowledge and promote developments which could lead to improved services for customers across the industry.

Customers who rate our service value for money in an independent quarterly survey

59%
2017: 58%

Customers we help each year through social tariffs and assistance schemes

51,716
2017: 50,903

Chief Financial Officer's Review

We have delivered a good financial performance in 2017/18, absorbing the upward pressures from sector-wide changes in business rates and energy pass-through costs. A full year's contribution from Dee Valley Water and higher revenues more than offset the impact of these pressures on our operating costs.

Our Return on Regulated Equity (RoRE) at 11.5% is 1.5 percentage points higher than the previous year, driven by a strong performance across all three levers – totex, customer ODIs and financing. Last year our RoRE was amongst the best in the sector and we expect to be in a similar position when this year's results for all companies are published in July.

On financing, we have a strong funding position, with all our projected investment and cash needs covered by cash or committed facilities through to March 2020. This year saw the first rate increase from the Bank of England in more than 10 years. We actively monitor and manage our interest rate expense and took steps to hold our proportion of debt at floating rates at 27% through the year end. We are also preparing for the introduction of CPIH indexation in AMP7, entering into CPI/RPI swaps with a notional value of £100 million in the second half of the year, which increased the total amount of these swaps to £150 million at 31 March 2018. And we have entered into a further swap for £100 million since the year end.

We are committed to paying the right amount of tax at the right time. In addition to the corporation tax that is shown in our tax charge in the income statement we also pay business rates, employers' national insurance and environmental taxes such as the Climate Change Levy and the Carbon Reduction Commitment. In 2017/18 we incurred £145.6 million of these taxes (2016/17: £147.1 million). Our corporation tax charge for the year was in line with the statutory rate of 19% with our cash tax payments reduced by the benefit of allowances on our capital programme, contributions to our pension schemes and by the timing of instalment payments to HMRC under the current rules.

A brief overview of our financial performance for the year is as follows:

- Group turnover from continuing operations was £1,606.9 million (2016/17: £1,556.1 million), an increase of 3.3% mainly due to RPI-linked tariff increases and a full year of Dee Valley Water.

- We increased underlying PBIT by 4.9% to £537.7 million (2016/17: £512.8 million). The first full year of Dee Valley Water contributed an additional £5.7 million and there was growth of £19.2 million in Severn Trent Water.

- We recorded net exceptional costs of £12.6 million (2016/17: credit of £27.6 million). Costs to prepare our Bioresources business for the introduction of the competitive market in 2020 were £20.9 million, partially offset by a credit from a Pension Exchange Arrangement.

- Net finance costs were £215.9 million (2016/17: £199.6 million). Our effective interest rate of 4.4% was up only marginally from 2017 (4.3%) despite the impact of higher RPI on our index linked debt.

Turnover and underlying PBIT

Turnover for our Severn Trent Water Group was £1,606.9 million (2016/17: £1,556.1 million) and underlying PBIT was £537.7 million (2016/17: £512.8 million).

	2018			2017			Better/(worse)	
	Excluding Dee Valley £m	**Dee Valley £m**	**Total £m**	Excluding Dee Valley £m	Dee Valley £m	Total £m	Excluding Dee Valley £m	%
Turnover	**1,579.0**	27.9	**1,606.9**	1,553.9	2.2	1,556.1	25.1	1.6
Net labour costs	**(142.0)**	(5.4)	**(147.4)**	(145.3)	(1.0)	(146.3)	3.3	2.3
Net hired and contracted costs	**(162.7)**	(1.9)	**(164.6)**	(161.3)	–	(161.3)	(1.4)	(0.9)
Power	**(76.9)**	(2.3)	**(79.2)**	(70.4)	(0.1)	(70.5)	(6.5)	(9.2)
Bad debts	**(25.1)**	(0.6)	**(25.7)**	(20.4)	(0.2)	(20.6)	(4.7)	(23.0)
Other costs	**(188.5)**	(4.8)	**(193.3)**	(187.7)	(0.6)	(188.3)	(0.8)	(0.4)
	(595.2)	(15.0)	**(610.2)**	(585.1)	(1.9)	(587.0)	(10.1)	(1.7)
Infrastructure renewals expenditure	**(134.4)**	(0.8)	**(135.2)**	(136.2)	–	(136.2)	1.8	1.3
Depreciation	**(317.6)**	(6.2)	**(323.8)**	(320.0)	(0.1)	(320.1)	2.4	0.8
Underlying PBIT	**531.8**	5.9	**537.7**	512.6	0.2	512.8	19.2	(3.7)

Dee Valley Water was acquired on 15 February 2017 so this is its first full year in the group. It contributed £27.9 million to turnover and £5.9 million to underlying PBIT in the year. The following commentary on Severn Trent Water excludes Dee Valley Water and is therefore on a like-for-like basis.

Turnover increased by 1.6% as higher tariffs, including the impact of the annual RPI increase on prices, increased revenue by £33.8 million. Customer ODI rewards earned in 2015/16 increased turnover by £25.8 million but this was offset by a reduction from the Wholesale Revenue Forecasting Incentive Mechanism of £24.5 million arising from revenue billed in excess of the wholesale price control also in 2015/16. Our successful drive to help more vulnerable customers reduced revenue by £4.6 million due to greater take-up of social tariffs. Other movements of £11.8 million (net) include the impact of customers opting for metered status offset by consumption increases. In the current year our billed revenue was around £3 million below the wholesale price control and this will be added to our revenue to be billed in 2019/20. Renewable energy sales increased by £6.4 million.

Net labour costs were £3.3 million (2.3%) lower. Gross employee costs increased by 5.4%, due to the annual pay award and as a result of our strategy to bring more work in-house. The increase in activity on capital projects resulted in an increase in the level of own labour capitalised, up £16.7 million on the previous year.

Net hired and contracted costs were up £1.4 million (0.9%).

Power costs were £6.5 million higher year on year driven as forecasted by higher pass through costs; greater consumption from higher volume of water produced and the costs of responding to incidents. The group manages its power costs through a combination of demand management, self-generation and forward price contracts.

The bad debt charge from household customers increased by £4.7 million this year, to 2.2% of household revenue (up from 1.8% last year on the same basis). In the year we improved cash collections on our current debt, but saw a decline in the amounts collected on debt 2-3 years old – in both accounts collected by us and by other water companies on our behalf. The prudent provisioning we apply to this older debt increased both our charge and the level of bad debt as a percentage of household revenue for the year.

Other costs increased by £0.8 million in total after higher profits on disposal of fixed assets (up £5.4 million) offset by higher business rates.

Infrastructure maintenance expenditure was £1.8 million lower in the year. We expect to see growth in the programme next year.

Depreciation of £317.6 million was £2.4 million lower than the prior year. Our underlying depreciation rate increased in line with our asset base, but the change was lower year on year due to impairments recorded in 2016/17.

Return on Regulatory Equity (‘RoRE’)

RoRE is a key performance indicator for the regulated business and reflects our combined performance on totex, customer ODIs and financing against the base return allowed in the Final Determination.

Severn Trent Water’s RoRE for the year ended 31 March 2018 and for the three years ended on that date is set out in the following table:

	2017/18	AMP6 to Date
Base return	5.6%	5.6%
Totex outperformance	0.8%	1.3%
ODI outperformance	2.3%	1.5%
Financing outperformance	2.8%	0.9%
RoRE[1]	**11.5%**	**9.3%**

1 Calculated in accordance with Ofwat guidance set out in RAG 4.07

We have delivered strong returns across the board – with outstanding Customer ODI performance, improved operational and investment efficiency driving totex savings, and continuing outperformance on finance.

Exceptional items before tax

We recorded a net exceptional charge of £12.6 million (2016/17: credit of £27.6 million).

We have made an early start in preparing our Bioresources business for AMP7. We have developed our business model and identified the actions that we need to take to compete effectively in the new market, determining the lowest cost structure from our existing network of sites, optimising our tanker fleet operations and identifying opportunities for trading in the new market. We have implemented a programme to reorganise the business to deliver our business model, reducing from 20 sites to 12, and as a result incurred exceptional costs of £20.9 million as follows:

- Set up and restructuring costs of £2.1 million;
- Write-off of assets that will not be used in the new business £16.8 million; and
- Provision for costs to decommission these assets £2.0 million.

An exceptional gain of £8.3 million (2016/17: gain of £16.6 million) arose from the net benefit, after implementation costs, of a Pension Increase Exchange arrangement, under which members of the defined benefit schemes will be offered the opportunity at retirement to exchange future non-statutory inflationary increases in a portion of their pensions earned prior to 1997 for a higher pension payment now. In the prior year the exceptional gain arose from a similar exercise for existing pensioners.

In 2016/17, the group recorded an exceptional profit on disposal of fixed assets of £11.0 million to other companies within the Severn Trent Plc group.

Net finance costs

Our net finance costs for the year were £215.9 million, up £16.3 million on the prior year. Our effective cash cost of interest (excluding the RPI uplift on index linked debt and pensions-related charges) was 3.4%, 30 basis points lower than 2016/17. Higher RPI inflation on our index-linked debt (up £22.5 million) and pensions-related charges meant our overall effective interest rate increased marginally year-on-year to 4.4% (2016/17: 4.3%), but still compares favourably to our position at the start of AMP6 (5.4%).

Capitalised finance costs were higher than the prior year due to the increased level of capital activity in the year.

Our earnings before interest, tax, depreciation and amortisation (EBITDA) interest cover was times 4.3 (2016/17: 4.4 times) and PBIT interest cover was 2.7 times (2016/17: 2.7 times). See note 43 for further details.

Gains/losses on financial instruments

We use financial derivatives solely to hedge risks associated with our normal business activities including:

- Exchange rate exposure on foreign currency borrowings;
- Interest rate exposures on floating rate borrowings; and
- Exposures to increases in electricity prices.

Accounting rules require that these derivatives are revalued at each balance sheet date and, unless the strict criteria for cash flow hedge accounting are met, the changes in value are taken to the income statement. If the risk that is being hedged does not impact the income statement in the same period as the change in value of the derivative, then an accounting mismatch arises and there is a net charge or credit to the income statement.

During the period a counterparty requested to terminate four interest rate swaps with a notional principal of £150 million. The fair value of the swaps at termination was a £42.6 million liability and the termination payment was £40.0 million. The gain on termination has been included in finance income.

We hold interest rate swaps with a net notional principal of £251.3 million, fixed to floating, and cross currency swaps with a sterling principal of £98.3 million, which economically act to hedge exchange rate risk on certain foreign currency borrowings. However, the swaps do not meet the hedge accounting rules of IAS 39 and so the changes in fair value are taken to gains/(losses) on financial instruments in the income statement. During the year there was a loss of £12.6 million (2016/17: gain of £11.2 million) in relation to these instruments.

Note 12 to the financial statements gives an analysis of the amounts charged to the income statement in relation to financial instruments.

As part of our power cost management strategy, we have fixed around 95% of our estimated wholesale energy usage for 2018/19.

Taxation

The total tax charge from continuing operations for the year was £59.6 million (2016/17: £9.4 million).

Note 13 in the financial statements sets out the tax charges and credits in the period, which are described in more detail below.

The current tax charge from continuing operations for the year was £32.5 million (2016/17: £41.2 million before exceptional tax) and the deferred tax charge was £27.1 million (2016/17: £20.2 million before exceptional tax). There was an exceptional credit of £52.0 million in 2016/17 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.

In common with other utilities, we have a significant deferred tax provision that mainly relates to the benefits received in the past from tax allowances on capital expenditure before the depreciation on those assets was charged to our profits. This provision does not represent a liability for tax payable but is released to the income statement as the depreciation catches up with the tax allowances received. The provision is calculated at the rate of tax applicable when the provision is expected to reverse.

Severn Trent Water Limited
Strategic Report (continued)
For the year ended 31 March 2018

Group cash flow	2018 £m	2017 £m
Cash generated from operations	**788.0**	851.9
Net capital expenditure	**(582.8)**	(441.1)
Purchase of subsidiaries	**(0.2)**	(77.7)
Net interest paid	**(177.4)**	(175.5)
Tax paid	**(14.9)**	(37.9)
Swap termination payment	**(40.0)**	-
Free cash flow	**(27.3)**	119.7
Dividends	**(204.0)**	(195.5)
Change in net debt from cash flows	**(231.3)**	(75.8)
Non-cash movements	**(57.0)**	(137.9)
Change in net debt	**(288.3)**	(213.7)
Net debt 1 April	**(5,027.2)**	(4,813.5)
Net debt at 31 March	**(5,315.5)**	(5,027.2)

	2018 £m	2017 £m
Cash and cash equivalents	**12.1**	0.2
Bank overdraft	**(8.4)**	(3.6)
Net cash and cash equivalents	**3.7**	(3.4)
Loans payable to parent company	**(9.3)**	(6.4)
Bank loans	**(1,182.1)**	(1,036.9)
Other loans	**(4,138.2)**	(4,007.8)
Finance leases	**(113.9)**	(115.7)
Cross currency swaps	**24.5**	43.4
Loans due from related parties	**99.8**	99.6
Net debt	**(5,315.5)**	(5,027.2)

At 31 March 2018 we held £3.7 million in cash and cash equivalents (2017: net overdraft of £3.4 million). Average debt maturity was around 14 years (2017: 15 years). Including committed facilities, our cash flow requirements are funded until March 2020.

Net debt at 31 March 2018 was £5,315.5 million (2017: £5,027.2 million) and balance sheet gearing (net debt/net debt plus equity) was 69.5% (2017: 69.1%). Regulated net debt, expressed as a percentage of estimated Regulatory Capital Value at 31 March 2018 was 60.8% (2017: 60.7%).

The estimated fair value of debt at 31 March 2018 was £1,177.8 million higher than book value (2017: £1,433.6 million higher). The decrease in the difference to book value is largely due to the increase in discount rates applied, driven by higher prevailing market interest rates.

Treasury management and liquidity

Our principal treasury management objectives are:

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

We invest cash in deposits with highly rated banks and liquidity funds. We regularly review the list of counterparties and report to the Treasury Committee.

Our policy for the management of interest rates is that at least 40% of our borrowings in AMP6 should be at fixed interest rates, or hedged through the use of interest rate swaps or forward rate agreements. At 31 March 2018, interest rates for 48% (2017: 52%) of our net debt of £5,315.5 million were fixed.

Our long term credit ratings are:

Agency	Rating	Outlook
Moody's	A3	Negative
Standard and Poor's	BBB+	Stable

Pensions

We have three defined benefit pensions arrangements, two from Severn Trent and one from Dee Valley Water. The Severn Trent schemes closed to future accrual on 31 March 2015.

Formal three-yearly actuarial valuations have been completed as at 31 March 2016 for the Severn Trent schemes ('the Schemes') and we have agreed the future funding plan for the Schemes with the Trustee. The agreement reached with the Trustee for the STPS, which is by far the largest of the schemes, includes:

- Deficit reduction contributions of £25 million were paid in the year ended 31 March 2017 and payments of £10 million for each of the subsequent financial years ending 31 March 2019.
- Inflation-linked payments of £15 million per annum through an asset-backed funding arrangement, potentially continuing to 31 March 2031, although these contributions will cease earlier should a subsequent valuation of the STPS show that these contributions are no longer needed.
- Payments under another asset-backed funding arrangement which provides £8.2 million per annum to 31 March 2032.
- In addition to these payments, the company will directly pay the annual PPF levy incurred by the STPS (£1.1 million in 2017/18).

The Schemes have entered into additional hedging arrangements to reduce the impact of fluctuations in interest rates and inflation on the Schemes' liabilities without adversely impacting the expected return from the Schemes' assets.

Dee Valley Water participates in the Dee Valley Water Limited Section of the Water Companies Pension Scheme (“the Section”). The Section funds are administered by trustees and are held separately from the assets of the group.

On an IAS 19 basis, the net position (before deferred tax) of all of the group's defined benefit pension schemes was a deficit of £511.1 million (2017: £574.6 million). To calculate the pension deficit for accounting purposes, we are required to use corporate bond yields as the basis for the discount rate of our long-term liabilities, irrespective of the nature of the scheme’s assets or their expected returns.

The movements in the net deficit during the period were:

	Fair value of plan assets	Defined benefit obligations	Net deficit
	£m	£m	£m
At start of the period	2,352.8	(2,927.4)	(574.6)
Amounts charged to income statement	60.2	(69.4)	(9.2)
Actuarial gains/(losses) taken to reserves	(0.6)	39.5	38.9
Cash received/paid by the schemes	(72.6)	106.4	33.8
At end of the period	2,339.8	(2,850.9)	(511.1)

On an IAS 19 basis, the funding level was 82.0% (2017: 80.4%).

Accounting policies and presentation of the financial statements

Our consolidated financial statements are prepared in accordance with International Financial Reporting Standards that have been endorsed by the European Union. The Company financial statements are prepared in accordance with FRS 101.

Risk management

Our approach to risk:
Risk is all about uncertainty and risk management describes the activities performed within our organisation to identify, assess, and control events which may impact on our ability to achieve our aims and objectives. We also recognise that uncertainty can manifest itself as both negative and positive impacts, hence our goal is to minimise these threats and maximise the opportunities for the benefit of our customers, people, contractors and key stakeholders.

The Board has overall accountability for ensuring that risk is effectively managed across the Group. The Board's mandate includes defining risk appetite and monitoring risk exposure to ensure significant risks are aligned with the overall strategy of the Group. The management of risk is embedded in our everyday business activities, with employees encouraged to play their part.

On behalf of the Board, the Audit Committee assesses the effectiveness of the Group's Enterprise Risk Management ('ERM') process and internal controls to identify, assess, mitigate and manage risk. Internal Audit supports the Audit Committee in evaluating the design and effectiveness of internal controls and risk mitigation strategies implemented by management.

The Executive Committee reviews strategic objectives and assesses the level of risk taken in achieving these objectives. This 'top down' risk process helps to ensure the 'bottom up' ERM process is aligned to current strategy and objectives.

Across the Group, we manage risks within the overall governance framework which includes clear accountabilities, delegated authority limits and reward policies. These are designed to provide employees with a holistic view of effective risk management.

Within Severn Trent Water Limited, our approach reflects our status as a regulated utility providing essential services and operating as part of the Critical National Infrastructure for the UK. The nature of our Severn Trent Water Limited business is such that there are some significant inherent risks, as illustrated on pages 55 to 60. We aim to have a strong control framework in place to enable us to understand and manage these risks in accordance with our risk tolerance and appetite.

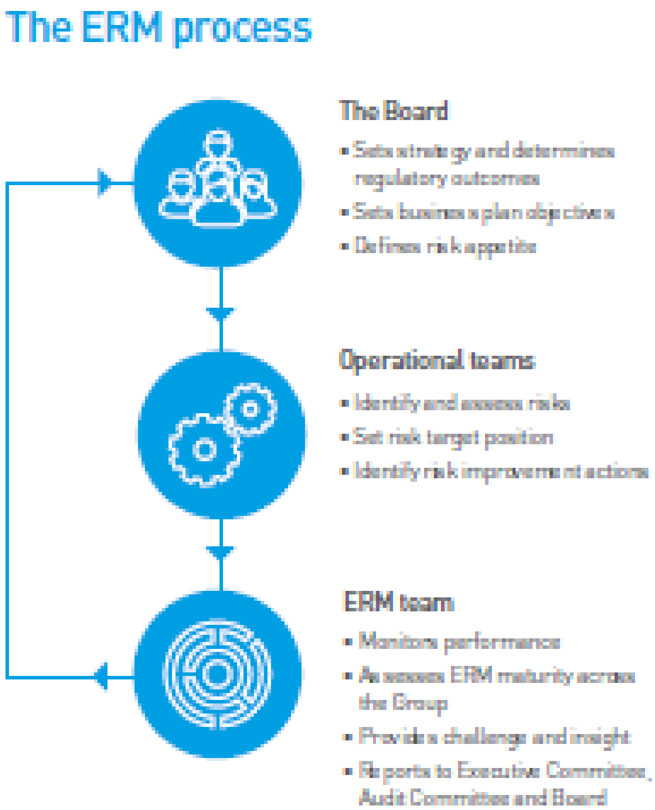
Our Enterprise Risk Management process
We use an established ERM process across the Group to assess and manage our significant risks, which are linked to our corporate objectives, core processes, key dependencies, stakeholder expectations and legal and regulatory obligations. The process is controlled by the central ERM team and underpinned by standardised tools and methodology to ensure consistency. ERM Champions and Co-ordinators operate throughout the business, with support and challenge from the ERM team, to identify and assess risks in their business units quarterly against a defined set of criteria that consider the likelihood of occurrence and potential financial and reputational impacts. The potential causes and subsequent impact of the risks are documented to enable mitigating controls to be assessed. This assessment allows us to put in place effective strategies to remediate defective controls or implement additional controls.

This information is combined to form a consolidated view of risk across the Group and allows the risks to be prioritised. Our significant risks, in terms of likelihood and impact, form our Group risk profile which is reported to the Executive Committee for review and challenge ahead of final review and approval by the Audit Committee and Board half-yearly. The report provides an assessment of the effectiveness of controls over each of those risks and an action plan to improve controls where this has been deemed necessary.

To further enhance our ERM information, we now report 'risk flightpaths'. These graphically demonstrate the level of risk the Group faces and the timeline for the key risk mitigation steps to manage the risk to the target position. The flightpaths help to facilitate a more thorough review of the target risk positions, considering risk appetite and whether improvement actions to achieve these are on target with the correct prioritisation in place.

In addition, individual risks or specific risk topics are also discussed by the Board during the year.

On a monthly basis, the status of open risk mitigation actions across the Group risk profile is reported into the Executive Committee by the central ERM team. The level of ERM maturity in each business unit is assessed half-yearly and reported to the Executive Committee. Improvement plans are agreed to ensure ERM is fully embedded and effective. An overview of accountability for our ERM process is illustrated in the diagram below.



Risk appetite
The Board keeps under ongoing review the relationship between our strategic ambitions and the management of risk.

The ERM process establishes target risk positions for each of our significant risks. The Board formally discusses the progress towards this position and the mitigating actions being undertaken every six months.

Financial risks
Like all businesses, we need to plan future funding in line with business need. This is part of our normal business planning process (see Principal Risk 2).

The Board receives regular updates relating to funding, solvency and liquidity matters through the Treasury Committee so we can respond quickly to any changes in our ability to secure financing (see Principal Risk 10). The pension fund Trustees and Company regularly monitor our pension deficit, with advice from investment managers and actuarial advisers. An annual pension fund review paper is produced for the Board to apprise them of fund performance and proposed initiatives to manage down pension liabilities and further balance pensions risk (see Principal Risk 9).

The ERM process and relevant risk assessments are factored into the 'stress testing' to assess the Group's prospects as part of our Long-Term Viability Statement.

Sustainability Risks
Sustainability risks are treated in the same way as all our other Company risks, captured at a local level by responsible teams and managed centrally through our established ERM process. By the nature of what we do, several of our principal risks have a Sustainability focus, and we monitor our social and environmental impacts in line with our broader performance.

Long-Term Viability Statement

Assessment of current position and long-term prospects

The directors' assessment of the Group's current financial position is set out in the Financial review on pages 41 to 48.

The Group's principal operating subsidiary is Severn Trent Water Limited, which is a regulated long-term business characterised by multi-year investment programmes and stable revenues. The water industry in England and Wales is currently subject to economic regulation rather than market competition and Ofwat, the economic regulator, has a statutory obligation to secure that water companies are able to finance their appointed activities. Ofwat meets this obligation by setting price controls for five year Asset Management Periods (AMPs). This mechanism reduces the potential for variability in revenues from the regulated business. The current AMP runs until March 2020. Ofwat has published its Final Methodology for assessing companies' business plans and setting price controls for the AMP period 2020 – 2025 and Severn Trent Water Limited has made significant progress in developing its business plan, which is due to be submitted to Ofwat in September 2018.

The Group has significant investment programmes that are largely funded through access to debt markets. The Group's strategic funding objectives reflect the long term nature of the Severn Trent Water Limited business and the Group seeks to obtain a balance of long term funding at the best possible economic cost. The Group's Treasury Policy requires that it maintains sufficient liquidity to cover cash flow requirements for a rolling period of 18 months in order to mitigate the risk of restricted access to capital markets. The Group's debt maturity profile is actively managed by the Group Treasury department to spread the timing of refinancing requirements and to enable such requirements to be met under most market conditions. The weighted average maturity of debt at the balance sheet date was 14 years.

The Group has an established process to assess its prospects. The Board undertakes a detailed assessment of the Group's strategy on an annual basis and the output from this assessment sets the framework for the Group's medium term plan, which is updated annually.

The plan assesses the Group's prospects and considers the potential impacts of the principal risks and uncertainties. Stress tests are performed to assess the potential impacts of combinations of those risks and uncertainties. The plan also considers the mitigating actions that might be taken to reduce the impact of such risks and uncertainties and the likely effectiveness of the mitigating actions.

Period of assessment

The directors considered a number of factors in determining the period to be covered by the assessment. The long-term nature of the Group's principal business together with relatively stable revenues and a model of economic regulation that places a duty on the regulator to secure that water companies can finance the proper carrying out of their functions support a longer period of assessment.

However, the changing nature of regulation of the water industry increases the uncertainty that is inherent in the Group's financial projections. The Group has an established planning and forecasting process and the directors consider that the assessment of the Group's prospects is more reliable if it is based on an established process. The Group's latest medium term plan extends to the end of the next AMP period in 2025 and the Board of Severn Trent Water Limited will make an assessment of viability covering that period in its business plan submission to Ofwat in September 2018.

A longer period of assessment introduces greater uncertainty as the variability of potential outcomes increases as the period considered extends.

Bearing in mind the long term nature of the Group's business; the enduring demand for its services; the nature of the Group's established planning process and the changing nature of the regulation of the water industry in England and Wales, the directors have determined that seven years is an appropriate period over which to assess the Group's prospects and make its viability statement this year.

Assessment of viability

In assessing the future prospects the Group has considered the potential effect of risks that could have a significant financial impact under severe but plausible scenarios. The risks considered were identified from the Group's ERM process, which is described on pages 49 to 51, and from the key assumptions in the financial model. The scenarios tested are described below.

Scenario tested	Related principal risk
1. *An increase in the funding deficit of the Group's defined benefit pension schemes* The planned funding for the Group's defined benefit pension arrangements is based on assumptions on future inflation, asset returns and members' longevity. Underperformance against these assumptions might result in additional cash contributions being required during the period under consideration. Contributions are reviewed and agreed with the scheme trustees on a triennial basis with the next valuation of the main scheme due as at 31 March 2019.	Risk 9: Increased funding for pension schemes
2. *A severe climate event, operational failure or other exceptional event with a very significant financial impact* The Group's Enterprise Risk Management process has identified a number of risks including cyber security, failure of key assets and severe weather events that might have a significant impact on the Group's operational and financial performance.	Risk 4: Cyber security Risk 6: Failure of key assets Risk 7: Health and safety and environmental impact Risk 8: Impact of extreme weather/climate change
3. *A reduction in inflation and increase in interest rates for the duration of the period under consideration* Severn Trent Water Limited's revenues are linked to inflation. Low or negative inflation tends to adversely impact profits and cash flows if increases in costs exceed revenue.	N/A – key assumption in financial model

4. *Underperformance against performance commitments* Severn Trent Water operates under a regulatory model which encourages companies to deliver what customers want using performance related rewards and penalties. Failure to deliver performance at the committed level can lead to significant penalties.	Risk 1: Failure to deliver what our customers want
5. *Higher costs than planned that are not funded* Significant overspending could result in a deterioration in financial metrics and performance, which might adversely impact the Group's solvency.	Risk 2: changes in the regulatory environment for the UK water industry
6. *A combination of scenarios 2,3 and 4* It is unlikely that scenarios 1 and 3 would occur simultaneously since lower inflation and higher interest rates would tend to reduce the pension deficit. Therefore scenario 3, which has a great individual impact has been included.	See above

The directors have identified actions, including reducing discretionary outflows of funds and working with providers of finance, that would be available to the Group to mitigate the impact of adverse outcomes.

