

Kemble Water Holdings Limited

Annual report and consolidated financial statements

For the year ended 31 March 2017



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Introduction

Kemble Water Holdings Limited ("the Company") is the ultimate parent company of the Kemble Water Holdings group of companies ("the Group"). The principal activity of the Company is to act as the holding company of the Group and it does not carry out any activities beyond this role.

The principal activity of the Group is the appointed supply of water and wastewater services to customers in London, the Thames Valley and surrounding area, delivered entirely through its wholly owned indirect subsidiary, Thames Water Utilities Limited ("TWUL" or "Thames Water"), in accordance with TWUL's Licence of Appointment. References to "our" or "we" in this report relates to the activities of the Group including TWUL.

In addition, the Group operates a separately managed property business. This manages the Group's property portfolio and the sale of land and other property that is no longer required by the appointed business.

As the performance of the Group is dependent largely on its appointed activities, this report makes reference to the performance of TWUL in order to provide appropriate explanation as to the performance of the overall Group.

The Group's management structure separates the Directors of the Company, who are all Non-Executives, and have no role to play in the day to day running of the appointed business (although certain matters require the approval of the Company's board having regard to the interests of its shareholders). In addition to their responsibilities to TWUL, the Executive Directors of TWUL also carry out work on behalf of the Group. There are controls in place to ensure that the day to day management of the appointed business is separated from the commercial water retail business.

Unless otherwise stated; all current year data included in this report is for the year ended 31 March 2017 ("2016/2017").

Directors and Advisors

Directors

Sir P Mason KBE – Chairman
R Blomfield-Smith
K Bradbury
J Divoky
A Hall
G Lambert
P Noble
A Osorio
P Sochocki
G Tucker
C Van Heijningen
Y Wang

Registered auditor

KPMG LLP
Chartered Accountants
15 Canada Square
London
E14 5GL

Company secretary and registered office

D Hughes

Clearwater Court
Vastern Road
Reading
Berkshire
RG1 8DB

Our Chairman – Sir Peter Mason

The next chapter

After a year of significant change, Thames Water is beginning a new chapter in its 400 year history.

Steve Robertson joined as our new Chief Executive Officer (CEO) in September 2016. As former CEO at Truphone and founding CEO of BT Openreach, Steve has crucial experience running essential infrastructure and high technology companies. We also welcomed our new Chief Financial Officer (CFO), Brandon Rennet, in March 2017. With 14 years in the power and utilities industries, most recently at SSE, Brandon brings a wealth of experience and another fresh perspective to our business.

To maintain our strong governance, we've appointed Nick Land, former Chairman of Ernst & Young, as our new Independent Non-Executive Director to replace Michael Pavia, who retired this year. Nick is the new Chairman of our Audit, Risk and Regulatory Committee. He has extensive boardroom experience and is currently the Chair of Vodafone's Audit and Risk Committee, as well as Chairman of the Private Equity Reporting Group and a member of the Board of the Financial Reporting Council.

2016/17 also saw the announcement of a change in our largest shareholder. Borealis Infrastructure, the infrastructure investment manager of OMERS, one of Canada's largest pension plans, and Wren House, the global direct infrastructure investment arm of the Kuwait Investment Authority, acquired the 26.3% Macquarie-managed stake. The sale completed on 31 May 2017. We welcome Kenton Bradbury, Managing Director of Asset Management at Borealis, to the Board of Thames Water Utilities Limited. A Chartered engineer, Kenton has many years' experience working with a range of major infrastructure and utility companies, including as a Director for Yorkshire Water and Affinity Water.

We've also seen Fiera Infrastructure (Aquila) increase their interest to nearly 5%. More than two thirds of our shareholders now represent pension funds. It is pleasing to know all our shareholders are high-quality, long-term investors who have long-term visions aligned with ours as we prepare for the future – of course, our provision of essential services doesn't stop at the end of each five-year regulatory period.

Amidst this change, we've made headway with some of our performance commitments and have been consolidating these achievements. We have also been working hard to nail down the detail of what we need to do in the coming year to drive a step change in critical areas, such as leakage and customer service, where we have not delivered our performance commitments to our customers. With Steve at the helm, we have a strong executive team in place to help Thames Water become a leading customer focused water and wastewater service provider.

Year in review

We've spent over £1 billion again this year in our business, which means we've invested around £12 billion during the last 12 years. We've seen our investment in producing energy from sewage start to pay off after a slower than expected start last year, with our best performance to date in energy production in 2016/17, and we're nearing the completion of a major upgrade of one of our largest sewage treatment works. Our resolution of complaints is also at an all-time high and, as well as having the largest investment programme in the industry, our average combined bill remains the third lowest in England and Wales at just over £1 a day (£374 per year in 2016/17: £367 in 2015/16). In April 2017, the ratings agency Moody's reaffirmed TWUL's, the principal operating company of the Group, Baa1 Corporate Family Rating (CFR) with a stable outlook, which is a strong investment grade rating and among the industry's best. Being efficient in how we deliver our investments, operate and finance our business, helps us keep bills lower for current and future generations of our customers.

Shareholders invest in companies and expect a return on their investment. We made a solid start to the regulatory period but we didn't pay an external distribution relating to 2015/16 while we supported our tender to award the delivery of the Thames Tideway Tunnel to an independent company. After another year of investing over £1 billion in our business, equivalent to about £20 million a week, we made our first distribution of this regulatory period to our external shareholders – a total of £100 million. This represents a cash yield of 2.6%.

Strengthening our focus

In March 2017 we incurred a £19.75 million fine for a group of pollution incidents, which occurred between 2012 and 2014 - during the last regulatory period - and we deeply regret these incidents. We're doing things very differently now. We've been more proactive in our wastewater network maintenance, changed our management structure in the affected region and invested heavily in our infrastructure and control systems. I'm pleased to say we've reduced our pollutions by 42% since 2013 and we know there's more we need to do. Our total expenditure on our wastewater network for 2016/17, including operational expenses and investment, was almost £900 million.

2016 was a year of re-evaluation for our water business after a cluster of significant bursts on our Victorian piped affected customers in London and contributed to us missing our leakage target. Although there was a series of high profile bursts in a short space of time, the number of bursts in 2016/17 didn't differ hugely from previous years. Nevertheless we take each incident and its impact on our customers very seriously and there's a lot of work going on to understand why they happened – the report of an independent forensic review about these bursts is available on our website. We continue to work to refocus our priorities and we've committed to increasing our investment in 'trunk' mains replacements by £97 million over the next three years to reduce the likelihood of these devastating events as we strive to ensure we deliver our responsibilities to customers.

Between 2004 and 2015/16 we reduced our leakage by a third. We set ourselves challenging targets for this five year regulatory period as we know it's very important to our customers and the environment. Disappointingly, we weren't where we wanted to be at the end of 2016/17. Our leakage has increased by 5% since last year from 642MI/d to 677MI/d and we will incur an outcome delivery incentive (ODI) penalty of £8.6 million. Next

year's target is tighter and we are committed to a recovery plan to bring us back on track with our leakage targets – however we know it will take time.

A changing landscape

Ahead of the opening of the business retail market to competition on 1 April 2017, all our business retail customers were moved across to Castle Water following our decision to exit the market – in July 2016 we reached an agreement with them to sell our retail non-household business, generating proceeds of £99 million. This change allows us to focus more on the delivery of our core service for our customers in the wholesale and household businesses. It also frees up funds to invest further in areas of the highest priority such as leakage and 'trunk' mains replacements.

We worked hard to ensure we were ready for the biggest change to the water industry since privatisation. The introduction of competition has brought a new dimension to the way we conduct our business – whilst we need to develop strong relationships with the retailers in our region, operationally we retain a direct relationship with business customers so we need to make sure we continue to support them and provide them with the high quality service they need and deserve. We work against an ever-changing backdrop - the water industry is poised for further change as part of Water 2020, and I believe our revised strategic priorities will put us into the best position to embrace the new opportunities and challenges this may bring.



Sir Peter Mason KBE
Chairman

A fresh perspective – Steve Robertson

Since joining Thames Water last September, I've been regularly asked why I decided to join this industry. The answer is simple. After a career in the telecommunications industry, it's hugely exciting to be involved in another sector that touches so many lives every day - and leading a company which is starting a new chapter.

Every day all of us at Thames Water make decisions and take actions that affect our customers, our environment and our business. One of my most critical tasks is to make sure the cumulative effect of these decisions results in the right long-term outcomes as well as meeting our immediate needs. Ensuring the right strategic outcomes for our business, to support the long term needs of our customers, is central to the future of Thames Water.

With this in mind I've spent a significant amount of time over the last few months meeting customers and employees. The passion and commitment of our employees really stood out as well as the overwhelming desire from our customers for us to deliver the service they need and deserve. Increasing our focus to deliver a great customer experience is crucial.

I fully recognise that the privileges of running a water company come with important responsibilities, and I understand the significant impact on our customers and the environment when we fall short of the standards our customers rightly expect of us.

During the last year we've seen a series of major bursts on our Victorian water pipes and we've missed our leakage target. Leaks are inevitable on a network of our enormous size and age, but it's vital we invest wisely and continually to improve our resilience. This is a huge priority for us.

We're also paying a high price both financially and reputationally for major pollution incidents between 2012 and 2014. We have apologised and learned our lessons. Since the events we've put in place new procedures and personnel, invested heavily in infrastructure, training and control systems, to limit the possibility of any such repeat and strengthen our position as a good corporate citizen.

Our understanding and successful management of potential risks, which could impact the way we run our business now and in the future, will underpin our success and we have strong governance in place to ensure we do this. As well as population growth and climate change there are a host of other risks, including infrastructure and cyber security, we need to consider.

This is a new chapter for Thames Water. Our new shareholders are investing in us for the long term and our refreshed executive team is committed to making the right business decisions that will benefit our customers and stakeholders over the long term.

At Thames Water, we have been innovating for more than 400 years and new technology is providing ever greater opportunities. From being pioneers with cutting edge technology to produce energy from waste to using data intelligently to predict and minimise the impact from storms, we're innovating across the business. Make no mistake - the work we all do must leave a positive legacy for future generations.

We are in a hugely privileged position with life-long investment from our customers through their bills, and everything we do impacts them, their children, their grandchildren and beyond. We're custodians of their money so we need to be smart and disciplined about how we spend it. Our customers also play an active part in operating our water and wastewater networks, every time they turn on a tap, use a washing machine or flush the toilet. So the way we engage with them and explain our business is a continuing priority.

As we take a fresh look at the business, Brandon, our new CFO, and I have been reviewing our spending, to ensure we deliver maximum value and protect the long term financial stability of the business. Making the best decisions for our customers requires us to carefully prioritise and phase our important projects.

As we move forward I, as the CEO of Thames Water, and my executive team have agreed that everything we do will be consistent with the following five principles, which will underpin our Company strategy:

- Listening to our customers, understanding their needs and putting those needs at the forefront of our decision making
- Being good custodians of the environment
- Ensuring that our assets are maintained, renewed and optimised to give the very best 'whole life outcomes'
- Operating our business with optimal efficiency and innovating continuously
- Being crystal clear in all our activities, both internal and external, that we are responsible for the service we give our customers and the health and wellbeing of our assets

To deliver our priorities and a strong customer proposition, everyone in the business needs to be engaged with our vision and values and the needs of our customers. This is why I've been bringing managers from all over the company together to talk about what our values mean to them, what our customers expect and what our strategy needs to deliver. As a Thames Water family, we all need to be committed to driving changes that will really deliver for our customers.

Being open and transparent with our customers and stakeholders in a two-way dialogue about how we're running their water and wastewater company is also vital. As part of our bid to enrich customer communication and experience, we've improved our social media presence during the last year, including offering a real-time 'around the clock' service.

We also need to be honest with our customers about our progress in achieving our performance commitments. This year we have incurred a total of £18.4 million in ODI penalties and we know we can – and must – do better. We also know we cannot deliver everything we want to immediately – it will take time – but we're committed to strengthening our focus so we can provide a service our customers expect and deserve. We've started an exciting new chapter, and we look forward to engaging you in our story along the way.

I look forward to working with you and thank you for your continued support,

Steve Robertson
Chief Executive Officer

Doing more for customers

Three key principles

To improve our customer service we are revising and focusing our approach. We have appointed Kelly Macfarlane as our new Managing Director for Customer Service and Retail to challenge the status quo and to drive the step change we need. Along with Steve Spencer, our new Chief Delivery Officer, Kelly is leading the launch and delivery of a three year, company-wide plan to set the trajectory for us to provide a consistently good customer experience.

Taking on board important customer feedback, the plan embraces three key principles:

- to make things easy for our customers;
- to deliver on our commitments; and
- to put ourselves in our customers' shoes.

To honour these principles, our customer strategy focuses on bolstering our communication channels to deliver a consistently good service and enable customers to contact us via the channel of their choice. We're also using these channels to become more proactive in our management of customer impacting incidents and events. As part of this approach, we want customers to understand what our service aspirations and promises are, so they know what they can expect from us and hold us accountable - we plan to launch our new 'commitment to customers' charter in 2017/18.

Our current performance

We've made significant improvements in our resolution of written complaints with a record 94.5% being resolved first time in 2016/17 (2015/16: 90.9%). We are also delighted there was only one complaint from our 15 million customers which needed to be investigated by the Consumer Council for Water during the year.

Our complaint levels are 44% lower than they were five years ago. In 2016/17, we achieved our second best performance to date in the number of total written complaints, with 19,384, after a record-breaking year in 2015/16. However, we recognise there's still more to do and we're confident we will continue to build on this success.

Our Service Incentive Mechanism (SIM) score, Ofwat's customer service measure, moved from 76.74 to 77.26 out of 100 in 2016/17 and our Ofwat customer satisfaction (CSAT) performance went from 4.10 to 4.12 out of five, with our highest company score of 4.18 achieved in quarter four. The CSAT score is calculated quarterly following a survey of 200 of our customers and makes up 75% of our SIM score. We are proud to be part of an industry that is so committed to service improvement and we recognise there remains much to be done to ensure we're reliably and consistently delivering our responsibilities to customers.

