Sustainable growth

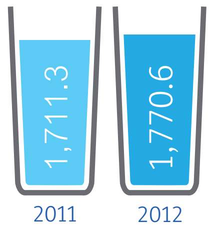
Severn Trent Plc Annual Report and Accounts 2012

2012 Severn Trent group highlights

- Leakage reduced by 7% year on year to a record low level, and below Ofwat target.
- Maintaining the lowest combined water and waste water bills for our customers.
- No usage restrictions in the Severn Trent Water region forecast for this year.
- Severn Trent Water operating expenditure below level allowed in Ofwat's Final Determination.
- Additional investment of £150 million in Severn Trent Water's networks over the next 3 years to enhance security and resilience for our customers, on top of £1.6 billion previously planned.
- Proposed capital return of £150 million to shareholders maintains an efficient and sustainable balance sheet with a strong investment grade credit rating.

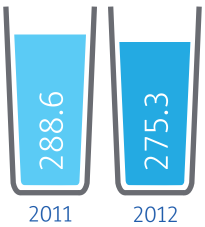
Group turnover £m

£1,770.6m



Group profit* £m

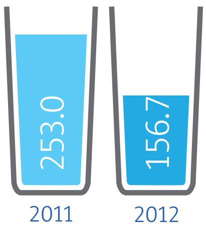
£275.3m



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

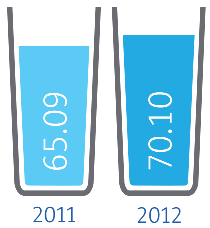
Group profit before tax £m

£156.7m



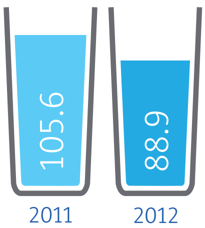
Dividend pence per share

70.10p



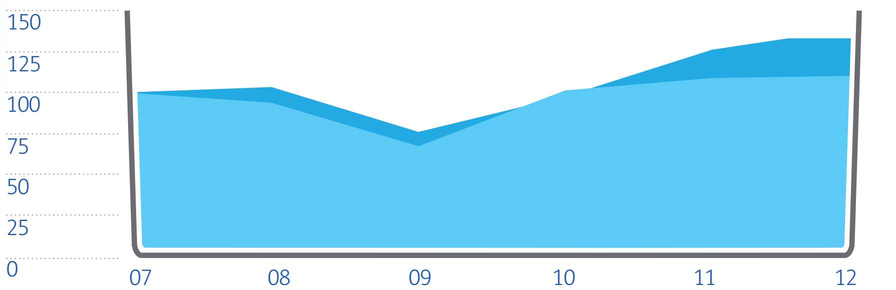
Earnings per share* pence

88.9p



* before exceptional items, gains/losses on financial instruments and deferred tax.

Total shareholder return (value £)



● Severn Trent Plc ● FTSE 100 index

This graph illustrates the value, by 31 March 2012, of £100 invested in Severn Trent on 31 March 2007 compared with the value of £100 invested in the FTSE 100 Index. The intermediate points show the value at intervening financial year ends.
Source: Datastream

Cautionary statement

This document contains certain 'forward looking statements' with respect to Severn Trent's financial condition, results of operations and business and certain of Severn Trent's plans and objectives with respect to these items.

Forward looking statements are sometimes, but not always, identified by their use of a date in the future or such words as 'anticipates', 'aims', 'due', 'will', 'could', 'may', 'should', 'expects', 'believes', 'intends', 'plans', 'potential', 'reasonably possible', 'targets', 'goal' or 'estimates'. By their very nature forward looking statements are inherently unpredictable, speculative and involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future.

There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward looking statements. These factors include, but are not limited to, changes in the economies and markets in which the group operates; changes in the regulatory and competition frameworks in which the group operates; the impact of legal or other proceedings against or which affect the group; and changes in interest and exchange rates.

All written or verbal forward looking statements, made in this document or made subsequently, which are attributable to Severn Trent or any other member of the group or persons acting on their behalf are expressly qualified in their entirety by the factors referred to above. Severn Trent does not intend to update these forward looking statements.

Nothing in this document should be regarded as a profits forecast.

This document is not an offer to sell, exchange or transfer any securities of Severn Trent Plc or any of its subsidiaries and is not soliciting an offer to purchase, exchange or transfer such securities in any jurisdiction. Securities may not be offered, sold or transferred in the United States absent registration or an applicable exemption from the registration requirements of the US Securities Act of 1933 (as amended).

We treat and provide water and treat waste water in the UK, and internationally, through our two complementary businesses – Severn Trent Water and Severn Trent Services.

Severn Trent Water is one of the largest of the 10 regulated water and sewerage companies in England and Wales. It provides high quality services to more than 4.2 million households and businesses in the Midlands and mid-Wales. See pages 8 – 21

Severn Trent Services is one of the world's leading commercial suppliers of water and waste water treatment services and products, with customers in the US, Europe, Middle East and Asia.
See pages 22 – 30

Find our more on our corporate website: **www.severntrent.com**
Severn Trent Water website: **www.stwater.co.uk**
Severn Trent Services website: **www.severntrentservices.com**

Chairman's statement

‘I'm delighted to report on another good year for Severn Trent. We delivered sound financial results and continued to improve key aspects of our operational performance.'

Andrew Duff, Chairman

Sound financial results

Severn Trent has a good financial track record and we delivered another solid set of results in 2011/12. Total group revenue rose by 3.5% to £1.77 billion, while our profit before tax, exceptional items and losses on financial instruments was £275.3 million, a decrease of 4.6%. This gave us adjusted earnings per share excluding deferred tax of 88.9 pence, down by 15.8%.

Our dividend policy is to grow our dividend by 3% more than the retail price index up to 2014/15. The board is therefore proposing a final dividend of 42.06 pence, to be paid on 27 July 2012. This will give a total dividend for the year of 70.10 pence, representing growth of 7.7%.

We are pleased to share the benefits of our strong balance sheet with our stakeholders, in an efficient and sustainable way which maintains our investment grade credit rating. We will increase by £150 million our investment programme in our water and waste water networks, to improve further our services to customers, and propose to return an additional £150 million to our shareholders. This special dividend, subject to shareholder approval, equates to 63 pence per share and will be payable with the final dividend on 27 July 2012. These actions underpin our ability to invest in our networks in the future, for the benefit of all stakeholders.

Continually improving our performance

I'm delighted that at Severn Trent Water we improved our operational performance in 2011/12. In particular, we were able to reduce leakage, to a record low level. Severn Trent Water is the only company targeting significant reductions in leakage over this five year regulatory period.

After the driest 18 months on record, it is pleasing that we are managing our water resources so well. Our customers continued to receive a high quality water supply and we have avoided a hosepipe ban to date. Good water management also helps us to maintain our environmental performance.

Chairman's statement

At Severn Trent, we know that we can always do better. The desire to continuously improve runs right through our company. We enjoyed our first full year in our new operating centre in Coventry which is helping our people to work together more effectively as a cohesive team. Our SAP-based systems allow us to respond to our customers more quickly and flexibly and make us more efficient. We're also continuing to invest in the training and development of our people so they can give our customers the best possible service.

Delivering a good service and value for money

Severn Trent Water customers over the last year have received high quality water, good overall service and value for money, with the lowest average annual water and sewerage bill in the UK. However, we recognise that we can do better in the way in which we deal with customers if they have reason to contact us.

Whilst complaints have significantly fallen and our new processes and systems mean that we handle customer enquiries efficiently, we do not always make it easy enough for customers to deal with us or resolve their problems at the first time of asking. This is an area of focus for us and at the end of the year we were seeing positive signs that the changes we are putting in place are making a difference.

I am also pleased to see the continued improvement in the level of service we provide to our customers. In other areas, Severn Trent Water has met its leakage targets and significantly reduced interruptions to supply.

Health and safety

There is nothing more essential than the health and safety of our customers, employees and contractors. I'm therefore particularly pleased that, across the company, we reduced the number of employee lost time injuries for the third successive year. Our annual employee survey showed that 95% of our people were clear about how to do their jobs safely and 89% believed that we give them the right support to do so.

We're always looking for ways to help our people work more safely and that is why we are introducing the MindSafety™ behavioural training programme which encourages our people to be aware of what they're doing and to be accountable for their own safety. Taking care over health and safety can also help us to improve performance in a whole range of other areas such as service quality, environmental compliance and productivity of our teams.

Changing Course

Over the last few years, Severn Trent has sought to lead the debate on our industry's future by publishing a series of papers called 'Changing Course'. During the year, we published our latest paper making the case for a new system of 'water trading' to allow water to be shared across water company boundaries as an economic and environmental alternative to developing new local resources.

We were therefore delighted to see strong UK Government support for increasing interconnection and the trading of bulk supplies of treated water in its Water White Paper, 'Water For Life', published during the year. With last year's drought conditions in parts of England, including the Midlands, continuing into the new year, far sighted ideas like this will become a necessity as England and Wales addresses its water balance.

Boosting the economy and employment

Severn Trent contributes significantly to the economy. We build much needed infrastructure and finance it efficiently, so it's not a burden on the public sector. Our business provides many job opportunities and boosts the economy.

I'm also delighted that we provide long term careers for the young people of our region. Our apprenticeship programme is going from strength to strength, helping young people into work and making sure that we have the skills we'll need in the future. We currently have 81 apprentices across customer service, water and waste water roles. One of our apprentices, Michael Williams, won the national EEF Outstanding Achievement by a Final Year Apprentice Award, for introducing process changes that improved efficiency and reliability and saved us money.

Severn Trent Services

Severn Trent Services had a challenging start to the year, while the second half saw an improved performance. Full year revenues were £332.3 million, an increase of 0.6% year on year, after adjusting for the impact of changes in exchange rates, driven by good performance in Europe offsetting a weak US result. PBIT[1] (profit before interest and tax) was £18.0 million, a decline of 26.5%, on a constant currency basis, due to investments in new business opportunities, a change in product mix in our water purification division and economic conditions. Interest in our new BALPURE® ballast water treatment products was greater than expected, with initial orders generating £5 million in recorded orders.

Summary

This has been another good year for Severn Trent. We've improved our operational performance and the efficiency of our investment, allowing us to deliver sustainable returns to our shareholders and the lowest cost of water and waste water services to our customers. I'm particularly grateful to all of the staff at Severn Trent for their contribution to our success.

Andrew Duff
Chairman

1. Before exceptional items.

Overview | Business review | Governance | Group financial statements | Company financial statements | Other information

Chief Executive's review

'Our long term success depends on balancing the needs of all our stakeholders and our ability to continually improve our services and efficiency. We also aim to drive the industry forwards, by leading the regulatory debate.'

Tony Wray, Chief Executive

Strategy

Our strategy is focused on delivering sustainable growth. This is crucial to us because we have to plan far ahead – often over decades. To be truly sustainable, we must maintain the appropriate balance across our customers, people, the environment and investors.

Water is vital to life, so we look to offer the highest quality at a price customers can afford. We need to attract investment, so we can fund the infrastructure our service depends on. Our people must have the skills, support and motivation to continually improve our service. We have to protect the environment because our business and our customers depend upon it to provide the resources we need.

Achieving this balance leads directly to good financial performance. It allows us to deliver organic growth and reliable returns over the long term, without excessive risk.

The timescales we work to are long, but our industry doesn't stand still. Politics, regulation, climate and the availability of finance all change over time, both in the UK and internationally. For this reason, our board considers strategic topics regularly and formally reviews our strategy every year. The experience of recent years supports our view that we're following the right strategy. Whatever happens to economies around the world, the need for clean water and sanitation remains.

Our strategy

Sustainable

Strategy aim	Highlights 2012	Key measures
Delivering value for our customers and investors.	• At Severn Trent Water we are focused on delivering key service improvements: – we have met our leakage targets; – interruptions to supply have been reduced; – we have maintained security of supply in a dry year; and – we have maintained the lowest charges in the UK. • Severn Trent Services has returned a creditable performance in difficult markets.	**4.88** Customer written complaints per 1,000 properties (STW) (2011: 5.72) **464 Ml/d** Leakage megalitres per day (2011: 497)
Sustainable financing, ensuring we have a strong and flexible balance sheet.	• We are well financed. • We have successfully refinanced part of our debt. • We have maintained a strong credit rating. • We have kept our dividend promise.	**£729.4m** Cash generated from operations (2011: £753.0m) **56.0%** Net Debt/RCV Gearing (2011: 56.8%)
Responsible leadership, protecting the environment, thinking long term and setting high standards in everything we do.	• We have improved our health and safety performance. • We have generated record levels of renewable energy. • We have completed a series of successful catchment management pilots. • We have influenced the regulatory debate around the future of our industry.	Support for water trading in the UK Government's Water White Paper, 'Water for Life'

Growth

Strategy aim	Highlights 2012	Key measures
Growing Severn Trent in the UK through investment in our networks and services.	• We have made good progress in preparation for the next price review in 2014 (PR14). • We have successfully transferred private drains and sewers to our asset database. • We grew our Regulated Capital Value (RCV) by £275.0 million.	**4.0%** RCV growth (2011: 6.2%)
Positioning Severn Trent to capitalise on opportunities in a changing regulatory framework.	• Severn Trent Services is well placed to compete in the emerging UK market for non-domestic retail. • Severn Trent Water is well placed geographically to benefit from future water trading.	• Granted both water and sewerage retail licences in Scotland • Severn Trent Water is looking at opportunities to provide water to other areas of the country
Deploying Severn Trent Services business into new markets.	• We have successfully introduced our existing water filtration products into a number of key markets in Spain, China and South America.	**58** Countries with representative/distributor locations (2011: 53)
Developing new treatment technologies.	• Water Purification (Products) – BALPURE® is making good progress with new contracts with Greenway Shipping (and others).	**£5m** New commercial orders

Business performance review

Severn Trent delivered good financial and operational performance in 2011/12, despite challenging UK and international markets. We maintained our focus on efficiency and service improvement, and both Severn Trent Water and Severn Trent Services achieved high standards for their customers.

Whilst keeping prices low, we delivered anticipated returns for investors, maintaining our dividend promise to grow our dividend by 3% more than the retail price index up to 2014/15. We also took important steps to maintain our financial strength. We completed a successful £250 million 30 year bond issue at 4.875%. We bought back 75% of our 2014 £200 million bond, which was due for repayment shortly before the next price review, when raising finance could be more difficult. We thus reduced a future refinancing risk.

Our performance is a credit to our employees throughout the group. We are proud of their continuing commitment whilst we've made major changes over the last few years, including key change projects introducing new systems and processes, and a significant change in benefits for our employees, being the closing of our defined benefit pensions schemes to future accrual from 2015.

Our employees have proved adaptable and willing to embrace change which is important for our future prospects of success.

Severn Trent Water

Our household customers still have the lowest bills, on average, in England and Wales, and our prices will increase by less than the industry average in 2012/13. We've also been able to keep bad debts down, despite rising unemployment, by helping customers in need to pay their bills.

During the year, we remained focused on improving our service and efficiency. We stepped up our network replacement, which helped us in the aftermath of the harsh December in 2010, which was the coldest in 100 years. Leakage was reduced to a new low, ahead of our target, and we dramatically reduced interruptions to supply.

Despite the driest 18 months on record, we managed our resources carefully and kept our customers supplied with high quality water, without having a hosepipe ban. As we enter the next financial year, our water resources mean that we do not presently expect any usage restrictions.

One of the year's key achievements was our smooth adoption of 37,000 km of private drains and sewers. Feedback from customers has been positive and the extra work required to repair and maintain these assets has so far been at the lower end of our expectations.

Any company that wants long term, sustainable success has to work in the right way. We call our approach 'Safer, Better Faster'. It's a combination of management disciplines and our belief in people taking responsibility for the way they work. We want our people to do the right thing the Severn Trent way, to get things right first time, to help cut waste from our systems and processes, and to care about one another.
We've built our ability to continuously improve, developing our people and upgrading our workplaces and technology, so we have a better working environment. All of these help us to deliver great service efficiently.

Key areas for continued improvement include our environmental management, further reducing water supply interruptions and our customers' experience of our services.

We're not content with what we've achieved, so we're always looking for new areas for success. For example, we're increasingly using technology to make it easier for our customers to contact us and for us to stay in touch with them. And we're introducing new water and waste water treatment processes that will cut energy use and make us more efficient.

Severn Trent Water already has a sector leading position in renewable energy and we're on track to generate up to 30% of our electricity by 2015. We have no strong desire to be a big electricity generator – our motivation is to keep prices low for customers and reduce our carbon emissions. The next steps include increasing our use of anaerobic digestion and wind turbines.

> 'Despite the driest 18 months on record, we managed our resources carefully and kept our customers supplied with high quality water, without having a hosepipe ban'

Severn Trent Services

Severn Trent Services performed creditably against a challenging economic backdrop. Severn Trent Services faced tough trading conditions, particularly in the first half of the year. Political unrest in the Middle East and North Africa (MENA) as well as sluggish economic growth in developed markets made for a challenging environment for product sales and contract renewals. Refinancing of the receivables for part of our business in Italy remained difficult for all partners amid the ongoing Eurozone crisis.

Over the year as a whole, our revenues were slightly ahead on a constant currency basis (versus last year), although profits were down by around a third, in part due to £2 million of investment in business development opportunities in both Products and Operating Services. Our Operating Services business continued to do well in the UK and Ireland but US markets were tougher and, as we reported at the half year, we have ceased any further development of our business activities in Italy.

Water purification products saw a slow recovery, with challenging markets in North Africa and the US, but better conditions in the Far East and the UK.

We made further progress with our new treatment product BALPURE®, our ballast water treatment system, which received Type Approval and we're pleased to have sold the first units in what is a potentially sizeable market.

Our UK Analytical Services business has reduced as two water utility clients have decided to insource their work.

At the end of the year, for Severn Trent Services, we appointed Martin Kane as the new Chief Executive Officer along with a new Chief Financial Officer, Stephane Bouvier.

Looking forward

The UK economy will remain tough for both consumers and businesses. This means we must continue to focus on delivering efficient, high quality and low cost services, and be attentive to our customers' needs. The UK climate will also be a challenge and we will have to manage our water resources carefully. The coming year will see us continuing with our preparations for the next price review in 2014 (PR14). Engaging with our customers and other stakeholders will be key, as we develop with them our plans for investment in our water and waste water networks to maintain the services provided, deliver our environmental obligations and ensure security of supply.

In Severn Trent Services our new management team is focused on operating efficiency and positioning for growth when the economy improves. We also continue to target new opportunities. For example, in addition to our existing England and Wales licence, we have been granted both water and sewerage retail licences in Scotland. Having the necessary operating licences in both markets prepares our business for the creation of a market across all of Great Britain as indicated in the UK Government's Water White Paper, 'Water for Life'. This will enable customers with sites across Great Britain to easily switch to Severn Trent Services as their single national water services supplier as the market opens up.

For several years, Severn Trent Water has been at the forefront of shaping the future of the water sector in the UK through the development of a series of publications known as 'Changing Course'. We're encouraged that our ideas are reflected in Ofwat's publications on regulatory compliance and future price limits, and in the UK Government's Water White Paper. These ideas will lead to optimal use of water resources, better financial and environmental outcomes for customers and more certainty for investors. Looking to future opportunities for growth, Severn Trent Water is ideally placed to benefit from water trading and to help other water companies meet their strategic shortfalls in supply – something we first championed in 'Changing Course' and that has now been picked up by Ofwat and the UK Government.

Tony Wray
Chief Executive

'For several years, Severn Trent Water has been at the forefront of shaping the future of the water sector in the UK'

Severn Trent Water
Group at a glance

Severn Trent Water provides high quality water and sewerage services to over 4.2 million households and businesses in the Midlands and mid-Wales. We want to be the best water and waste water company in the UK, by providing the highest standards and lowest possible charges, through our great people.

Key strengths

- We are committed to long term sustainability, keeping in balance the needs of our customers, the environment and our investors.
- Our high standards and efficiencies keep our costs low and generate progressive, sustainable returns for our shareholders.
- Our bills for water and sewerage combined are the lowest on average in England and Wales.
- We have one of the lowest per capita consumption rates in the UK.
- We continually work to improve our performance and deliver cost and operational efficiencies against Key Performance Indicators (KPIs), each of which is aligned to our long term strategy.
- We have a clear business plan and a strong management team.

Where we operate

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

Key facts

1.8bn litres
Drinking water supplied per day

1.4bn litres
Waste water collected per day

5,294
Employees
as at 31 March 2012

Turnover

£1,457.5m
(2011: £1,389.8m)

Profit*

£500.0m
(2011: £503.7m)

* Before interest, tax and exceptional items.

The industry

The water industry in England and Wales invests more than £3 billion a year and employs over 27,000 people. There are currently 10 water and sewerage companies in England and Wales. Our sector is facing significant long term challenges. The privatisation of the industry in 1989 led to improvements in services to customers, better quality drinking water and higher environmental standards. Our proposals for changes in our industry are helping us to play a role in shaping the debate.

Our business

Severn Trent Water is a regulated business. We work within five year planning cycles, with the prices we charge our customers set at the beginning of each cycle by our economic regulator, Ofwat. These five year cycles are known as Asset Management Plan (AMP) periods. We have just reached the end of the second year of AMP5.

How we measure success

Water companies are required to publish performance against a set of indicators. These indicators provide Ofwat with an overall picture of company performance against the commitments made as part of the AMP5 price review.

As well as being regulated by Ofwat, our performance is also monitored by:

- the Drinking Water Inspectorate, which is responsible for making sure we comply with drinking water quality regulations; and
- the Environment Agency, which controls water abstraction, river pollution and flooding.

We also work with the UK Government (including the Department for Environment, Food and Rural Affairs and the Welsh Assembly Government) and other agencies such as the Consumer Council for Water, Natural England and Countryside Council for Wales to make sure we meet the highest customer service and environmental standards, while offering our customers the lowest prices.

Key strategic intentions...

Our strategy is based on eight Key Strategic Intentions (KSIs) which reflect what matters to our customers and wider stakeholder groups. We measure our performance within each KSI against our 20 Key Performance Indicators (KPIs):

1. Providing a continuous supply of quality water
2. Dealing effectively with waste water
3. Responding to customers' needs
4. Minimising our carbon footprint
5. Having the lowest possible charges
6. Having the right skills to deliver
7. Maintaining investor confidence
8. Promoting an effective regulatory regime

...delivered through our areas of focus

We focus on four key areas – customers, people, process and finance – to deliver the highest standards and lowest charges to our customers, through a highly skilled and committed workforce:

Customers

Our household customers have on average, the lowest bills in England and Wales. But keeping customers satisfied is not just about low charges and value for money. We also need to deliver reliability, reflect their needs and priorities in our plans, communicate clearly, keep our promises and put things right if they go wrong.

More on customers on **page 12**

People

Our people are the cornerstone of our success. We strive to recruit, train and retain the best people, underpinned by great workplaces and a strong culture of safety and personal responsibility.

More on people on **page 16**

Process

Our drive to work safer, better and faster is the foundation of our approach to continuous improvement. Making sure we have the right processes and systems in place is a fundamental part of our drive for operational excellence.

More on process on **page 17**

Finance

The higher our standards the more effectively and efficiently we work. In turn this improves our ability to keep our costs low and generate progressive, sustainable returns which earns the trust of our investors and shareholders. We always look to finance the company in an efficient, sustainable way and maintain an investment grade credit rating.

More on finance on **page 19**

Our business model

Water is essential to life and to the communities in which we live and work. Severn Trent Water is intrinsically linked to the life cycle of water. The customer is at the heart of our continuous drive to improve our operations and services across collection, delivery and cleaning of water.

Severn Trent Water is a regulated business. We work within five year planning cycles, with customer prices set by our economic regulator, Ofwat, to allow us to fund our investment programme and cover an efficient level of operating costs. We are also subject to regulation by two quality regulators – the DWI and the EA (details of these regulators are provided below).

Our prices and asset base are adjusted by RPI inflation each year. In certain circumstances we can ask for prices to be reviewed within the five year period due to costs associated with ‘notified items’ or ‘relevant changes of circumstance’. Customer bad debt and the adoption of private drains and sewers are included in these categories for the current five year period.

The company earns a return on our asset base. We can generate additional returns if we outperform Ofwat’s assumptions by becoming more efficient in the delivery of our capital programme, managing our operational costs more effectively, and by financing our business at a lower cost.

Our operating performance is assessed and benchmarked against the sector by Ofwat. At the next price review there is scope to earn additional income, or suffer penalties, based on our performance.

Regulatory framework

Consumer Council for Water
Consumer Council for Water is an independent body designed to protect the rights of consumers.
www.ccwater.org.uk

Drinking Water Inspectorate (DWI)
The Drinking Water Inspectorate makes sure companies supply water that is safe to drink and complies with all national and European standards.
www.dwi.defra.gov.uk

Environment Agency (EA)
The Environment Agency is a public body set up to protect and improve the environment.
www.environment-agency.gov.uk

Health and Safety Executive
The Health and Safety Executive is the enforcing authority on health and safety law.
www.hse.gov.uk

Natural environment
Such as Countryside Council for Wales and Natural England.

Ofwat
The economic regulator for the water and sewerage industry. It makes sure that water companies use customers’ money efficiently and effectively and sets our price limits.
www.ofwat.gov.uk

The role of Severn Trent Water

1 Water is collected (abstraction)

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

2 Water is cleaned

Our 126 waterworks clean raw water to the highest standards making it safe to drink.

Regulatory framework

- Natural environment
- Environment Agency
- Drinking Water Inspectorate

Risks (where these are currently considered Principal Risks, further details provided on pages 37–40)

- We may be unable to collect and store sufficient water to meet customer demand.
- Failure of key assets may result in damage to property, injury to people and/or disruption to our ability to supply our customers. (Principal Risk Ref 4 and 6)
- Failure of key assets or processes may result in a decline in water quality, disruption in our supply to customers or failure to meet regulatory targets.
- Hazardous processes or chemicals may result in people being injured. (Principal Risk Ref 4)

7 Networks invested and maintained

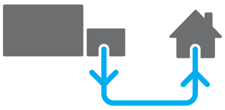
We are an investment led industry, and our capital programme this year was £474 million, or £112 per connected property reflecting increased investment year on year in our water and sewerage

Risks

We operate within a complex legal and regulatory environment as a water and sewerage service provider in England and Wales. As a result we face a number of risks including those associated with possible non-compliance with our legal and regulatory framework and failure to meet the terms of our regulatory contract as set out in our agreed business plan for 2010–2015. We also face risks associated with possible future changes in legislation which may result in our business plans becoming unsustainable. (Principal Risk Ref 1, 7 and 8 on pages 38–40)

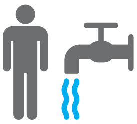
3 Clean water is distributed

A 46,000 km network of pipes and enclosed storage reservoirs bring a continuous supply of clean water right to our customers' taps.



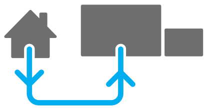
4 Customers enjoy our services

We bill 4.2 million businesses and households a year. In return, we provide a safe, reliable supply of water and the collection of waste water 24 hours a day, 365 days a year.



5 Waste water is collected

Our c. 92,000 km of sewers collect waste water from homes and businesses, and surface water from outside properties and drains.



6 Waste water is treated

Waste water is carefully screened, filtered and treated in our 1,026 works to meet stringent environmental standards. We pay the Environment Agency an annual consent fee to return the now treated water to the water system.

3 – Clean water is distributed

- Ofwat
- Health and Safety Executive
- Drinking Water Inspectorate

- The performance of our distribution network may fall below the standards expected by DWI or Ofwat, resulting in poor service to our customers and increased leakage from our network. (Principal Risk Ref 5)
- Failure of one of our key assets could result in disruption to supply to customers. (Principal Risk Ref 6)

4 – Customers enjoy our services

- Ofwat
- Consumer Council for Water
- Drinking Water Inspectorate

- We may be unable to sufficiently improve our performance in relation to customer service in order to deliver what our customers tell us they want. (Principal Risk Ref 2)

5 – Waste water is collected

- Ofwat
- Environment Agency

- We may be unable effectively to integrate management of new assets taken on as a result of adoption of private drains and sewers resulting in deterioration in customer service and/or increased operational costs.
- Failure to deal with customer waste effectively may lead to sewer flooding. (Principal Risk Ref 5)

6 – Waste water is treated

- Natural environment
- Environment Agency

- We may suffer operational failure in our waste water operations which results in damage to the local environment. (Principal Risk Ref 3)

networks, including finding and fixing more leaks and reducing the number of supply interruptions, improvements to our water and sewage treatment plants and upgrades to our sewer network to reduce incidents of sewer flooding. We fund this investment programme from the profits we generate, but also by borrowing money from the capital markets.

This capital investment is added onto our asset base, called the regulated capital value (or RCV). Our asset base also rises in line with inflation each year.

The returns that we generate for shareholders on that asset base are set by our regulator, Ofwat, over five year planning cycles. We can increase these returns by outperformance.

Performance

As we explain on page 9, Severn Trent Water strives for high standards and focuses on four key areas – customers, people, process and finance. Having the right people with the right skills, using the right processes, enables us to offer high quality, low cost services to our customers. This in turn drives our financial results.

The following pages describe what we delivered for our customers during the year, along with the development of our people and processes. Severn Trent Water's financial performance is explained in the financial review, on page 33.

Customers

We want to deliver the highest standards and lowest possible prices for our customers. Our water and sewerage bills are the lowest on average in England and Wales, at £311. We're also increasing prices slower than most other companies. In 2012/13, the industry average price increase will be 5.7%, compared to 5.0% for our customers.

A continuous supply of quality water

We aim to deliver water that's good to drink, meaning that it's safe, tastes and looks good, and is always available.

Although the last 18 months were the driest ever recorded, we avoided any hosepipe bans or other limits on our customers' water use. We did this by reacting quickly to conditions and by effective, forward and proactive planning. We draw our water from reservoirs, rivers and underground aquifers. By making sure we always used the most appropriate source, even if it was not always the most cost effective, we preserved water in areas where levels were lower. We improved our networks, so we could move water around more effectively, and invested in additional equipment at our water treatment works, so we could get water to the right place at the right time.

Our water quality remained high and once again we achieved 99.97% compliance with the Drinking Water Inspectorate's standards. We continued to deliver water at the right pressure and significantly reduced supply interruptions. However, interruptions are still higher than we would like and we expect to reduce them further in the coming year. To do this, we're investing in training, better incident management and further improving our network.

We continue to invest to ensure we provide the best water quality. This includes improvements to our biggest water treatment works at Frankley, West Birmingham and a major investment programme at Bamford, Derbyshire.

We're also progressing with our catchment management programme, as a key part of our water supply strategy. We're encouraging farmers and other large land users to change the way they work, so they reduce their impact on water resources. For example, we've developed an online nutrient budget calculator for farmers, which allows them to make quick and easy savings through efficient fertiliser use. If we can help farmers to apply fertiliser more efficiently, it saves them money and reduces the water treatment we need to do.

Customer complaints per 1,000 properties

2012	2011
4.88	5.72

Properties at risk of low pressure per 1,000 properties

2012	2011
0.06	0.07

First time call resolution (%)

2012	2011
93.8	97.5

Average water and sewage bill

£311

Average customer cost per day

85p

Customer experience

We recognise that most of our customers don't have a choice about who supplies them. That doesn't mean they are not our first priority. We recognise that we will not be in business if they are not satisfied with the service we provide.

Ofwat's Service Incentive Mechanism (SIM) measures our customers' experience of dealing with us and helps us to track our performance. Our SIM score is based on the number of times customers have to contact us and the quality of service we deliver when they do.

While we're much better than average for the number of contacts, the quality of our service has not been as good as it should be. We've done a lot of work over the last year to put this right. Areas we've focused on include:

- fixing problems before customers have to contact us;
- resolving problems first time, when they do have to contact us; and
- providing more ways to keep in touch with customers, for example by making better use of web channels and using text messages to confirm appointments.

We've also improved our bills. They're now simpler to understand and we can add targeted messages for customers, letting them know about different ways to pay or tips for saving water.

It's also important to get direct feedback about how we're doing. We're now surveying many customers at the end of their calls, asking whether their problem was solved, how helpful our agent was and for their general views of our service. This process will be fully rolled out by the middle of 2012 and will inform us how to do better.

We are starting to see the benefits of our actions with a continuous increase in SIM qualitative scores through the first half of 2012 and an improvement in performance relative to other water companies in the final quarter of the year.

We have reduced the number of written complaints by 14%, which brings us to a record low number of complaints. This was helped by the actions we've taken and the milder winter.

Managing debt

We aim to keep bad debts down, while helping people who want to pay but are struggling to do so. Despite the weak economy and rising unemployment, we were able to limit bad debts to 2.2% of sales, a similar level to last year.

We have several tariffs and schemes to help people pay. During the year we piloted the Together Scheme for people with debt problems, whereby we match the customer's payments. The WaterSure tariff caps bills for people with low incomes, who use large amounts of water because of a medical condition or because they have a big family. We also have a scheme called Water Direct, which allows customers to make payments directly from their benefits. During the year, we helped 139 people through the Together Scheme, 6,347 through WaterSure and over 42,000 through Water Direct.

The Severn Trent Trust Fund distributes money to people who are finding it difficult to pay their bills. We donated £3.5 million during the year. We're also looking at ways to help vulnerable customers more broadly, by working with the Citizens Advice Bureau to advise people about managing their money and give them a sustainable solution to their debt issues.

Engaging with customers

As we approach the next price review in 2014 (PR14), we'll be working closely with customers and other stakeholders to find out what they want from us and what they're willing to pay for. Their input will be a key part of the plan we put forward to Ofwat.

As part of this, we've created the Severn Trent Water Forum with representatives from a wide range of stakeholders. The Forum will engage with us to help us develop our plan to ensure we take account of their views. We will be holding workshops on issues such as climate change and how we manage waste water. We've also published a document called 'Making the Right Choices', which explains our challenges, the choices we have to make and asks for our stakeholders' input.

Making the Right Choices

During 2012, Severn Trent Water will be consulting with customers and stakeholders on our investment plans for 2015–2020. We have published a consultation document, 'Making the Right Choices' which can be downloaded from our website. Stakeholder workshops will be held throughout the summer, supported by customer research and a wider programme of customer awareness and engagement.

‘It’s nice to be able to speak to someone who understands your situation and will do everything they can to help. The services they offer, such as the large print bills, are gratefully received and very much appreciated.’

Miss B Elwell, Stourbridge customer

Keeping customers happy

Our customers continue to benefit from high quality drinking water, a good service and value for money.

Meeting leakage targets

We have achieved our lowest levels of leakage ever, and have beaten our Ofwat target of 474 Ml/d by 10 Ml/d (2%). This was achieved through improvements to targeting areas for leak detection, increases in efficiency in leakage find, improved work scheduling and improvements to leak repairs.

Lowest levels of leakage achieved.

Maintaining security

We avoided the need for usage restrictions (hosepipe bans) despite the driest 18 months on record in the Midlands. This was achieved using our strategic grid to move water from the wetter areas in our North and West regions to the drier areas, by installation of additional pipelines and by operating our existing assets even more flexibly.

18 months of the driest weather didn't affect water usage.

Reducing interruptions

We have reduced interruptions over 12 hours by over 10,000 properties to 5,223. This was achieved through a focused 'Always On' programme which has delivered people, process and technical improvements during the year.

10,000 fewer properties affected by interruptions

Reducing complaints

We have shown significant reductions this year including a reduction in Water Service complaints of around 34%. The overall complaint reduction of 14% is against the backdrop of greatly increased sewerage jobs and contacts since the transfer of private drains and sewers to us in October 2011.

34% reduction in water service complaints

Support for WaterAid

Severn Trent Water has continued to support WaterAid as its partner charity. In March 2012, a team of nine from Severn Trent Water travelled to Tanzania to climb Mount Kilimanjaro raising over £30,000 for WaterAid. The team also visited projects run by WaterAid in rural areas in the country. The team came back challenged and inspired by the experience:

"The whole trip was amazing. Climbing Kilimanjaro was fantastically rewarding. We were fortunate to see first hand the ways in which WaterAid spends this money. We visited a village that now has easy access to safe drinking water and a school that now benefits from simple yet effective sanitation. The difference relatively small sums of money can make to people's lives is amazing."

Andrew Fairburn
UK Government & Stakeholder Engagement Manager

People

Our aim is to have people with the right skills and the right approach to work, personal development and customer focus. To encourage the behaviours we think are important, we launched a new Code of Conduct in September 2011 across Severn Trent, called 'Doing the Right Thing, the Severn Trent Way'. This sets out our approach to corporate responsibility issues ranging from health and safety, to ethics and honesty, to delivering excellent customer service. 'Doing the Right Thing, the Severn Trent Way' is supported by 15 group policies and their supporting standards and guidance notes.

A safe and healthy workforce

Protecting the health and safety of our people and contractors is our number one priority. We were pleased to have reduced the number of lost time injuries and can report that Severn Trent Water's overall performance remains in the industry's upper quartile.

Our employee survey shows that we have a strong safety culture. This year, 95% of our people said they were clear about their role and their responsibility for doing their job safely, while 89% said that we provided the right support for them to do their job safely.

One example of the actions we are taking was the launch of the Waste Water Services Safety Improvement Strategy, with the aim of eliminating all accidents in the workplace. This involves 12 safety improvement workstreams, which are being developed through teams of employees, and five safety improvement projects. By the end of the financial year, we had completed five of the workstreams, including site standards and leadership behaviour, and two of the projects – occupational road risk and managing contractors.

We focused on health and safety training and education during the year. This included piloting the MindSafety™ behavioural training programme. It teaches people about different states of awareness, so they understand why we want them to work in certain ways and they can take responsibility for their own safety. Attendees found the programme changed their behaviour and made them think more positively about health and safety.

We've also worked closely with our supply chain partners to make sure we both prioritise health and safety performance. This includes ensuring we have the same vision and values focused on health and safety, the right systems and training, and share lessons about safe working.

While we are rightly focused on safety, we also want to support our employees' health. More than 600 people attended our wellbeing days, which included blood pressure, cholesterol and diabetes checks. We also piloted a back pain clinic and launched a physiotherapy helpline.

Engaging our people

Our annual employee survey once again showed that our people are positive about working for us. Our overall Engagement Index revealed 75% of our employees remain positively engaged.

Some notable results included:

- 92% saying they took responsibility for 'Doing the Right Thing, the Severn Trent Way';
- 87% being happy to go the extra mile at work; and
- 85% understanding how their role contributes to customers' experience.

The survey also highlighted areas where we need to improve. For example, only 39% said that the changes we have made over the last 12 months were well implemented. Our people also wanted visibility of the Severn Trent Executive Committee and to see that it is leading the business effectively.

We know that our employees often haven't had the chance to discuss with the Executive Committee face to face what we're doing and why, and that these conversations can really help people to connect their role to the aims of the business. As a result, we have set up a rolling 12 month programme of discussions. The aim is for members of the Executive Committee to meet around 1,500 people from all parts of the business in small groups, in their workplaces. The conversations are open ended, so employees can ask whatever they want and share their view of the challenges and opportunities we face. As we can't meet all of our people, we're encouraging the invitees to talk to their colleagues before and after the meetings so everyone gains from the process.

New Shrewsbury office building improves effectiveness

In January 2012, more than 200 of our employees moved into our new 29,000 sq ft office building in Shrewsbury.

The layout of the innovative building was designed in conjunction with key managers to enable the optimal use of office areas and collaborative work spaces; the best mix of purpose-built facilities as well as an effective common space at the heart of the building to encourage teams to meet and share ideas. The result is an engaging environment that has dramatically improved employees' working experience and created an opportunity for them to work at their best every day.

Improving our organisation

We continue to review the structure and organisation of our teams to deliver improved efficiency and effectiveness. For example, in November 2011 we changed our operating model in Waste Water. This involved moving around 750 people into new teams. Each team covers a smaller geographic area but now has more responsibility for customer service and repairing assets. In the run up to the change we trained our people so they could work on any of our assets in their area. The model gives us a platform on which to build service improvements.

Following our successful move to Coventry, we refurbished our Shrewsbury and Derby offices and adopted the same tools and ways of working, such as collaborative workspaces. This ongoing programme is giving our people a modern and effective working environment.

Developing our people

We invest heavily in training and developing our people. This year involved a significant amount of technical training, as well as leadership development. We continued to encourage our people to use our 'Safer Better Faster' approach to continuous improvement and we refocused our line manager training to help them manage and engage their teams more effectively.

The talent review process is ongoing and we have assessed over 600 managers and potential leaders this year. We're increasingly creating individual development plans and moving people on our talent list around the company to broaden their experience.

Our apprenticeship programme continues to grow, helping young people into work and giving us the skills we'll need in the future. We currently have 81 apprentices – in customer relations, water and waste water. One of our apprentices – Michael Williams – won the national EEF Outstanding Achievement by a Final Year Apprentice Award, for introducing process changes that saved money for the company by improving efficiency and reliability. We plan to recruit another 20 apprentices during 2012.

Diversity

Having the right people means having a suitably diverse workforce. This year, we focused on understanding gender issues and conducted gender diversity research with women employed by Severn Trent Water to understand more about the perceptions and experiences of women employees. This focused particularly on issues relating to job progression and the achievement of senior positions. The insights from the research will help us to improve our policies and practices in developing women in our organisation. We plan to use the same methodology to explore ethnic diversity in the near future, so we can gain more insights into this aspect of our workforce composition.

Process

To deliver great service to our customers we are continuously improving our processes and technology, whether it's for treating water, monitoring our network, or scheduling our staff.

At our Minworth Sewage Treatment Works in Birmingham, we're using an anaerobic ammonium oxidation treatment process, which is new to the UK. It's a more efficient biological treatment process for waste water, which allows us to reduce the energy and chemicals we use.

Another UK first is an activated sludge process known as HYBACS, which we're installing at Ashbourne, Derbyshire. This technique is used extensively in the Far East and allows us to process higher volumes, with much lower energy use and on a much smaller footprint.

We continued to add sensors to our telemetry system, which monitors the health and performance of our network, checking, for example, the pressure and flow of water, water quality and reservoir levels. This gives us an early warning of problems, so we can proactively fix them with minimum disruption for customers.

We also invested to exploit new and existing features in our SAP and telemetry systems to deliver a better service to our customers. SAP now supports all our key processes and holds our operational data allowing us to make better operational and investment decisions. We have an ongoing programme of improvement to increasingly exploit SAP's and other systems' functionality to drive performance.

We have invested in giving our customers access to data from our telemetry and SAP systems through our website, helping our customers find out if there is work going on in their area and what the latest status is.