The Group has significant funding requirements to refinance existing debt that falls due for repayment during the period under review and to fund the Group's capital programme. Under all scenarios considered the Group would remain solvent and have access to sufficient funds in normal market conditions. The Group's Treasury Policy requires that it retains sufficient liquidity to meet its forecast obligations, including debt repayments for the next 18 months. In making its assessment the Board has made the following key assumption:

- Any period in which the Group is unable to access capital markets to raise finance during the period under review will be shorter than 18 months.

On this basis, the stress tests indicated that none of these scenarios, including the combined scenario, resulted in an impact to the Group's expected liquidity, solvency or credit metrics that could not be addressed by mitigating action and hence were not considered to be threats to the Group's viability.

Governance and assurance

The Board reviews and approves the medium term plan on which this viability statement is based. The Board also considers the period over which the assessment of prospects and viability statement should be made. The Audit Committee of Severn Trent Plc supports the Board in performing this review. Details of the Audit Committee's activity in relation to the Viability Statement are set out in the Audit Committee report on pages 83 to 89 of the Severn Trent Plc Annual Report.

This statement is subject to review by Deloitte, our external auditor. Their audit report is set out on pages 95 to 103.

Assessment of viability

The directors have assessed the viability of the Company over a seven year period to March 2023, taking into account the Company's current position and principal risks.

Based on that assessment, the directors have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the period to 31 March 2025.

Going Concern Statement
In preparing the financial statements the Directors considered the Company's ability to meet its debts as they fall due for a period of one year from the date of this report. This was carried out in conjunction with the consideration of the Viability Statement above.

On this basis the Directors considered it appropriate to adopt the going concern basis in preparing the financial statements.

Principal risks

The directors have carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity. These have been categorised across:

- **Customer perception;**
- **Legal and regulatory environment;**
- **Operations, assets and people; and**
- **Financial risks.**

For each risk we state what it means for us and what we are doing to manage it.

Customer perception

1

What is the risk?

We may be unable to improve or maintain our levels of customer service sufficiently to deliver what our customers tell us they want.

Link to how we're achieving our strategy

Embedding customers at the heart of all we do

Link to our values

We put our customers first

We are passionate about what we do

We act with integrity

ODIs

ODIs 24-27

What does it mean for us?

We are a regulated utility providing essential services to our customers. We recognise that our customers increasingly expect more from us and demand an improved and more consistent experience. As other industries improve their levels of service, the bar continues to be raised.

Failure to deliver the service that customers expect will lead to customer dissatisfaction. This may result in financial penalties under Ofwat's Service Incentive Mechanism ('SIM') and associated ODI outturn.

What are we doing to manage the risk?

The three upper quartile ('UQ') programmes in Retail, Water and Waste are key to SIM improvement. Whilst Retail has a number of transformation actions in flight there are further actions to be delivered which will improve customer experience, for example website transformation. Customers tell us they are delighted when we are able to complete billing issues for them at Point of Contact so the retail programme is looking at how to improve our Point of Contact resolution to improve the overall experience.

The Waste UQ programme is focusing on both the work of our supply partner Amey in our day-to-day customer offering and also how Severn Trent supports them in complex cases. The Waste UQ programme has identified some key areas to drive and improve performance in order to improve our SIM score.

The Water UQ programme is at an early stage. The rapid action team pilot that is currently ongoing in our Derbyshire area is showing fantastic customer benefit. The programme is currently developing a rollout plan to all other areas. The E2E customer communications workstream is looking at the expectation that we set when a customer contacts us through their channel of choice and how we keep the customer informed along the journey. An element of this workstream is a review of our Track my Job customer communication tool that we use to keep customers informed.

Movement in net risk exposure

Key:

Increase in net risk exposure

No change in net risk exposure

Decrease in net risk exposure

Legal and regulatory environment

2

What is the risk?

We may be unable to effectively anticipate and/or influence future developments in the UK water industry resulting in our business plans becoming unsustainable.

Link to how we're achieving our strategy

Changing the market for the better

Investing responsibly for sustainable growth

ODIs

N/A

What does it mean for us?

Severn Trent Water operates in a highly regulated environment. Whilst we are broadly content with the direction of changes proposed for our industry, there remains a risk that future changes could have a significant impact on Severn Trent Water.

What are we doing to manage the risk?

Severn Trent has always contributed to the debate about our industry's future, including through our series of Changing Course publications. We will continue to be an active participant in these conversations, so we can help shape thinking about how to best serve our customers in the future.

We have contributed to embedding the role of Market Operator Services Ltd (the body which oversees the non-household retail market) and contributed towards the success of competition in the non-household market.

We continue to participate in discussions with Ofwat on the development of the future regulatory environment and since publication of Ofwat's final methodology in relation to Water 2020 we are developing our business plan. We are actively participating in discussions on the opening of the competitive market for bioresources.

Engagement with our peers, other regulators, UK Government departments and other stakeholders, including the Welsh Government, helps us to influence the direction of regulatory policy where possible and put forward our own case for change in a constructive way.

We continue to engage constructively with stakeholders following Labour's 2017 manifesto commitment to re-nationalise the water sector. We are encouraged that both the benefits to customers of the current model and the cost to taxpayers of re-nationalisation are now being better understood.

Movement in net risk exposure

3

What is the risk?

The regulatory landscape is complex and subject to ongoing change. There is a risk that processes may fail or that our processes may not effectively keep pace with changes in legislation leading to the risk of non-compliance.

Link to how we're achieving our strategy

Driving operational excellence and continuous innovation

Changing the market for the better

Investing responsibly for sustainable growth

Link to our values

We act with integrity

We protect our environment

ODIs

ODIs 1-4, 19-23, 30-43

What does it mean for us?

Our policies and processes must reflect the current legal and regulatory environment and all relevant employees must be kept aware of new requirements. The Group as a whole may face censure for non-compliance in an individual group company or a specific region in which we operate.

What are we doing to manage the risk?

Our Governance Framework, transparency, engagement with customers and stakeholders, policies and internal controls ensure our ongoing compliance with all applicable laws and regulations.

For the operation of separate Wholesale and Retail business we have a control framework of protocols, policies, systems, guidance and training to ensure ongoing compliance with the relevant legislation including Competition Law.

Following the integration of Dee Valley into the Severn Trent Group we have refreshed our policy framework and are updating our systems, protocols and policies in readiness for the boundary realignment of our regulated businesses.

Ensuring readiness for the General Data Protection Regulation ('GDPR') coming into effect on 25 May 2018 has also been a key area of focus for us.

Changes to the legal and regulatory environment are captured as 'emerging risks' through our ERM process with the necessary owners and actions identified to ensure compliance when the changes come into effect.

Movement in net risk exposure

Operations, assets and people

4

What is the risk?

We may experience loss of data or interruptions to our key business systems as a result of cyber threats.

Link to how we're achieving our strategy

Embedding customers at the heart of all we do

Driving operational excellence and continuous innovation

Link to our values

We put our customers first

ODIs

ODIs 1-4, 5-18, 19-23, 24-37

What does it mean for us?

The risks arising from loss of one or more of our major systems or corruption of data held in those systems could have far reaching effects on our business. We have recognised the increasing threats of cyber attacks on our systems and data. Whilst this threat can never be eliminated and will continue to evolve, we are focused on the need to maintain effective mitigation.

What are we doing to manage the risk?

We continue to follow guidance from the National Cyber Security Centre ('NCSC') to improve our defences against cyber attacks and have focused this year on more layered-security controls to protect sensitive data in readiness for the introduction in May 2018 of the GDPR.

We have also completed risk assessments of cyber threats to our water supply systems for the introduction in May 2018 of the Network and Information Systems Directive ('NISD').

We have participated in a number of Government led and internal cyber incident exercises to test our response capability to cyber attacks.

Although not directly impacted by significant recent cyber incidents (e.g. WannaCry and NotPetya), we did review our security controls and response plans to ensure we are prepared for future attacks of this type.

Movement in net risk exposure

5

What is the risk?

We may fail to meet our regulatory targets including targets from Ofwat for operational performance of our assets resulting in regulatory penalties.

Link to how we're achieving our strategy

Embedding customers at the heart of all we do

Driving operational excellence and continuous innovation

Investing responsibly for sustainable growth

Link to our values

We put our customers first

We are passionate about what we do

We protect our environment

ODIs

ODIs 1-45

What does it mean for us?

If we are unable to meet operational performance targets, we may be subjected to significant regulatory penalties either within the current price review period, or applied to the next price review.

Regulatory targets apply to all of our water treatment, distribution, sewerage and sewage treatment assets. Measures are in place in relation to water quality, continuous supplies, sewer flooding, sewer collapses and pollution events.

What are we doing to manage the risk?

Our business plan for 2015-2020 includes considerable investment in our assets to improve the resilience of our networks, reduce interruptions and improve the service that our customers receive. We recognise there are areas where our performance is not as consistent as we would like and we are committed to improving these.

We are continuing our Cleanest Water Plan which drives the inspection, cleaning and repair of storage tanks, increasing our capital maintenance interventions, optimising our operation and maintenance tasks and formalising our processes, standards and operating procedures involved in delivering clean water.

We use leading measures on our comm cells and performance meetings to track delivery against customer ODIs and performance commitments so that we can intervene in a timely fashion if performance is drifting.

The three UQ programmes in Retail, Water and Waste are key to us delivering our targets for the remainder of this business plan.

Movement in net risk exposure

6

What is the risk?

Failure of certain key assets or processes may result in inability to provide a continuous supply of clean water and safely take waste water away within our area.

Link to how we're achieving our strategy

Embedding customers at the heart of all we do

Driving operational excellence and continuous innovation

Investing responsibly for sustainable growth

Link to our values

We put our customers first

We are passionate about what we do

ODIs

ODIs 1-4, 5-18, 19-23

What does it mean for us?

Some of our assets are critical to the provision of water to large populations for which we require alternative means of supply.

Examples include our reservoirs and water treatment works. These assets are regularly inspected and maintained and our assessment of the overall condition of these assets is good.

Other examples are our IT, telephony systems and remote monitoring systems which are also key to our operations.

What are we doing to manage the risk?

We included substantial investment in our AMP6 plan to reduce the likelihood of failure of strategic assets that supply Birmingham and to provide the city with a second source of water. We are ahead of delivery on the improvements to our strategic assets and on track with the provision of a second source.

We continue to maintain and test our 'Being prepared framework' to ensure our business continuity arrangements are fit for purpose and the Group can react quickly to safeguard our critical operations.

In addition to investing in resilience improvements to our network we also have assurance plans in place to monitor, inspect and maintain our most critical assets and to ensure clean water is always available to our customers and we will always be able to safely take their waste water away.

We will continue to make significant investment into our network and processes but we accept there is always a risk of unexpected failures. For example, we experienced a number of trunk main bursts in 2017 which led to supply interruptions to our customers and in March 2018 the very rapid thaw following 'The Beast from the East' resulted in a substantial increase in pipe bursts. Our incident response helped to mitigate the impact of these failures. During the bursts we worked with local resilience forums and other agencies and had great community engagement to return suppliers back to normal as quickly as possible. We are taking the learnings from the incidents to expand our network condition monitoring programme to detect vulnerabilities before failures occur and to ensure that our incident response procedures are as good as they can be.

Movement in net risk exposure

7

What is the risk?

Due to the nature of our operations we could endanger the health and safety of our people, contractors and members of the public as well as negatively impact our local and wider environment.

Link to how we're achieving our strategy

Driving operational excellence and continuous innovation

Investing responsibly for sustainable growth

Creating an awesome place to work

Link to our values

We protect our environment

We act with integrity

ODIs

ODIs 30-41, 42-43

What does it mean for us?

The nature of our assets, operations and business are such that threats to the safety of our employees, contractors, customers and the wider public exist. Operational failures or negligence could result in damage to the environment.

We are responsible for a large estate of assets and have to secure these from unauthorised access to ensure our operations are not impacted nor the safety of the public compromised.

What are we doing to manage the risk?

Our 2015-2020 business plan includes substantial investment in community schemes to ensure the risk of failure at key points along our Elan Valley Aqueduct, that could cause substantial damage and endanger the safety of the public, is further reduced.

We have a well-established Health, Safety & Wellbeing framework to ensure all operations and processes are conducted in compliance with Health and Safety legislation and in the interests of the safety of our people and contractors. Our Goal Zero initiative clearly establishes our target that no one should be injured or made unwell as a result of what we do. We've continued to reduce total injuries to staff and contractors through the application of the Goal Zero plan and we work collaboratively with our supply chain and other key stakeholders to continue to seek improvements.

There are a number of ODI commitments we have made to protect our local environment, including river water quality, pollution incidents, biodiversity improvements and environmental compliance. In AMP6 we will be delivering our largest ever environment programme, spending over £300 million to deliver improvements to rivers throughout our region, a programme which is supported by our customers who want to see us do more to improve river water quality. This year we expect to regain our 4* Environmental Performance Assessment status from the Environment Agency.

We recognise the impact our operations have on the wider environment and we want to reduce our carbon footprint by seeking lower carbon ways of operating our business, driving energy efficiency and generating renewable energy. We aim to increase the amount of renewable energy we generate and to invest in ways to make our processes more energy efficient, and our target is to generate the equivalent 50% of Severn Trent Water's energy needs by 2020.

Movement in net risk exposure

8

What is the risk?

We are unable to deal with the impact of extreme and unpredictable weather events on our assets and infrastructure and/or are unable to successfully plan for future water resource supply and demand due to climate change.

Link to how we're achieving our strategy

Driving operational excellence and continuous innovation

Investing responsibly for sustainable growth

Link to our values

We protect our environment

ODIs

ODIs 1-4, 5-18, 19-23, 42-43

What does it mean for us?

Climate change (hotter and drier summers, wetter winters and increased frequency of storms) could result in an inability to meet customer demand, lower river levels, decreased raw water quality, flooding of our water or waste works, sewer capacity being exceeded and increased land movement. Climate change could also be a contributing factor for principal risks 1, 5, 6 and 7 detailed above.

There are also some potential opportunities that climate change presents for us, including aquifer recharge and increased biological treatment. It is important that we understand these opportunities to maximise the benefits.

What are we doing to manage the risk?

Our climate change adaptation report sets out our strategy for coping with future changes to our climate.

In February 2018, we published our draft water resources management plan for the next 25 years. The plan includes a detailed assessment of climate change impact for our region and our demand management and proposed new sources are designed to offset any supply risk resulting from climate change.

Our analysis for the National Flood Resilience Review ('NFRR'), that was instigated by Defra/the Cabinet Office after the flooding of winter 2015/16, identified our non-infrastructure (overground) sites that could be at risk from river or surface water flooding using a new higher standard called the 'Extreme Flood Outline'. This has informed our contingency plans and future investment plans.

We don't consider climate change risks in isolation and we view them alongside all the challenges we face. To that effect a large number of our current objectives and targets agreed as part of our ODI commitments will increase our resilience from climate change, including reducing leakage, improving water efficiency, reducing properties prone to low pressure, protecting prone properties/areas from sewer flooding and increasing the resilience of our water supply and water/waste works.

Our own impact and contribution to climate change cannot be ignored and, as outlined in principal risk 7 overleaf, there are a number of ways in which we are addressing our impact on the environment.

Movement in net risk exposure

Financial risks

9

What is the risk?

Lower interest rates, higher inflation or underperforming equity markets may require us to provide more funding for our pension schemes.

Link to how we're achieving our strategy

Investing responsibly for sustainable growth

What does it mean for us?

We already provide significant funding but could be called upon to provide more money to reduce pension deficits in our defined benefits schemes.

What are we doing to manage the risk?

Following the Brexit vote, our main defined benefit pension scheme has seen a significant growth in the accounting value of liabilities due to the fall in long term interest rates. Volatile financial conditions are likely to remain for the foreseeable future. The growth in the accounting deficit has adversely impacted the headroom on some of our credit ratios, such as gearing, which are relevant for debt covenant and credit ratings purposes. It also has a reputational impact that could have a bearing on investment and distribution decisions.

We have completed the process of immunising our bank financial covenants from adverse movements in the accounting deficit, gaining approval from relevant banks and the European Investment Bank ('EIB'). We have worked with the ratings agencies to focus on the impact of our repair payments on credit ratings, rather than movements in the accounting value of the deficit. Importantly, we have agreed cash repair payments with the Trustee until the next Triennial Valuation at 31 March 2019. We have also completed, with Trustee agreement, additional inflation and interest rate hedging and introduced downside protection to the fund's equity holdings. The Pension Regulator has confirmed that the March 2016 actuarial valuation will not be subject to further review. However, the Regulator has stated that it believes that the current repair period, to 2032, is very long and in the event of a further deterioration in deficit does not see an extension of the recovery plan end date an appropriate solution.

Movement in net risk exposure

10

What is the risk?

We are unable to fund the business sufficiently in order to meet our liabilities as they fall due.

Link to how we're achieving our strategy

Investing responsibly for sustainable growth

What does it mean for us?

We must ensure sufficient liquidity is available to meet our near term financial commitments. We have a significant funding requirement in AMP6, to fund our investment programme and refinance maturing debt. This is a well-controlled risk, but it is important that we maintain these high standards to mitigate this risk.

What are we doing to manage the risk?

Whilst Brexit may impact our access to funding from the EIB, an attractive source of finance, we have other sources of funding we can call upon. In November 2015, we raised £471 million through a US Private Placement debt issue and in November 2016 to December 2017, we raised £900 million through three sterling bond issues. Despite some initial volatility following the Brexit vote, global debt capital markets continue to deliver substantial levels of liquidity.

See our Long-Term Viability Statement on pages 58 and 59.

Movement in net risk exposure

The strategic report, as set out from page 3 through to page 61, has been approved by the Board.

By order of the Board

Bronagh Kennedy
Group General Counsel and Company Secretary
22 May 2018

Chairman's Introduction to Governance

Leadership & Effectiveness

"The Board provides strong leadership and support to the business. All Directors have a passion for the business and there is a sense of "creating a legacy for those who come after us"

Manchester Square Partners
Board Effectiveness Report

Dear Shareholder
I am pleased to introduce our Governance report for 2018 on behalf of your Board in accordance with the April 2016 UK Corporate Governance Code (the "Code"). This report reflects the themes of the Code and provides details on the activities and governance processes of the Board and its Committees (and refers you to other areas of the annual report and accounts where further relevant information can be found).

The Board has had a diverse agenda during the year: from addressing the challenges of the upcoming Ofwat Price Review ("**PR19**") without losing focus on other key strategic and operational priorities; to ensuring that Dee Valley Water is operating effectively as a standalone business within the Group. PR19 is a key strategic item for the business that has required a robust governance process to ensure the right level of debate and oversight without allowing this topic to dominate the strategic landscape. In summary, the Board's principal areas of focus have been:

- **PR19;**
- **Customer service;**
- **Water quality;**
- **Environmental performance;**
- **Financing our businesses; and**
- **Dee Valley integration**

Customers continue to be at the forefront of our attention, as our strategic focus on such topics as Upper Quartile Performance and Customer Experience demonstrate. Customer Delivery, Water Quality and Environmental Performance have been the subject of regular "performance review" items on the agenda and financing has been addressed through the continuing important work of the Treasury Committee, through the Chief Financial Officer's regular reports to the Board and via specific finance related items on the agenda. The cost of debt methodology for PR19 has been a key consideration due to its wider impact for the business as a whole. (See Board activities on pages 73 to 76).

Alignment on strategy and clarity on individual roles have allowed clear strategic focus for the Board during the year, and produced robust challenge where appropriate. There is a great dynamic in the Board room but we are by no means complacent and recognise that there are still many challenges to tackle. We continue to foster a culture of ownership, stewardship and always **doing the right thing**, sharing the wider company values: we put our customers first; we are passionate about what we do; we act with integrity; we protect our environment; and we are inspired to create an awesome company.

The Board has continued to keep the Group's **risk management and internal control systems** under close scrutiny during the year and believes the quality of risk management and reporting, and in particular the risk identification, mitigation plans, business ownership and tracking, are excellent and continue to evolve and improve.

In respect of the company's **stakeholders**, there has been oversight of a full range of engagement with shareholders, regulators, customers, pension trustees, communities and employees alike. There have been regular communications with shareholders and open lines of communication with Ofwat, CCW and the DWI. In particular, the Corporate Responsibility Committee has overseen a broad range of well received community initiatives (detailed in its report on page 91 to 93 of the Severn Trent Plc Annual Report). All the Board members have multiple formal and informal opportunities to engage with customers and employees and are constantly impressed at the quality of Severn Trent's people, wherever they work in the Group and whatever their role. Engagement scores from the annual employee engagement questionnaire are excellent and this is mirrored in the Board's communication with employees at and below management level.

We continue to strive for comprehensive **talent development and succession planning** at all levels of the business. Whilst much has been done in this respect and plans are in place, with great graduate and apprenticeships programmes and strong external hiring and internal promotions, we are keen to make further progress in identifying, developing and progressing top talent through the organisation and making further improvements in respect of management and leadership development. The focus on improving diversity remains strong and, whilst we have made good progress on gender diversity in line with the Hampton-Alexander review, we are looking to make further progress in terms of wider diversity.

Looking forward, Severn Trent has a strong unified Board with the broad range of professional backgrounds, skills and perspectives needed to take the company into the next regulatory period.

Finally, on a personal note, whilst I hope you find this report provides insight into governance within Severn Trent, I always welcome feedback if you feel there is more we could do to enlighten shareholders. We encourage participation at our AGM and look forward to meeting with many of our shareholders in July.

Andrew Duff
Chairman

UK Corporate Governance Code Compliance Statement

As Severn Trent Water Limited is not a listed company it is not required to comply with the Code. However, we have voluntarily chosen to apply the principles of the Code to our governance arrangements, where appropriate and reasonably practicable.

The version of the Corporate Governance Code applicable to the current reporting period is the April 2016 UK Corporate Governance Code (the 'Code'). The Code is available on the Financial Reporting Council's (FRC) website (www.frc.org.uk).

In December 2017 the FRC published proposals for a revised code, which we expect to apply to financial years beginning after 1 January 2019, to reflect the changing business environment and help in achieving the highest levels of governance. As the revised code is not yet finalised, we are reporting against the 2016 Code in this report but are looking closely at the new proposals and assessing what more we can do to align with best practice principles to further engender trust in our business.

The Boards of Severn Trent Water and Severn Trent Plc have the same Directors. This structure was implemented in 2007 to ensure that the highest standards of corporate governance were applied at the regulated subsidiary level and to promulgate greater visibility and supervision of Severn Trent Water Limited by the Plc Board. Severn Trent Water Limited is therefore voluntarily complying with the 2016 Code to ensure these high standards also apply to it.

For the whole of the financial year ended 31 March 2018, Severn Trent Water Limited was compliant with the Code, with the following exceptions:

- The Board committees operate at the Severn Trent Plc level rather than the Company level. Whilst the Board committees are not duplicated at the Company level, in practice their remit includes work in respect of the Company. In particular the Audit Committee reviews Severn Trent Water's:
    - Processes for producing regulatory submissions;
    - Statutory and regulatory accounts prior to their approval by the Severn Trent Water Board; and
    - Processes for ensuring compliance with the requirements of the Scheme of Charges submitted to Ofwat and compliance with licence Condition E.
- The Board committees are all led by Independent Non-Executive Directors who comprise the majority of membership of each Committee. Details of the committees are reported publicly in the Severn Trent Plc Annual Report and Accounts.
- The Company does not comply with the provisions relating to Relations with Shareholders which covers Dialogue with Shareholders and Constructive use of the AGM, as it would not be appropriate to do so. However, Severn Trent Plc does fully comply with these requirements.

Severn Trent Plc and Severn Trent Water Limited operate as distinct legal entities. The Boards comply with the Severn Trent Plc Board governance framework and the respective Matters Reserved to the Board. They are assisted through the management of separate agendas, meetings and minutes by Company Secretariat and advised in their meetings by the Company Secretary, where appropriate. Subsidiary Company Boards are managed through designated governance processes. In particular, the relationships between Severn Trent Water Limited, Dee Valley water Limited and our other businesses such as Severn Trent Business Services are monitored and controlled to ensure that regulatory requirements and obligations under competition law are complied with in respect of all transactions between them, or with third parties.

Board of Directors

1. Andrew Duff **BSc FEI (59)**
Appointed: Non-Executive Director on 10 May 2010, Chairman on 20 July 2010

Membership: n Chair c r
Skills, competence and experience:

Andrew's extensive experience of international and regulated business, strategic management and customer service in high profile, dynamic environments, has equipped him well for the role of Chairman of the Group. Andrew spent 16 years at BP in marketing, strategy and oil trading. He joined National Power in 1998 and the Board of Innogy plc upon its demerger from National Power in 2000. He played a leading role in its restructuring and transformation through the opening of competition in energy markets culminating in its subsequent sale to RWE in 2003. He became CEO of the successor Company and a member of the RWE Group Executive Committee until his retirement in 2010. He was a Non-Executive Director of Wolseley plc from July 2004 until November 2013. Andrew was appointed Non-Executive Deputy Chairman of Elementis plc on 1 April 2014 and became Non-Executive Chairman of Elementis plc on 24 April 2014. He is the senior trustee of Macmillan Cancer Support and a trustee of the Earth Trust.

Other roles:

- **Member of the CBI President's Committee**
- **Trustee of Macmillan Cancer Support and Earth Trust**
- **Fellow of the Energy Institute**

2. Olivia Garfield **BA (Hons) (42)**
Appointed: Chief Executive on 11 April 2014

c e

Skills, competence and experience:

Olivia (Liv) brings to the Board a wealth of experience managing customer service delivery and complex infrastructure and organisations in a regulated environment. Before joining Severn Trent, Liv was Chief Executive Officer of Openreach, part of the BT Group, where she spearheaded and oversaw the commercial roll-out of fibre broadband to two thirds of the country. She joined BT in 2002 and held the pivotal roles of Group Director of Strategy and Regulation, Managing Director Commercial and Brands, Global Services and UK Customer Services Director. From 1998 to 2002, Liv worked for Accenture as a consultant in the Communications and High Tech Market Unit, designing and implementing business change solutions across a number of industry sectors.

Other roles:

- **Member of The 30% Club**
- **Director of Water UK**
- **Member of Take Over Panel**
- **Director of Water Plus Limited - joint venture with United Utilities**

3. James Bowling **BA (Hons) Econ, ACA (49)**

Appointed: Chief Financial Officer on 1 April 2015

Membership: e t d

Skills, competence and experience:

James is a chartered accountant, having started his career with Touche Ross and brings significant financial management, M&A and business transformation expertise to the Board. Prior to joining Severn Trent, James was interim Chief Financial Officer of Shire plc, where he had been since 2005, first as Head of Group Reporting and from 2008 as Group Financial Controller. Prior to joining Shire, James spent nine years at Ford Motor Company in various finance roles of increasing responsibility.