The investment in our restructured 'one-stop-shop' wastewater service centre in Slough, which brings customer service and operational expertise under one roof, gives us confidence in our plans going forward. Our wastewater Ofwat CSAT scores have been improving each quarter and reached 4.34 at the end of the year, bringing us up to 6th out of 10 companies in the wastewater league table.

Given the problems experienced during the winter months with burst pipes and leakages we're investing to reduce the likelihood of these incidents as well as investing companywide in our emergency responses, to provide our customers with the support and reassurance they understandably expect.

Understanding our customers

We serve one of the most diverse cross sections of the UK, both in terms of demographics and geography, and we continually work with our customers to better understand and address their needs. Last year we surveyed thousands of customers and ran numerous workshops throughout our region on a wide range of topics including 'intergenerational fairness', 'delivering a resilient service in the face of emerging threats' and 'what it is to be a good neighbour'. We continue to involve our customers in preparations for our 2020-2025 business plan around five key commitments:

- Delivering an effortless customer experience
- Delivering a safe and dependable water service
- Delivering a safe and dependable wastewater service
- Planning for the future
- Being a responsible group

Being socially responsible

We understand the varying personal circumstances of our customers and we are committed to doing what we can to help. For those who can't afford to pay their bills we offer support - we helped 6,161 customers with nearly £4.5 million of debt in 2016/17 through our customer assistance fund. We also help 37,975 customers remain water debt free through our social tariffs - Water Sure and Water Sure Plus.

We work with the communities in our catchment area to do what we can to accommodate the particular needs of our customers. For those customers who require extra assistance in an emergency, for example people on dialysis, we have a priority services register. With London in our catchment, many of our customers don't have English as their first language and we've introduced a new audio translation service so we can better understand their individual requirements.

Dealing with our customers in a fair way is something which we are passionate about. Most 'bad debt' actually comes from those who choose not to pay rather than those who genuinely can't, and money is added to customer bills to account for it. We remain committed to taking measures to help ensure the vast majority who pay their bills, on time, are not penalised by those who don't pay their fair share. This includes being accurate in our billing and disciplined in collecting bills and outstanding debts. Following its launch in 2015, we're pleased to see our award-winning debt management team – underpinned by a new system and improved processes – is continuing to drive positive results, including a £14.6 million reduction in bad debt in 2016/17. A reduction in refusal to pay means we have more money to invest in our business for the benefit of all our customers.

On the subject of fairness, we've increased our resources to prevent people illegally connecting to our network, which could also affect water quality. Following the investigations we carried out and completed in 2016/17 we expect to save 23.5 million litres of 'stolen' water over the next ten years, which would otherwise have been attributed to leakage.

Engaging the community

We continue to be an active member of the community in which we operate. In 2016/17, we met with over 20,000 school children as part of our extensive education programme promoting campaigns such as 'Bin it - don't block it' to encourage good habits from childhood. We also do what we can to promote enjoyment of our sites – after vandalism at our Nunhead reservoir in 2016, we worked with local residents to arrange special open days to enable them to continue enjoying this much-loved South London site.

Engaging our stakeholders

We run an extensive stakeholder engagement programme to build strong relationships and we play an active role in the public debate about important issues affecting the water industry. We regularly engage with political representatives and stakeholders so they can find out more about what we do, and raise concerns on behalf of the people they represent. We ensure their views are considered in our plans and seek their support around smart metering and drainage strategies, for example.

Our independent Customer Challenge Group, made up of customer representatives and stakeholders, has continued to challenge and advise us on the development of our business plan and how it can better reflect the needs of our customers. They will publish an independent report about how we report our performance alongside our Annual Performance Report.

Improving communication channels

To make things easy for our diverse demographic of customers and stakeholders we need to give them the option to choose how they interact with us and ensure high quality communication every time. We've been making some significant improvements during the last year:

Face-to-face engagement

- We've set up a new office and field based incident management team dedicated to helping customers in emergency situations, however large or small they may be.

Phone

- Our new waste 'one-stop-shop' service centre is improving customer experience and the speed of customer resolution.
- We're investing in new telephony solutions to improve our customer experience of speed and ease of contact and to provide more reliability and resilience in our voice channel.

Text alerts

- We offer customers the option of receiving text message updates relating to supply issues or interruptions.

Mail

- We're striving to ensure high quality and clear written communication for the wide range of customers we serve and who choose to contact us via email or written letter.

Our digital evolution

- We've been improving our digital capability as part of the launch of our new technology alliance and 2016/17 saw some investments to improve our customer experience. Our digital capability will only increase as we utilise and develop our new digital platform and as the alliance embeds
- We're investing approximately £120 million before 2020 in a multi-faceted solution to update our customer relationship management and billing capabilities. Clearly being able to accurately, reliably and easily bill our customers is critical. This big investment will underpin our ability to do this going forward and support our ambition of continually improving the ease of doing this for our customers.
- We've extended our social media service to become 24/7, to introduce another 'round-the-clock' communications channel for our customers. As part of this focus on social media, we have also started to proactively monitor customer comments online so we're able to proactively respond to concerns.
- We launched our new digital platform and website to provide the foundation to enrich the look and feel as well as the content to improve our customer and stakeholder experience.
- The increase in the number of registered users on our online account management system continues to gather pace, with over 600,000 of our customers now signed up.

Investing in infrastructure

Investing in our infrastructure is critical to enable us to reliably serve our customers. With thousands of ageing pipes across our network, improvement can only be made with a regular and targeted programme of investments. We've invested over £12 billion in the last 12 years in our business.

Strengthening our network

The landmark Thames Tideway Tunnel construction project, which is being delivered by an independent company – Bazalgette Tunnel Limited (BTL), is progressing well and will transform the health of London's rivers. After buying the land along the tunnel's path and preparing for the project, our responsibility now is for the connections to the tunnel, which we are delivering ahead of schedule. By the end of this regulatory period (2015-2020), we expect to have spent £1.4 billion in total on our share of the works. From 1 April 2016 we started recognising revenue on the arrangement with BTL, as agreed with Ofwat. As cash is collected, it is passed on to BTL to fund construction of the tunnel. Our first super sewer, the Lee Tunnel was commissioned during the previous financial year 2015/16, and was awarded the Greatest Contribution to London award by the Institution of Civil Engineers in 2016/17.

As well as ambitious projects to ready London for the future, with our alliance partners we're also investing heavily in equally important schemes in our other regions to help local communities – the £30 million Axford pipeline near Swindon, the £24 million Angelinos pipeline near Abingdon and a £8.4 million sewer in Didcot to name just a few.

As enduring and committed custodians of the natural environment we've invested £4.4 million in screens to protect endangered eels from entering our network and reduce the likelihood of pollutions, as well as £6.7 million on a major sustainable urban drainage project for the Nine Elms development in Battersea in 2016/17.

Water

An exceptional product

We deliver 2.6 billion litres of clean drinking water direct to our customers' homes, 365 days a year for an average of just over £1 a day and our water quality achieved 99.96% compliance for 2016. Performing 475,000 tests a year on water samples, we ensure our water quality remains among the highest in the world.

Improving water network resilience

We've invested heavily in our ageing water infrastructure in recent years, and have committed to spending an extra £97 million during the next three years to improve the resilience of our largest water mains for the benefit of our customers, the environment and future generations. Renewing our water network, which could stretch three quarters of the way around the world, is a mammoth task.

Although we missed our leakage target for 2016/17, we increased our investment in leakage reduction during the year and we're trialling a raft of new technologies to improve our performance and reduce our susceptibility to extreme weather. Although the major bursts are a visible reminder that some of our pipes are fragile, most leakage actually comes from leaks below the ground that we can't see and are more difficult to locate and repair.

Reducing supply interruptions continues to be a challenging commitment to meet, but we have improved our performance since 2015/16. 1 in 7 of our water complaints relate to an interruption in the water supply, so we know it's something we need to get right. We have performed well in minimising the number of interruptions lasting for more than four hours (0.12 hours per property served) so we have beaten our performance commitment and achieved a reward of £3.1 million in 2016/17. We have also minimised the occurrence of low water pressure experienced by our customers. Disappointingly, we will miss our 1,354 properties target for supply interruptions of over 12 hours. As a result, the health (asset health) of our underground network, including pipes, will be categorised as 'marginal' and we will incur a penalty of £4.7 million. The health of our above ground assets remains 'stable'. We performed well against our security of supply index (SOSI) commitment which represents our ability to supply water in extreme conditions, with 99, however, as the target is 100, we will incur a penalty of £2.27 million for 2016/17.

As this year reminded us, mains replacements are vital to ensure our network is resilient now and in the future. Despite replacing over 2,800 km of our pipes since 2004, 25% of our pipes are still over 100 years old, so there's much more to do and we must do it in ways which are efficient, affordable and minimise disruption to our customers' daily lives. We plan to invest in the maintenance and renewal of 650 km (404 miles) of mains during this regulatory period and we've replaced and repaired 103 km of pipes this year. We've just completed a £4.4 million refurbishment of a 1.6 km pipe in Swiss Cottage by inserting a robust plastic pipe inside the existing main to reduce disruption. We're also using this technique to re-line pipes in Leigham Vale and Upper Street, which flooded properties in December 2016. With two thirds of our network sitting under London, a densely populated and developed area, we need to strike the right balance between creating a resilient network and keeping disruption to a minimum for our customers. Large scale mains replacements are disruptive, can impact water supplies and increase customer bills.

Wastewater

Our customers rely on us to remove wastewater safely from their homes, treat it and return clean water back to the environment.

Pollutions and treatment works compliance

We saw 315 pollution incidents in 2016, which, although up on last year, is a 42% decrease since 2013, when we experienced significant problems. We were fined for some of these historical pollutions in March 2017 and other historical incidents are still being investigated. We've continued to invest in our network with new pump monitoring technology and the installation of new inlet screens to reduce the likelihood of problems. We've also improved our site monitoring technology so we can respond quickly when problems do occur.

We have to pass every discharge quality test to meet our sewage treatment works compliance commitment of 100%. We failed six in 2016/17, so we incurred an ODI penalty of £2.3 million. Although some of the problems were the result of human error, sewer abuse by third parties, for example, caused by the wet wipes and fat being put down the drains, also contributed to us missing our target.

Keeping our waste network flowing

We saw an improvement in our sewer flooding performance this year with a 13% reduction in sewer flooding incidents and a 4.6% reduction in sewer blockages compared to last year. Despite the reduction in sewer flooding incidents, the number of incidents still exceeded the penalty threshold and we incurred a penalty of £0.5 million (2015/16: £11.7 million). Knowing prevention is better than cure we've continued to be proactive in our approach to sewer cleaning and in promoting what our customers can do too. Our extensive customer education programme has continued to gather pace. In 2016/17 we spent £1.4 million on targeted 'Bin It – Don't Block It' campaigns across our region and, following a pilot study of Oxford restaurants in 2015, we launched a new project in 2016/17 to educate fast food establishments across the region about cooking fat disposal. We also formed a successful partnership with the Marine Conservation Society to highlight the problems caused by wet wipes, which has captured the media's attention.

Reducing odour considerably

As the population grows and housing developments get closer to our sewage treatment works, we've made headway in recent years in reducing odour for those local communities. In 2016/17 we made further improvements at two sewage treatment works in Aldershot and Esher. This work has led to a reduction of 1,305 properties being affected by odour as assessed through odour modelling. Our major upgrade of Deephams sewage treatment works, involving 500 construction workers, will take this one step further, with an expected reduction in a further 3,850 properties affected by odour.

The £250 million plus upgrade at Deephams will be completed in 2018 and will increase the capacity of this major treatment works from 887,000 to just less than 990,000 people. In recognition for the way we limited local disruption, the scheme won two National Bronze awards as part of the Considerate Constructors Scheme.

Custodians of the environment

We recognise that we have a huge responsibility to protect our natural environment and to transition our business towards using more renewable energy. We are committed to taking major precautionary measures to ensure the safety of local ecosystems while also helping us meet our pollution targets.

The provision of essential services is energy intensive. It costs over £50 million a year to power our water treatment process alone and this is one of our largest single operational costs. Our customers provide us with valuable fuel every day, in the form of sewage, and through the use of innovative new technology, we're making huge progress in our bid to realise its full potential to reduce our energy costs. Alongside this, we're doing what we can to drive energy efficiency across the business including:

- Finding the most energy efficient route to deliver water to our customers
- Committing £3.6 million of investment in energy efficient pumping systems.

Record-breaking energy production

We generated a record 267GWh of electricity from sewage in 2016/17, enough to power 86,000 homes a year, and this will only increase in future years. Combining this with the 6.4GWh we generated and used from other sources, one fifth of our electricity came from renewable sources, including our own generation, during 2016/17. This saved us £24 million off our annual energy bill.

We're also exploring other innovative ways to produce energy close to our sites, similar to last year's construction of Europe's largest floating solar panel array on our Queen Elizabeth II reservoir, which part powers Hampton water treatment works. Where we're not able to produce our own green energy, we've been buying in renewable electricity following an agreement with Haven Power.

To drive costs down and help us become a more environmentally sustainable organisation, we aim to source 33% of our energy from embedded renewables by 2020.

In 2016/17 our greenhouse gas emissions fell by around one third to 507.4 kTCO₂e (kilograms of carbon dioxide equivalent per million litres of water treated). We reduced our water greenhouse gas emissions intensity from 273.0 kgCO₂e/MI by almost one half to 141.3 kgCO₂e/MI. We reduced our wastewater greenhouse gas emissions intensity from 303.1 kgCO₂e/MI by one quarter to 225.4 kgCO₂e/MI.

Protecting water resources

We continue to drive programmes to protect water resources for the future and we're currently working on our next Water Resources Management Plan. It is due to be submitted to DEFRA later in 2017 and published in draft early in 2018 for consultation. Every five years the Secretary of State requires water companies to submit 25 year plans to develop an efficient and economic water supply system which will maintain security of supply for customers. With climate change and population growth forecast to result in a substantial supply and demand imbalance in our area, some areas will require significant capital investment, such as mains replacement, wastewater recycling, new storage reservoirs and inter-regional transmission pipelines. In London, water demand is forecast to outstrip supply by approximately 150 million litres of water per day by 2025, and without appropriate action the situation is only going to get worse. As well as strong governance to ensure a 'whole of life' and cost efficient investment plan, we have been engaging with external shareholders for the last three years to help inform our plans.