We've also introduced a shared support organisation. This brings together people from operations and information systems, who between them understand how our employees, technology and processes work. Their goal is to continuously improve, optimise and exploit SAP and other systems. We're now seeing step changes in our use of the system. For example, we've re-engineered our process for handling bursts on private properties, so we can offer quicker service.

New processes have also been added to automate operational fieldwork crews. SAP holds data on the skills of all our operational employees. When a job is raised, the system automatically schedules a nearby work crew with the right skills to go and fix the problem. It also provides them with the information they need, such as plans and maps, and records the time and materials used.

Environment

Delivering our environmental obligations is central to the way we work and has a real impact on our customers and the communities in which they live and work. The case studies on pages 20 and 21 provide details of our investment in renewable energy.

Managing waste water

The driest 18 months on record contributed to a deterioration in our performance in the first six months last year. Pollution incidents rose and we suffered a higher level of sewage treatment works breaches of consent.

We responded by increasing our asset maintenance activities, inspection regimes and installed more remote monitoring on our assets to help pre-empt potential failures. This has improved our performance from the summer onwards. We also continued our policy of self reporting to the Environment Agency, to raise our standards and highlight areas where we need to do better. Even so, for the year as a whole our performance fell short of the standards we aim for. There were 445 reported pollution incidents (2011: 353), 14 serious pollution incidents (2011: 4) and our sewage treatment works failing consent limit was 2.54% (2011: 1.69%). Our maintenance and inspection programme should deliver further improvements in the coming year.

Successful delivery of our investment programme is very important in delivering good service to our customers. We've invested in major schemes, particularly in Gloucester and Leamington Spa, which have improved our network reliability and have removed the risk of sewer flooding – one of the worst service failures that can happen to a customer – for around 150 properties, gardens and other areas. We've also tried to minimise disruption to our customers while we carried out this work, for example by working with other utility companies to reduce road closures. In addition, we have a programme to refurbish some of our largest sewage treatment works, which will make them more resilient and improve river quality.

The transfer of private drains and sewers to us on 1 October 2011 went smoothly, adding 37,000 km to our existing 55,000 km network. So far, we've had to do less repair work than we expected and customer feedback has been good. We've cleared around 12,000 sewer blockages on the transferred assets, which was 41% of the total blockages cleared since the transfer on 1 October 2011. We're now seeing fewer blockages and better management of pollution incidents on these assets. To help the transfer, we reorganised our supply chain so we have fewer contractor companies looking after our assets. Our remaining contractors have scaled up their operations so they can handle the greater workload.

Deploying water resources wisely

Severn Trent is the only company to have targeted a significant reduction in leakage during AMP5. We were pleased to improve our performance again during the year. We cut leakage to 464 megalitres per day (Ml/d), compared to 497 Ml/d last year and our target of 474 Ml/d.

The investment we've made in SAP and in our 'Safer Better Faster' approach has helped us to improve our repair processes, so we can fix leaks more quickly. We're also benefiting from our investment in a system to help us improve detection of leaks.

Customers also have an important part to play and our water efficiency programme helps them to reduce their usage. For example, customers can use our website to view their water usage and understand where they can make savings. We also offer water saving devices such as aerated taps and shower timers. In addition, we work with schools and colleges to help them view and reduce their water usage, and with social housing providers to fit water efficient devices.

This work ensures our customers continue to have among the lowest water usage in the UK. During the year, our customers used an average of 125 litres per person each day, compared to the national average of 148 litres.

Cutting our carbon footprint

We've been investing in renewable energy for nearly a decade. Renewables provided 23.7% of the electricity we needed during the year and we're on track to meet our target of generating 30% of our electricity by 2014/15.

The 'energy crop' anaerobic digestion plant next to the Stoke Bardolph Sewage Treatment Works in Nottinghamshire is the UK's first on an industrial scale. It converts crops into electricity, using crops grown on land unsuitable for food production, and has been so successful that it's received three awards. It's also given us valuable experience that is helping us to improve the performance of our sludge anaerobic digestion plants.

In 2013, our first large wind turbine will start generating electricity on land next to our Wanlip Sewage Treatment Works in Leicestershire, with another at Newthorpe in Nottinghamshire due to come on stream soon after. These, and four others currently in planning, could generate 6% of our electricity needs. We're also pursuing a gas-to-grid project, which will allow us to provide cleaned up sewage gas to the national grid, and we are looking at several hydroelectric projects.

Protecting biodiversity

Severn Trent has a role in protecting and enhancing biodiversity at our sites or sites affected by our activities. We own or partly manage 37 sites of special scientific interest and work in partnership with our tenants and other partners to safeguard them. We have 21 rangers who manage our 12 public access sites working with volunteers and organisations like the RSPB and Wildlife Trusts. The sites provide the opportunity to engage with customers whilst enhancing and protecting the sites for nationally and internationally important species such as butterflies, water voles and tree sparrows.

Finance

Our business is funded by receipts from customer bills, by raising money (debt) on the capital markets, and by shareholders retaining equity in the business. We aim to finance the company in an efficient and sustainable way. By keeping financing costs low we can keep customer bills low. We currently have an investment grade credit rating, with a stable outlook. In January we successfully issued a £250 million, 30 year bond, with an interest rate of 4.875%, the lowest rate we have seen to date.

Outlook

We continue to deliver on our programmes to raise standards and drive efficiency improvements. We are committed to enhancing our capital investment programme and delivering improved customer service and network performance. Whilst we are seeing signs of improvement in our SIM performance, industry benchmarks have moved forward and so must we. In terms of prospects for regulatory and industry change, Severn Trent remains at the forefront of industry thinking and we were pleased to see some of our ideas reflected in consultations from both our regulator and the UK Government. We will continue to make a positive contribution to the debate. Throughout our operations, our goal continues to be to deliver long term sustainable growth. This strategy, underpinned by a clear focus on customers, people, environmental performance and shareholder value will continue.

The 'energy crop' anaerobic digestion plant at Stoke Bardolph Sewage Treatment Works.

Water efficiency

We are working closely with the Environment Agency, social housing providers, Global Action Plan and South Staffordshire Water on a joint programme, 'Plug-In'. The aim of this programme is to encourage water and energy efficiency. Through it we are educating consumers and installing water efficiency measures including tap and shower flow regulators, dual flush systems and shower heads in 10,000 properties.

10,000
properties were installed with water efficiency measures

Renewables

We've been investing in renewable energy for nearly a decade. This year, we have continued the growth, generating 212 GWh of electricity from renewable sources. This equates to 23.7% of the electricity that Severn Trent Water needs to provide its water and waste water services and represents another significant step towards our target of 30% by 2014/15. In 2013, our first large wind turbine will start generating electricity on land next to our Wanlip Sewage Treatment Works in Leicestershire, with another at Newthorpe in Nottinghamshire due to come on stream soon after. These, and four others currently in planning, could produce 6% of our electricity needs.

212 GWh
of electricity was generated from renewable sources

Always innovating

Innovation is driving operational performance across all of our operations.

The Renewable Heat Incentive scheme aims to stimulate investment in the supply of renewable heat and the injection of renewable gas (bio-methane) into the gas grid. We can benefit from this scheme by diverting gas away from electricity generation and into the gas grid. This is an emerging field with no commercial installations in operation yet which means an inevitable variety of technical and regulatory challenges that have to be negotiated for the first time. But we are making good progress and hope to be injecting gas in 2013.

Group at a glance

Severn Trent Services is one of the world's leading suppliers of water and waste water treatment solutions. We are known for innovation, reliability, quality services and leadership in our chosen markets.

Key strengths

- Our business has a clear strategy for growth, which focuses on the growing global demand for clean water and safe, efficient waste water treatment.
- We provide operating services to an increasing number of utilities, municipalities and commercial customers in targeted countries.
- We are a leader in the design, production and sale of water purification products in high growth markets such as disinfection, filtration, adsorption and marine/offshore waste water treatments.

Where we operate

Our activities are focused in four regions – the Americas, Europe, Middle East and North Africa (MENA) and Asia Pacific. Operating Services operates in the US, UK, Ireland and Italy. Water Purification operates in all four regions and Analytical Services operates in the UK.

Key facts

£56.5m
order book

2,933
Employees
as at 31 March 2012

Turnover

£332.3m
(2011: £336.1m)

Profit*

£18.0m
(2011: £25.7m)

* Before interest, tax and exceptional items.

The industry

The market for water and waste water products and services is large with substantial prospects for growth in the areas we serve. That is because the drivers of the water and waste water business: water scarcity; population growth; climate change; and more stringent regulatory requirements remain strong.

Our business

Severn Trent Services provides water and waste water treatment products and operating services to utilities, municipalities and commercial customers in selected key markets around the world. We focus on the high growth markets and geographies where our specific products and services meet the significant needs of our customers.

We have three principal business streams:

- **Water Purification** (Products) is one of the leading global providers of advanced technologies products and integrated solutions for water and waste water disinfection, filtration, adsorption and marine/offshore waste water treatment.
- **Operating Services** provides contract operating services to manage and maintain water and waste water plants and networks in selected countries worldwide. We are a leading provider in the United States and United Kingdom, one of the few integrated water operators in Italy and are building a strong presence in Ireland.
- **Analytical Services** operates in the UK environmental water and contaminated land testing services.

Key strategic intentions...

Eight Key Strategic Intentions define our strategy and set out how we intend to achieve our objectives:

1. Deliver what customers value
2. Establish long term contracts and strong sales channel relationships
3. Expand our global technology programme
4. Continuously improve quality, health, safety and environmental performance
5. Invest in strategic partnerships to supplement organic growth
6. Optimise processes and organisational capabilities
7. Continue to build a strong, coherent and respected brand
8. Increase employee engagement

...delivered through our areas of focus

Severn Trent Services is one of the leading water and waste water businesses in the world.
To achieve our strategy we focus on:

Water Purification (Products)

Municipal, commercial, industrial and marine applications require water treatment technologies to meet their disinfection, filtration and process needs. The Water Purification group's portfolio of water products are used around the world in support of these applications.

More on Water Purification on **page 26**

Operating Services

Operating Services delivers safe drinking water and waste water treatment services. It is responsible for the operation of more than 900 treatment facilities in the United States, United Kingdom, Ireland and Italy.

More on Operating Services on **page 29**

Severn Trent Services
Our business model

Our core customers are municipal utilities looking to sustain high quality standards and to find cost efficiencies through public–private partnerships.

The market for water and waste water products and services is significant, with good prospects for long term sales and profit growth due to fundamental drivers: water scarcity, population growth, climate change and more stringent regulatory requirements.

Our strategy is to introduce new technologies into existing markets, such as our BALPURE® ballast water treatment technology, as well as growing our Operating Services business in the US and Europe where we operate more than 900 facilities and have £205 million revenue.

We target a return on capital in excess of the regulated water business, commonly above 10%.

Key to our services

- **Filtration**
  Areas where STS offers filtration products/services for all or part of the process cycle
- **Disinfection**
  Areas where STS offers disinfection products/services for all or part of the process cycle
- **Operating Services**
  Areas of the process cycle where STS offers contract operations

Our websites

www.severntrentservices.com
www.severntrentdenora.com
www.stsoperatingservices.co.uk
www.stsanalytical.com

Providing Operating Services and Water Purification Products to:

1

Municipal Water Treatment

Severn Trent Services provides a multiple barrier treatment approach incorporating filtration, disinfection and process solution technologies for various municipal water treatment applications.

In addition, we provide contract operations for municipal water treatment facilities in the US, UK, Ireland and Italy.

Disinfection

Product:
Advance™, AQUAWARD®, Capital Controls®, Chlor-a-Vac®, Chloromatic™, ClorTec®, MicroDynamics®

Filtration

Product:
Bayoxide® E33, Omni-SORB™, SORB 07™/09™/33®, TETRA® DeepBed™, TETRApHix®, UAT™

Seawater and Separation

Product:
Bayoxide® E33, Capital Controls®, ClorTec®, Higgins Loop™, MicroDynamics®, Omni-Flow™, Omni-SORB™, SORB 33®, SORB 07™, TETRA FlumeFlow®, TETRA® LP Blocks™, TETRApHix®, UAT™

Services:

Water Facility Operations & Maintenance (O&M), Water System Treatment & Distribution, Asset & Capital Management, Design & Build, Integrated Water Services Management, Leakage Detection & Reduction, Legionella Control, Meter Installation, Repair & Maintenance, Network Repair, Maintenance & Renewal, Project Finance Arrangements, Water Quality Sampling, Assessment & Rectification, Water Regulations Compliance, Water Sampling & Analysis

Risks

- We may be unable to collect and store sufficient water to meet customer demand.
- Hazardous processes may result in our people being injured. (Principal Risk Ref 4)
- Regulatory or political change may lead to decreased demand for our services.

2

Municipal Waste Water Treatment

Severn Trent Services provides a multiple barrier treatment approach incorporating filtration, disinfection and process solution technologies for various municipal waste water treatment applications.

In addition, we provide contract operations for municipal waste water treatment facilities in the US, UK, Ireland and Italy.

Primary Treatment

Secondary/Biological Treatment

Product:
TETRA® SAF, Amphidrome, TETRA® ColOX

Tertiary/Advanced Treatment

Product:
TETRA® DeepBed™, TETRA® Denite®, TETRA® NSAF, TETRA® Shortcut-NRT™, TETRA® SNAP-T®

Final Treatment UV/Chlor Disinfection

Product:
Capital Controls®, ClorTec®, MicroDynamics®

Services:

Waste Water Facility Operations & Maintenance (O&M), Waste Water System Treatment & Collection, Asset & Capital Management, Design & Build, Industrial Pre-treatment, Network Repair, Maintenance & Renewal, Project Finance Arrangements, Sludge Treatment & Disposal, Waste Water Sampling & Analysis

Risks

- Failure of treatment processes may result in environmental damage and regulatory non-compliance.
- Regulatory or political change may lead to decreased demand for our services.
- Hazardous processes may result in our people being injured. (Principal Risk Ref 4)

3

Industrial

Severn Trent Services offers a range of disinfection, filtration and process solutions for a suite of industrial water and waste water applications. In addition, we provide design, build and contract operations for water and waste water treatment facilities for a variety of industrial segments in the US, UK, Ireland and Italy.

Process Water

Product:
Capital Controls®, ClorTec®, EST™, MicroDynamics®, TETRA® DeepBed™, TETRA® Higgins Loop™, UAT™, UltraDynamics®

Cooling Water

Product:
Capital Controls®, ClorTec®, EST™, MicroDynamics®, SANILEC®, SEACLOR®, TETRA® DeepBed™, TETRA® Higgins Loop™, UAT™, UltraDynamics®

Services:

Severn Trent Services provides a full range of expertise from the individual aspects of water/ waste water utility management to the provision of integrated water/waste water services for a variety of clients, including:

- Utilities
- Public Sector
- Estates and Facilities Management
- UK MoD
- Developers
- Domestic Customers

Risks

- Failure of products or treatment processes may result in injury to people, environmental damage and regulatory non-compliance. (Principal Risk Ref 4 and 8)
- Disruption in the global supply chain may impact our ability to meet customer needs.

4

Marine

Severn Trent Services offers a range of disinfection, filtration and process solutions for marine and offshore water and waste water applications.

Electrochlorination

Product:
ClorTec®, SANILEC®, SEACLOR®

Desalination

Product:
SANILEC®, SEACLOR®, UAT™, UltraDynamics®

Marine Sewerage

Product:
MARINER OMIPURE® Series M55, OMNIPURE™ & OMNIPURE™ Series 55, SANILEC®, SEACLOR®, UAT™, UltraDynamics®

Ballast Water Treatment

Product:
BALPURE®

Risks

- The Intellectual Property in our key products may be used by competitors.
- Regulatory change may lead to decreased demand for our products.
- Competitors may enter the market leading to decreased demand for our products and services.

Severn Trent Services Performance

As we explain on pages 22 and 23, Severn Trent Services focuses on Water Purification (Products) and Operating Services to provide water and waste water treatment products as well as providing contract operations such as managing water treatment plants on behalf of our customers and environmental testing services. We look to enhance our products and contract operations to improve our effectiveness and efficiency; develop and launch new technologies; move new and existing products into new territories; and expand the scope of our Operating Services. The following pages describe how we performed during the year, along with details of our approach to continuous improvement.

Severn Trent Services had a challenging start to the year, with economic and operating conditions in many of our markets impacting negatively on both turnover and profit. The second half saw an improved performance and while markets remain challenging, the business is well positioned to take advantage of longer term growth drivers. In 2011/12 revenue was £332.3 million, growth of 0.6%, on a constant currency basis, driven by increased Operating Services sales in UK and Ireland markets. PBIT[1] (profit before interest and tax) was £18.0 million, a decline of 25.6% on a constant currency basis, due to investments in business development, a change in product mix in our Water Purification division and competitive pressures.

At the end of the year we made two significant management changes with the appointment of Martin Kane as Chief Executive Officer, taking over from Len Graziano who retired, and he was joined by our new Chief Financial Officer, Stephane Bouvier.

Water Purification (Products)

Economic conditions in our markets were mixed during the year. In Filtration, which accounts for 32% of Products turnover, the US saw limited investment by local municipalities due to their weaker finances. The main driver of demand is the ongoing regulation of environmental and quality standards. So, many municipalities struggling with financial pressures have chosen to delay making upgrades and improvements not critical to achieving these standards. In the industrial market, sales grew year on year due to higher demand from the steel industry.

Emerging markets such as Asia Pacific and the Middle East and North Africa (MENA) grew, and in the UK the second year of the regulatory cycle saw water companies' capital investment programmes ramp up, meaning demand for our filtration products was robust.

In Disinfection, which accounts for 68% of Products turnover, activity in the Gulf of Mexico increased due to the lifting of the drilling ban and strong oil prices. This in turn increased demand for our sewage treatment and disinfection products in that segment. In MENA and Asia Pacific, investment in power and water projects contributed to growth in demand for our ClorTec® electrochlorination product. Egypt remains a key target market for industrial water treatment products, but political uncertainties and civil unrest have delayed investment and thus dampened demand.

Savings in the supply chain helped reduce costs and assisted in combating competitive pricing pressures.

In the marine market, we received Type Approval for our full line of BALPURE® ballast water treatment products in October 2011. Interest in this product line was greater than expected with recorded orders of £5 million. Orders were received from various shipyards and ship owners, including Greenway Shipping and Sasaki Shipbuilding. We have a pipeline of projects that supports our ambitious growth targets. To sustain this growth, during the year we invested in establishing a dedicated BALPURE® sales organisation. We will continue to develop our channels to market, with additional investment anticipated for the coming year.

1. Before exceptional items.

> 'Greenway Shipping chose the BALPURE® system because of its technical features and Severn Trent De Nora's long history of water treatment in the marine industry. We strongly believe Severn Trent De Nora will support us throughout the barge's expected lifespan of 30 years.'

Trym Gade Lintoft Greenway Shipping

Expanding our markets

We are successfully introducing our products into a number of key markets in Asia, China and Europe.

BALPURE®

The BALPURE® system has gained headway globally among larger vessels requiring a reliable ballast water treatment solution. Since its initial Type Approval in July 2011, BALPURE® was selected for use across different vessel types, attesting to its flexibility and suitability for the diverse and demanding marine market. The BALPURE® system is chosen over competing vendors due to its robust and proven electrolytic disinfection technology perfected by Severn Trent De Nora over 35 years in the marine and offshore industries. BALPURE® has been chosen by ship operators and yards for its treatment approach, low power consumption and low maintenance requirements.

50,000+ ships
requiring ballast water treatment systems

£21.3 billion
estimated market value to 2020

Iqbal Hossain, BALPURE® Service Engineer

Developing relationships

Severn Trent Services' business with Costain, C2C (Coast to Coast Water and C2C Services), is delivering operations and maintenance for the UK MoD's water and waste water assets as part of a 25 year, £1 billion contract.

'To date, C2C has exceeded leakage reduction targets, upheld environmental performance, and invested in assets and crown fire standards. Behind these headlines are hard working teams managing the day to day operation and maintenance of the MoD assets, providing a 24-7 service. They continually ensure that the contract requirements are met, and customers receive the appropriate level of service.'

Defence Infrastructure Organisation (DIO), Aquatrine, UK MoD

Project Aquatrine

Severn Trent Services' business with Costain, C2C, has been working with the Ministry of Defence (MoD) under Project Aquatrine since 2005, providing a fully managed service to operate, maintain and improve nearly 5,000 water and waste water assets across 1,300 sites in England. C2C has built a strong relationship with the MoD establishing a safe, efficient, and responsive service across this wide geography. C2C manages over 7,100 megalitres of water, takes around 69,000 water samples and processes over 17,000 bills a year. This year it has reduced average monthly leakage across the MoD estate by over 250 megalitres, which is equivalent to over 100 Olympic swimming pools, and with the installation of a highly accurate metering system with telemetry to C2C headquarters, both parties can check progress in an instant. Thanks to the success of Aquatrine, the MoD and its contractors now appoint C2C to carry out water and waste water services work outside of the contract, where MoD 'Value for Money' tests have been proved.

11 years ahead

C2C achieved the UK Government's MoD target to cut water consumption by 25% by the year 2020 in 2009, 11 years early

Operating Services

Operating Services (OS) revenues were £204.5 million, growth of 3% on a constant currency basis, compared to the previous year. The calendar year 2011 was challenging for our US region which accounts for 51% of OS revenues. The lagging effects of the recession resulted in constrained municipal budgets and the loss of some small contracts taken back in house by municipalities, although the total number of contracts remained broadly stable. The US market was flat overall, although we maintained our market share. We have focused our business development efforts accordingly, but we do not expect market conditions to change significantly in 2012. All of the basic market drivers for public-private partnerships remain strong – regulatory compliance, cost control necessitated by shrinking municipal budgets, human resources management, infrastructure investment requirements, need for technical resources, transfer of risk, and safety concerns. Our investment in business development began to pay off in the second half of the year, as we won several projects in new states such as Georgia and improved our opportunity pipeline.

As noted in the half year results, political and economic uncertainty impacted our Italian business which represents 16% of OS revenues. While the business is profitable and cash generative, the impact of the economic crisis in Italy in the autumn of 2011 hampered the efforts of all partners to agree a refinancing package for part of our business. This led us to take a provision against our economic exposure in this associate company. The political situation also stalled the move of any further regional water companies, known as ATOs, from the public to the private sector.

However, project growth in the UK and Ireland exceeded our expectations, driven by new contracts wins, including a five year contract to design, build and operate waste water treatment for a major European food manufacturer worth £2.0 million, and a four year water hygiene contract worth £2.0 million with a large London borough council.

Analytical Services

This has been a very challenging year for Analytical Services. The Drinking Water Inspectorate published its report on the results of its investigation into aspects of the services provided at our Bridgend Laboratory. No financial penalty was imposed and as a result of this report no further liability has arisen. Low levels of activity in the UK economy led to a lower level of soil analysis work for the construction market, while the Water Framework Directive contributed to higher volumes for analysis.
We improved our operational efficiency during the year through investment in instruments and an improved project management process. Towards the end of the year and early in the new financial year we have been informed that certain contracts from utilities companies will not be renewed and will be taken back in house. This will significantly reduce the size of this business in the future with a greater balance of commercial versus utility work.

Continuous improvement

Environment

We understand the need to find innovative ways to reduce our environmental impact and to help our customers do the same. We do this by carefully managing our resources, waste water discharges and treatment sites, and by developing new technologies.

Several of our businesses are certified under ISO 14001:2004, the international standard for environmental management systems, which we use to manage and minimise our environmental impact. For the fourth year in a row, our US Operating Services business completed site energy management plans for three major plants. These help us to determine the most energy efficient treatment processes.

Many of our products and services help our customers to improve their environmental performance and to operate more efficiently. The Environmental Business Journal recognised us for the range of new technologies we have introduced over the past year, including inorganics removal systems, BALPURE®, and a system to control chemical feed in water and waste water applications.

People, health and safety

Severn Trent Services ended the financial year with a loss time injury (LTI) accident frequency rate (LTI per 100,000 hours worked) up 9% on the previous year, although an improvement in performance was seen during the second half of the year.

We need to recruit and develop a talented and motivated workforce and provide them with a safe and rewarding place to work. We were therefore delighted that our employee engagement survey showed that the majority of our employees (69%) are proud to work for us, and that we outperformed many other industry and country benchmarks.

Given our strategy to embed health, wellbeing and safety in all areas of our business, we were pleased that our C2C and Metering Services businesses in the UK once again received Gold Awards from the Royal Society for the Prevention of Accidents. These awards recognise effective health and safety management systems. The continuous improvement of our management systems is paying off, with our UK, Ireland and Italian Operating Services businesses working through the year with no lost time injuries. Overall Severn Trent Services ended the financial year with an LTI accident frequency rate of 0.36. We're also sharing lessons and best practice with Severn Trent Water. For example, we're introducing the MindSafety™ behavioural training programme which Severn Trent Water introduced this year.

Outlook

The medium term outlook for Severn Trent Services is positive, driven by the fundamentals of population growth, water scarcity, and regulation, although there remain short term challenges. Our Water Purification business will target growth in emerging markets, although European and US markets will remain challenging. In Operating Services, although the US utility outsourcing market remains flat we are in a favourable position on several new projects, and we are investing to extend our geographic reach and support our longer term growth. In the UK and Ireland we aim to capture additional opportunities in both contract operations and the design, build and operate (DBO) markets. Overall we expect additional costs of around £2 million in 2012/13 from ongoing investment in new business opportunities across Severn Trent Services to position ourselves for future growth.

Get the World Moving

We were also pleased with the results of our commitment to improve health through the Global Corporate Challenge, a 16 week virtual walking journey around the world. We had 735 employees taking part. Afterwards, 89% said it improved their health and 82% thought it increased office morale. We also gave 735 children the chance to participate in the Global Children's Challenge.

Looking forward

Severn Trent is committed to helping shape the future of the water industry so it is better able to meet future challenges.

In 2010 we published the first of our 'Changing Course' documents setting out our contribution to the debate on the future of the industry. We have been encouraged by how many of these ideas were reflected in recent UK Government and Ofwat publications.

In December 2011, the UK Government published 'Water for Life', its Water White Paper setting out its strategic vision for the water industry. We welcome the objectives and strategic direction of the White Paper. We are particularly encouraged by the White Paper's support for water trading, upstream competition and catchment management. We also welcome the UK Government's strong and explicit acknowledgement of the need to maintain the confidence of investors.

Earlier in May, Ofwat published 'Future price limits – statement of principles' setting out how it proposes to regulate the industry in the future. We welcome this document and look forward to working with Ofwat and others to achieve the best possible outcomes for our stakeholders.

In terms of general principles set out in 'Future price limits', we particularly support:

- Ofwat's overall objectives of creating a more targeted, proportionate and appropriate regulatory framework which focuses on the most important outcomes;
- the aim of reducing the regulatory burden and a move to a more targeted, risk based approach for the next price review; and
- more involvement from customer groups in the price setting process.

We were also pleased to see the strong encouragement by Ofwat for water trading, building on the policy direction set by ministers in the White Paper.

We will continue to work constructively with the UK Government, our regulators and others to help shape the water industry so it can meet future challenges.

The challenges for the next 20 years

The challenge of the last 20 years was ensuring higher quality. The challenges for the next 20 will be no less demanding, with climate change putting resilience and security of supply at the top of the agenda.

'Water for Life' emphasises the need for making the true social, economic and environmental cost of water visible. We think that's right. The UK has a growing water scarcity problem, particularly in the south and east, which will affect everyone over the next two decades. We all have a part to play in maintaining supplies and delivering high standards.

We're particularly pleased that the White Paper supports more focus on network interconnection and water trading, with the Environment Agency challenging companies' Water Resource Management Plans where alternative water sources are available. Applied effectively, this will help to correct the UK's supply-demand imbalance and increase water trading. Moving water across areas should be cheaper and have less environmental impact than current practices, which increase carbon emissions and capital intensive local investment.

We're also pleased to see support for the trading of abstraction licences. Change in this significant area needs full consultation, so the UK Government's timetable is sensible, with the new regime expected to start in the mid to late 2020s.

The encouragement to reduce pollution through catchment management, instead of expensive 'end of pipe' solutions, is also welcome. We're keen to share our experience of this over the last few years.

Taken together, these initiatives should improve the UK's resilience to drought and water scarcity, while reducing carbon emissions. There are also possible incentives for water companies to reduce consumption and for the sustainable 'economic level' of leakage calculation to be revisited.

Changing Course

In April 2010 we published Changing Course, a report setting out six proposals to secure a sustainable future for the water industry. Since then, the report has contributed to a wide-ranging policy and regulatory debate, and our proposals for water trading were taken forward in the UK Government's Water White Paper, 'Water for Life'.

The customers' role

Customers have a key role in reducing water use. The industry needs to change the way that customers think about and value water, and encourage them to use less.

We're pleased that the White Paper rules out universal metering. Metering must make sense in the context of an area's supply and demand balance, and our experience shows that it's more effective alongside behavioural change.

Affordability is also a key theme and there's no doubt that customers want value for money. Bills could be lower if the industry were to tackle bad debts and follow the White Paper's principles, which emphasise catchment management and smarter environmental solutions.

Still more work to do

There are aspects of 'Water for Life' that we like but that need further work, to keep regulation clear and predictable.

There's no doubt that the sector will need to invest significant sums and will rely on the capital markets for financing. The UK Government recognises the need to reassure investors and has said that reforms will be evolutionary, rather than revolutionary. It has also avoided fundamental structural change, such as legally separating companies' retail operations. Even so, there are areas where we need to move cautiously and in full consultation with all stakeholders.

One of the key talking points is the shift towards more competition. While the UK Government has ruled out retail competition for domestic customers, it will take long overdue steps to improve retail competition for business customers. We have positioned Severn Trent Services for new opportunities in this market and expect that competition will be largely around service innovation and not just price.

Scrapping the 'cost principle' could promote competition but it needs to be replaced with something more sensible. We would like to see Ofwat working with the Office of Fair Trading to design a better access price system, and not rushing to a conclusion that risks passing the cost to domestic customers. This may mean waiting to abolish the cost principle from law and not leaving the industry in limbo. Changes to the Water Services licence to introduce upstream competition should also be treated with caution, in case it's seen as weakening the fundamental business model.

The case for change has been made

In summary, the case for change has been made and the direction is set. 'Water for Life' is the start of a process of breaking down the sector's rigidity, by creating space for competition and allowing more flexibility, so we can meet the challenges of climate change, affordability and carbon reduction. As an industry, we should get behind it and work out the best outcomes.

Sustainable financing

The water industry has been investing heavily to renew ageing infrastructure, to meet growing demand and to deliver environmental improvements. Much has been achieved, but significant further investment is needed.

At the same time, public sector finances are stretched and there is growing competition for limited private sector funds that can be used to invest in infrastructure.

Against this backdrop it is essential that the financial structure of the companies in the sectors enables finance for the future investment programme to be raised, when required, and at reasonable cost.

Up to now most of the additional finance that has been needed to fund their growing asset base has been raised by borrowing and many companies have even reduced their equity financing. We think that this financing model cannot be relied on indefinitely.

There are risks in highly geared financial structures and there may be limits to the capacity of the debt market to continue to provide low cost finance. In addition, one company getting into financial difficulties could have long term impacts on the financial market's confidence in the regulatory framework and its assessment of risk in the utility sectors.

The financial and banking crisis in 2008, the credit crunch that followed, and more recently the sovereign debt crisis and associated turmoil in financial markets all underline that there may be benefits from a lower risk approach to financing in the sector, in which not all future finance is raised from borrowing.

Severn Trent has worked with National Grid to examine how to make the financing of the utility sector more sustainable in the longer term. We think that action needs to be taken to encourage additional equity financing, rather than waiting for problems to develop. We will shortly be publishing a report proposing modest but important evolutionary change.

Financial review

Group financial performance

We have sought, since the start of the financial crisis in 2008, to retain a cautious view on management of our cost base and financing. At Severn Trent Water we were pleased to see that the ability of our customers to pay their bills did not see any serious deterioration, and indeed our level of bad debt charges improved in the year as we continue our proactive efforts in this area. Costs remain a key focus and while we saw increases in environmental taxes and other charges we do not control, our performance on controlled costs was satisfactory.

Access to long term secure financing in these economic conditions has remained a key focus and our actions over the last year reflect this. We renewed our five year £500 million revolving credit facility (RCF) with 11 banks and issued a 30 year sterling bond at 4.875%, the lowest rate we have seen to date. We called in early £150 million of our bonds due for redemption in 2014, the year of the next price review for Severn Trent Water, a time which traditionally has been difficult for regulated water companies to refinance in public bond markets. This latter action resulted in a one off finance charge of £16.5 million in the year but considerably reduces the risk of not being able to refinance our bonds that were due in 2014.

PBIT is profit before interest and tax; underlying PBIT is PBIT excluding exceptional items as set out in note 8.

Group turnover was £1,770.6 million (2011: £1,711.3 million), an increase of 3.5% over last year.

Underlying group PBIT decreased by 2.9% to £504.2 million (2011: £519.1 million). The primary factors affecting underlying PBIT are described in the commentary on Severn Trent Water and Severn Trent Services below.

There were net exceptional charges of £50.9 million (2011: charges of £21.4 million). Group PBIT decreased 5.6% to £469.8 million (2011: £497.7 million).

Severn Trent Water

Turnover in Severn Trent Water increased by 4.9% in 2011/12, to £1,457.5 million. Sales prices were increased by inflation from 1 April 2011 which gave rise to an increase in turnover of £73.1 million. Consumption from metered customers was lower year on year reducing turnover by £10.5 million. New growth and meter optants increased turnover by £0.2 million and there were other increases amounting to £4.9 million.

Underlying PBIT was down by 0.7% on the same period last year, to £500.0 million. Direct operating costs increased by £32.5 million (see below), there was an increase in infrastructure renewals expenditure of £32.0 million and depreciation increased by £7.5 million including £3.7 million in respect of the early retirement of an experimental sludge dryer.

Employment costs increased by 2.1% to £202.4 million. Hired and contracted costs increased by £36.1 million to £155.6 million partly as a result of increased leakage detection and repair work performed by sub-contractors and also due to £2.9 million of costs relating to private drains and sewers (PDaS). Raw materials and consumables at £46.8 million were 1.3% higher than the same period in the prior year. Bad debts were 9.8% lower at £30.3 million, representing 2.2% of turnover (2011: 2.3%).

An increase of only £1.3 million in power costs to £51.8 million reflected the success of our strategy of fixing these costs through our supply contract and by using energy swaps. Quasi taxes, which comprise rates, service charges and the Carbon Reduction Commitment ('CRC') levy, increased by £13.5 million to £107.6 million, mainly due to the introduction of the CRC. Other operating costs decreased by £2.9 million to £44.0 million. Labour and related overheads capitalised at £76.8 million were £16.9 million higher than in 2010/11, mainly due to the higher level of capital expenditure in 2011/12.

During the financial year, Severn Trent Water invested £474.2 million (UK GAAP after deducting grants and contributions) (2011: £405.3 million) in fixed assets and maintaining and improving its infrastructure network. Included in this total was net infrastructure renewals expenditure of £128.9 million (2011: £96.9 million), charged to the income statement under IFRS.

Severn Trent Services

	2012 £m	2011 £m	Increase/ (decrease) %
Turnover			
Services as reported	332.3	336.1	(1.1%)
Impact of exchange rate fluctuations	–	(5.9)	
In constant currency	332.3	330.2	0.6%

	2012 £m	2011 £m	Increase/ (decrease) %
Underlying PBIT			
Services as reported	18.0	25.7	(30.0%)
Impact of exchange rate fluctuations	–	(1.2)	
In constant currency	18.0	24.5	(26.5%)

In Severn Trent Services, some activities saw improvements in the second half of the year. However, looking forward the scale of our activities in Analytical Services will be reducing significantly. Also the macro economic outlook has deteriorated in Spain and Italy. We have therefore, as required by IAS 36, reviewed the underlying forward looking assumptions supporting the carrying value of the goodwill in these businesses and adjusted goodwill values to lower levels. More details are provided in the exceptional items section overleaf.

Reported turnover in Severn Trent Services was £332.3 million in 2011/12, a decrease of 1.1% versus the prior year, and reported underlying PBIT decreased by 30.0% to £18.0 million.

After adjusting for the impact of exchange rate fluctuations turnover on a like for like constant currency basis was up 0.6% and underlying PBIT measured on the same basis was down 26.5%.

Operating Services

Turnover for the year was £204.6 million, an increase of 3.2% compared to the prior year on a constant currency basis. In the UK new contract wins and increased activity on our C2C contract delivered revenue growth but this was offset by contract losses in the US and lower activity in Italy.

Water Purification

Turnover for the year was £97.3 million, a decrease of 5.4% compared to the prior year on a constant currency basis as US market conditions remained difficult and in Europe sales remained flat.

Analytical Services

Turnover for the year was £30.4 million, an increase of 4.1%. Towards the end of the year and early in the new financial year we have been informed that certain contracts from utilities companies will not be renewed and will be taken back in house. Management of this business is developing a plan to reduce the scale of the business accordingly.

Corporate and other

Corporate overheads amounted to £15.6 million (2011: £13.0 million). Our other businesses generated an underlying profit of £0.2 million (2011: loss of £0.6 million) and there were exchange gains in Corporate of £0.1 million (2011: £1.1 million).

Exceptional items

There were net exceptional charges in the year to 31 March 2012 of £50.9 million (2011: £21.4 million) including exceptional operating costs of £34.4 million (2011: £21.4 million) which are described in further detail below and exceptional finance costs of £16.5 million arising on the early redemption of debt.

Exceptional operating costs included:

- costs arising from Severn Trent Water's programme to restructure and realign the business which resulted in an exceptional charge of £11.5 million (2011: £13.0 million);
- exceptional provisions in Severn Trent Services of £23.1 million including £21.5 million against our economic interests in SII, an associate company in Italy, as previously reported;
- impairments of £22.9 million were recorded against the carrying value of goodwill comprising:
  - £12.0 million against our UK Laboratories business to recognise the smaller scale of the business going forward; and
  - £10.9 million against our businesses in Italy (£5.7 million) and Spain (£5.2 million) against a more cautious backdrop for growth of these Eurozone countries; and
- an exceptional credit arising from the agreement to close the group's defined benefit pension schemes to future accrual with effect from 31 March 2015. This resulted in exceptional credits of £21.8 million in Severn Trent Water and £1.3 million in Severn Trent Services.

Net finance costs

The group's net finance costs before exceptional items were £229.0 million, compared to £230.6 million in the prior year.

The refinancing exercise referred to under Treasury management and liquidity resulted in exceptional finance costs of £16.5 million on the early redemption of debt. Total finance costs were £245.5 million (2011: £230.6 million).

The effective interest rate, including index linked debt, for 2011/12 was 6.4% (2011: 5.6%). The cash interest rate was 4.9% (2011: 5.0%).

Gains/(losses) on financial instruments

The group uses financial derivatives solely to hedge risks associated with its normal business activities including:

- exchange rate exposure on borrowings denominated in foreign currencies;
- interest rate exposures on floating rate borrowings; and
- exposures to increases in electricity prices.

Accounting rules generally 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 then an accounting mismatch arises from the hedging activities and there is a net charge or credit to the income statement.

Over the lives of the derivatives, these mismatches are expected to net out. Furthermore, the changes in value that are recorded during the lives of the derivatives do not represent cash flows.

Therefore the group presents adjusted earnings figures that exclude these non-cash items. An analysis of the amounts charged to the income statement in the period is presented in note 12 to the financial statements.

Profit before tax

Underlying group profit before tax decreased by 4.6% to £275.3 million (2011: £288.6 million). Group profit before tax was £156.7 million (2011: £253.0 million).

Taxation

The total tax charge for the full year was £17.7 million (2011: £21.5 million). Current tax represented a charge of £60.5 million (2011: £32.1 million) including credits relating to adjustments to prior year computations of £8.7 million (2011: £34.4 million). Deferred tax (see note 26) was a credit of £78.2 million (2011: credit of £53.6 million) including an exceptional credit of £69.1 million (2011: £67.7 million) arising from the reduction in corporation tax rate from 26% to 24% with effect from 1 April 2012.

The effective rate of current tax, excluding prior year charges and exceptional items, calculated on profit before tax, exceptional items and gains/(losses) on financial instruments was 25.7% (2011: 24.4%).

Going forward, we expect the effective current tax rate for 2012/13 to be in the range of 24% to 26%.

Profit for the period and earnings per share

Profit for the period was £174.4 million (2011: £274.5 million).

Adjusted basic earnings per share (before exceptional items, gains/(losses) on financial instruments and deferred tax) were 88.9 pence (2011: 105.6 pence) (see note 15). Basic earnings per share were 72.5 pence (2011: 115.2 pence).

Cash flow

	2012 £m	2011 £m
Cash generated from operations	725.9	753.0
Net capital expenditure	(351.2)	(399.5)
Net interest paid	(210.4)	(180.3)
Tax (paid)/received	(72.0)	(32.4)
Other cash flows	(1.0)	(1.5)
Free cash flow	91.3	139.3
Dividends	(159.0)	(169.4)
Net issue of shares	2.4	2.7
Change in net debt from cash flows	(65.3)	(27.4)
Non cash movements	(33.7)	(80.0)
Change in net debt	(99.0)	(107.4)
Net debt 1 April	(3,868.8)	(3,761.4)
Net debt at 31 March	(3,967.8)	(3,868.8)

Net debt comprises:		
Cash and cash equivalents	295.1	315.2
Bank overdrafts	(0.4)	–
Cross currency swaps hedging debt	135.9	160.4
Bank loans	(852.5)	(846.8)
Other loans	(3,326.9)	(3,230.9)
Finance leases	(219.0)	(266.7)
	(3,967.8)	(3,868.8)

Cash generated from operations was £725.9 million (2011: £753.0 million). Capital expenditure net of grants and proceeds of sales of fixed assets was £351.2 million (2011: £399.5 million). Net interest paid increased to £210.4 million (2011: £180.3 million).

Net debt at 31 March 2012 was £3,967.8 million (2011: £3,868.8 million). Balance sheet gearing (net debt/ net debt plus equity) at the year end was 80.2% (2011: 77.8%). Net debt, expressed as a percentage of Regulatory Capital Value at 31 March 2012 was 56.0% (2011: 56.8%). The group's net interest charge, excluding gains/(losses) on financial instruments and net finance costs from pensions, was covered 3.3 times (2011: 3.4 times) by profit before interest, tax, depreciation and exceptional items, and 2.2 times (2011: 2.3 times) by underlying PBIT.