4. John Coghlan **BCom, ACA (60)**
Appointed: Independent Non-Executive Director on 23 May 2014

Membership: a Chair t Chair

Skills, competence and experience:

John is a chartered accountant and has a valuable background in financial and general management across a variety of sectors. Currently, John is also a Non-Executive Director and Audit Committee Chairman of Clarion Housing Association and Associated British Ports Holdings Limited. Previously, John was a Director of Exel plc for 11 years to 2006, where he was Deputy Chief Executive and Group Finance Director. Since 2006, John has been a Non-Executive Director of various publicly-quoted and private equity-owned companies.

Other roles:

- **Chairman of Freight Transport Association Ireland Limited**

5. Dame Angela Strank **DBE BSc PhD (65)**
Appointed: Independent Non-Executive Director on 24 January 2014

Membership: c Chair n r

Skills, competence and experience:

Angela brings a wealth of strategic, technical and commercial experience to the Board. Angela is Head of Downstream Technology and Group Chief Scientist at BP plc. She is a member of the Downstream Executive Leadership Team. Angela is responsible for enabling delivery of the Downstream strategic agenda through the development of differentiated technology advantage across the refining, fuels, lubricants and petrochemicals businesses. Since joining BP in 1982, she has held many senior leadership roles around the world in business development, commercial and technology, including in 2012, Vice President and Head of the Chief Executive's Office. In 2010, Angela was the winner of the UK First Woman's Award in Science and Technology in recognition of pioneering UK women in business and industry. Her track record and experience in strategy, operations, technology and transformational change are a complementary addition to the Board's skill set. In June 2017, Angela was recognised in the Queen's Birthday Honours List with the title Dame Commander of the Most Excellent Order of the British Empire (DBE) for services to the Oil and Gas Industry and encouraging women into STEM careers.

Other roles:

- **Board Governor of The University of Manchester**

- **BP Group plc- Chief Scientist**
- **Member of the Royal Society's Science, Industry & Translation Committee**

6. The Hon. Philip Remnant **CBE FCA MA (63)**
Appointed: Independent Non-Executive Director on 31 March 2014

Membership: r Chair a n t

Skills, competence and experience:

Philip is a senior investment banker and brings substantial advisory and regulatory experience to the Board. A chartered accountant, he is Senior Independent Director of Prudential plc and Chairman of M&G Group Limited, Deputy Chairman of the Takeover Panel, Senior Independent Director of UK Financial Investments Limited and Chairman of City of London Investment Trust plc. Previously, Philip was Vice Chairman of Credit Suisse First Boston Europe and Head of the UK Investment Banking Department. Philip was Director General of the Takeover Panel for two years between 2001 and 2003, and again in 2010. He served on the Board of Northern Rock plc from 2008 to 2010 and from 2007 to 2012 was Chairman of the Shareholder Executive.

Other roles:

- **Governor of Goodenough College, Director and Trustee of St Paul's Cathedral Foundation**
- **Director and Trustee of St Paul's Cathedral Foundation**

7. Dominique Reiniche **MBA (62)**
Appointed: Independent Non-Executive Director on 20 July 2016

Membership: c r

Skills, competence and experience:

Dominique has a wealth of operational experience in Europe and has international consumer marketing and innovation experience. Dominique is Independent Vice Chairman of CHR Hansen Holdings A/S and also a Non-Executive Director of Mondi plc and PayPal (Europe). Dominique started her career with Procter & Gamble AG before moving to Kraft Jacobs Suchard AG as Director of Marketing and Strategy where she was also a member of the Executive Committee. Dominique previously held a number of senior roles at Coca-Cola Enterprises and at Coca-Cola Company, including President – Western Europe, President – Europe and Chairman – Europe. Until December 2015, Dominique was a Non-Executive Director of Peugeot-Citroen SA. Until April 2017, Dominique was a Non-Executive Director of AXA SA.

8. Kevin Beeston **FCMA (55)**
Appointed: Senior Independent Non-Executive Director on 1 June 2016

Membership: a n r

Skills, competence and experience:

Kevin has a wealth of commercial, financial and high level management experience. Kevin is Chairman of Taylor Wimpey plc and Elysium Healthcare and also a Non–Executive Director of The Football Association Premier League Limited and Marston Corporate Limited. Previously Kevin spent 25 years at Serco plc, where he held the roles of Finance Director, Chief Executive and finally Chairman until 2010. Kevin was previously Chairman of Domestic & General Limited and Partnerships in Care Limited, Equiniti Group plc and a Non-Executive Director of IMI plc.

Severn Trent Water Limited
Directors' Report (continued)
For the year ended 31 March 2018

Director serving for part of the year
Emma FitzGerald **MA, DPhil Oxon, MBA (51)**
Managing Director, Wholesale Operations

Directorship ceased on 31 December 2017

Emma stepped down from the Board on 31 December 2017, having been a director since 1 April 2016. She remained on the Executive Committee until 16 April 2018 and is due to leave Severn Trent in July 2018.

Committee membership key
a Audit Committee

c Corporate Responsibility Committee

e Executive Committee

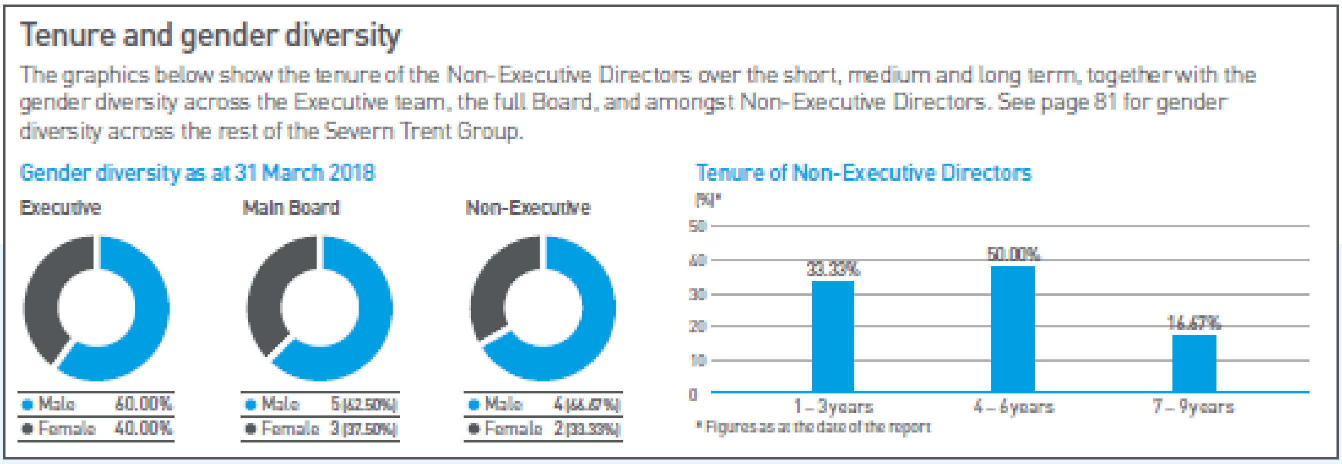
n Nominations Committee

r Remuneration Committee

t Treasury Committee

d Disclosure Committee

Tenure and gender diversity
The graphics below show the tenure of the Non-executive directors over the short, medium and long term, together with the gender diversity across the Executive team, the full Board, and amongst Non-executive directors. See page 77 for gender diversity across the rest of the Severn Trent group.



Governance framework

Board of Directors

Responsible and accountable for the long term success of the Severn Trent Group; ensuring Severn Trent delivers the Group's strategic objectives whilst operating to the highest standards of corporate governance in meeting its obligations to all stakeholders.

Board Committees

Nominations Committee

Keeps the structure, size, composition and succession needs of the Board under review and assists the Board on conflicts of interest and independence issues.

Read more on pages 80 to 82

Audit Committee

Assists the Board in discharging its responsibilities for the integrity of the Company's financial statements, the assessment of the effectiveness of the systems of Internal Control, Risk Management and scrutinises the work of the Internal and External Auditors. It also reviews the adequacy of the Company's whistleblowing arrangements.

Read more on pages 83 to 89

Corporate Responsibility Committee

Provides guidance and direction to the Company's Corporate Responsibility and Sustainability programme based on Severn Trent's values and reviews the Group's non-financial risks and opportunities.

Read more on pages 91 to 93

Remuneration Committee

Determines the Company's policy on the remuneration of the Executive Directors, other members of the Executive Committee and the Chairman of the Board.

Read more on pages 96 to 128

Treasury Committee*

Provides oversight of treasury activities in implementing the policies, funding and treasury risk management plan including: the measurement and management of risks in respect of interest rates; funding; counterparty credit; liquidity and treasury operations; funding proposals; relationship with rating agencies; debt investor relations; bank relationship management; and treasury internal controls.

Read more on page 90

Severn Trent Executive Committee ('STEC')

Oversees the development and execution of Group strategy, with accountability for achieving financial and operational performance.

CEO – Liv Garfield

Delegated responsibility for the development and implementation of strategy and overall commercial objectives, and responsible for the day-to-day management of the business and the communication of Board agreed objectives to employees.

Executive Sub-Committee

Disclosure Committee

Executive Sub-Committee overseeing Severn Trent's compliance with its disclosure obligations, considering the materiality, accuracy, reliability and timeliness of information disclosed and assessment of assurance received.

Governance Framework Foundations

- Matters Reserved to the Board
- Terms of Reference for Board Committees
- Charter of Expectations
- Doing the Right Thing – the Severn Trent Way
- Group Authorisation Arrangements
- Conflicts of Interest review
- Board strategy days
- Training
- Board Effectiveness Review
- Policies and procedures
- Diversity/Independence

Corporate Governance Code

* Membership of the Treasury Committee includes Head of Group Treasury, a non-Board position.

The Board is responsible to all stakeholders, including the Company's shareholders, for the approval and delivery of the Group's strategic objectives. It makes sure that the necessary financial, technical and human resources are in place for the Company to meet its objectives. The Board leads the Group within a framework of practical and effective controls which enable risk to be assessed and managed.

Responsibility for the development and implementation of the Group's strategy and overall commercial objectives is delegated to the Chief Executive who is supported by the Severn Trent Executive Committee ('STEC').

In compliance with the Code, the Board also delegates certain roles and responsibilities to its various Committees, which assist by focusing in detail on their particular areas, reporting to the Board on decisions and actions they've taken, and making any necessary recommendations in line with their Terms of Reference.

Charter of Expectations
The Severn Trent Charter of Expectations sets out clearly the defined roles of the Chairman, Chief Executive, Chief Financial Officer, Senior Independent Director and Non-Executive Directors, the operation of the Board and Board Committees, and also reflects the Board's responsibility for setting the tone of the Group's culture, values and behaviour. In accordance with the Code, it sets out a clear division of responsibilities between the roles of Chairman and CEO.

The Charter of Expectations is reviewed annually, with the last review undertaken in March 2018. It's also used to assist in the ongoing assessment of the effectiveness of the Board and its Committees and that of individual Directors (see page 78 for further details). It is available on our website (www.severntrent.com).

Matters Reserved to the Plc Board
The Schedule of Matters Reserved to the Board sets out the processes in place regarding the Board's tasks and activities and the matters specifically reserved for the Board's decision making. A copy is available on our website (www.severntrent.com).

The Board has reserved the following matters, amongst others, for its own consideration:

- **the Group's strategic and operating plans**
- **financial reporting and controls**
- **major acquisitions and disposals**
- **key Group policies**
- **Group Authorisation Arrangements ("GAA")**

Board composition, roles and attendance

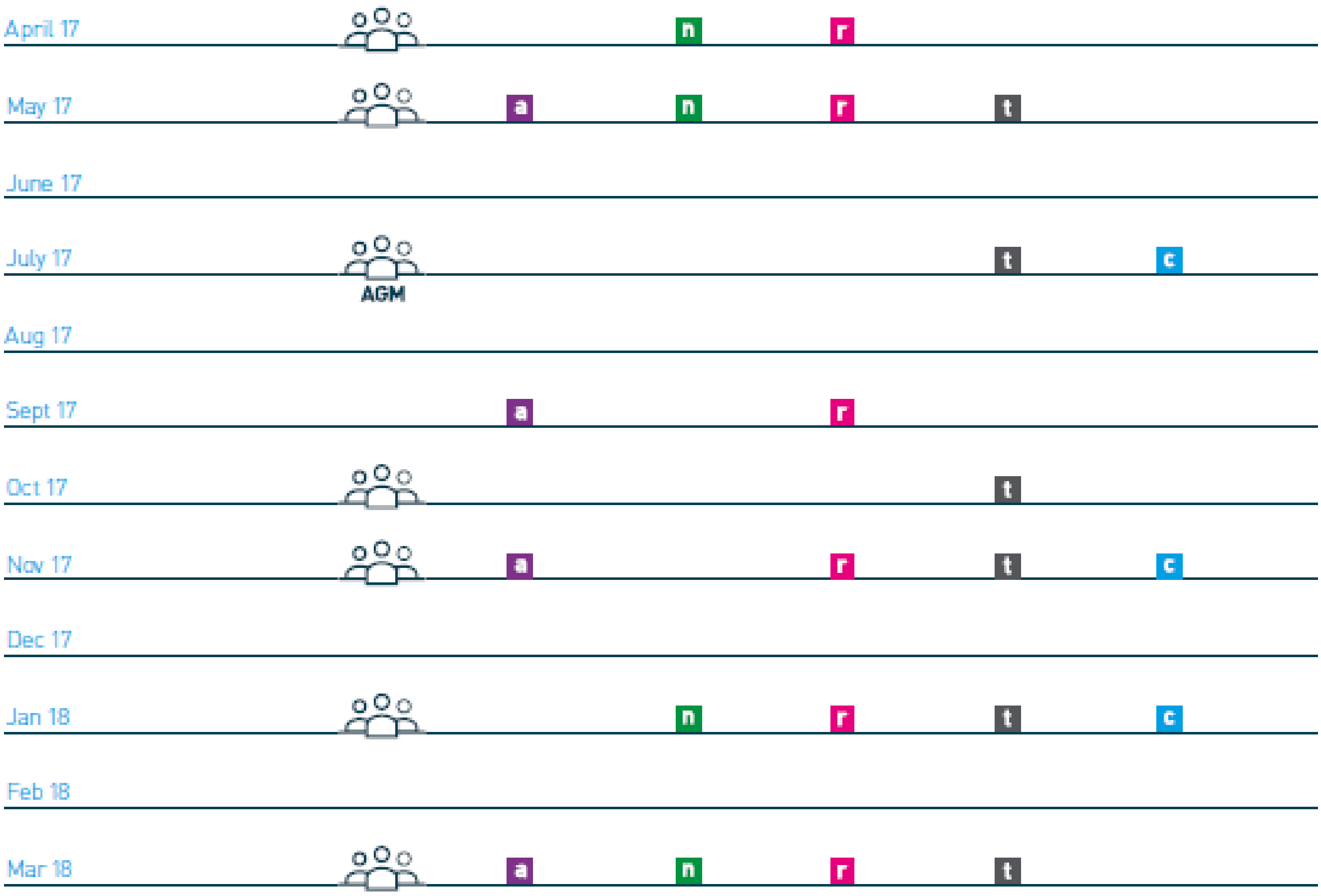
Where Directors have not been able to attend meetings, they have still received related papers in advance of the scheduled meeting and any input they have provided has been considered.

The Board held seven scheduled meetings during the year, and the key roles of individuals and their attendance is set out overleaf. For additional information on the activities of the Board, see pages 76 and 77.

There were 11 additional ad hoc meetings of the Board or Committee of the Board convened throughout the year.

Director		Responsibility
Chairman	Andrew Duff	• Leads our unified Board and is responsible for its effectiveness. • Sets agendas and ensure timely dissemination of information to the Board, in consultation with CEO, CFO and Company Secretary. • Responsible for scrutinising the performance of the Executive Committee. • Facilitates contribution from our Directors. • Ensures effective communication with our shareholders and other stakeholders.
CEO	Liv Garfield	• Develops and implements the Group's strategy, as approved by the Board. • Responsible for the overall commercial objectives of the Group. • Promotes and conducts Group affairs with the highest standards of integrity, probity and corporate governance. • Sets the cultural tone of the organisation.
CFO	James Bowling	• Manages the Group's financial affairs. • Supports the CEO in the implementation and achievement of the Group's strategic objectives.
SID	Kevin Beeston	• Supports the Chairman in delivery of his objectives. • Alternative contact for shareholders should they have a concern that is unresolved by the Chairman, CEO or CFO. • Leads the appraisal of the Chairman's performance with the Non-Executive Directors. • Key role in succession planning for the Board, together with the Board Committees, Chairman, and NEDs.
NED	John Coghlan Dominique Reiniche Dame Angela Strank Philip Remnant	• Constructively challenge our Executive Directors in all areas. • Monitor the delivery of strategy by the Executive Committee within the risk and control framework set by the Board. • Satisfy themselves that internal controls are robust and that the External Audit is undertaken properly. • Responsible for agreeing appropriate levels of remuneration for Executive Directors. • Key role in succession planning for the Board, together with the Board Committees, Chairman, and SID.
Executive Director	Emma FitzGerald (until 31.12.17)	• Responsible for the Group's wholesale business until 31 December 2017. • Supported the CEO in the implementation and achievement of the Group's strategic objectives until 31 December 2017.

Board attendance



Director	Board Meeting Attendance[i]	Audit Committee[i]	Nominations Committee[i]	Remuneration Committee[i]	Treasury Committee[i]	CR Committee[i]
Andrew Duff	7/7	–	4/4	6/6	–	2/3
Liv Garfield	7/7	–	–	–	–	3/3
James Bowling	7/7	–	–	–	6/6	–
Kevin Beeston[ii]	6/7	4/4	4/4	6/6	–	–
John Coghlan[iii]	6/7	4/4	3/4	–	6/6	–
Dominique Reiniche	7/7	–	4/4	–	–	3/3
Dame Angela Strank	7/7	–	4/4	6/6	–	3/3
Philip Remnant	7/7	3/4	4/4	6/6	6/6	–
Emma FitzGerald (until 31.12.17)	5/5	–	–	–	–	–

(i) Includes the scheduled Board meetings. Some additional meetings have been required to cover specific matters throughout the year.
(ii) Kevin Beeston was unable to attend a Board meeting due to illness during the year.
(iii) John Coghlan was unable to attend a Board and Committee meeting due to a bereavement.

Committee membership key

- a Audit Committee
- c Corporate Responsibility Committee
- n Nominations Committee
- r Remuneration Committee
- t Treasury Committee
- Board

Conflicts

The Board formally considers conflicts of interest at every meeting, and reviews the authorisation of any potential conflicts of interest every six months.

Group Authorisation Arrangements

The GAA is the framework through which the Severn Trent Plc Board authorises the right people, at the right level, to take important decisions to effectively control and manage legal, financial and administrative decisions throughout the Group. These arrangements are reviewed annually, with the last review undertaken in April 2018.

The flow of authority is from the Severn Trent Plc Board to the Chief Executive and the Severn Trent Executive Committee. In respect of certain decisions, the delegated authority is subject to an obligation to work with specialist business service areas (such as Tax, Treasury, Group Finance, Group Commercial and General Counsel), which provides additional expertise and a Group-wide perspective.

'Doing the Right Thing – the Severn Trent Way'

In addition to the Charter of Expectations and Terms of Reference for the Board, and the company-wide GAA, Severn Trent also sets out the cultural tone expected of its workforce through clearly defined values and standards of behaviour that are expected from everyone who works for the Severn Trent Group. Its Code of Conduct 'Doing the Right Thing – the Severn Trent Way' has been rolled out across the Group in the form of all-employee training programme, is integral to the induction process and is continuously re-enforced by management to make sure that all of our people embody Severn Trent's values:

- **we put our customers first**
- **we are passionate about what we do**
- **we act with integrity**
- **we protect our environment**
- **we are inspired to create an awesome company**

Our Code of Conduct is key to helping us achieve our vision of being the most trusted water company by 2020.

We know that the right culture must be set from the top and we have conducted an annual review of the key metrics which indicate what kind of culture exists in Severn Trent.

Policies, Standards and Procedures

In addition to our Code of Conduct, Severn Trent has an additional twelve policies which apply to everyone who works for the Severn Trent Group. These policies have been designed to help employees and contractors understand their role within the company and their responsibility to the Severn Trent Group. They also, in turn, outline the group's responsibility to the individual. These policies are the strategic link between the Severn Trent vision and how we manage our day to day business, and are underpinned by specific company standards and procedures.

Board activities

The table below sets out the main matters considered by the Board in 2017/18 at its scheduled Board meetings and the updates covered as part of its Lunch and Learn and operational site visit sessions. The Board's agenda is ordinarily structured as follows:

- **procedural matters (including Board Committee reports)**
- **performance review (including health and safety, operational, customer and financial matters)**
- **strategic items**
- **items for approval/noting (including the Company Secretary's Update on governance and regulatory issues)**

This structure has been agreed to ensure that Matters Reserved to the Board are addressed appropriately and that the Board's time is spent effectively. Strategic items are regularly presented to the Board by senior managers within the business, giving the Directors the opportunity to meet with key members of management who report into the Executive team. This also assists the succession planning process.

Board strategy days

In addition to formal meetings at which strategic matters are regularly reviewed, in June 2017 the Board held a dedicated strategy meeting along with the Executive Committee to consider areas of future value creation across the Group and spent time considering asset strategy and potential future disruptors, regulatory strategy and growth strategies across our portfolio of businesses. For 2018, success of the PR19 plans are key, therefore a good portion of the Board's strategy meeting is scheduled to focus on this. Over the medium to long term it's anticipated that opportunities and risks to the business will come from emerging technologies so this will be on the agenda, together with mergers and acquisitions and a discussion about our future people strategy.

The format of each day involves a few topics being discussed in-depth; with external speakers to challenge thinking and an interactive approach to each of the conversations.

Summary Board Activities 2017/18

Overview

All Board meetings are a full day's agenda consisting of: Procedural matters; Performance Reviews; Strategy; Items for approval/noting. Further details are provided below:

Board Focus

Topic & Actions

Procedural matters

Agreeing minutes of last meeting, reviewing progress against specific actions. Updates from the Chairman of each Board Committee has been strategically moved to this early part of the agenda to reflect the importance of the Committees' activities. See Committee reports on pages 80 to 125 of the Severn Trent Plc Annual Report for further details.

Performance Reviews

Reviews are received from the CEO and CFO at every meeting and from Directorates at regular intervals. There has been a strong focus on Production and Customer Delivery during the year. The financial reviews have included consideration of the annual report and accounts and the pension scheme funding, in addition to budget and dividend approval.

Strategy
Whilst the following is not an exhaustive list of all the matters the Board have considered during the financial year, it does indicate the key areas of activity and hopefully provide insight into the strategic workings of the Board:

Upper Quartile: As part of its focus on achieving and maintaining upper quartile retail, water and waste performance as measured by Ofwat, the Board have reviewed a route map of key milestones on outputs so it can monitor progress towards achieving this aspiration.

M&A Strategy: The Board have continued to keep merger and acquisition opportunities under review and gave more detailed consideration to this matter at its Strategy Day.

Bioresources Trading: The Board have been considering the opportunities created by the development of this market. Technology and potential investment opportunities have been discussed and considered in more depth at its Strategy Day.

Insourcing Opportunities: To address service issues, the Board have considered proposals for insourcing, exploring alternative models and seeking practical worked examples from management for specified issues and considering the resources required in each case.

Water Resources Management Plan: The Board have challenged the prescribed methodology and drilled down in terms of the assumptions, variances and scenarios in addition to simply testing alternative methodologies, applying the expertise of those board members who have the skills set for such matters.

Dee Valley Water Board Composition: Further to consultation with Ofwat, the Board in consultation with the Nominations Committee have considered the future make-up of the Dee Valley Water Limited Board, appointed the Chairman of this Board and sourced candidates for three new independent Non-Executive Directors.

Customer Service: As well as receiving updates on performance at every meeting the Board met with CCW for both England and Wales to listen to its perspective on Customers' views on Severn Trent's performance.

PR19: This price review is a particularly challenging area this year and the Board has therefore spent a commensurate amount of time on it to enable progressive scrutiny.

Enterprise Risk Management ("ERM") Update: The Board receives six monthly updates on ERM risks. Following its feedback to management, the Board now receives 'Cost to Target' and 'Flightpath' analysis on Board level risks, the former providing confirmation that risk reduction actions have been reflected in the budgeting process, business plans and long range plans, and the latter mapping out the risk reduction over time. The combined effect of these enhancements now provides the Board with greater insight to enable reprioritisation of such risks enabling more efficient risk reduction. The Board are rolling out true cost of control approach across all ERM risks.

Health, Safety and Wellbeing Strategy: The Board received an update and noted pleasing progress with the achievement of certain important milestones during the year (see pages 32 to 33 for further information) but acknowledge there are still further issues to improve upon and the cultural challenge continues.

Property Strategy: The Board considered the new clear strategy and approved the communication of property profits to the market and the inclusion of property profits in future business targets to reflect the value arising from that strategy in the Company's share price.

HomeServe Update: The Board have reviewed the HomeServe affinity partnership.

Re-nationalisation Debate: The Board has been closely following topical debate around the proposal by the Labour Party in its May 2017 election manifesto to re-nationalise utilities, including the water sector.

Water Quality: The Board met with the DWI and invited them to give feedback on the Company's water quality performance, both in terms of current performance and challenges for the next AMP.

Business Security and Resilience Review: The Board have kept abreast of progress during the year through its established incident management steering group which continually reviews and learns from incidents, both planned events and real incidents. It receives reports which include a guide path showing progress against specified targets.

Cyber Security: Given the Cyber Security landscape continues to evolve with an increasing level of activity and a number of high profile incidents for other companies and government departments, the Board has received an update on the company's Cyber Security Roadmap during the year. It noted the scrutiny by the National Cyber Security Centre, its risk based approach and investment priorities, and increased in-house support and positive reviews by Defra and PwC.

GDPR: The Board recognises that the implementation of GDPR is challenging but through a considered update during the year was reassured about what has to be done by management in order to prepare for it. It has scheduled future updates to review progress.

Innovation Investment Review: The Board reviewed the work of the innovation team and the progress that has been made to accelerate the pace of application in deploying value-generating technology.

Items for approval/ noting

This is a standing item on the agenda to meet the requirements of the business in terms of approving matters such as leases and land disposals, the alignment of water licences (particularly in light of re-defining the English/Welsh boundaries following the acquisition of Dee Valley Water), and setting tariff charges. This item always includes the Company Secretary's Update to address regular reviews of governance matters (by way of example see annual reviews shown below), keep abreast of regulatory changes and obtain board approvals for specific matters reserved to the Board.