We have also continued to install meters at our customers' homes and on our network, including 146,000 smart meters to increase customers' awareness of their water usage and help us detect leaks.

Helping households, business sites, schools, local authorities and housing associations become more 'water smart', our hugely successful water efficiency programme is the largest in the industry, saving over 11 million litres of water each day. Awarded the 'Water Resource Management award' by the Water Industry Achievement Awards, our Smarter Home Visits initiative installed 200,000 water efficiency devices in 60,000 households, helping our customers reduce their metered water and energy bills. We're leading by example – our water saving toilets and taps at our head office in Reading have helped the entire building use 50% less water – winning the 'Sustainable Water Management award' by the Institution of Civil Engineers.

A safe work environment

The safety and health of our employees and customers is of paramount importance and in 2016/17 we reached two major health and safety milestones. We saw our first ever day when no employees or contractors across our entire business were off work with a work related injury. Also, twice during the year we clocked up 2,000,000 consecutive hours worked without a lost time injury. Over the year we have seen a 17% reduction in the Lost Time Injury Frequency Rate (LTIFR) and 21% drop in RIDDOR (serious) Injury Frequency Rate.

As part of our health and well-being strategy, we have been encouraging employees to look after their physical and mental health. Benefits such as confidential personal medical assessments for all, education courses and other well-being initiatives collectively led to a 30% decrease in work related mental health referrals during the year.

In 2016/17 we saw a further 46% increase in the number of hazards being reported by our employees, which prevents incidents before they occur - our health and safety stand-down meetings have also been effective in highlighting potential areas of concern. To help increase the number of safety inspections and provide a 'fresh pair of eyes', senior managers from across the business have also been conducting health and safety inspections. Over 800 inspections were carried out in 2016/17 and the number of management inspections increasing by 57%.

We have continued to increase the competency of our workforce through new and innovative training such as our industry leading water safety course. There was an 11% increase in health and safety training days delivered to our employees during 2016/17.

Giving back

We have a culture of giving back to the community and environment we serve through our 'time to give' programme. From litter picks, to helping in schools and decorating furniture to sell for charity, employees spent 6,632 hours taking part in 962 volunteering opportunities for local causes in 2016/17.

We also help those further afield. After raising £2 million for Bangladesh through numerous projects, we have committed to raising £2 million to change the lives of people in two villages in Malawi, who don't currently have running water. We raised £350,147, with a further £93,000 of income pledged in 2016/17 for our WaterAid 'Thames loves Malawi' campaign, with some projects, including our summer raft race on the River Thames, raising significant sums.

Natural environment

As part of our operations we work alongside a lot of different species of wildlife and we are fully committed to protecting local ecosystems. We've invested £4.4 million in screens to protect endangered eels entering our network alongside £740,000 in other biodiversity projects. They include creating an osprey tower at Pinkhill Reservoir, putting up barn owl boxes at Beckton sewage treatment works and creating mixed species hedgerows at various sites across our region.

Caring for our people

Without our people Thames Water couldn't exist and we need the best people in our business to enable us to deliver our commitments to our customers, stakeholders and the environment. Our people strategy sets out how we will support our internal investors, the Thames Water family, on this journey by building a working environment and culture in which we inspire them to live our values and do their very best for every one of our customers, every day.

Engagement

Having an engaged workforce who understand what is happening in the business and their role in our success is really important to us and we ensure that we do this on a regular basis whether through team meetings or through our internal social media channels.

Every year our employees are invited to complete our 'hear for you' survey so we can measure our progress in a range of areas.

Diversity and inclusion

It's important to us that all our employees can be themselves at work and are able to give their best. Being diverse in our approach isn't about ticking boxes - it's about hiring the right people for the job regardless of their background and we are working hard to become a more inclusive organisation. In recent months, the percentage of women in our executive team has increased from 10% to 30%, which is more in line with the percentage of women throughout the company – 32% of employees and 33% of managers are women. We have extended our internal diversity networks, introduced unconscious bias training, updated our facilities, and extended our recruitment pipelines and practices to attract a wider audience, including a returner's to work programme. We continue to be sponsors of the Pride events across our region.

We are committed to fulfilling our obligations under the Equality Act 2010 and have policies and procedures in place to ensure both applicants and employees have equality of opportunity, are treated fairly and have a safe workplace, free from discrimination, bullying, harassment and victimisation. We seek to promote a culture of honesty and integrity in everything we do and will not tolerate acts of fraud, dishonesty, bribery, corruption or theft of assets or data. Our code of conduct, alongside our Honest and Ethical Behaviour Policy, expresses our approach to business activities and how we work, providing a clear, ethical and legal framework for our employees, customers and stakeholders. It covers a wide range of human rights issues including discrimination, working conditions, modern slavery and human trafficking and equal opportunities. We have a confidential 24-hour whistleblowing helpline available where any employees can ask questions or raise concerns. Our contractors and alliance partners have agreed to follow the provisions of this code. You can find our latest Modern Slavery Act statement, and the steps we are taking, on our website, alongside our Honest and Ethical Behaviour policy.

Reward and recognition

We celebrate success and when our people go the extra mile to demonstrate they are living our values. This year's Spotlight Awards attracted over 900 nominations which highlighted some great achievements by our people. To promote a healthy work life balance we also offer initiatives such as 'Benefits on Tap', which offers high street discounts, a cycle to work scheme and a free health assessment for every employee.

Talent pipeline

We need to ensure that we continue to attract talent to our organisation and we have great apprentice and graduate schemes that support our longer term resourcing needs. In 2016/17 we brought another 32 apprentices and 38 graduates into the Thames Water family. We also work closely with schools and colleges in our region to develop an early passion in STEM subjects and careers with us. We are a key sponsor of the London Design and Engineering University Technical College, a college dedicated to educating engineers of the future and our HR Director, Janet Burr, is a Governor. Linking across our pipeline our graduates share their experiences and mentor students at the college.

Strategic report

The Directors present their strategic report of the Kemble Water Holdings Limited Group for the year ended 31 March 2017.

Business review

Principal Activities

The principal activity of the Group is the appointed supply of water and sewerage services through its wholly owned indirect subsidiary, TWUL. The Company's principal activity is to act as the holding company of the Group.

The three main segments to the TWUL business are:

- Retail:** comprising both the household and non-household Operating Companies and provides certain customer-facing activities including billing and revenue collection within the Thames Valley region;
- Water:** responsible for all aspects of raw water abstraction and treatment as well as the distribution of high quality drinking water to household and non-household customers; and
- Wastewater:** responsible for all aspects of wastewater collection, treatment and safe disposal.

Whilst the appointed supply of water and wastewater services provides approximately 98% of the Group's gross revenues, TWUL also manages certain non-appointed activities including:

- property searches, including the provision of information required by property developers;
- sale of gravel and other aggregates extracted through day-to-day operations; and
- treatment of trade effluent and other septic waste.

In addition, outside of TWUL, the Group operates a property business to manage and optimise the value of the Group's property portfolio, and a commercial water retail business incorporated to take advantage of the opening of the water industry to competition.

From 1 April 2017 the Company no longer provides non-household retail services since non-household customers have been transferred to Castle Water.

Business strategy

The Group's strategy is as follows:

- For the appointed business of TWUL, the aim is to deliver safe reliable services for customers while ensuring reasonable returns for shareholders. This means keeping customers' bills as low as possible whilst investing efficiently in assets to ensure its customers' needs are met now and in the future. From a shareholder perspective, this means meeting and outperforming our regulatory outputs and financial settlement to provide the returns they require and expect.
- Outside of the appointed business, the Group continues to provide property search services to conveyancers and homebuyers. The Group also retains a property services arm which focuses on the development and enhancement of the value of land and sites that are no longer required for the appointed business, including disposal to third parties.

Principal risks and uncertainties

"Management of our risks is key to ensuring the successful delivery of our strategic objectives and plans. We are committed to continuing to develop a practical and flexible framework that effectively identifies, assess and manages risks and opportunities."

Nick Fincham, Strategy and Regulation Director, Chair of Risk, Opportunity and Controls Committee

Our risk management and governance framework

Responsibility for the effectiveness of our risk management and governance framework sits with the Board. Regular oversight is delivered through the Audit, Risk and Regulatory Committee (ARRC).

The principal risks are reviewed in detail by the ARRC at each Committee meeting and there is a rolling agenda for each Executive team member to present to the Committee key risks within his/her business area. In addition, we carry out 'deep dives' into the management of specific risks.

The quarterly Risk, Opportunity and Controls Committee (ROCC), chaired by Nick Fincham, the Strategy and Regulation Director, is responsible for reviewing and challenging the key risks, opportunities and controls identified by business area.

Our approach to risk management

The system of internal controls and risk management recognises that the risk of failure to meet business objectives cannot be eliminated entirely. Any framework can only provide reasonable, not absolute, assurance against the impact of key risks.

We align our risk management approach to ISO 31000 to support continuous improvement and review the effectiveness of the systems of risk management and internal control.

During 2016/17 we refined the focus and terms of reference of the ROCC (formerly known as the Risk and Controls Committee) to more explicitly focus on managing current and emerging risks, and increasing the viability of current mitigations and future action plans.

We prioritise risks according to our defined risk scoring criteria which takes into consideration both impact and likelihood.

Our principal risks and uncertainties

We continually monitor the principal risks facing the Company, including those that would threaten our business model, future performance, solvency or liquidity.

Movement in the period

The most notable movements across the risk profile relate to our customer service, asset availability and performance and information systems cyber security risks.

During the year, we reviewed the principal risks identified in 2015/16 and determined that the risks relating to bad debt and pension commitments are no longer considered significant.

Bad debt costs have reduced during the year, both in absolute terms, and as a percentage of gross revenue (2016/17: 2.4% versus 2015/16: 3.1%). This has been achieved by effective control mitigations including the implementation of a new debt management system and focus on improving data quality to enable more effective targeting of support and investigation of non-payment.

With respect to pension commitments, we are confident that there are sufficient and appropriate mitigating controls in place. The 31 March 2016 pension valuation is currently being concluded with the scheme trustees. Thames is a long-term business with a strong financial covenant to support future pension deficit payments. A recovery plan is in place based on the actuarial valuation dated March 2013, as agreed between our Directors and the scheme trustees. Under this plan, additional contributions are made to each of our two defined benefit schemes, totalling around £20 million annually. As part of the March 2016 actuarial valuation, we are engaging with the trustees to agree an undated recovery plan.

During the year we experienced a series of trunk mains bursts, which impacted a number of customers in London, and which consequently caused reputational damage for our key stakeholders. The resilience of our infrastructure is an area of significant focus and attention for the Board and Executive Team.

The terror attacks this year, worldwide cyber incidents and corporate information systems failures have increased focus on ensuring we have adequate and effective systems of prevention, detection and response.

Lastly, we have consolidated our risks associated with inflation, financing and credit ratings and review them holistically as part of a broader financial market risk.

We continue to identify and assess and manage current and emerging risks within our risk categories.

Key: ↑ Risk profile has increased

→ No change in risk profile

↓ Risk profile has decreased

Risk categories	Principal risks 2015/16:	Principal risks 2016/17:
<p>Operational Loss resulting from inadequate or failed internal processes, systems, controls and people</p>	<p>Customer service Failure to improve and then maintain service levels</p> <p>Economic and efficient delivery of services and capital projects Inability to economically and efficiently deliver services and capital projects through alliance partnerships</p> <p>Key assets and processes <i>Inability to provide water or treat waste due to failure of key assets and/or processes</i></p> <p>Health, safety and wellbeing The environment in which the Company operates, and the work it undertakes, exposes the workforce, business partners and the community to hazards that could harm their health, safety and wellbeing</p> <p>Data and key business systems Loss of data or interruptions to key business systems</p>	<p>Customer service Failure to improve and then maintain service levels</p> <p>Economic and efficient delivery of services and investment projects Inability to deliver services and investment projects economically and efficiently through supply chain and alliance partnerships</p> <p>Asset availability and performance Interruptions to supply and services from repairs, maintenance, operational issues, weather or security</p> <p>Health, safety, environment and security Failure to manage risks that may result in injuries, environmental damage, crime and/or sabotage</p> <p>Information systems and cyber security Failure to protect information technology and operational technology potentially causing data loss and systems/service failure</p>
<p>Compliance Compliance with laws, regulations and ethical standards</p>	<p>Competition regulation Failure to adapt to changes in the regulatory landscape due to the introduction of competition</p> <p>Key legislation and regulation Failure to comply with key regulation and legislation</p>	<p>Competition regulation Failure to adapt to changes in the regulatory landscape due to the introduction of competition</p> <p>Legal and regulatory compliance Failure to comply with and prepare for relevant regulation and legislation</p>
<p>Financial Risks associated with exposure to financial markets, meeting financial obligations and accuracy of financial reporting</p>	<p>Financing and credit rating Inability to finance the Company and maintain target credit ratings. We are subject to a financial covenant that requires us, at each periodic review, to apply to Ofwat for a price determination which, in the reasonable opinion of the our Directors, would allow, at a minimum, a credit rating the same as the original credit rating at the establishment of the securitisation (A3/ BBB+)</p> <p>Inflation rates Consistently low inflation or deflation could lead to pressure on covenants and financing structures</p> <p>Pension commitments Inability to fund pension commitments</p> <p>Bad debt recovery The law prohibits the disconnection of a water supply from certain premises including domestic dwellings as a method of enforcing payment. This results in high levels of bad debt which cannot be recovered and need to be written off.</p>	<p>Financial market (consolidation of relevant risk from 2015/16) Volatility in interest rates and inflation, and maintaining ability to refinance effectively</p>