The fair value of the group's net debt at 31 March 2012 is estimated to be £4,579.3 million (2011: £4,196.2 million) compared to the book value of £3,967.8 million (2011: £3,868.8 million). Discounted future cash flows are used to determine fair values for debt. Discount rates are derived from yield curves based on quoted interest rates and are adjusted for the group's credit risk.

Treasury management and liquidity

The group's principal treasury management objectives 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 maintain an investment grade credit rating; and
- to maintain a flexible and sustainable balance sheet structure.

The group continues to carefully monitor liquidity. At 31 March 2012 the group had £295.1 million in cash and cash equivalents.

In January 2012 the group issued £250 million 4.875% Guaranteed Notes under its Euro Medium Term Note Programme. The Notes have a 30 year term. Part of the proceeds were used to redeem £150.6 million 5.25% Notes which were due for repayment in 2014. The Notes were redeemed at a premium of 10.515%, which represents a 1.1% premium to market value, resulting in an exceptional finance cost of £16.5 million.

A new five year £500 million revolving credit facility was agreed in October 2011. This replaced the existing £500 million revolving credit facility. A new 10 year £100 million bilateral facility was agreed in March 2012. This facility was drawn on 18 April 2012. Average debt maturity is around 16 years. The group is funded for its investment and cash flow needs up to December 2013.

Cash is invested in deposits with highly rated banks and liquidity funds and the list of counterparties is regularly reviewed and reported to the board.

Treasury policy and operations

Our treasury affairs are managed centrally and in accordance with our Treasury Procedures Manual and Policy Statement. The treasury operation's role is to manage liquidity, funding, investment and our financial risk, including risk from volatility in interest and (to a lesser extent) currency rates and counterparty credit risk. The board determines matters of treasury policy and its approval is required for certain treasury transactions.

Our strategy is 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. Our principal operating subsidiary, Severn Trent Water, is a long term business characterised by multi year investment programmes. Our strategic funding objectives reflect this and the liquidity position and the availability of committed funding are essential to meeting our objectives and obligations. We therefore aim for a balance of long term funding or commitment of funds across a range of funding sources at the best possible economic cost.

The group's current policy for the management of interest rate risk requires that no less than 45% of the group's borrowings should be at fixed interest rates, or hedged through the use of interest rate swaps or forward rate agreements. At 31 March 2012, interest rates for some 74% of the group's net debt of £3,967.8 million were fixed in this way.

We use financial derivatives solely to manage risks associated with our normal business activities. We do not hold or issue derivative financial instruments for financial trading.

Except for debt raised in foreign currency, which is fully hedged, our business does not involve significant exposure to foreign exchange transactions. We have investments in various assets denominated in foreign currencies, principally the US dollar and the euro. Our current policy is to hedge an element of the currency translation risk associated with certain foreign currency denominated assets.

We have entered into energy swaps that fix the cost of substantially all of Severn Trent Water's expected net electricity consumption for the next three years and part of its anticipated consumption for the following year. The price fixed in these swaps is lower than the amount assumed in the Final Determination for AMP5.

The group issues notes in foreign currency under its EMTN programme and uses cross currency swaps to convert the proceeds to sterling. The effect of these swaps is that interest and principal payments on the borrowings are denominated in sterling and hence the currency risk is eliminated. The foreign currency notes and the cross currency swaps are recorded in the balance sheet at their fair values and the changes in fair values are taken to gains/(losses) on financial instruments in the profit and loss account. Since the terms of the swaps closely match those of the underlying notes, such changes tend to be broadly equal and opposite.

The group holds interest rate swaps with a net notional principal amount of £463.6 million and cross currency swaps with a net notional principal amount of £536.6 million which economically act to hedge the interest rate risk on floating rate debt or the exchange rate risk on certain foreign currency borrowings. However, the swaps do not meet the hedge accounting rules of IAS 39 and therefore these swaps are carried in the balance sheet at fair value. The changes in fair value are taken to gains/(losses) on financial instruments in the income statement. During the period there has been a decrease of £80.3 million in the fair value of these instruments.

It is important to note that we intend to, and typically do hold these swaps to maturity. Further, this is not a cash movement and, over the life of the swaps, these changes in fair value will net out.

The group's long term credit ratings are:

Long term ratings	Severn Trent Plc	Severn Trent Water
Moody's	Baa1	A3
Standard and Poor's	BBB-	BBB+

Pensions

The group operates two defined benefit pension schemes, of which the Severn Trent Pension Scheme (STPS) is by far the largest. Formal triennial actuarial valuations and funding agreements for the STPS have been renewed as at 31 March 2010. The key actuarial assumptions from these valuations have been updated for these accounts as at 31 March 2012. The valuations left the level of current service contributions unchanged and agreed deficit reduction contributions of £10.0 million per annum in cash and a further £8.0 million per annum through an asset backed funding arrangement.

On 11 May 2011, Severn Trent announced that it was consulting with its 6,000 plus UK employees on proposed changes to its pension arrangements, which would see all existing pensions replaced by one new defined contribution scheme. Following the period of consultation and after discussion with the schemes' trustees, final proposals have been accepted by the employees' representatives and the trustees. A new defined contribution scheme has been established and from 1 April 2012 new employees have been auto enrolled into this scheme. The defined benefit schemes will close to future accrual on 31 March 2015 and members of the defined benefit schemes will then become members of the new defined contribution scheme. The existing defined contribution scheme will also be replaced by the new pension arrangements with effect from 1 April 2015 and it is proposed to automatically enrol those employees who are not currently members of a Severn Trent scheme from 2013.

On an IAS 19 basis, the estimated net position (before deferred tax) of the group's defined benefit pension schemes was a deficit of £345.8 million as at 31 March 2012. This compares to a deficit of £292.1 million as at 31 March 2011. The movements in the net deficit are summarised in note 27.

On an IAS 19 basis, the funding level has reduced from around 83.5% at 31 March 2011 to around 81.8% at 31 March 2012.

	2012 %	2011 %
Price inflation	3.1	3.5
Salary increases	3.6	4.0
Pension increases in payment	3.1	3.5
Pension increases in deferment	3.1	3.5
Discount rate	4.9	5.6
Long term rate of return on equities	6.8	7.9

Age to which current pensioners aged 65 are expected to live		
– men	87.5	87.4
– women	91.1	91.0
Age to which future pensioners aged 45 at the balance sheet date are expected to live		
– men	88.0	88.0
– women	91.9	91.8

The following table summarises the estimated impact on scheme liabilities resulting from changes to key actuarial assumptions whilst holding all other assumptions constant.

Assumption	Change in assumption	Impact on scheme liabilities
Discount rate	Increase/decrease by 0.1%	Decrease/increase by £35.0 million
Price inflation	Increase/decrease by 0.1%	Increase/decrease by £30.0 million
Mortality	Increase in life expectancy by one year	Increase by £45.0 million

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.

Risk management

Our approach to risk

Overall we take a considered approach to risk. Across the group, individual risks and decisions are managed in line with our Group Authorisation Arrangements which set out clear limits for delegated authority.

Within the largest part of our group, Severn Trent Water, 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 business is such that there are some significant inherent risks as illustrated in the following paragraph on Principal Risks. We aim to have a strong control framework in place to enable us to understand our risks and manage them effectively.

Although the Severn Trent Services businesses are not generally regulated, we provide products and services for customers who operate in regulated environments, and as a result we take a similarly considered approach to risk.

Our Enterprise Risk Management Process

Our now established Enterprise Risk Management (ERM) process which is used across the group, identifies possible risks, their causes and their potential impacts. This allows us to place focus on having the right controls in place to manage our risks by considering both how to minimise the likelihood of risks occurring and how to maximise our resilience to risks. In addition to assessing financial impact, our assessment of risks includes explicit consideration of the possible effect on the reputation of the group.

Key risks are reported to the Audit Committee and to the board every six months in the form of risk maps.

In addition, individual risks or specific risk topics are also discussed by the board during the year. This year we have paid particular attention to low likelihood, high impact risks, with the board requesting additional assurance that controls around such risks are robust. We have also introduced regular risk 'deep dives' at our Severn Trent executive team meetings. These take the form of updates from individual business teams within Severn Trent Water on their progress with improving controls and providing effective mitigation for their most significant risks.

For the preparation of our annual business plan for Severn Trent Water we have introduced an explicit link between the ERM and business planning processes in order that we can have greater confidence that business plans sufficiently address areas of key risk.

Principal risks

There are a number of significant risks which are inherent to all water and sewerage companies, as shown on our business models on pages 10 and 11 and 24 and 25, including:

- Severn Trent Water operates in a heavily regulated environment and is subject to many varied, complex and changing obligations. As a result, we face risks associated with non-compliance;
- Severn Trent Water has an extensive network of assets and the failure of key individual or collections of these assets could result in a significant impact on our core business activities;
- we face risks to the health, safety and wellbeing of our people, customers, contractors and others as a result of the nature of our operations; and
- we share a concern with many other businesses over our ability to fund long term pension promises.

Where appropriate these are included in the table of Principal Risks overleaf.

How does our ERM process work in practice?

Our sewerage network consists of thousands of miles of sewers carrying waste water to our treatment plants. There is a risk that these sewers could collapse or become blocked resulting in flooding of our customers' homes or pollution of the environment.

We recognise that sewer flooding of property is very distressing for customers affected and we aim to minimise the possibility of this happening. Similarly, pollution of watercourses has an adverse effect on the environment and enjoyment of the amenities in the communities we serve. Both types of incident incur additional costs to the company in rectifying such incidents.

Our risk assessment was primarily set around the Ofwat requirement to supply assets capable of delivering an agreed level of service to our customers and the environment. We further analysed our risks to introduce more specific risks based around infrastructure (below ground assets) and non infrastructure (above ground assets) within our ERM process to help to generate clarity on causes and controls of failure. From this we were able to develop further improvement actions to ensure risks are constructively managed to deliver the service promises. In order to mitigate the risk we have enhanced our programme of investment to maintain our sewerage network to reduce sewer blockages, collapses and sewer flooding incidents.

We have also embarked on an holistic Environmental Improvement Programme which considers all aspects of our processes and how these can be improved to minimise our impact on the environment. Reducing these incidents is good for customers, good for the environment and good for the company.

Risk management

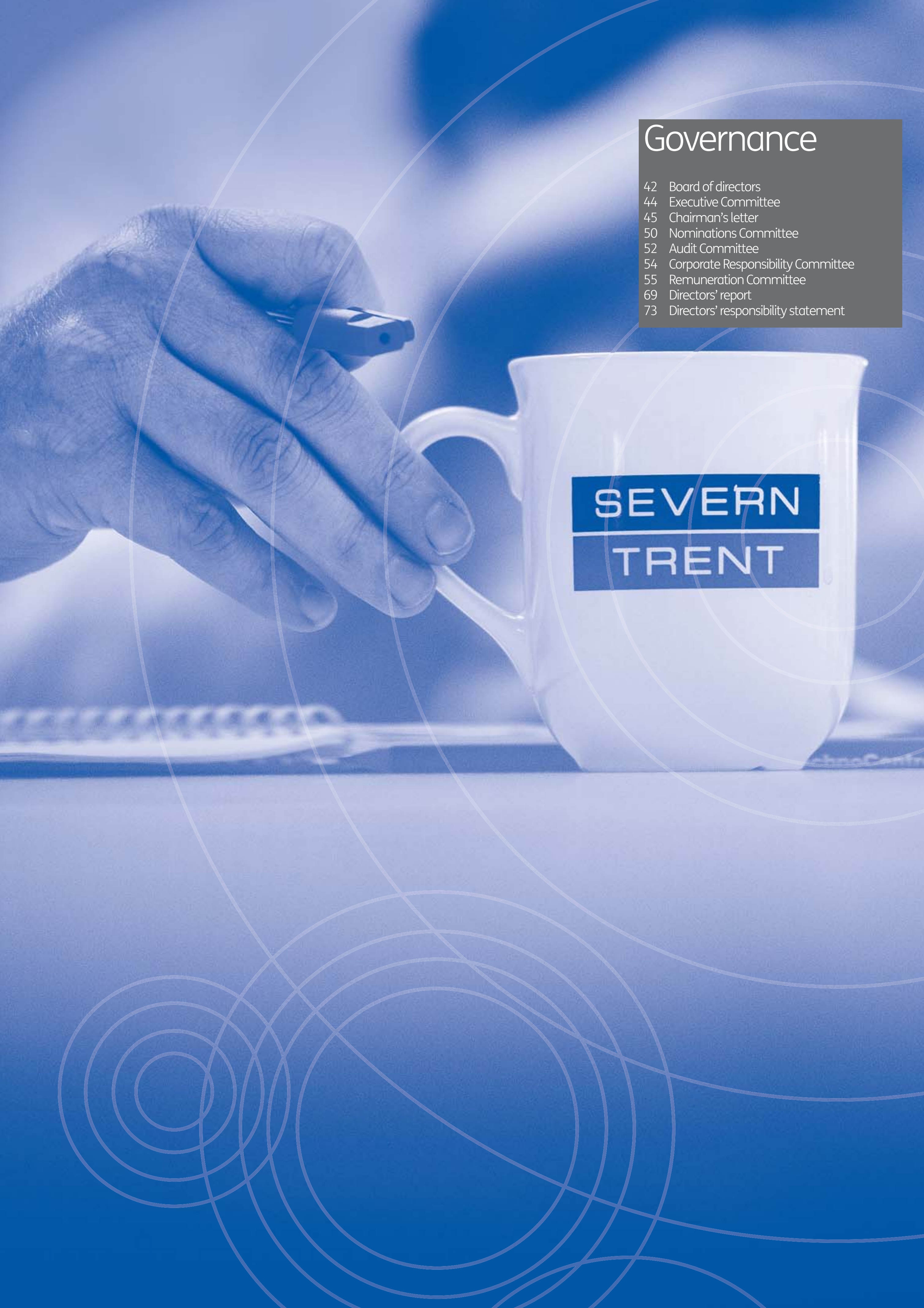
Ref	What is the risk?	Which part of Severn Trent is affected?	What does it mean for us?	What are we doing to manage the risk?
Business Model Risks				
1	We may not be able to achieve all of the challenging targets agreed with Ofwat for our business plan from 2010 to 2015 resulting in reduction in funding.	Severn Trent Water	Current performance against plan does not indicate particular cause for concern. However, if we are unable to meet all of the targets and regulatory outputs agreed in our business plan within the constraints assumed in the plan, the following may occur: • we may require additional funding or experience reduced profit during this five year planning period; • financial penalties may be imposed by Ofwat during the AMP6 period 2015–2020; or • our share price may be affected if we are unable to deliver the financial and performance targets we have shared with investors.	We have robust business planning processes. Our business plans are updated and reviewed on an annual basis. We monitor progress against agreed targets each month and are able to make adjustments to planned activities if we identify any concerns.
2	We may be unable to sufficiently improve our performance in relation to customer service in order to deliver what our customers tell us they want.	Severn Trent Water	Our current customer service performance is disappointing, and we have programmes of work underway to address the root causes of the issues highlighted. We recognise, however, that failure to address these issues may result in customer dissatisfaction and as a result we may fail to gain customer support for our plans for the next price review period (AMP6) between 2015–2020. At present, we believe we can achieve the necessary improvements in our performance.	We have programmes of work underway across Severn Trent Water to make the necessary improvements in our processes and technology to enable Severn Trent Water to deliver outstanding customer service.
3	We may suffer operational failure in our waste water operations which results in damage to the local environment.	Severn Trent Water	Failure of certain key assets may result in process failure, leading to environmental damage. This is a particular concern in relation to our waste water treatment processes. For example, failure of our key assets may render our treatment less effective resulting in pollution.	We monitor the performance of our treatment works and the effluent we are producing to within strict limits. Where we are unable to prevent pollutions, we clean up polluted waters as quickly as possible and put in place measures to prevent recurrence. We have introduced an Environmental Improvement Programme which includes regular audits of our sites and we continue to work to improve our environmental performance.

Ref	What is the risk?	Which part of Severn Trent is affected?	What does it mean for us?	What are we doing to manage the risk?
Business Model Risks (continued)				
4	Our assets or processes may fail resulting in injury to an employee, contractor, customer or member of the public.	Group wide	The nature of our work requires our employees and contractors to undertake activities or to use equipment which have potential to cause serious harm. Whilst we seek to take precautions to prevent injury, asset failure or failure to follow agreed processes may result in someone being hurt. Specific examples include injury to our employees using chemicals in our processes. Additionally, failure of one of our key assets such as a reservoir could result in injury to customers or members of the public.	We have risk and safety action teams at site level who identify local hazards and how these can be mitigated. Safety performance is monitored and we are delivering year on year improvement. Wherever hazardous work is to be undertaken or hazardous chemicals are used, we undertake thorough training, which is kept up to date, to minimise the risk. Our assets are subject to regular and rigorous monitoring including independent inspections of our reservoirs to ensure that they remain safe and that maintenance work is undertaken where needed.
5	We may fail to meet all of our regulatory targets, including targets from Ofwat, in relation to ongoing operational performance of our assets resulting in regulatory penalties.	Severn Trent Water	If we are unable to meet operational performance targets, we may be subjected to significant regulatory penalties. 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.	We continue to monitor and invest in our assets and to improve our processes in order to maintain the performance of our key assets. We have programmes of work ongoing to review all aspects of our operations, including the necessary improvements to maintain continuous supplies, ensure water quality, reduce sewer collapses and sewer flooding and improve environmental performance.
6	Failure of certain key assets may result in inability to provide a continuous supply of quality water to large populations within our area, or in damage to third party property.	Severn Trent Water	Some of our assets are not duplicated, and whilst every effort is made to maintain the assets, failure may occur which could result in temporary inability to continue to serve our customers.	We have asset management plans in place which drive investment in maintenance and improvement of our assets in order to maintain our service to customers. We also have security measures to protect our assets and contingency plans to maintain supplies in the event of failure.
Legal and Regulatory Risks				
7	We may be unable to effectively anticipate and/or influence future developments in the UK water industry resulting in our business plans becoming unsustainable.	Severn Trent Water	The major part of our business, Severn Trent Water, operates in a highly regulated environment. Our document 'Changing Course' sets out the key changes we believe are necessary to ensure a sustainable future for the water industry in England and Wales. Although some of our points are reflected in the UK Government Water White Paper issued in December 2011, future changes in legislation could have a significant impact on Severn Trent.	We will continue to work with: • peers across the water industry; • UK Government departments; • Ofwat and other regulators; and • other agencies to ensure we keep abreast of policy developments and influence the future direction of regulatory policy where possible.

Risk management

Ref	What is the risk?	Which part of Severn Trent is affected?	What does it mean for us?	What are we doing to manage the risk?
Legal and Regulatory Risks (continued)				
8	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.	Group wide	Our policies and processes must reflect the current legal and regulatory environment and all relevant employees need to be kept aware of new requirements. Due to the spread of our operations, and changes in activity and organisational structure this is not always straightforward. The group as a whole may face censure for non-compliance in an individual group company or a specific region in which we operate.	We have policies, standards, procedures and relevant training for employees to mitigate this risk. During this year, we have refreshed our Code of Conduct and group policies and are carrying out an extensive programme to raise awareness of the updated Code of Conduct and policies.
Financial Risks				
9	The current crisis in the Eurozone may increase the difficulties associated with obtaining funding for the group (at similar rates to those assumed in our business plan).	Group wide	As a result of current market and economic conditions across the Eurozone, there may be increased difficulty for all businesses to obtain funds. We may therefore be unable to meet all of our funding requirements at commercially attractive rates.	We ensure we maintain access to funds through cash held on short term deposit and through our committed borrowing facilities. We constantly monitor the possible impacts of economic conditions on the funding requirements for the group. We have diversified sources of funding and have a timetable for replacement of committed lending facilities which allows us more than one opportunity to go to market in order to mitigate against short term problems in the marketplace.
10	Changing demographics and fluctuations in the investment market may affect our ability to fund pensions promises sustainably.	Group wide	We already provide significant funding. We may be called upon to provide more money to reduce deficits in our pension schemes. Although the risk is not considered likely to occur, the impact could be significant.	We regularly revalue our schemes and monitor our investment performance. We are introducing new pensions arrangements which we believe will be fairer for all our employees as well as reducing the build up of further deficit in our schemes in future years, thus allowing us to continue to fund pensions sustainably into the future.
11	Counterparties with whom we have invested money may fail, putting our investment at risk.	Group wide	We may have cash which we have not yet invested in agreed capital programmes, and we need to manage this in the most advantageous way for our customers and shareholders. There is a risk that we may deposit cash with third parties who may default resulting in financial loss.	We have strict policies which restrict the counterparties we can invest with and limit the amount which can be invested with individual counterparties. We closely monitor the credit status of all our counterparties to ensure we only deposit with those who have good credit status. Compliance with our policies is monitored continuously to mitigate this risk.

Governance



Governance

Board of directors

Dr Tony Ballance

BSc (Hons) MA (Econ) PhD (47)
Director, Strategy and Regulation
Appointed to the board on 2 October 2007

Tony's extensive experience in utility policy and regulation leaves him ideally placed to lead the company's strategic and regulatory work. He has previously held the posts of Chief Economist for Ofwat, economic consultant, director of London Economics and a director of Stone and Webster Consultants.

External appointments
Member of Water UK Council

Committee membership
Executive Committee

Dr Bernard Bulkin

BS PhD FRSC FRSA FIE (70)
Independent non-executive director
Appointed to the board on 1 January 2006

Bernard has been involved in a range of scientific, technology and engineering businesses, including holding the position of Chief Scientist of BP Plc. His involvement in both innovation and policy on climate change and renewable energy, together with an understanding of how to guide improved performance on safety and environmental operational issues, enables him to contribute significantly to the board.

External appointments
Chairman of Chemrec AB (Sweden)
Non-executive director of Ze-gen Corporation (USA)
Non-executive director, Chairman of the Remuneration Committee and member of the Audit Committee of Pursuit Dynamics plc
Chair of the Office of Renewable Energy Deployment at the UK Department of Energy and Climate Change

Committee membership
Audit Committee
Corporate Responsibility Committee (Chairman)
Nominations Committee
Remuneration Committee

Richard Davey

BA (63)
Senior independent non-executive director
Appointed to the board on 1 January 2006

Richard has an investment banking background and was formerly Head of Investment Banking at NM Rothschild and Sons. With extensive experience of the financial services sector, having run Rothschild's Financial Services Group and working with a number of high street banks and insurers, Richard brings valuable financial expertise to the board, the Audit Committee and as chair of the Remuneration Committee. Previously he held non-executive roles at Yorkshire Building Society, where he was Vice Chairman, Freeserve Plc and Scottish Widows Fund and Life Assurance Society.

External appointments
Non-executive Chairman of London Capital Group Holdings Plc
Non-executive Chairman of Amlin Plc

Committee membership
Audit Committee
Nominations Committee
Remuneration Committee (Chairman)

Martin Lamb

BSc MBA (52)
Independent non-executive director
Appointed to the board on 29 February 2008

Martin has extensive experience of managing and developing large engineering businesses in all parts of the world. Martin has worked for IMI for over 25 years where he has held a number of senior management roles. His strong commercial acumen, experience of managing complex projects, and familiarity with current market pressures as a serving Chief Executive leave him well placed to add value to the Severn Trent business. Previously Martin was a non-executive director of Spectris plc.

External appointments
Chief Executive of IMI plc
Member of the Advisory Board of AEA Investors (UK) Limited

Committee membership
Nominations Committee
Remuneration Committee

Michael McKeon

MA CA (55)
Finance Director
Appointed to the board on 13 December 2005

Michael brings significant financial and commercial expertise to the board. Prior to joining Severn Trent he was Finance Director of Novar Plc and before that held various senior roles with Rolls-Royce Plc, including Finance Director of Aerospace Group. He has extensive international business experience having worked overseas for CarnaudMetalbox, Elf Atochem and Price Waterhouse. Michael is a Chartered Accountant and a Member of the Institute of Chartered Accountants of Scotland.

External appointments
Non-executive director and Chairman of the Audit Committee of The Merchants Trust Plc

Committee membership
Executive Committee

Baroness Noakes

DBE LLB FCA (62)
Independent non-executive director
Appointed to the board on 29 February 2008

Sheila is an experienced director on UK listed company boards and an experienced audit committee chairman. A qualified chartered accountant, she previously headed KPMG's European and International Government practices and has been President of the Institute of Chartered Accountants in England and Wales. Sheila was appointed to the House of Lords in 2000 and has served on the Conservative front bench in various roles including as shadow treasury minister between 2003 and May 2010. Previously she held non-executive roles on the Court of the Bank of England, Hanson Plc, ICI Plc, John Laing and SThree.

External appointments
Non-executive director, member of the Group Audit, Group Nominations and Board Risk Committees of The Royal Bank of Scotland Group Plc
Deputy Chairman, senior independent director and Chairman of the Audit and Nominations Committees of Carpetright Plc
Trustee of the Thomson Reuters Founders Share Company

Committee membership
Audit Committee (Chairman)
Nominations Committee

Andrew Duff
BSc FEI (53)
Non-executive Chairman
Appointed to the board on 10 May 2010 and Chairman on 20 July 2010

Andrew's extensive knowledge of international business, strategic management, customer service and regulated business make him the right Chairman to lead the group. Andrew spent 16 years at BP in marketing, strategy and oil trading. He joined National Power in 1998 and the board of its daughter company Innogy plc upon its demerger from National Power in 2000. He led the restructuring and subsequent sale of Innogy to RWE in 2003. He became CEO of the successor company, npower, and a member of the RWE Group Executive Committee. He was non-executive Chairman of RWE npower until his retirement in December 2010.

External appointments

Senior independent director, Chairman of the Remuneration Committee, member of the Audit Committee and Nominations Committee of Wolseley Plc
Member of the CBI President's Committee
Trustee of Macmillan Cancer Support and Earth Trust
Fellow of the Energy Institute

Committee membership

Corporate Responsibility Committee
Nominations Committee (Chairman)
Remuneration Committee

Gordon Fryett
(58)
Independent non-executive director
Appointed to the board on 1 July 2009

Gordon's extensive experience working in and with international businesses, accountability for managing large areas of capital expenditure and a broad range of executive and operational experience in a highly customer facing environment, enables him to bring substantial experience and expertise to the board. He is currently Tesco Group Property Director and CEO of Central Europe, having previously held a number of senior positions within the Tesco Group including CEO Republic of Ireland and Director of International Support.

External appointments

CEO of Tesco Europe
Alumnus of INSEAD

Committee membership

Corporate Responsibility Committee
Nominations Committee

Martin Kane
BSc CEng CEnv MICE MIWEM FIW (59)
Chief Executive Officer, Severn Trent Services
Appointed to the board on 2 October 2007

Martin joined Severn Trent Water in 1975 and has held various senior posts giving him an extensive understanding of the design, construction and operation of water and waste water treatment plants, water distribution networks and sewerage systems. Martin held the role of Director of Customer Relations, Severn Trent Water, from May 2006 until January 2012, at which point he was appointed Chief Executive Officer of Severn Trent Services.

External appointments

Member of the boards of Utilities and Service Industries Training Limited and National Association of Water Companies (US).
Trustee of International Society for Trenchless Technology

Committee membership

Executive Committee

Andy Smith
BTech (Hons) (51)
Director of Water Services
Appointed to the board on 2 October 2007

Andy brings a broad range of executive and operational expertise gained from different sectors to the board. Andy has significant experience having worked in the UK and overseas with BP, Mars and Pepsi, in engineering and operational management roles. Previously he was Group HR Director and a member of the board at Boots Group Plc.

Committee membership

Executive Committee

Tony Wray
BSc (Hons) (50)
Chief Executive
Appointed to the board on 7 March 2005

Tony became Chief Executive on 2 October 2007. His extensive experience in a wide range of operational and strategic leadership roles in the Energy, Telecoms, Water and Waste industries enables him to bring a multi disciplined approach to the board. Tony brings to his position an in-depth operational knowledge of Severn Trent and strategic vision for the group. Previously he was director of Networks at Eircom, the Republic of Ireland's telephone operation and has held director roles within Transco and National Grid Transco.

External appointments

Non-executive director and member of the Audit Committee of Grainger plc
Member of Business Advisory Board for 'Living with Environmental Change'
Member of Water UK Board

Committee membership

Corporate Responsibility Committee
Executive Committee (Chairman)
Nominations Committee

Governance

Executive Committee

The Chief Executive is supported in his role by the executive management team and together they comprise the Executive Committee. During the year, the Executive Committee comprised the executive directors and senior executive managers responsible for key operational and central functions. Photographs of the members of the committee, together with their biographies are set out below.

The Executive Committee oversees the development and execution of the Severn Trent strategy. It also has accountability for achieving business results. The terms of reference of the Executive Committee are available on the company's website (www.severntrent.com) or from the Company Secretary.

During the year, the Executive Committee met to consider strategy, business management, policy and planning, and operational performance.

Members of the Executive Committee are delegated responsibility to sit on steering groups that oversee the delivery of our strategy and business management. During the year, steering groups were set up to oversee areas such as the integrated delivery of our year end results and Ofwat Annual Return.

1. Dr Tony Ballance

BSc (Hons) MA (Econ) PhD (47)

Director, Strategy and Regulation

Please see full biography on page 42.

2. Simon Cocks

BA (Hons) (46)

Waste Water Services Director

Joined Severn Trent in July 2009. Simon is an electrical engineer by training and began his career in military communications working for Plessey and then GEC. He previously worked for London Electricity in various operational and management roles and, more recently, for National Grid where he was Head of UK Operations Performance and Planning, then Commercial Director for the gas and electricity business in the UK and Europe and more recently held the position of Chief Procurement Officer before joining Severn Trent. Simon is a board member of UK Water Industry Research.

3. Evelyn Dickey

BSc (Hons) (49)

Director of Human Resources

Joined Severn Trent in November 2006. Evelyn has wide HR experience leading design and delivery of major change programmes, business restructuring, employee relations, resourcing, organisational capability and performance management initiatives. Before joining Severn Trent Evelyn worked in HR consultancy and as HR Director (HR Operations) for Boots the Chemists.

4. Myron Hrycyk

MBA (55)

Chief Information Officer

Joined Severn Trent in April 2008. Myron has held senior IT posts for major organisations across a range of business sectors, Financial Services, Publishing, Automotive and Logistics/Supply Chain. He has delivered strategic IT and business transformation programmes, restructured corporate IT units and deployed high performance IT practices. Myron also has executive responsibility for Supply Chain & Procurement and our Business Improvement Team of programme managers and 'Safer, Better, Faster' continuous improvement practitioners.

5. Angela Hunter-Dobson

MA (Hons) (40)

Customer Relations Director

Joined Severn Trent in May 2012. Angela commenced her career with IBM during its transformation from manufacturing to services business. She has since held senior operational leadership positions for Barclays, Hiscox and Vodafone, delivering customer services across B2B, B2C, domestic, international, indirect and regulated markets. In addition to leading her own award winning customer operations, she has consulted widely in the area of customer service in multiple sectors.

6. Martin Kane

BSc CEng CEnv MICE MIWEM FIW (59)

Chief Executive Officer, Severn Trent Services

Please see full biography on page 43.

7. Bronagh Kennedy

(BA) (Hons) (48)

General Counsel and Company Secretary

Joined Severn Trent in June 2011. Bronagh is a Solicitor and was previously Group Company Secretary and General Counsel at Mitchells & Butlers, where she worked for 15 years. Prior to that, she was a Senior Associate at Allen & Overy.

8. Michael McKeon

MA CA (55)

Finance Director

Please see full biography on page 42.

9. Alec Richmond

BSc (Econ) FCA FIIA (54)

Director of Internal Audit

Joined Severn Trent in June 2007. Prior to that, he worked for Cadbury Schweppes Plc, leading the company's global internal audit service from 2000–2005. Before joining Severn Trent, he worked for RSM Robson Rhodes as a director and a member of the management board responsible for Risk Assurance Services. Alec is a fellow of the Institute of Chartered Accountants in England and Wales and the Institute of Internal Auditors.

10. Andy Smith

BTech (Hons) (51)

Director of Water Services

Please see full biography on page 43.

11. Tony Wray

BSc (Hons) (50)

Chief Executive

Please see full biography on page 43.

Governance

Chairman's letter

Andrew Duff
Chairman

Governance in Severn Trent

The way we are structured

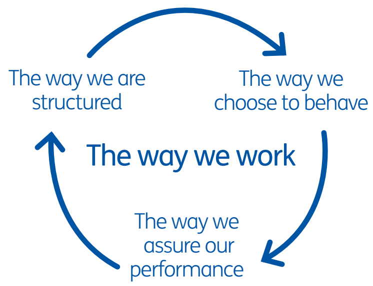
- Our organisation is structured to allow for effective and efficient decision making with clear accountabilities.

The way we choose to behave

- Our Code of Conduct: 'Doing the Right Thing – the Severn Trent Way' (which was reissued during the year) sets out our approach to responsible business behaviours.
- The Code of Conduct is supported by 15 group policies and our behaviours model. Further details of these can be found on our website (www.severntrent.com)

The way we assure our performance

- Management assurance is provided by a combination of effective management processes and risk and compliance activities.
- Independent assurance is provided primarily by Internal Audit, by our external auditors and other external bodies.



Dear Shareholder

Introduction

At Severn Trent, we are committed to delivering value and building a sustainable business, supported by good governance. As a board we are responsible and accountable to shareholders for ensuring effective governance processes are in place and complied with.

The board's role is to:

- understand and meet its obligations to the company's stakeholders;
- lead the group within a framework of prudent and effective controls which enable risk to be assessed and managed;
- approve the group's strategic objectives; and
- ensure that sufficient resources are available to enable it to meet those objectives.

The Combined Code on Corporate Governance issued by the Financial Reporting Council (FRC) in 2008 has been replaced by the UK Corporate Governance Code (the 'Governance Code'). There have been a number of substantive changes to both the main principles and provisions designed primarily to place greater emphasis on board behaviours. These are all changes which your board encouraged and supported.

The following sections of this report set out how good governance underpins our activities in Severn Trent and describe how we apply the principles of the Governance Code.

Compliance with the UK Corporate Governance Code

For the whole of the financial year ended 31 March 2012, Severn Trent was fully compliant in its application of the Governance Code, which is available on the FRC website www.frc.org.uk. This demonstrates our commitment to the highest standards of governance and corporate behaviour.

Board membership

During the year under review the board has consisted of me, your non-executive Chairman, five executive directors and five independent non-executive directors. Photographs of the members of the board, together with their biographies and a description of the complementary skills and wealth of experience that they bring to bear, can be found on pages 42 and 43.

Together, as a unified board, I believe we bring an appropriate balance of innovation, experience, independence and challenge to ensure effective decision making.

Details of our policy on diversity in the boardroom are provided in the Nominations Committee report on pages 50 and 51.

Role of the Chairman

The role of the Chairman is to lead a unified board, facilitating the contribution of its members at its meetings, and to be responsible for ensuring that the principles and processes of the board are maintained in line with the Board Governance document.

Agendas for our meetings are agreed in consultation with the Chief Executive and Company Secretary, although any director may request that an item be added to the agenda. I have authority to act and speak for the board between its meetings, including engaging with the Chief Executive. I report to the board and committee chairmen as appropriate on decisions and actions taken between meetings of the board. I also meet with the non-executive directors without the executive directors present, to consider the performance of the executive directors and to provide feedback.

Senior independent non-executive director

Richard Davey is the senior independent non-executive director. He chairs the Remuneration Committee and is a member of the Audit and Nominations Committees. The board has agreed that Richard will act as Chairman of the board in the event that I am unable to do so for any reason.

Group Authorisation Arrangements

The Group Authorisation Arrangements (GAA) are the framework through which the Severn Trent Plc board authorises the right people, at the right level, to take important decisions as we manage legal, financial and administrative issues throughout the group. The GAA are designed to facilitate good control, efficient decision making and demonstrable compliance.

The flow of authority is from the Severn Trent Plc board to the Chief Executive and his Executive Committee (STEC). In respect of certain issues, the delegated authority is subject to an obligation to work with specialist business services areas (such as Tax, Treasury, Group Finance and Company Secretariat) that provide additional expertise and a group wide perspective.

Governance of subsidiaries

The board of the listed company, Severn Trent Plc, is the same as that of its regulated subsidiary, Severn Trent Water Limited. This structure was implemented in 2007 when it was decided to integrate the management of the companies to gain greater focus, transparency and effectiveness around Severn Trent Water.

Following his appointment as CEO of Severn Trent Services in January 2012, Martin Kane became a non-executive director of Severn Trent Water Limited.

The two companies operate as distinct legal entities. The boards have regard to the Severn Trent Plc Board Governance document and the Severn Trent Water Limited 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 required to be managed scrupulously with respect to legal, fiscal and administrative matters. In particular, the relationships between Severn Trent Water Limited and our other businesses such as Severn Trent Services are monitored and controlled to ensure that we comply with our Ofwat obligations on arm's length transactions.

Non-executive directors

Your non-executive directors are appointed to the board to contribute their individual external expertise and experience in areas of importance to the group such as corporate finance, general finance, corporate strategy, customer care, property, environmental and scientific matters, general management and supply chain management. They also provide independent challenge and rigour in the board's deliberations and are encouraged to make independent assessments of the group's competencies. The non-executive directors, led by Richard as the senior independent non-executive director, meet without me at least once a year, where there is an opportunity for them to appraise my performance.

Your board has reviewed the status of the non-executive directors and considers them all to be independent in character and judgement as defined by the Governance Code.

Chief Executive

Responsibility has been delegated to the Chief Executive, Tony Wray, to achieve the company's strategy. He is empowered to take all decisions and actions that further the company's strategy and which in his judgement are reasonable, having regard to the Chief Executive limits set out in the company's Group Authorisation Arrangements (GAA). The non-executive directors, led by me, appraise his performance annually.

Executive directors

The executive directors support Tony in driving the implementation of strategy forward in Severn Trent. They are committed to implementing strategy in a responsible way that takes account of our commitment to long term responsible stewardship of the business, the environment, our customers and the communities in which we live and work.

Role of the Company Secretary

All directors have access to the advice and services of the Company Secretary, Bronagh Kennedy, and the Company Secretariat team. The Company Secretary is responsible for ensuring that the board operates in accordance with the governance framework it has adopted and that there are good information flows to the board and its committees and between senior management and the non-executive directors.

The appointment and resignation of the Company Secretary is a matter for consideration by the board as a whole.

Induction

On joining the board, a director's induction needs are evaluated and then they are provided with a comprehensive and individualised induction pack which includes information on the group structure, the regulatory framework of the operating businesses within the group, strategic plans, financial reports and business plans and information on our governance framework.

Meetings are arranged with members of the executive management team and with external advisers who provide support to the relevant board committees the directors may serve on. Visits to operational and office sites across the group are also arranged for directors joining the board and subsequently throughout the year.

Continuing professional development

The directors received updates throughout the year on matters such as the impacts of the proposals on private drains and sewers, the UK Government's Water White Paper, 'Water for Life', PR14 and changes in Listing Rules requirements.

The directors also have access to professional development provided by external bodies and our advisers.

Reporting obligations

As a public listed company, the company has a range of reporting obligations to meet that are set out by law and regulation. The company is committed to the promotion of investor confidence by taking steps within its power to ensure that trade in its securities takes place in an efficient and informed market.

The company recognises the importance of effective communication as a key part of building shareholder value and that, to prosper and achieve growth, it must (among other things) earn the trust of security holders, employees, customers, suppliers and communities, by being open in its communications and consistently delivering on its commitments.

The company announces its results on a half yearly basis and complies with the requirement to make interim management statements.

The Chief Executive has established a Disclosure Committee, chaired by the Finance Director, with specific responsibilities for the delivery of the interim and year end reporting processes. The Committee oversees the delivery of an integrated plan incorporating all elements of the year end reporting process, namely the group's final results announcement and report and accounts, the company's Annual General Meeting, the statutory and regulatory accounts of Severn Trent Water Limited and the Ofwat Annual Return.

Performance and effectiveness reviews

In November 2011 I commissioned an independent external review of the effectiveness of the board, which was conducted between December and March. The review was carried out by Boardroom Review and was designed to encourage the directors to step back from the normal business of the board, and provide them with an opportunity to question the board's approach, assess its impact and contribution and prepare for the challenges ahead.

The reviewer conducted confidential interviews with all 11 directors and the Company Secretary and reviewed a selection of board papers. This enabled the reviewer to consider the board's effectiveness and identify any key themes arising from the review, which were then presented to and discussed by the board at its meeting in March.

The strengths of the board identified included a good understanding of stakeholder views including the company's regulators and shareholders; good market information to the non-executive directors; strong Audit, Corporate Responsibility and Remuneration Committees; and open access to executives below board level.

Areas for further development which were discussed included prioritisation of strategic matters on board agendas and improving focus on leadership development and succession planning. In fact, during and after the review, progress has already been made in these areas.

Board processes

We have processes in place regarding:

- our tasks and activities (board membership and administration);
- the matters specifically reserved for our decision making, the authority delegated to the Chief Executive, the accountability of the Chief Executive for that authority, and guidance on managing the relationship between us and the Chief Executive; and
- the boundaries on Chief Executive action (Chief Executive limits).

An approved Board Governance document outlines those processes and is available on our website (www.severntrent.com).

The board has reserved the following for its own consideration:

- the appointment of the Chief Executive, directors, the Company Secretary and the Director of Internal Audit;
- the strategy and budgets of the company;
- the GAA which set out the group's delegated approval limits;
- decisions regarding the company and its subsidiaries required to be made by the company's GAA, constitutional documents, statute or external regulation; and
- the approval or adoption of documents (including the publication of reports and statements to shareholders), required to be made by the board by the company's GAA, constitutional documents, statute or external regulation.

Board meetings

We have regular scheduled meetings throughout the year and committee meetings are convened when required.

Papers, including minutes of board committees held since the previous board meeting and performance reports, are circulated in advance of each meeting.

There is an agreed procedure in place which allows directors to take independent professional advice in the course of their duties and all directors have access to the advice and services of the Company Secretary. Where a director has a concern over any unresolved matter he/she is entitled to require the Company Secretary to minute that concern. Should the director later resign over the issue, I, as Chairman, will bring it to the attention of the board.

In addition to formal board meetings, your board attended a full day strategy session this year, where the board and executive management team together considered the strategic change agenda and the strategic context for and overall approach to PR14. During the financial year, six ad hoc meetings of the board were convened to consider such matters as Severn Trent Plc's preliminary and interim results and interim management statements.

Institutional shareholders and analysts

The board recognises the importance of representing and promoting the interests of its shareholders and that it is accountable to shareholders for the performance and activities of the company.