Annual Governance Reviews:

- Directors' conflicts of interest
- Gifts and Hospitality Register
- Anti-Slavery and Human Trafficking Statement
- Board Diversity Policy
- Sharesave Invitation
- Board Evaluation Process
- Board Committee Terms of Reference
- Charter of Expectations
- Matters Reserved to the Board
- Group Authorisation Arrangements

- Feedback from Institutional Shareholders

Lunch and Learn Sessions

The Board's time has been maximised by utilising the time spent over lunch to conduct deep dives into topics such as:

- **Investor Technology Day**
- **Building an ethical culture**
- **HS2, update on route, programmes and costs**
- **Nationalisation Defence Debate**
- **Water Forum**
- **Responding to customers: Inspiring the next generation of water users**

Term of office

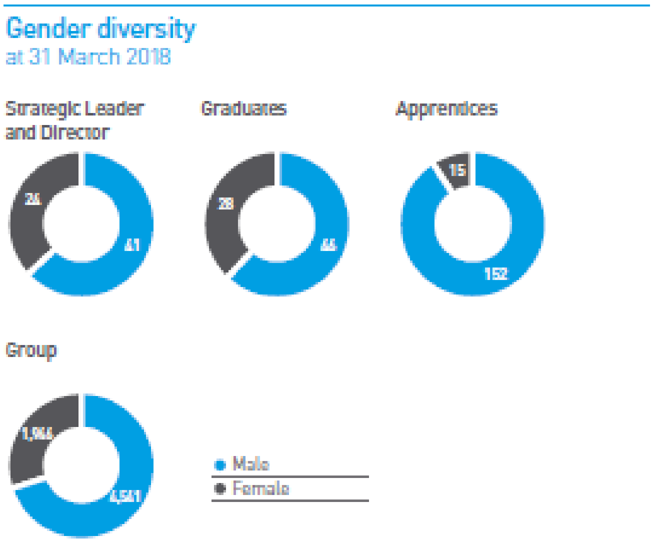
The Board recognises the Code's recommendation that Directors serve a fixed term of appointment and considers plans for orderly succession to the Board to maintain an appropriate balance of skills and experience within the Company. As such, the Company maintains a clear framework of Non-Executive Director tenure and the skill set that each Director provides. Individual Directors' biographies can be found on pages 64 to 66. In accordance with the Code, all the Directors will retire at this year's AGM and submit themselves for reappointment by shareholders. An overview of tenure for the Board is shown in the table on page 67. Each of the Non-Executive Directors seeking reappointment at the AGM is considered by the Board to be independent in character and judgement.

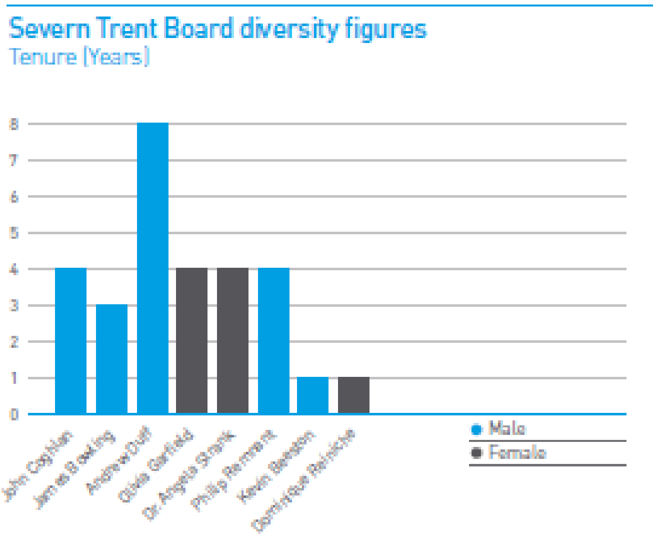
Diversity

The Board and Nominations Committee are committed to diversity. Female representation on the Board exceeds 30% in respect of the main Board and Board Committees and is 40% on the Executive Committee. There is also a continual focus on promoting wider diversity. We believe that our Company should reflect our communities and customers, and embrace a diverse range of perspectives, experiences and expertise to support our long term viability and commercial success.

We are committed to developing our talent pipeline, to ensure we have appropriate representation from minority ethnic candidates, as well as other relevant diverse groups. You can find additional details on our progress and ambitions on page 81 of the Nominations Committee report in the Severn Trent Plc Annual Report, and details of diversity across the Severn Trent Group on page 77.

Severn Trent Water Limited
Directors' Report (continued)
For the year ended 31 March 2018





*Emma FitzGerald stepped down from the Board on 31 December 2017.

Training and continuing professional development
As well as Board agenda items, training sessions in relation to specific topics of interest that were presented to Directors during the year are set out on pages 73 to 76.

The aim of the training sessions is to continually refresh and expand the Board's knowledge and skills to enable them to fulfil their roles effectively on the Board and its Committees and contribute to discussions on technical and regulatory matters. The sessions also serve as an opportunity for the Board to discuss strategy and risks with management below Executive Committee level and gain further insight into our businesses and management capability.

Directors' resources
An online resource library and Continuing Professional Development ('CPD') repository is available for use by the Directors, which is constantly reviewed and updated. The library includes a Corporate Governance Manual, a Results Centre and Investor Relations section, Strategy Day materials and details of Board training sessions. It also contains a further reading section which covers updates and guidance on changes to legislation and corporate governance best practice. The Directors also have access to professional development provided by external bodies and our advisers. CPD requirements were considered, through individual performance review meetings between the Chairman and each Director, as part of the externally facilitated Board effectiveness review in 2017/18.

Induction programme
Whilst there have been no new appointments to the Board of Severn Trent Water Limited during the year, there is an induction programme in place which can be tailored as applicable and includes the following elements/details:

- ***Ofwat pre-appointment process***
- ***Company structure including regulatory overview and performance***
- ***Company strategy***
- ***Key stakeholder relations including customers, suppliers, regulators and service providers***
- ***Key operations and processes including operational areas and key sites***
- ***Financial performance including analyst and investor opinion***

- ***Our people – including health, safety and wellbeing, talent and succession, trade unions and an overview of our remuneration policy***
- ***Group risk profile and our approach to risk***
- ***Governance framework***
- ***Board calendar, effectiveness reviews and action plans***
- ***Insight into key areas of focus for any specific appointment***

We will continue to enhance the Board's induction process, particularly bearing in mind feedback from new appointees.

The new Independent Non-Executive Directors of Dee Valley Water Limited received an appropriate induction facilitated by the Company Secretary covering the above topics, as well as a tour of key operational sites to understand our water treatment and distribution processes, and the customer journey, in a live environment, as follows:

- ***Water process – from rain to tap***
- ***Waste water process – from drain to river***
- ***Customer journey – from moving into a new home to moving out***

Independence of NEDs
The independence of our Non-Executive Directors is formally reviewed annually by the Nominations Committee, and as part of the Board evaluation exercise. The Nominations Committee and Board consider that there are no business or other circumstances that are likely to affect the independence of any Non-Executive Director and that all Non-Executive Directors continue to demonstrate independence. The Board recognises the Code's recommendation that Directors serve a fixed term of appointment and considers plans for orderly succession to the Board to maintain an appropriate balance of skills and experience within the Company. As such, the Company maintains a clear framework of Non-Executive Director tenure and the skill sets that each Director provides. Individual Director biographies can be found on pages 64 to 66. In accordance with the Code, all the Directors will retire at this year's AGM and submit themselves for reappointment by shareholders. Each of the Non-Executive Directors seeking reappointment are considered to be independent in judgement and character.

Board Evaluation

The effectiveness of the Board is reviewed annually and progress is reviewed every six months. An independent externally facilitated review of the effectiveness of the Board is conducted every three years. An externally facilitated evaluation was therefore undertaken this year, the last having taken place in 2014/15. Manchester Square Partners ("MSP"), who undertook the previous review, were chosen to facilitate the exercise to provide continuity and progress against their prior review. MSP has no other connection with the company.

While the Board was functioning well at the time of the last external review a number of areas were highlighted for attention:

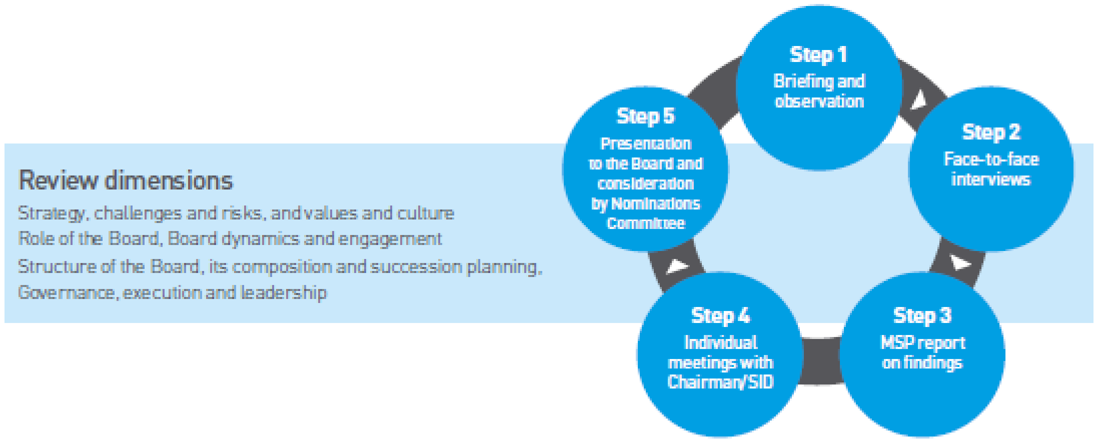
- ***Strategy: While there was alignment at a high level on the strategic priorities there was more to be done on agreeing the strategic opportunities to be pursued and the plans to achieve these.***
- ***Pace of change: There was a need to ensure the pace of change could be delivered in a sustainable way, with the Board considering major change earlier in the process, so as to be able to review over several meetings and provide appropriate support and challenge.***
- ***Mentoring, Talent management and succession planning were identified as needing further focus once the new Executive team was in place.***

- ***Board Agenda: Change suggested to provide more time to discuss a range of strategic opportunities and other key initiatives, whilst not losing focus on performance and finance.***

MSP concluded that significant progress had been made since 2014/15 and there had been a noticeable step change in the focus, alignment, contribution and effectiveness of the Board with well planned and structured board agendas.

The process for the 2017/18 review is set out below:

Step 1	MSP briefed by Chairman and Company Secretary and attended the January Board Meeting in order to observe the Board first hand. They were also provided with access to prior years' Board and Committee papers and minutes and details of the previous internal reviews and progress updates to provide relevant background material.
Step 2	MSP conducted face to face interviews with each Director and the General Counsel and Company Secretary.
Step 3	MSP produced a report setting out their findings which they discussed with the Chairman and Senior Independent Director. Details of their observations and suggested focus areas are shown below, together with the related actions arising from the evaluation process.
Step 4	The Chairman met with each of the Directors and the General Counsel & Company Secretary to discuss the performance of the Board and their individual contributions. The Senior Independent Director met with the Non Executive Directors to discuss the performance of the Chairman and the Non Executive Directors met to discuss the performance of the Chief Executive Officer.
Step 5	MSP's report discussed by the Nominations Committee in its consideration of the re-election of Directors and reported to the full Board at its meeting in April 2018, together with a recommendation by MSP.
Step 6	Six-monthly reviews of progress against recommendations in the report.



Directors' remuneration report

Remuneration details

The Executive Directors of Severn Trent Water Limited mirror those of Severn Trent Plc and, consequently it is not possible to separate the remuneration received solely for their services to Severn Trent Water Limited. Therefore, the Remuneration Report that follows is a summary of the Remuneration Report found in the Severn Trent Plc Annual Report and Accounts which is available on the Severn Trent Plc website.

The Severn Trent Plc Remuneration Committee (the 'Committee') sets the Remuneration Policy for Executive Directors and other senior executive managers, taking into account the Company's strategic objectives over the short and the long term and the external market.

The Committee addresses the need to balance risk and reward. The Committee monitors the variable pay arrangements to take account of risk levels, ensuring an emphasis on long term and sustainable performance. The Committee believes that the incentive schemes are appropriately managed, and that the choice of performance measures and targets does not encourage undue risk taking by the Executives, so that the long term performance of the business is not compromised by the pursuit of short term value. The schemes incorporate a range of internal and external performance metrics, measuring both operational and financial performance over differing and overlapping performance periods, providing a rounded assessment of overall Company performance.

Directors' remuneration and annual bonus scheme

Remuneration for Executive Directors comprises the following elements:

- base salary and benefits;
- annual bonus;
- long term incentive plan; and
- pension arrangements.

As outlined in the Severn Trent Plc Annual Report and Accounts, the non-executive Chairman, Andrew Duff, and non-executive directors, do not participate in the Company's incentive arrangements, i.e. annual bonus or share plans.

Base salaries and benefits

Base salaries for individual Directors are reviewed annually by the Committee and normally take effect from 1 July. Salaries are set with reference to individual performance, experience and contribution, together with developments in the relevant employment market (having regard to similar roles in publicly quoted companies of a comparable size (currently FTSE 51-150) and practice in other water companies), Company performance, affordability and internal relativities.

In addition to base salary, Executive Directors receive a benefits package which contractually includes car allowance, membership of a defined contribution pension scheme or cash allowance in lieu, family level private medical insurance, life assurance, personal accident insurance, health screening and incapacity benefits scheme. Executive Directors may also take advantage of the Severn Trent flexible benefit scheme open to all employees.

Annual Bonus 2017/18

The annual bonus is designed to encourage improved financial and operational performance, and to align the interests of Directors with shareholders through the partial deferral of payment in shares. The maximum bonus opportunity is 120% of salary, with 60% of base salary being paid at target.

Bonuses are based on customer, financial, operational and personal performance. No more than 20% of the bonus will relate to personal contribution for any Executive. Half of the bonus is paid in cash and half in shares which vest after three years (with the value of any dividends to be rolled up and paid on vesting).

Malus and clawback mechanisms also apply to allow the recoupment within three years of the payment of the cash bonus or the grant of deferred shares in the event of financial misstatement, error in the calculation or gross misconduct.

Annual bonus performance is measured over a single financial year. An annual bonus was awarded of 72.54% of salary for each of the Chief Executive Officer and the Chief Financial Officer, and 68.94% of salary for the Managing Director, Wholesale Operations.

The table below shows a summary of the metrics and targets which were used to determine the annual bonus awards, together with the actual performance achieved (please note that the Business Services PBIT element of the bonus has been omitted as it does not relate to the performance of Severn Trent Water):

Measure	***Weighting*** ***% Total award***	**Threshold** **(0% payable)**	**Target** **(50% payable)**	**Stretch** **(100% payable)**	**Actual Performance**	**Outcome** **% Total award**
Severn Trent Water Limited PBIT (i)	*47%*	£515.8m	£529.2m	£542.6m	£527.6m	21%
Customer ODIs	*20%* *(30% in respect of the Managing Director, Wholesale Operations)*	£13.0m	£23.0m	£33.0m	£80.2m	20% for CEO and CFO 30% for MD.WO
Customer Experience (ii)	*8%*	15%	20%	25%	17.2%	2%
Health and safety (iii)	*8%*	0.20	0.16	0.12	0.17	2%
Personal Performance	*7%*	Detailed overleaf				Chief Executive Officer – 6% Chief Financial Officer - 6% Managing Director, Wholesale Operations - 3%

(i) PBIT excluding exceptional items, adjusted for profit on property disposals.
(ii) Measured as percentage reduction is written complaints.
(iii) Measured as number of lost time incidents divided by number of hours worked by multiplied by 100,000.

Despite a period with some significant operational challenges and a difficult year on bad debt, we have continued to make good progress in managing our underlying cost base to absorb these and other cost pressures to end the year delivering PBIT of £527.6m in STW (before property profits). Our customer ODI rewards of £80.2m were underpinned by significant improvements in internal and external sewer flooding, and sustained performance on Category 3 pollutions with a gross performance on waste of £109m. However, this was offset by the impact of operational incidents on water measures such as supply interruptions, which resulted in a net penalty of £29m. This year the Committee agreed to include an additional measure to drive improvement in customer experience, targeting a 20% reduction in written complaints.

In the last few months we have seen a significant improvement in performance driven by a significant improvement in billings related complaints, with these learnings being rolled out across our other teams. The result of these improvements is represented by a 17.2% reduction for the year. We set ourselves bold targets to improve the safety of our employees this year and, although we still incurred 18 LTIs, this represents a 23% year on year improvement, resulting in our best ever year and the lowest LTI rate in the sector in England. Business Services has had a particularly strong year, benefiting from a new contract with plumbing and drainage insurers that contributed significantly to both revenue and PBIT.

Personal objectives for the Executive Directors are linked to our strategic framework which will move us towards our ambition to be the most trusted water company. Objectives were shared across the team with each Executive Director leading on the areas which best align with their accountabilities and expertise.

The achievement of the personal objectives for each of the Executive Directors was as follows: 6%, 6% and 3% for the CEO, CFO and Managing Director, Wholesale Operations, respectively.

The table below sets out performance outcomes for each Executive Director in relation to their specific personal objectives.

CEO

Objective	Activity	Key achievements in 2017/18	Performance outcome
Embed customers at the heart of all we do	Deliver a step change in customer experience Support financially vulnerable customers Be recognised as a UQ Wholesaler Provide an industry leading New Connections experience	Conducted detailed customer research study. Focussed efforts on resolving issues more rapidly. Customer complaints down 6%. 38,000 customers have received financial help with their bills through relaunched Big Difference scheme. 50,00 vulnerable customers supported overall Achieved 1st and 2nd place in Ofwat's water and waste rankings respectively for new connections UQ for UK Customer Service Index for 17/18	Partly met
Drive operational excellence and continuous innovation	Be UQ in water and waste Develop the profitability and growth of the Business Services operations Deliver a sustainable pipeline and process for innovation	Held a staff roadshow to capture and share ideas around innovation and improvement Exceptional waste customer ODI performance	Fully met
Invest responsibly for sustainable growth	On track delivery of AMP6 plans to deliver growth and reduce risk Integrate and deliver benefits from the acquisition of Dee Valley Set up Severn Trent and Water Plus for success in new business retail market	Delivery of additional £100m Totex savings Completed integration of Dee Valley into the business Advanced in realigning boundaries along national boarders Water Plus maintaining its share of a growing market	Partly met

Change the market for the better	Clear PR19 plan in place that evidences our leading status Produce compelling case for investment at PR19 Design and implement the bio-resources change programme and business model Be seen as the water sector's thought leaders	Strong position to submit by September 2018 Created a standalone bio-resources team identifying opportunities for operating efficiencies Collaborated with Thames Water and United Utilities to publish thought leadership document	Fully met
Create an awesome place to work	Improve safety programme Deliver 5% uplift in employee engagement scores Strive to continue to improve diversity and inclusion	Lost Time Injury frequency rate decreased by 23% Employee engagement increased by 6% Increase in the number of BAME employees on graduate programme Launched key inclusion initiatives such as "Dying to work" charter and menopause education.	Fully met

CFO

Objective	Activity	Key achievements in 2017/18	Performance outcome
Embed customers at the heart of all we do	• Improve insurance approach to third part damage	• Completed the review and implemented identified improvements	Fully met
Drive operational excellence and continuous innovation	Support the business to identify and achieve cost efficiencies Continue the evolution of finance, internal audit and enterprise risk functions Reduce the downside risk to pension scheme liability Finance plan in place for key remaining maturities	Identified £100 million of efficiencies to be re-invested into the business ERM Champions and co-ordinators operate throughout the business Significantly reduced pension risk through implemented hedging strategy and financing actions	Fully met
Invest responsibly for sustainable growth	Build and deploy new risk based interest management policy Support the Energy and Renewables growth strategy Deliver target M&A strategy	• Generated 38% of energy needs from renewable sources	Partly met
Change the market for the better	• Support regulatory finance in PR19 and bioresources plan	• Created a standalone bio-resources team identifying opportunities for operating efficiencies.	Fully met
Create an awesome place to work	Deliver change in visible Health and Safety leadership, with a focus on mental wellbeing Deliver better engagement and diversity in finance	LTI rate improvement Improvement of 5% in Finance Employee Engagement performance	Fully met

MD, WO

Objective	Activity	Key achievements in 2017/18	Performance outcome
Embed customers at the heart of all we do	Improvement in customer experience and delivery of customer strategy Be recognised as an UQ Wholesaler	• Exceptional waste customer ODI performance	Partly met
Drive operational excellence and continuous innovation	Be UQ in water and waste Provide environmental leadership Deliver 10 innovation projects	Gained provisional EA 4* status Strong progress made on innovation	Partly met

Invest responsibly for sustainable growth	• On track to delivery of the AMP6 plan to deliver growth and reduce risk • Integrate and deliver benefits from the acquisition of Dee Valley	Delivery of Totex savings Delivery of Water Resources Management Plan Completed integration of Dee Valley into the business	Partly met
Change the market for the better	Clear PR19 plan in place that evidences our leading status and investment case Design and implement the bio-resources change programme and business model Be seen as the water sector's thought leaders	Strong position to submit by September 2018 Created a standalone bio-resources team identifying opportunities for operating efficiencies.	Partly met

The bonuses awarded for 2017/18 were 72.54% of base salary for Liv Garfield (£500,961), 72.54% of base salary for James Bowling (£301,911) and 68.94% of base salary for Emma FitzGerald (£209,819 – note this is pro-rated to reflect her time on the Board during 2017). Please note that the bonuses incorporate amounts in respect of the achievement of Severn Trent Business Services targets (with the exception of the Managing Director, Wholesale Operations) and personal performance targets. Annual bonus payments to Executive Directors are not pensionable.

Summary of Remuneration Policy, proposed amendments and implementation in 2018/19

Shareholders approved the Remuneration Policy at the AGM in 2015 (97.99% voted in favour). As such, the Company is required to seek approval for the new Policy at the 2018 AGM. The table below sets out an overview of the key areas of the Policy and summarises how the Committee is proposing to implement the Policy in 2018/19. Full details of the proposed Policy can be found on pages 120 to 128 of the Group Annual Report and Accounts. The Committee believes that the fundamental architecture of the Executive Directors' remuneration package is appropriate but we have made a number of evolutionary changes to the previous Remuneration Policy to reflect the development of the Company, our Executive Directors and the latest corporate governance best practice:

- Pension contributions for any new Executive Directors will be capped at 15% of salary in line with other employees;
- The maximum LTIP award opportunity will be increased to 200% of salary;
- A 2 year holding period will apply following the vesting of LTIP awards for the Executive Directors (this holding period will continue post cessation of employment); and
- The minimum shareholding guidelines will be increased to 300% of salary for the CEO and 200% of salary for other Executive Directors, reflecting best practice

Annual Bonus 2018/19

In summary, the annual bonus performance measures and weightings for 2018/19 financial year will be as follows:

- RWWW Profit Before Interest & Tax – 47%
- STW Customer Outcome Delivery Incentives – 20%
- Business Services Profit Before Interest & Tax – 10%
- Customer Experience – 8%
- Health and Safety (Lost Time Incidents) – 8%
- Personal Objectives – 7%

The Committee considers the forward looking performance targets to be commercially sensitive and has, therefore, determined not to disclose them in advance. Details of the targets used will be disclosed in next year's Remuneration Report.

Long Term Incentive Plan

Executive Directors may also participate in the Severn Trent Plc Long Term Incentive Plan ('LTIP') which is designed to encourage strong and sustained improvements in financial performance, in line with the Company's strategy, and long term shareholder returns. Under this plan conditional awards of performance shares are made to Directors up to an annual maximum limit and vest after three years. The value of dividends paid on the shares comprising the award will be rolled up and paid on vesting.

Malus and clawback mechanisms apply to allow the recoupment of incentive awards within three years of vesting in the event of financial misstatement, an error in calculating the level of vesting or gross negligence, fraud or gross misconduct.

2015 LTIP Awards

The 2015 awards are subject to a RoRE performance condition measured over three financial years. Average RoRE performance is compared with the baseline RoRE figure set by Ofwat in our FD. 25% of the award will vest if average RoRE matches the baseline figure, increasing on a straight-line basis to full vesting for outperforming the baseline by 1.29 times. The 2015 LTIP awards were granted on 15 July 2015. The share price used to calculate the number of shares granted was £21.49 (being the average price over the preceding three days).

The RoRE calculation used for LTIPs differs slightly from that used in the annual performance report, which uses the Ofwat definition. The LTIP measure seeks to better align our LTIP targets to actual cash flows and against a clearly defined target (the FD). In this measure financing outperformance is based on actual gearing rather than the notional capital structure and compares our cost of debt against the allowance in the Ofwat Financial Model. It includes profits/losses associated with land sales, miscellaneous activities and the impact of the wholesale revenue forecasting incentive mechanism.

The three year performance period for the 2015 LTIP award ended on 31 March 2018.
Our final RoRE of 1.79 times the Final Determination results in a vesting of 100% of the maximum. Further details can be found in the Severn Trent Plc Annual Report and Accounts.

2016, 2017 & 2018 LTIP Awards

Awards granted from 2015 onwards are subject to a Return on Regulated Equity (RoRE) performance condition measured over three financial years. Average RoRE performance is compared with the baseline RoRE figure set by Ofwat in our Final Determination (FD). For the 2016 and 2017 awards threshold performance is equal to the FD, increasing on a straight line basis to target vesting for out-performing the FD by 1.39 times. For 2018 awards an additional stretch target of upper quartile RoRE has been added. A 2-year post vesting holding period will also apply. Further details can be found in the Severn Trent Plc Annual Report and Accounts.

The grant level for the 2018 LTIP award is 200% of base salary for the Chief Executive Officer and 150% of base salary for the Chief Financial Officer, subject to shareholder approval of the new Remuneration Policy at the 2018 AGM.

Shareholding guidelines

The Company operates shareholding guidelines under which Executive Directors are expected to build and maintain a shareholding in the Company. The Chief Executive Officer is expected to build and maintain a holding of shares to the value of 300% of salary, and the Chief Financial Officer 200% of salary. Executive Directors are expected to retain all of the net of tax number of shares they receive through the LTIP and deferred share bonus until the shareholding guidelines have been met.

The Chief Executive Officer has exceeded the new shareholding requirement of 300% and the Chief Financial Officer is expected to meet the new shareholding requirement of 200% of base salary in 2019.

Directors' Report

The Directors present their report and the audited financial statements, for the year ended 31 March 2018. The performance review of the Company can be found within the Strategic report on pages 3 to 60. This provides detailed information relating to the Group, its business model and strategy, the operation of its businesses, future developments and the results and financial position for the year ended 31 March 2018. The Governance Report set out on pages 61 to 86 is incorporated by reference into this report and, accordingly, should be read as part of this report. Details of the Group's policy on addressing the Principal risks and uncertainties facing the Group are set out in the risk management section on pages 55 to 60.

Principal activity
The principal activity of the Company is to treat and provide water and remove waste water in the UK. There have not been any significant changes to the Company's principal activities in the year under review. The Directors are not aware, at the date of this report, of any likely major changes in the Company's activities in the next year.

Directors and their interests
Biographies of the Directors currently serving on the Board are set out on pages 64 to 66.

All of the Directors at the year-end are also Directors of Severn Trent Plc, they will all be offering themselves for appointment or reappointment at the Severn Trent Plc AGM, as set out in the Governance report on page 78.

Details of Directors' service contracts are set out in the Directors' Remuneration Report on page 125 of the Severn Trent Plc Annual Report. The interests of the Directors in the shares of Severn Trent Plc are disclosed in the Annual Report and Accounts for that Company for the year ended 31 March 2018.

The Board has a documented process in place in respect of conflicts which is described on page 72.

Insurance and indemnities
The Company maintains Directors' and Officers' liability insurance in respect of legal action that might be brought against its Directors and Officers. As permitted by the Company's Articles of Association (the 'Articles'), and to the extent permitted by law, the Company indemnifies each of its Directors and other Officers of the Group against certain liabilities that may be incurred as a result of their positions with the Group. The indemnity was in force throughout the tenure of each Director during the last financial year, and is currently in force.

Severn Trent Water Limited does not have in place any indemnities for the benefit of the external Auditor.