Key: ↑ Risk profile has increased

→ No change in risk profile

↓ Risk profile has decreased

<p>Customer service</p> <p>What the risk means to us Providing consistently high quality customer service is central to our overall strategy. Unacceptable customer service levels or the perception that we are failing to maintain and improve service quality will have a detrimental effect on customer satisfaction and the level of complaints.</p> <p>Some of the largest financial penalties and rewards are attached to the service incentive mechanism (SIM) which is used by Ofwat to assess our customer service performance relative to other companies in the industry.</p> <p>Movement in the year: ↑ To improve our customer service we are revising and focusing our approach. We exited the non-household market to allow for greater focus on our core retail household customers. We have seen improvement in complaint resolution with 94.5% being resolved first time (90.9% in 2015/16). Whilst our SIM score has moved from 76.74 to 77.26 in 2016/17, we recognise that much remains to be done and is part driving the risk profile.</p>	<p>Risk category: customer</p> <p>What we are doing to manage the risk We recognise that there is still much to do to meet customers' increasing expectations. To support this we:</p> <ul style="list-style-type: none"> • are investing in a 'one-stop-shop' customer service centre, bringing together customer service and wastewater operational expertise under one roof to enhance our service and response level to customers; • have a new customer experience plan focusing on improving our customer communication channels, including our digital platforms, and online account management system to support customers' choice and allow customers to choose how they interact with us; and • are continuing to develop our customer case management capability to manage and resolve queries, reduce complaints and proactively assist our most vulnerable customers. <p>Looking forward</p> <ul style="list-style-type: none"> • We are engaging with customers in preparation for our 2020-2025 business plan to support our understanding of customer needs and expectations; • We continue to focus on developing our new customer relationship management and billing system, as well as stabilising existing IT architecture; and • We are developing and implementing of a company-wide customer experience plan under the leadership of the new Managing Director for Customer Services and Retail.
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<p>Economic and efficient delivery of services and investment projects</p> <p>What the risk means to us We have an investment programme of over £4 billion to deliver between 2015 and 2020.</p> <p>Failure to deliver the investment programme to time, cost and quality could affect customers, profitability and our reputation.</p> <p>Movement in the year: ↑ Technology services were transferred to the Technology and Transformation Alliance during the year. Activities associated with the transition, stabilisation and enhancement of services have caused disruption and affected availability. In addition, the wider operating businesses including other alliances have yet to deliver expected levels of efficiency and transformation.</p>	<p>Risk category: operational</p> <p>What we are doing to manage the risk</p> <ul style="list-style-type: none"> • We are seeking to drive operational and financial efficiency and effectiveness through targeted improvement projects sponsored by Executive members with assurance provided by the Chief Delivery Officer; • We are refreshing our governance and investment case appraisal process under the leadership of the Chief Financial Officer to support effective allocation of economic capital onto key projects and priorities; and • We are reviewing our technology strategy through the Technology and Transformation Alliance to support increased investment in our infrastructure to improve system availability and stability. <p>Looking forward</p> <ul style="list-style-type: none"> • We are focused on the delivery and execution of our business-wide improvement projects with a significant focus on our customers, while stabilising our technology architecture and systems; and • We are considering the most efficient and effective delivery routes as part of planning for our 2020 to 2025 business plan submission due in September 2018.
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Key: ↑ Risk profile has increased → No change in risk profile ↓ Risk profile has decreased

<p>Asset availability and performance</p> <p>What the risk means to us Asset failure may lead to supply and service interruptions, environmental breaches, failure to meet regulatory targets and/or health and safety incidents.</p> <p>In addition, certain specific assets are critical to the provision of water and wastewater services to large populations. These require continued high levels of investment to ensure security and resilience.</p> <p>Movement in the year: ↑ We have had a series of high-profile trunk mains bursts as well incurring an ODI penalty in respect of failure of sewage treatment works discharge compliance.</p>	<p>Risk category: operational</p> <p>What we are doing to manage the risk</p> <ul style="list-style-type: none"> • We have established high operational standards for our significant assets; • We have an extensive customer education programme in place; • We inform investment decisions using asset based risk assessments, forecasting, quality assurance procedures and structural integrity monitoring reports; and • We have the largest investment programme in the industry to maintain and improve network and asset resilience. <p>Looking forward</p> <ul style="list-style-type: none"> • We are looking to further improve insight and innovation in asset performance; • We are reviewing our business contingency plans for asset based incidents including site monitoring technology on our wastewater sites to allow us to respond quickly when an incident occurs; and • We are investing heavily in mains replacements and will be replacing approximately 500km of mains by 2020 We've committed to spending an additional £97 million during the next three years to replace 'trunk' mains.
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<p>Health, safety, environment and security (HSES)</p> <p>What the risk means to us If we fail to manage risks associated with our operations it could result in fatality or injury, significant environmental damage, interruption to production or services, personal health and safety incidents, crime and sabotage and/or internal security related attacks.</p> <p>The wider consequences of significant HSES events include precautionary closures, suspension of activities, or breach of applicable Health and Safety Executive ("HSE") regulations. This could lead to loss of licence, legal liability, regulatory enforcement, criminal proceedings and damage to our reputation.</p> <p>Movement in the year: → We were fined £19.75 million plus costs for pollution incidents that took place at our sewage treatment works in Aylesbury, Didcot, Henley, Little Marlow and Arborfield, and Littlemore sewage pumping station between 2012 and 2014. We have also focused, in particular, on occupational process and safety, and business continuity. We reduced to zero the reservoirs presenting unacceptable levels of risk, and twice achieved two million consecutive man-hours without a lost time injury. We also achieved for the first time, a day when zero employees were absent with a work- related injury.</p>	<p>Risk category: operational</p> <p>What we are doing to manage the risk</p> <ul style="list-style-type: none"> • We have a zero tolerance approach when safeguarding the health, safety and wellbeing of employees, partners and the public; • We continually review our HSES risks and the effectiveness of controls to manage them; • We have continued to increase the competency of our workforce through new and innovative training such as our industry leading water safety course. There was an 11% increase in health and safety training days delivered to our employees during 2016/17; • We have increased the numbers of employees in key operational roles and are investing heavily to improve reliability of sewage treatment works; • We added £1.5 million to our Community Investment Fund to improve the river and surrounding environment at pollution affected locations; and • We have robust security intelligence and operating procedures in place, and regularly evaluate and test crisis management and business continuity. <p>Looking forward</p> <ul style="list-style-type: none"> • We will continue to regularly review performance levels, including asset defect management; and • We will review the potential threat from terrorism to our people, assets and operations is kept under review by our Security Board.
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<p>Information systems and cyber security</p> <p>What the risk means to us The effectiveness of our operations and the safeguarding of personal, commercial and operational data rely on the availability, integrity and security of complex information systems and networks. This includes those of our third-party service providers and alliance partners.</p> <p>There can be no guarantee that our response, recovery and contingency plans will be sufficient to prevent and respond to all possible breaches. This could affect customer service delivery, security of data, performance of assets and cause reputational damage.</p> <p>Movement in the year: ↑ We monitor the cyber-threat landscape and take proactive steps to ensure we protect our infrastructure, operations and the data we hold.</p>	<p>Risk category: operational</p> <p>What we are doing to manage the risk</p> <ul style="list-style-type: none"> • We work collaboratively with working groups across the utilities industry and public and private sectors to manage security threats to our national infrastructure; • Our information security strategy integrates data, cyber, physical and personnel security overseen by our Security Board; • We have solutions in place to detect and investigate security threats and incidents to ensure potentially vulnerable systems are identified and vulnerability gaps closed; and • We review the adequacy and effectiveness of our infrastructure and technology security controls, undertake employee security awareness training, and test contingency and recovery processes. <p>Looking forward</p> <ul style="list-style-type: none"> • With the introduction of the Technology and Transformation Alliance we are undertaking an exercise to better understand our business and future technology requirements, and our threat landscape; and • We are increasing technology spend to modernise our infrastructure and improve system availability and stability.
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Key: ↑ Risk profile has increased

→ No change in risk profile

↓ Risk profile has decreased

<p>Competition regulation</p> <p>What the risk means to us As a wholesaler in the non-household market, we have delivered our business transformation programme, meeting all market requirements. One key requirement is providing a 'level playing field' to all retailers operating in our region. It is vital that we do not prejudice any retailer in the services we offer.</p> <p>Movement in the year: → We sold our non-household retail business to Castle Water to focus on our retail household and wholesale businesses. We continue to ensure we follow the market codes and fulfil our market obligations. We have not revised the risk profile in light of the market opening on 1 April 2017.</p>	<p>Risk category: compliance</p> <p>What we are doing to manage the risk</p> <ul style="list-style-type: none"> • We have designed and implemented our processes with competition and market code obligations front and central; • We have established a Wholesale Market Services team to ensure we fulfil our market obligations; and • We are actively engaged with Market Operator Services Limited ("MOSL") to support effective and efficient operation of the market. <p>Looking forward</p> <ul style="list-style-type: none"> • We are satisfied that the processes and procedures we have introduced offer all retailers a fair and consistent service, however, we are aware that improvements will be necessary as the market matures in order to meet our objectives to deliver excellent service to new and existing retailers.
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<p>Legal and regulatory compliance</p> <p>What the risk means to us The water industry is subject to a wide range of regulations, laws and rules that are overseen by statutory and regulatory bodies in the UK and, currently, the EU.</p> <p>Failure to comply with relevant regulations could undermine public trust in our business and management. Furthermore, this may lead to regulatory and/or legislative action or investigation, potentially resulting in enforcement notices, licence changes, criminal proceedings, financial penalties, damage to our reputation and delivery of our operations</p> <p>Movement in the year: ↑ We continue with preparations to adapt to changes in the regulatory landscape. This includes the introduction of non-household competition, as well as new and impending legislation that impacts our business, such as the Modern Slavery Act (MSA) and General Data Protection Regulation ("GDPR") which comes into force in May 2018 and carries a penalty per offence of up to 4% of global turnover (circa £80 million).</p>	<p>Risk category: compliance</p> <p>What we are doing to manage the risk</p> <ul style="list-style-type: none"> • We have a clear understanding of our regulatory and key legal obligations, as well as identifying impending new legislation, and changes to existing legislation and licence conditions. Compliance is monitored through Audit and Assurance and as part of the annual company self-assessment; • We provide training programmes to employees and service delivery partners to support compliance with key laws; • We support industry consultations to influence regulatory and legal developments; and • We changed our processes and procedures to support compliance within the non-household market from 1 April 2017. <p>Looking forward</p> <ul style="list-style-type: none"> • We continue to strengthen our regulatory and legislative compliance programme. We pay specific attention to our environmental responsibilities, including learning lessons following pollution incidents occurring between 2012 and 2014 for which we incurred a significant fine in 2017; and • We are developing plans in response to the UK Government white paper on corporate governance, the DEFRA paper on enabling resilience in the water sector and to ensure compliance when the GDPR comes into force.
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Key: ↑ Risk profile has increased

→ No change in risk profile

↓ Risk profile has decreased

<p>Financial markets</p> <p>What the risk means to us Our financial performance is dependent upon our ability to access new competitively priced sources of debt financing and manage exposure to financial market and economic risks resulting from changes in interest rates, inflation and exchange rates.</p> <p>Our Regulatory Capital Value ("RCV") and wholesale revenue are linked to the underlying rate of inflation, measured by the Retail Price Index (RPI). A prolonged period of low inflation and/or deflation adversely impacts financial performance.</p> <p>Movement in the year: →In accordance with our Instrument of Appointment, we continue to maintain a strong investment grade credit rating, as assigned by external ratings agencies Moody's and Standard & Poor's ("S&P"). The assessment by these two agencies provides an independent view of our performance and future prospects. In April 2017, Moody's reaffirmed our Baa1 Corporate Family Rating ("CFR") with a stable outlook. Moody's cited our low business risk profile and the relatively stable and predictable cash flows generated under a well-established and transparent regulatory framework as drivers which support the rating, as well as the creditor protections incorporated within the financing structure. Moody's did, however, recognise that these strengths are somewhat offset by the relatively high gearing we employ.</p> <p>In their most recent credit opinion in September 2016, S&P assigned ratings of A- (Class A) and BBB (Class B) and maintained a negative outlook. Whilst S&P recognise positive developments in operating performance over the previous two years, it assessed these improvements as lagging behind our peers and retained a negative outlook reflecting their assessment of the limited headroom at current leverage levels.</p>	<p>Risk category: financial</p> <p>What we are doing to manage the risk</p> <ul style="list-style-type: none"> • The impact of low inflation and/or high interest rates is mitigated by the fact that most of our debt is fixed rate or linked to RPI; • We have used forward starting interest rate swaps to reduce the interest rate risk associated with new debt raised; • Our annual funding strategy is approved by the Board. We successfully issued £568.1 million of new debt in the year to 31 March 2017, and a further £550.0 million in May 2017; • We swap all foreign currency debt to sterling using derivatives; • We maintain an open dialogue with credit rating agencies on financial and operational performance to support credit rating agency understanding of our plans and delivery execution; • We have £1.45 billion of committed bank facilities to provide guaranteed liquidity; • We have long-term refinancing with staggered maturity dates to minimise refinancing risk; and • We maintain a diverse portfolio of debt sources to reduce reliance on particular markets or providers of debt financing. <p>Looking forward</p> <ul style="list-style-type: none"> • Volatility in financial markets is expected to continue, particularly in sterling interest rate and foreign exchange markets, as the future trading and political relationship between the UK and the EU is redefined. • It is unclear whether Brexit will impact on the ability of the European Investment Bank ("EIB") to continue to lend to the UK water sector; and • We will continue to focus on improving operational performance and delivering further improvements over the course of the remainder of this regulatory period.
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Managing our finances - Brandon Rennet

Our financial review

To support the efficient delivery of our long-term investment programme, which has exceeded £12 billion over the last 12 years, we remain highly focused on the strength of our financial position.