Presentations are made to shareholders and analysts following the release of the interim and year end results. The Chief Executive and Finance Director regularly meet shareholders during the year. The Chairman and, if appropriate, the senior independent non-executive director are available to meet shareholders if required. The board receives written feedback following meetings with institutional shareholders and monitors shareholder activity on a quarterly basis at its meetings.

Board attendance in 2011/12

Andrew Duff	7/7	Martin Lamb	7/7
Tony Ballance	7/7	Michael McKeon	7/7
Dr Bernard Bulkin	7/7	Baroness Noakes	7/7
Richard Davey	6/7	Andy Smith	7/7
Gordon Fryett	6/7	Tony Wray	7/7
Martin Kane	7/7		

Board committees

We have established committees of the board to deal with specific issues or approvals, as and when necessary.

The four permanent committees of the board assist in the execution of its responsibilities and the board delegated some of its responsibilities to those board committees. The committees assist the board by fulfilling their roles and responsibilities, focusing on their specific activities, reporting back to the board on decisions and actions taken, and making any necessary recommendations.

The terms of reference of the Audit, Remuneration and Nominations Committees comply with the provisions of the Governance Code and are available for inspection, together with the terms of reference of the Corporate Responsibility Committee, on the company's website (www.severntrent.com) or may be obtained on written request from the Company Secretary at the address given on the back cover.

The effectiveness of each of the committees has been reviewed during the year as part of the wider externally facilitated board review and the committees have also considered their terms of reference during the year.

Reports from the Chairmen of these committees are set out on pages 50 to 68 of this report.

Terms and conditions of appointment

We have made the terms and conditions of appointment of the directors available for inspection by any person at the company's registered office during normal business hours. They will also be available at the AGM. The letters of appointment of the directors can also be seen on our website (www.severntrent.com).

Remuneration

The Directors' remuneration report is set out on pages 55 to 68.

Interests

No director had a material interest at any time during the year in any contract of significance with the company or any of its subsidiary undertakings.

Conflicts of interests

The board has a full process in place to authorise situational conflicts in accordance with the provisions of the Companies Act 2006.

For any actual or potential conflicts, the following procedure has been adopted by the board to consider and, if it sees fit, to authorise situations where a director has an interest that conflicts, or may possibly conflict, with the interests of the company:

- the director will notify the Chairman and Company Secretary of the actual or potential conflict;
- the Nominations Committee will consider the notification and determine whether it needs to be proposed to a board meeting for authorisation; and
- the conflict will be considered by the board at a scheduled board meeting.

Full details of the conflict will be sent to directors in advance of the meeting. If there is a major conflict or it is decided that authorisation should not wait until the next scheduled meeting, the board would be asked to authorise the conflict by way of written resolution.

Retail shareholder engagement strategy

The board has an active shareholder engagement strategy, the main elements of which are set out below:

The annual report and accounts is the principal means of communicating with shareholders. The group adopted e-communications after they were approved by shareholders as an alternative means of receiving company information at the 2007 Annual General Meeting. As at 3 May 2012, 34,629 shareholders receive company communications via electronic method whilst 26,015 shareholders continue to receive communications by post.

The company's website (www.severntrent.com) contains an archive of annual reports together with other information relevant to investors. This includes comprehensive share price information, financial results, company news and financial calendars.

The company offers a Dividend Reinvestment Plan (DRIP). Details of the DRIP are available on our website and the website of Equiniti, our registrar.

Shareholder networking day

As part of our Shareholder Networking Programme, participants in October 2011 had a choice to visit either a waste water or clean water site. These were hosted by Simon Cocks, Waste Water Services Director and Martin Kane, who was Director of Customer Relations at the time. Twenty participants were taken to our Minworth Sewage Treatment Works (Birmingham) for a tour and presentation on renewable energy. Twenty participants were taken to Campion Hills Water Treatment Works (Royal Leamington Spa) for a tour then on to Severn Trent Water Finham for a demonstration of making a connection to a live water main and a display of materials used in the distribution network. This was followed by both groups visiting our operating centre in Coventry.

Positive feedback was given on the organisation and content with strong support for the company continuing the programme, both from shareholders and employees who enjoyed the positive interest shown in their work.

In addition to reviewing any conflicts notified and proposing them for authorisation by the board, the Nominations Committee monitors changes to previously notified conflicts and any conditions imposed. Half yearly reports are made to the board of all directors' conflicts and directors are reminded from time to time of their obligations.

An annual review of conflicts is carried out and this is incorporated into the year end process of verifying directors' interests. This review has confirmed that there were no conflicts of interest requiring authorisation by the board.

In addition, at every board meeting there is a standing agenda item at the beginning of the meeting to consider and discuss whether any potential conflicts exist.

Annual general meeting

The AGM of the company will be held at the International Convention Centre, Broad Street, Birmingham B1 2EA at 11am on Wednesday 18 July 2012.

Presentations are made on the group's activities, performance during the year and an operationally focused presentation prior to the formal business of the meeting. The Chairmen of the Audit, Corporate Responsibility, Remuneration and Nominations Committees, together with all other directors, will attend the AGM.

The AGM gives shareholders an opportunity to feedback to the company on performance, management and the way we work in a very direct fashion – through the way they vote – either in favour of the resolution, against the resolution or by withholding their vote so that it does not count either for or against. Shareholders may also meet informally with directors and senior management before and after the meeting and ask formal questions during the meeting.

The board encourages shareholders to attend the company's AGM and to exercise their right to vote. The notice of meeting and related papers are sent to shareholders at least 20 working days before the meeting. Separate resolutions are proposed on each substantially separate issue.

The company uses electronic voting at the AGM, allowing shareholders present at the meeting to register one vote per share held. Results of the poll on each resolution, including details of the votes for and against registered prior to and at the meeting, proxy votes and the number of abstentions will be displayed at the meeting.

The poll results from the AGM will be made available on our website after the meeting.

At the 2011 AGM, 54 shareholders registered to participate in the Severn Trent Shareholder Networking Programme which took place on Tuesday 11 October 2011. The aim of the programme is to offer retail shareholders the opportunity to learn more about the company, through a combination of site visits and talking to staff. Further details of the event are set out in the box on this page. Your board encourages those shareholders attending the 2012 AGM to register for this year's event.

Reappointment

In accordance with the Governance Code, and as was the case at the AGM last year, all the directors will retire at this year's AGM and submit themselves for reappointment by the shareholders.

Conclusions

Good governance is not simply an exercise in compliance. For Severn Trent it is a vital aspect of the foundation for the sustainable growth of the business. I firmly believe that we will continue to deliver value and achieve profitable and sustainable growth for our company through the successful mix of good governance, a clear strategy with a supporting business plan and a strong management team.

Andrew Duff
Chairman

Governance

Nominations Committee

Andrew Duff
Chairman of the Nominations Committee

The main purpose of the Committee is to assist the board by keeping the composition of the board under review and conducting a rigorous and transparent process when making or renewing appointments of directors to the board. It also advises the board on issues of directors' conflicts of interest and independence. The full terms of reference for the Committee can be found on the company's website (www.severntrent.com) and are also available from the Company Secretary.

This report provides details of the role of the Nominations Committee and the work it has undertaken during the year.

The Committee keeps under review the balance of skills on the board and the knowledge, experience, length of service and performance of the directors. It also reviews their external interests with a view to identifying any actual, perceived or potential conflicts of interests, including the time available to commit to their duties to the company. The Committee monitors the independence of each non-executive director and makes recommendations concerning such to the board. The results of these reviews are important when the board considers succession planning and the election and reappointment of directors. Members of the Committee take no part in any discussions concerning their own circumstances.

The members of the Committee in 2011/12 were the non-executive directors of the board and the Chief Executive, Tony Wray.

During the year the Committee reviewed the procedure for reporting and authorising, as appropriate, any actual or potential conflicts of interests, in accordance with the provisions of the Companies Act 2006.

During the year the Committee reviewed succession planning below board level. The Committee considered in detail the appointment of Martin Kane as the new Chief Executive Officer for Severn Trent Services, following the retirement of Len Graziano. The Committee has also considered the consequential appointment of Angela Hunter-Dobson as the new Customer Relations Director to succeed Martin. Angela will be a member of the Executive Committee and not a member of the board.

In accordance with the requirements of the Governance Code, all members of the board will seek re-election at the Annual General Meeting in July 2012. In March this year the Committee formally reviewed the performance, contribution and commitment of each of the directors retiring at this year's AGM and seeking reappointment and supported and recommended their reappointment to the board. The Committee has confirmed that each director continues to perform well on an individual and collective basis, making a valuable contribution to the board's deliberations and demonstrating commitment to the long term interests of the company.

Nominations Committee attendance in 2011/12

Dr Bernard Bulkin	4/4	Martin Lamb	4/4
Richard Davey	3/4	Baroness Noakes	4/4
Andrew Duff	4/4	Tony Wray	4/4
Gordon Fryett	4/4		

Each Committee meeting complied with the terms of reference in that a minimum of five members were in attendance, with the majority being independent, non-executive directors.

Succession planning

When considering new appointments to the board, the Committee oversees the preparation of a role specification that is provided to an independent recruitment organisation retained to conduct a global search. In addition to the specific skills, knowledge and experience deemed necessary, the specification contains criteria such as:

- a proven track record of creating shareholder value;
- unquestioned integrity and a diversity of psychological mindset;
- a commitment to the highest standards of governance;
- having the required time available to devote to the job;
- strategic mindset, an awareness of market leadership, outstanding monitoring skills;
- a preparedness to question, challenge and openly assess; and
- an independent point of view.

Diversity

Further to the publication of the Davies Report, 'Women on Boards', in February 2011, boards of FTSE 350s have been encouraged to promote greater female representation on corporate boards. Guidance from the Financial Reporting Council has also highlighted the importance of greater diversity of psychological profile around the board table.

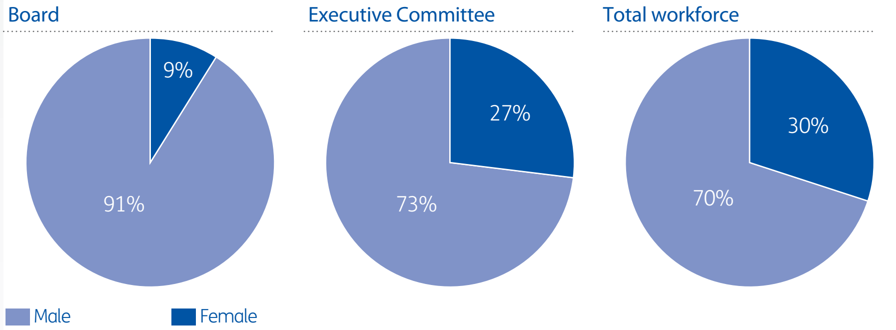
Severn Trent believes that a diverse and inclusive culture is a key factor in being a successful business. Severn Trent Plc shares the aspiration of the Davies Report to promote greater female representation on listed company boards.

As and when board appointment opportunities arise, recognising the relatively short tenure of current directors, we will make full use of the procedures recommended by the Davies Report and by the Governance Code to support this aspiration. All board appointments will be based on merit and must be in the interests of all stakeholders.

As at 31 March 2012 we had one female member on our board of 11 (representing 9%) and two female members out of 11 on the Executive Committee (representing 18%). As at the date of this report, and following the recent appointment of Angela Hunter-Dobson, there are three female members of the Executive Committee (representing 27%). The total workforce gender split is 30% female and 70% male.

As reported on page 17, we have conducted gender diversity research with women employees in Severn Trent Water to understand what is important to them in developing careers at Severn Trent. We plan to use the same methodology to explore ethnic diversity in the near future, so we can gain more insights into this aspect of our workforce composition and the findings will be examined by our Diversity Working Group.

Gender diversity



Andrew Duff
Chairman of the Nominations Committee

Governance

Audit Committee

Baroness Noakes DBE
Chairman of the Audit Committee

The 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 controls and monitoring the effectiveness and objectivity of the internal and external auditors. The role and the responsibilities of the Committee are set out in written terms of reference. These can be found on the company's website (www.severntrent.com) and are also available from the Company Secretary.

This report provides details of the role of the Audit Committee and the work it has undertaken during the year.

The members of the Committee are Baroness Noakes DBE (Chairman), Dr Bernard Bulkin and Richard Davey whose experience and background are set out on pages 42 and 43. The board is satisfied that Baroness Noakes and Richard Davey have recent and relevant financial experience and that all members of the Committee remain independent.

The members of the Committee receive updates in financial reporting and the group's regulatory framework in various forms throughout the year. The Chairman, the Chief Executive, the Finance Director, the Director of Internal Audit, the Group Financial Controller and the external auditors normally attend, by invitation, all meetings of the Committee. Other members of senior management are also invited to attend as appropriate. In performing its duties, the Committee has access to the services of the Director of Internal Audit, the Company Secretary and external professional advisers.

The Committee reports to the subsequent meeting of the board on the Committee's work.

The Committee met four times in 2011/12 and our work focused on four key areas:

- financial statements and accounting policies;
- internal controls;
- oversight of internal and external audit; and
- the regulatory reporting obligations of our subsidiary Severn Trent Water Limited.

Financial statements and accounting policies

Reviewing the financial statements and accounting policies requires an examination of material judgements made in preparing the financial statements. We set out below some of the key issues we discussed in respect of 2011/12:

- a provision of £21.5 million in exceptional charges, for the potential non recovery of our economic interest in an Operating Services business in Italy;
- the value of goodwill including impairments of £22.9 million to the goodwill in respect of three Severn Trent Services businesses; and
- the group's accounting policy for exceptional items and the criteria to determine when items would be classified as exceptional.

In reviewing the financial statements, we receive input from the Disclosure Committee and Deloitte LLP (Deloitte). The former is chaired by the Finance Director and considers the content, accuracy and tone of the financial statements, the Ofwat Annual Return and other public disclosures prior to their release.

Deloitte reported to the Committee on their review of the half year interim results and on their audit of the year end financial statements.

Internal controls

We receive regular reports from Internal Audit in respect of their work on internal controls and we review management letters received from the external auditors.

We reviewed the processes for and outputs from our enterprise risk management process, through which the principal risks and related controls are identified. In addition, we monitored the ongoing development of our compliance and assurance processes in respect of the key risks.

The Committee in particular reviewed the systems and processes designed to prevent fraud and bribery. The Committee also receives a regular log of incidents of fraud or bribery which includes the actions taken to investigate and respond to the incidents. There were no material incidents during the year.

Further details of our Internal Control Framework, including the main features of our internal control and risk management systems in relation to the financial reporting process, can be found in the Directors' report on page 71.

Policy on the provision of non-audit services

The company has approved a formal policy on the provision of non-audit services aimed at safeguarding and supporting the independence and objectivity of the external auditors.

The policy sets out the approach to be taken by the group when using the services of the external auditors, including requiring that certain services provided by the external auditors are pre-approved by the Audit Committee or its Chairman.

It distinguishes between those services where an independent view is required and that should be performed by the external auditors (such as statutory and non-statutory audit and assurance work), prohibited services where the independence of the external auditors could be threatened and they must not be used, and other non-audit services where the external auditors may be used.

Non-audit services where the external auditors may be used include: non-recurring internal controls and risk management reviews (excluding outsourcing of internal audit work), advice on financial reporting and regulatory matters, due diligence on acquisitions and disposals, project assurance and advice, tax compliance services, and employee tax services.

The approval of the Audit Committee or its Chairman is always required if a non-audit service provided by the auditors is expected to cost more than £100,000 or if non-audit fees for the year would thereby exceed the amount of the audit fee.

Oversight of Internal Audit and external audit

We are responsible for overseeing the work of the Internal Audit function and also for managing the relationship with the group's external auditors. We review the performance of the internal and external auditors annually to ensure that they are effective and recommend to the board whether the external auditors should be reappointed.

The Committee regularly holds discussions with both the internal and external auditors in the absence of management.

Internal Audit

The Director of Internal Audit and his Internal Audit team report on a day to day basis to management on the effectiveness of the group's systems of internal controls and the adequacy of these systems to manage business risk and to safeguard the group's assets and resources. This work is summarised and reported to the Committee on a regular basis and is a key element of the assurance that the Committee receives on the risks and controls in the group.

The plans, the level of resources and the budget of the Internal Audit function are reviewed at least annually by the Committee. The Director of Internal Audit is free to raise any issues with the Committee or its Chairman at any time during the year.

External auditors

Deloitte was appointed auditors of the company in 2005. The Committee reviews the auditors' effectiveness each year prior to recommending to the board that they be proposed for reappointment at the AGM. Deloitte audit all significant subsidiaries of the group.

Annually, the Committee reviews information provided by the external auditors confirming their independence and objectivity within the context of applicable regulatory requirements and professional standards. The company does not have a policy of tendering the external audit at specific intervals but would initiate a tender process if there were any concerns about the quality of the audit or the independence and objectivity of the auditors. There are no contractual obligations that act to restrict the Committee's choice of external auditors.

Details of the amounts paid to Deloitte for audit and non-audit services are provided in note 7 to the accounts page 91.

Severn Trent Water Limited

The regulated activities carried out by Severn Trent Water Limited result in two other reporting requirements to Ofwat and these are also covered by the Committee: an annual return on Severn Trent Water Limited's regulatory obligations, known as the Ofwat Annual Return; and a statement that underpins the customer charges made by Severn Trent Water Limited, known as the Principal Statement.

In March 2012 the Committee discussed the assurance framework in place for the new Ofwat Annual Return process.

Deloitte makes reports to Ofwat in respect of Severn Trent Water's regulatory accounts. The Ofwat Annual Return covers many aspects which are not financial and Severn Trent Water Limited appoints engineering consultants, Atkins, to report on those aspects. The Committee receives reports from Deloitte and Atkins on their work as part of its review of the returns.

Audit Committee attendance in 2011/12

Baroness Noakes	4/4	Richard Davey	3/4
Dr Bernard Bulkin	4/4		

The performance of the Committee was included in the external review of the board referred to on page 47. No matters requiring action by the Committee arose from that review.

Governance

Corporate Responsibility Committee

Dr Bernard Bulkin
Chairman of the Corporate Responsibility Committee

The Committee provides guidance and direction to the group's Corporate Responsibility (CR) programme, reviews the group's key non-financial risks and opportunities and monitors progress.

The terms of reference for the Committee can be found on the company's website (www.severntrent.com) and are also available from the Company Secretary.

The Committee reviews annually the group's formal whistleblowing policy that deals with allegations from employees relating to breaches of the Code of Conduct and reviews at each of its meetings the whistleblowing incident log.

The purpose of the Corporate Responsibility (CR) Committee is to provide board oversight of the management of all non-financial risks to the group. The structure for our CR policy and framework has been based around the four areas of Workplace, Marketplace, Environment and Community. This provides a common framework for both our businesses – regulated and non-regulated. We will continue to review the framework as we integrate corporate responsibility into our core business operations for both Severn Trent Water and Severn Trent Services.

Within our CR framework, we have identified focus areas that are critical to our management of risk and reputation. These areas have been determined through stakeholder dialogue, risk assessment and benchmarking within the water industry and the FTSE 100.

The focus areas have provided the basis for the forward agenda of the Committee, and will continue to be aligned to the nine principles set out in our Code of Conduct.

1. Keeping everyone healthy and safe
2. Supporting employees' rights and diversity
3. Maintaining ethical and honest behaviour
4. Staying free from bribery and corruption
5. Keeping our communications open and responsible
6. Delivering excellent customer service
7. Working within the community
8. Protecting our environment
9. Standing up for what's right

The focus areas also determine our approach to working in collaboration with other organisations who share mutual interests and objectives. Further information is available on our corporate website (www.severntrent.com).

Within Severn Trent Water we have an effective performance management system in place through 20 core business Key Performance Indicators (KPIs) and eight Key Strategic Intentions (KSIs). These are overseen by the Executive Committee and the board. Many of the business KPIs relate directly to our CR focus areas and therefore contribute significantly to our CR performance.

We report internally on our performance through both our Executive Committee and the Committee. Externally, we report through a number of channels including our annual regulatory submission to Ofwat, our websites and our Annual Report and Accounts.

During the year the Committee has received papers on key business programmes and strategies linked to the terms of reference of the Committee. These included catchment management, climate change adaptation, diversity and employee motivation. The Committee also received reports from Internal Audit with respect to their work on non-financial risk aligned with the CR framework and regular updates on health, safety and environmental performance. In addition, the Committee responds to emerging issues and fluoridation was tabled as a result of questions posed at the 2011 AGM.

The members of the Committee are Dr Bernard Bulkin (Chairman), Andrew Duff, Gordon Fryett and Tony Wray.

Corporate Responsibility Committee attendance in 2011/12

Dr Bernard Bulkin	5/5	Gordon Fryett	5/5
Andrew Duff	5/5	Tony Wray	4/5

Governance

Remuneration Committee

Richard Davey
Chairman of the Remuneration Committee

The Remuneration Committee determines, on behalf of the board, the company's policy on the remuneration of executive directors, other members of the Severn Trent Executive Committee (STEC) and the Chairman of the board. The Committee determines the total remuneration packages and contractual terms and conditions for these individuals. The policy framework for remunerating all senior executive managers is consistent with the approach taken for executive directors.

The members of the Remuneration Committee during the year were Dr Bernard Bulkin, Richard Davey (Committee Chairman) and Martin Lamb all of whom are independent non-executive directors. Andrew Duff, the company Chairman, who was independent on his appointment to the board, is also a member. Accordingly, the composition of the Committee is in accordance with the Governance Code.

Dear Shareholder

This report sets out the remuneration policy for the directors of Severn Trent Plc and discloses the amounts paid to them in the year ended 31 March 2012.

The report is subject to a shareholder vote and a resolution to approve the Directors' remuneration report will be proposed at the AGM. The report has been prepared in accordance with the requirements of the Companies Act 2006, the principles of the Governance Code and best practice guidelines.

Key developments for 2012/13

Following a thorough review of the variable arrangements for the executive directors and other members of the Severn Trent Executive Committee (STEC) in 2010/11, the Remuneration Committee has continued to monitor the policy to take account of evolving best and market practice, whilst also seeking to ensure that a stable framework is maintained and avoiding making unnecessary and frequent changes to the structure of pay. Accordingly, for 2012/13, there is limited change to the remuneration policy. However, the following points are of note:

- the annual bonus plan will continue to be based on a portfolio of KPIs linked to our Balanced Scorecard and Ofwat's measures of success. The number of KPIs will be reduced from 20 to 10 to align with Ofwat's revised suite of published KPIs;
- the existing clawback provisions within the bonus plan, Long Term Incentive Plan (LTIP) and Share Matching Plan have been amended to include the right to claw back in the event of misconduct or misstatement of results due to an error in calculation in line with the Governance Code. This reflects best practice since the original provisions were adopted; and
- the policy on pensions for new executive directors who are appointed to the board will be an entitlement to 25% of salary.

The Committee will continue to take a pro-active approach to responding to developments in legislation, best practice and the wider market, as well as the corporate strategy, in order to ensure that our senior executive reward policy remains fit for purpose.

Richard Davey
Chairman of the Remuneration Committee

Remuneration Committee activity

During the year ended 31 March 2012, the Committee met five times to discuss key remuneration issues arising, the review and operation of the company's remuneration policy and market updates by its advisers.

Remuneration Committee attendance in 2011/12

Richard Davey	5/5
Andrew Duff	5/5
Dr Bernard Bulkin	5/5
Martin Lamb	5/5

With the exception of the company Chairman, the Committee members have no personal financial interest, other than as shareholders, in the matters to be decided. As company Chairman, Andrew Duff's fees are set by the Committee but he is not party to this discussion.

Advisers

To ensure that the company's remuneration practices are market competitive, the Committee has access to detailed external research on market data and trends from experienced specialist consultants.

New Bridge Street (a trading name of Aon Corporation) is the independent adviser to the Committee. Neither New Bridge Street nor any other part of the Aon Corporation provided other services to the company during the year. During 2011/12, the Committee carried out a formal review of its advisers, and reappointed New Bridge Street.

The Chief Executive (Tony Wray) and the Director of Human Resources (Evelyn Dickey) also attended the Committee meetings to provide advice and respond to specific questions. Such attendances specifically excluded any matter concerning their own remuneration. The Company Secretary, Bronagh Kennedy, acts as secretary to the Committee.

How we reflect our core strategic priorities in executive remuneration

The remuneration policy for senior executives is set with close regard to the company's four key focus areas and risk management.

Key focus	Remuneration policy
Customer – delivering quality services at prices customers can afford	Annual bonus and LTIP potential just below the median when compared to the FTSE 51–150, supported by competitive base salary at or below market median. RoRCV targets within the LTIP and financial based KPIs within the annual bonus are set with close regard to Ofwat's determination, ensuring that we closely manage our performance within the regulatory limits. Customer focused KPIs form a substantial part of the annual bonus scorecard.
Employee – investing in the right people with the right skills	The Committee aims to ensure that the executive salary movement is aligned to the rest of the workforce. The corporate scorecard approach is used for the annual bonus throughout the company. HMRC approved share plans (all-employee SIP and SAYE) are operated annually for UK based executives and employees.
Environment – reducing pollution and our carbon footprint	KPIs within the annual bonus for all employees include environmental factors.
Financial – making our business attractive to investors	A variety of financial KPIs are used within the annual bonus plan to help ensure our financial performance is optimised. Out-turn under the LTIP is wholly determined by the achievement of RoRCV against the Ofwat Final Determination. No LTIP payout will be made if performance is below the RoRCV target set by Ofwat. Relative TSR is used to measure performance in the Share Matching Plan to reward executives for Severn Trent outperforming the stock market.

Remuneration policy

Each year, the Committee reviews the remuneration policy for executive directors and other senior executive managers, taking into account both the external market and the company's strategic objectives over the short and the medium term. Furthermore, there is a clear link between all-employee remuneration policies and those operated at senior executive level.

The Committee addresses the need to balance risk and reward. The Committee continues to monitor the variable pay arrangements for the executive directors and other members of the Executive Committee to take account of the risk profile of the company ensuring sustainability and how this is reflected in variable remuneration. The Committee believes that the 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 put at the risk of short term value. The schemes incorporate a range of internal and external performance metrics, measuring both operational and financial performance providing a rounded assessment of overall company performance.

Workforce remuneration policy and its linkage to senior executive policy

The Committee addresses the need to ensure that changes in senior executive remuneration is kept in line with workforce pay. Whilst it has not set a specific policy on the relationship between executive directors' pay and that of the rest of the workforce, it aims to ensure that executive salary movement is appropriately aligned to the rest of the workforce and specifically considers this aspect as part of its decision making process.

All-employee share plans (UK)

The company also actively encourages all-employee share ownership, and aims to ensure that employees are given the opportunity to share in the success of the company. For example, two all-employee share plans are operated as follows:

- an all-employee Share Incentive Plan. Awards are currently made which include a performance condition based on achievement of the KPIs. Employees of Severn Trent Plc and Severn Trent Water Limited participate in the plan. In respect of 2011/12 performance, in the forthcoming year awards of shares to the value of £309 will be made to all eligible employees; and
- an all-employee HMRC approved SAYE plan on an annual basis.

The Committee periodically reviews the use of other all-employee incentive vehicles.

In addition, the employee bonus plans include a significant element of performance consistent with the KPIs measured within the executive directors' annual bonus plan.

Remuneration arrangements for executive directors

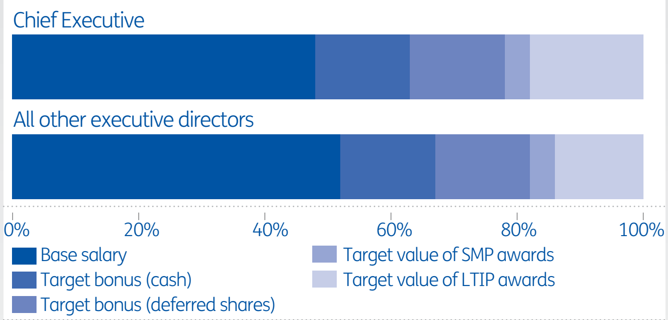
The remuneration arrangements for the executive directors comprise the following elements:

- base salary and benefits;
- annual bonus scheme;
- LTIP and Share Matching Plan (SMP); and
- pension.

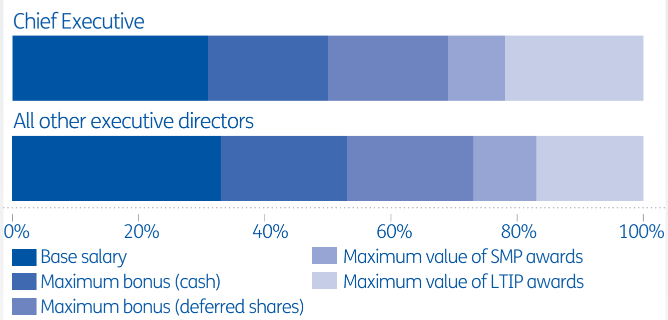
Details of each of the above elements follow but the table below summarises the packages of each of the executive directors:

Component	Tony Wray Chief Executive	Michael McKeon Finance Director	Tony Ballance Director, Strategy and Regulation	Martin Kane Chief Executive Officer – Severn Trent Services	Andy Smith Director of Water Services
Base salary from 1 July 2012	£561,000	£455,400	£206,100	£250,600	£267,900
On target bonus (% of salary)	60%	60%	60%	60%	60%
Maximum bonus (% of salary)	120%	120%	120%	120%	120%
% of bonus earned deferred into shares	50%	50%	50%	50%	50%
LTIP award (% salary)	70%	50%	50%	50%	50%
SMP award – maximum ratio of matching shares to deferred shares	0.5 : 1	0.5 : 1	0.5 : 1	0.5 : 1	0.5 : 1
Pension arrangement	Final salary occupational scheme to 31.12.2011 and cash allowance effective from 01.01.2012	Cash allowance	Defined contribution scheme	Cash supplement	Final salary occupational scheme
Benefits	A car allowance, private medical insurance, life assurance and an incapacity benefits scheme				

Target value



Maximum value



Pay arrangements for Martin Kane

Martin Kane was promoted to the role of Chief Executive Officer (CEO) – Severn Trent Services with effect from 1 January 2012. From that date, his salary was increased to £250,600 and a disturbance allowance of £29,400 has been put in place in recognition of the international nature of this role and Martin's continued board duties. His bonus, LTIP and Share Matching Plan award levels remain unchanged.

In order to carry out his new role, Martin was required to relocate to the US. Consequently, his benefits figure for 2011/2012 included an amount of £28,628 relating to his relocation and associated costs. Of this total, £12,470 was 'one off' in nature, being in respect of household goods. The balance of £16,158 relates to ongoing costs including property lease rental, US medical insurance and US lease car. This relates to an annualised amount of £54,091. The associated tax liability in relation to these relocation costs will be borne by Severn Trent when they fall due. For 2011/2012 this is estimated to be £21,458. Martin also receives an allowance of £2,909 to cover US Utilities cost associated with his relocation. In setting his relocation package specialist external advice was sought from ECA who specialise in expatriate remuneration.

Base salaries and benefits

Base salaries for individual directors are reviewed annually by the Committee and 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 the market median for similar roles in publicly quoted companies of a comparable size and practice in other water companies) and internal relativities.

The Committee gives due consideration to the current economic climate and current market practice regarding executive salary reviews and the broader employee salary review policy at the company.

The Committee has reviewed salaries for 2012/13 and has determined that salaries for all executive directors except Martin Kane (who will receive no further increase until July 2013), will be increased by 2% from 1 July 2012. This 2% increase is in line with the average increase across the rest of the company.

The core non-salary benefits for executive directors comprise:

- a car allowance;
- private medical insurance;
- life assurance; and
- an incapacity benefits scheme.

Private medical insurance and some other benefits may be flexed under the company's flexible benefits scheme.

Annual Bonus Scheme

Executive directors are eligible for annual bonuses to encourage improved performance, with targets established by the Committee to align executive directors' interests with shareholders. The annual bonus opportunity for all the executive directors is 120% of salary. For the achievement of target performance (which requires satisfaction of challenging goals), 60% of salary could be earned.

Half of any bonus paid is deferred into shares to be held for three years following payment. If the executive is summarily dismissed without notice under his/her employment contract then the deferred bonuses are forfeited. In all other cases of cessation of employment the deferred bonus is not lost and the shares are automatically released on the dealing day after the cessation of employment.

For several years, Severn Trent has operated a clawback provision which will continue for the forthcoming year. In light of the publication of the Governance Code, the Committee considered the structure of the company's clawback provision reviewing best and evolving practice. In the light of this it made some changes to the operation of the clawback to allow for the clawback to be triggered on gross misconduct, an error in the basis of calculation and misstatement of results. The clawback would usually be satisfied by reducing future annual bonus payments or the next release of share based awards. In the event that a cash clawback were necessary, it would normally be only to the net of tax amounts.

Annual bonus payments to executive directors are not pensionable.

Bonus out-turn for 2011/12

In 2012, the Chief Executive and Finance Director had 80% of their bonus out-turn based on the performance of Severn Trent Water, 10% based on Severn Trent Services performance and 10% based on personal contribution to reflect the risk profile of the group and their level of accountability. The remaining executive directors had 90% of their bonus out-turn attributed to Severn Trent Water performance and 10% based on personal performance.

Severn Trent Water performance

The bonus outturn in respect of Severn Trent Water performance was operated by reference to a balanced scorecard of measures, based on the 20 KPIs set at the start of the financial year. The bonus entitlement was determined by reference to the aggregate number of points awarded across all the KPIs. The targets taken together are considered by the board to have an impact on the longer term financial performance of the company and a number of them are reported to Ofwat.

The total score achieved against the KPIs was 63.72% of the maximum available. The Committee applied discretion by moving downwards two KPIs. 10.39% relates to Customer Metrics, 14.06% to Employee Metrics, 21.26% relates to Environment Metrics and 18.01% to Financial Metrics.

Severn Trent Services performance

The Chief Executive and Finance Director had 10% of their bonus linked to the performance of Severn Trent Services. Performance is measured against the profit before interest and tax (before exceptional items) return on invested capital of Severn Trent Services and specific personal objectives relating to governance and control.

Personal performance measures

In addition, each director has 10% of their bonus opportunity measured against a set of personal performance metrics. The personal performance scores for the executive directors ranged from 8.5% to 9.4% out of a maximum 10% available.

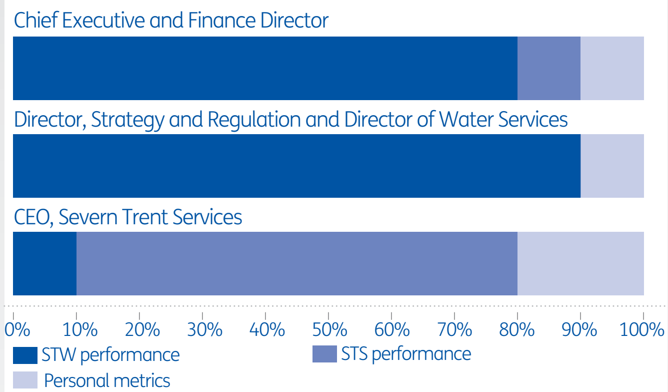
Bonus targets for 2012/13

The Committee has reviewed the operation of the plan and concluded that it should operate on a similar basis for 2012/13. However, under the Severn Trent Water element, a change is being made to reduce the number of KPIs from 20 to 10. This change reflects that Ofwat has published a revised suite of KPIs against which they have indicated that they will assess water companies, and it is therefore appropriate to measure the company's performance consistently with those externally published measures of success.

As a result of his promotion to CEO – Severn Trent Services, Martin Kane's bonus will now comprise 70% linked to the performance of Severn Trent Services, 10% linked to the performance of Severn Trent Water and 20% to personal performance. For the other executive directors, their bonus weightings will remain unchanged.

The following chart summarises how the annual bonus metrics are weighted for the executive directors for 2012/13:

Annual bonus metric weightings



Long term incentives

The executive directors are eligible to participate in two long term incentive schemes: a Long Term Incentive Plan; and a Share Matching Plan.

a) Long Term Incentive Plan

The Long Term Incentive Plan (LTIP) was approved by shareholders at the 2005 AGM. Under the LTIP, annual conditional awards of performance shares may be made to executive directors and senior staff, up to an annual maximum limit of shares worth 125% of base salary.

The policy level of LTIP awards is 70% of salary for the Chief Executive and 50% of salary for the other executive directors. Awards of this level were made in 2011.

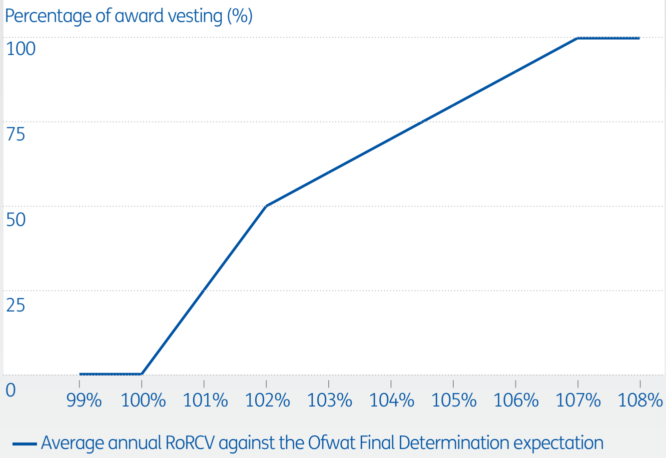
Participants are entitled to additional shares in lieu of dividends paid on vested shares over the performance period. Awards will normally vest as soon as the Committee determines that the performance conditions have been met provided that the participant remains in employment at the end of the performance period.

In 2011, the Committee changed the performance targets applying to LTIP awards to be based on return on regulatory capital value (RoRCV). The Committee believes that the use of RoRCV provides a strong alignment between the long term financial and operational performance of the group and the rewards delivered to management. It is felt by the Committee to be the most all encompassing indicator of performance.

This measure is entirely consistent with the method used by Ofwat in setting customer prices as part of the Final Determination (the process whereby Ofwat set the level of prices we can charge customers), and reflects the efficiency of earnings rather than simply being an absolute measure of profit and is verified and published as part of the Ofwat Annual Return process.

A sliding scale of targets is used, linked to outperformance of the Ofwat Final Determination shown graphically below:

RoRCV vesting schedule for 2011 and 2012 LTIP awards



This vesting schedule is set so as to ensure that executives are appropriately rewarded for performance in excess of the Final Determination, with no payouts for performance below this. However, it is also important that executives are not over-incentivised to achieve excessive levels of RoRCV, which could in theory incentivise inappropriate behaviours such as operational performance which does not deliver customer value or inadequate investment in our capital base. The Committee believes the above scale encourages delivery of strong performance against the Final Determination, but without compromising the company's wider values.

For 2012 awards, performance will be measured over the three financial years ending 31 March 2013, 2014 and 2015. If the vesting result is 0% or greater than 50% than the Committee reserves the discretionary power to change this result. If it is greater than 50% it may reduce the vesting to a number not less than 50% as it considers appropriate; and if it is 0% it may increase it to any figure not greater than 50%. The use of this discretion is expected to be exceptional, but may be invoked by the Committee in order to take into account of any of the following factors (not an exhaustive list):

- Actual RPI compared to the Ofwat assumed RPI figure – even though the RoRCV is adjusted each year for RPI a significant swing in inflation during the year can result in substantial under or over performance on the RoRCV target. RPI in itself is not a factor that management can influence;
- Changes to the financing of the company as approved by the board during the performance period – for example a significant change to the level of gearing of the balance sheet would result in partially meeting this performance condition; and
- Policy changes that occur during the performance period – there is much discussion on the future shape of the water industry in the UK and if enacted we would wish to ensure that any changes have a neutral impact on existing awards.

b) Share Matching Plan

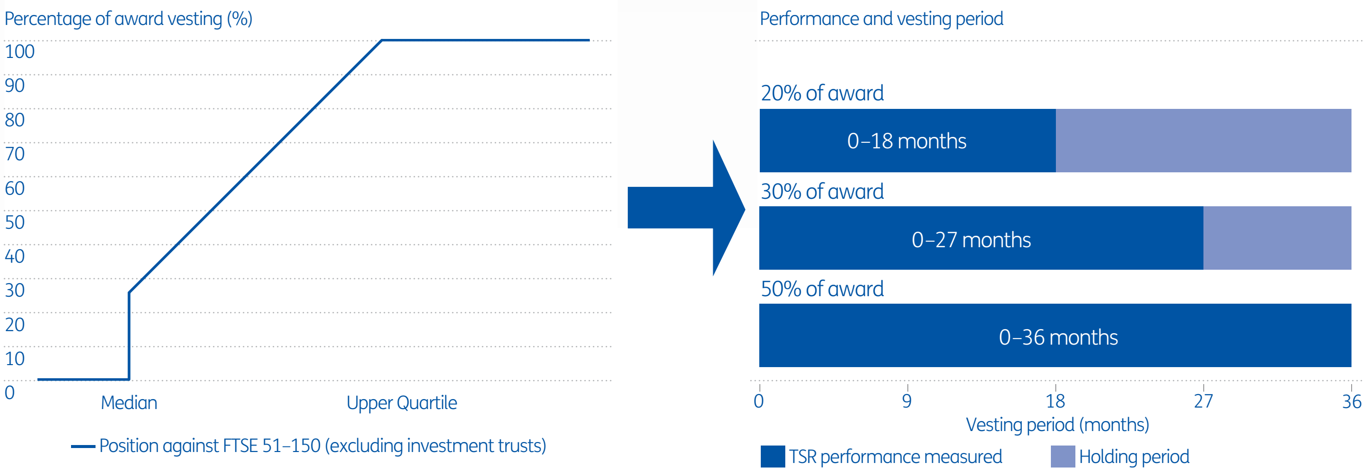
Under the Share Matching Plan ('SMP') executives can receive up to one matching share for each share deferred under the annual bonus plan. The current policy is that they receive 0.5 matching share for each deferred share. At the time of vesting participants will receive the dividends paid on vested shares over the vesting period. Awards will normally vest as soon as the Committee determines that the performance conditions have been met provided that the participant remains in employment at the end of the three year period.

Awards under the SMP are subject to a relative Total Shareholder Return (TSR) measure over three distinct performance periods. However, awards will not normally vest to participants until the third anniversary of grant. The performance condition requires the company's TSR to be measured relative to those companies ranked 51–150 in the FTSE Index by market capitalisation (excluding investment trusts). This is considered to be the most suitable comparator group since the number of comparable regulated utilities against which to compare the company's performance remains too small to enable meaningful analysis. The FTSE 51–150 comparator group allows for the company's performance to be measured against a broader market without any one sector overly impacting the group. In addition, for awards to vest, the Committee must be satisfied that the TSR is reflective of the company's underlying performance.