Employees
The average number of employees within the Group is shown in note 6 to the financial statements on page 119.

Severn Trent Water believes a diverse and inclusive workforce is a key factor in being a successful business. Through our Diversity and Equal Opportunities Policy, the Company seeks to ensure that every employee, without exception, is treated equally and fairly and that all employees are aware of their responsibilities. This means more than ensuring we don't discriminate in any way – we want to create and maintain a culture open to a diverse population.

We are an equal opportunities employer and welcome applications from all individuals, including those with a disability. We are fully committed to supporting applications made by disabled persons, and make reasonable adjustments to their environment where possible (having regard to their particular aptitudes and abilities). We are also responsive to the needs of our employees. As such, should any employee become disabled during their time with us, we will actively re-train that employee and make reasonable adjustments to their environment where possible, in order to keep them in employment with us. All our training, promotion and career development processes are in place for all our employees to access, regardless of their gender, race, age or disability. The provision of occupational health programmes is of crucial importance to Severn Trent with the aim of keeping our employees fit, healthy and well, including an employee assistance programme.

Employee engagement
We continuously engage with our employees in a number of ways to accommodate different working patterns. This includes:

- all people briefings, 'Team Talk';
- corporate communications events and roadshows held by functions across the Company;
- a dedicated intranet, 'Streamline';
- online news portal and weekly roundup,'Pipeline News';
- an active employee social media presence, 'Yammer';
- conference calls and email;
- leadership engagement channels – Chief Executive's weekly blog, senior management monthly visibility programme and quarterly events;
- Company forum; and
- regular meetings with Unions.

Details of the financial and economic factors affecting the performance of the Company are shared with all employees at the appropriate time using the methods listed above. We provide opportunities for employees to give their feedback to the Company in a number of ways, from team or shift meetings and annual employee satisfaction surveys.

The Company is keen to encourage greater employee involvement in the Group's performance through share ownership. To help align employees' interests with the success of the Company's performance, we operate an HMRC approved all-employee plan, the Severn Trent Sharesave Scheme ('Sharesave'), which is offered to UK employees on an annual basis.

Over 70% of Severn Trent Water's UK employees participate in one or more of our schemes, with the average participant contributing £274 each month.

During the year, Severn Trent Plc has remained within its headroom limits for the issue of new shares for share plans as set out in the rules of the above plan.

Research and development
Innovative use of existing and emerging technologies will continue to be crucial to the successful development of new products and processes for the Group and our products must continue to deliver value for customers.

Expenditure on research and development is set out in note 4 to the financial statements on pages 117.

Post balance sheet events
Details of post balance sheet events are set out in note 41 to the financial statements on page 160.

Contributions for political and charitable purposes
Donations to charitable organisations during the year amounted to £81,947 (2017: £312,588). Donations are given to charities whose projects align closely with our aim to promote the responsible use of water resources and waste water services which provide the opportunity for longer term partnerships.

In addition, we provide donations to employee nominated charities through a matched funding scheme and health and safety reward schemes. We are also committed to supporting WaterAid, the UK's only major charity dedicated to improving access to safe water, hygiene and sanitation in the world's poorest countries.

Severn Trent's policy is not to make any donations for political purposes in the UK, or to donate to EU political parties or incur EU political expenditure. Accordingly neither Severn Trent Plc nor its subsidiaries made any political donations or incurred political expenditure in the financial year under review. Under the provisions of the Political Parties Elections and Referendums Act 2000 (the relevant provisions of which are now contained in Part 14 of the Companies Act 2006), shareholder authority is required for political donations to be made or political expenditure to be incurred by the Company or any of its subsidiaries in the EU and disclosure of any such payment must be made in the Annual Report and Accounts. The legislation gives a wide definition of what constitutes political donations and political expenditure including sponsorship, subscriptions, payment of expenses, paid leave for employees fulfilling public duties and support for bodies representing the business community in policy review or reform. The Company has therefore obtained limited authority from shareholders as a precautionary measure to allow the Company to continue supporting the community and such organisations without inadvertently breaching the legislation.

At the 2017 AGM, shareholders gave the Company authority to make political donations or to incur political expenditure in the EU (which would not ordinarily be regarded as political donations) up to an aggregate annual limit of £150,000 for the Company and its subsidiaries. Pursuant to those authorities, during the year ended 31 March 2018 the Group incurred costs of £nil (2017: £nil). Those authorities will expire at the 2018 AGM and, in line with market practice to renew the authorities on an annual basis, the Board has decided to put forward a resolution to this year's AGM to renew the authorities to make donations to political organisations and to incur political expenditure up to a maximum aggregate of £150,000 p.a. As permitted under the Companies Act 2006, this resolution also covers any political donations made or political expenditure incurred by any subsidiaries of the Company.

Supplier payment policy

Individual operating companies within the Group are responsible for establishing appropriate policies with regard to the payment of their suppliers, in accordance with the Prompt Payment Code ('PPC'). The companies agree terms and conditions under which business transactions with suppliers are conducted. It is Group policy that provided a supplier is complying with the relevant terms and conditions, including the prompt and complete submission of all specified documentation, payment will be made in accordance with agreed terms. It is also Group policy to ensure that suppliers know the terms on which payment will take place when business is agreed.

Internal controls

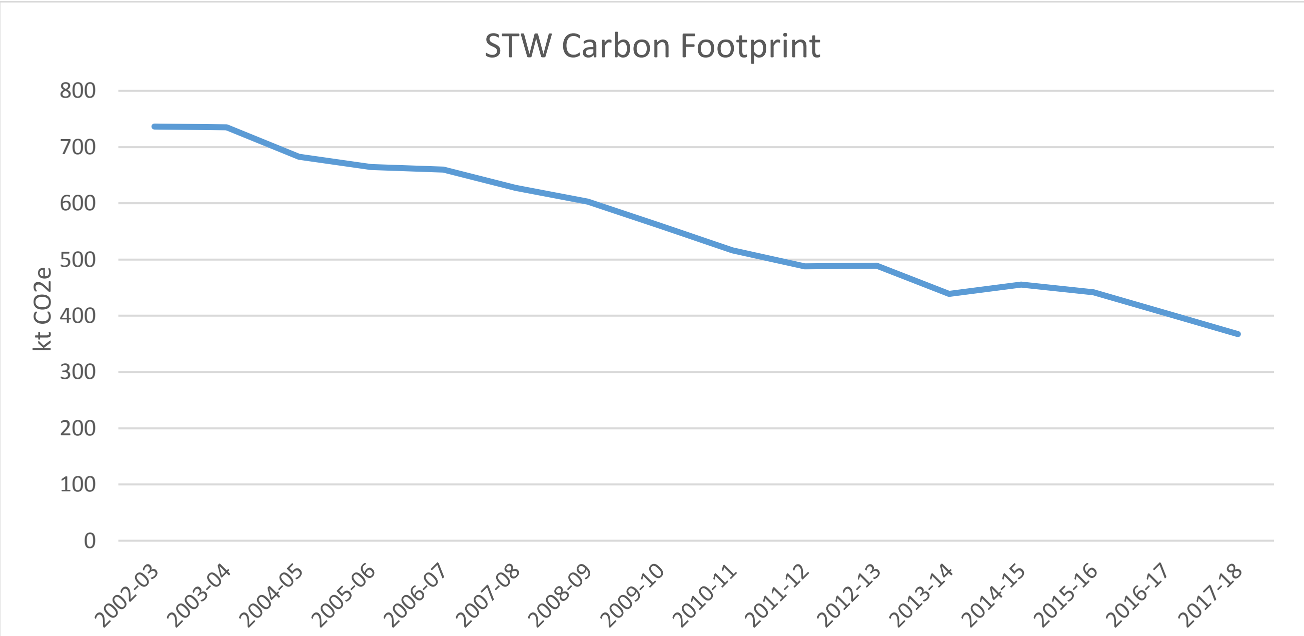
The Board is responsible for the Group's Internal Control systems and for reviewing their effectiveness. The Audit Committee regularly monitors and reviews the effectiveness of the systems of Internal Control, including Risk Management, financial, operational and compliance aspects, in accordance with the requirements of the Code and the Guidance, and these systems have been in place for the year ending 31 March 2018 and up to the date of the Annual Report. This is described in the Severn Trent Plc Audit Committee report on page 86 of the Severn Trent Plc Annual Report.

The Internal Control system can provide only reasonable and not absolute assurance against material misstatement or loss, as it is designed to manage rather than eliminate the risk of failure to achieve business objectives.

Greenhouse gas emissions
We reduce our carbon footprint

The UK is playing a leading part in reducing carbon emissions. We want to play our part in reducing our impact by reducing our carbon emissions. As the majority of our carbon emissions are driven by our use of energy, managing carbon means managing costs. We therefore aim to reduce carbon emissions and increase our generation of renewable energy.

We are achieving both of these aims, and this year we have seen another reduction in overall carbon emissions. We've seen a consistent reduction since 2002 when we began publicly reporting on our greenhouse gas emissions. We have held the Carbon Trust Standard since 2009 in recognition of this achievement and we've been recertified to 2019.



The Carbon Trust Standard recognises our consistent emissions reductions and effective carbon management processes and we scored in the top quartile of companies. We continue to report to the Carbon Disclosure Project ('CDP') each year which means our climate change information is publicly accessible. CDP request information about climate change from companies on behalf of investors and score each company on the quality and completeness of their responses.

We plan to continue to reduce our operational emissions by reducing our energy use and increase our renewable energy generation. Pursuing these measures will continue to reduce our key sources of emissions, reduce our reliance on the electricity grid and bring financial benefits for our customers and investors.

Report on Greenhouse gas emissions

This is the fifth year Severn Trent has been required to report greenhouse gas (GHG) emissions in the Directors' report.

Severn Trent is committed to reducing its GHG emissions. For Severn Trent Water, which accounts for 99% of Severn Trent Group's total emissions, we have been publicly reporting on our emissions since 2002. In that time we have reduced our emissions by being more energy efficient and generating more renewable energy.

Our GHG emissions are reported in tonnes of carbon dioxide equivalent (tCO2e), for the period 1 April 2017 to 31 March 2018.

Our total net emissions have fallen again this year, due to our increased generation of renewable energy, a reduction in the emissions-intensity of UK grid electricity and reduced fuel and process emissions.

The GHG data we report is reported internally during the year to the Corporate Responsibility Committee and to the Board. We have subjected our GHG data and processes to external assurance by Jacobs.

Severn Trent Water Limited - Operational Greenhouse Gas Emissions (Tonnes CO_2e)	2013-14	2014-15	2015-16	2016-17	2017-18
Scope 1 Emissions (Combustion of fuel and operation of facilities)	123,940	122,282	126,009	128,584	130,662
Scope 2 Emissions (Electricity purchased for own use)	333,721	357,701	340,484	298,872	264,290
Total Annual Gross Operational Emissions	457,661	479,983	466,493	427,456	394,951
Emissions benefit of the renewable energy we export (including biogas for which we hold green gas certificates)	18,638	24,247	24,887	22,790	27,476
Total Annual Net Operational Emissions	439,023	455,735	441,606	404,666	367,475

Annual GHG intensity ratio (t CO_2/unit)	2013-14	2014-15	2015-16	2016-17	2017-18
Operational GHG emissions of Severn Trent per £m turnover	248.6	255.2	234.7	214.0	217.4

Our approach to reporting is based on the GHG Protocol Corporate Accounting and Reporting Standard and we have included only emissions from the assets which we own and operate and which we can directly influence and reduce, known as the financial control boundary. In accordance with the reporting regulations, we have not reported on emissions we can influence, but which we are not responsible for, referred to as indirect emissions. We have used the **'location based'** methodology rather than the more recently-introduced 'market-based' method to account for use of grid electricity in order to ensure consistency with previous years.

For the appointed UK Water businesses Severn Trent and Dee Valley, we have calculated our emissions using the 'Carbon accounting in the UK Water Industry: methodology for estimating operational emissions, Version 12' (released April 2018). This is a peer-reviewed calculation tool developed and used by all the major water companies in the UK. It is updated each year to include the latest available emissions factors.

External Auditor
Having carried out a review of their effectiveness during the year, described in the Severn Trent Plc Audit Committee report on page 87 of the Severn Trent Plc Annual Report, the Severn Trent Plc Audit Committee has recommended to the Board the reappointment of Deloitte LLP.

The reappointment and a resolution to that effect will be on the agenda at the Severn Trent Plc AGM. Deloitte LLP indicated their willingness to continue as Auditor. The Severn Trent Plc Audit Committee will also be responsible for determining the audit fee on behalf of the Board.

Severn Trent Relevant audit information
The Directors confirm that:
- so far as each of them is aware, there is no relevant audit information of which the Company's Auditor is unaware; and
- each of them has taken all the steps that he/she ought to have taken as a Director to make himself/herself aware of any relevant audit information and to establish that the Company's Auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Annual Performance Report of Severn Trent Water Limited
The Annual Performance Report for Severn Trent Water Limited is prepared and sent to Ofwat. A copy of this will be available on the website of Severn Trent Water Limited or on request to the Company Secretary. There is no charge for this publication.

By order of the Board
Bronagh Kennedy
Group General Counsel and Company Secretary
22 May 2018

Directors' responsibilities statement

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors are required to prepare the Group financial statements in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the European Union and the Parent Company financial statements in accordance with United Kingdom Generally Accepted Practice (United Kingdom Accounting Standards and applicable law) including FRS101 'Reduced Disclosure Framework'. Under company law the Directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

In preparing the parent company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the Going Concern basis unless it is inappropriate to presume that the Company will continue in business.

In preparing the Group financial statements, International Accounting Standard 1 requires that Directors:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the Company's ability to continue as a Going Concern.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement
Each of the Directors confirm that to the best of their knowledge:

- the financial statements, prepared in accordance with the relevant financial reporting framework, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole;
- the Strategic report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face; and

- The Annual Report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's position and performance, business model and strategy.

This Responsibility Statement was approved by the Board of Directors on 22 May 2018 and is signed on its behalf by:

Andrew Duff
Chairman

James Bowling
Chief Financial Officer

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SEVERN TRENT WATER LIMITED

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.**

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

- the Consolidated and Company income statements;
- the Consolidated and Company statements of comprehensive income;
- the Consolidated and Company balance sheets;
- the Consolidated and Company cash flow statements;
- the Consolidated and Company statements of changes in equity; and
- the related Notes to the Group and Company financial statements 1 to 44.

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, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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 in the current year was £16 million (2017: £16 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 100% of the group's turnover and over 90% of the group's net operating assets and profit before tax, gains/losses on financial instruments and exceptional items being subject to audit procedures
Significant changes in our approach	There have been no significant changes to our scoping approach for the year ended 31 March 2018.

Conclusions relating to going concern, principal risks and viability statement

Going concern
We have reviewed the directors' statement on page 54 to the financial statements 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 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 55 to 60 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation on page 55 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 page 53 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 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 which 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
- 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 23.1% of the Turnover disclosed in Note 5. 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.
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 WaterPlus management 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 at 31 March 2018 is £128.2 million (31 March 2017 £128.3 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.
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, along with investment returns 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 groups retirement benefit obligation at 31 March 2018 is £511.1 million (31 March 2017 £574.6 million) as per Note 27 Retired Benefit Schemes.
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 27, 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 the year for Severn Trent Water Limited were £663.2 million disclosed in Note 17 (31 March 2017 £541.5 million). 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.
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

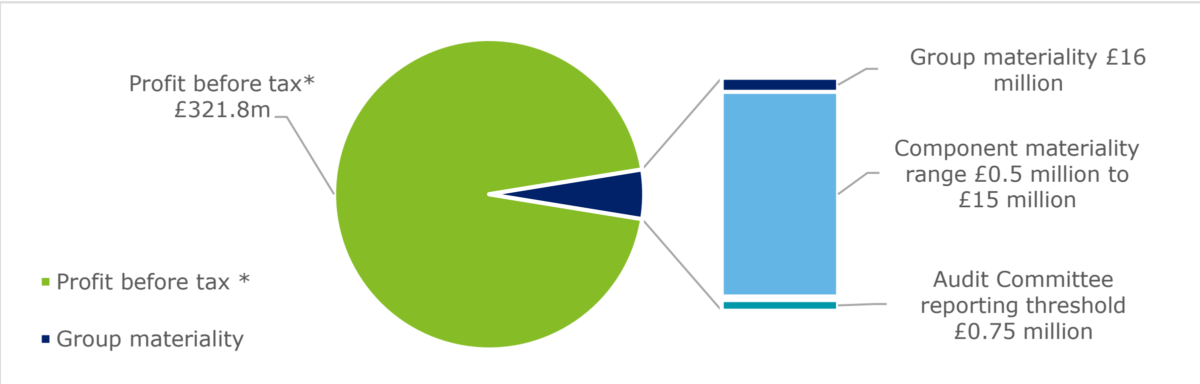
	• we agreed a sample of costs to third party invoices and assessed whether the split between capital and operating expenditure was aligned to the original approved business plan.
Key observations	We are satisfied that the valuation and classification of assets capitalised in the year is appropriate.

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	£16 million (2017: £16 million)	£15 million (2017: £15 million)
Basis for determining materiality	5.0% (2017: 5.1%) of profit before tax, exceptional items and fair value movements in derivative financial instruments.	4.8% (2017: 5.0%) of profit before tax, exceptional items and fair value movements in derivative financial instruments.
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.	As in 2017, profit before tax, gains/losses on financial instruments and exceptional items has been used in order to focus on the parent company's underlying trading performance consistent with the parent company's internal and external reporting.



** 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.

Based on that assessment, we focused our group audit scope on the consolidation at the parent company level and Severn Trent Water Limited, Severn Trent Utilities Finance plc and Dee Valley Group plc.

Severn Trent Water Limited, Severn Trent Utilities Finance Plc and Dee Valley Group Plc were subject to full statutory audits using component of £15 million (2017: £15 million), £9 million (2017: £9 million) and £547,000 (2017: £7.5 million) respectively and together account for 100% of the group's turnover (2017: 100%), and over 90% (2017: 90%) of the group's net assets and profit before tax, gains/losses on financial instruments and exceptional items.

The group audit team performs the audits of Severn Trent Water Limited, Severn Trent Utilities Finance Plc and Dee Valley Group Plc without the involvement of a component audit team.

Parent company and consolidation
At the parent entity level 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 audit or audit of specified account balances.

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.

We have nothing to report in respect of these matters.

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.

Although not required to do so, the directors have voluntarily chosen to make a corporate governance statement detailing the extent of their compliance with the UK Corporate Governance Code. We reviewed the part of the Corporate Governance Statement relating to the company's compliance with certain provisions of the UK Corporate Governance Code.

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

Opinion on other matters prescribed by the Companies Act 2006

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

- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Directors' Report has 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.

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 period ending 31 March 2006 and subsequent financial periods. Following a competitive tender process, we were reappointed as auditor of the Company for the period 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 period 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).

Kate Hadley, FCA (Statutory auditor)
for and on behalf of Deloitte LLP
Statutory Auditor
Birmingham, United Kingdom
22 May 2018

Severn Trent Water Limited
Group and company income statement

For the year ended 31 March 2018

		Group		Company	
		2018	2017	**2018**	2017
	Note	**£m**	£m	**£m**	£m
Turnover	5	**1,606.9**	1,556.1	**1,579.0**	1,554.0
Operating costs before exceptional items	6	**(1,069.2)**	(1,043.3)	**(1,047.0)**	(1,041.3)
Exceptional items	7	**(12.6)**	27.6	**(12.6)**	27.6
Total operating costs	6	**(1,081.8)**	(1,015.7)	**(1,059.6)**	(1,013.7)
Profit before interest, tax and exceptional items		**537.7**	512.8	**532.0**	512.7
Exceptional items	7	**(12.6)**	27.6	**(12.6)**	27.6
Profit before interest and tax		**525.1**	540.4	**519.4**	540.3
Finance income	10	**66.5**	73.6	**86.1**	84.6
Finance costs	11	**(282.4)**	(273.2)	**(305.1)**	(294.6)
Net finance costs		**(215.9)**	(199.6)	**(219.0)**	(210.0)
Net losses on financial instruments	12	**(7.2)**	(6.6)	**(7.2)**	(6.6)
Profit on ordinary activities before taxation		**302.0**	334.2	**293.2**	323.7
Current tax	13	**(32.5)**	(41.2)	**(30.4)**	(39.4)
Deferred tax	13	**(27.1)**	(20.2)	**(27.9)**	(5.5)
Exceptional tax	13	**–**	52.0	**–**	52.8
Taxation on profit on ordinary activities		**(59.6)**	(9.4)	**(58.3)**	7.9
Profit for the year from continuing operations		**242.4**	324.8	**234.9**	331.6
Loss for the year from discontinued operations	37	**(1.2)**	(0.2)	**(1.2)**	(0.2)
Profit for the year		**241.2**	324.6	**233.7**	331.4

Severn Trent Water Limited
Group and company statement of comprehensive income

For the year ended 31 March 2018

	Group		Company	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
Profit for the year	**241.2**	324.6	**233.7**	331.4
Other comprehensive income/(loss)				
Items that will not be reclassified to the income statement:				
Net actuarial gains/(losses)	**38.9**	(311.2)	**30.7**	(311.2)
Tax on net actuarial gains/(losses)	**(9.2)**	56.5	**(7.8)**	56.5
Deferred tax arising on change of rate	**–**	(2.6)	**–**	(2.6)
	29.7	(257.3)	**22.9**	(257.3)
Items that may be reclassified to the income statement:				
Gains/(losses) on cash flow hedges	**4.1**	(8.0)	**4.1**	(8.0)
Deferred tax on gains/losses on cash flow hedges	**(0.7)**	1.4	**(0.7)**	1.4
Amounts on cash flow hedges transferred to the income statement	**8.5**	3.3	**8.5**	3.3
Deferred tax on transfer to the income statement	**(1.4)**	(0.7)	**(1.4)**	(0.7)
	10.5	(4.0)	**10.5**	(4.0)
Other comprehensive income/(loss) for the year	**40.2**	(261.3)	**33.4**	(261.3)
Total comprehensive income for the year	**281.4**	63.3	**267.1**	70.1

Severn Trent Water Limited
Group 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	Hedging reserve £m	Retained earnings £m	Total £m	Non-controlling interests £m	Total equity £m
At 1 April 2016	100.0	–	(92.7)	889.1	896.4	10.6	907.0
Profit for the year	–	–	–	324.6	324.6	–	324.6
Losses on cash flow hedges	–	–	(8.0)	–	(8.0)	–	(8.0)
Deferred tax on losses on cash flow hedges	–	–	1.4	–	1.4	–	1.4
Amounts on cash flow hedges transferred to the income statement	–	–	3.3	–	3.3	–	3.3
Deferred tax on transfer to the income statement	–	–	(0.7)	–	(0.7)	–	(0.7)
Net actuarial losses	–	–	–	(311.2)	(311.2)	–	(311.2)
Tax on net actuarial losses	–	–	–	56.5	56.5	–	56.5
Deferred tax arising on change of rate	–	–	–	(2.6)	(2.6)	–	(2.6)
Transfer net of deferred tax	–	–	7.0	(7.0)	–	–	–
Total comprehensive income for the year	–	–	3.0	60.3	63.3	–	63.3
Share options and LTIPs							
- value of employees' services	–	–	–	6.0	6.0	–	6.0
Current tax on share based payments	–	–	–	0.8	0.8	–	0.8
Deferred tax on share based payments	–	–	–	0.1	0.1	–	0.1
Capital injection	–	1,470.0	–	–	1,470.0	–	1,470.0
Reduction in capital	(99.0)	(1,470.0)	–	1,569.0	–	–	–
Dividends paid	–	–	–	(195.5)	(195.5)	–	(195.5)
At 31 March 2017	1.0	–	(89.7)	2,329.8	2,241.1	10.6	2,251.7
Profit for the year	–	–	–	241.2	241.2	–	241.2
Gains on cash flow hedges	–	–	4.1	–	4.1	–	4.1
Deferred tax on gains on cash flow hedges	–	–	(0.7)	–	(0.7)	–	(0.7)
Amounts on cash flow hedges transferred to the income statement	–	–	8.5	–	8.5	–	8.5
Deferred tax on transfer to the income statement	–	–	(1.4)	–	(1.4)	–	(1.4)
Net actuarial gains	–	–	–	38.9	38.9	–	38.9
Tax on net actuarial gains	–	–	–	(9.2)	(9.2)	–	(9.2)
Total comprehensive income for the year	–	–	10.5	270.9	281.4	–	281.4
Share options and LTIPs							
- value of employees' services	–	–	–	6.8	6.8	–	6.8
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	–	–	–	(204.0)	(204.0)	–	(204.0)
At 31 March 2018	**1.0**	**–**	**(79.2)**	**2,403.0**	**2,324.8**	**10.6**	**2,335.4**

Severn Trent Water Limited
Company 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	Hedging reserve £m	Retained earnings £m	Total £m
At 1 April 2016	100.0	–	(92.7)	932.5	939.8
Profit for the year	–	–	–	331.4	331.4
Losses on cash flow hedges	–	–	(8.0)	–	(8.0)
Deferred tax on losses on cash flow hedges	–	–	1.4	–	1.4
Amounts on cash flow hedges transferred to the income statement	–	–	3.3	–	3.3
Deferred tax on transfer to the income statement	–	–	(0.7)	–	(0.7)
Net actuarial losses	–	–	–	(311.2)	(311.2)
Tax on net actuarial losses	–	–	–	56.5	56.5
Deferred tax arising on change of rate	–	–	–	(2.6)	(2.6)
Transfer net of deferred tax	–	–	7.0	(7.0)	-
Total comprehensive income for the year	–	–	3.0	67.1	70.1
Share options and LTIPs					
- value of employees' services	–	–	–	6.0	6.0
Current tax on share based payments	–	–	–	0.8	0.8
Deferred tax on share based payments	–	–	–	0.1	0.1
Capital injection	–	1,470.0	–	–	1,470.0
Reduction in capital	(99.0)	(1,470.0)	–	1,569.0	–
Dividends paid	–	–	–	(195.5)	(195.5)
At 31 March 2017	1.0	–	(89.7)	2,380.0	2,291.3
Profit for the year	–	–	–	233.7	233.7
Gains on cash flow hedges	–	–	4.1	–	4.1
Deferred tax on gains on cash flow hedges	–	–	(0.7)	–	(0.7)
Amounts on cash flow hedges transferred to the income statement	–	–	8.5	–	8.5
Deferred tax on transfer to the income statement	–	–	(1.4)	–	(1.4)
Net actuarial gains	–	–	–	30.7	30.7
Tax on net actuarial gains	–	–	–	(7.8)	(7.8)
Total comprehensive income for the year	–	–	10.5	256.6	267.1
Share options and LTIPs					
- value of employees' services	–	–	–	6.8	6.8
Current tax on share based payments	–	–	–	0.8	0.8
Deferred tax on share based payments	–	–	–	(1.3)	(1.3)
Dividends paid	–	–	–	(204.0)	(204.0)
At 31 March 2018	**1.0**	–	**(79.2)**	**2,438.9**	**2,360.7**