The principal operating company of the Group, TWUL's, Class A debt is rated as A3 (stable) with Moody's and A- (negative outlook) with S&P, and the Class B debt is rated as Baa3 (stable) with Moody's and BBB (negative outlook) with S&P. The Group have successfully issued £568.1 million of new debt in the year to 31 March 2017, and a further £550.0 million in April 2017. The Group's weighted average cost of debt is now 4.86%, and the average maturity of the debt book is now 18 years.

Underlying revenue for the financial year ended 31 March 2017 was generally in line with the previous year at £2,031.6 million (2015/16: £2,046.8 million), and underlying operating cash flows (note 29 of the financial statements) were reduced in comparison with the previous financial year at £1,098.9 million (2015/16: £1,169.6 million). Underlying operating profit fell year-on-year to £583.5 million (2015/16: £713.4 million), primarily due to an increase in operating expenses of £87.0 million, driven by higher depreciation charges and transformation costs, and a £44.4 million reduction in profits on the sale of properties. Underlying result before taxation is significantly lower year-on-year at a loss of £237.7 million (2015/16: a profit of £384.6 million), with the majority of this reduction being attributable to the £220.2 million net mark-to-market loss on financial instruments and the £97.6 million increase in the net finance expense, driven by lower capitalisation of interest and higher RPI accretion on debt. We continue to invest more than any other water and wastewater company in England and Wales to improve our vast network and create a sustainable service for the benefit of our customers, stakeholders and the environment. In order to achieve this, our focus is on efficiency and disciplined delivery – setting the foundations for delivery across a wide range of areas.

Key financial performance indicators

	Underlying 2017 £m	BTL 2017 £m	Total 2017 £m	Underlying 2016 £m	BTL 2016 £m	Total 2016 £m
Revenue	2,031.6	33.0	2,064.6	2,046.8	-	2,046.8
Operating expenses	(1,543.1)	-	(1,543.1)	(1,456.1)	-	(1,456.1)
Operating profit	583.5	33.0	616.5	590.7	-	590.7
Net finance expense	(449.1)	-	(449.1)	(351.5)	-	(351.5)
Net (losses)/gains on financial instruments	(372.1)	-	(372.1)	22.7	-	22.7
(Loss)/ profit before tax	(237.7)	33.0	(204.7)	384.6	-	384.6
(Loss)/ profit after tax	(135.1)	30.8	(104.3)	470.5	-	470.5
Capital expenditure excluding intangibles	1,117.1	n/a	1,117.1	1,198.8	-	1,198.8
Net debt (statutory basis)	11,840.1	-	11,840.1	11,186.0	-	11,186.0

Relationship with Bazalgette Tunnel Limited (BTL)

From 1 April 2016 we started recognising revenue on the arrangement with BTL, as agreed with Ofwat. As cash is collected, it is passed on to BTL to fund the construction of the TTT. We have presented all amounts associated with this arrangement separately within these financial statements. This non-appointed revenue is excluded from our key performance indicators, which is consistent with our banking covenants. The cash collected and paid over to BTL during the period of construction represents a prepayment for the use of the tunnel once the project is complete. As a result of this unique arrangement and the resultant accounting treatment, our revenues and profits will increase during the period of construction, but such profits will not be supported by cash – instead a prepayment is created on the balance sheet. Once construction is complete, Bazalgette will lease the tunnel to us under a finance lease arrangement.

Revenue

As a result of our arrangement with BTL, our total revenue has increased by £33.0 million compared to 2015/16. Excluding the effect of this revenue, underlying revenue for the year has decreased compared to the previous year by 0.7% to £2,031.6 million. As a regulated business, our revenue is not subject to significant variances year-on-year, but is affected by variables such as consumption, inflation and population growth. Our underlying revenue is shown after a deduction of £45.9 million (2016: £37.7 million), relating to amounts billed in 2016/17 and considered to be irrecoverable (bad debt) from our customers.

Bad debt

Our focus on reducing bad debt, particularly the debt which arises from customers who are unwilling to pay (as opposed to unable to pay), has delivered a year-on-year reduction in total bad debt cost of £14.7 million to £50.4 million (2015/16: £65.1 million). Of the total cost of £50.4 million, £46.5 million (including £0.6m in respect of BTL revenue) (2015/16: £37.7 million) is shown as a deduction in revenue and £3.9 million (2015/16: £27.3 million) within operating expenses.

Operating expenses

Our net operating costs increased by £87.0 million (6.3%) to £1,543.1 million from 2015/16. £40.4 million of the increase is attributable to higher depreciation and amortisation charges on our operational assets. The remainder of the increase is driven by one-off transition costs associated with our technology and transformation alliance, additional investment in customer service and higher spend levels targeted at a number of key performance commitments.

Net finance expense (borrowing costs)

In order ensure our investment programme is affordable for customers, we spread the cost of these long-term assets by borrowing through public and private debt capital markets or through loans from relationship banks. We are required to pay interest on any amounts that we borrow. Our strong investment grade credit rating means that we continue to be able to obtain financing at favourable interest rates.

Our net finance expense consists of:

	2017 £m	2016 £m
Finance income	115.2	107.5
Gross finance expense	(640.6)	(459.0)
Capitalised borrowing costs	76.3	114.4
Finance expense	(564.3)	(459.0)
Net finance expense	(449.1)	(351.5)

Our gross finance expense has increased by £105.3 million from the prior year primarily due to higher RPI accretion costs. Some of our borrowing costs are incurred in relation to the delivery of certain major capital projects. As a result, we are able to capitalise these borrowing costs, which reduces the finance expenses recognised in the income statement. The reduction in borrowing costs eligible for capitalisation was primarily driven by the commissioning of the Lee Tunnel at the end of 2015/16.

Fair value of derivatives

As we borrow money from a variety of external sources, we are exposed to fluctuations in interest and inflation rates as well as foreign exchange rates. Our revenue and operational and capital expenditure are also exposed to fluctuations in inflation rates. We manage these exposures by entering into certain derivative contracts. We have approximately £5.2 billion of derivative financial instruments (face value), which include £1.35 billion of forward starting interest rate swaps that have fixed a significant element of the cost of debt we expect to borrow between 2017 and 2020. A net loss of £372.1 million on financial instruments has been recognised in the income statement during the year (2015/16: net gain of £22.7 million), primarily driven by higher forecast RPI (inflation) rates.

Profit before tax

A summary of the movement in our profit before tax is summarised below:

	2017 £m
Profit before tax for the year ended 31 March 2016	384.6
Decrease in underlying revenue	(15.2)
Net BTL revenue	33.0
Increase in operating expenses	(87.0)
Decrease in profit on sale of property, plant and equipment	(44.4)
Increase in other operating income	16.7
Increase in net interest payable	(97.6)
Movement in (losses)/gains on financial instruments	(394.8)
Loss before tax for the year ended 31 March 2017	(204.7)

Capital expenditure

During the year, we have invested a total of £1,115.6 million (2016: £1,198.8 million) in our network and infrastructure. This spend has included the following key projects:

	31 March 2017 £m
Thames Tideway Tunnel – development and interface works	37.1
Deephams sewage treatment works upgrade	65.0
Our new customer relationship management and billing (CRMB) system*	38.2

*including spend on intangible assets

Spend on the Thames Tideway Tunnel is limited to the cost of work required to connect our network to the tunnel and land acquisition costs. Capital spend relating to the Thames Tideway Tunnel reduced by £91.3 million compared to 2015/16.

Net debt and cash flow

Net debt (the total of external borrowings less cash at bank and in hand) has increased by £654.1 million to £11,840.1 million, as we continue to fund our capital programme. In order to fund ourselves efficiently we have significantly reduced our cash and short term investment balances to £103.8 million (2016: £856.8 million).

Net debt includes accrued interest on debt and excludes derivative accretion and foreign exchange. In the prior year financial statements, we disclosed net debt of £11,171.5 million. This net debt excluded £240.5 million accrued interest on debt and included £226.0 million relating solely to accretion on index-linked swaps and the effect of movement in foreign exchange rate on cross currency swaps held by the Group. After including interest on debt and excluding derivative accretion and foreign exchange net debt as at 31 March 2016 would have been £11,186.0 million.

Gearing and interest cover

As we use external funding, we have to operate within certain financial parameters (covenants) that are set by the institutions we borrow from. Our two major covenants are gearing (the ratio of covenant net debt to RCV) and interest cover (the ratio of our profits to interest payable).

The gearing ratio (covenant basis) has increased at Kemble Water Finance Limited (the company in the Group where all external Group debt is consolidated) from 87.6% to 88.0%. and our interest cover (the ratio of our profits to interest payable), at 1.6x, was well above the minimum level mandated of 1.05x.

Regulatory Capital Value (RCV)

Our RCV reflects the investment we've made in delivering water and wastewater services to our customers. We finance this investment through a combination of borrowing (debt), and equity from our shareholders.

At 31 March 2017, our RCV was £12.9 billion (2016: £12.3 billion).

Dividends and distributions to external shareholders

Our shareholders provide another source of funding to enable us to invest in our network. In return for providing funding, they expect a return on their investment, which we pay in the form of dividends. The level of dividends is influenced by operational and financial performance. Investment in our business for our customers is our top priority and reinvestment will come before any funds are deemed available for distribution.

During the year, TWUL paid dividends of £157.0 million (2016: £82.4 million) to our parent company Thames Water Utilities Holdings Limited (TWUHL). £57.0 million of dividends paid in respect of the current year were made to other companies within the Kemble Water Group, to service their own debt obligations and working capital requirements (2016: £82.4 million). External shareholders have received distributions relating to this financial year totalling £100.0 million (2016: £nil).

Credit rating

In accordance with the Instrument of Appointment the principal trading company of the Group, TWUL, continues to maintain a strong investment grade credit rating, as assigned by external ratings agencies Moody's and S&P. The assessment by these two agencies provides an independent view of our performance and future prospects.

In April 2017, Moody's reaffirmed the Baa1 Corporate Family Rating (CFR) of TWUL with a stable outlook. This supports specific ratings of A3 and Baa3 for TWUL's Class A and Class B debt respectively. Moody's cited TWUL's low business risk profile and the relatively stable and predictable cash flows generated under a well-established and transparent regulatory framework as drivers which support the rating, as well as the creditor protections incorporated within the financing structure. Moody's do, however, recognise that these strengths are somewhat offset by the relatively high gearing employed.

In their most recent credit opinion in September 2016, S&P assigned ratings of A- (Class A) and BBB (Class B) and maintained a negative outlook. Whilst S&P recognised positive developments in operating performance over the previous two years, S&P assessed these improvements as lagging behind our peers and retained a negative outlook reflecting their assessment of the very limited headroom at current leverage levels. We continue to focus on improving operational performance and delivering further improvements over the course of the remainder of this regulatory period.

Moody's rating for the KWF Company debt remains at B1 (Stable) and Fitch at BB- (Stable).

Pensions

The Group is the sponsoring employer of three material pension schemes - two defined benefit schemes and one defined contribution scheme. The latest actuarial valuations for the two defined benefit schemes, dated March 2013, have been updated to 31 March 2017 on our behalf by independent and professionally qualified consulting actuaries, PricewaterhouseCoopers LLP. The valuation shows that overall, the net pension liability, representing the net surplus and deficits of all schemes to which the Group is a sponsoring employer, has increased by £119.6 million to £373.5 million (2016: £253.9 million). This increase has been primarily caused by use of a lower discount rate in the actuarial calculation, driven by lower yields on AA-rated corporate bonds, which is consistent with other companies that operate a defined benefit pension scheme.

There is a recovery plan in place (based on the latest actuarial valuation dated March 2013), as agreed between our Directors and the scheme trustees. The March 2013 actuarial valuation and agreed recovery plan has committed the Group to making additional contributions to each scheme annually. These additional amounts, calculated by a qualified and independent actuary working on behalf of the scheme trustees, have averaged £20 million per year, since 2013, across the two schemes.

The updated triennial valuation, dated 31 March 2016, is expected to be finalised by the scheme actuary by the end of June 2017. As part of the March 2016 actuarial valuation, we are engaging with the trustees to agree and updated recovery plan. The TWUL Company works closely with the scheme trustees throughout this process and remain committed to maintaining a strong and viable pension scheme for active members.

During 2016/17, we contributed £6.8 million (£5.2 million) to the defined contribution scheme.

Taxation

This year, we have paid around £170 million in taxes, including business rates, PAYE and National Insurance. As in recent years, we have not paid any corporation tax to HMRC during 2016/17. As a result of the Government's capital allowances scheme to encourage investment in UK infrastructure, our corporation tax payments are delayed while we invest so heavily in our network. If this scheme was not in place, average combined customer bills would be £4 higher per year.

On 6 September 2016 Parliament enacted a reduction in the future corporation tax rate from 18% to 17% which will be effective from 1 April 2020. This has reduced our deferred tax liabilities by £49.5 million, of which £57.8 million is included in the income statement. This represents a reduction in the level of corporation tax payable in future years and therefore does not constitute a refund from HMRC. Ultimately this will benefit our customers in the form of lower bills in future years.

Our aim is to be clear and transparent about our approach to tax and our tax profile and this year we have incorporated the Financial Reporting Council's recommendations on tax disclosures. We will also be publishing our tax strategy on our website at the end of June. In summary our tax strategy has five key principles:

- We will comply with all tax legislation requirements at all times, both within the letter and spirit of the law;
- We will not use tax avoidance schemes, tax havens or aggressive tax planning;
- We will engage fully and transparently with HMRC and other Governmental bodies, and seek to resolve disputes in a co-operative manner;
- We will adopt a conservative approach to tax risk management and apply a strong tax governance framework; and
- We will accept only a low level of risk in relation to taxation.

Capital and financial risk management policies and objectives

The Group's operations expose it to a variety of capital and financial risks. The Group's treasury operations are managed centrally, by a specialist team. The team operates with delegated authority of, and under policies approved by, the Group's Board of Directors. Risks are therefore managed on a Group wide basis.

The operation of the treasury function is governed by specific policies and procedures that set out guidelines for the management of liquidity, credit and market risks associated with the financing activities of the Group. The treasury policy and procedures are incorporated within the financial control procedures of the Group.