At the time of vesting participants will receive the dividends paid on vested shares over the performance period.

Shown graphically, the vesting schedule and performance and vesting periods applying to the 2011 and 2012 SMP awards is:

TSR vesting schedule and performance periods for 2011 and 2012 awards



Pensions

Severn Trent executives receive retirement benefits from a variety of legacy pension arrangements including defined benefit, defined contribution, payments made direct to personal plans and cash in lieu. However, whilst for legacy reasons the executive directors participate in a variety of different arrangements, the policy for employer contributions for new executive directors has been agreed at 25% of salary (with cash equivalent above the Annual Allowance or cash in lieu of the whole pension contribution if above the Lifetime Allowance).

As a result of the changes in pension legislation for high earners, Severn Trent has introduced the following options for any individuals who are affected by the tax changes:

For defined contribution members

- Continue in the scheme and individuals meet any tax liabilities as they fall due; or
- Continue in the scheme up to the Annual Allowance (£50,000 for 2011/12 tax year) and receive a cash alternative (equivalent to the level of employer contributions made to the scheme) above the Annual Allowance. If affected by the Lifetime Allowance, executives may receive cash in lieu of the pension contribution they would otherwise have received.

For defined benefit members

- Continue in the scheme and individuals meet any tax liabilities as they fall due; or
- Opt out of future defined benefit accrual and join the defined contribution section with the same options as above.

Tony Wray has elected to opt out of the defined benefit scheme since he is affected by the Lifetime Allowance. Therefore, he will now receive a salary supplement of 40% of base salary in lieu of future pension provision.

Of the current executive directors, Andy Smith participates in the Severn Trent Pension Scheme, and he has elected to remain in this scheme until its closure in 2015. The scheme is a funded HMRC registered final salary occupational pension scheme which provides:

- a normal retirement age of 60 years;
- an overall pension at normal retirement age of two thirds of final pensionable salary, which for executive directors is defined as base salary only, subject to the completion of 20 years' pensionable service;
- life cover of 4 x pensionable earnings;
- a pension payable in the event of retirement on grounds of ill health; and
- a dependant's pension on death of two thirds of the member's pension.

Andy Smith participates up to the level of the scheme specific earnings cap which in 2011/12 was £129,600. He is provided with a cash supplement in lieu of pension entitlement above this scheme cap at 40% of his salary.

Members' contributions are payable at the rate of 6% of pensionable earnings. Early retirement is available after the age of 55 with the consent of the company. Any pension would be subject to a reduction that the trustees consider appropriate, acting on actuarial advice, to reflect the expected longer payment of the pension. In the event of incapacity, early retirement is available on an unreduced basis allowing for pensionable service to age 60.

Under the Trust Deed and Rules, pensions in payment in excess of any Guaranteed Minimum Pension are guaranteed to increase in line with price inflation subject to a maximum of 5% each year. In the calculation of individual cash equivalent transfer values, allowance is made for such increases.

Individual executives are able to choose whether the allowance is paid to the company's registered defined contribution scheme, taken as cash or paid to a personal pension arrangement. This reflects the wish of the Committee to remove future exposure to defined benefit schemes for senior executives. These arrangements apply to Michael McKeon at 40% of base salary.

Martin Kane is a member of the Severn Trent Pension Scheme (WPS Section) but opted out of the scheme in June 2007. He receives a cash supplement of 30% of his basic salary in lieu of accrual for future service from that date. While he no longer accrues additional years of service for pension purposes, consistent with the legislation, Martin Kane's accrued benefits generally continue to be linked to his final salary (or £161,000 plus RPI from 30 June 2007 to the date of his retirement, if higher) and scheme benefits are preserved in relation to ill health, retirement and death in service. The normal retirement age for the scheme is 65 although early retirement is possible prior to age 65 with the consent of the company, but any benefits relating to service accruing after 1 December 2006 would be subject to an actuarial reduction.

Tony Ballance is a member of the Severn Trent Pension Scheme (Pension Choices section) which is the company's defined contribution scheme. He currently contributes 3% of salary and the company contributes at 30%, plus a further 2.5% in respect of death in service and ill health benefits. The normal retirement age for the scheme is 65 although retirement prior to 65 is possible with the consent of the company.

Personal shareholdings

The company operates shareholding guidelines under which executive directors are expected to build and maintain a minimum holding of shares in the company. The Chief Executive is expected to build and maintain a holding of shares to the value of 1.5 x base salary and other executive directors 1 x base salary. Executive directors are expected to retain all of the net of tax number of shares they receive through the LTIP, SMP and other share-based plans until the shareholding guidelines have been met. Good progress is being made to meet the guideline holdings. Details of the current shareholdings of the executive directors are set out on page 65.

Directors' service agreements and letters of appointment

The Committee continues to ensure that service contracts for new executive directors reflect best practice. Taking this into account, it is the Committee's policy that for future executive director appointments, the termination provisions within the service contracts will state that any termination payment should be based upon an estimate of salary and fixed benefits only.

The existing executive directors all have contracts under a model which was approved by the Committee in 2004 and updated during 2007/08. The main terms of the contracts for existing executive directors are summarised in the table below.

The Committee believes that the contracts provide as much scope as is feasible to protect the interests of shareholders when negotiating a termination, at which time it would address the duty of mitigation.

All are subject to reappointment as directors at the forthcoming AGM.

External directorships

Executive directors are permitted to take on external non-executive directorships, though normally only one other FTSE 100 appointment. In order to avoid any conflicts of interest, all such appointments are subject to the approval of the Nominations Committee. Executive directors are normally only permitted to retain the fees arising from one such appointment. External non-executive appointments help to bring a further external perspective to the group and help in the development of key individuals experience.

Michael McKeon was appointed as a non-executive director of The Merchants Trust Plc on 1 May 2008 and in respect of the appointment for the year ended 31 March 2012 he was paid fees of £23,205. He has retained these fees in accordance with the above policy.

Tony Wray was appointed as a non-executive director of Grainger plc on 24 October 2011 and in respect of the appointment for the year ended 31 March 2012 has been paid fees of £17,590.

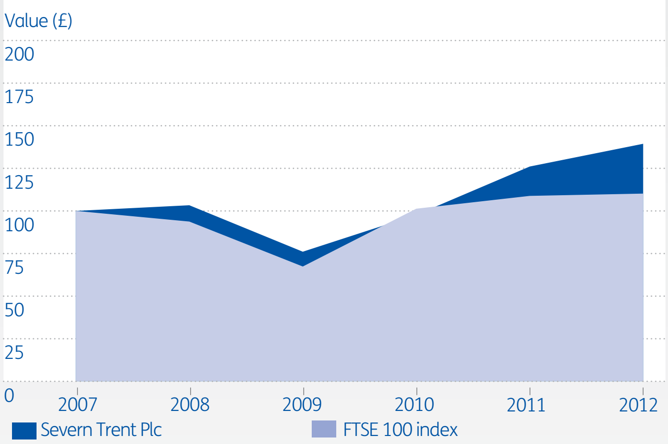
No other executive directors currently hold any external fee earning non-executive directorships.

Provision	Policy		
Notice period	12 months from either party.		
Termination payment	Theoretical maximum payment in the case of redundancy or termination in breach of the agreement by the company of 175% of base salary. In determining actual payouts, the Committee has a duty to take into account the following: • A reduction of up to 10% can be made at the Committee's sole discretion (i.e. lowering the payout to 157.5% of salary); and • There is an explicit clause in the contract stating that the company shall not be required to reward poor performance. Any payment will not include amounts in respect of awards which have been made under any share plan which are governed by the rules of individual plans.		
Mitigation	Any termination payment will not be made automatically but will be subject to both phasing and mitigation (including offset against any earnings from new employment) unless, in the circumstances, the Committee considers it appropriate to achieve a clean break through payment of a lump sum, in which case it will require some discount for early payment.		
Change of control	There are no specific contractual payments or benefits which would be triggered in the event of a change in control of the company.		
Contract dates	Executive directors	Date of current agreement	Date of appointment to Severn Trent
	Tony Wray	20 May 2008	7 March 2005
	Michael McKeon	6 December 2005	13 December 2005
	Tony Ballance	2 June 2008	23 July 2005
	Martin Kane	1 January 2012	30 September 1975
	Andy Smith	2 June 2008	1 January 2005

Performance graph

This graph shows the value, by 31 March 2012, of £100 invested in Severn Trent Plc on 31 March 2007 compared with the value of £100 invested in the FTSE 100 Index. The FTSE 100 was chosen as the comparator because the company is a constituent of that index. The intermediate points show the value at intervening financial year ends.

Total shareholder return



Source: Datastream

Chairman and other non-executive directors

The remuneration policy for non-executive directors, other than the Chairman, is determined by the board, within the limits set out in the articles of association.

The level and structure of the non-executive directors' fees was reviewed by the board in 2012 and some changes made which were effective from April 2012. Rather than paying a separate fee for membership of board committees, a single fee including such memberships will be paid. Additional fees will continue to be paid for the senior independent director and chairmanship of the board committees.

The breakdown of the non-executive directors' fees from 1 April 2012 is shown in the table below:

	Fees
Base fee paid to all non-executive directors	£50,000
Supplementary fees:	
– Senior independent director	£10,000
– Audit Committee Chairman	£15,000
– Remuneration Committee Chairman	£15,000
– Corporate Responsibility Committee Chairman	£13,000

The Chairman receives a fee of £250,000 per annum. This was reviewed in 2012 and no change was made to his fee. He does not receive any additional fees for Committee memberships. He does not participate in any of the company's pension arrangements, share or bonus schemes.

The board does not require directors to take a proportion of their fees in shares and, instead, leaves decisions regarding the holding of shares to individual non-executive directors.

Non-executive directors do not participate in share or bonus schemes, nor is any pension provision made.

Non-executive directors normally serve three terms of three years. They do not have service contracts but their terms of engagement are regulated by letters of appointment, details of which are shown below:

Chairman and non-executive directors	Initial appointment	Current appointment	Current expiry date*
Bernard Bulkin	1 January 2006	1 January 2012	31 December 2014
Richard Davey	1 January 2006	1 January 2012	31 December 2014
Andrew Duff (Chairman)	10 May 2010	10 May 2010	9 May 2013
Gordon Fryett	1 July 2009	1 July 2009	30 June 2012
Martin Lamb	29 February 2008	1 March 2011	28 February 2014
Baroness Noakes	29 February 2008	1 March 2011	28 February 2014

* Subject to the requirements of the company's articles of association for the reappointment of directors at AGMs.

All of the directors are subject to reappointment as directors at the 2012 AGM.

The text and tables that follow comprise the auditable part of the Directors' remuneration report, being the information required by the UKLA Listing Rules 9.8.6 and 9.8.8.

Directors' emoluments

	Basic salary and fees £000	BIKs[1] £000	Annual bonus – cash[2] £000	Annual bonus – deferred[2] £000	Other[3] £000	Total 2011/12 before DC pensions £000	DC pension contributions[4] £000	Total including DC pension contributions £000	Total 2010/11 including DC pensions £000
Chairman and other non-executive directors									
Dr Bernard Bulkin	59.4	–	–	–	–	59.4	–	59.4	59.4
Richard Davey	71.4	–	–	–	–	71.4	–	71.4	71.5
Andrew Duff (Chairman)	250.0	–	–	–	–	250.0	–	250.0	224.2
Gordon Fryett	46.4	–	–	–	–	46.4	–	46.4	46.4
Martin Lamb	46.4	–	–	–	–	46.4	–	46.4	46.4
Baroness Noakes	58.4	–	–	–	0.2	58.6	–	58.6	58.7
Executive directors									
Tony Ballance	195.1	2.8	55.6	55.6	15.0	324.1	71.2	395.3	379.3
Martin Kane	226.7	34.7	69.9	69.9	100.2	501.4	–	501.4	413.6
Michael McKeon	442.3	6.9	119.1	119.1	142.4	829.8	50.0	879.8	842.7
Andy Smith	251.5	3.2	72.2	72.2	67.4	466.5	–	466.5	456.7
Tony Wray	530.1	7.7	153.0	153.0	191.1	1,034.9	–	1,034.9	905.1
	2,177.7	55.3	469.8	469.8	516.3	3,688.9	121.2	3,810.1	3,504.0

1 In respect to Martin Kane's relocation cost, the associated tax will be borne by Severn Trent when it falls due estimated at £21,458 for 2011/2012. Please refer to page 58 which provides further details.

2 The directors receive 50% of their bonus in cash and 50% in shares, awarded under the Annual Bonus Scheme. The amounts shown in respect of share bonus are those awards made in respect of 2012 performance. Outstanding unreleased Annual Bonus Scheme awards are shown as non-beneficial interests in the table of directors' share interests and in the deferred bonus awards table.

3 Other emoluments include expenses chargeable to income tax, car allowances, travel allowances, telephone allowances and amounts paid in lieu of pension contributions. Included in other emoluments are:

- Baroness Noakes expenses £179.
- Tony Ballance car allowance £15,000 and expenses £5.
- Martin Kane pension supplement £67,950, car allowance £15,000 and expenses £17,300.
- Michael McKeon pension supplement £127,300, car allowance £15,000 and expenses £115.
- Andy Smith pension supplement £52,440, car allowance £15,000 and expenses £7.
- Tony Wray pension supplement £176,120 and car allowance £15,000.

4 Michael McKeon received £50,000 up to the annual allowance, the balance of his pension arrangement £127,300 was provided in a cash supplement under 'other'.

Directors' defined benefit pension provisions

Name	Service completed in years (including transferred in service credits)	Accrued pension at 31 March 2012 £pa	Increase in accrued pension during the year £pa	Increase in accrued pension during the year (net of inflation) £pa	Transfer value of accrued pension at 31 March 2012 £000	Transfer value of accrued pension at 31 March 2011 £000	Increase/(decrease) in transfer value over the year, net of directors' contributions £000
Andy Smith	7	31,317	5,581	4,629	493.3	434.2	51.3
Tony Wray	6	29,471	4,469	3,544	424.3	404.8	13.7
Martin Kane	35	134,773	7,944	3,251	2,166.1	2,000.6	165.5

Name	Accrued pension at 31 March 2012 £pa	Increase in accrued pension during the year £pa	Increase in accrued pension during the year (net of inflation) £pa	Transfer value of accrued benefits net of directors' contributions £000
Andy Smith	31,317	5,581	4,629	80.1
Tony Wray	29,471	4,469	3,544	58.5
Martin Kane	134,773	7,944	3,251	128.0

Notes:

Accrued pension figures and transfer value calculations provided by Towers Watson.

There have been no changes to the transfer value basis since last year's disclosures.

Tony Wray ceased to contribute to the Scheme from 31 December 2011 further details can be found on page 61.

Allowance has been made for changes in market conditions over the year by applying the relevant Market Value Adjustment.

Inflation figure used in respect of year is to February 2012 (3.7%) as the latest available figure prior to the year end.

Directors' share interests

The directors of the company at 31 March 2012 and their beneficial interests in the shares of the company were as follows:

i) Beneficial holdings and outstanding deferred shares

	At 1 April 2011 (or date of appointment if later) Number of ordinary shares of 97 17/19p each		At 31 March 2012 Number of ordinary shares of 97 17/19p each		At 22 May 2012 Number of ordinary shares of 97 17/19p each	
	Beneficial	Non-beneficial[1]	Beneficial	Non-beneficial[1]	Beneficial	Non-beneficial[1]
Chairman and other non-executive directors						
Dr Bernard Bulkin	554	–	554	–	554	–
Richard Davey	588	–	588	–	588	–
Andrew Duff (Chairman)	3,500	–	3,500	–	3,500	–
Martin Lamb	3,012	–	3,012	–	3,012	–
Baroness Noakes	4,018	–	4,018	–	4,018	–
Gordon Fryett	1,018	–	1,064	–	1,064	–
Executive directors						
Tony Ballance	3,149	11,626	4,218	13,544	4,218	13,544
Martin Kane[2]	9,699	13,373	11,162	15,678	11,384	15,678
Michael McKeon	4,231	31,043	8,168	32,574	8,168	32,574
Andy Smith	7,516	17,329	9,514	19,333	9,514	19,333
Tony Wray	10,158	32,000	13,429	35,453	13,429	35,453

Notes

1 Non-beneficial holdings are yet to be released shares conditionally held under the Annual Bonus Scheme, to which directors become unconditionally entitled on the third anniversary of grant. Details of the yet to be released Annual Bonus Scheme shares are provided on page 67.

2 Martin Kane acquired 222 shares on 1 May 2012, with a market price of 1,683p per share, following the exercise of his 2009 three year Sharesave scheme option.

ii) Long Term Incentive Plan

The executive directors have further interests in the company's ordinary shares of $97^{17}/_{19}$p each by virtue of having received contingent awards of shares under the LTIP. The LTIP operates on a three year rolling basis. The Severn Trent Employee Share Ownership Trust is operated in conjunction with the LTIP. Awards do not vest until they have been held in trust for three years and specific performance criteria have been satisfied.

Executive directors have a technical interest in 515,844 shares held by the Severn Trent Employee Share Ownership Trust. The details of the performance criteria are explained on page 59 of this report. The individual interests, for the above named directors, which represent the maximum aggregate number of shares to which each individual could become entitled, are as follows:

	Awards granted	Maximum award	Awards vested	Awards lapsed	Maximum outstanding awards as at 31 March 2012
Tony Ballance	14 July 2008	5,486	–	5,486	–
	7 July 2009	7,405	–	–	7,405
	21 June 2010	6,803	–	–	6,803
	22 June 2011	6,525	–	–	6,525
Martin Kane	14 July 2008	6,001	–	6,001	–
	7 July 2009	8,154	–	–	8,154
	21 June 2010	8,504	–	–	8,504
	22 June 2011	7,121	–	–	7,121
Michael McKeon	14 July 2008	13,717	–	13,717	–
	7 July 2009	18,733	–	–	18,733
	21 June 2010	17,211	–	–	17,211
	22 June 2011	14,411	–	–	14,411
Andy Smith	14 July 2008	8,230	–	8,230	–
	7 July 2009	11,019	–	–	11,019
	21 June 2010	10,124	–	–	10,124
	22 June 2011	8,477	–	–	8,477
Tony Wray	14 July 2008	19,684	–	19,684	–
	7 July 2009	27,769	–	–	27,769
	21 June 2010	25,512	–	–	25,512
	22 June 2011	23,271	–	–	23,271

The market price on the date of the 2011 award was 1,398p.

The LTIP awards made in 2009 and 2010 are subject to TSR performance, measured relative to those companies ranked 51–150 in the FTSE by market capitalisation (excluding investment trusts). 25% of awards vest at median performance, and 100% vest for performance in the upper quartile. In addition, for awards to vest, the Committee must be satisfied that the company's TSR is reflective of the company's underlying performance.

The TSR performance up to 31 March 2012 for the 2010 award indicates that this award is currently on track to vest at 100%. The 2009 award ended its TSR performance period on 31 March 2012 and will vest at 28.4%.

iii) Annual Bonus Scheme

The shares in respect to 2011/2012 performance year will be granted in June 2012. The table below shows outstanding unreleased share awards from previous years.

	Date of grant	Annual bonus deferred into shares	Number of shares	Deferred share award release date
Tony Ballance	7 July 2009	£62,294	5,669	6 July 2012
	21 May 2010	£51,448	4,139	20 May 2013
	20 May 2011	£51,823	3,736	19 May 2014
Martin Kane	7 July 2009	£68,598	6,243	6 July 2012
	21 May 2010	£64,310	5,173	20 May 2013
	20 May 2011	£59,119	4,262	19 May 2014
Michael McKeon	7 July 2009	£157,590	14,343	6 July 2012
	21 May 2010	£128,724	10,355	20 May 2013
	20 May 2011	£109,242	7,876	19 May 2014
Andy Smith	7 July 2009	£92,700	8,437	6 July 2012
	21 May 2010	£75,810	6,098	20 May 2013
	20 May 2011	£66,555	4,798	19 May 2014
Tony Wray	7 July 2009	£166,680	15,187	6 July 2012
	21 May 2010	£138,996	11,182	20 May 2013
	20 May 2011	£126,000	9,084	19 May 2014

iv) Share Matching Plan

The Share Matching Plan received shareholder approval at the 2009 AGM. Under the Share Matching Plan executives can receive, subject to performance, matching shares for each share deferred under the annual bonus plan. For awards made in 2010 (the first set of awards granted under the plan), the ratio was limited to 0.5 matching share for each deferred share. The performance condition for the 2010 SMP awards is the same as that applying to the LTIP awards granted in 2010 (see page 60). The details of the performance criteria applying to the 2011 awards are explained on page 59 of this report. The individual interest of the directors under the Share Matching Plan, are as follows:

	Date of grant	Maximum award	Awards vesting	Award lapsing	Maximum outstanding awards as at 31 March 2012
Tony Ballance	21 May 2010	2,069	–	–	2,069
	20 May 2011	1,868	–	–	1,868
Martin Kane	21 May 2010	2,586	–	–	2,586
	20 May 2011	2,131	–	–	2,131
Michael McKeon	21 May 2010	5,177	–	–	5,177
	20 May 2011	3,938	–	–	3,938
Andy Smith	21 May 2010	3,049	–	–	3,049
	20 May 2011	2,399	–	–	2,399
Tony Wray	21 May 2010	5,591	–	–	5,591
	20 May 2011	4,542	–	–	4,542

The TSR performance up to 31 March 2012 for the 2010 and 2011 SMP awards against the median and upper quartile of the comparator group indicate that these awards are currently on track to both vest at 100%.

v) Sharesave options over ordinary shares

	At the start of the year (No. of shares)	Exercised during the year (No. of shares)	Cancelled during the year (No. of shares)	Granted during the year (No. of shares)	At the end of the year (No. of shares)	Year of grant of option	Exercise price (p)	Date from which exercisable	Expiry date
Sharesave[1]									
Tony Ballance	556	–	–	–	556	2009	862	May 2012	Oct 2012
	561	–	–	–	561	2010	808	May 2013	Oct 2013
Martin Kane[2]	314	(314)	–	–	–	2008	1221	May 2011	Oct 2011
	222	–	–	–	222	2009	862	May 2012	Oct 2012
	449	–	–	–	449	2010	808	May 2013	Oct 2013
	–	–	–	316	316	2011	1137	May 2014	Oct 2014
Michael McKeon	1,943	–	–	–	1,943	2009	862	May 2014	Oct 2014
Andy Smith	1,123	–	–	–	1,123	2010	808	May 2013	Oct 2013
Tony Wray	1,123	–	–	–	1,123	2010	808	May 2013	Oct 2013

1 The executive directors, in common with all eligible UK employees of the group, are entitled to participate in the company's HMRC approved Sharesave Scheme.

2 Martin Kane acquired 314 shares on 5 May 2011, with a market price of 1,482p per share, following the exercise of his 2008 three year Sharesave scheme options, generating a £820 gain.

The terms and conditions applicable to these options are those provided in that scheme. The options have no performance conditions as such conditions are not permitted by legislation.

a) No executive share options in respect of executive directors were granted or lapsed during the year. At 31 March 2012 there were no other executives participating in the group's historical executive Share Option Scheme (31 March 2011: five other executives).

b) At the close of business on 31 March 2012 the mid-market price of the company's shares was 1,520p and the range during the year was 1,375p to 1,613p.

Signed on behalf of the board which approved the Directors' remuneration report on 29 May 2012.

Richard Davey
Chairman of the Remuneration Committee

Governance

Directors' report

The directors present their report, together with the audited financial statements of the group, for the year ended 31 March 2012.

Principal activity

The principal activity of the group is to provide and treat water and remove waste water in the UK and internationally.

Details of the principal joint ventures, associated and subsidiary undertakings of the group at 31 March 2012 appear in notes 19, 20 and 40 to the financial statements on pages 99 and 127.

Business review

The Chairman's statement, the Chief Executive's review, the report and performance reviews for the group's main businesses and the Financial review on pages 2 to 36 provide detailed information relating to the group, its business models and strategy, the operation of its businesses and the results and financial position for the year ended 31 March 2012.

Details of the principal risks and uncertainties facing the group are set out in the risk management section on pages 37 to 40.

All of the above are incorporated by reference in (and are deemed to form part of) this report.

Directors and their interests

Biographies of the directors currently serving on the board are set out on pages 42 and 43.

All of the directors will be offering themselves for reappointment at the Annual General Meeting (AGM), as set out in the Chairman's letter on pages 45 to 49.

Details of directors' service agreements are set out in the Directors' remuneration report on page 55. The interests of the directors in the shares of the company are shown on pages 65 to 68 of that report.

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. In accordance with the company's articles of association, and to the extent permitted by law, in November 2011 the company indemnified 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.

Severn Trent does not have in place any indemnities for the benefit of the auditors.

Employees

The average number of employees within the group is shown in note 9 to the financial statements on page 92.

Severn Trent believes that a diverse and inclusive culture is a key factor in being a successful business. Apart from ensuring an individual has the ability to do the job we do not discriminate in any way and make every effort to ensure that those with disabilities are able to be employed by us. We endeavour to retain employees in the workforce if they become disabled, we make all reasonable adjustments to their role and, if necessary, look for redeployment opportunities to support them in seeking an alternative role within Severn Trent. We ensure that training, career development and promotion opportunities are available for all our employees irrespective of their gender, race, age or disability.

The group actively encourages employee involvement and consultation and places emphasis on keeping its employees informed of its activity and financial performance by way of briefings and publication to staff of all relevant information and corporate announcements. To help develop employees' interest in the company's performance, Severn Trent offers two employee share plans. The Severn Trent Sharesave Scheme, an HM Revenue and Customs approved SAYE plan, is offered to UK employees on an annual basis. The Severn Trent Share Incentive Plan, approved by HM Revenue and Customs, makes an annual award of shares to Severn Trent Plc and Severn Trent Water Limited employees, based on performance against the KPIs.

Research and development

Expenditure on research and development is set out in note 7 to the accounts on page 91.

Treasury management

The disclosures required under the EU Fair Value Directive in relation to the use of financial instruments by the company are set out in note 32 to the accounts on pages 108 to 118. Further details on our treasury policy and management are set out in the Financial review on page 35.

Post balance sheet events

Details of post balance sheet events are set out in note 38 to the group financial statements on page 126.

Dividends

An interim dividend of 28.04 pence per ordinary share was paid on 13 January 2012. The directors recommend a final dividend of 42.06 pence per ordinary share to be paid on 27 July 2012 to shareholders on the register on 22 June 2012. This would bring the total dividend for 2011/12 to 70.10 pence per ordinary share (2011: 65.09 pence). The payment of the final dividend is subject to shareholder approval at the AGM.

In addition to the recommended final dividend, the directors recommend a special dividend of 63.0 pence per ordinary share to be paid on 27 July 2012 to shareholders on the register on 22 June 2012. The payment of the final dividend is subject to shareholder approval at the AGM.

Capital structure

Details of the company's issued share capital and of the movements during the year are shown in note 29 to the financial statements on page 107. The company has one class of ordinary shares which carries no right to fixed income. Each share carries the right to one vote at general meetings of the company. The issued nominal value of the ordinary shares is 100% of the total issued nominal value of all share capital.

There are no specific restrictions on the size of a holding nor on the transfer of shares, which are both governed by the general provisions of the articles of association and prevailing legislation. The directors are not aware of any agreements between holders of the company's shares that may result in restrictions on the transfer of securities or on voting rights.

Details of employee share schemes are set out in note 33 to the financial statements on pages 119 to 123. For shares held by the Severn Trent Employee Share Ownership Trust, the trustee abstains from voting.

No person has any special rights of control over the company's share capital and all issued shares are fully paid.

With regard to the appointment and replacement of directors, the company is governed by its articles of association, the Governance Code, the Companies Act 2006 and related legislation. The articles may be amended by special resolution of the shareholders. The powers of directors are described in the Board Governance document, the articles and the Chairman's letter on pages 45 to 49.

Under its articles of association, the directors have authority to allot ordinary shares, subject to the aggregate nominal amount limit set at the 2011 AGM.

There are a number of agreements that take effect after, or terminate upon, a change of control of the company, such as commercial contracts, bank loan agreements, property lease arrangements and employee share plans. None of these is considered to be significant in terms of their likely impact on the business of the group as a whole. There are no agreements between the company and its directors or employees that provide for compensation for loss of office or employment that occurs because of a takeover bid.

Substantial shareholdings

As at 31 March 2012 the company had been notified in accordance with chapter 5 of the Disclosure and Transparency Rules of the following major shareholdings:

Name of holder	No. of ordinary shares of $97^{17}/_{19}$p each	Percentage of voting rights and issued share capital
Blackrock Inc	26,001,134	10.94%
Newton Investment Management Ltd	12,087,473	5.09%
Legal & General Group Plc	9,403,273	3.97%

Percentages rounded to two decimal places.

As at 29 May 2012, the company had been notified of the following holdings of voting rights in the ordinary share capital of the company: Blackrock Inc 23,457,458 (9.87%); Newton Investment Management Ltd 12,087,473 (5.09%) and Legal & General Group Plc 9,403,273 (3.97%).

Authority to purchase shares

The company was given authority at its AGM in 2011 to make market purchases of ordinary shares up to a maximum number of 23,748,497 shares. Similar authority will again be sought from shareholders at this year's AGM. No market purchases were made by the company during the year ended 31 March 2012.

Supplier payment policy

Individual operating companies within the group are responsible for establishing appropriate policies with regard to the payment of their suppliers. 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. Details of supplier payment policies can be obtained from the individual companies at the addresses shown in note 40 to the financial statements on page 127. Trade creditors for the group at the year end are estimated as representing 21.2 days' purchases (2011: 24.4 days' purchases).

Contributions for political and charitable purposes

Donations to charitable organisations during the year amounted to £107,325 (2011: £181,843). 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 disclose any such payments in the annual report. 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 2011 AGM, shareholders gave the company authorities 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 £50,000 for the company and its subsidiaries. Pursuant to those authorities, during the year ended 31 March 2012 the group incurred costs of £nil (2011: £nil). Those authorities will expire at the 2012 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 of £50,000 per annum. 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.

Analysis of shareholdings at 31 March 2012

Category	Number of shareholders	% of shareholders	Number of shares	% of shares
Individual and joint accounts	64,900	91.91	25,499,121	11.07
Other*	5,709	8.09	212,108,990	88.93
Total	70,609	100.00	237,608,111	100.00

* Includes insurance companies, nominee companies, banks, pension funds, other corporate bodies, limited and public limited companies.

Size of holding	Number of shareholders	% of shareholders	Number of shares	% of shares
1–499	51,947	73.57	9, 985,255	4.20
500–999	12,158	17.22	8,525,535	3.59
1,000–4,999	5,487	7.77	9,439,778	3.97
5,000–9,999	315	0.45	2,131,111	0.90
10,000–49,999	322	0.46	7,705,422	3.24
50,000–99,999	116	0.16	8,268,252	3.48
100,000+	264	0.37	191,552,758	80.62
Total	70,609	100.00	237,608,111	100.00

Internal controls

The board is responsible for the group's system of internal control and for reviewing its effectiveness. The board reviews the effectiveness of the system of internal control, including financial, operational and compliance and risk management, at least annually in accordance with the requirements of the Governance Code. 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.

The Audit Committee reviews the group's risk management process and the effectiveness of the system of internal control on behalf of the board and keeps under review ways in which to enhance the control and audit arrangements. The Audit Committee receives reports every six months from the Chief Executive detailing the significant risks and uncertainties faced by the group, an assessment of the effectiveness of controls over each of those risks and an action plan to improve controls where this has been assessed as necessary. During the course of its review of the system of internal control in 2011/12, the Audit Committee has not identified nor been advised of any failings or weaknesses which it has determined to be significant. Therefore a confirmation in respect of necessary actions has not been considered appropriate.

The Internal Audit department provides objective assurance and advice on risk management and control. The external auditors also report on significant financial control issues to the Audit Committee.

An independent reporter (Atkins) provides objective assurance in relation to the Severn Trent Water Limited Ofwat Annual Return.

The board confirms that procedures providing an ongoing process for identifying, evaluating and managing the principal risks and uncertainties faced by the group have been in place for the year to 31 March 2012 and up to the date of approval of the annual report, which is in accordance with the revised guidance on internal control published in October 2005 (the Turnbull Guidance).

The group's procedures for exercising control and managing risk in relation to financial reporting and preparation of consolidated accounts include:

- the formulation and communication of group accounting policies which are regularly updated for developments in IFRS and other reporting requirements;
- specification of a set of financial controls that all of the group's operating businesses are required to implement as a minimum;
- deployment of a group wide consolidation system with controls to restrict access and maintain integrity of data;
- recruitment, training and development of appropriately qualified and experienced financial reporting personnel; and
- monthly reviews by STEC of financial reports from the group's operating businesses.

Relevant Audit Information

In the case of each of the persons who were directors of the company at the date when this report was approved:

- so far as each of the directors is aware, there is no relevant audit information of which the company's auditors are unaware; and
- each of the directors 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 auditors are 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.

External Auditors

The Audit Committee has recommended to the board the reappointment of Deloitte LLP and a resolution to that effect will be on the agenda at the AGM. Deloitte LLP have indicated their willingness to continue as auditors. The Audit Committee will also be responsible for determining the audit fee on behalf of the board.

Accounts of Severn Trent Water Limited

Regulatory accounts for Severn Trent Water Limited are prepared and sent to Ofwat. A copy of these accounts will be available from the website of Severn Trent Water Limited (www.stwater.co.uk) or on written request to the Company Secretary (at the address given on the back cover). There is no charge for this publication.

Going concern

The group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Chief Executive's review on pages 4 to 7 and the business reviews of Severn Trent Water and Severn Trent Services on pages 8 to 30. The financial position of the group, its cash flows, liquidity position and borrowing facilities are described in the Financial review on pages 33 to 36. The group's objectives, policies and processes for managing its capital and its financial risk management objectives are described in the Financial review, the risk management report and the Governance report on pages 37 to 73. Details of the group's financial instruments, hedging activities and exposure to credit risk and liquidity risk are described in note 32 to the group financial statements.

The group's principal operating subsidiary, Severn Trent Water, is a regulated long term business characterised by multi year investment programmes. The group's strategic funding objectives reflect this. The group therefore seeks to attain a balance of long term funding or commitment of funds across a range of funding at the best possible economic cost. Average debt maturity is 16 years and the effective average interest cost before exceptional finance costs during the year was 6.4%. The group is in a strong liquidity position and had £295.1 million in cash and liquid reserves and £600.0 million of undrawn committed bank facilities at 31 March 2012, which are expected to be sufficient to fund its investment and cash flow needs until at least December 2013 in the normal course of business.

Severn Trent Water operates in an industry that is currently subject to economic regulation rather than market competition. Ofwat, the economic regulator, has a statutory obligation to set price limits that it believes will enable the water companies to finance their activities. As a consequence the directors believe that the group is well placed to manage its business risks successfully despite the current uncertain economic outlook.

After making enquiries, the directors have a reasonable expectation that the company and the group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

Annual general meeting

The AGM of the company will be held at the International Convention Centre, Broad Street, Birmingham B1 2EA at 11am on Wednesday 18 July 2012. The notice convening the meeting, together with details of the business to be considered and explanatory notes for each resolution, is distributed separately to shareholders. It is also available on the company's website (www.severntrent.com).

By order of the board

Bronagh Kennedy
General Counsel and Company Secretary
29 May 2012

Governance

Directors' responsibility statement

The directors are responsible for preparing the annual report, Directors' remuneration report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors are required to prepare group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and Article 4 of the IAS Regulation and have chosen to prepare the parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). 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 these financial statements, International Accounting Standard 1 requires that the 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 United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

We confirm that to the best of our 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; and
- the management report, which is incorporated into the Directors' 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.

Andrew Duff
Chairman

Michael McKeon
Finance Director

Financial statements

Group financial statements

Company financial statements

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

We have audited the group financial statements of Severn Trent Plc for the year ended 31 March 2012 which comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity, the consolidated balance sheet, the consolidated cash flow statement, and the related notes 1 to 40. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' responsibility statement, the directors are responsible for the preparation of the group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the group financial statements:

- give a true and fair view of the state of the group's affairs as at 31 March 2012 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' report for the financial year for which the group financial statements are prepared is consistent with the group financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

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

- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the directors' statement, contained within the Directors' report, in relation to going concern;
- the part of the Chairman's letter relating to the company's compliance with the nine provisions of UK Corporate Governance Code specified for our review; and
- certain elements of the report to shareholders by the board on directors' remuneration.

Other matters

We have reported separately on the parent company financial statements of Severn Trent Plc for the year ended 31 March 2012 and on the information in the Remuneration Committee report that is described as having been audited.

Carl D Hughes (Senior statutory auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, UK
29 May 2012

Consolidated income statement

For the year ended 31 March 2012

	Notes	2012 £m	2011 £m
Turnover	5, 6	1,770.6	1,711.3
Operating costs before exceptional items	7	(1,266.4)	(1,192.2)
Exceptional operating costs	8	(34.4)	(21.4)
Total operating costs	7	(1,300.8)	(1,213.6)
Profit before interest, tax and exceptional items	5	504.2	519.1
Exceptional items before interest and tax	8	(34.4)	(21.4)
Profit before interest and tax		469.8	497.7
Finance income	10	107.7	100.7
Finance costs excluding exceptional costs	11	(336.7)	(331.3)
Exceptional finance costs	11	(16.5)	–
Net finance costs		(245.5)	(230.6)
Losses on financial instruments	12	(67.7)	(14.2)
Share of results of associates and joint ventures		0.1	0.1
Profit before tax, losses on financial instruments and exceptional items		275.3	288.6
Exceptional items before tax	8	(50.9)	(21.4)
Losses on financial instruments	12	(67.7)	(14.2)
Profit on ordinary activities before taxation		156.7	253.0
Taxation on profit on ordinary activities			
Current tax	13	(60.5)	(32.1)
Deferred tax excluding exceptional credits	13	9.1	(14.1)
Exceptional deferred tax credit	13	69.1	67.7
Total taxation	13	17.7	21.5
Profit for the year		174.4	274.5
Attributable to:			
Owners of the company		171.8	272.6
Non-controlling interests		2.6	1.9
		174.4	274.5
Earnings per share (pence)			
Basic	15	72.5	115.2
Diluted	15	72.1	114.6

Consolidated statement of comprehensive income

For the year ended 31 March 2012

	2012 £m	2011 £m
Profit for the year	174.4	274.5
(Losses)/gains on cash flow hedges taken to equity	(86.5)	16.0
Deferred tax on losses/gains on cash flow hedges taken to equity	20.8	(4.1)
Amounts on cash flow hedges transferred to the income statement	3.7	4.5
Deferred tax on transfers to income statement	(0.9)	(1.2)
Exchange movement on translation of overseas results and net assets	(1.4)	(6.3)
Tax on exchange movement	–	(0.4)
Actuarial (losses)/gains on defined benefit pension schemes	(110.7)	50.7
Tax on actuarial losses/gains	26.6	(13.2)
Deferred tax movement arising from rate change	1.7	0.7
Other comprehensive (loss)/income for the year	(146.7)	46.7
Total comprehensive income for the year	27.7	321.2
Attributable to:		
Owners of the company	25.1	319.7
Non-controlling interests	2.6	1.5
	27.7	321.2

Consolidated statement of changes in equity

For the year ended 31 March 2012

	Equity attributable to owners of the company						
	Share capital £m	Share premium £m	Other reserves £m	Retained earnings £m	Total £m	Non-controlling interests £m	Total equity £m
At 1 April 2010	231.6	75.9	455.6	177.6	940.7	6.3	947.0
Profit for the period	–	–	–	272.6	272.6	1.9	274.5
Gains on cash flow hedges	–	–	16.0	–	16.0	–	16.0
Deferred tax on gains on cash flow hedges	–	–	(4.1)	–	(4.1)	–	(4.1)
Amounts on cash flow hedges transferred to the income statement	–	–	4.5	–	4.5	–	4.5
Deferred tax on transfers to the income statement	–	–	(1.2)	–	(1.2)	–	(1.2)
Exchange movement on translation of overseas results and net assets	–	–	(5.9)	–	(5.9)	(0.4)	(6.3)
Tax on exchange differences	–	–	(0.4)	–	(0.4)	–	(0.4)
Actuarial gains	–	–	–	50.7	50.7	–	50.7
Tax on actuarial gains	–	–	–	(13.2)	(13.2)	–	(13.2)
Deferred tax arising from rate change	–	–	–	0.7	0.7	–	0.7
Total comprehensive income for the period	–	–	8.9	310.8	319.7	1.5	321.2
Share options and LTIPs							
– proceeds from shares issued	0.6	4.1	–	–	4.7	–	4.7
– value of employees' services	–	–	–	4.6	4.6	–	4.6
– free shares issued	–	–	–	(2.0)	(2.0)	–	(2.0)
Current tax on share based payments	–	–	–	0.3	0.3	–	0.3
Deferred tax on share based payments	–	–	–	1.2	1.2	–	1.2
Dividends paid	–	–	–	(169.4)	(169.4)	(1.5)	(170.9)
At 31 March 2011	232.2	80.0	464.5	323.1	1,099.8	6.3	1,106.1
Profit for the period	–	–	–	171.8	171.8	2.6	174.4
Losses on cash flow hedges	–	–	(86.5)	–	(86.5)	–	(86.5)
Deferred tax on losses on cash flow hedges	–	–	20.8	–	20.8	–	20.8
Amounts on cash flow hedges transferred to the income statement	–	–	3.7	–	3.7	–	3.7
Deferred tax on transfers to the income statement	–	–	(0.9)	–	(0.9)	–	(0.9)
Exchange movement on translation of overseas results and net assets	–	–	(1.4)	–	(1.4)	–	(1.4)
Actuarial losses	–	–	–	(110.7)	(110.7)	–	(110.7)
Tax on actuarial losses	–	–	–	26.6	26.6	–	26.6
Deferred tax arising from rate change	–	–	–	1.7	1.7	–	1.7
Total comprehensive income for the period	–	–	(64.3)	89.4	25.1	2.6	27.7
Share options and LTIPs							
– proceeds from shares issued	0.4	3.8	–	–	4.2	–	4.2
– value of employees' services	–	–	–	4.5	4.5	–	4.5
– free shares issued	–	–	–	(1.8)	(1.8)	–	(1.8)
Current tax on share based payments	–	–	–	0.4	0.4	–	0.4
Deferred tax on share based payments	–	–	–	0.3	0.3	–	0.3
Dividends paid	–	–	–	(159.0)	(159.0)	(1.0)	(160.0)
At 31 March 2012	232.6	83.8	400.2	256.9	973.5	7.9	981.4

Consolidated balance sheet

At 31 March 2012

	Note	2012 £m	2011 £m
Non-current assets			
Goodwill	16	44.9	68.3
Other intangible assets	17	116.0	134.9
Property, plant and equipment	18	6,577.8	6,427.0
Interests in joint ventures	19	0.2	0.2
Interests in associates	20	4.6	4.8
Derivative financial instruments	32	132.6	188.1
Available for sale financial assets	32	0.1	0.1
		6,876.2	6,823.4
Current assets			
Inventory	21	34.4	27.1
Trade and other receivables	22	479.4	478.5
Derivative financial instruments	32	30.0	4.3
Cash and cash equivalents	23	295.1	315.2
		838.9	825.1
Total assets		7,715.1	7,648.5
Current liabilities			
Borrowings	32	(89.3)	(23.9)
Derivative financial instruments	32	(0.5)	(0.1)
Trade and other payables	25	(397.6)	(391.2)
Current income tax liabilities		(46.5)	(67.0)
Provisions for liabilities and charges	28	(17.0)	(12.6)
		(550.9)	(494.8)
Non-current liabilities			
Borrowings	32	(4,309.5)	(4,320.5)
Derivative financial instruments	32	(288.0)	(122.4)
Trade and other payables	25	(411.0)	(367.8)
Deferred tax	26	(801.5)	(919.4)
Retirement benefit obligations	27	(345.8)	(292.1)
Provisions for liabilities and charges	28	(27.0)	(25.4)
		(6,182.8)	(6,047.6)
Total liabilities		(6,733.7)	(6,542.4)
Net assets		981.4	1,106.1
Equity			
Called up share capital	29	232.6	232.2
Share premium account	30	83.8	80.0
Other reserves	31	400.2	464.5
Retained earnings		256.9	323.1
Equity attributable to owners of the company		973.5	1,099.8
Non-controlling interests		7.9	6.3
Total equity		981.4	1,106.1

Signed on behalf of the board who approved the accounts on 29 May 2012.