Severn Trent Water Limited
Group and company balance sheet
At 31 March 2018

	Note	Group 2018 £m	Group 2017 £m	Company 2018 £m	Company 2017 £m
Non-current assets					
Goodwill	15	**63.5**	67.3	**1.3**	1.3
Other intangible assets	16	**85.7**	75.7	**81.4**	75.7
Property, plant and equipment	17	**8,362.7**	8,003.6	**8,223.8**	7,876.4
Investments in subsidiaries, joint ventures and associates	18	**1,470.0**	1,470.0	**1,948.3**	1,948.1
Derivative financial instruments	19	**36.0**	67.0	**36.0**	67.0
Trade and other receivables	20	**101.9**	–	**262.8**	154.3
Retirement benefit surplus	27	**18.2**	9.8	**–**	–
		10,138.0	9,693.4	**10,553.6**	10,122.8
Current assets					
Inventory		**7.6**	6.6	**7.1**	6.3
Trade and other receivables	20	**432.4**	497.1	**422.1**	472.8
Current tax receivable		**–**	–	**–**	2.8
Derivative financial instruments	19	**0.2**	–	**0.2**	–
Cash and cash equivalents		**12.1**	0.2	**9.2**	–
		452.3	503.9	**438.6**	481.9
Current liabilities					
Borrowings	22	**(304.2)**	(565.3)	**(319.7)**	(584.6)
Derivative financial instruments	24	**–**	(0.5)	**–**	(0.5)
Trade and other payables	25	**(449.3)**	(420.1)	**(430.3)**	(391.0)
Current tax payable		**(7.9)**	(0.3)	**(4.8)**	–
Provisions for liabilities	28	**(16.6)**	(8.0)	**(16.6)**	(8.0)
		(778.0)	(994.2)	**(771.4)**	(984.1)
Net current liabilities		**(325.7)**	(490.3)	**(332.8)**	(502.2)
Total assets less current liabilities		**9,812.3**	9,203.1	**10,220.8**	9,620.6
Non-current liabilities					
Borrowings	22	**(5,147.7)**	(4,605.1)	**(5,821.0)**	(5,282.3)
Derivative financial instruments	24	**(108.2)**	(174.2)	**(108.2)**	(174.2)
Trade and other payables	25	**(1,008.9)**	(954.3)	**(998.7)**	(943.9)
Deferred tax	26	**(676.6)**	(626.6)	**(662.3)**	(614.0)
Retirement benefit obligations	27	**(529.3)**	(584.4)	**(263.7)**	(308.1)
Provisions for liabilities	28	**(6.2)**	(6.8)	**(6.2)**	(6.8)
		(7,476.9)	(6,951.4)	**(7,860.1)**	(7,329.3)
Net assets		**2,335.4**	2,251.7	**2,360.7**	2,291.3
Equity					
Called up share capital	29	**1.0**	1.0	**1.0**	1.0
Hedging reserve		**(79.2)**	(89.7)	**(79.2)**	(89.7)
Retained earnings		**2,403.0**	2,329.8	**2,438.9**	2,380.0
Equity attributable to owners of the company		**2,324.8**	2,241.1	**2,360.7**	2,291.3
Non-controlling interests		**10.6**	10.6	**–**	–
Total equity		**2,335.4**	2,251.7	**2,360.7**	2,291.3

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

Andrew Duff
Chairman

James Bowling
Chief Financial Officer

Company Number 02366686

Severn Trent Water Limited
Group and company cash flow statement
For the year ended 31 March 2018

		Group		Company	
	Note	**2018 £m**	2017 £m	**2018 £m**	2017 £m
Cash generated from operations	38	**788.0**	851.9	**799.5**	854.6
Tax paid	38	**(14.9)**	(37.9)	**(13.0)**	(36.3)
Net cash generated from operating activities		**773.1**	814.0	**786.5**	818.3
Cash flows from investing activities					
Purchases of subsidiary, net of cash acquired		**(0.2)**	(77.7)	**(0.2)**	(79.0)
Purchases of property, plant and equipment		**(599.9)**	(467.0)	**(582.2)**	(466.4)
Purchases of intangible assets and goodwill		**(25.3)**	(26.1)	**(25.5)**	(26.1)
Contributions and grants received		**36.7**	39.5	**36.8**	39.5
Proceeds on disposal of property, plant and equipment		**5.7**	12.5	**5.5**	12.5
Net loans advanced to related parties		**–**	(99.7)	**–**	(99.7)
Interest received from intercompany finance leases		**–**	–	**5.1**	5.1
Interest received		**5.5**	1.6	**5.1**	2.8
Net cash from investing activities		**(577.5)**	(616.9)	**(555.4)**	(611.3)
Cash flow from financing activities					
Interest paid		**(177.8)**	(171.3)	**(197.9)**	(176.9)
Interest element of finance lease payments		**(5.1)**	(5.8)	**(5.3)**	(5.8)
Dividends paid to shareholders of the parent		**(204.0)**	(195.5)	**(204.0)**	(195.5)
Swap termination payment		**(40.0)**	–	**(40.0)**	–
Repayments of borrowings		**(552.7)**	(275.0)	**(151.5)**	(275.0)
Repayments of obligations under finance leases		**(1.8)**	(1.5)	**(18.4)**	(16.1)
New loans raised		**790.0**	498.0	**290.0**	497.9
New intercompany loans raised		**2.9**	(46.6)	**106.6**	(22.9)
Receipts from intercompany finance leases		**–**	–	**0.6**	0.6
Interest element of intercompany finance lease payments		**–**	–	**(2.8)**	(10.9)
Repayments of obligations under intercompany finance leases		**–**	–	**(3.1)**	(3.1)
Net cash flow from financing activities		**(188.5)**	(197.7)	**(225.8)**	(207.7)
Net movement in cash and cash equivalents		**7.1**	(0.6)	**5.3**	(0.7)
Net cash at the beginning of the year		**(3.4)**	(2.8)	**(4.9)**	(4.2)
Net cash and cash equivalents at end of the year		**3.7**	(3.4)	**0.4**	(4.9)
Cash and cash equivalents		**12.1**	0.2	**9.2**	–
Bank overdrafts		**(8.4)**	(3.6)	**(8.8)**	(4.9)
Net cash and cash equivalents at end of the year		**3.7**	(3.4)	**0.4**	(4.9)

38 General information

The Severn Trent Water group includes Severn Trent Water Limited and its subsidiary companies.

Severn Trent Water Limited is a company incorporated and domiciled in the United Kingdom. The address of its registered office is Severn Trent Centre, 2 St John's Street, Coventry, CV1 2LZ.

Accounting policies

Basis of preparation

The financial statements have been prepared on the going concern basis (see Strategic report on page 53) under the historical cost convention as modified by the revaluation of certain financial assets and liabilities (including derivative instruments) at fair value.

i) Group 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) Company financial statements

The 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 company has taken advantage of the disclosure exemptions available under that standard in relation to 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 and also where required, equivalent disclosures are given in the group accounts of Severn Trent Plc. The group accounts of Severn Trent Plc are available to the public and can be obtained as set out in note 44.

The key accounting policies for the group and the company, which have been applied consistently in the current and preceding year, are set out below.

Basis of consolidation

The consolidated financial statements include the results of Severn Trent Water Limited and its subsidiaries. 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.

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.

Revenue recognition

i) Revenue includes turnover and interest income.

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

k) Turnover is not recognised until the service has been provided to the customer.

l) 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.

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

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.

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 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.

2 Accounting policies (continued)

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. 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 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.

Other intangible and non-current assets

Intangible assets acquired separately are capitalised at cost. Following initial recognition, the historical cost model is applied.

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 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 cost can be measured reliably.

Research expenditure is expensed when it is incurred.

Property, plant and equipment

Property, plant and equipment is held at cost (or at deemed cost for infrastructure assets on transition to IFRS/FRS 101) less accumulated depreciation. 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.

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

2 Accounting policies (continued)

Leased assets

Leases where the group or company obtains assets which transfer substantially all the risks and rewards of ownership to the group or company 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.

Where the company transfers substantially all the risks and rewards of ownership of an asset to a lessee (finance lease), the assets are accounted for as if they had been sold, and the net investment in the lease is shown as a receivable due from the lessee. Over the lease term, rentals are apportioned between a reduction in the net investment in the lease and finance lease income, such that finance lease income produces a constant rate of return on the net cash investment in the lease. Finance lease income is included within finance income.

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 waste water 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 income statement in the period that they become receivable.

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. Severn Trent Water and Dee Valley Water are considered to be single cash-generating units. Therefore where the asset does not generate cash flows that are independent from other assets, the company estimates the recoverable amount of the company as a whole. 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 or the company's estimated cost of capital.

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.

Company investments in subsidiaries and associates

Investments in subsidiaries and associates are stated at cost less, where appropriate, provisions for impairment. Investments in subsidiaries are reviewed for impairment in line with note 2 k) when indicators of impairment have been identified.

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.

Trade and other 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 historical collection experience for receivables of similar age or characteristics.

2 Accounting policies (continued)

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 period, 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 re-measurements, 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 for the Severn Trent or Dee Valley Water Limited schemes to participating group companies of the ultimate parent. As the net defined benefit cost for these schemes is recognised by the sponsoring employer, Severn Trent Water Limited, the full net defined benefit cost is disclosed in the Severn Trent Water group financial statements. For the company financial statements, contributions made by other Severn Trent group companies are disclosed within actuarial gains and losses in the statement of comprehensive income.

(ii) Defined contribution scheme

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

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.

Self-insurance provisions are recognised for claims notified and for claims incurred but which have not yet been notified, based on advice from the ultimate parent company'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.

Borrowings

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

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.

Derivative financial instruments

Derivative financial instruments are stated at fair value, including accrued interest. Fair value is determined using the methodology described in note 32 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 and company use derivative financial instruments such as cross currency swaps, forward currency contracts and interest rate swaps to hedge 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 and company continue 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.

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.

2 Accounting policies (continued)

s) Derivative financial instruments (continued)

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.

t) Share based payment

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.

The grant of awards of shares of the ultimate parent company is treated as a capital contribution and credited to reserves. When awards vest, payments made to the ultimate parent company for the issue of shares are charged against the capital contributions previously received in respect of the same awards. Any payments in excess of capital contributions are treated as distributions.

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.

Net debt

Net debt comprises borrowings, 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 related parties.

Foreign exchange

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

New accounting policies and future requirements

As permitted by FRS 101, the company has taken advantage of the disclosure exemptions relating to various standards that are in issue but not yet effective.

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.

For the Severn Trent Water Group, at the balance sheet date, the following Standards and Interpretations were in issue but not yet effective.

IFRS 9 "Financial Instruments" will affect 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" will affect the measurement and recognition of revenue with effect from 1 April 2018. The group has performed an impact analysis and the expected impact on the results and financial position are set out below.

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 98% 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 changes to this treatment is anticipated as a result of the adoption of IFRS 15.

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.

Critical accounting judgements and sources of estimation uncertainty

In the process of applying the group and company accounting policies, the group and company are required to make certain judgements, estimates and assumptions that they believe 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 sources of estimation uncertainty and critical judgements and resolved that the following were no longer considered to be critical judgements or sources of estimation uncertainty:

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, management no longer considers there to be significant risk of a material adjustment to tax provisions.

ii) Goodwill arising on acquisition of Dee Valley Water

As set out in note 36, 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 significant estimate.

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 significant estimate.

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 h). 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 27 to the financial statements.

3 Revenue

	Group		Company	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
Water and waste water services	**1,574.6**	1,527.6	**1,546.6**	1,525.5
Other services	**32.3**	28.5	**32.4**	28.5
Turnover	**1,606.9**	1,556.1	**1,579.0**	1,554.0
Finance income	**4.5**	1.8	**25.8**	12.8
	1,611.4	1,557.9	**1,604.8**	1,566.8

4 Net operating costs

Group

			2018			2017
	Before exceptional costs	**Exceptional costs**	**Total**	Before exceptional costs	Exceptional costs	Total
	£m	**£m**	**£m**	£m	£m	£m
Wages and salaries	**221.7**	**0.6**	**222.3**	204.3	–	204.3
Social security costs	**22.0**	**–**	**22.0**	20.6	–	20.6
Pension costs	**20.1**	**(8.3)**	**11.8**	19.7	(16.6)	3.1
Share based payment	**6.8**	**–**	**6.8**	6.0	–	6.0
Total employee costs	**270.6**	**(7.7)**	**262.9**	250.6	(16.6)	234.0
Power	**79.2**	**–**	**79.2**	70.5	–	70.5
Carbon Reduction Commitment	**5.9**	**–**	**5.9**	6.3	–	6.3
Raw materials and consumables	**45.8**	**–**	**45.8**	44.7	–	44.7
Rates	**81.9**	**–**	**81.9**	77.4	–	77.4
Charge for bad and doubtful debts	**25.7**	**–**	**25.7**	20.6	–	20.6
Service charges	**34.3**	**–**	**34.3**	33.1	–	33.1
Depreciation of tangible fixed assets	**304.0**	**16.8**	**320.8**	302.7	–	302.7
Amortisation of intangible fixed assets	**19.8**	**–**	**19.8**	17.4	–	17.4
Hired and contracted services	**184.6**	**3.5**	**188.1**	178.1	–	178.1
Operating lease rentals						
- land and buildings	**(0.3)**	**–**	**(0.3)**	0.4	–	0.4
- other	**0.3**	**–**	**0.3**	0.3	–	0.3
Hire of plant and machinery	**3.8**	**–**	**3.8**	3.3	–	3.3
Research and development expenditure	**2.1**	**–**	**2.1**	2.2	–	2.2
Profit on disposal of tangible fixed assets	**(4.6)**	**–**	**(4.6)**	0.8	(11.0)	(10.2)
Infrastructure maintenance expenditure	**135.2**	**–**	**135.2**	136.2	–	136.2
Ofwat licence fees	**3.6**	**–**	**3.6**	3.6	–	3.6
Net other operating costs	**34.8**	**–**	**34.8**	28.2	–	28.2
	1,226.7	**12.6**	**1,239.3**	1,176.4	(27.6)	1,148.8
Release from deferred credits	**(14.3)**	**–**	**(14.3)**	(13.9)	–	(13.9)
Own work capitalised	**(143.2)**	**–**	**(143.2)**	(119.2)	–	(119.2)
	1,069.2	**12.6**	**1,081.8**	1,043.3	(27.6)	1,015.7

Further details of exceptional costs are given in note 7.

Severn Trent Water Limited
Notes to the group and company financial statements (continued)
For the year ended 31 March 2018
6 Net operating costs (continued)

Company

	2018			2017		
	Before exceptional costs	**Exceptional costs**	**Total**	Before exceptional costs	Exceptional costs	Total
	£m	**£m**	**£m**	£m	£m	£m
Wages and salaries	**215.6**	**0.6**	**216.2**	203.8	–	203.8
Social security costs	**21.6**	**–**	**21.6**	20.6	–	20.6
Pension costs	**19.4**	**(8.3)**	**11.1**	19.6	(16.6)	3.0
Share based payment	**6.8**	**–**	**6.8**	6.0	–	6.0
Total employee costs	**263.4**	**(7.7)**	**255.7**	250.0	(16.6)	233.4
Power	**76.9**	**–**	**76.9**	70.3	–	70.3
Carbon Reduction Commitment	**5.7**	**–**	**5.7**	6.3	–	6.3
Raw materials and consumables	**44.6**	**–**	**44.6**	44.6	–	44.6
Rates	**80.0**	**–**	**80.0**	77.4	–	77.4
Charge for bad and doubtful debts	**25.0**	**–**	**25.0**	20.5	–	20.5
Service charges	**33.5**	**–**	**33.5**	33.1	–	33.1
Depreciation of tangible fixed assets	**297.9**	**16.8**	**314.7**	302.6	–	302.6
Amortisation of intangible fixed assets	**19.8**	**–**	**19.8**	17.4	–	17.4
Hired and contracted services	**182.7**	**3.5**	**186.2**	178.4	–	178.4
Operating lease rentals						
- land and buildings	**(0.3)**	**–**	**(0.3)**	0.4	–	0.4
- other	**0.3**	**–**	**0.3**	0.3	–	0.3
Hire of plant and machinery	**3.6**	**–**	**3.6**	3.3	–	3.3
Research and development expenditure	**2.1**	**–**	**2.1**	2.2	–	2.2
Profit on disposal of tangible fixed assets	**(4.4)**	**–**	**(4.4)**	0.8	(11.0)	(10.2)
Infrastructure maintenance expenditure	**134.4**	**–**	**134.4**	136.2	–	136.2
Ofwat licence fees	**3.5**	**–**	**3.5**	3.6	–	3.6
Net other operating costs	**33.7**	**–**	**33.7**	27.3	–	27.3
	1,202.4	**12.6**	**1,215.0**	1,174.7	(27.6)	1,147.1
Release from deferred credits	**(14.1)**	**–**	**(14.1)**	(13.9)	–	(13.9)
Own work capitalised	**(141.3)**	**–**	**(141.3)**	(119.5)	–	(119.5)
	1,047.0	**12.6**	**1,059.6**	1,041.3	(27.6)	1,013.7

Further details of exceptional costs are given in note 7.

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

	Group and company	
	2018	2017
	£m	£m
Fees payables to the company's auditors for:		
- the audit of the company's annual accounts	**0.4**	0.3
Total audit fees	**0.4**	0.3
Fees payables to the company's auditors and their associates for other services to the group:		
- audit related assurance	**0.1**	0.1
- other assurance services	**0.1**	0.3
Total non-audit fees	**0.2**	0.4

5 Exceptional items before tax

	Group and Company	
	2018	2017
	£m	£m
Restructuring costs	**20.9**	–
Profit on disposal of fixed assets	**–**	(11.0)
Gain arising on pension exchange arrangement	**(8.3)**	(16.6)
	12.6	(27.6)

The total net exceptional charge for the year was £12.6 million (2016/17: credit of £27.6 million).

In preparing our Bioresources business for AMP7, we have developed our business model and identified the actions that we need to take to compete effectively in the new market and as a result incurred exceptional restructuring costs of £20.9 million as follows:

- Set up and restructuring costs of £2.1 million,
- Write-off of assets that will not be used in the new business £16.8 million
- Provision for costs to decommission these assets £2.0 million

An exceptional gain of £8.3 million arose (2016/17: gain of 16.6 million) from the net benefit, after implementation costs, of a Pension Increase Exchange arrangement under which members of the defined benefit schemes will be offered the opportunity at retirement to exchange future non-statutory inflationary increases in a portion of their pensions earned prior to 1997 for a higher pension payment now.

Exceptional tax is disclosed in note 13.

6 Employee numbers

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

	Group		Company	
	2018 Number	2017 Number	**2018 Number**	2017 Number
	5,996	5,594	**5,859**	5,572

7 Directors' interests and remuneration – Group and Company

a) Directors' interests

All of the directors as at the end of the year are also directors of Severn Trent Plc, the ultimate parent undertaking, and their interests in the share capital of that company are disclosed in the Severn Trent Plc Annual Report and Accounts for the year ended 31 March 2018. Share options were granted and exercised in accordance with the Severn Trent Sharesave Scheme as appropriate.

The executive directors have further interests in Severn Trent Plc ordinary shares of $97^{17}/_{19}$ p each by virtue of having received contingent awards of shares under the Severn Trent Long Term Incentive Plan (LTIP), and deferred shares under the Severn Trent Annual Bonus Scheme.

The individual interests, which represent the maximum aggregate number of shares to which each individual could become entitled, are disclosed in the Annual Report and Accounts of Severn Trent Plc for the year ended 31 March 2018.

b) Directors' remuneration

The following table shows the remuneration due to directors for their services to the company during the year:

	2018	2017
	£m	£m
Short term employee benefits	**3.3**	3.9
Post employment benefits	**–**	–
Share based payment	**1.7**	1.6
	5.0	5.5

The emoluments of the non-executive directors are paid by Severn Trent Plc.

There were no retirement benefits accruing to directors (2017: none) under a defined benefit scheme and one director (2017: one director) accrues benefits under a defined contribution scheme.

Three directors (2017: three directors) exercised share options or received LTIP awards which vested during the year.

9 Directors' interests and remuneration – Group and Company (continued)

c) Highest paid director

	2018 £m	2017 £m
Aggregate emoluments (excluding pension contributions)	**2.2**	2.4

The highest paid director at 31 March 2018 and 31 March 2017 was not a member of the defined benefit pension scheme.

10 Finance income

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Interest income earned on:				
Bank deposits	**0.6**	0.1	**0.6**	0.1
Amounts due from group undertakings	**0.1**	0.9	**4.1**	2.3
Amounts due from group undertakings under finance	**–**	–	**5.1**	5.1
Other finance income	**3.8**	0.8	**16.0**	5.3
Total interest receivable	**4.5**	1.8	**25.8**	12.8
Interest income on defined benefit scheme assets	**62.0**	71.8	**60.3**	71.8
	66.5	73.6	**86.1**	84.6

11 Finance costs

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Interest expense charged on:				
Bank loans and overdrafts	**19.3**	20.1	**19.3**	19.8
Other loans	**181.0**	166.0	**1.2**	13.0
Finance leases	**4.4**	4.2	**5.3**	5.5
Amounts payable to group undertakings	**0.4**	0.1	**192.8**	162.7
Amounts payable to group undertakings on finance leases	**–**	–	**10.7**	10.8
Total borrowing costs	**205.1**	190.4	**229.3**	211.8
Other finance expenses	**0.1**	0.1	**0.1**	0.1
Interest expense on defined benefit scheme liabilities	**77.2**	82.7	**75.7**	82.7
	282.4	273.2	**305.1**	294.6

Borrowing costs of £24.6 million (2017: £17.4 million) incurred funding eligible capital projects have been capitalised at an interest rate of 3.89% (2017: 3.94%). Tax relief of £4.7 million (2017: £3.5 million) was claimed on these costs which was credited to the income statement, offset by a related deferred tax charge of £4.2 million (2017: £3.0 million).

12 Losses on financial instruments

	Group and Company	
	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**	(15.4)
Loss on cash flow hedges transferred from equity	**(8.5)**	(3.2)
Hedge ineffectiveness on cash flow hedges	**1.2**	(0.4)
(Loss)/gain arising on swaps where hedge accounting is not applied	**(12.6)**	11.2
Amortisation of fair value adjustment on debt	**1.1**	0.5
	(7.2)	(6.6)

The group's hedge accounting arrangements are described in note 34.

13 Taxation

a) Analysis of tax charge in the year

Group

	2018			2017
	Total	Before exceptional tax	Exceptional tax	Total
	£m	£m	£m	£m
Current tax at 19% (2017: 20%)				
Current year	**37.4**	49.9	–	49.9
Prior years	**(4.9)**	(8.7)	(16.4)	(25.1)
Total current tax	**32.5**	41.2	(16.4)	24.8
Deferred tax				
Origination and reversal of temporary differences:				
Current year	**19.5**	14.6	–	14.6
Prior years	**7.6**	5.6	4.0	9.6
Exceptional credit from rate change	–	–	(39.6)	(39.6)
Total deferred tax	**27.1**	20.2	(35.6)	(15.4)
	59.6	61.4	(52.0)	9.4

The group current tax charge was £32.5 million (2017: £41.2 million). In 2017, there was an exceptional current tax credit of £16.4 million which arose from agreeing a number of prior year tax items with HMRC.

The deferred tax charge was £27.1 million (2017: £20.2 million). In 2017, there was an exceptional deferred tax credit of £35.6 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 1 April 2020.

Company

	2018			2017
	Total	Before exceptional tax	Exceptional tax	Total
	£m	£m	£m	£m
Current tax at 19% (2017: 20%)				
Current year	**36.7**	48.1	–	48.1
Prior years	**(6.3)**	(8.7)	(16.4)	(25.1)
Total current tax	**30.4**	39.4	(16.4)	23.0
Deferred tax				
Origination and reversal of temporary differences:				
Current year	**19.3**	–	–	–
Prior years	**8.6**	5.5	4.0	9.5
Exceptional credit from rate change	–	–	(40.4)	(40.4)
Total deferred tax	**27.9**	5.5	(36.4)	(30.9)
	58.3	44.9	(52.8)	(7.9)

The company current tax charge was £30.4 million (2017: £39.4 million). In 2017, there was an exceptional current tax credit of £16.4 million which arose from agreeing a number of prior year tax items with HMRC.

The deferred tax charge was £27.9 million (2017: £5.5 million). In 2017, there was an exceptional deferred tax credit of £36.4 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 1 April 2020.

The company earns profits primarily in the UK. Therefore the tax rate used for tax on profit on ordinary activities is the main rate for UK corporation tax.

13 Taxation (continued)

b) Factors affecting the tax charge in the year

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

Group:

	2018 £m	2017 £m
Profit on ordinary activities before taxation from continuing operations	**302.0**	334.2
Tax at standard rate of corporation tax in the UK 19% (2017: 20%)	**57.4**	66.9
Tax effect of depreciation on non-qualifying assets	**1.7**	2.3
Other permanent differences	**0.1**	(1.4)
Current year impact of rate change	**(2.3)**	(3.3)
Adjustments in respect of prior years	**2.7**	(15.5)
Exceptional deferred tax credit arising from rate change	**–**	(39.6)
Total tax charge	**59.6**	9.4

	2018 £m	2017 £m
Profit on ordinary activities before taxation from continuing operations	**302.0**	334.2
Tax at standard rate of corporation tax in the UK 19% (2017: 20%)	**57.4**	66.9
Tax effect of depreciation on non-qualifying assets	**1.7**	2.3
Other permanent differences	**0.1**	(1.3)
Tax effect of accelerated capital allowances	**(18.3)**	(11.5)
Other timing differences	**(3.5)**	(6.5)
Adjustments in respect of prior years	**(4.9)**	(25.1)
Total current tax charge	**32.5**	24.8

Company:

	2018 £m	2017 £m
Profit on ordinary activities before taxation from continuing operations	**293.2**	323.7
Tax at standard rate of corporation tax in the UK 19% (2017: 20%)	**55.7**	64.8
Tax effect of depreciation on non-qualifying assets	**1.7**	2.4
Other permanent differences	**0.9**	(18.3)
Current year impact of rate change	**(2.3)**	(0.8)
Adjustments in respect of prior years	**2.3**	(15.6)
Exceptional deferred tax credit arising from rate change	**–**	(40.4)
Total tax charge	**58.3**	(7.9)

	2018 £m	2017 £m
Profit on ordinary activities before taxation from continuing operations	**293.2**	323.7
Tax at standard rate of corporation tax in the UK 19% (2017: 20%)	**55.7**	64.8
Tax effect of depreciation on non-qualifying assets	**1.7**	2.4
Other permanent differences	**0.9**	(18.3)
Tax effect of accelerated capital allowances	**(18.2)**	(11.5)
Other timing differences	**(3.4)**	10.7
Adjustments in respect of prior years	**(6.3)**	(25.1)
Total current tax charge	**30.4**	23.0

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) directly to other comprehensive income or equity:

Group:

	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	**(9.2)**	(14.1)
Total current tax credited to other comprehensive income or equity	**(10.0)**	(14.9)
Deferred tax		
Tax on actuarial gain/loss	**18.4**	(42.4)
Tax on cash flow hedges	**0.7**	(1.4)
Tax on share based payments	**1.3**	(0.1)
Tax on transfers to the income statement	**1.4**	0.7
Effect of change in tax rate	**–**	2.6
Total deferred tax charged/(credited) to other comprehensive income or equity	**21.8**	(40.6)

Company:

	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	**(9.2)**	(14.1)
Total current tax credited to other comprehensive income or equity	**(10.0)**	(14.9)
Deferred tax		
Tax on actuarial gain/loss	**17.0**	(42.4)
Tax on cash flow hedges	**0.7**	(1.4)
Tax on share based payments	**1.3**	(0.1)
Tax on transfers to the income statement	**1.4**	0.7
Effect of change in tax rate	**–**	2.6
Total deferred tax charged/(credited) to other comprehensive income or equity	**20.4**	(40.6)

14 Dividends – Group and Company

Amounts recognised as distributions to equity holders in the period:

	2018		2017	
	Pence per share	**£m**	Pence per share	£m
Interim dividend for the year ended 31 March	**20.40**	**204.0**	19.55	195.5

15 Goodwill - Group

	2018 £m	2017 £m
Cost		
At 1 April	**67.3**	1.3
Acquisition of subsidiary	**–**	66.0
Adjustment to provisional fair values (note 36)	**(4.0)**	–
Additional consideration in respect of acquisition	**0.2**	–
Net book value at 31 March	**63.5**	67.3

Goodwill impairment tests

Goodwill is allocated to the group's cash-generating units (CGUs) identified according to the company giving rise to the goodwill.