Capital risk management

Capital risk primarily relates to whether the Group is adequately capitalised and financially solvent. The key objectives of the funding strategy are to maintain customer bills at a level which is both affordable and sustainable, retain the Group's investment grade credit rating and provide liquidity sufficient to fund ongoing obligations.

The Board reviews the Group's exposure to these risks and actively oversees the treasury activities, reviewing the treasury policy and approving the treasury strategy and funding plan.

The capital structure of the Group consists of net debt and equity as disclosed in note 18. The Group's net debt is comprised of cash and cash equivalents, short-term investments, bank loans and intercompany loans from subsidiary undertakings that issue secured bonds.

The Group's funding policy is to maintain a broad portfolio of debt (diversified by source and maturity in order to protect the Company against risks arising from adverse movements in interest rates and currency exposure) and to maintain sufficient liquidity to fund the operations of the business for a minimum of a 15-month forward period on an on-going basis. Derivative financial instruments are used, where appropriate, to manage interest rate risk, inflation risk and foreign exchange risk. No open or speculative positions are taken.

Financial risk management

(i) Market risk

Market risk is the risk that changes in market variables, such as inflation, foreign currency rates and interest rates, will affect the Group's income or the value of its holdings of financial instruments. Financial instruments entered into by the Group include RPI linked bonds, loans and swaps. These instruments are exposed to movements in the UK RPI index. The principal operating company of the Group, TWUL, is a regulated water company with RPI linked revenues. Therefore the Group's index linked borrowings form a partial economic hedge as the assets and liabilities partially offset. The Group also uses derivatives to manage inflation risk on non-index linked borrowings.

The Group's foreign currency risk exposure results from debt raised in currencies other than Sterling. The Group uses cross currency swaps to hedge the foreign currency exposure of debt issued in a foreign currency. All hedges are undertaken for commercial reasons with the objective of minimising the impact of exchange rate fluctuations. The Group has no material unhedged monetary assets and liabilities denominated in a currency different from the local currency of the Group. Further disclosures regarding financial instruments can be found in note 18.

Interest rate risk arises on interest-bearing financial instruments. Fixed rate borrowings are exposed to a risk of change in their fair value due to changes in interest rates. Floating rate borrowings are exposed to a risk of change in interest cash flows due to changes in interest rates. The Group uses interest rate swaps which economically hedge future cash flows to protect against interest rate movements.

In mid-2014 the principal operating company of the Group, TWUL, executed £2.25 billion of forward-starting pay fixed/receive floating interest rate swaps of a five to seven year maturity with various financial institutions to fix the future interest costs of an element of the anticipated new debt issuance in this regulatory period. This protects TWUL against adverse movements in underlying interest rates by matching projected future debt issuance against a derivative instrument with a fixed cash flow. Derivatives are revalued to fair value at the end of each reporting period.

(ii) Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's trade receivables, short-term investments and cash flows receivable from counterparties to the derivative financial instruments.

TWUL has a statutory obligation to provide water and sewerage services to customers within its region. Due to the large area served by the TWUL and the significant number of household and business customers within this area, there is considered to be no concentration of trade receivables credit risk, however, TWUL's credit control policies and procedures are in place to minimise the risk of bad debt arising from its trade receivables. Amounts provided against trade receivables and movements in the provision in the year are disclosed in note 14. Management have considered and taken action for TWUL's exposure to credit risk arising from the opening of the non-household retail market to competition (effective 1 April 2017), as the bad debt risk for non-household water and wastewater services will lie with a small number of retailers and not the end user.

(iii) Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group manages long-term liquidity by maintaining continuity of funding through access to different market and debt instruments, raising funds in the capital markets and ensuring that

manageable debt maturity profiles are maintained. The Group also maintains a level of committed liquidity facilities provided by a range of financial institutions. Details of the Group's borrowings and other financial instruments are disclosed in note 17 and 18, respectively.

Actuarial risk management

The two defined benefit pension schemes are exposed to actuarial risks including investment risk, inflation risk and longevity risk. Details of these risks are disclosed in note 23 of the financial statements. The trustees have taken a number of steps to control the level of investment risk within the schemes over the last year, including reducing the schemes' exposures to higher risk assets and increasing the level of protection against adverse movements in interest rates and inflation. The trustees of both schemes continue to review the risk exposures in light of the longer term objectives of the respective schemes.

Viability statement

The Directors have assessed the viability of the Group over a three year period to 31 March 2020. In making this assessment, the Directors have considered the current position of the Group, its ability to effectively and efficiently manage its finances, the current regulatory regime, its continued access to the debt markets, and ability to maintain a strong investment grade credit rating, whilst having regard to the principal risks and uncertainties as described on pages 16 to 21.

As part of TWUL's, the principal operating company of the Group, recurring Price Review process, five year Company Business Plans (CBPs) are developed, the latest of which covers the five year period ending 31 March 2020. As part of the Group's financial resilience assessment, management has designed a number of 'stress tests' which subject the Group's existing model, that underlies the Group's planning processes, to a number of different scenarios and tests its sensitivity to these. The stress tests consider factors, both individually and in combination. These include:

- Fluctuations in interest rates, which could affect the cost of financing the business;
- Fluctuations in inflation rates, which could affect the cost of investment and day-to-day operations, in addition to impacting amounts we bill our customers;
- Increase in operating expenditure, which would reduce profits and cash flow;
- Inability to secure new finance and/or delays in raising finance, reducing the cash available to deliver our investment programme; and
- Unforeseen maintenance and capital expenditure, which would increase costs and decrease cash flow.

Management have prepared a detailed methodology statement that sets out the approach taken to assessing the long-term viability of the Group, including specifics of the variables tested and their effect on the financial covenants of the Group. Taking account of the range of scenarios, the Directors consider that the Group has sufficient mitigating actions in place to address particular circumstances and events, should they arise.

The Directors consider that a three year period is reasonable given the nature of the industry in which the Group operates and to more closely align with the regulatory planning process given the changes in the regulatory framework that are being proposed.

Taking account of the range of severe, but plausible scenarios, the Group's current position and its principal risks, the Directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the next three years.

Approved by the Board of Directors on 13 June 2017 and signed on its behalf by



Sir Peter Mason KBE

Chairman
Clearwater Court
Vastern Road
Reading
Berkshire
RG1 8DB

Directors' report

The Directors present their annual report and the audited financial statements of Kemble Water Finance Limited (the "Company") and the audited consolidated financial statements of its group ("the Group") for the year ended 31 March 2017. These are the Group and Company's statutory accounts as required to be delivered to the Registrar of Companies. This Directors' Report includes certain disclosures required under the Companies Act 2006.

The Directors consider that the annual report and audited financial statements, taken as a whole, is fair, balanced and understandable, and provides the information necessary for shareholders to assess both the Group's and Company's position and performance, business model and strategy.

The Directors have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity, and details of these risks and their management or mitigation can be found on page 25.

The registered number of the Company is 05819262 (England and Wales).

Principal activity

The Group's principal activity is the appointed supply of water and wastewater services to customers in London, the Thames Valley and surrounding area, delivered through its wholly owned subsidiary Thames Water Utilities Limited ("TWUL" or "Thames Water") in accordance with TWUL's licence of appointment.

Details of the associated and subsidiary undertakings of the Group at 31 March 2017 has been provided in the notes to these financial statements.

Future outlook

The future outlook of the Group is discussed in the Strategic Report.

Directors

The Directors who held office during the year ended 31 March 2017 and to the date of this report were:

Sir Peter Mason KBE - Chairman	
E Beckley	(resigned 30 August 2016)
R Blomfield-Smith	
K Bradbury	(appointed 31 May 2017)
M Braithwaite	(appointed 30 August 2016, resigned 31 May 2017)
J Divoky	
R Greenleaf	(resigned 31 May 2017)
A Hall	(appointed 31 May 2017)
G Lambert	
P Noble	
A Osorio	
P Sochocki	(appointed 31 May 2017)
G Tucker	
C Van Heijningen	
Y Wang	

During the year under review, none of the Directors had significant contracts with the Company or any other body corporate other than their contracts of service (2016: none). Directors are allowed to appoint an alternative Director to represent them if they are unable to attend a meeting. The following Directors have formally appointed alternate Directors to represent them when they are unavailable:

Director	Alternate Director
G Tucker	P Mulholland
P Noble	P Hofbauer (resigned 12 October 2016) E Lewis (appointed 12 October 2016)
Y Wang	F Sheng
J Divoky	L Webb

Share capital

As at 13 June 2017, the Company's issued share capital was 1,991,600,000 ordinary shares of £1 each amounting to £1,991,600,000. There were no movements in the Company's share capital during the year.

Dividends

The Group's dividend policy is to pay a progressive dividend commensurate with the long-term returns and performance of the business, after considering the business' current and expected regulatory and financial performance, regulatory restrictions, management of economic risks and debt covenants. Directors, in assessing the dividend to be paid (to a maximum of statutory distributable reserves), are required to ensure that:

- sufficient liquidity is maintained to enable the business to meet its financial obligations for at least 15 months;
- the Group maintains a minimum of 2% headroom on its Regulated Asset Ratio covenant restrictions; and
- post-dividend financial ratios remain within their agreed limits at both the balance sheet date and on a forward-looking basis.

The Company declared and paid £22.8 million of dividends in the current financial year (2016: £nil).

Operations outside the United Kingdom

There are no active operations conducted outside the United Kingdom. The Group has two wholly owned subsidiary entities incorporated in the Cayman Islands. These companies act solely as a financing vehicle for Thames Water Utilities Limited and their operations are conducted entirely within the UK. These companies are (and have always been) resident in the UK for tax purposes.

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position, the financial position of the Group, its cash flows, liquidity position and borrowing facilities are set out in the Strategic Report.

The Directors believe, after due and careful enquiry, and noting that the Group is in a net current liabilities position as at the year end, that both the Group and Company have sufficient resources for their present requirements and are able to meet their liabilities as they fall due for the foreseeable future. For these purposes the foreseeable future is taken to mean a period of at least twelve months from the date of approval of these financial statements. This is based upon a review of the Group's and Company's financial forecasts for the forthcoming financial year, consideration of the Group's compliance with its covenants, and the cash, current asset investments and available facilities of the Group and Company.

On this basis the Directors consider it appropriate to prepare the financial statements on a going concern basis.

Financial risk management

The Company has access to the Chief Executive Officer and the Executive Team of Thames Water Utilities Limited, who also manage the wider Kemble Water Holdings Group on a day-to-day basis on behalf of the Directors of individual group companies. The Board receives regular reports from all areas of the business. This enables prompt identification of financial and other risks so that appropriate actions can be taken in the relevant group companies.

The Group's operations expose it to a variety of financial risks and information on the use of financial instruments by the Group to manage these risks is disclosed in the Strategic Report.

Political donations

No political donations were made by the Group or Company during the current or preceding year.

Charitable donations

Charitable donations of £0.5 million were made by the Group during the year.

Employee Involvement

We undertake significant levels of communication with our people, through regular business review conferences, team briefs and varied written communications. In 2016 we have significantly expanded the use of an internal social media platform called Yammer which enables employees to share successes and discuss issues. In 2017 the Executive also launched a series of group-wide discussions to seek employee input in to developing our Strategy, Vision and Values. Having already held face to face conferences with managers, the senior leaders of the business are meeting all employees in their teams, using 'rich pictures' to illustrate the critical values we aspire to achieve to drive a discussion on how these might be achieved.

The Group recognises three trade unions, UNISON, GMB and Unite, working with them through an agreed Partnership approach. Group, trade union and where appropriate non-union representatives regularly meet at Group, business unit and function level to discuss issues affecting employees. In addition specific groups consider issues relating to Health, Safety and Wellbeing as well as undertake reviews of Group policies. Pay and conditions for non-managerial grades are negotiated by the Partnership trade unions. In 2016 the Group and trade unions ran a joint employee survey and workshops on pay and benefits to provide a clearer understanding of what all of our people value in their remuneration package and how we might develop this in the future.

All Managers and Senior Leaders in the Group are incentivised to deliver Group performance against the same key performance indicators, including financial, customer, asset health, health and safety indicators as well as the delivery of strategic and personal objectives. Following requests from employees for greater involvement in Group performance, we launched a cash saving scheme for all employees in 2015 focussing on

two of the same critical performance indicators, specifically EBIT and Customer Satisfaction. Further schemes have been launched in 2016 and further schemes are planned each year.

The Group regularly shares key performance and other critical business information to employees through the various communications mentioned above, including business reviews and written communications. Specifically a monthly 'Team Talk' session includes key performance, customer and business unit information which is communicated to every team. This session includes key messages from the CEO and CFO, typically in video format.

Equal Opportunities

At Thames Water, we recognise that our people are at the heart of our business. To help us succeed in our aim to provide best-in-class water and sewerage service, to be profitable and sustainable and to act in the long-term interests of our wider community, we need a range of skills and capabilities, representative of society, throughout our business.

We seek to attract, develop, reward, promote and retain a mix of colleagues who can offer different but complementary attitudes, ideologies, talents and knowledge. We understand the importance of appreciating and harnessing the unique skills, experiences and backgrounds that each individual brings to our family.

To support an equal opportunity, fair, diverse and inclusive Thames Water free from discrimination, bullying, harassment or victimisation, we are committed to building a working environment and culture that inspires our people to live our values.

All employees at all levels including managers and partners have a part to play to ensure people feel comfortable to bring their whole self to work.

The attitude and behaviour of all our staff working for an on behalf of Thames Water, including our Alliance partners, has a profound impact on our reputation and ability to ensure that everyone is provided with the same opportunities, treated with respect and valued, irrespective of their protected characteristic; age, disability, gender reassignment marriage and civil partnership, pregnancy and maternity, race, religion and belief, sex or sexual orientation.

Everyone is entitled to be treated fairly, equally and provided with the same opportunities regardless of the nine protected characteristics defined by the Equality Act 2010 or factors such as trade union membership, political opinion, part-time or fixed-term status.

Employees with disability

As an equal opportunities company we aim for people with disabilities to have full and fair consideration for all vacancies. During the year, we have focussed on attracting people with disabilities to our join our organisation. We have received the governments 'Disability Confident' accreditation and promote opportunities at Disability Job Fairs.