Andrew Duff
Chairman

Michael McKeon
Finance Director

Company Number: 2366619

Consolidated cash flow statement

For the year ended 31 March 2012

	Note	2012 £m	2011 £m
Cash generated from operations	34	725.9	753.0
Tax paid		(72.0)	(32.4)
Net cash generated from operating activities		653.9	720.6
Investing activities			
Interest received		6.7	10.3
Proceeds on disposal of property, plant and equipment and intangible assets		9.1	5.1
Purchases of intangible assets		(12.0)	(20.9)
Purchases of property, plant and equipment		(371.1)	(403.1)
Contributions and grants received		22.8	19.4
Net cash used in investing activities		(344.5)	(389.2)
Financing activities			
Interest paid		(203.5)	(179.8)
Closed out swap		–	20.5
Interest element of finance lease payments		(13.6)	(10.8)
Dividends paid to shareholders of the parent		(159.0)	(169.4)
Dividends paid to non-controlling interests		(1.0)	(1.5)
Repayments of borrowings		(157.4)	(28.7)
Repayments of obligations under finance leases		(47.6)	(47.3)
New loans raised		250.0	171.2
Issues of shares		4.2	4.7
Purchase of own shares		(1.8)	(2.0)
Net cash used in financing activities		(329.7)	(243.1)
(Decrease)/increase in cash and cash equivalents		(20.3)	88.3
Net cash and cash equivalents at beginning of period		315.2	227.8
Effect of foreign exchange rates		(0.2)	(0.9)
Net cash and cash equivalents at end of period		294.7	315.2
Net cash and cash equivalents comprise:			
Total cash and cash equivalents		295.1	315.2
Bank overdrafts		(0.4)	–
Net cash and cash equivalents at end of period		294.7	315.2

The decrease in cash and cash equivalents is reconciled to the movement in net debt in note 34.

Notes to the group financial statements

For the year ended 31 March 2012

1 General information

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

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

Severn Trent Plc is listed on the London Stock Exchange.

2 Accounting policies

a) Basis of preparation

The financial statements 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 2012.

The financial statements have been prepared on the going concern basis (see Directors' report on page 72) under the historical cost convention as modified by the revaluation of certain financial assets and liabilities (including derivative instruments) at fair value.

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses for the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results may ultimately differ from those estimates.

b) Basis of consolidation

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

The results of subsidiaries are consolidated where the group has the power to control a subsidiary.

The results of joint venture undertakings are accounted for on an equity basis where the company exercised joint control under a contractual arrangement.

The results of associates are accounted for on an equity basis where the company holding is 20% or more or the company has the power to exercise significant influence.

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

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

c) Revenue recognition

Revenue 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.

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

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

In respect of long term contracts, revenue is recognised based on the value of work carried out during the year with reference to the total sales value and the stage of completion of these contracts.

Interest income is accrued on a time basis by reference to the principal outstanding and at the effective interest rate applicable. Dividend income from investments is recognised when the group's rights to receive payment have been established. Interest and dividend income are included in finance income.

d) Exceptional items

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

e) Taxation

Current tax payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income and expenses that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

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

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the group intends to settle its current tax assets and liabilities on a net basis.

2 Accounting policies (continued)

f) Goodwill

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

Goodwill arising on all acquisitions prior to 1 April 1998 was written off to reserves under UK GAAP and remains eliminated against reserves. Purchased goodwill arising on acquisitions after 31 March 1998 is treated as an intangible fixed asset.

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

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

g) Intangible non-current assets

Intangible assets acquired separately are capitalised at cost and when acquired in a business combination are capitalised at fair value at the date of acquisition. Following initial recognition, the historical cost model is applied to intangible assets.

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 with finite lives is taken to the income statement through operating costs.

Intangible assets are reviewed for impairment where indicators of impairment exist.

h) Research and development

Research expenditure is expensed when it is incurred. Development expenditure is capitalised 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.

Expenditure on property, plant and equipment relating to research and development projects is capitalised and written off over the expected useful life of those assets.

i) Pre-contract costs

Pre-contract costs are expensed as incurred except where it is probable that the contract will be awarded, in which case they are recognised as a prepayment which is written off to the income statement over the life of the contract.

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

j) Property, plant and equipment

Property, plant and equipment is held at cost (or at deemed cost for infrastructure assets on transition to IFRS) less accumulated depreciation. The costs of like for like replacement of infrastructure components are recognised in the income statement as they arise. Where it is probable that the expenditure will cause future economic benefits to flow to the group, then costs are 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.

Borrowing costs directly attributable to the acquisition, construction or production of assets, that necessarily take a substantial period of time to get ready for their intended use, are added to the cost of those assets until such time as the assets are ready for their intended use.

Property, plant and equipment is depreciated 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)

k) Leased assets

Where the group obtains assets under leasing arrangements which transfer substantially all the risks and rewards of ownership of an asset to the group as lessee (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 reducing the obligation to the lessor and the finance charge being 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.

l) Grants and contributions

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

m) Impairment of non-current assets

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

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

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

Impairments are recognised in the income statement.

n) Inventory

Inventory and work in progress is stated at the lower of cost and net realisable value. Cost includes labour, materials, transport and attributable overheads.

o) Service concession agreements

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

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

p) Retirement benefits

The group operates both defined benefit and defined contribution pension 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. 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, which is the increase in the present value of the liabilities of the group's defined benefit pension schemes expected to arise from employee service in the period, is included in operating costs. The expected return on the scheme's assets and the increase during the period in the present value of the scheme's liabilities, arising from the passage of time, are included in other finance income or cost.

Actuarial gains and losses arising from experience adjustments, changes in actuarial assumptions and amendments to pension plans are charged or credited to equity and recorded in the statement of comprehensive income.

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

q) Provisions

Provisions are recognised where:

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

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

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

2 Accounting policies (continued)

r) Purchase of own shares

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

s) Financial instruments

(i) Financial assets

Financial assets are classified into the following categories:

- at fair value through profit or loss;
- held to maturity investments;
- available for sale financial assets; and
- loans and receivables.

Financial assets at fair value through profit or loss

A financial asset is classified at fair value through profit or loss if it is so designated or if it is classified as 'held for trading'. Derivative financial assets that are not designated and effective as hedging instruments are required to be classified as 'held for trading' by IAS39. However, the group's Treasury Policy, described in the Financial Review on page 35, is that the group does not hold or issue derivative financial instruments for trading. Financial assets at fair value through profit or loss are stated at fair value, with any gains or losses arising on remeasurement recognised in gains/losses on financial instruments in the income statement. Fair value is determined using the methodology described in note 32. Interest received in respect of derivative financial assets is included in finance income but changes in accrued interest receivable are included in gains/losses on financial instruments.

Held to maturity investments

Where the group has the ability and intent to hold an investment to maturity the financial asset is classified as held to maturity. Such financial assets are measured at amortised cost using the effective interest rate method, with any gains or losses being recognised in the income statement.

Available for sale financial assets

After initial recognition at cost (being the fair value of the consideration paid), investments which are classified as available for sale are measured at fair value, with gains or losses recognised in other comprehensive income. When an available for sale investment is disposed of or impaired, the gain or loss previously recognised in other comprehensive income is taken to the income statement. Where there is no active market in the investments and the fair value cannot be measured reliably, the investments are held at cost.

Loans and receivables

Trade receivables, loans and other receivables that have fixed or determinable payments and that are not quoted in an active market are classified as loans and receivables. Such assets are measured at fair value on initial recognition and are subsequently measured at amortised cost using the effective interest rate method unless there is objective evidence that the asset is impaired, where it is written down to its recoverable amount and the irrecoverable amount is recognised as an expense.

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.

(ii) Financial liabilities

Financial liabilities are classified as either:

- financial liabilities at fair value through profit or loss; or
- other financial liabilities.

Financial liabilities at fair value through profit or loss

A financial liability is classified at fair value through profit or loss if it is so designated or if it is classified as 'held for trading'. Derivative financial liabilities that are not designated and effective as hedging instruments are required to be classified as 'held for trading' by IAS39. However, the group's Treasury Policy, described in the Financial Review on page 35, is that the group does not hold or issue derivative financial instruments for trading. Financial liabilities at fair value through profit or loss are stated at fair value, with any gains or losses arising on remeasurement recognised in gains/losses on financial instruments in the income statement. Fair value is determined using the methodology described in note 32. Interest paid in respect of derivative financial liabilities is included in finance costs but changes in accrued interest payable are included in gains/losses on financial instruments.

Other financial liabilities

Other financial liabilities, including borrowings, are initially recognised at fair value less transaction costs. After initial recognition, other financial liabilities are subsequently measured at amortised cost using the effective interest rate method.

(iii) Hedge accounting

The group uses derivative financial instruments such as cross currency swaps, forward currency contracts and interest rate swaps to hedge its risks associated with foreign currency and interest rate fluctuations. Such derivative instruments are recognised and measured in accordance with the accounting policies described above.

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

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

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

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

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 hedging instrument is taken to gains/losses on financial instruments in the income statement where the effective portion of the hedge will offset the gain or loss on the hedged item.

When hedge accounting is discontinued, the fair value adjustment to the carrying amount of the hedged item arising from the hedged risk is amortised to the income statement from that date.

2 Accounting policies (continued)

s) Financial instruments (continued)

(iii) Hedge accounting (continued)

Cash flow hedges

The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in equity and the ineffective portion in gains/losses on financial instruments in the income statement. The gains or losses deferred in equity in this way are recycled through gains/losses on financial instruments in the income statement in the same period in which the hedged underlying transaction or firm commitment is recognised in the income statement.

When hedge accounting is discontinued any cumulative gain or loss on the hedging instrument 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.

Hedges of net investments in foreign operations

Where forward currency contracts and foreign currency borrowings are used to hedge net investments in foreign currency denominated operations, to the extent that they are designated and effective as net investment hedges, they are matched in equity against changes in value of the related assets. Any ineffectiveness is taken to gains/losses on financial instruments in the income statement.

(iv) Embedded derivatives

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contract and the host contract is not carried at fair value, with gains and losses reported in gains/losses on financial instruments in the income statement.

t) Share based payments

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

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

u) 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. Cash and cash equivalents also 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.

v) Foreign currency

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

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

Exchange differences arising in respect of foreign exchange instruments taken out as hedges of overseas investments are also treated as movements in equity to the extent that the hedge is effective (see note 2s).

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

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.

w) Discontinued operations and assets held for sale

Where an asset or group of assets (a disposal group) is available for immediate sale and the sale is highly probable and expected to occur within one year then the disposal group is classified as held for sale. The disposal group is measured at the lower of the carrying amount and fair value less costs to sell.

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

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

then the component is classified as a discontinued operation.

Non-current assets classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell. Depreciation is not charged on such assets.

3 New accounting policies and future requirements

The following standards have been issued by the International Accounting Standards Board and are likely to affect future financial statements.

IFRS 9 'Financial instruments' is likely to affect the measurement and disclosure of financial instruments. The standard is required to be implemented by the group with effect from 1 April 2013, subject to EU endorsement.

IFRS 10 'Consolidated Financial Statements' was issued in May 2011 and is required to be implemented by the group from 1 April 2013. The standard includes a new definition of control to be used to determine when entities are consolidated. The standard is not expected to have a material impact on the group's financial statements.

IFRS 11 'Joint Agreements' was issued in May 2011 and is required to be implemented by the group from 1 April 2013. IFRS 11 replaces IAS 31 'Interests in Joint Ventures' and SIC-13 'Jointly-controlled Entities'. IFRS 11 uses the definition of control given in IFRS 10 to define joint control and removes the option to account for joint ventures using proportionate consolidation. This is not expected to have a material impact on the group's financial statements.

IFRS 12 'Disclosure of Interests in Other Entities' was issued in May 2011 and is required to be implemented by the group from 1 April 2013. The standard provides disclosure requirements for subsidiaries, associates, joint agreements and structured entities which were previously covered in IAS 27, IAS 28 and IAS 31. Additional disclosures will be required in the group financial statements to meet the requirements of the standard.

IFRS 13 'Fair Value Measurement' was issued in May 2011 and is required to be implemented by the group from 1 April 2013. The standard provides additional guidance on how to measure fair value but does not change when fair value is permitted or required. The standard may impact the methods of determining fair value which are currently employed by the group and will require enhanced disclosure of these methods.

IAS 19 'Employee Benefits' (revised) includes a requirement to measure the expected return on the defined benefit pension scheme assets using the discount rate applied to the scheme liabilities. This will impact the income statement and statement of comprehensive income. It is not possible to estimate the impact this will have on the financial statements at this time. The other amendments are not likely to have a material impact on the group. The standard is required to be implemented by the group with effect from 1 April 2013, subject to EU endorsement.

The directors assess that the other standards and interpretations issued but not yet effective are not likely to have a significant impact on future financial statements.

4 Significant accounting judgements and key sources of estimation uncertainty

In the process of applying the group's accounting policies, the group is required to make certain judgements, estimates and assumptions that it believes are reasonable based on the information available.

The more significant judgements were:

a) Tax provisions

Assessing the outcome of uncertain tax positions requires judgements to be made regarding the result of negotiations with and enquiries from tax authorities in a number of jurisdictions. The assessments made are based on advice from independent tax advisers and the status of ongoing discussions with the relevant tax authorities.

b) Provisions for other liabilities and charges

Assessing the financial outcome of uncertain commercial and legal positions requires judgements to be made regarding the relative merits of each party's case and the extent to which any claim against the group is likely to be successful. The assessments made are based on advice from the group's internal counsel and, where appropriate, independent legal advice.

The key accounting estimates were:

a) Goodwill impairment

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating unit ('CGU') to which goodwill has been allocated. The value in use calculation requires the group to estimate the future cash flows expected to arise from the CGU and a suitable discount rate to calculate present value. Details of the assumptions used are set out in note 16 to the financial statements.

b) 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 j).

c) 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, salary and pension increases, investment returns 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 are set out in note 27 to the financial statements.

4 Significant accounting judgements and key sources of estimation uncertainty (continued)

d) Unbilled revenue

Severn Trent Water raises bills and recognises revenue in accordance with its right to receive revenue in line with the limits established by the periodic regulatory price review processes. For water and waste water customers with water meters, the amount recognised is dependent upon the volume supplied including an estimate of the sales value of units supplied between the date of the last meter read and the year end. Meters are read on a cyclical basis and the group recognises revenue for unbilled amounts based on estimated usage from the last billing to the end of the financial year. The estimated usage is based on historical data, judgement and assumptions.

e) 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. The actual amounts collected could differ from the estimated level of recovery which could impact operating results.

f) Adoption of private drains and sewers

On 1 October 2011 Severn Trent Water was required to adopt approximately 37,000 km of drains and sewers as a result of legislation. The group's accounting policy is to recognise adopted assets at fair value at the point of adoption. Estimation of the fair value of these assets requires assumptions to be made about:

- the costs required to bring the assets up to the required standard;
- the costs required to maintain the operating capability of the assets at the required standard; and
- the extent and timing of recovery of these costs.

In all reasonably probable scenarios, the present value of the costs recovered will not exceed the present value of the costs incurred and hence a fair value of nil has been attributed to these assets.

5 Segmental analysis

The group has two reportable segments: Severn Trent Water and Severn Trent Services. The key factor determining the identification of reportable segments is the regulatory environment in which the businesses operate. Severn Trent Water is subject to economic regulation by Ofwat and operates under a licence to provide water and sewerage services within a defined geographical region in England and Wales. Severn Trent Services is not subject to economic regulation and operates in markets in the USA, Europe and Asia.

The Severn Trent Executive Committee (STEC) is considered to be the group's chief operating decision maker. The reports provided to STEC include segmental information prepared on the basis described above. Details of Severn Trent Water's operations are described on pages 8 to 21 of the Business Review and those of Severn Trent Services on pages 24 to 30.

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

The group has a large and diverse customer base and there is no significant reliance on any single customer.

The measure of profit or loss that is reported to STEC for the segments is profit before interest, tax and exceptional items (underlying PBIT). A segmental analysis of sales and underlying PBIT is presented below:

2012	Severn Trent Water £m	Severn Trent Services £m
External sales	1,456.1	313.3
Inter-segment sales	1.4	19.0
Total sales	1,457.5	332.3
Profit before interest, tax and exceptional items	500.0	18.0
Exceptional items	10.3	(44.7)
Profit/(loss) before interest and tax	510.3	(26.7)
Profit before interest, tax and exceptional items is stated after:		
Amortisation of intangible assets	28.7	1.9
Depreciation of property, plant and equipment	252.1	5.9
Profit on disposal of fixed assets	(4.2)	(0.2)

5 Segmental analysis (continued)

2011	Severn Trent Water £m	Severn Trent Services £m
External sales	1,388.9	321.7
Inter-segment sales	0.9	14.4
Total sales	1,389.8	336.1
Profit before interest, tax and exceptional items	503.7	25.7
Exceptional items	(13.0)	(4.5)
Profit before interest and tax	490.7	21.2
Profit before interest, tax and exceptional items is stated after:		
Amortisation of intangible assets	23.6	1.6
Depreciation of property, plant and equipment	247.4	6.4
Profit on disposal of fixed assets	(2.1)	(0.5)

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

Interests in joint ventures and associates are not material and are not included in the segmental reports reviewed by STEC.

Separate segmental analyses of assets and liabilities are not reviewed by STEC. The balance sheet measure reviewed by STEC on a segmental basis is capital employed which includes the following components:

2012	Severn Trent Water £m	Severn Trent Services £m
Operating assets	7,022.9	185.5
Goodwill	–	44.8
Interests in joint ventures and associates	0.1	4.6
Segment assets	7,023.0	234.9
Segment operating liabilities	(1,064.3)	(95.3)
Capital employed	5,958.7	139.6

2011	Severn Trent Water £m	Severn Trent Services £m
Operating assets	6,864.8	203.8
Goodwill	–	68.3
Interests in joint ventures and associates	0.1	4.7
Segment assets	6,864.9	276.8
Segment operating liabilities	(959.7)	(87.8)
Capital employed	5,905.2	189.0

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

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

5 Segmental analysis (continued)

Additions to other intangible assets and property, plant and equipment were as follows:

2012	Severn Trent Water £m	Severn Trent Services £m
Other intangible assets	9.8	2.1
Property, plant and equipment	405.3	5.5

2011	Severn Trent Water £m	Severn Trent Services £m
Other intangible assets	18.3	2.6
Property, plant and equipment	370.7	4.9

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

	2012 £m	2011 £m
Severn Trent Water	1,457.5	1,389.8
Severn Trent Services	332.3	336.1
Other	9.8	8.1
Inter-segment sales	(29.0)	(22.7)
Group turnover	1,770.6	1,711.3

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

	2012 £m	2011 £m
Underlying PBIT		
– Severn Trent Water	500.0	503.7
– Severn Trent Services	18.0	25.7
– Corporate and other costs	(15.3)	(12.5)
Consolidation adjustments	1.5	2.2
Group underlying PBIT	504.2	519.1
Exceptional operating costs		
– Severn Trent Water	10.3	(13.0)
– Severn Trent Services	(44.7)	(4.5)
– Corporate and other	–	(3.9)
Share of results of associates and joint ventures	0.1	0.1
Net finance costs	(245.5)	(230.6)
Losses on financial instruments	(67.7)	(14.2)
Profit before tax	156.7	253.0

5 Segmental analysis (continued)

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

	2012 £m	2011 £m
Segment assets		
– Severn Trent Water	7,023.0	6,864.9
– Severn Trent Services	234.9	276.8
Corporate assets	46.4	46.8
Other financial assets	457.8	507.7
Consolidation adjustments	(47.0)	(47.7)
Total assets	7,715.1	7,648.5

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

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

	2012 £m	2011 £m
Segment liabilities		
– Severn Trent Water	(1,064.3)	(959.7)
– Severn Trent Services	(95.3)	(87.8)
Corporate liabilities	(57.8)	(59.0)
Other financial liabilities	(4,687.3)	(4,466.9)
Current tax	(46.5)	(67.0)
Deferred tax	(801.5)	(919.4)
Consolidation adjustments	19.0	17.4
Total liabilities	(6,733.7)	(6,542.4)

The consolidation adjustments comprise elimination of intra-group creditors.

Geographical areas

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

	2012 £m	2011 £m
UK	1,538.0	1,465.4
USA	136.5	154.0
Other	96.1	91.9
	1,770.6	1,711.3

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

	2012 £m	2011 £m
UK	6,670.4	6,550.8
USA	59.2	58.3
Other	14.0	26.2
	6,743.6	6,635.3

6 Revenue

	2012 £m	2011 £m
Water and sewerage services	1,446.3	1,380.0
Other services	191.4	192.3
Sale of goods	94.4	103.2
Service concession arrangements (note 36)	38.5	35.8
Total turnover	1,770.6	1,711.3
Interest receivable (note 10)	7.0	7.5
	1,777.6	1,718.8

7 Operating costs

	2012 Before exceptional costs £m	2012 Exceptional costs £m	2012 Total £m	2011 Before exceptional costs £m	2011 Exceptional costs £m	2011 Total £m
Wages and salaries	264.2	2.6	266.8	263.7	3.1	266.8
Social security costs	17.7	0.1	17.8	15.8	0.4	16.2
Pension costs	27.5	(23.1)	4.4	27.0	0.6	27.6
Share based payments	4.1	–	4.1	4.6	–	4.6
Total employee costs	313.5	(20.4)	293.1	311.1	4.1	315.2
Power	59.0	–	59.0	57.9	–	57.9
Carbon Reduction Commitment	5.9	–	5.9	–	–	–
Raw materials and consumables	135.0	0.4	135.4	135.3	0.6	135.9
Rates	69.4	–	69.4	62.4	–	62.4
Charge for bad and doubtful debts	30.7	21.5	52.2	35.2	–	35.2
Service charges	33.3	–	33.3	32.6	–	32.6
Depreciation of property, plant and equipment	256.0	–	256.0	251.5	–	251.5
Amortisation of intangible fixed assets	30.8	–	30.8	25.4	–	25.4
Impairment of goodwill	–	22.9	22.9	–	–	–
Hired and contracted services	219.2	4.3	223.5	177.6	7.2	184.8
Operating leases rentals						
– land and buildings	3.4	–	3.4	4.3	0.4	4.7
– other	1.5	–	1.5	0.8	–	0.8
Hire of plant and machinery	5.6	–	5.6	7.8	–	7.8
Research and development expenditure	4.5	–	4.5	4.5	–	4.5
Profit on disposal of property, plant and equipment	(4.4)	–	(4.4)	(2.6)	–	(2.6)
Foreign exchange gains	0.1	–	0.1	(0.9)	–	(0.9)
Infrastructure maintenance expenditure	128.9	–	128.9	96.9	–	96.9
Other operating costs	59.2	5.7	64.9	60.8	9.1	69.9
	1,351.6	34.4	1,386.0	1,260.6	21.4	1,282.0
Release from deferred income	(8.7)	–	(8.7)	(8.4)	–	(8.4)
Own work capitalised	(76.5)	–	(76.5)	(60.0)	–	(60.0)
	1,266.4	34.4	1,300.8	1,192.2	21.4	1,213.6

Further details of exceptional costs are given in note 8.

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

	2012 £m	2011 £m
Fees payable to the company's auditors for		
– the audit of the company's annual accounts	0.1	0.1
– the audit of the company's subsidiaries pursuant to legislation	0.4	0.4
– audit fees payable to associates of the company's auditors	0.2	0.1
Total audit fees	0.7	0.6
Fees payable to the company's auditors and their associates for other services to the group		
– other services pursuant to legislation	0.2	0.2
– other services relating to taxation	–	0.2
Total non-audit fees	0.2	0.4

Details of directors' remuneration are set out in the Directors' remuneration report on pages 55 to 68.

Notes to the group financial statements

8 Exceptional items before tax

	2012 £m	2011 £m
Exceptional operating costs		
Severn Trent Water		
Restructuring costs	11.5	13.0
Curtailment gains on defined benefit pension schemes	(21.8)	–
	(10.3)	13.0
Severn Trent Services		
Provisions for commercial disputes and bad debts	23.1	–
Curtailment gains on defined benefit pension schemes	(1.3)	–
Impairment of goodwill	22.9	–
Restructuring costs	–	0.7
Costs relating to regulatory matters (see note 35)	–	3.8
	44.7	4.5
Corporate and Other		
Costs relating to regulatory matters (see note 35)	–	3.9
	–	3.9
Total exceptional operating costs	34.4	21.4
Exceptional finance costs		
Costs incurred on early redemption of debt	16.5	–
Exceptional items before tax	50.9	21.4

9 Employee numbers

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

	2012 Number	2011 Number
By type of business		
Severn Trent Water	5,162	5,237
Severn Trent Services	2,878	3,032
Corporate and Other	11	13
	8,051	8,282

10 Finance income

	2012 £m	2011 £m
Interest revenue earned on:		
Bank deposits	4.1	3.8
Other financial income	2.9	3.7
Total interest revenue	7.0	7.5
Expected return on defined benefit scheme assets	100.7	93.2
	107.7	100.7

11 Finance costs

	2012 Before exceptional costs	2012 Exceptional costs	2012 Total £m	2011 Total £m
Interest on bank loans and overdrafts	28.9	–	28.9	6.9
Interest on other loans	198.9	–	198.9	214.1
Interest on finance leases	9.7	–	9.7	11.1
Total borrowing costs	237.5	–	237.5	232.1
Other financial expenses	1.5	16.5	18.0	0.8
Interest cost on defined benefit scheme obligations	97.7	–	97.7	98.4
	336.7	16.5	353.2	331.3

In accordance with IAS 23 borrowing costs of £10.5 million (2011: £11.4 million) incurred funding eligible capital projects have been capitalised at an interest rate of 5.93% (2011: 5.99%).

12 Losses on financial instruments

	2012 £m	2011 £m
(Loss)/gain on cross currency swaps used as hedging instruments in fair value hedges	(5.1)	17.6
Gain/(loss) arising on adjustment for foreign currency debt in fair value hedges	1.9	(10.4)
Exchange gain/(loss) on other loans	41.5	(1.2)
Loss on cash flow hedges transferred from equity	(3.7)	(4.5)
Loss arising on swaps where hedge accounting is not applied	(102.3)	(15.7)
	(67.7)	(14.2)

The group's hedge accounting arrangements are described in note 32 f).

13 Taxation

a) Analysis of tax credit in the year

	2012 £m	2011 £m
Current tax		
Current year at 26% (2011: 28%)	69.2	66.5
Prior year at 28% (2011: 30%)	(8.7)	(34.4)
Total current tax	60.5	32.1
Deferred tax		
Origination and reversal of temporary differences – current year	(14.0)	4.6
Origination and reversal of temporary differences – prior year	4.9	9.5
Exceptional credit arising from rate change	(69.1)	(67.7)
Total deferred tax	(78.2)	(53.6)
	(17.7)	(21.5)

The exceptional deferred tax credit arises from the reduction in the rate at which the temporary differences are expected to reverse from 26% to 24%. The standard rate of corporation tax in the UK changed from 26% to 24% with effect from 1 April 2012.

13 Taxation (continued)

b) Factors affecting the tax credit in the year

The tax expense for the current year is lower (2011: lower) than the standard rate of corporation tax in the UK. The differences are explained below:

	2012 £m	2011 £m
Profit on ordinary activities before tax	156.7	253.0
Tax at the standard rate of corporation tax in the UK 26% (2011: 28%)	40.8	70.8
Tax effect of expenditure not deductible/(income not taxable) in determining taxable profits	12.0	(0.2)
Current year impact of rate change	1.9	–
Effect of different rates in overseas jurisdictions	0.5	0.5
Adjustments in respect of prior years	(3.8)	(24.9)
Exceptional deferred tax credit arising from rate change	(69.1)	(67.7)
Total tax credit	(17.7)	(21.5)

c) Tax (credited)/charged directly to equity

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

	2012 £m	2011 £m
Current tax		
Tax on share based payments	(0.4)	(0.3)
Tax on pension contributions in excess of profit and loss charge	(8.8)	–
Tax on exchange movement	–	0.4
Total current tax (credited)/charged directly to equity	(9.2)	0.1
Deferred tax		
Tax on actuarial losses/gains	(17.8)	13.2
Tax on cash flow hedges	(19.9)	5.3
Tax on share based payments	(0.3)	(1.2)
Effect of change in tax rate	(1.7)	(0.7)
Total deferred tax (credited)/charged directly to equity	(39.7)	16.6

14 Dividends

Amounts recognised as distributions to equity holders in the period:

	2012		2011	
	Pence per share	£m	Pence per share	£m
Final dividend for the year ended 31 March 2011 (2010)	39.05	92.5	45.61	107.8
Interim dividend for the year ended 31 March 2012 (2011)	28.04	66.5	26.04	61.6
	67.09	159.0	71.65	169.4
Proposed final dividend for the year ended 31 March 2012	42.06			
Proposed special dividend	63.00			

The proposed final and special dividends are subject to approval by shareholders at the AGM and have not been included as a liability in these financial statements.

15 Earnings per share

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

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all potentially dilutive ordinary shares. These represent share options granted to employees where the exercise price is less than the average market price of the company's shares during the year.

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

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

Earnings

	2012 £m	2011 £m
Earnings for the purpose of basic and diluted earnings per share from operations		
Profit for the period attributable to the equity holders of the company	171.8	272.6

Number of shares

	2012 m	2011 m
Weighted average number of ordinary shares for the purpose of basic earnings per share	237.0	236.7
Effect of dilutive potential ordinary shares		
– share options and LTIPs	1.2	1.1
Weighted average number of ordinary shares for the purpose of diluted earnings per share	238.2	237.8

Adjusted earnings per share

	2012 pence	2011 pence
Adjusted basic earnings per share	88.9	105.6
Adjusted diluted earnings per share	88.5	105.1

Adjusted earnings per share figures are presented for continuing operations. These exclude the effects of deferred tax, losses on financial instruments and exceptional items in both 2012 and 2011. The directors consider that the adjusted figures provide a useful additional indicator of performance. The denominators used in the calculations of adjusted basic and diluted earnings per share are the same as those used in the unadjusted figures set out above.

Adjustments to earnings

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

	2012 £m	2011 £m
Earnings for the purpose of basic and diluted earnings per share from continuing operations	171.8	272.6
Adjustments for		
– exceptional items	50.9	21.4
– current tax related to exceptional items at 26% (2011: 28%)	(1.5)	(4.7)
– losses on financial instruments	67.7	14.2
– deferred tax	(78.2)	(53.6)
Earnings for the purpose of adjusted basic and diluted earnings per share	210.7	249.9

16 Goodwill

	2012 £m	2011 £m
Cost		
At 1 April	68.3	70.6
Exchange adjustments	(0.5)	(2.3)
At 31 March	67.8	68.3
Impairment		
At 1 April	–	–
Amounts written off	(22.9)	–
At 31 March	(22.9)	–
Net book value		
At 31 March	44.9	68.3

Goodwill impairment tests

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

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

	2012 £m	2011 £m
Severn Trent Services		
Water Purification US	26.3	26.2
Contract Operations	11.7	11.6
UK Laboratories	–	12.0
Services Italy	2.2	8.2
Services Spain (formerly Apliclor)	4.7	10.3
	44.9	68.3

The group has reviewed the carrying value of goodwill for impairment in accordance with the policy stated in note 2m).

The value in use calculations use cash flow projections based on financial budgets approved by management covering a five year period. The key assumption underlying these budgets is revenue growth. Management of each CGU determines assumptions based on past experience, current market trends and expectations of future developments.

Cash flows beyond the five year period are extrapolated using an estimated nominal growth rate stated below. The growth rate does not exceed the long term average growth rate for the economy in which the CGU operates. The assumptions used in relation to growth rates beyond the five year period and discount rates were:

	Nominal growth rate		Discount rate	
	2012 %	2011 %	2012 %	2011 %
Water Purification US	3.5	3.0	5.8	7.3
Contract Operations	3.5	3.0	5.9	7.7
UK Laboratories	–	3.0	8.0	7.3
Services Italy	3.0	3.0	11.0	11.0
Services Spain	3.1	3.0	8.9	11.6

The weighted average growth rates used are consistent with the forecasts included in industry reports. The discount rates used are pre-tax and reflect specific risks relating to the CGU.

As a result of the impairment review, the group has recorded the following impairment losses in the Severn Trent Services segment. In each case the recoverable amount has been determined by calculating the value in use of the asset using the assumptions described above.

16 Goodwill (continued)

In UK Laboratories, towards the end of the year, and early in the new financial year, management was informed that certain contracts from utilities companies would not be renewed. Management is developing a plan to reduce the scale of this business accordingly. The business's cash flow projections have been amended to take these changes into account and as a result an impairment loss of £12.0 million has been recognised in these financial statements.

The group has discontinued any further investment in resources to support future market growth in Italy and continues to take a cautious view as to the medium term business opportunities in that country. As a result an impairment loss of £5.7 million has been recognised in these financial statements in respect of Services Italy.

In Services Spain the group has taken a cautious view of the prospects for growth both in the short and medium term. As a result an impairment loss of £5.2 million has been recognised in these financial statements.

Changes in the growth rate outside the five year period or in the discount rate applied to the cash flows may cause a CGU's carrying value to exceed its recoverable amount. However, in the opinion of the directors, the changes in growth rate or discount rate that would be required to reduce the recoverable amounts of Water Purification US and Contract Operations below their carrying value are not reasonably possible and therefore no sensitivity analysis has been provided.

17 Intangible assets

	Computer software		Other	
	Internally generated £m	Purchased £m	Internally generated £m	Total £m
Cost				
At 1 April 2010	117.4	185.3	21.8	324.5
Additions	4.1	14.6	2.2	20.9
Disposals	–	(29.8)	–	(29.8)
Reclassifications	–	0.2	1.2	1.4
Exchange adjustments	–	(0.2)	(0.4)	(0.6)
At 1 April 2011	121.5	170.1	24.8	316.4
Additions	0.3	9.7	2.0	12.0
Disposals	–	(0.4)	–	(0.4)
Exchange adjustments	–	0.2	(0.2)	–
At 31 March 2012	121.8	179.6	26.6	328.0
Amortisation				
At 1 April 2010	(73.4)	(100.9)	(11.7)	(186.0)
Amortisation for year	(9.4)	(15.1)	(0.9)	(25.4)
Disposals	–	29.7	–	29.7
Exchange adjustments	–	0.1	0.1	0.2
At 1 April 2011	(82.8)	(86.2)	(12.5)	(181.5)
Amortisation for year	(19.4)	(9.7)	(1.7)	(30.8)
Disposals	–	0.2	–	0.2
Exchange adjustments	–	–	0.1	0.1
At 31 March 2012	(102.2)	(95.7)	(14.1)	(212.0)
Net book value				
At 31 March 2012	19.6	83.9	12.5	116.0
At 31 March 2011	38.7	83.9	12.3	134.9

Other assets primarily comprise capitalised development costs and patents.

18 Property, plant and equipment

	Land and buildings £m	Infrastructure assets £m	Fixed plant and equipment £m	Movable plant £m	Total £m
Cost					
At 1 April 2010	2,483.3	4,062.0	3,150.0	60.0	9,755.3
Additions	94.7	130.2	153.5	3.8	382.2
Disposals	(7.5)	(0.5)	(32.0)	(6.4)	(46.4)
Reclassifications	(0.3)	–	(3.9)	–	(4.2)
Exchange adjustments	(0.3)	–	(1.4)	(0.7)	(2.4)
At 1 April 2011	2,569.9	4,191.7	3,266.2	56.7	10,084.5
Additions	106.9	118.8	181.5	4.5	411.7
Disposals	(3.6)	(0.1)	(26.4)	(4.3)	(34.4)
Exchange adjustments	–	–	(0.8)	0.1	(0.7)
At 31 March 2012	2,673.2	4,310.4	3,420.5	57.0	10,461.1
Depreciation					
At 1 April 2010	(769.1)	(1,065.9)	(1,587.4)	(30.9)	(3,453.3)
Charge for the year	(56.3)	(27.6)	(160.5)	(7.1)	(251.5)
Disposals	7.3	–	31.5	5.0	43.8
Reclassifications	1.9	–	–	–	1.9
Exchange adjustments	0.1	–	1.0	0.5	1.6
At 1 April 2011	(816.1)	(1,093.5)	(1,715.4)	(32.5)	(3,657.5)
Charge for the year	(56.0)	(28.2)	(165.1)	(6.7)	(256.0)
Disposals	3.3	–	22.8	3.8	29.9
Exchange adjustments	–	–	0.3	–	0.3
At 31 March 2012	(868.8)	(1,121.7)	(1,857.4)	(35.4)	(3,883.3)
Net book value					
At 31 March 2012	1,804.4	3,188.7	1,563.1	21.6	6,577.8
At 31 March 2011	1,753.8	3,098.2	1,550.8	24.2	6,427.0

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

	Land and buildings £m	Infrastructure assets £m	Fixed plant and equipment £m	Movable plant £m	Total £m
Net book value					
At 31 March 2012	–	119.2	76.3	–	195.5
At 31 March 2011	–	120.1	96.4	–	216.5

Property, plant and equipment includes £372.3 million (2011: £433.8 million) in respect of assets in the course of construction for which no depreciation is charged.

19 Interests in joint ventures

	2012 £m	2011 £m
Group's share of		
Long term assets	0.2	0.2
Current assets	0.6	0.6
Current liabilities	(0.6)	(0.6)
	0.2	0.2
Group's share of		
Turnover	0.4	3.3
Operating costs	(0.4)	(3.3)
Profit before tax	–	–
Tax	–	–
Profit after tax	–	–

As at 31 March 2012 and 2011 the joint ventures had no significant contingent liabilities to which the group was exposed and the group did not have any significant contingent liabilities in relation to its interests in the joint ventures. The group had no capital commitments in relation to its interests in the joint ventures at 31 March 2012 or 2011.

Particulars of the group's principal joint venture undertakings at 31 March 2012 were:

Name	Country of incorporation	Proportion of ownership interest
Cognica Limited	Great Britain	50%
Jackson Water Partnership	USA	70%

The partnership agreement for the Jackson Water Partnership requires that certain key decisions require the unanimous consent of the partners and consequently the partnership has been accounted for as a joint venture.

20 Interests in associates

	2012 £m	2011 £m
At 1 April	4.8	4.6
Share of profits	0.1	0.1
Exchange adjustments	(0.3)	0.1
At 31 March	4.6	4.8
Group's share of		
Total assets	24.7	26.1
Total liabilities	(20.1)	(21.3)
	4.6	4.8
Turnover	7.7	7.6
Profit before tax	0.1	0.1

At 31 March 2012 and 2011 the associate company had no significant contingent liabilities to which the group was exposed. The group had no capital commitments in relation to its interests in the associate at 31 March 2012 or 2011.

The principal associate at 31 March 2012 was Servizio Idrico Integrato S.c.p.a., a company incorporated in Italy. The proportion of ownership interest held by the group was 25%.

The group has given certain guarantees in respect of the associate's borrowings. The guarantees are limited to €11.2 million (2011: €11.2 million). The group does not expect any liabilities that are not provided for in these financial statements to arise from these arrangements.

Notes to the group financial statements

21 Inventory

	2012 £m	2011 £m
Inventory and work in progress	34.4	27.1

22 Trade and other receivables

	2012 £m	2011 £m
Trade receivables	306.3	286.6
Less provisions for impairment of receivables	(125.2)	(98.5)
Trade receivables net	181.1	188.1
Receivables from related parties	0.2	0.2
Other amounts receivable	32.5	40.1
Prepayments and accrued income	265.6	250.1
	479.4	478.5

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

Prepayments and accrued income include £25.5 million (2011: £27.1 million) in respect of amounts due from customers for contract work and £43.1 million (2011: £49.7 million) which is recoverable after more than one year.

Credit control policies and procedures are determined at the individual business unit level. By far the most significant business unit of the group is Severn Trent Water Limited, which represents 82% of group turnover and 79% of net trade receivables. 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.

Movements on the doubtful debts provision were as follows:

	2012 £m	2011 £m
At 1 April	98.5	91.8
Amounts written off during the year	(24.4)	(28.5)
Amounts recovered during the year	(0.3)	–
Charge for bad and doubtful debts	30.7	35.2
Exceptional charge for bad and doubtful debts	21.5	–
Exchange adjustments	(0.8)	–
At 31 March	125.2	98.5

Included in trade receivables are balances with a carrying amount of £157.8 million (2011: £146.0 million) which were past due at the reporting date but for which no specific provision has been made as the collective impairment recorded against such assets is considered to be sufficient allowance for the risk of non-collection of such balances.