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

	2018 £m	2017 £m
Severn Trent Water	**1.3**	1.3
Dee Valley Water	**62.2**	66.0
	63.5	67.3

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 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.

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 WACC 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 risk already reflected in the cash flows for AMP7 and beyond. This post-tax rate which was converted to the equivalent pre-tax 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.

16 Other intangible assets

Group

	Computer software				
	Internally generated £m	Purchased £m	Capitalised development costs and patents	Instrument of appointment £m	Total £m
Cost					
At 1 April 2016	186.1	93.2	12.0	–	291.3
Additions	13.3	12.8	–	–	26.1
At 1 April 2017	199.4	106.0	12.0	–	317.4
Additions	7.6	17.9	–	–	25.5
Adjustment to provisional fair values	–	–	–	4.3	4.3
At 31 March 2018	**207.0**	**123.9**	**12.0**	**4.3**	**347.2**
Amortisation					
At 1 April 2016	(156.0)	(57.0)	(11.3)	–	(224.3)
Amortisation for the year	(7.5)	(9.3)	(0.6)	–	(17.4)
At 1 April 2017	(163.5)	(66.3)	(11.9)	–	(241.7)
Amortisation for the year	(7.5)	(12.2)	(0.1)	–	(19.8)
At 31 March 2018	**(171.0)**	**(78.5)**	**(12.0)**	**–**	**(261.5)**
Net book value					
At 31 March 2018	**36.0**	**45.4**	**–**	**4.3**	**85.7**
At 31 March 2017	35.9	39.7	0.1	–	75.7

Company

	Computer software			
	Internally generated £m	Purchased £m	Capitalised development costs and patents £m	Total £m
Cost				
At 1 April 2016	186.1	93.2	12.0	291.3
Additions	13.3	12.8	–	26.1
At 1 April 2017	199.4	106.0	12.0	317.4
Additions	7.6	17.9	–	25.5
At 31 March 2018	**207.0**	**123.9**	**12.0**	**342.9**
Amortisation				
At 1 April 2016	(156.0)	(57.0)	(11.3)	(224.3)
Amortisation for the year	(7.5)	(9.3)	(0.6)	(17.4)
At 1 April 2017	(163.5)	(66.3)	(11.9)	(241.7)
Amortisation for the year	(7.5)	(12.2)	(0.1)	(19.8)
At 31 March 2018	**(171.0)**	**(78.5)**	**(12.0)**	**(261.5)**
Net book value				
At 31 March 2018	**36.0**	**45.4**	**–**	**81.4**
At 31 March 2017	35.9	39.7	0.1	75.7

17 Property, plant and equipment

Group	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	3,148.7	4,939.9	3,778.9	50.4	520.1	12,438.0
Additions	15.5	73.7	11.3	–	441.6	542.1
Transfers on commissioning	134.1	39.9	190.4	6.3	(370.7)	–
Disposals	(5.7)	(0.7)	(21.9)	(3.1)	–	(31.4)
Acquisition of Dee Valley Water	0.8	61.4	64.3	–	–	126.5
At 1 April 2017	3,293.4	5,114.2	4,023.0	53.6	591.0	13,075.2
Additions	8.9	60.4	16.3	–	594.9	680.5
Transfers on commissioning	67.8	52.2	137.4	4.4	(261.8)	–
Disposals	(2.0)	(0.3)	(12.0)	(2.7)	–	(17.0)
Reclassifications	1.4	6.5	(8.1)	–	0.2	–
Adjustment to provisional fair values	–	0.8	–	–	–	0.8
At 31 March 2018	**3,369.5**	**5,233.8**	**4,156.6**	**55.3**	**924.3**	**13,739.5**
Depreciation						
At 1 April 2016	(1,114.2)	(1,257.8)	(2,391.4)	(32.9)	–	(4,796.3)
Charge for the year	(81.2)	(42.6)	(173.8)	(5.1)	–	(302.7)
Disposals	3.7	0.2	20.7	2.8	–	27.4
At 1 April 2017	(1,191.7)	(1,300.2)	(2,544.5)	(35.2)	–	(5,071.6)
Charge for the year	(84.1)	(31.5)	(184.2)	(4.2)	–	(304.0)
Disposals	1.7	–	11.3	2.6	–	15.6
Exceptional depreciation	(10.1)	–	(6.7)	–	–	(16.8)
At 31 March 2018	**(1,284.2)**	**(1,331.7)**	**(2,724.1)**	**(36.8)**	**–**	**(5,376.8)**
Net book value						
At 31 March 2018	**2,085.3**	**3,902.1**	**1,432.5**	**18.5**	**924.3**	**8,362.7**
At 31 March 2017	2,101.7	3,814.0	1,478.5	18.4	591.0	8,003.6

17 Property, plant and equipment (continued)

Company	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	3,148.7	4,939.9	3,778.9	50.4	520.1	12,438.0
Additions	15.5	73.4	11.0	–	441.6	541.5
Transfers on commissioning	134.1	39.9	190.4	6.3	(370.7)	–
Disposals	(5.7)	(0.7)	(21.9)	(3.1)	–	(31.4)
At 1 April 2017	3,292.6	5,052.5	3,958.4	53.6	591.0	12,948.1
Additions	8.9	60.4	16.3	–	577.6	663.2
Transfers on commissioning	67.8	52.2	137.4	4.4	(261.8)	–
Disposals	(2.0)	(0.3)	(11.7)	(2.7)	–	(16.7)
At 31 March 2018	**3,367.3**	**5,164.8**	**4,100.4**	**55.3**	**906.8**	**13,594.6**
Depreciation						
At 1 April 2016	(1,114.2)	(1,257.8)	(2,391.4)	(32.9)	–	(4,796.3)
Charge for the year	(81.2)	(42.6)	(173.7)	(5.1)	–	(302.6)
Disposals	3.7	–	20.7	2.8	–	27.2
At 1 April 2017	(1,191.7)	(1,300.4)	(2,544.4)	(35.2)	–	(5,071.7)
Charge for the year	(84.0)	(30.9)	(178.8)	(4.2)	–	(297.9)
Disposals	1.7	–	11.3	2.6	–	15.6
Exceptional depreciation	(10.1)	–	(6.7)	–	–	(16.8)
At 31 March 2018	**(1,284.1)**	**(1,331.3)**	**(2,718.6)**	**(36.8)**	**–**	**(5,370.8)**
Net book value						
At 31 March 2018	**2,083.2**	**3,833.5**	**1,381.8**	**18.5**	**906.8**	**8,223.8**
At 31 March 2017	2,100.9	3,752.1	1,414.0	18.4	591.0	7,876.4

The £16.8 million exceptional depreciation charge arises as a result of group restructuring in preparing our Bioresources business for AMP7. Information about this is available in note 7.

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

Group	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

Company	Land and buildings £m	Infrastructure assets £m	Fixed plant and equipment £m	Total £m
Net book value				
At 31 March 2018	**166.2**	**115.8**	**6.4**	**288.4**
At 31 March 2017	169.7	118.8	10.2	298.7

The net book value of land and buildings is analysed as follows:

Group	**2018 £m**	2017 £m
Freehold	**2,085.0**	2,101.4
Short leasehold	**0.3**	0.3
	2,085.3	2,101.7

Company

	2018 £m	2017 £m
Freehold	**2,082.9**	2,100.6
Short leasehold	**0.3**	0.3
	2,083.2	2,100.9

18 Investments

	Group	Company		
	Associates £m	Subsidiaries £m	Associates £m	Total £m
As at 1 April 2017	1,470.0	478.1	1,470.0	1,948.1
Additions	–	0.2	–	0.2
As at 31 March 2018	**1,470.0**	**478.3**	**1,470.0**	**1,948.3**

The company has the following subsidiary undertakings:

Subsidiary undertaking	Country of operation and incorporation	Principal activity	Percentage and class of share capital held
Aqua Deva Limited	England and Wales	Dormant company	100% ordinary
Biogas Generation Limited	England and Wales	Dormant company	100% ordinary
Chester Water Limited	England and Wales	Holding company	100% ordinary
Dee Valley Group Limited	England and Wales	Holding company	100% ordinary
Dee Valley Limited	England and Wales	Holding company	100% ordinary
Dee Valley Services Limited	England and Wales	Dormant company	100% ordinary
Dee Valley Water (Holdings) Limited	England and Wales	Holding company	100% ordinary
Dee Valley Water Limited	England and Wales	Regulated water and waste water company	100% ordinary
East Worcester Water Limited	England and Wales	Finance company	100% ordinary and 100% non-voting
Energy Supplies UK Limited	England and Wales	Dormant company	100% ordinary
North Wales Gas Limited	England and Wales	Dormant company	100% ordinary
Northern Gas Supplies Limited	England and Wales	Dormant company	100% ordinary
Severn Trent Funding Limited	England and Wales	Dormant company	100% ordinary
Severn Trent General Partnership Limited	Scotland	Non-trading company	100% ordinary
Severn Trent LCP Limited	England and Wales	Non-trading company	100% ordinary
Severn Trent Leasing Limited	England and Wales	Leasing company	100% ordinary
Severn Trent Power Generation Limited	England and Wales	Non-trading company	100% ordinary
Severn Trent Reservoirs Limited	England and Wales	Finance company	100% ordinary
Severn Trent Utilities Finance Plc	England and Wales	Finance company	100% ordinary
Wrexham Water Limited	England and Wales	Dormant company	100% ordinary

The company has the following associated undertaking:

Associated undertaking	Country of operation and incorporation	Principal activity	Percentage and class of share capital held
Severn Trent Trimpley Limited	England and Wales	Non-trading company	49% ordinary

The company also has an indirect investment in Severn Trent Limited Partnership and Severn Trent 2017 Limited Partnership, limited partnerships registered in Scotland, as a result of Severn Trent General Partnership Limited being the general partner in each partnership.

In the opinion of the directors the fair values of the company's investments are not less than the amount at which they are stated in the balance sheet.

As at 31 March 2018 the associate did not have any significant contingent liabilities to which the group was exposed (2017: nil). The group has no capital commitments in relation to its interests in associates at 31 March 2018 (2017: nil).

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

The registered office of the following entities is Packsaddle, Wrexham Road, Rhostyllen, Wrexham, LL14 4EH:

Dee Valley Limited
Dee Valley Water Limited

The registered office of Severn Trent General Partnership Limited is 50 Lothian Road, Festival Square, Edinburgh, EH3 9WJ.

19 Categories of financial assets - group

	Note	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	20	**182.7**	193.1
Amounts due from group undertakings	20	**8.4**	6.4
Amounts due from related parties	20	**99.8**	99.6
Cash at bank and in hand		**12.1**	0.2
Total loans and receivables		**303.0**	299.3
Total financial assets		**339.2**	366.3
Disclosed in the balance sheet as:			
Non-current assets			
Derivative financial assets		**36.0**	67.0
Trade and other receivables		**99.8**	–
		135.8	67.0
Current assets			
Derivative financial assets		**0.2**	–
Trade receivables		**182.7**	193.1
Amounts due from group undertakings		**8.4**	6.4
Amounts due from related parties		–	99.6
Cash and cash equivalents		**12.1**	0.2
		203.4	299.3
		339.2	366.3

20 Trade and other receivables

	Group		Company	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
Current assets				
Trade receivables	**310.9**	321.4	**297.7**	313.9
Bad debt provision	**(128.2)**	(128.3)	**(124.5)**	(125.4)
Net trade receivables	**182.7**	193.1	**173.2**	188.5
Other amounts receivable	**26.3**	40.1	**26.6**	23.2
Prepayments	**11.9**	10.5	**11.9**	10.5
Accrued income	**203.1**	147.4	**199.6**	143.3
Loan receivable from related parties	**–**	99.6	**–**	99.6
Receivables due from group undertakings	**8.4**	6.4	**10.2**	7.1
Receivables due from group undertakings under finance leases	**–**	–	**0.6**	0.6
	432.4	497.1	**422.1**	472.8
Non-current assets				
Prepayments	**2.1**	–	**2.1**	–
Loan receivable from related parties	**99.8**	–	**99.8**	–
Receivables due from group undertakings under finance leases	**–**	–	**98.5**	99.1
Receivables due from group undertakings under loan agreements	**–**	–	**62.4**	55.2
	101.9	–	**262.8**	154.3
	534.3	497.1	**684.9**	627.1

20 Trade and other receivables (continued)

Doubtful debt provision

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

Severn Trent Water has a statutory obligation to provide water and sewerage services to customers within its region. Therefore there is no concentration of credit risk with respect to its trade receivables and the credit quality of its customer base reflects the wealth and prosperity of all of the commercial businesses and domestic households within its region. None of the other business units are individually significant to the group.

Water Plus

In the current and prior year Water Plus, a joint venture between the group's ultimate holding company, Severn Trent Plc, and United Utilities PLC was the largest retailer for non-domestic customers in the Severn Trent region. The amounts receivable from Water Plus are shown in note 42.

Movements on the doubtful debts provision were as follows:

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
At 1 April	**128.3**	124.3	**125.4**	124.3
Charge for bad and doubtful debts	**25.7**	20.6	**25.0**	20.5
Acquisition of Dee Valley Water	**–**	2.9	**–**	–
Amounts written off during the year	**(25.8)**	(19.5)	**(25.9)**	(19.4)
At 31 March	**128.2**	128.3	**124.5**	125.4

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

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Up to 90 days	**0.5**	0.7	**0.5**	0.6
91 - 365 days	**0.8**	4.7	**0.8**	4.4
1 - 2 years	**4.9**	2.5	**4.9**	1.8
2 - 3 years	**2.5**	3.9	**2.5**	3.2
More than 3 years	**5.6**	6.9	**5.6**	5.9
	14.3	18.7	**14.3**	15.9

A collective provision is recognised 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.

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

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Up to 90 days	**41.8**	56.6	**41.0**	55.3
91 - 365 days	**79.2**	85.8	**73.5**	84.0
1 - 2 years	**57.5**	57.2	**54.4**	56.6
2 - 3 years	**40.7**	35.1	**38.9**	34.9
More than 3 years	**77.4**	68.0	**75.6**	67.2
	296.6	302.7	**283.4**	298.0

20 Trade and other receivables (continued)

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

Group			2018			2017
	Gross £m	Provision £m	Net £m	Gross £m	Provision £m	Net £m
Overdue not specifically provided	**296.6**	**(113.9)**	**182.7**	302.7	(109.6)	193.1
Overdue and specifically provided	**14.3**	**(14.3)**	**–**	18.7	(18.7)	–
	310.9	**(128.2)**	**182.7**	321.4	(128.3)	193.1

Company			2018			2017
	Gross £m	Provision £m	Net £m	Gross £m	Provision £m	Net £m
Overdue not specifically provided	**283.4**	**(110.2)**	**173.2**	298.0	(109.5)	188.5
Overdue and specifically provided	**14.3**	**(14.3)**	**–**	15.9	(15.9)	–
	297.7	**(124.5)**	**173.2**	313.9	(125.4)	188.5

21 Finance lease receivables - company

Minimum lease payments receivable are as follows:

	2018 £m	2017 £m
Within 1 year	**5.7**	5.7
1 - 2 years	**5.7**	5.7
2 - 5 years	**17.0**	17.0
After more than 5 years	**227.2**	232.8
Gross obligations under finance leases	**255.6**	261.2
Less: unearned interest receivable	**(156.5)**	(161.5)
	99.1	99.7

The present value of minimum lease payments receivable are as follows:

	2018 £m	2017 £m
Within 1 year	**0.6**	0.6
1 - 2 years	**0.6**	0.6
2 - 5 years	**2.1**	2.0
After more than 5 years	**95.8**	96.5
Included in non-current liabilities	**98.5**	99.1
	99.1	99.7

The company has granted finance leases of between 44 and 57 years in respect of concrete settling tanks. The interest terms were set at the inception of the leases. Leases bear interest at a weighted average interest rate of 5.1% (2017: 5.1%).

22 Borrowings

	Group		Company	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
Current liabilities				
Bank overdraft	**8.4**	3.6	**8.8**	4.9
Bank loans	**287.9**	147.1	**287.9**	147.1
Other loans	**5.0**	406.1	**–**	5.3
Loans due to parent and fellow subsidiary undertakings	**–**	6.4	**0.2**	406.4
Finance leases	**2.9**	2.1	**19.5**	17.7
Finance leases payable to other group companies	**–**	–	**3.3**	3.2
	304.2	565.3	**319.7**	584.6
Non-current liabilities				
Bank loans	**894.2**	889.8	**894.2**	889.8
Other loans	**4,133.2**	3,601.7	**567.5**	556.0
Loans due to parent and fellow subsidiary undertakings	**9.3**	–	**4,015.7**	3,470.5
Finance leases	**111.0**	113.6	**147.8**	167.0
Finance leases payable to other group companies	**–**	–	**195.8**	199.0
	5,147.7	4,605.1	**5,821.0**	5,282.3
	5,451.9	5,170.4	**6,140.7**	5,866.9

23 Finance leases

Obligations under finance leases are as follows:

	Group		Company	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
Within 1 year	**6.5**	6.1	**39.0**	26.0
1 - 2 years	**7.0**	6.5	**40.1**	38.6
2 - 5 years	**24.3**	22.6	**85.7**	101.7
After more than 5 years	**113.1**	121.9	**370.5**	401.4
Gross obligations under finance leases	**150.9**	157.1	**535.3**	567.7
Less future finance charges	**(37.0)**	(41.4)	**(168.9)**	(180.7)
Present value of lease obligations	**113.9**	115.7	**366.4**	387.0

Net obligations under finance leases fall due as follows:

	Group		Company	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
Within 1 year	**2.9**	2.1	22.8	20.9
1 - 2 years	**3.2**	2.6	24.5	22.6
2 - 5 years	**13.6**	11.5	44.3	59.4
After more than 5 years	**94.2**	99.5	274.8	284.1
Included in non-current liabilities	**111.0**	113.6	343.6	366.1
	113.9	115.7	366.4	387.0

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. Leases with capital outstanding of £113.9 million (2017: £115.7 million) bear fixed interest at a weighted average rate of 5.34% (2017: 5.34%) for the group. Leases which bear fixed interest at a weighted average rate of 5.2% (2017: 5.2%) have capital outstanding of £312.8 million (2017: £318.0 million) for the company. 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.

24 Categories of financial liabilities - group

	Note	2018 £m	2017 £m
Fair value through profit and loss			
Interest rate swaps - not hedge accounted		**98.7**	163.1
Inflation swaps - not hedge accounted		**2.8**	–
		101.5	163.1
Derivatives designated as hedging instruments			
Interest rate swaps - cash flow hedges		**5.9**	10.8
Energy hedges - cash flow hedges		**0.8**	0.8
		6.7	11.6
Total derivative financial liabilities		**108.2**	174.7
Other financial liabilities			
Borrowings	22	**5,451.9**	5,170.4
Trade payables	25	**12.3**	15.0
Amounts due to group undertakings	25	**17.6**	1.7
Total other financial liabilities		**5,481.8**	5,187.1
Total financial liabilities		**5,590.0**	5,361.8
Disclosed in the balance sheet as:			
Non-current liabilities			
Derivative financial liabilities		**108.2**	174.2
Borrowings		**5,147.7**	4,605.1
		5,255.9	4,779.3
Current liabilities			
Derivative financial liabilities		**–**	0.5
Borrowings		**304.2**	565.3
Trade payables		**12.3**	15.0
Amounts due to group undertakings		**17.6**	1.7
		334.1	582.5
		5,590.0	5,361.8

25 Trade and other payables

	Group		Company	
	2018 £m	2017 £m	2018 £m	2017 £m
Current liabilities				
Trade payables	**12.3**	15.0	**12.0**	10.2
Social security and other taxes	**5.6**	5.6	**5.5**	5.6
Other payables	**18.8**	24.8	**4.5**	6.5
Accruals	**380.1**	360.6	**336.0**	310.0
Deferred income	**14.9**	12.4	**14.7**	12.2
Amounts owed to parent and fellow subsidiary undertakings	**17.6**	1.7	**57.6**	46.5
	449.3	420.1	**430.3**	391.0
Non-current liabilities				
Accruals	**–**	0.7	**–**	0.8
Deferred income	**1,008.9**	953.6	**998.7**	943.1
	1,008.9	954.3	**998.7**	943.9
	1,458.2	1,374.4	**1,429.0**	1,334.9

The directors consider that the carrying value of trade payables is not materially different from their fair values.

26 Deferred tax

Group

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	764.2	(55.9)	(49.8)	11.7	670.2
Reclassification	–	15.5	–	(15.5)	–
Acquired through business combinations	11.9	1.7	–	(1.1)	12.5
Charge/(credit) to income	21.8	0.1	3.0	(0.7)	24.2
(Credit)/charge to income arising from rate change	(42.5)	0.5	2.2	0.2	(39.6)
Credit to equity	–	(42.4)	(0.8)	(0.1)	(43.3)
Charge to equity arising from rate change	–	1.7	0.8	0.1	2.6
At 1 April 2017	755.4	(78.8)	(44.6)	(5.4)	626.6
Charge/(credit) to income	22.9	(0.3)	1.7	2.8	27.1
Charge for adjustments to provisional fair values	0.1	–	–	1.0	1.1
Charge to equity	–	18.4	2.1	1.3	21.8
At 31 March 2018	**778.4**	**(60.7)**	**(40.8)**	**(0.3)**	**676.6**

Company

An analysis of the movements in the major deferred tax liabilities and assets recognised by the company 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	764.2	(55.8)	(49.9)	27.1	685.6
Reclassification	–	30.9	–	(30.9)	–
Charge/(credit) to income	21.8	(14.5)	3.0	(0.8)	9.5
(Credit)/charge to income arising from rate change	(42.5)	(0.4)	2.3	0.2	(40.4)
Credit to equity	–	(42.4)	(0.8)	(0.1)	(43.3)
Charge to equity arising from rate change	–	1.7	0.8	0.1	2.6
At 1 April 2017	743.5	(80.5)	(44.6)	(4.4)	614.0
Charge/(credit) to income	23.8	(0.3)	1.7	2.7	27.9
Charge to equity	–	17.0	2.1	1.3	20.4
At 31 March 2018	**767.3**	**(63.8)**	**(40.8)**	**(0.4)**	**662.3**

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:

Group

	2018 £m	2017 £m
Deferred tax asset	**(101.8)**	(128.7)
Deferred tax liability	**778.4**	755.3
	676.6	626.6

Company

	2018 £m	2017 £m
Deferred tax asset	**(105.0)**	(129.5)
Deferred tax liability	**767.3**	743.5
	662.3	614.0

27 Retirement benefit schemes

a) Defined benefit pension schemes

n) 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.

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

	2018 £m	2017 £m
Fair value of assets	**2,339.8**	2,352.8
Present value of the defined benefit obligations	**(2,850.9)**	(2,927.4)
	(511.1)	(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	**–**	(10.5)
Retirement benefit obligation – total	**(529.3)**	(584.4)
Net retirement benefit obligation	**(511.1)**	(574.6)

Company

	2018 £m	2017 £m
Fair value of assets	**2,540.4**	2,558.2
Present value of the defined benefit obligations - funded and unfunded schemes	**(2,804.1)**	(2,866.3)
Retirement benefit obligation recognised in the balance sheet	**(263.7)**	(308.1)

27 Retirement benefit schemes (continued)

a) Defined benefit pension schemes (continued)

STPS, STMIPS, and DVWS	Group 2018 £m	Group 2017 £m	Company 2018 £m	Company 2017 £m
Fair value of scheme assets				
Equities	**360.4**	914.3	**350.4**	897.9
Diversified growth funds	**5.3**	5.3	**–**	–
Gilts	**–**	412.6	**–**	412.6
Corporate bonds	**825.7**	670.8	**825.7**	670.8
Liability driven investment funds (LDI)	**783.1**	42.6	**740.7**	–
Property	**180.7**	174.9	**180.7**	174.9
Emerging markets multi-asset funds	**3.9**	3.3	**–**	–
High-yield bonds	**3.4**	3.3	**–**	–
Hedge funds	**0.6**	1.2	**0.6**	1.2
Contributions due from the Scottish Limited Partnerships	**–**	–	**265.6**	276.3
Cash	**176.7**	124.5	**176.7**	124.5
Total fair value of assets	**2,339.8**	2,352.8	**2,540.4**	2,558.2

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 schemes' assets were as follows:

	Group 2018 £m	Group 2017 £m	Company 2018 £m	Company 2017 £m
Fair value at 1 April	**2,352.8**	2,039.8	**2,558.2**	2,039.8
Interest income on scheme assets	**62.0**	71.8	**60.3**	71.8
Contributions paid by the group/company	**33.8**	33.2	**9.3**	33.2
Contributions from other Severn Trent group companies	**0.7**	–	**0.7**	–
Contributions from scheme members	**0.1**	–	**–**	–
Return on plan assets (excluding amounts included in finance income)	**(1.3)**	227.6	**(0.9)**	227.6
Scheme administration costs	**(1.8)**	(3.3)	**(1.6)**	(3.3)
Benefits paid	**(106.5)**	(87.2)	**(98.7)**	(87.2)
Contribution from the Scottish Limited Partnerships[1]	**–**	–	**–**	276.3
Unwind of discount on contribution due from SLPs	**–**	–	**13.1**	–
Acquisition of Dee Valley	**–**	70.9	**–**	–
Fair value at 31 March	**2,339.8**	2,352.8	**2,540.4**	2,558.2

1 The Scottish Limited Partnerships (SLPs) are subsidiaries of Severn Trent Water and therefore any movements are eliminated upon consolidation.

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

	Group 2018 £m	Group 2017 £m	Company 2018 £m	Company 2017 £m
Present value at 1 April	**(2,927.4)**	(2,349.3)	**(2,866.3)**	(2,349.3)
Exceptional past service credit	**8.3**	17.3	**8.3**	17.3
Current service cost	**(0.5)**	–	**–**	–
Interest cost	**(77.2)**	(82.7)	**(75.7)**	(82.7)
Contributions from scheme members	**(0.1)**	–	**–**	–
Actuarial gains arising from changes in demographic assumptions	**21.5**	16.6	**17.5**	16.6
Actuarial gains/(losses) arising from changes in financial assumptions	**17.4**	(470.6)	**12.6**	(470.6)
Actuarial gains/(losses) arising from experience adjustments	**0.6**	(84.8)	**0.8**	(84.8)
Benefits paid	**106.5**	87.2	**98.7**	87.2
Acquisition of Dee Valley Water	**–**	(61.1)	**–**	–
Present value at 31 March	**(2,850.9)**	(2,927.4)	**(2,804.1)**	(2,866.3)

27 Retirement benefit schemes (continued)

a) Defined benefit pension schemes (continued)

Severn Trent Plc 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. 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 is now included within Severn Trent Plc.