Our 'Give Someone a Start' programme offers 3 weeks work experience to those people not in work including those with disabilities or health conditions with the aim to helping them into employment.

We endeavour to retain employees in the workforce if they become disabled during employment. We support individuals with their personal requirements and currently have a programme of work to ensure our key buildings have disability friendly facilities.

Research and development

The Group's research and development programme consists of a portfolio of projects designed to address technical needs across the range of water cycle activities. Research and development activities deliver innovative technical solutions through a research programme aligned with business needs to address challenges for AMP6 and also provide specialist technical support to the business. Expenditure on research and development totalled £4.0 million for the year (2016: £3.1 million).

Greenhouse gas emissions

We have made strong progress throughout 2016/17 in reducing our emissions, both by reducing our energy consumption and by increasing our renewable self-generation. Where we're not able to produce our own energy, we started sourcing renewable electricity through a contract with Haven Power. As a result we have achieved our 2016/17 emissions targets.

In the last year we have reduced our emissions by 246 kTCO₂e to 507.3 kTCO₂e. We calculate our greenhouse gas emissions using the UK Water Industry Research Carbon Accounting Workbook (CAW). The CAW is the industry standard which is updated annually to reflect changes to emission factors and carbon reporting guidance from the Department of Environment, Food and Rural Affairs (Defra).

Operational Greenhouse Gas Emissions (GHG) within the regulated business are calculated annually reflecting the six major greenhouse gases and the Defra Environmental Reporting Guidelines. The emissions reported are associated with the operational emissions of the regulated business and include:

- Scope 1 (Direct emissions);
- Scope 2 (Indirect energy use emissions);
- Scope 3 (Emissions from outsourced services and business travel); and
- Carbon intensity ratios per mega-litre day (MLd) of service delivered

Emissions from the greenhouse gases are standardised to global warming potential represented as carbon dioxide equivalents (CO₂e).

Intellectual property

The Company protects intellectual property of material concern to the business as appropriate, including the filing of patents where necessary.

Directors' indemnities

The Group has made qualifying third party indemnity provisions for the benefit of its Directors and for the benefit of other persons who are directors of associated companies of the Group and these remain in force at the date of this report.

Insurance

The Group maintains a comprehensive insurance programme, renewed annually. This includes cover for a range of insurance classes including Public Liability, Property, Employers Liability, Construction, Motor, and Directors & Officer liability cover.

The insurance coverage has been reviewed and approved by an Independent insurance adviser retained to ensure that the Group's insurances are consistent with good industry practice, have regard to the risk being covered and address the interests of the Group.

Shareholder changes

During the year ended 31 March 2017 Kemble Water International Holdings Limited, an entity managed by the Macquarie Group, agreed to sell its full 26.315% shareholding in Kemble Water Holdings Limited, the ultimate parent company of the Company.

The legal transfer of shares was made on 31 May 2017 from Kemble Water International Holdings Limited. Of the total shareholding in Kemble Water Holdings Limited, Farmoor Holdings B.V., an entity registered in the Netherlands and managed by Borealis Infrastructure Management Inc., a Canadian investment manager of the Ontario Municipal Employees Retirement System, received 17.543%, and Wren House Infrastructure Management Limited, the investment manager of the Kuwait Investment Authority, received 8.772%.

During the year ended 31 March 2017 SAS Trustee Corporation, agreed to sell its 2.389% shareholding in Kemble Water Holdings Limited to Aquila GP Inc., a Canadian entity managed by the Aquila Sonnet Limited Partnership. The legal transfer of shares was made on 25 April 2017. Following the transfer Aquila GP Inc. holds 4.995% of the total shareholding in Kemble Water Holdings Limited.

QIC Diversified Infrastructure Limited, agreed to sell 3.336% of the total shareholding in Kemble Water Holdings Limited to QS Infrastructure Pty Ltd, an entity registered in Australia and managed by QS UK Infrastructure Trust No. 1. The legal transfer of shares was made on 28 April 2017. At the same time QIC Diversified Infrastructure Limited transferred the remainder of their holding, 5.352% to QIC Infrastructure Management Pty Limited

There will be no direct financial effect on the financial statements of the Group or Company.

Transfer of non-household retail customers to Castle Water

From 1 April 2017 the Water Act 2014 allows all non-household customers to choose their supplier of water and wastewater retail services. On 18 July 2016, we announced our decision to exit the non-household retail market, and transfer our non-household customers to Castle Water Limited from the date of retail non-household water market opening. The Company continues to recognise wholesale revenue from these customers. On 1 April 2017 all non-household retail customers of Thames Water were transferred to Castle Water Limited which will result in the recognition of a profit on sale of the business. The sale did not become unconditional until the date of market opening (post year-end) and therefore the profit on sale, which we expect to be between £85.0 million and £87.0 million, will be recognised during the next financial year.

New bonds issued

A total of £550.0 million in new class B sterling bonds were issued by Thames Water Utilities Cayman Finance Limited on 3rd May 2017, with a £300.0 million tranche maturing in 2023 and £250.0 million maturing in 2027. The proceeds are expected to be used to fund the redemption of the existing £550.0 million class B bonds which mature in 2025 but have their first call date in July 2017.

Disclosure of information to the auditor

The Directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware; and each Director has taken all the steps that they ought to have taken as Director to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Auditor

Pursuant to Section 487 of the Companies Act 2006, the auditor will be deemed to be reappointed and KPMG LLP will therefore continue in office.

Approved by the Board of Directors on 13 June 2017 and signed on its behalf by

A handwritten signature in black ink, appearing to read 'Peter Mason', is written over a solid black horizontal line.

Sir Peter Mason KBE

Chairman
Clearwater Court
Vastern Road
Reading
Berkshire
RG1 8DB

Statement of Directors' responsibilities in respect of the Annual Report, Strategic Report, the Directors' Report and the financial statements

The Directors are responsible for preparing the Annual Report, the Strategic Report, the Directors' Report and financial statements in accordance with applicable law and regulations. Company law requires the directors to prepare Group and Company financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU") and applicable law.

Under company law, the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss for that period.

In preparing these financial statements the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and Company will continue in business.

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 have general responsibility for ensuring such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

Independent auditor's report to the members of Kemble Water Holdings Limited

We have audited the financial statements of Kemble Water Holdings Limited for the year ended 31 March 2017 set out on pages 34 to 86. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU and, as regards the Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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' Responsibilities Statement set out on page 32, the Directors are responsible for the preparation of the 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 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

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 March 2017 and of the Group's loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; 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 information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements. Based solely on the work required to be undertaken in the course of the audit of the financial statements and from reading the Strategic Report and the Directors' Report:

- we have not identified material misstatements in those reports; and,
- in our opinion, those reports have been prepared in accordance with the Companies Act 2006.

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



Robert Brent (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London
E14 5GL
13 June 2017

Consolidated income statement

For the year ended 31 March

	Note	Underlying £m	2017 BTL £m	Total £m	Underlying £m	2016 BTL £m	Total £m
Revenue	1	2,031.6	33.0	2,064.6	2,046.8	-	2,046.8
Operating expenses	2	(1,543.1)	-	(1,543.1)	(1,456.1)	-	(1,456.1)
Profit on the sale of property, plant and equipment		4.1	-	4.1	48.5	-	48.5
Other operating income	4	90.9	-	90.9	74.2	-	74.2
Operating profit		583.5	33.0	616.5	713.4	-	713.4
Finance income	5	115.2	-	115.2	107.5	-	107.5
Finance expense	6	(564.3)	-	(564.3)	(459.0)	-	(459.0)
Net (losses)/gains on financial instruments	7	(372.1)	-	(372.1)	22.7	-	22.7
(Loss)/profit on ordinary activities before taxation		(237.7)	33.0	(204.7)	384.6	-	384.6
Taxation on loss/(profit) on ordinary activities	8	102.6	(2.2)	100.4	85.9	-	85.9
(Loss)/profit for the year		(135.1)	30.8	(104.3)	470.5	-	470.5

Consolidated statement of other comprehensive income

For the year ended 31 March

	Note	Underlying £m	2017 BTL £m	Total £m	Underlying £m	2016 BTL £m	Total £m
(Loss)/profit for the year		(135.1)	30.8	(104.3)	470.5	-	470.5
Other comprehensive income							
<i>Will not be reclassified to the income statement:</i>							
Net actuarial (losses)/gains on pension schemes	23	(151.5)	-	(151.5)	113.2	-	113.2
Deferred tax on net actuarial losses/(gains)	19	21.6	-	21.6	(30.8)	-	(30.8)
<i>May be reclassified to the income statement:</i>							
Losses on cash flow hedges		(50.7)	-	(50.7)	(65.0)	-	(65.0)
Cash flow hedges transferred to income statement	7	2.1	-	2.1	-	-	-
Deferred tax charge on cash flow hedges	19	6.0	-	6.0	8.7	-	8.7
Other comprehensive (loss)/income for the year		(172.5)	-	(172.5)	26.1	-	26.1
Total comprehensive (loss)/income for the year		(307.6)	30.8	(276.8)	496.6	-	496.6

All of the Group's activities above are derived from continuing activities.

Bazalgette Tunnel Limited (BTL) is an independent company un-related to Thames Water Utilities Limited, and was appointed in 2015 to construct the Thames Tideway Tunnel. This is the first year that we have recognised revenue on the arrangement with BTL and so we have disclosed our underlying performance separately.

The arrangement with BTL means the Group has included construction costs of the Thames Tideway Tunnel within its bills to wastewater customers during the year ended 31 March 2017. As cash is collected, these amounts are subsequently paid to BTL. Accounting standards require the Group to present the amounts billed as revenue in our financial statements, and with no associated costs, this also gives rise to reporting profit on which tax arises. This non-appointed revenue is excluded from our key performance indicators which is consistent with our banking covenants. The revenue and resulting profit on this arrangement has been disclosed separately to the Group's underlying performance in the statements above. As a result of this arrangement with no cash retained, a prepayment is created and recorded by the company as BTL will transfer the tunnel to us once construction is complete under a finance lease arrangement.

As permitted by Section 408 of the Companies Act 2006, no income statement is presented for the parent Company. For the year ended 31 March 2017 the Company generated a profit after taxation of £198.3 million (2016: profit of £268.2 million).

The accounting policies and notes on pages 41 to 86 are an integral part of these financial statements.

Consolidated statement of financial position

As at 31 March

	Note	Underlying £m	2017 BTL £m	Total £m	Underlying £m	2016 BTL £m	Total £m
Non-current assets							
Goodwill	9	1,468.1	-	1,468.1	1,468.1	-	1,468.1
Interest in associates	10	-	-	-	-	-	-
Intangible assets	11	141.0	-	141.0	66.4	-	66.4
Property, plant and equipment	12	14,627.0	-	14,627.0	14,025.1	-	14,025.1
Trade and other receivables	14	2.8	30.4	33.2	2.5	1.3	3.8
Retirement benefit surplus	23	6.3	-	6.3	6.1	-	6.1
Derivative financial assets	18	170.6	-	170.6	366.6	-	366.6
		16,415.8	30.4	16,446.2	15,934.8	1.3	15,936.1
Current assets							
Inventories and current intangible assets	13	21.7	-	21.7	22.0	-	22.0
Assets held for sale		1.0	-	1.0	1.0	-	1.0
Trade and other receivables	14	644.0	0.8	644.8	570.2	-	570.2
Short term investments	18	1.0	-	1.0	289.5	-	289.5
Cash and cash equivalents	15	99.0	3.8	102.8	567.3	-	567.3
		766.7	4.6	771.3	1,450.0	-	1,450.0
Current liabilities							
Trade and other payables	16	(913.3)	(4.4)	(917.7)	(813.0)	(1.5)	(814.5)
Borrowings	17	(381.5)	-	(381.5)	(1,037.4)	-	(1,037.4)
Derivative financial liabilities	18	(23.8)	-	(23.8)	(42.4)	-	(42.4)
		(1,318.6)	(4.4)	(1,323.0)	(1,892.8)	(1.5)	(1,894.3)
Net current (liabilities)/assets		(551.9)	0.2	(551.7)	(442.8)	(1.5)	(444.3)
Non-current liabilities							
Trade and other payables	16	(404.9)	-	(404.9)	(362.2)	-	(362.2)
Borrowings	17	(11,562.4)	-	(11,562.4)	(11,005.4)	-	(11,005.4)
Derivative financial liabilities	18	(1,398.0)	-	(1,398.0)	(1,302.1)	-	(1,302.1)
Deferred tax	19	(836.6)	-	(836.6)	(963.6)	-	(963.6)
Provisions for liabilities and charges	20	(113.9)	-	(113.9)	(100.0)	-	(100.0)
Retirement benefit obligations	23	(379.8)	-	(379.8)	(260.0)	-	(260.0)
		(14,695.6)	-	(14,695.6)	(13,993.3)	-	(13,993.3)
Net assets		1,168.3	30.6	1,198.9	1,498.7	(0.2)	1,498.5
Equity							
Called up share capital	21	1,991.6	-	1,991.6	1,991.6	-	1,991.6
Cash flow hedge reserve	21	(222.5)	-	(222.5)	(179.9)	-	(179.9)
Retained earnings	21	(600.8)	30.6	(570.2)	(313.0)	(0.2)	(313.2)
Total equity		1,168.3	30.6	1,198.9	1,498.7	(0.2)	1,498.5

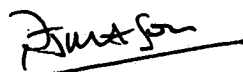
Bazalgette Tunnel Limited (BTL) is an independent company un-related to Thames Water Utilities Limited, and was appointed in 2015 to construct the Thames Tideway Tunnel. This is the first year that we have recognised revenue on the arrangement with BTL and so we have disclosed our underlying performance separately.

Bazalgette Tunnel Limited (BTL) is responsible for the construction of the Thames Tideway Tunnel. For the year ended 31 March 2017 the Group has included construction costs of the Thames Tideway Tunnel within its bills to wastewater customers. These amounts are subsequently paid to BTL. The revenue and profit on this arrangement, which is excluded from our key performance indicators, has been disclosed separately to the Group's underlying performance in the income statements. The statement of financial position above separately recognises the associated assets and liabilities as a result of this arrangement.