The aged analysis of past due receivables that were not individually impaired is as follows:

	2012 £m	2011 £m
Up to 90 days	46.4	47.7
91–365 days	70.1	60.6
1–2 years	26.4	25.0
2–3 years	9.5	8.4
More than 3 years	5.4	4.3
	157.8	146.0

22 Trade and other receivables (continued)

Included in the allowance for doubtful debts are provisions amounting to £27.5 million (2011: £24.0 million) against specific trade receivables. The age of the impaired receivables was as follows:

	2012 £m	2011 £m
Up to 90 days	1.4	2.5
91–365 days	2.9	18.1
1–2 years	15.1	4.1
2–3 years	4.5	3.7
More than 3 years	4.1	4.7
	28.0	33.1

23 Cash and cash equivalents

	2012 £m	2011 £m
Cash at bank and in hand	37.4	66.6
Short term deposits	257.7	248.6
	295.1	315.2

Of the £257.7 million (2011: £248.6 million) of short term bank deposits, £26.9 million (2011: £28.4 million) is held as security deposits for insurance obligations and is not available for use by the group.

24 Finance leases

Obligations under finance lease are as follows:

	2012 £m	2011 £m
Gross obligations under finance leases	292.1	352.6
Less future finance charges	(73.1)	(85.9)
Present value of lease obligations	219.0	266.7

A maturity analysis of gross obligations under finance leases is presented in note 32. Net obligations under finance leases fall due as follows:

	2012 £m	2011 £m
Within 1 year	–	13.5
1–2 years	17.8	16.4
3–5 years	85.5	84.1
After more than 5 years	115.7	152.7
Included in non-current liabilities	219.0	253.2
	219.0	266.7

The remaining terms of finance leases ranged from 3 to 20 years at 31 March 2012. Interest terms are set at the inception of the leases. Leases with capital outstanding of £219.0 million (2011: £266.7 million) bear fixed interest at a weighted average rate of 5.4% (2011: 5.4%). 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.

25 Trade and other payables

	2012 £m	2011 £m
Current liabilities		
Trade payables	34.9	31.8
Social security and other taxes	7.0	6.8
Other payables	18.4	32.1
Accruals and deferred income	337.3	320.5
	397.6	391.2
Non-current liabilities		
Trade payables	–	0.5
Other payables	0.4	2.1
Deferred income	396.6	345.9
Accrued expenses	14.0	19.3
	411.0	367.8

The directors consider that the carrying value of trade payables is not materially different from their fair values.

Accruals and deferred income includes nil (2011: nil) in respect of amounts due to customers for contract work.

26 Deferred tax

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

	Accelerated tax depreciation £m	Retirement benefit obligation £m	Tax losses £m	Fair value of financial instruments £m	Other £m	Total £m
At 1 April 2010	1,161.8	(99.4)	(7.1)	(33.5)	(65.4)	956.4
Charge to income	13.6	3.2	0.3	1.0	(4.0)	14.1
Credit to income arising from rate change	(77.5)	3.1	–	1.2	5.5	(67.7)
Charge to equity	–	13.2	–	5.3	(1.2)	17.3
Credit to equity arising from rate change	(5.5)	4.0	–	1.2	(0.4)	(0.7)
Exchange differences	(0.5)	–	0.4	–	0.1	–
At 1 April 2011	1,091.9	(75.9)	(6.4)	(24.8)	(65.4)	919.4
Charge to income	(83.1)	13.7	–	(16.7)	77.0	(9.1)
Credit to income arising from rate change	(72.4)	2.8	–	1.1	(0.6)	(69.1)
Charge to equity	–	(17.8)	–	(19.9)	(0.3)	(38.0)
Credit to equity arising from rate change	(5.5)	3.0	–	0.7	0.1	(1.7)
At 31 March 2012	930.9	(74.2)	(6.4)	(59.6)	10.8	801.5

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:

	2012 £m	2011 £m
Deferred tax asset	(194.9)	(14.4)
Deferred tax liability	1,000.4	933.8
	805.5	919.4

27 Retirement benefit schemes

a) Defined benefit pension schemes

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

	2012 £m	2011 £m
Fair value of scheme assets		
Equities	798.6	798.8
Gilts	235.2	41.3
Corporate bonds	339.1	530.6
Property	105.7	95.0
Hedge funds	52.6	–
Cash	26.0	7.7
Total fair value of assets	1,557.2	1,473.4
Present value of the defined benefit obligations – funded schemes	(1,894.4)	(1,757.4)
	(337.2)	(284.0)
Present value of the defined benefit obligations – unfunded schemes	(8.6)	(8.1)
Liability recognised in the balance sheet	(345.8)	(292.1)

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

	2012 £m	2011 £m
Fair value at 1 April	1,473.4	1,393.0
Expected return on scheme assets	100.7	93.2
Contributions from the sponsoring companies	53.5	40.0
Contributions from scheme members	5.6	6.1
Actuarial (losses)/gains recognised in the statement of comprehensive income	(4.5)	12.2
Benefits paid	(71.5)	(71.1)
Fair value at 31 March	1,557.2	1,473.4

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

	2012 £m	2011 £m
Present value at 1 April	1,765.5	1,747.9
Service cost	22.6	22.7
Interest cost	97.7	98.4
Net curtailment gain	(23.1)	–
Contributions from scheme members	5.6	6.1
Actuarial losses/(gains) recognised in the statement of comprehensive income	106.2	(38.5)
Benefits paid	(71.5)	(71.1)
Present value at 31 March	1,903.0	1,765.5

Of which:

	2012 £m	2011 £m
Amounts relating to funded schemes	1,894.4	1,757.4
Amounts relating to unfunded schemes	8.6	8.1
Present value at 31 March	1,903.0	1,765.5

27 Retirement benefit schemes (continued)

a) Defined benefit schemes (continued)

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

	2012 £m	2011 £m
Amounts charged to operating costs		
Current service cost	(22.6)	(22.7)
Exceptional curtailment gain	23.1	–
	0.5	(22.7)
Amounts charged to finance costs		
Interest cost	(97.7)	(98.4)
Amounts credited to finance income		
Expected return on scheme assets	100.7	93.2
Total amount credited/(charged) to the income statement	3.5	(27.9)

The actual return on scheme assets was a gain of £95.9 million (2011: gain of £105.4 million).

Actuarial gains and losses have been reported in the statement of comprehensive income. The cumulative amount of actuarial gains and losses recognised in the statement of comprehensive income since the adoption of IFRS is a net loss of £280.1 million (2011: net loss of £169.4 million).

(iii) Background

The group operates a number of defined benefit pension schemes in the UK, covering the majority of UK employees. The defined benefit pension schemes are funded to cover future salary and pension increases and 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 as a proportion (varying between 1/30 and 1/80 for each year of service) of their salary for the final year of employment with the group or, if higher, the average of the highest three consecutive years' salary in the last ten years of employment.

On 11 May 2011, Severn Trent announced that it was consulting with its 6,000 plus UK employees on proposed changes to its pension arrangements, which would see all existing pensions replaced by one new defined contribution pension scheme. Following the period of consultation and after discussion with the schemes' trustees, final proposals have been accepted by the employees' representatives and the trustees. A new defined contribution pension scheme has been established and from 1 April 2012 new employees have been auto enrolled into this scheme. The defined benefit pension schemes will close to future accrual on 31 March 2015 and members of the defined benefit pension scheme will then become members of the new defined contribution pension scheme. This resulted in an exceptional net curtailment gain of £23.1 million being recognised in the income statement. The existing defined contribution pension scheme will also be replaced by the new pension arrangements with effect from 1 April 2015 and it is proposed to automatically enrol those employees who are not currently members of a Severn Trent scheme from 1 April 2013.

The final salary sections of the pension schemes listed below are closed to new entrants and the age profile of scheme participants is expected to rise and hence service costs are also expected to rise until the schemes are closed to future accrual.

The UK defined benefit pension schemes and the date of their last formal actuarial valuation are as follows:

	Date of last formal actuarial valuation
Severn Trent Pension scheme (STPS)*	31 March 2010
Severn Trent Mirror Image Pension Scheme	31 March 2009

* The STPS is by far the largest of the group's UK defined benefit schemes.

The group has an obligation to pay pensions to a number of former employees, whose benefits would otherwise have been restricted by the Finance Act 1989 earnings cap. Provision for such benefits amounting to £8.6 million (2011: £8.1 million) is included as an unfunded scheme within the retirement benefit obligation.

27 Retirement benefit schemes (continued)

a) Defined benefit pension schemes (continued)

(iv) Actuarial assumptions

The major assumptions used in the valuation of the STPS (also the approximate weighted average of assumptions used for the valuations of all group schemes) were as follows:

	2012 %	2011 %
Price inflation	3.10	3.50
Salary increases	3.60	4.00
Pension increases in payment	3.10	3.50
Pension increases in deferment	3.10	3.50
Discount rate	4.90	5.60
Long term rate of return on:		
Equities	6.80	7.85
Gilts	3.30	4.35
Corporate bonds	4.90	5.60
Property	5.80	6.85
Hedge funds	6.30	–
Cash	3.90	4.25

The assumption for price inflation is derived from the difference between the yields on longer term fixed rate gilts and on index-linked gilts. The discount rate is set by reference to AA rated sterling 17 year corporate bonds.

(iv) Actuarial assumptions (continued)

The expected rate of return on scheme assets is based on market expectations at the beginning of the period for returns over the life of the benefit obligation. For gilts and corporate bonds the expected rates of return are based on market yields. For equities, property and hedge funds, a risk premium has been added to the gilt rate.

The mortality assumptions adopted are based on mortality tables applicable to the sex and year of birth of individual members, with allowance for the CMI 2010 future improvements and a 0.5% trend. For men the assumptions are based on 110% of the 'SAPS' S1NMA_L tables and for women on 78% of the S1NFA_L tables. These have been based on a mortality investigation carried out in conjunction with the valuation of the STPS as at 31 March 2010 on behalf of the trustees.

The life expectancies implied by the mortality assumptions adopted at each year end are as follows:

	2012 Years	2011 Years
Age to which current pensioners aged 65 are expected to live		
– men	87.5	87.4
– women	91.1	91.0
Age to which future pensioners aged 45 at the balance sheet date are expected to live		
– men	88.0	88.0
– women	91.9	91.8

The calculation of the scheme liabilities is sensitive to the actuarial assumptions and in particular to the assumptions relating to discount rate, price inflation and mortality. The following table summarises the estimated impact on scheme liabilities and service cost resulting from changes to key actuarial assumptions whilst holding all other assumptions constant.

Assumption	Change in assumption	Impact on scheme liabilities
Discount rate	Increase/decrease by 0.1%	Decrease/increase by £35 million
Price inflation	Increase/decrease by 0.1%	Increase/decrease by £30 million
Mortality	Increase in life expectancy by 1 year	Increase by £45 million

27 Retirement benefit schemes (continued)

a) Defined benefit pension schemes (continued)

(v) Contributions to the schemes

Contribution rates are set in consultation with the trustees for each scheme and each participating employer. It is anticipated that normal contributions to the scheme in the year ended 31 March 2013 will be unchanged and agreed lump sum deficit contributions include a payment of £10 million per annum in cash and a further £8 million per annum through an asset backed funding arrangement.

(vi) History of actual and expected performance of pension scheme assets and liabilities

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Present value of defined benefit obligations	(1,903.0)	(1,765.5)	(1,747.9)	(1,308.0)	(1,458.3)
Fair value of scheme assets	1,557.2	1,473.4	1,393.0	1,075.0	1,332.3
Deficit in schemes	(345.8)	(292.1)	(354.9)	(233.0)	(126.0)
Difference between actual and expected return on scheme assets	(4.5)	12.2	270.4	(329.8)	(125.7)
Experience adjustments on scheme liabilities	(106.2)	105.1	19.8	(7.9)	(64.3)

b) Defined contribution pension schemes

The group also operates defined contribution arrangements for certain of its UK and overseas employees. In September 2001, the Severn Trent Group Pension Scheme (an occupational defined contribution pension scheme) was established to ensure compliance with stakeholder legislation and to provide the group with an alternative pension arrangement. This was closed to new entrants on 1 April 2005 and replaced by the Severn Trent Stakeholder Pension Scheme.

The total cost charged to operating costs of £4.9 million (2011: £4.9 million) represents contributions payable to these schemes by the group at rates specified in the rules of the schemes. As at 31 March 2012, all contributions (2011: 100%) due in respect of the current reporting period had been paid over to the schemes.

28 Provisions

	Restructuring £m	Insurance £m	Onerous contracts £m	Terminated operations and disposals £m	Other £m	Total £m
At 1 April 2011	3.3	23.1	6.9	3.7	1.0	38.0
Charged to income statement	1.4	7.4	–	2.7	5.3	16.8
Utilisation of provision	(2.8)	(5.6)	(1.6)	–	(1.1)	(11.1)
Unwinding of discount	–	–	0.2	–	0.1	0.3
At 31 March 2012	1.9	24.9	5.5	6.4	5.3	44.0

	2012 £m	2011 £m
Included in		
Current liabilities	17.0	12.6
Non-current liabilities	27.0	25.4
	44.0	38.0

The restructuring provision reflects costs to be incurred in respect of committed restructuring programmes.

Derwent Insurance Limited, a captive insurance company, is a wholly owned subsidiary of the group. Provisions for claims are made as set out in note 2 . The associated outflows are estimated to arise over a period of up to five years from the balance sheet date.

The onerous contract provision relates to specific contractual liabilities either assumed with businesses acquired or arising in existing group businesses, where estimated future costs are not expected to be recovered in revenues. The associated outflows are estimated to occur over a period of ten years from the balance sheet date.

Provisions relating to terminated operations and disposals include amounts that it is probable will be paid in respect of claims arising from services performed by these businesses and the indemnities described in note 35 b).

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

29 Share capital

	2012 £m	2011 £m
Total issued and fully paid share capital		
237,608,111 ordinary shares of $97^{17}/_{19}$p (2011: 237,142,534)	232.6	232.2

Changes in share capital were as follows:

	Number	£m
Ordinary shares of $97^{17}/_{19}$p		
At 1 April 2011	237,142,534	232.2
Shares issued under the Employee Sharesave Scheme	442,593	0.4
Shares issued under the Unapproved Share Option Scheme	22,984	–
At 31 March 2012	237,608,111	232.6

30 Share premium

	2012 £m	2011 £m
At 1 April	80.0	75.9
Share premium arising on issue of shares for Employee Sharesave Scheme	3.7	4.1
Share premium arising on issue of shares for Unapproved Share Option Scheme	0.1	–
At 31 March	83.8	80.0

31 Other reserves

	Capital redemption reserve £m	Infrastructure reserve £m	Translation exchange reserve £m	Hedging reserve £m	Total £m
At 1 April 2010	156.1	314.2	31.7	(46.4)	455.6
Total comprehensive income for the period	–	–	(6.3)	15.2	8.9
At 1 April 2011	156.1	314.2	25.4	(31.2)	464.5
Total comprehensive loss for the period	–	–	(1.4)	(62.9)	(64.3)
At 31 March 2012	156.1	314.2	24.0	(94.1)	400.2

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

The infrastructure reserve arose on restating infrastructure assets to fair value as deemed cost on transition to IFRS.

The translation reserve arises from exchange differences on translation of the results and financial position of foreign subsidiaries as well as exchange differences arising from hedges of net investment.

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.

32 Financial instruments

a) Capital management

The group's principal objectives in managing capital are:

- to access a broad range of sources of finance to obtain both the quantum required and lowest cost compatible with the need for continued availability;
- to 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 does not have a specific gearing target but seeks to maintain gearing at a level consistent with its capital management objectives described above.

The group's dividend policy is a key tool in achieving its capital management objectives. This policy is reviewed and updated in line with Severn Trent Water's five year price control cycle and takes into account, inter alia; the planned investment programme; the appropriate gearing level achieving a balance between an efficient cost of capital; and retaining an investment grade credit rating and delivering an attractive and sustainable return to shareholders.

The directors have reviewed the group's capital structure, taking into account the funding requirements over the remainder of AMP5, the proportion of index linked debt in issue and historical and forecast RPI, and concluded that there is an opportunity to deliver additional returns to shareholders. The board has therefore proposed a return to shareholders of £150 million, which equates to 63.00 pence per share. See note 14.

The group monitors future funding requirements and credit market conditions to ensure continued availability of funds.

On 24 January 2012, the group issued a £250 million bond with a coupon of 4.875% and a maturity of 30 years. On 27 January 2012, the group purchased £150.6 million of a £200 million bond maturing in 2014 through a tender offer launched simultaneously with the bond issue. The costs of the tender offer gave rise to an exceptional finance charge of £16.5 million, representing the difference between the purchase price and the carrying value of the bond.

A new five year £500 million Revolving Credit Facility was agreed in October 2011. This replaced the existing £500 million Revolving Credit Facility. A new 10 year £100 million bilateral bank facility was agreed in March 2012. This facility was drawn on 18 April 2012.

At 31 March the group's equity and debt capital comprised the following:

	2012 £m	2011 £m
Cash and short term deposits	295.1	315.2
Bank overdrafts	(0.4)	–
Bank loans	(852.5)	(846.8)
Other loans	(3,326.9)	(3,230.9)
Obligations under finance leases	(219.0)	(266.7)
Cross currency swaps	135.9	160.4
Net debt	(3,967.8)	(3,868.8)
Equity attributable to the company's equity shareholders	(973.5)	(1,099.8)
Total capital	(4,941.3)	(4,968.6)

32 Financial instruments (continued)

b) Categories of financial assets

	2012 £m	2011 £m
Fair value through profit and loss		
Cross currency swaps – fair value hedges	95.2	98.1
Interest rate swaps – not hedge accounted	23.7	17.3
Energy swaps – cash flow hedges	2.5	14.7
Cross currency swaps – not hedge accounted	41.2	62.3
	162.6	192.4
Available for sale investments carried at fair value		
Unquoted shares	0.1	0.1
Loans and receivables (including cash and cash equivalents)		
Trade receivables	181.1	188.1
Short term deposits	257.7	248.6
Cash at bank in hand	37.4	66.6
	476.2	503.3
Total financial assets	638.9	695.8

	2012 £m	2011 £m
Disclosed in the balance sheet as:		
Non-current assets		
Derivative financial instruments	132.6	188.1
Available for sale financial assets	0.1	0.1
	132.7	188.2
Current assets		
Derivative financial instruments	30.0	4.3
Cash and cash equivalents	295.1	315.2
Trade receivables (note 22)	181.1	188.1
	506.2	507.6
	638.9	695.8

32 Financial instruments (continued)

c) Categories of financial liabilities

	2012 £m	2011 £m
Fair value through profit and loss		
Cross currency swaps – not hedge accounted	(0.5)	–
Interest rate swaps – cash flow hedges	(91.6)	(17.8)
Interest rate swaps – not hedge accounted	(194.4)	(104.6)
Energy swaps – cash flow hedges	(1.4)	–
Foreign exchange forward contracts – not hedge accounted	(0.6)	(0.1)
	(288.5)	(122.5)
Other financial liabilities		
Bank loans	(852.5)	(846.8)
Other loans	(3,326.9)	(3,230.9)
Obligations under finance leases	(219.0)	(266.7)
Overdraft	(0.4)	–
Trade payables	(34.9)	(32.3)
	(4,433.7)	(4,376.7)
Total financial liabilities	(4,722.2)	(4,499.2)

Disclosed in the balance sheet as:		
Non-current liabilities		
Derivative financial instruments	(288.0)	(122.4)
Borrowings	(4,309.5)	(4,320.5)
	(4,597.5)	(4,442.9)
Current liabilities		
Derivative financial instruments	(0.5)	(0.1)
Borrowings	(89.3)	(23.9)
Trade payables (note 25)	(34.9)	(32.3)
	(124.7)	(56.3)
	(4,722.2)	(4,499.2)

32 Financial instruments (continued)

d) Fair values of financial instruments

Except as disclosed below, the directors consider that there is no significant difference between the carrying amount of financial assets and liabilities recorded in the financial statements and their fair values:

	2012		2011	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Bank loans – amortised cost	(852.5)	(858.3)	(846.8)	(836.8)
Other loans	(3,326.9)	(3,936.2)	(3,230.9)	(3,597.6)
Obligations under finance leases – amortised cost	(219.0)	(215.4)	(266.7)	(237.4)
	(4,398.4)	(5,009.9)	(4,344.4)	(4,671.8)

Discounted future cash flows are used to determine fair values for debt. Discount rates are derived from yield curves based on quoted interest rates and are adjusted for the group's credit risk.

Fair value measurements recognised in the balance sheet

In 2012 and 2011, all the fair values of financial instruments that were measured subsequent to initial recognition at fair value, were based on observable inputs other than quoted prices for identical instruments, defined as 'Level 2' in IFRS 7.

The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows estimated and discounted based on the application of yield curves derived from quoted interest rates.

Cross currency swaps and forward exchange contracts are valued by reference to quoted forward exchange rates at the balance sheet date and yield curves derived from quoted interest rates matching the maturities of the contracts.

e) Financial risk factors

The group's activities expose it to a variety of financial risks: market risk (including currency and interest rate 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. Group Treasury identifies, evaluates and hedges financial risks in close co-operation with the group's operating units. The board provides 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. Derivative financial instruments are used to hedge exposure to changes in exchange rates and interest rates. The group's policy is that derivative financial instruments are not held for trading.

(i) Market risk

The principal market risk that the group is exposed to is fluctuations in interest rates.

Interest rate risk

The group's income and 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 cash flow interest rate risk. Borrowings issued at fixed rates expose the group to fair value interest rate risk. The group's policy is to maintain 45% to 90% of its net debt in fixed rate instruments. At 31 March 2012 74.0% of the group's net debt was at fixed rates (2011: 75.9%).

The group manages its cash flow interest rate risk by using floating to fixed interest rate swaps. Such interest rate swaps have the economic effect of converting borrowings from floating rates to fixed rates. Under the terms of the interest rate swaps, the group agrees with other parties to exchange, mainly semi-annually, the difference between fixed contract and floating rate interest rates calculated by reference to the agreed notional principal amounts. The group has entered into a series of long dated interest rate swaps to hedge future debt. Economically these act to fix the interest cost of debt within the group which is denominated as floating rate, but do not achieve hedge accounting under the strict criteria of IAS 39. This has led to an £80.3 million charge (2011: charge of £15.7 million) in the income statement.

Some of the group's debt is index-linked, that is its cost is linked to changes in the Retail Price Index (RPI). This debt provides an economic hedge for Severn Trent Water's revenues and Regulatory Capital Value that are also RPI linked under its regulatory regime.

32 Financial instruments (continued)

e) Financial risk factors (continued)

(i) Market risk (continued)

Financial liabilities analysed by interest rate after taking account of various interest rate swaps entered into by the group

2012	Non-interest bearing liabilities £m	Floating rate £m	Fixed rate £m	Index-linked £m	Total £m
Bank loans and overdrafts	–	(500.4)	(192.2)	(160.3)	(852.9)
Other loans	(1.2)	(265.2)	(2,063.1)	(997.4)	(3,326.9)
Finance leases	–	–	(219.0)	–	(219.0)
Other financial liabilities	(34.9)	–	–	–	(34.9)
	(36.1)	(765.6)	(2,474.3)	(1,157.7)	(4,433.7)
Impact of interest rate swaps not matched against specific debt instruments	–	463.6	(463.6)	–	–
	(36.1)	(302.0)	(2,937.9)	(1,157.7)	(4,433.7)
Weighted average interest rate			5.84%		
Weighted average period for which interest is fixed (years)			12.8		

2011	Non-interest bearing liabilities £m	Floating rate £m	Fixed rate £m	Index-linked £m	Total £m
Bank loans and overdrafts	–	(544.1)	(150.0)	(152.7)	(846.8)
Other loans	(1.2)	(263.5)	(2,014.7)	(951.5)	(3,230.9)
Finance leases	–	–	(266.7)	–	(266.7)
Other financial liabilities	(32.3)	–	–	–	(32.3)
	(33.5)	(807.6)	(2,431.4)	(1,104.2)	(4,376.7)
Impact of interest rate swaps not matched against specific debt instruments	–	462.3	(462.3)	–	–
	(33.5)	(345.3)	(2,893.7)	(1,104.2)	(4,376.7)
Weighted average interest rate			5.96%		
Weighted average period for which interest is fixed (years)			11.7		

Financial assets analysed by interest rates

2012	Non-interest bearing assets £m	Floating rate £m	Fixed rate £m	Index-linked £m	Total £m
Available for sale financial assets	0.1	–	–	–	0.1
Loans and receivables	181.0	–	–	–	181.0
Cash and cash equivalents	–	295.1	–	–	295.1
	181.1	295.1	–	–	476.2

2011	Non-interest bearing assets £m	Floating rate £m	Fixed rate £m	Index-linked £m	Total £m
Available for sale financial assets	0.1	–	–	–	0.1
Loans and receivables	188.1	–	–	–	188.1
Cash and cash equivalents	–	315.2	–	–	315.2
	188.2	315.2	–	–	503.4

32 Financial instruments (continued)

e) Financial risk factors (continued)

(i) Market risk (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 changes in interest rates at 31 March is as follows:

	2012		2011	
	+1.0% £m	-1.0% £m	+1.0% £m	-1.0% £m
Profit or loss	75.3	(90.1)	46.1	(55.3)
Cash flow	0.1	(0.1)	0.1	(0.1)
Equity	121.7	(143.1)	83.3	(98.6)

Inflation rate sensitivity analysis

The sensitivity of the group's profit and equity to changes in inflation at 31 March is set out in the following table. This analysis excludes any impact on Severn Trent Water's revenues and Regulated Capital Value, or accounting for defined benefit pension schemes.

	2012		2011	
	+1.0% £m	-1.0% £m	+1.0% £m	-1.0% £m
Profit or loss	(8.8)	8.8	(8.0)	8.0
Equity	(8.8)	8.8	(8.0)	8.0

Exchange rate risk

The group operates internationally and is exposed to exchange risk arising from net investments in foreign operations, primarily with respect to the US dollar and the euro. However, since substantially all of the group's profits and net assets arise from Severn Trent Water which has very limited and indirect exposure to changes in exchange rates, the sensitivity of the group's results to changes in exchange rates is not material.

The group's net debt includes foreign currency borrowings, primarily denominated in yen and euros. The group's policy is to manage the exchange risk arising from foreign currency borrowings by entering into cross currency swaps or forward contracts with external parties.

The group's gross and net currency exposures arising from currency borrowings are summarised below:

2012	Sterling £m	Euro €m	US Dollar $m	Japanese Yen ¥Bn	Czech Krona CZKm
Borrowings by currency	(3,473.5)	(720.6)	(50.0)	(30.0)	(1,970.0)
Cross currency swaps – hedge accounted	(184.0)	19.9	50.0	20.0	1,970.0
Cross currency swaps – not hedge accounted	(617.6)	700.0	–	10.0	–
	(4,275.1)	(0.7)	–	–	–
Cash	276.9	5.3	22.1		
Net currency exposure	(3,998.2)	4.6	22.1	–	–

2011	Sterling £m	Euro €m	US Dollar $m	Japanese Yen ¥Bn	Czech Krona CZKm
Borrowings by currency	(3,536.5)	(721.4)	(50.0)	(31.0)	(1,970.0)
Cross currency swaps – hedge accounted	(188.9)	19.9	50.0	21.0	1,970.0
Cross currency swaps – not hedge accounted	(617.7)	700.0	–	10.0	–
	(4,343.1)	(1.5)	–	–	–
Cash	284.9	12.1	31.6	–	–
Net currency exposure	(4,058.2)	10.6	31.6	–	–

The euro and US dollar net cash balances relate to operations in which the euro or US dollar is the functional currency.

32 Financial instruments (continued)

e) Financial risk factors (continued)

Monetary assets and liabilities by currency, excluding functional currency

Certain of the group's subsidiaries enter into transactions in currencies other than the functional currency of the operation. Exchange risks relating to such operations are not material but are managed centrally by Group Treasury through forward exchange contracts to buy or sell currency.

(ii) 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, 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 22.

For financing purposes, derivative counterparties and cash transactions are limited to high credit quality financial institutions. The group has policies that limit the amount of credit exposure to any one financial institution.

Credit risk analysis

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

	Credit limit		Amount deposited	
	2012 £m	2011 £m	2012 £m	2011 £m
AAA	20.0	300.0	0.1	54.8
Double A range	150.0	450.0	111.1	81.2
Single A range	450.0	525.0	146.5	112.6
	620.0	1,275.0	257.7	248.6

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

	Derivative assets	
Rating	2012 £m	2011 £m
Double A range	44.6	100.9
Single A range	118.0	91.5
	162.6	192.4

(iii) Liquidity risk

Prudent liquidity management implies maintaining sufficient cash balances and the availability of funding through an adequate amount of committed facilities 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:

	2012 £m	2011 £m
Within 1 year	–	41.7
1–2 years	–	458.3
2–5 years	500.0	–
After more than 5 years	100.0	–
	600.0	500.0

32 Financial instruments (continued)

e) Financial risk factors (continued)

(iii) Liquidity risk (continued)

Non-derivative financial instruments analysed by maturity date

The following tables detail the group's remaining contractual maturity for its 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.

2012	Within one year £m	Between one and two years £m	Between two and five years £m	Between five and ten years £m	Between ten and twenty years £m	Greater than twenty years £m	Total £m
Financial liabilities							
Overdraft	(0.4)	–	–	–	–	–	(0.4)
Bank loans	(20.7)	(384.6)	(191.4)	(340.1)	(33.9)	–	(970.7)
Other loans	(262.1)	(175.1)	(1,908.9)	(837.7)	(2,224.8)	(6,022.7)	(11,431.3)
Finance leases	(4.4)	(25.4)	(103.6)	(35.6)	(123.1)	–	(292.1)
Other financial liabilities	(34.9)	–	–	–	–	–	(34.9)
	(322.5)	(585.1)	(2,203.9)	(1,213.4)	(2,381.8)	(6,022.7)	(12,729.4)
Financial assets							
Trade receivables	181.1	–	–	–	–	–	181.1
Cash and short term deposits	295.1	–	–	–	–	–	295.1
	476.2	–	–	–	–	–	476.2
Net cash flow	153.7	(585.1)	(2,203.9)	(1,213.4)	(2,381.8)	(6,022.7)	(12,253.2)

2011	Within one year £m	Between one and two years £m	Between two and five years £m	Between five and ten years £m	Between ten and twenty years £m	Greater than twenty years £m	Total £m
Financial liabilities							
Bank loans	(19.7)	(26.8)	(431.5)	(507.7)	(39.4)	–	(1,025.1)
Other loans	(135.8)	(201.3)	(1,264.3)	(808.8)	(1,650.1)	(5,770.3)	(9,830.6)
Finance leases	(19.0)	(25.5)	(106.8)	(70.2)	(114.7)	(16.4)	(352.6)
Other financial liabilities	(32.3)	–	–	–	–	–	(32.3)
	(206.8)	(253.6)	(1,802.6)	(1,386.7)	(1,804.2)	(5,786.7)	(11,240.6)
Financial assets							
Trade receivables	188.1	–	–	–	–	–	188.1
Cash and short term deposits	315.2	–	–	–	–	–	315.2
	503.3	–	–	–	–	–	503.3
Net cash flows	296.5	(253.6)	(1,802.6)	(1,386.7)	(1,804.2)	(5,786.7)	(10,737.3)

Other loans include index-linked debt with maturities up to 55 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 calculations above are based on forward inflation rates at the balance sheet date.

32 Financial instruments (continued)

e) Financial risk factors (continued)

(iii) Liquidity risk (continued)

Derivative financial instruments analysed by maturity date

The following table details the group's liquidity analysis for its 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.

2012	Within one year £m	Between one and two years £m	Between two and five years £m	Between five and ten years £m	Between ten and twenty years £m	Greater than twenty years £m	Total £m
Derivative liabilities							
Instruments settled net							
Interest rate swaps	(33.5)	(39.4)	(110.6)	(93.6)	(74.9)	(4.6)	(356.6)
Energy swaps	–	(0.4)	(1.1)	–	–	–	(1.5)
	(33.5)	(39.8)	(111.7)	(93.6)	(74.9)	(4.6)	(358.1)
Derivative assets							
Instruments settled net							
Interest rate swaps	3.8	3.2	3.4	–	–	–	10.4
Energy swaps	1.8	0.7	–	–	–	–	2.5
Instruments settled gross							
Cross currency swaps							
– cash receipts	125.9	37.4	814.9	5.2	44.7	–	1,536.3
– cash payments	(97.8)	(37.0)	(715.4)	(3.7)	(24.8)	–	(878.7)
	33.7	4.3	102.9	1.5	19.9	–	670.5
Net cash flow	0.2	(35.5)	(8.8)	(92.1)	(55.0)	(4.6)	312.4

2011	Within one year £m	Between one and two years £m	Between two and five years £m	Between five and ten years £m	Between ten and twenty years £m	Greater than twenty years £m	Total £m
Derivative liabilities							
Instruments settled net							
Interest rate swaps	(30.2)	(23.4)	(42.8)	(15.2)	(6.9)	0.8	(117.7)
	(30.2)	(23.4)	(42.8)	(15.2)	(6.9)	0.8	(117.7)
Derivative assets							
Instruments settled net							
Interest rate swaps	7.1	5.1	6.2	–	–	–	18.4
Energy swaps	1.9	9.1	4.8	–	–	–	15.8
Instruments settled gross							
Cross currency swaps							
– cash receipts	48.3	131.4	891.9	2.4	27.5	–	1,101.5
– cash payments	(31.6)	(99.2)	(759.8)	(2.2)	(12.2)	–	(905.0)
	25.7	46.4	143.1	0.2	15.3	–	230.7
Net cash flow	(4.5)	23.0	100.3	(15.0)	8.4	0.8	113.0

32 Financial instruments (continued)

f) Hedge accounting

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

(i) Fair value hedges

The group raises debt denominated in currencies other than sterling – principally yen and euro. 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. The terms of the receivable leg of the swap closely match the terms of the underlying debt hence the swaps are expected to be effective hedges. At the year end the amounts of cross currency swaps designated as fair value hedges were as follows:

	Notional principal amount		Fair value	
	2012 £m	2011 £m	2012 £m	2011 £m
US dollar	27.0	27.0	7.6	6.6
Euro	11.4	11.4	7.8	6.0
Yen	98.4	103.3	59.0	60.8
Czech krona	47.2	47.2	20.8	24.7
	184.0	188.9	95.2	98.1

(ii) 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. The group also entered into a number of interest rate contracts with future start dates during the AMP5 regulatory period. Such contracts enable the group to mitigate the risk of changing interest rates on debt which is highly probable to be issued over the AMP5 period to fund Severn Trent Water's capital programme and have been accounted for as cash flow hedges. The fair value of interest rate swaps at the balance sheet date is determined by discounting the future cash flows using the yield curve prevailing at the balance sheet date and the credit risk inherent in the contract.

The interest rate swaps primarily settle net on a biannual basis. The floating rate on the interest rate swaps is six months LIBOR.

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

	Average contract fixed interest rate		Notional principal amount		Fair value	
Period to maturity	2012 %	2011 %	2012 £m	2011 £m	2012 £m	2011 £m
Less than 10 years	–	–	–	–	–	–
10-20 years	5.07%	5.07%	(492.3)	(493.0)	(91.6)	(17.8)
More than 20 years	–	–	–	–	–	–
	5.07%	5.07%	(492.3)	(493.0)	(91.6)	(17.8)

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 2015.

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32 Financial instruments (continued)

f) Hedge accounting (continued)

(ii) Cash flow hedges (continued)

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

	Average contract price		Notional contracted amount		Fair value	
Period to maturity	2012 £/MWh	2011 £/MWh	2012 MWh	2011 MWh	2012 £m	2011 £m
Less than 1 year	48.8	42.0	725,088	131,040	1.8	1.8
1–2 years	53.3	45.1	550,368	428,064	0.3	6.2
2–5 years	62.9	54.7	174,720	1,087,632	(1.0)	6.7
	52.2	47.3	1,450,176	1,646,736	1.1	14.7

Changes in the amounts deferred in equity during the period relating to cash flow hedges were as follows:

	2012 £m	2011 £m
Fair value gains/(losses) deferred in equity at the start of the period	18.4	(2.1)
Fair value (losses)/gains recognised in equity in the period	(86.5)	16.0
Fair value losses transferred to finance costs in the period	3.7	4.5
Fair value (losses)/gains deferred in equity at the end of the period	(64.4)	18.4

(iii) Interest rate swaps not hedge accounted

The group has a number of interest rate swaps which are not accounted for as cash flow hedges. Contracts where the group pays fixed rate interest are summarised below:

	Average contract fixed interest rate		Notional principal amount		Fair value	
Period to maturity	2012 %	2011 %	2012 £m	2011 £m	2012 £m	2011 £m
Less than 1 year	–	–	–	–	–	–
1–2 years	–	–	–	–	–	–
2–5 years	6.32	6.32	225.0	225.0	(37.9)	(33.0)
5–10 years	–	–	–	–	–	–
10–20 years	5.41	5.41	313.6	237.3	(114.6)	(41.2)
20–30 years	5.10	5.22	125.0	200.0	(41.9)	(30.4)
	5.61	5.61	663.6	662.3	(194.4)	(104.6)

Contracts where the group receives fixed interest are summarised below:

	Average contract fixed interest rate		Notional principal amount		Fair value	
Period to maturity	2012 %	2011 %	2012 £m	2011 £m	2012 £m	2011 £m
Less than 1 year	–	–	–	–	–	–
1–2 years	–	–	–	–	–	–
2–5 years	5.18	5.18	200.0	200.0	23.7	17.3
5–10 years	–	–	–	–	–	–
10–20 years	–	–	–	–	–	–
20–30 years	–	–	–	–	–	–
	5.18	5.18	200.0	200.0	23.7	17.3

33 Share based payments

The group operates a number of share based remuneration schemes for employees. During the period, the group recognised total expenses of £4.1 million (2011: £4.6 million) related to equity settled share based payment transactions.

The weighted average share price during the period was £15.00 (2011: £13.40).

At 31 March 2012, there were no options exercisable under any of the share based remuneration schemes (2011: 22,984 options in the Unapproved Share Option Scheme).

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 have been made on different bases to Severn Trent Plc and Severn Trent Water employees (the LTIP) and to Severn Trent Services employees (the Services LTIP).

(i) Awards outstanding

Awards made under the LTIP

In July 2011 awards over 112,446 shares (2011: 141,111 shares) with a fair value of £12.16 (2011: £7.91) were made to 18 employees (2011: 20 employees) under the LTIP. These awards are 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. The LTIP awards granted in July 2010 are subject to total shareholder return (TSR) over three years relative to the companies ranked 51–150 by market capitalisation in the FTSE index (excluding investment trusts). It has been assumed that performance against the LTIP non-market conditions will be 100%) (2011: 100%).

Awards made under the Services LTIP

In July 2011 awards over 38,493 shares with a fair value of £12.16 were made to 10 employees under the Services LTIP. These awards are subject to achievement of turnover and profit targets in the year ending 31 March 2014. It has been assumed that performance against the 2011 Services LTIP non-market conditions will be 75%.

The awards granted in July 2008 vest in three equal tranches which are subject to achievement of turnover and profit targets in the years ending 31 March 2011, 2012 and 2013. It has been assumed that performance against the 2008 Services LTIP non-market conditions will be 0% (2011: 0.3%).

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

	Number of awards	
	LTIP	Services LTIP
Outstanding at 1 April 2010	393,483	110,440
Granted during the year	141,111	–
Vested during the year	(71,849)	–
Forfeited during the year	(10,671)	(9,053)
Lapsed during the year	(49,373)	–
Outstanding at 1 April 2011	402,701	101,387
Granted during the year	112,446	38,493
Vested during the year	–	–
Forfeited during the year	(14,946)	(10,329)
Lapsed during the year	(116,714)	(34,607)
Outstanding at 31 March 2012	**383,487**	**94,944**

33 Share based payments (continued)

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

Date of grant	Normal date of vesting	Number of awards 2012	2011
July 2008	2011	–	151,322
July 2008	2012	33,671	33,671
July 2008	2013	31,145	33,109
July 2009	2012	151,786	151,786
July 2010	2013	127,727	134,200
July 2011	2014	134,102	–
		478,431	504,088

(ii) Fair value

The share price at the grant date was £13.98 (2011: £12.28). The vesting period commences before the grant date. Performance in the vesting period prior to the grant date is taken into account in determining the fair value of the award.

The fair value of the LTIP awards made during the year was calculated using the Black-Scholes method using the principal assumptions set out below:

Assumptions	2012
Expected volatility – Severn Trent Plc	27%
Expected dividend yield	4.7%
Risk free rate	1.57%

Expected volatility is based on historical weekly volatility over a three year period. Weekly volatility in the observed data was between 25% and 31%.

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

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

The fair value of the LTIP awards made during the previous year was calculated using the Monte Carlo method using the principal assumptions set out below:

Assumptions	2011
Expected volatility	
Severn Trent Plc	27%
Comparator group	47%
Correlation between Severn Trent Plc and comparator group	32%

Expected volatility is based on historical weekly volatility over a three year period. Weekly volatility in the observed data was between 25% and 31%.

For the July 2010 LTIP award the comparator group is the group of companies ranked 51–150 in the FTSE index excluding investment trusts.

The volatility of the comparator companies, the correlation between Severn Trent Plc and the comparator companies, and performance over the portion of the performance period that had elapsed at the date of grant was taken into account when modelling the TSR performance condition.

Dividends 'paid' on shares during the vesting period are accumulated during the vesting period and released subject to achievement of the performance condition in the same manner as the underlying shares. As a result a dividend yield assumption is not required.

Details of the basis of the LTIP schemes are set out in the remuneration report on page 59 and 60.