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 schemes

	Group		Company	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
Amounts credited/(charged) to operating costs				
Current service cost	**(0.5)**	–	**–**	–
Exceptional past service credit	**8.3**	17.3	**8.3**	17.3
Scheme administration costs	**(1.8)**	(3.3)	**(1.6)**	(3.3)
	6.0	14.0	**6.7**	14.0
Amounts charged to finance costs				
Interest cost	**(77.2)**	(82.7)	**(75.7)**	(82.7)
Amounts credited to finance income				
Interest income on scheme assets	**62.0**	71.8	**60.3**	71.8
Total amount (charged)/credited to the income statement	**(9.2)**	3.1	**(8.7)**	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.

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.

27 Retirement benefit schemes (continued)

a) Defined benefit pension schemes (continued)

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.

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.

27 Retirement benefit schemes (continued)

a) Defined benefit pension schemes (continued)

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 £19.6 million (2017: £19.7 million) for the group and £19.4 million (2017: £19.6 million) for the company 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.

28 Provisions – group and company

	Restructuring £m	Insurance £m	Other £m	Total £m
At 1 April 2017	–	7.2	7.6	14.8
Charged to income statement	0.8	4.7	6.6	12.1
Utilisation of provision	–	(3.5)	(0.6)	(4.1)
At 31 March 2018	**0.8**	**8.4**	**13.6**	**22.8**

	2018 £m	2017 £m
Included in		
Current liabilities	**16.6**	8.0
Non-current liabilities	**6.2**	6.8
	22.8	14.8

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.

The insurance provision relates to self-insurance. 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 and commercial disputes. The associated outflows are estimated to arise over a period up to three years from the balance sheet date.

29 Share capital

	2018 £m	2017 £m
Total issued and fully paid share capital		
1,000,100,000 ordinary shares of 0.1p (2017: 1,000,100,000)	**1.0**	1.0

30 Hedging reserve – group and company

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.

31 Capital management – group

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 increase exposure to low floating interest rates.

The group's dividend policy is to declare dividends which are consistent with the group's regulatory obligations and at a level which is decided each year after consideration of a number of factors, including regulatory uncertainty, future cash flow requirements and balance sheet considerations. The amount declared is expected to vary each year as the impact of these factors changes.

The group's capital at 31 March was:

	2018 £m	2017 £m
Cash and cash equivalents	**12.1**	0.2
Bank overdrafts	**(8.4)**	(3.6)
Bank loans	**(1,182.1)**	(1,036.9)
Other loans	**(4,138.2)**	(4,007.8)
Loans from parent company	**(9.3)**	(6.4)
Obligations under finance leases	**(113.9)**	(115.7)
Cross currency swaps	**24.5**	43.4
Loans due from joint ventures	**99.8**	99.6
Net debt	**(5,315.5)**	(5,027.2)
Equity attributable to owners of the company	**(2,324.8)**	(2,241.1)
Total capital	**(7,640.3)**	(7,268.3)

32 Fair values of financial instruments – group

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 period 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 period end and contract interest rates discounted at a rate that reflects the credit risk of counterparties.
Liabilities	**(104.6)**	(173.9)	
Energy swaps			Discounted cash flow
Assets	**0.3**	–	Future cash flows are estimated based on forward electricity prices from observable indices at the period 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 instrument are estimated based on observable forward inflation indices.
			Future cash flows on the CPI leg of the instrument are estimated based on the future expected differential between RPI and CPI.
			Both legs are discounted using observable swap rates at the period end, at a rate that reflects the credit risk of counterparties. This is considered to be a Level 3 valuation technique.

32 Fair values of financial instruments – group (continued)

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

The directors consider that the carrying amounts of cash and short term deposits, bank overdrafts, loans due 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		2017	
	Carrying £m	**Fair value £m**	Carrying £m	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
Loan from parent company	**9.3**	**9.3**	6.4	6.4
	1,112.3	**1,119.1**	970.5	984.9
Fixed rate debt				
Bank loans	**150.0**	**150.0**	150.0	150.0
Sterling bonds	**2,356.9**	**2,700.2**	2,257.3	2,746.2
Fixed rate notes	**343.4**	**347.6**	355.2	397.4
Other loans	**5.0**	**5.0**	6.5	6.5
Finance leases	**113.9**	**122.5**	115.7	130.5
	2,969.2	**3,325.3**	2,884.7	3,430.6
Index-linked debt				
Bank loans	**115.0**	**124.9**	110.6	126.7
Sterling bonds	**1,158.8**	**1,964.9**	1,113.7	1,970.9
Other loans	**88.2**	**87.1**	87.3	87.3
	1,362.0	**2,176.9**	1,311.6	2,184.9
	5,443.5	**6,621.3**	5,166.8	6,600.4

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.

33 Risks arising from financial instruments – group

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 Management 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 co-operation 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 sections a) (i) and note 34.

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) below.

Energy swaps are held to mitigate the groups exposure to changes in electricity prices. Further details are provided in note 34.

Severn Trent Water and Dee Valley Water operate under a regulatory environment where sales 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 in 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 38)	**5,315.5**	5,027.2
Cash and cash equivalents	**12.1**	0.2
Loans due from joint ventures and associates	**99.8**	99.6
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	**5,413.0**	5,117.7

The group manages its cash flow interest rate risk by borrowing at fixed or index-linked rates and by using interest rate swaps. Under these swaps the group receives floating 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 floating rates to fixed rates. The group has entered into a series of these interest rate swaps to hedge future interest payments to 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 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.

33 Risks arising from financial instruments – group (continued)

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 group's interest rate swaps on the amount of liabilities bearing fixed interest.

2018	**Floating rate £m**	**Fixed rate £m**	**Index-linked £m**	**Total £m**
Overdrafts	(8.4)	–	–	**(8.4)**
Bank loans	(917.1)	(150.0)	(115.0)	**(1,182.1)**
Other loans	(167.6)	(2,684.7)	(1,247.0)	**(4,099.3)**
Loans due to parent company	(9.3)	–	–	**(9.3)**
Finance leases	–	(113.9)	–	**(113.9)**
	(1,102.4)	**(2,948.6)**	**(1,362.0)**	**(5,413.0)**
Impact of swaps not matched against specific debt instruments	(349.6)	349.6	–	–
Interest bearing financial liabilities	**(1,452.0)**	**(2,599.0)**	**(1,362.0)**	**(5,413.0)**
Proportion of interest bearing financial liabilities that are fixed		**48%**		
Weighted average interest rate of fixed rate debt		**4.34%**		
Weighted average period for which interest is fixed (years)		**8.7**		

2017	Floating rate £m	Fixed rate £m	Index-linked £m	Total £m
Overdrafts	(3.6)	–	–	(3.6)
Bank loans	(776.3)	(150.0)	(110.6)	(1,036.9)
Other loans	(167.6)	(2,586.5)	(1,201.0)	(3,955.1)
Loans due to parent company	(6.4)	–	–	(6.4)
Finance leases	–	(115.7)	–	(115.7)
	(953.9)	(2,852.2)	(1,311.6)	(5,117.7)
Impact of swaps not matched against specific debt instruments	(205.3)	205.3	–	–
Interest bearing financial liabilities	(1,159.2)	(2,646.9)	(1,311.6)	(5,117.7)
Proportion of interest bearing financial liabilities that are fixed		52%		
Weighted average interest rate of fixed rate debt		5.22%		
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 £7.8 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)	**(32.5)**	(37.8)
	5.16	5.11	**(373.7)**	(518.1)	**(98.1)**	(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	**(87.3)**	(139.5)

33 Risks arising from financial instruments – group (continued)

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 reasonably possible changes in interest rates at 31 March is as follows:

		2018		2017
	1.0%	**-1.0%**	1.0%	-1.0%
	£m	**£m**	£m	£m
Profit or loss	**(47.8)**	**54.0**	(36.5)	54.6
Cash flow	**(11.6)**	**11.6**	9.2	(9.2)
Equity	**(47.8)**	**54.0**	(36.5)	54.6

(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 and therefore the sensitivity of the group's results to changes in exchange rates is not material.

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.

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 32 a).

The group also has a number of fixed to floating rate cross currency swaps with a notional 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 million (2017: credit of £3.1 million) in the income statement which is offset by the exchange gain of £12.7 million (2017: 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.

	Euro	**US Dollar**	**Yen**
2018	**€m**	**$m**	**¥Bn**
Borrowings by currency	(19.9)	(150.0)	(2.0)
Cross currency swaps - hedge accounted	19.9	–	2.0
Cross currency swaps - not hedge accounted	–	150.0	–
Net currency exposure	**–**	**–**	**–**

	Euro	US Dollar	Yen
2017	€m	$m	¥Bn
Borrowings by currency	(19.9)	(150.0)	(2.0)
Cross currency swaps - hedge accounted	19.9	–	2.0
Cross currency swaps - not hedge accounted	–	150.0	–
Net currency exposure	–	–	–

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 Group Limited, whose operating licence obliges it 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 20.

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.

33 Risks arising from financial instruments – group (continued)

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	2017	**2018**	2017
	£m	£m	**£m**	£m
AAA	**–**	5.0	–	–
Double A range	**105.0**	100.0	–	–
Single A range	**650.0**	615.0	–	–
Triple B range	**10.0**	20.0	–	–
	765.0	740.0	–	–

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

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

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	2017
	£m	£m
2-5 years	**610.0**	900.0

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**	**Fixed rate**	**Index linked**	**Trade payables**	**Payments on financial liabilities**
	£m	**£m**	**£m**	**£m**	**£m**
Within 1 year	(314.9)	(135.7)	(26.7)	(12.3)	**(489.6)**
1 - 2 years	(9.2)	(116.1)	(28.2)	**–**	**(153.5)**
2 - 5 years	(32.2)	(982.6)	(223.1)	–	**(1,237.9)**
5 - 10 years	(758.8)	(1,333.6)	(199.9)	–	**(2,292.3)**
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	**(1,167.8)**	**(3,983.7)**	**(5,785.6)**	**(12.3)**	**(10,949.4)**

33 Risks arising from financial instruments – group (continued)

Undiscounted amounts receivable:	Loans due from related parties £m	Trade receivables £m	Cash and short term deposits £m	Amounts due from group undertakings £m	Receipts from financial assets £m
Within 1 year	–	182.7	12.1	8.4	**203.2**
1 – 2 years	99.8	–	–	–	**99.8**

2017 Undiscounted amounts payable:	Floating rate £m	Fixed rate £m	Index linked £m	Trade payables £m	Payments on financial liabilities £m
Within 1 year	(165.4)	(538.6)	(25.0)	(15.0)	(744.0)
1 - 2 years	(9.9)	(108.7)	(26.0)	–	(144.6)
2 - 5 years	(35.3)	(469.8)	(82.1)	–	(587.2)
5 - 10 years	(725.5)	(1,383.4)	(314.0)	–	(2,422.9)
10 - 15 years	(105.7)	(1,110.0)	(347.1)	–	(1,562.8)
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	(1,041.8)	(3,982.3)	(5,690.3)	(15.0)	(10,729.4)

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	99.6	193.1	0.2	292.9

Index-linked debt includes loans with maturities up to 51 years. The principal is revalued at fixed intervals and is linked to movements in the Retail Price Index. 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**	**Inflation swaps £m**	**Energy swaps £m**	**Interest rate swaps £m**	**Energy swaps £m**	**Cash receipts £m**	**Cash payments £m**	**Total £m**
Within 1 year	(13.4)	–	–	5.1	0.2	1.1	(0.2)	**(7.2)**
1 - 2 years	(13.6)	–	–	1.7	–	1.1	(0.3)	**(11.1)**
2 - 5 years	(44.3)	0.2	(0.8)	3.5	0.1	3.4	(1.1)	**(39.0)**
5 - 10 Years	(32.9)	0.8	–	3.9	–	23.3	(13.0)	**(17.9)**
10 - 15 Years	(13.0)	1.6	–	–	–	17.5	(8.8)	**(2.7)**
15 – 20 years	–	(6.7)	–	–	–	–	–	**(6.7)**
	(117.2)	**(4.1)**	**(0.8)**	**14.2**	**0.3**	**46.4**	**(23.4)**	**(84.6)**

33 Risks arising from financial instruments – group (continued)

2017	Derivative liabilities: Interest rate swaps	Derivative liabilities: Energy swaps	Derivative assets: Interest rate swaps	Derivative assets: Cross currency swaps: Cash receipts	Derivative assets: Cross currency swaps: Cash payments	Total
	£m	£m	£m	£m	£m	£m
Within 1 year	(23.7)	(0.2)	6.9	1.1	(0.2)	(16.1)
1 - 2 years	(23.3)	(0.5)	6.2	1.1	(0.2)	(16.7)
2 - 5 years	(70.0)	(0.3)	13.1	3.4	(0.8)	(54.6)
5 - 10 years	(57.8)	–	4.3	23.9	(13.1)	(42.7)
10 - 15 years	(11.4)	–	(6.4)	18.1	(9.0)	(8.7)
	(186.2)	(1.0)	24.1	47.6	(23.3)	(138.8)

d) Inflation risk

The group's parent company, 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 reasonably possible 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 Regulated Capital Value, or accounting for defined benefit pension schemes.

	2018		2017	
	+1.0%	**-1.0%**	+1.0%	-1.0%
	£m	**£m**	£m	£m
Profit or loss	**(11.8)**	**11.8**	(10.5)	10.5
Equity	**(11.8)**	**11.8**	(10.5)	10.5

34 Hedge accounting – group

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		**Fair Value**	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£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

34 Hedge accounting – group (continued)

b) Cash flow hedges

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	
	2018	2017	**2018**	2017	**2018**	2017
Period to maturity	**%**	%	**£m**	£m	**£m**	£m
5-10 years	**1.73**	1.70	**100.0**	50.0	**(0.9)**	(1.1)
10-20 years	**1.83**	1.82	**298.0**	348.0	**(5.0)**	(9.7)
	1.80	1.80	**398.0**	398.0	**(5.9)**	(10.8)

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 fixed interest rate		Notional principal amount		Fair Value	
	2018	2017	**2018**	2017	**2018**	2017
Period to maturity	**£/MWh**	£/MWh	**MWh**	MWh	**£m**	£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)

35 Share based payment – group

The group operates a number of share based remuneration schemes for employees. During the period, the group recognised total expenses of £6.8 million (2017: £6.0 million) related to equity settled share based payment transactions.

The weighted average share price of the ultimate parent company 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 LTIPs, 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 outstanding

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 LTIP awards onwards 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%).

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

	Number of awards
Outstanding at 1 April 2016	453,679
Granted during the year	187,549
Vested during the year	(132,697)
Lapsed during the year	(21,122)
Outstanding at 1 April 2017	487,409
Granted during the year	200,615
Vested during the year	(126,356)
Lapsed during the year	(19,435)
Outstanding at 31 March 2018	**542,233**

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

		Number of awards	
Date of grant	**Normal Date of Vesting**	**2018**	2017
July 2014	2017	**–**	140,251
July 2015	2018	**156,940**	159,609
July 2016	2019	**184,678**	187,549
July 2017	2020	**200,615**	–
		542,233	487,409

35 Share based payment – group (continued)

b) Employee Sharesave Scheme

Under the terms of the Sharesave Scheme, the board may grant the right to purchase ordinary shares in Severn Trent Plc 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	2,785,577	1,491p
Granted during the year	840,566	1,663p
Forfeited during the year	(64,219)	1,571p
Cancelled during the year	(90,990)	1,635p
Exercised during the year	(436,170)	1,225p
Lapsed during the year	(7,557)	1,367p
Outstanding at 1 April 2017	3,027,207	1,572p
Granted during the year	1,058,944	1,652p
Forfeited during the year	(42,224)	1,636p
Cancelled during the year	(130,418)	1,665p
Exercised during the year	(418,806)	1,306p
Lapsed during the year	(8,557)	1,367p
Outstanding at 31 March 2018	**3,486,146**	1,625p

Sharesave options outstanding at 31 March were as follows:

			Number of share options	
Date of grant	**Normal date of exercise**	**Option price**	**2018**	2017
January 2012	2017	1,177p	**–**	85,345
January 2013	2016 or 2018	1,241p	**108,034**	110,206
January 2014	2017 or 2019	1,331p	**148,805**	480,969
January 2015	2018 or 2020	1,584p	**831,411**	867,375
January 2016	2019 or 2021	1,724p	**603,931**	648,300
January 2017	2020 or 2022	1,663p	**759,196**	835,012
January 2018	2021 or 2023	1,652p	**1,034,769**	–
			3,486,146	3,027,207

c) Share Matching Plan ('SMP')

Under the Share Matching Plan members of STEC have received 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 Severn Trent Plc Remuneration Committee determines that the performance conditions have been met provided that the participant remains in employment at the end of the performance period.

35 Share based payment – group (continued)

c) Share Matching Plan (‘SMP’) (continued)

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 out below:

	2018			2017		
	LTIP	**SAYE**		LTIP	SAYE	
		3 year scheme	**5 year scheme**		3 year scheme	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.

36 Acquisitions – group

On 15 February 2017, the company 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.

	2018 £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.

37 Discontinued Operations

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 Great Britain. 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.

During the year, we wrote off the remaining balance on the non-household retail receivable amounts that were retained when that business was transferred to Water Plus. 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.

The profit for the period from discontinued operations was as follows:

	2018 **£m**	2017 £m
Turnover	**–**	3.8
Total operating costs	**(1.5)**	(4.1)
Loss before tax	**(1.5)**	(0.3)
Attributable tax credit	**0.3**	0.1
Loss for the year	**(1.2)**	(0.2)

The group and company did not dispose of any assets during this disposal.

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

	2018 **£m**	2017 £m
Cash flow from operating activities	**–**	0.2

The group and company did not recognise any cash flows from the disposal.

38 Cash flow statement

a) Reconciliation of operating profit to operating cash flows

	Group		Company	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
Profit before interest and tax from continuing operations	**525.1**	540.4	**519.4**	540.3
Loss before interest and tax from discontinued operations	**(1.2)**	(0.3)	**(1.2)**	(0.3)
Profit before interest and tax	**523.9**	540.1	**518.2**	540.0
Depreciation of property, plant and equipment	**304.0**	302.7	**297.9**	302.6
Amortisation of intangible assets	**19.8**	17.4	**19.8**	17.4
Pension service credit	**(7.8)**	(17.3)	**(8.3)**	(17.3)
Defined benefit pension scheme administration costs	**1.8**	3.3	**1.6**	3.3
Exceptional depreciation – property, plant and equipment	**16.8**	–	**16.8**	–
Defined benefit pension scheme contributions	**(33.8)**	(33.2)	**(9.3)**	(33.2)
Share based payments charge	**6.8**	6.0	**6.8**	6.0
Profit on sale of property, plant and equipment and intangible assets	**(4.6)**	(10.2)	**(4.4)**	(10.2)
Deferred income movement	**(14.3)**	(13.9)	**(14.1)**	(13.9)
Provisions charged to the income statement	**12.1**	9.4	**12.1**	9.4
Utilisation of provisions for liabilities and charges	**(4.1)**	(1.7)	**(4.1)**	(1.7)
Operating cash flows before movements in working capital	**820.6**	802.6	**833.0**	802.4
Increase in inventory	**(0.9)**	(0.3)	**(0.9)**	(0.3)
(Increase)/decrease in amounts receivable	**(36.7)**	61.3	**(51.1)**	60.5
Increase/(decrease) in amounts payable	**5.0**	(11.7)	**18.5**	(8.0)
Cash generated from operations	**788.0**	851.9	**799.5**	854.6
Tax paid	**(14.9)**	(37.9)	**(13.0)**	(36.3)
Net cash generated from operating activities	**773.1**	814.0	**786.5**	818.3

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

	Group and company	
	2018	2017
	£m	£m
Disposal of fixed assets	**–**	11.0
Costs of pension exchange arrangement	**–**	(0.7)
	–	10.3

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

Group

	As at 1 April 2017	Cash flow	Fair value adjustments	RPI uplift on index-linked debt	Foreign exchange	Other non-cash movements	**As at 31 March 2018**
	£m	£m	£m	£m	£m	£m	**£m**
Net cash and cash equivalents	(3.4)	7.1	–	–	–	–	**3.7**
Loans payable to parent company	(6.4)	(2.9)	–	–	–	–	**(9.3)**
Bank loans	(1,036.9)	(140.0)	–	(4.4)	–	(0.8)	**(1,182.1)**
Other loans	(4,007.8)	(97.3)	2.0	(46.7)	12.7	(1.1)	**(4,138.2)**
Finance leases	(115.7)	1.8	–	–	–	–	**(113.9)**
Cross currency swaps	43.4	–	(18.9)	–	–	–	**24.5**
Loans due from related parties	99.6	–	–	–	–	0.2	**99.8**
Net debt	**(5,027.2)**	**(231.3)**	**(16.9)**	**(51.1)**	**12.7**	**(1.7)**	**(5,315.5)**

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

38 Cash flow statement (continued)

Company

	As at 1 April 2017	Cash flow	Fair value adjustments	RPI uplift on index-linked debt	Foreign exchange	Other non-cash movements	**As at 31 March 2018**
Net cash and cash equivalents	(4.9)	5.3	–	–	–	–	**0.4**
Loans receivable from other group companies	55.2	5.4	–	1.9	–	(0.1)	**62.4**
Loans payable to other group companies	(3,876.9)	(112.0)	(1.9)	(44.9)	–	19.8	**(4,015.9)**
Bank loans	(1,036.9)	(140.0)	–	(4.4)	–	(0.8)	**(1,182.1)**
Other loans	(561.3)	1.5	0.8	(1.9)	12.7	(19.3)	**(567.5)**
Finance leases	(184.7)	18.4	–	–	–	(1.0)	**(167.3)**
Intercompany finance leases payable	(202.2)	3.1	–	–	–	–	**(199.1)**
Intercompany finance leases receivable	99.7	(0.6)	–	–	–	–	**99.1**
Cross currency swaps	43.4	–	(18.9)	–	–	–	**24.5**
Loans due from related parties	99.6	–	–	–	–	0.2	**99.8**
Net debt	**(5,569.0)**	**(218.9)**	**(20.0)**	**(49.3)**	**12.7**	**(1.2)**	**(5,845.7)**

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

39 Contingent liabilities – group and company

a) 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.

b) Banking arrangements

The banking arrangements of the group operate on a pooled basis with certain fellow group undertakings. Under these arrangements participating companies guarantee each others' balances only to the extent that their credit balances can be offset against overdrawn balances of other Severn Trent group companies.

At 31 March 2018 the group's maximum liability under these arrangements was £12.1 million (2017: £0.2 million).

At 31 March 2018 the company's maximum liability under these arrangements was £9.2 million (2017: £nil million).

40 Financial and other commitments – group and company

a) Investment expenditure commitments

Capital commitments are as follows:

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

In addition to these contractual commitments, the group and company have 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 and company had outstanding 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**	1.1
1 - 5 years	**2.2**	3.1
After more than 5 years	**4.2**	4.1
	7.5	8.3

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

41 Post balance sheet events – group and company

There are no post balance sheet events.

42 Related party transactions – group and company

Transactions between the company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not included in this note. Transactions between the group, joint ventures and ultimate parent Severn Trent Plc are disclosed below.

Trading transactions

	Transactions with fellow subsidiary undertakings		Transactions with ultimate parent		Transactions with Water Plus	
	2018 £m	2017 £m	2018 £m	2017 £m	2018 £m	2017 £m
Sale of services	**3.5**	1.6	**–**	–	**354.9**	310.5
Purchase of services	**5.6**	6.9	**1.5**	–	**–**	–
Net interest income	–	–	**0.1**	0.9	**2.2**	0.9
	9.1	8.5	**1.6**	0.9	**357.1**	311.4
Balances outstanding at 31 March:						
Amounts due from related parties	**5.4**	6.4	**3.0**	3.2	**44.9**	34.1
Amounts due to related parties	**(2.0)**	(1.7)	**(15.6)**	(0.7)	**–**	(8.8)
Loans due from related parties due after 1 year	**–**	–	**–**	–	**99.8**	100.0
Loans due to related parties	**–**	–	**(9.3)**	(6.5)	**–**	–
Dividends payable to related parties	**204.0**	(195.5)	**–**	–	**–**	–
	207.4	(190.8)	**(21.9)**	(4.0)	**144.7**	125.3

Water Plus is a joint venture between the group's ultimate holding company, Severn Trent Plc, and United Utilities PLC.

The related parties are fellow subsidiary undertakings and the ultimate parent is Severn Trent Plc.

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.

	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

The retirement benefit schemes entered into by the group are considered to be related parties. Details of transactions and balances with the retirement benefit schemes are disclosed in note 27.

43 Alternative performance measures – group

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 with 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. This provides a consistent measure of operating performance excluding distortions caused by exceptional items.

b) 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 £m
Net finance costs	**215.9**	199.6
Net finance costs from pensions	**(15.2)**	(10.9)
Capitalised interest	**24.6**	17.4
	225.3	206.1
Average net debt	**5,085.2**	4,745.2
Effective interest rate	**4.4%**	4.3%

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

c) 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 £m
Net finance costs	**215.9**	199.6
Net finance costs from pensions	**(15.2)**	(10.9)
RPI interest	**(51.2)**	(28.7)
Capitalised interest	**24.6**	17.4
	174.1	177.4
Average net debt	**5,085.2**	4,745.2
Effective cash cost of interest	**3.4%**	3.7%

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

43 Alternative performance measures – group (continued)

d) 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 £m
Underlying PBIT	**537.7**	512.8
Net finance costs	**215.9**	199.6
Net finance costs from pensions	**(15.2)**	(10.9)
Net finance costs excluding finance costs from pensions	**200.7**	188.7

	ratio	ratio
PBIT interest cover ratio	**2.7**	2.7

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

e) EBITDA and EBITDA interest cover

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

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

	2018 £m	2017 £m
Underlying PBIT	**537.7**	512.8
Depreciation	**304.0**	302.7
Amortisation	**19.8**	17.4
EBITDA	**861.5**	832.9
Net finance costs	**215.9**	199.6
Net finance costs from pensions	**(15.2)**	(10.9)
Net finance costs excluding finance costs from pensions	**200.7**	188.7

	ratio	ratio
EBITDA interest cover ratio	**4.3**	4.4

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

43 Alternative performance measures – group (continued)

f) 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 and exceptional items.

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

	2018 £m	**2018** Current tax thereon £m	2017 £m	2017 Current tax thereon £m
Profit before tax	**302.0**	**(37.4)**	334.2	(49.9)
Adjustments:				
Exceptional items	**12.6**	**(0.7)**	(27.6)	1.1
Net losses on financial instruments	**7.2**	**(3.3)**	6.6	(4.8)
	321.8	**(41.4)**	313.2	(53.6)
Underlying effective current tax rate		**12.9%**		17.1%

44 Ultimate parent undertaking

The immediate parent undertaking is Severn Trent Draycote Limited.

The ultimate parent undertaking and controlling party is Severn Trent Plc, which is the parent undertaking and controlling party of the smallest and largest group to consolidate these financial statements. Copies of the Severn Trent Plc consolidated financial statements can be obtained from Severn Trent Plc's registrars at Equiniti, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6DA.