33 Share based payments (continued)

b) Employee Sharesave Scheme

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

(i) Options outstanding

The number of employees entering into Sharesave contract and the number of options granted during the year were as follows:

	2012		2011	
	3 year scheme	5 year scheme	3 year scheme	5 year scheme
Number of employees	1,610	363	1,073	448
Number of options granted	440,930	127,631	223,291	142,981

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 2010	3,637,068	899p
Granted during the year	366,272	1,137p
Forfeited during the year	(146,468)	895p
Cancelled during the year	(92,030)	875p
Exercised during the year	(550,525)	841p
Lapsed during the year	(86,132)	1,062p
Outstanding at 1 April 2011	3,128,185	904p
Granted during the year	568,561	1,177p
Forfeited during the year	(60,732)	903p
Cancelled during the year	(51,578)	947p
Exercised during the year	(442,593)	928p
Lapsed during the year	(57,357)	913p
Outstanding at 31 March 2012	3,084,486	950p

Sharesave options outstanding at 31 March were as follows:

			Number of share options	
Date of grant	Normal date of exercise	Option price	2012	2011
January 2004	2011	592p	–	45,820
January 2005	2012	759p	52,912	54,324
January 2006	2011 or 2013	823p	20,468	212,941
January 2007	2012 or 2014	1,172p	78,280	93,243
January 2008	2011 or 2013	1,221p	78,488	218,048
January 2009	2012 or 2014	862p	1,141,447	1,247,781
January 2010	2013 or 2015	806p	810,413	890,670
January 2011	2014 or 2016	1,137p	334,910	365,358
January 2012	2015 or 2017	1,177p	567,568	–
			3,084,486	3,128,185

33 Share based payments (continued)

b) Employee Sharesave Scheme (continued)

(ii) Fair value

The fair value of the Sharesave options granted during the year was calculated using the Black Scholes model. The principal assumptions were as follows:

Assumptions	2012 3 year scheme	2012 5 year scheme	2011 3 year scheme	2011 5 year scheme
Expected volatility	27%	27%	27%	27%
Expected dividend yield	4.6%	4.6%	4.4%	4.4%
Risk free rate	0.53%	1.75%	1.63%	2.24%
Fair value per share	320p	339p	348p	359p

Expected volatility is based on historical weekly volatility over a three year period. Weekly volatility in the observed data was between 25% and 31%. The risk free rate is derived from yields at the grant date of gilts of similar duration to the Sharesave contracts. The dividend yield is calculated using the expected dividend for the year divided by the share price at the date of grant.

The following data was used in calculating the fair value of the Sharesave options:

	2012 3 year scheme	2012 5 year scheme	2011 3 year scheme	2011 5 year scheme
Share price at grant date	1,520p	1,520p	1,486p	1,486p
Vesting period (years)	3	5	3	5
Option life (years)	3.5	5.5	3.5	5.5

c) Share Incentive Plan (SIP)

Under the SIP the board may grant share awards to employees of group companies. During the year the board has announced that it will make awards under the SIP based on performance against Severn Trent Water's targets for its Key Performance Indicators. Eligible employees will be entitled to shares to a maximum value of £750. It is expected that these awards will be made in August 2012. SIP shares vest with the employee on the date of grant.

d) Unapproved Share Options Scheme

The board has granted options to purchase ordinary shares in the company to a number of executives under an unapproved share option scheme. No awards have been made under this scheme since July 2003.

Details of movements in the share awards outstanding during the year were as follows:

	Number of share options	Weighted average exercise price
Outstanding at 1 April 2010	35,259	728p
Exercised during the year	(3,679)	720p
Lapsed during the year	(8,596)	729p
Outstanding at 1 April 2011	22,984	729p
Exercised during the year	(22,984)	729p
Outstanding at 31 March 2012	–	–

Options outstanding under this scheme at 31 March were as follows:

Date of grant	Normal date of exercise	Option price	Number of shares 2012	Number of shares 2011
June 2001	2004–2011	738p	–	11,844
June 2002	2005–2012	720p	–	11,140
			–	22,984

33 Share based payments (continued)

e) Share Matching Plan (SMP)

Under the Share Matching Plan members of STEC receive matching share awards over those shares which have 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 one deferred share and are subject to a three year vesting period. During the year matching shares were awarded at a ratio of 0.5 to 1.

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). This replicates the LTIP performance condition for the July 2010 award.

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

(i) Awards outstanding

During the year 19,072 (2011: 25,187) matching shares with a fair value of £8.84 (2011: £6.79) were awarded to 11 employees (2011: 11).

	Number of awards
Outstanding at 1 April 2010	–
Granted during the year	25,187
Outstanding at 1 April 2011	25,187
Granted during the year	19,072
Cancelled during the year	(1,900)
Vested during the year	(909)
Outstanding at 31 March 2012	41,450

Details of share matching awards outstanding at 31 March were as follows:

		Number of awards	
Date of grant	Normal date of vesting	2012	2011
May 2010	June 2013	22,378	25,187
May 2011	May 2014	19,072	–
		41,450	25,187

(ii) Fair value

The fair value of the share matching awards made during the year was calculated using the Monte Carlo method using the principal assumptions set out below:

Assumptions	2012	2011
Expected volatility		
Severn Trent group	26%	27%
Comparator group	41%	46%
Correlation between Severn Trent Plc and comparator group	n/a	33%

Share price volatility is based on observations over a historical period prior to the date of grant, commensurate to the expected term of the performance period.

The comparator group is the companies ranked 51–150 in the FTSE Index.

The share price at the grant date was £15.02 (2011: £11.26).

Dividends paid on the shares during the vesting period are accumulated during the vesting period and released subject to the achievement of the performance condition, in the same manner as the underlying shares. As a result a dividend yield assumption is not required.

34 Cash flow statement

a) Reconciliation of operating profit to operating cash flows

	2012 £m	2011 £m
Profit before interest and tax	469.8	497.7
Depreciation of property, plant and equipment	256.0	251.5
Amortisation of intangible assets	30.8	25.4
Exceptional impairment	22.9	–
Pension service cost	22.6	22.7
Curtailment gain	(23.1)	–
Pension contributions	(53.5)	(40.0)
Share based payments charge	4.1	4.6
Profit on sale of property, plant and equipment and intangible assets	(4.4)	(2.6)
Deferred income movement	(8.7)	(8.4)
Provisions charged to the income statement	16.8	6.8
Utilisation of provisions for liabilities and charges	(11.1)	(19.0)
Increase in inventory	(7.4)	(0.5)
Decrease/(increase) in amounts receivable	6.1	(7.5)
Increase in amounts payable	5.0	22.3
Cash generated from operations	725.9	753.0
Tax paid	(72.0)	(32.4)
Net cash generated from operating activities	653.9	720.6

b) Non-cash transactions

No additions to property, plant and equipment during the year were financed by new finance leases (2011: nil).

c) Exceptional cash flows

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

	2012 £m	2011 £m
Restructuring costs	(14.4)	(27.6)
Regulatory matters	(3.9)	(3.8)
Finance costs	(16.5)	–
	(34.8)	(31.4)

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

	As at 1 April 2011 £m	Cash flow £m	Fair value adjustments £m	RPI uplift on index-linked debt £m	Foreign exchange £m	Other non cash movements £m	As at 31 March 2012 £m
Cash and cash equivalents	315.2	(19.9)	–	–	(0.2)	–	295.1
Bank overdrafts	–	(0.4)	–	–	–	–	(0.4)
Net cash and cash equivalents	315.2	(20.3)	–	–	(0.2)	–	294.7
Bank loans	(846.8)	1.9	–	(7.6)	–	–	(852.5)
Other loans	(3,230.9)	(94.5)	1.9	(46.0)	41.5	1.1	(3,326.9)
Finance leases	(266.7)	47.6	–	–	–	0.1	(219.0)
Cross currency swaps	160.4	–	(26.6)	–	–	2.1	135.9
Net debt	(3,868.8)	(65.3)	(24.7)	(53.6)	41.3	3.3	(3,967.8)

35 Contingent liabilities

a) Bonds and guarantees

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

The group has given certain guarantees in respect of the borrowings of its associate, Servizio Idrico Integrato S.c.p.a. The guarantees are limited to €11.2 million (2011: €11.2 million). The group does not expect any liabilities that are not provided for in these financial statements to arise from these arrangements.

b) Disposal of subsidiaries

The group has given certain guarantees and indemnities in relation to disposals of businesses.

Following a hearing in the Commercial Court in Belgium in February 2010 in relation to a claim from Veolia Proprete S.A. ('Veolia') arising from the sale of Biffa Belgium to Veolia in 2006, the Court rendered judgment in favour of the group on 1 April 2010 and declared all of Veolia's claims to be unfounded. Veolia has filed an appeal against this decision, however, the group considers that Veolia's case remains unfounded and no provision has been recorded in respect of this matter.

The group is not aware of any other liability that is likely to result from these guarantees and indemnities that has not been provided for in these financial statements.

c) Regulatory matters

On 17 December 2010 Severn Trent Plc, Severn Trent Water Limited and Severn Trent Laboratories Limited received a request from Ofwat to provide certain information under the Competition Act in connection with Severn Trent Laboratories Limited's contracts with Severn Trent Water Limited and certain other water companies. The information requested has subsequently been provided to Ofwat.

At this stage it is not possible to determine what, if any, liability will arise as a result of this request.

36 Service concession arrangements

The group's contract to provide water and waste water services to the Ministry of Defence (MoD) is a service concession arrangement under the definition set out in IFRIC 12. The group acts as the service provider under the MoD Project Aquatrine Package C – a 25 year contract spanning 1,523 sites across England covering the Eastern sea border and from Lancashire in the North West to West Sussex on the South Coast.

Under the contract the group maintains and upgrades the MoD infrastructure assets and provides operating services for water and waste water. The maintenance and upgrade services are charged at an agreed rate, adjusted for inflation, that is agreed in the contract. The operating services are charged under an agreed volumetric tariff.

Since the group has an unconditional right to receive cash in exchange for the maintenance and upgrade services, the amounts receivable are recognised as a financial asset within prepayments and accrued income. At 31 March 2012 the amount receivable were £25.5 million (2011: £27.1 million).

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

37 Financial and other commitments

a) Investment expenditure commitments

	2012 £m	2011 £m
Contracted for but not provided in the financial statements	159.8	91.7

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

b) Leasing commitments

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

	2012 £m	2011 £m
Within 1 year	4.7	4.4
2–5 years	12.0	11.2
After more than 5 years	8.1	7.3
	24.8	22.9

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

38 Post balance sheet events

Following the year end the board of directors has proposed a final dividend of 42.06 pence per share and a special dividend of 63.00 pence per share. Further details of this are shown in note 14.

39 Related party transactions

Transactions between the company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not included in this note. Transactions between the group and its associates and joint ventures are disclosed below:

Trading transactions

	Sale of goods		Purchase of goods		Amounts due from related parties		Amounts due to related parties	
	2012 £m	2011 £m	2012 £m	2011 £m	2012 £m	2011 £m	2012 £m	2011 £m
SII	5.6	6.9	–	–	16.1	18.5	–	–
Jackson Water Partnership	–	2.9	–	–	–	–	–	–
	5.6	9.8	–	–	16.1	18.5	–	–

The related parties are associates and joint ventures in which the group has a participating interest.

Remuneration of key management personnel

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

The remuneration of the directors is included within the amounts disclosed below. Further information about the remuneration of individual directors is provided in the audited part of the Directors' remuneration report on pages 64 to 68.

	2012 £m	2011 £m
Short term employee benefits	5.1	4.8
Post employment benefits	0.5	0.5
Termination benefits	–	0.3
Share based payments	0.8	0.6
	6.4	6.2

40 Principal subsidiary undertakings and their directors

Details of the principal operating subsidiaries as at 29 May 2012 are given below. A complete list of subsidiary undertakings is available on request to the company and will be filed with the next Annual Return.

Severn Trent Water

Severn Trent Water Limited
2 St John's Street, Coventry CV1 2LZ
Telephone 02477 715 000

Directors

A J Duff	M J Lamb
A J Ballance	M J E McKeon
B Bulkin	Baroness Noakes
R H Davey	A P Smith
G Fryett	A P Wray
M J Kane	

Severn Trent Services

Severn Trent Services Inc.
Suite 300, 580 Virginia Drive,
Ft Washington, Pennsylvania 19034, USA
Telephone 001 215 646 9201
(Incorporated and operational in the United States of America)

Directors

S Bouvier	M J Kane

Severn Trent Environmental Services Inc.
Park 10, 16337 Park Row
Houston, Texas 77084, USA
Telephone 001 281 578 4200
(Incorporated and operational in the United States of America)

Directors

S Bouvier	K J Kelly
M J Kane	

Severn Trent Services Limited
Arley Drive, Birch Coppice Business Park
Dordon, Tamworth B78 1SA
Telephone 01827 266 000

Directors

M J Kane	R C McPheely
B Kennedy	G P Tyler

Severn Trent Water Purification Inc.
3000 Advance Lane,
Colmar, Pennsylvania 18915, USA
Telephone 001 215 997 4000
(Incorporated and operational in the United States of America)

Directors

S Bouvier	K J Kelly
M J Kane	

Severn Trent Services International Limited
2308 Coventry Road, Birmingham B26 3JZ
Telephone 0121 722 6000

Directors

B Kennedy	G P Tyler
R C McPheely	

C2C Services Limited
(80% owned)
2308 Coventry Road, Birmingham B26 3JZ
Telephone 0121 722 6000

Directors

D Godfrey	R J Phillips
A J Handford	W G Weatherdon
R G Piper	E A Wilson

Severn Trent Laboratories Limited
STL Business Centre, Torrington Avenue
Coventry CV4 9GU
Telephone 024 764 21213

Directors

B Kennedy	G P Tyler
R C McPheely	

Other Businesses

Derwent Insurance Limited
6A Queensway, PO Box 64, Gibraltar
Telephone 00 350 200 45502
(Insurance company – incorporated and operational in Gibraltar)

Directors

J P J Davies	A Richmond
N Feetham	F White

Severn Trent Luxembourg Overseas Holdings S.a.r.l.
1A rue Thomas Edison L-1445 Strassen, Luxembourg
(Finance company – registered and operational in Luxembourg)

Managers

S Bouvier	M J E McKeon
F Gerardy	J Prendergast
B Kennedy	D Robyns

Country of incorporation and main operation is Great Britain and registration is in England and Wales unless otherwise stated. All subsidiary undertakings are wholly owned unless otherwise indicated. All shareholdings are in ordinary shares.

All subsidiary undertakings have been included in the consolidation.

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

We have audited the parent company financial statements of Severn Trent Plc for the year ended 31 March 2012 which comprise the company balance sheet, the company statement of total recognised gains and losses, and the related notes 1 to 17. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' responsibility statement, the directors are responsible for the preparation of the parent company financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the parent company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the parent company financial statements:

- give a true and fair view of the state of the parent company's affairs as at 31 March 2012;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' remuneration report to be audited has been properly prepared in accordance with Companies Act 2006; and
- the information given in the Directors' report for the financial year for which the financial statements are prepared is consistent with the parent company financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- 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 and the part of the Directors' remuneration report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Other matter

We have reported separately on the group financial statements of Severn Trent Plc for the year ended 31 March 2012.

Carl D Hughes (Senior statutory auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor

London, UK
29 May 2012

Company balance sheet

At 31 March 2012

	Note	2012 £m	2011 £m
Non-current assets			
Tangible fixed assets	2	0.2	0.2
Investments in subsidiaries	3	3,638.0	3,550.1
Derivative financial instruments		20.8	27.5
		3,659.0	3,577.8
Current assets			
Debtors	4	44.3	16.2
Derivative financial instruments		6.7	–
Cash at bank and in hand		234.6	223.2
		285.6	239.4
Creditors: amounts falling due within one year	5	(181.0)	(827.2)
Net current assets/(liabilities)		104.6	(587.8)
Total assets less current liabilities		3,763.6	2,990.0
Creditors: amounts falling due after more than one year	6	(96.9)	(167.7)
Net assets		3,666.7	2,822.3
Capital and reserves			
Called up share capital	8	232.6	232.2
Share premium account	9	83.8	80.0
Other reserves	9	152.4	150.6
Retained earnings	9	3,197.9	2,359.5
Total capital and reserves	9	3,666.7	2,822.3

Signed on behalf of the board who approved the accounts on 29 May 2012.

Andrew Duff
Chairman

Michael McKeon
Finance Director

Company number: 2366619

Company statement of total recognised gains and losses

For the year ended 31 March 2012

	2012 £m	2011 £m
Transfers to the profit and loss account on cash flow hedges	2.3	2.7
Deferred tax on transfers to the profit and loss account	(0.6)	(0.7)
	1.7	2.0
Profit for the period	993.3	264.5
Total recognised gains and losses for the period	995.0	266.5

Notes to the company financial statements

For the year ended 31 March 2012

1 Accounting policies

a) Basis of accounting

The financial statements have been prepared under the historical cost convention as modified by the revaluation of financial assets and liabilities (including derivative instruments) at fair value through profit or loss and in accordance with applicable United Kingdom Accounting Standards and comply with the requirements of the United Kingdom Companies Act 2006 ('the Act').

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

b) Tangible fixed assets and depreciation

Tangible fixed assets are included at cost less accumulated depreciation. Freehold land is not depreciated. Other assets are depreciated on a straight line basis over their estimated economic lives, which are principally as follows:

	Years
Buildings	30–60
Computers and software	2–15

c) Impairment of fixed assets and investments

Impairments of fixed assets and investments are calculated as the difference between the carrying values of net assets of income generating units, including where appropriate investments and goodwill, and their recoverable amounts. Recoverable amount is defined as the higher of net realisable value or estimated value in use at the date the impairment review is undertaken. Net realisable value represents the net amount that can be generated through sale of assets. Value in use represents the present value of expected future cash flows, discounted on a pre-tax basis using the estimated cost of capital of the income generating unit. Impairment reviews are carried out if there is some indication that an impairment may have occurred, or where otherwise required, to ensure that goodwill and fixed assets are not carried above their estimated recoverable amounts. Impairments are recognised in the profit and loss account.

d) Financial instruments

(i) Financial assets

Financial assets are classified into the following categories:

- at fair value through profit or loss;
- held to maturity investments;
- available for sale financial assets; and
- loans and receivables.

Financial assets at fair value through profit or loss

A financial asset is classified at fair value through profit or loss if it is so designated or if it is classified as 'held for trading'. Derivative financial assets that are not designated and effective as hedging instruments are required to be classified as 'held for trading' by FRS26. However, the group's Treasury Policy, described in the Financial review on page 35, is that the group does not hold or issue derivative financial instruments for trading. Financial assets at fair value through profit or loss are stated at fair value, with any gains or losses arising on remeasurement being recognised in the profit and loss account. Fair value is determined using the methodology described in note 32 to the group's financial statements.

Held to maturity investments

Where the company has the ability and intent to hold an investment to maturity the financial asset is classified as held to maturity. Such financial assets are measured at amortised cost using the effective interest rate method, with any gains or losses being recognised in the the profit and loss account.

Available for sale financial assets

After initial recognition at cost (being the fair value of the consideration paid), investments which are classified as available for sale are measured at fair value, with gains or losses recognised in equity. When an available for sale investment is disposed of or impaired, the gain or loss previously recognised in equity is taken to the profit and loss account. Where there is no active market in the investments and the fair value cannot be measured reliably, the investments are held at cost.

Loans and receivables

Trade receivables, loans and other receivables that have fixed or determinable payments and that are not quoted in an active market are classified as loans and receivables. Such assets are measured at fair value on initial recognition and are subsequently measured at amortised cost using the effective interest rate method unless there is objective evidence that an asset is impaired, when it is written down to its recoverable amount and the irrecoverable amount is recognised as an expense.

1 Accounting policies (continued)

d) Financial instruments (continued)

(ii) Financial liabilities

Financial liabilities are classified as either:

- financial liabilities at fair value through profit or loss; or
- other financial liabilities.

Financial liabilities at fair value through profit or loss

A financial liability is classified at fair value through profit or loss if it is so designated or if it is classified as 'held for trading'. Derivative financial liabilities that are not designated and effective as hedging instruments are required to be classified as 'held for trading' by FRS26. However, the group's Treasury Policy, described in the Financial review on page 35, is that the group does not hold or issue derivative financial instruments for trading. Financial liabilities at fair value through profit or loss are stated at fair value, with any gains or losses arising on remeasurement being recognised in the profit and loss account. Fair value is determined using the methodology described in note 32 in the group financial statements.

Other financial liabilities

Other financial liabilities, including borrowings, are initially recognised at fair value less transaction costs. After initial recognition, other financial liabilities are subsequently measured at amortised cost using the effective interest rate method.

(iii) Hedge accounting

The company uses derivative financial instruments such as cross currency swaps, forward currency contracts and interest rate swaps to hedge its risks associated with foreign currency and interest rate fluctuations. Such derivative instruments are recognised and measured in accordance with the accounting policies described above.

At the inception of the hedge relationship the company documents:

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

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

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

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 the profit and loss account.

When hedge accounting is discontinued the fair value adjustment to the carrying amount of the hedged item arising from the hedged risk is amortised to the profit and loss account from that date.

Cash flow hedges

The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in equity and the ineffective portion in the profit and loss account. The gains or losses deferred in equity in this way are recycled through the profit and loss account in the same period in which the hedged underlying transaction or firm commitment is recognised in the profit and loss account.

When hedge accounting is discontinued any cumulative gain or loss on the hedging instrument recognised in equity is kept in equity until the forecast transaction occurs, or transferred to the profit and loss account if the forecast transaction is no longer expected to occur.

Hedges of net investments in foreign operations

Where forward currency contracts and foreign currency borrowings are used to hedge net investments in foreign currency denominated operations, to the extent that they are designated and effective as net investment hedges, they are matched in equity against changes in value of the related assets. Any ineffectiveness is taken to the profit and loss account.

(iv) Embedded derivatives

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contract and the host contract is not carried at fair value, with gains and losses reported in the profit and loss account.

e) Investments

Investments in subsidiary undertakings are held at historical cost.

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

f) Share based payments

The company 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 a pricing model, excluding the impact of any non-market conditions. The number of awards 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 based condition.

g) Cash flow statement

The company has taken advantage of the exemption under Financial Reporting Statement 1 'Cash flow statements' and not produced a cash flow statement.

1 Accounting policies (continued)

h) Deferred taxation

Deferred taxation is fully provided for in respect of timing differences between the treatment of certain items for taxation and accounting purposes only to the extent that the company has an obligation to pay more tax in the future or a right to pay less tax in the future. Deferred tax assets are only recognised to the extent that taxable profits are expected to arise in the future. Material deferred taxation balances arising are discounted by applying an appropriate risk free discount rate.

i) Pensions

The company participates in the group's defined benefit and defined contribution pension schemes, details of which are set out in note 27 to the group financial statements. However, the company is currently unable to identify its share of assets and liabilities relating to the defined benefit schemes. The pension costs charged in the profit and loss account are the contributions payable to the scheme in respect of the accounting period in respect of the defined benefit and defined contribution schemes.

2 Tangible fixed assets

	Land and buildings £m	Plant and equipment £m	Total £m
Cost			
As at 1 April 2011	0.7	0.6	1.3
Additions	–	0.2	0.2
As at 31 March 2012	0.7	0.8	1.5
Depreciation			
As at 1 April 2011	(0.7)	(0.4)	(1.1)
Charge for the year	–	(0.2)	(0.2)
As at 31 March 2012	(0.7)	(0.6)	(1.3)
Net book value			
As at 31 March 2012	–	0.2	0.2
As at 31 March 2011	–	0.2	0.2

3 Investments

	Subsidiary undertakings		
	Shares £m	Loans £m	Total £m
As at 1 April 2011	3,292.5	257.6	3,550.1
Additions/loans advanced	14.8	81.2	96.0
Provisions	–	(8.1)	(8.1)
As at 31 March 2012	3,307.3	330.7	3,638.0

Details of principal subsidiaries of the company are given in note 40 of the group financial statements.

4 Debtors

	2012 £m	2011 £m
Amounts owed by group undertakings	34.4	5.4
Deferred tax	7.9	9.2
Other debtors	0.3	0.2
Prepayments and accrued income	1.7	1.4
	44.3	16.2

5 Creditors: amounts falling due within one year

	2012 £m	2011 £m
Bank overdrafts	(31.0)	(4.9)
Other loans	(22.8)	–
Borrowings	(53.8)	(4.9)
Derivative financial instruments	(0.4)	–
Trade creditors	(0.4)	(0.2)
Amounts due to group undertakings	(120.1)	(808.3)
Other creditors	(5.9)	(8.6)
Taxation and social security	–	(0.7)
Accrued expenses	(0.4)	(4.5)
	(181.0)	(827.2)

6 Creditors: amounts falling due after more than one year

	2012 £m	2011 £m
Borrowings – other loans (note 7)	(59.0)	(81.8)
Amounts due to group undertakings	–	(52.8)
Derivative financial instruments	(37.9)	(33.1)
	(96.9)	(167.7)

7 Borrowings

	2012 £m	2011 £m
Borrowings due within one year	53.8	4.9
Borrowings due after more than one year		
Between one and two years	–	22.9
Between two and five years	59.0	58.9
After more than five years	–	–
Total borrowings due after one year	59.0	81.8
	112.8	86.7

Borrowings analysed by interest rate after taking account of interest rate swaps entered into by the company were:

2012	Non-interest bearing liabilities £m	Floating rate £m	Fixed rate £m	Total £m
Bank loans and overdrafts	–	31.0	–	31.0
Other loans	–	81.8	–	81.8
Other financial liabilities	0.4	–	–	0.4
	0.4	112.8	–	113.2
Impact of interest rate swaps not matched against specific debt instruments	–	(225.0)	225.0	–
	0.4	(112.2)	225.0	113.2
Weighted average interest rate			6.32%	
Weighted average period for which interest is fixed (years)			3.5	

7 Borrowings (continued)

2011	Non-interest bearing liabilities £m	Floating rate £m	Fixed rate £m	Total £m
Bank loans and overdrafts	–	4.9	–	4.9
Other loans	–	81.8	–	81.8
Other financial liabilities	–	–	–	–
	–	86.7	–	86.7
Impact of interest rate swaps not matched against specific debt instruments	–	(225.0)	225.0	–
	–	(138.3)	225.0	86.7
Weighted average interest rate			6.32%	
Weighted average period for which interest is fixed (years)			4.5	

The company's borrowings are denominated in sterling, after taking account of cross currency swaps the company has entered into. There is no significant difference between the book value and the fair value of the company's borrowings. Fair values are based on the expected future cash flows discounted using zero coupon forward interest rates related to the expected timing of payments.

A new five year £500 million Revolving Credit Facility was agreed in October 2011 for Severn Trent Plc and Severn Trent Water Limited. This replaced the existing £500 million Revolving Credit Facility. Severn Trent Plc has access to £200 million of this facility.

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

	2012 £m	2011 £m
Within 1 year	–	41.7
1–2 years	–	458.3
2–5 years	200.0	–
After more than 5 years	–	–
	200.0	500.0

8 Share capital

	2012 £m	2011 £m
Total issued and fully paid share capital		
237,608,111 ordinary shares of $97^{17}/_{19}$p (2011: 237,142,534)	232.6	232.2

Changes in share capital were as follows:

	Number	£m
Ordinary shares of $97^{17}/_{19}$p		
At 1 April 2011	237,142,534	232.2
Shares issued under the group's Employee Sharesave Scheme	442,593	0.4
Shares issued under the group's Share Option Scheme	22,984	–
At 31 March 2012	237,608,111	232.6

9 Reconciliation of movements in shareholders' equity

	Share capital £m	Share premium £m	Hedging reserve £m	Capital redemption reserve £m	Retained earnings £m	Total £m
At 1 April 2010	231.6	75.9	(7.5)	156.1	2,260.0	2,716.1
Cash flow hedges						
– transfers to net profit	–	–	2.0	–	–	2.0
Share options and LTIPs						
– proceeds from shares issued	0.6	4.1	–	–	–	4.7
– awards granted by subsidiaries	–	–	–	–	4.4	4.4
Net profit for the year	–	–	–	–	264.5	264.5
Dividends	–	–	–	–	(169.4)	(169.4)
At 1 April 2011	232.2	80.0	(5.5)	156.1	2,359.5	2,822.3
Cash flow hedges						
– transfers to net profit	–	–	1.8	–	–	1.8
Share options and LTIPs						
– proceeds from shares issued	0.4	3.8	–	–	–	4.2
– awards granted by subsidiaries	–	–	–	–	4.1	4.1
Net profit for the year	–	–	–	–	993.3	993.3
Dividends	–	–	–	–	(159.0)	(159.0)
At 31 March 2012	232.6	83.8	(3.7)	156.1	3,197.9	3,666.7

The capital redemption reserve arose on the repurchase of B shares. This is not distributable. As permitted by Section 408 of the Companies Act 2006, no profit or loss account is presented for the company.

In previous years £1,221.2 million of the company's retained profit arose as a result of group restructuring exercises, and is not considered likely to be distributable.

10 Employee costs and auditors' remuneration

	2012 £m	2011 £m
Wages and salaries	1.4	1.3
Social security costs	0.2	0.2
Pension costs	1.7	0.6
Total employee costs	3.3	2.1

For details of directors' remuneration see the Directors' remuneration report on pages 64 to 68.

Fees payable to Deloitte LLP and their associates for non-audit services to the company are not required to be disclosed because the consolidated financial statements are required to disclose such fees on a consolidated basis.

11 Employee numbers

Average number of employees of the company (including executive directors) during this year was 12 (2011: 12).

All were based in the United Kingdom.

12 Employee share schemes

For details of employee share schemes and options granted over the shares of the company, see note 33 of the group financial statements. Details of the LTIP conditional awards and share options granted by the company to its employees are set out below.

The company has charged £0.1 million (2011: £0.1 million) to the profit and loss account in respect of share based payments.

At 31 March 2012, there were no options (2011: no options) exercisable under any of the share based remuneration schemes.

a) Long Term Incentive Plan

Changes in the number of awards outstanding during the year:

	Number of awards
Outstanding at 1 April 2010	8,379
Granted during the year	4,422
Lapsed during the year	–
Outstanding at 1 April 2011	12,801
Granted during the year	3,702
Lapsed during the year	(3,566)
Outstanding at 31 March 2012	12,937

Awards outstanding at 31 March were:

		Number of awards	
Date of grant	Normal date of vesting	2012	2011
July 2008	2011	–	3,566
July 2009	2012	4,813	4,813
July 2010	2013	4,422	4,422
July 2011	2014	3,702	–
		12,937	12,801

b) Employee Sharesave Scheme

Changes in the number of options outstanding during the year:

	Number of share options	Weighted average exercise price
Outstanding at 1 April 2010	4,556	867p
Exercised during the year	(161)	1,172p
Outstanding at 1 April 2011	4,395	856p
Granted during the year	916	1,177p
Forfeited during the year	(445)	862p
Transferred during the year	1,301	996p
Exercised during the year	(314)	1,221p
Outstanding at 31 March 2012	5,853	918p

Options outstanding at 31 March were:

			Number of share options	
Date of grant	Normal date of vesting	Option price	2012	2011
January 2009	2012 or 2014	862p	3,723	3,946
January 2010	2013 or 2015	806p	898	449
January 2011	2014 or 2016	1,137p	316	–
January 2012	2015 or 2017	1,177p	916	–
			5,853	4,395

12 Employee share schemes (continued)

c) Share Matching Plan

Changes in the number of awards outstanding during the year:

	Number of awards
Outstanding at 1 April 2010	–
Granted during the year	457
Outstanding at 1 April 2011	457
Granted during the year	360
Outstanding at 31 March 2012	817

Awards outstanding at 31 March were:

		Number of awards	
Date of grant	Normal date of vesting	2012	2011
May 2010	June 2013	457	457
May 2011	May 2014	360	–
		817	457

13 Pensions

The company participates in two defined benefit pension schemes (being the Severn Trent Pension Scheme and the Severn Trent Water Mirror Image Pension Scheme). In addition, the company operates an unfunded arrangement for certain employees whose earnings are above the pension cap.

Further details regarding the operation of these schemes are given in note 27 of the group financial statements.

The company is currently unable to identify its share of the underlying assets and liabilities from the group's defined benefit pension schemes, and hence it continues to account for the cost of contributions as if the scheme was a defined contribution pension scheme.

The pension charge for the year was £1.7 million (2011: £0.6 million).

14 Related party transactions

The company has taken advantage of the exemption under FRS 8 'Related Party Disclosures' and not disclosed details of transactions with other undertakings within the Severn Trent group of companies.

15 Contingent liabilities

a) Bonds and guarantees

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

b) Bank offset arrangements

The banking arrangements of the company operate on a pooled basis with certain of its subsidiary undertakings. Under these arrangements participating companies guarantee each others' overdrawn balances to the extent of their credit balances, which can be offset against balances of participating companies.

16 Post balance sheet events

Following the year end the board of directors has proposed a final dividend of 42.06 pence per share and a special dividend of 63.00 pence per share.

17 Dividends

For details of the dividends paid in the years ended 31 March 2012 and 31 March 2011 see note 14 in the group financial statements.

Five year summary

Continuing operations	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Turnover	1,770.6	1,711.3	1,703.9	1,642.2	1,552.4
Profit before interest, tax and exceptional items	504.2	519.1	557.1	469.9	469.5
Net exceptional items	(50.9)	(21.4)	(49.7)	(18.9)	(68.8)
Net interest payable before losses on financial instruments and exceptional finance costs	(229.0)	(230.6)	(218.8)	(196.4)	(177.4)
Losses on financial instruments	(67.7)	(14.2)	45.7	(87.0)	(31.0)
Results of associates and joint ventures	0.1	0.1	0.1	–	0.1
Profit on ordinary activities before taxation	156.7	253.0	334.4	167.6	192.4
Current taxation on profit on ordinary activities	(60.5)	(32.1)	(40.7)	(52.1)	(56.2)
Deferred taxation	78.2	53.6	(42.2)	(171.5)	74.4
Profit on ordinary activities after taxation	174.4	274.5	251.5	(56.0)	210.6
Discontinued	–	–	–	–	0.8
Profit for the period	174.4	274.5	252.5	(56.0)	211.4
Net assets employed					
Fixed assets	6,743.6	6,635.3	6,516.1	6,169.9	5,892.9
Other net liabilities excluding net debt, retirement benefit obligation provisions and deferred tax	(341.3)	(320.4)	(317.2)	(287.2)	(217.3)
Derivative financial instruments[1]	(261.8)	(90.5)	(125.3)	(153.9)	(26.1)
Retirement benefit obligation	(345.8)	(292.1)	(354.9)	(233.0)	(165.6)
Provisions for liabilities and charges and deferred tax	(845.5)	(957.4)	(1,010.3)	(988.0)	(885.5)
Net assets held for sale	–	–	–	4.2	–
	4,949.2	4,974.9	4,708.4	4,512.0	4,598.4
Financed by					
Called up share capital	232.6	232.2	231.6	231.0	229.7
Reserves	740.9	867.6	709.1	715.1	971.3
Total shareholders' funds	973.5	1,099.8	940.7	946.1	1,201.0
Non-controlling interests	7.9	6.3	6.3	6.0	4.2
Net debt[2]	3,967.8	3,868.8	3,761.4	3,559.9	3,393.2
	4,949.2	4,974.9	4,708.4	4,512.0	4,598.4
Statistics					
Earnings per share (continuing) – pence	72.5	115.2	105.6	(24.6)	89.3
Adjusted earnings per share – pence	88.9	105.6	122.8	92.7	97.8
Dividends per share (excluding special dividend) – pence	70.1	65.1	72.3	67.3	65.6
Dividend cover (before exceptional items and deferred tax)	1.3	1.6	1.7	1.4	1.5
Gearing	80.2%	77.8%	79.9%	78.9%	74.0%
Ordinary share price at 31 March – pence	1,544.0	1,446.0	1,195.0	990.0	1,419.0
Average number of employees			–	–	–
– Severn Trent Water	5,162	5,237	5,686	5,624	5,569
– Other	2,889	3,045	3,102	3,144	2,814

[1] Excludes instruments hedging foreign currency debt

[2] Includes instruments hedging foreign currency debt

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

Delivering against our KPIs

Basis	KPI	2010/11 Performance	2011/12 performance	2011/12 quartile	At a glance
MAT	1 Lost time incidents per 100,000 hrs worked [1]	0.37	0.30	Upper	⊖
QR	2 Employee motivation % [2]	74%	75%	Median	⊖
MAT	3 Water quality (test failure rate) ppm	210	225	Median	▼
MAT	4 SIM – Qualitative	–	3.96	Median	⊖
MAT	5 SIM – Quantitative	–	205	Upper	⊖
MAT	6 Unplanned interruptions > 6 hrs per 1,000 properties [3]	23.85	11.12	Lower	⊖
NPR	7 Properties at risk of low pressure per 1,000 properties [3]	0.07	0.06	Upper	⊖
MAT	8 First time job resolution % [4]	97.5%	93.8%	Upper	⊖
QR	9 Non-performance against Regulatory Obligations % [4]	4%	6%	Upper	⊖
ACT	10 Capex (net) % [5,6]	7.40%	4.31%	n/a	n/a
MAT	11 Capital process quality	–	972	n/a	n/a
ACT	12 Debtor days [6]	33.8	35.8	Median	⊖
ACT	13 Opex – £m [5,6]	519	548	n/a	n/a
ACT	14 Efficient billing factor (per 1,000 properties connected)	–	3,306	n/a	n/a
MAT	15 Pollution incidents (cat 1, 2 & 3) [7]	378	458	Median	⊖
MAT	16 Sewer flooding incidents – other causes per 1,000 properties [3,8]	0.154	0.141	Median	⊖
ACT	17 Sewage Treatment Works – breach of consents % [7]	1.69%	2.54%	Lower	▼
ACT	18 Supply availability %	94.4%	96.5%	Lower	⊖
MAT	19 Net Energy Use – GWh [4]	706	679	Upper	⊖
MLE	20 Leakage Ml/d [3,5]	497	464	Upper	▲

Key

▲ Improved quartile

⊖ Maintained quartile

▼ Declined quartile

Notes

Benchmarks updated in September.
Excludes PDaS.

MAT = Moving annual total
QR = Quarterly review
NPR = Number of properties on register
MLE = Maximum likelihood estimate
ACT = Year end actual

1. Actual performance across all employees and agency staff.
2. Performance based on annual survey of all employees.
3. As reported in the Ofwat Annual Return. Performance figures are provisional at this stage as the Ofwat Annual Return will be submitted to Ofwat on 15 June 2012.
4. Actual performance based partially or wholly on internal data.
5. Benchmark data is unavailable until September 2012.
6. Actual performance based on audited UK GAAP financial statements for the year ended 31 March 2012.
7. Measure for calendar year to 31 December 2011.
8. Includes minor escape of sewage. Prior year restated.

KPIs 4 & 5 SIM (Service Incentive Mechanism). Consists of 2 equally weighted measures: Quantitative looks at the number of complaints, unwanted contacts and engaged/abandoned calls. Qualitative looks at the end to end customer service by completing 200 customers surveys 4 times a year. Customers rate us based on a score of 1 (very dissatisfied) to 5 (very satisfied). The 2 SIM measures replace customer written complaints per 1,000 properties and first time call resolution for billing.

KPI 11 Capital process quality. This covers the capital work undertaken by the One Supply Chain. There is no external benchmark available for this measure. The KPI is based on an index of four areas (people, process, customer and finance) incorporating a number of metrics such as health and safety, programme management, customer service, and financial performance.

KPI 14 Efficient billing factor ('000 properties connected). Ofwat have introduced a Billing Incentive which is designed to ensure that companies are appropriately rewarded for the efficiency of their billing in terms of maintaining and growing their chargeable customer base. It looks at the average number of billable properties connected to water services.

Information for shareholders

Corporate website

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

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

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

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

Electronic communications

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

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

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

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

Severn Trent shareholder helpline

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

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

Registrar contact details:

Online: https://help.shareview.co.uk from here, you will be able to securely email Equiniti with your query.

Telephone: 0871 384 2967*
Overseas enquiries: +44 121 415 7044
Text phone: 0871 384 2255*
By post: Equiniti, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6DA.

Dividend payments

Bank mandates

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

The benefits of doing this are you will:

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

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

Dividend reinvestment plan

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

Telephone: 0871 384 2268*
Telephone number from outside the UK: +44 121 415 7173

Buying and selling shares in the UK

If you wish to buy or sell certificated Severn Trent Plc shares, you will need to use a stockbroker or high street bank which trades on the London Stock Exchange. There are also many telephone and online services available to you. If you are selling, you will need to present your share certificate at the time of sale. Details of low cost dealing services may be obtained from www.shareview.co.uk or 0845 603 7037**.

Share price information

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

Shareholder security

Share fraud includes scams where investors are called out of the blue and offered shares that often turn out to be worthless or non-existent, or an inflated price for shares they own. These calls come from fraudsters operating in 'boiler rooms' that are mostly based abroad.

If you are offered unsolicited investment advice, discounted shares, a premium price for shares you own, or free company or research reports, you should take these steps before handing over any money:

- Get the name of the person and organisation contacting you.
- Check the Financial Services Authority (FSA) Register at www.fsa.gov.uk/fsaregister to ensure they are authorised.
- Use the details on the FSA Register to contact the firm.
- Call the FSA Consumer Helpline on 0845 606 1234 if there are no contact details on the Register or you are told they are out of date.
- Search the FSA list of unauthorised firms and individuals to avoid doing business with.
- Remember, if it sounds too good to be true, it probably is.

* Calls to these numbers are charged at 8 pence per minute from a BT landline. Other providers' costs may vary. Lines are open from 8.30am to 5.30pm Monday to Friday.

** Lines are open Monday – Friday, 8.00am to 4.30pm for dealing, and until 6.00pm for enquiries.

If you use an unauthorised firm to buy or sell shares or other investments, you will not have access to the Financial Ombudsman Service or Financial Services Compensation Scheme (FSCS) if things go wrong.

If you are approached about a share scam you should inform the FSA using the share fraud reporting form at www.fsa.gov.uk/scams, where you can find out about the latest investment scams. You can also call the Consumer Helpline on 0845 606 1234.

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

Unsolicited mail

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

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

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

American Depositary Receipts (ADRs)

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

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

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

By post:
The Bank of New York Mellon
PO Box 358516
Pittsburgh
PA 15252 – 8516
USA

By telephone:
If calling from within the USA: (888) 269 2377 (toll-free)
If calling from outside the USA: +1 201 680 6825

By email: shrrelations@bnymellon.com

Website: www.bnymellon.com/shareowner

Financial calendar

Preliminary results announcement	30 May 2012
Ex dividend date – final and special dividend	20 June 2012
Record date to be eligible for the final and special dividend	22 June 2012
AGM	18 July 2012
Interim management statement – Q1 year ending 31 March 2013	18 July 2012
Final and special dividend payment date	27 July 2012
Interim results announcement – year ending 31 March 2013	27 November 2012
Ex dividend date – interim dividend	5 December 2012
Record date to be eligible for the interim dividend	7 December 2012
Interim dividend payment date	11 January 2013

All future dates are indicative and may be subject to change.

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