The accounting policies and notes on pages 41 to 86 are an integral part of these financial statements.

The financial statements for Kemble Water Holdings Limited, registered in England & Wales company number 05819262, were approved by the Board of Directors on 13 June 2017 and signed on its behalf by:

Sir Peter Mason KBE
Chairman



Company statement of financial position

As at 31 March

	Note	2017 £m	2016 £m
Non-current assets			
Investment in subsidiaries	33	1.0	1.0
Current assets			
Intercompany loans receivable	34	3,927.6	3,678.5
Current liabilities			
Trade and other payables	35	(206.3)	(132.7)
Net current assets		3,721.3	3,545.8
Net assets		3,722.3	3,546.8
Equity			
Called-up share capital	21	1,991.6	1,991.6
Retained earnings		1,730.7	1,555.2
Total equity		3,722.3	3,546.8

The accounting policies and notes on pages 41 to 86 are an integral part of these financial statements.

The financial statements were approved by the Board of Directors on 13 June 2017 and signed on its behalf by:

The financial statements for Kemble Water Holdings Limited, registered in England & Wales company number 05819262, were approved by the Board of Directors on 13 June 2017 and signed on its behalf by:



Sir Peter Mason KBE
Chairman

Consolidated statement of changes in equity

For the year ended 31 March

	Share capital £m	Cash flow hedge reserve £m	Retained earnings £m	Total equity £m
At 1 April 2015	1,991.6	(123.6)	(866.1)	1,001.9
Profit for the year	-	-	470.5	470.5
Loss on cash flow hedges	-	(65.0)	-	(65.0)
Deferred tax on cash flow hedge	-	8.7	-	8.7
Actuarial loss on pension schemes	-	-	113.2	113.2
Deferred tax on actuarial loss	-	-	(30.8)	(30.8)
At 31 March 2016	1,991.6	(179.9)	(313.2)	1,498.5
Loss for the year	-	-	(104.3)	(104.3)
Loss on cash flow hedges	-	(50.7)	-	(50.7)
Cash flow hedges transferred to income statement	-	2.1	-	2.1
Deferred tax on cash flow hedge	-	6.0	-	6.0
Actuarial loss on pension schemes	-	-	(151.5)	(151.5)
Deferred tax on actuarial loss	-	-	21.6	21.6
Dividends paid	-	-	(22.8)	(22.8)
At 31 March 2017	1,991.6	(222.5)	(570.2)	1,198.9

Company statement of changes in equity

For the year ended 31 March

	Share capital £m	Retained earnings £m	Total equity £m
At 1 April 2015	1,991.6	1,287.0	3,278.6
Profit for the year	-	268.2	268.2
At 31 March 2016	1,991.6	1,555.2	3,546.8
Profit for the year	-	198.3	198.3
Dividends paid	-	(22.8)	(22.8)
At 31 March 2017	1,991.6	1,730.7	3,722.3

The accounting policies and notes on pages 41 to 86 are an integral part of these financial statements.

Consolidated statement of cash flows

For the year ended 31 March

	Note	2017			2016		
		Underlying £m	BTL £m	Total £m	Underlying £m	BTL £m	Total £m
Cash generated from operations	29	1,098.9	3.8	1,102.7	1,169.6	-	1,169.6
Tax paid		-	-	-	(2.3)	-	(2.3)
Net cash generated by operating activities		1,098.9	3.8	1,102.7	1,167.3	-	1,167.3
Investing activities:							
Interest received		119.7	-	119.7	109.5	-	109.5
Decrease/(increase) in current asset investments		288.5	-	288.5	(12.4)	-	(12.4)
Increase in deferred income - retail non-household sale		97.3	-	97.3	-	-	-
Purchase of property, plant and equipment		(1,145.2)	-	(1,145.2)	(1,262.4)	-	(1,262.4)
Purchase of intangible assets		(102.7)	-	(102.7)	(27.3)	-	(27.3)
Proceeds from sale of property, plant and equipment		5.6	-	5.6	14.7	-	14.7
Net cash used in investing activities		(736.8)	-	(736.8)	(1,177.9)	-	(1,177.9)
Financing activities:							
New loans raised		568.1	-	568.1	1,082.9	-	1,082.9
Repayment of borrowings		(843.4)	-	(843.4)	(550.6)	-	(550.6)
Interest paid		(534.7)	-	(534.7)	(367.9)	-	(367.9)
Derivative settlements		2.4	-	2.4	(149.3)	-	(149.3)
Derivative collateral liability		-	-	-	(7.4)	-	(7.4)
Dividends paid		(22.8)	-	(22.8)	(1.5)	-	(1.5)
Net cash used in financing activities		(830.4)	-	(830.4)	6.2	-	6.2
Net (decrease)/increase in cash and cash equivalents		(468.3)	3.8	(464.5)	(4.4)	-	(4.4)
Net cash and cash equivalents at beginning of year		567.3	-	567.3	571.7	-	571.7
Net cash and cash equivalents at end of year		99.0	3.8	102.8	567.3	-	567.3

No additions to property, plant and equipment during the year, or the immediately preceding year, were financed through new finance leases.

The Group holds short term investments as current financial assets (see note 18) which include money market deposits held with external parties. In the prior year the net cash flows on these investments were presented within financing activities. The Directors have considered the nature of these short term investments and have presented the net cash movement within investing activities with the prior year comparative re-presented in this same category. There is no impact on the total net movement in cash and cash equivalents resulting from this change in presentation.

Bazalgette Tunnel Limited (BTL) is an independent company un-related to Thames Water Utilities Limited, and was appointed in 2015 to construct the Thames Tideway Tunnel. This is the first year that we have recognised revenue on the arrangement with BTL and so we have disclosed our underlying performance separately.

Bazalgette Tunnel Limited (BTL) is responsible for the construction of the Thames Tideway Tunnel. For the year ended 31 March 2017 the Group has included construction costs of the Thames Tideway Tunnel within its bills to wastewater customers. These amounts are subsequently paid to BTL. The revenue and profit on this arrangement, which is excluded from our key performance indicators, has been disclosed separately to the Group's underlying performance in the statements above. The cash balance included above reflects amounts collected and not paid over at the balance sheet date.

The accounting policies and notes on pages 41 to 86 are an integral part of these financial statements.

Company statement of cash flows

For the year ended 31 March

	Note	2017 £m	2016 £m
Cash generated from operations	37	-	-
Net cash generated by operating activities		-	-
<i>Investing activities:</i>			
Interest received		22.8	-
Net cash generated by investing activities		22.8	-
<i>Financing activities:</i>			
Dividends paid		(22.8)	(1.5)
Net cash used in financing activities		(22.8)	(1.5)
Net decrease in cash and cash equivalents		-	(1.5)
Net cash and cash equivalents at beginning of the year		-	1.5
Net cash and cash equivalents at end of the year		-	-

The accounting policies and notes on pages 41 to 86 are an integral part of these financial statements.

Accounting policies

The following accounting policies have been adopted in the preparation of these financial statements. They have been applied consistently in dealing with items which are considered material, except as noted below.

General information

Kemble Water Holdings Limited ("the Company") is a company incorporated and domiciled in the United Kingdom under the Companies Act 2006 whose principal activity is to act as the holding company for the Kemble Water Holdings Limited group of companies ("the Group"). The Group's principal activity is that of an appointed water and wastewater services provider, including acting as a retailer for household and non-household customers, operating in London, the Thames Valley and surrounding area, delivered through its wholly owned subsidiary Thames Water Utilities Limited ("TWUL" or "Thames Water") in accordance with TWUL's licence of appointment. Following our decision in July 2016 to exit from the competitive non-household retail market, from the date of market opening (1 April 2017), the Group no longer acts as a retailer to non-household customers.

The address of the registered office of both the Company is Clearwater Court, Vastern Road, Reading, RG1 8DB.

Statement of compliance with International Financial Reporting Standards ("IFRS")

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU").

The Group and parent Company financial statements have been prepared in accordance with IFRS, International Accounting Standards ("IAS") and IFRIC interpretations issued and effective and ratified by the European Union as at 31 March 2017.

Basis of preparation

The financial statements for the Group and Company for the year ended 31 March 2017, set out on pages 34 to 86, have been prepared on the going concern basis and under the historical cost convention, as modified by the revaluation of certain financial assets and liabilities at fair value.

Basis of consolidation

The Group financial statements consolidate the financial statements of the Company and entities controlled by the Company (its subsidiaries) and incorporate the results of its share of joint ventures using equity accounting. Associates are accounted for on an equity basis either where the Group's holding exceeds 20% or the Group has the power to exercise significant influence.

Where necessary, adjustments have been made to the financial statements of subsidiaries to align the accounting policies used under the relevant local GAAP into line with those used by the Group. Control is achieved where the Company has the power to govern the financial and operating policies, generally accompanied by a shareholding of more than one half of the voting rights, of an investee entity so as to obtain benefits from its activities. All intra-group transactions, balances, income and expenses are eliminated on consolidation. The results of subsidiary undertakings acquired or disposed of during the year are included in the consolidated profit and loss account from the date of acquisition or up to the date of disposal.

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position, the financial position of the Group, its cash flows, liquidity position and borrowing facilities are set out in the Strategic Report.

The Directors believe, after due and careful enquiry, and noting that the Group is in a net current liabilities position as at the year end, that both the Group and Company have sufficient resources for their present requirements and are able to meet their liabilities as they fall due for the foreseeable future. For these purposes the foreseeable future is taken to mean a period of at least twelve months from the date of approval of these financial statements. This is based upon a review of the Group and Company's financial forecasts for the forthcoming financial year, consideration of the Group and Company's compliance with its covenants and the cash, current asset investments and available facilities.

On this basis the Directors consider it appropriate to prepare the financial statements on a going concern basis.

Goodwill

Goodwill arises on the acquisition of subsidiaries and represents the excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired. If the total of consideration transferred, non-controlling interest recognised and previously held interest measured at fair value is less than the fair value of the net assets of the subsidiary acquired, in the case of a bargain purchase, the difference is recognised directly in the income statement.

For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the cash generating units (CGU), or groups of CGUs, which is expected to benefit from the synergies of the combination. Each unit or group of units to which the goodwill is allocated represents the lowest level within the entity at which the goodwill is monitored for internal management purposes.

Goodwill impairment reviews are undertaken annually or more frequently if events or changes in circumstances indicate a potential impairment. The carrying value of the CGU containing the goodwill is compared to the recoverable amount, which is the higher of the value in use and the fair value less costs of disposal. Any impairment is recognised immediately as an expense within the income statement and is not subsequently reversed. 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.

Foreign currency

Transactions in foreign currencies are translated to sterling (the Group and Company's functional and presentational currency) at the foreign exchange rate ruling at the date of the transaction. On consolidation the results of overseas subsidiaries and associated undertakings (none of which are domiciled in a country with a hyper-inflationary economy) are translated into sterling using average rates of exchange ruling during the financial year. The net investment is translated into sterling at the rates of exchange ruling at the year end and any exchange differences so arising are treated as movements in equity.

Monetary assets and liabilities denominated in foreign currencies at the financial reporting date are retranslated to the functional currency at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement except for differences arising on the retranslation of qualifying cash flow hedges, which are recognised directly in the cash flow hedge reserve.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are retranslated to the functional currency at foreign exchange rates ruling at the dates the fair value was determined.

Revenue recognition

Revenue represents the fair value of the consideration received or receivable in the ordinary course of business, excluding value added tax and trade discounts, for goods and services provided which are recognised in accordance with IAS18 *Revenue*. Revenue is recognised at the time of delivery of the service. Should the Company consider that the criteria for full revenue recognition are not met at the time of a transaction, recognition of the associated revenue would be deferred until such time as the criteria have subsequently been met. Bad debt on bills raised in the year, which are considered uncollectable based on historic experience, is recognised as a deduction to revenue to ensure revenue is recorded at fair value.

Revenue includes an estimate of the amount of mains water and wastewater charges unbilled at the period end, which are recorded within accrued income. The usage is estimated using a defined methodology based upon historical data and assumptions. When a new property is connected to the infrastructure network an estimate is made of the sales value of water supplied and wastewater charges incurred between the date of connection and the period end. Where actual results differ from estimates used, revenue is adjusted in the period for which the revision to the estimate is determined.

For unmetered customers, the amount to be billed is dependent upon the rateable value of the property, as assessed by an independent rating officer. The amount billed is recorded within deferred income and is apportioned to revenue over the period to which the bill relates.

The Company only raises bills in the name of the "occupier" when it has evidence that an unmeasured property is occupied but cannot confirm the name of the occupier. When the Company identifies the occupants the bill is cancelled and re-billed in the customer's name. If the Company has not identified an occupant within six months the bill is cancelled and the property is classified as empty.

Revenue includes amounts billed to wastewater customers in respect of construction costs for the Thames Tideway Tunnel. Under specific arrangements with Bazalgette Tunnel Limited, TWUL (in its capacity as principal) is responsible for the billing and collection of cash. TWUL passes the associated cash on to Bazalgette Tunnel Limited within 50 working days after the month end in which the cash is collected. The cost of any bad debt is borne by Bazalgette Tunnel Limited. Accounting standards require the Company to present the amounts billed as revenue in our financial statements, and with no associated costs this also gives rise to reporting profit on which tax arises. The cash collected is not retained by the Company and accordingly the revenue and resulting profit on this arrangement has been disclosed separately in the Company's financial statements, and is excluded from our key performance indicators. As a result of this arrangement with no cash retained, a prepayment is created and recorded by the company as BTL will transfer the tunnel to TWUL once construction is complete under a finance lease arrangement.

Interest income is accrued on a time basis by reference to the principal outstanding and the Effective Interest Rate (EIR) applicable. The EIR is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or liability. Interest income is presented within finance income in the income statement.

Property, plant and equipment

Property, Plant and Equipment (PP&E) is comprised of network assets (including water mains, sewers, pumped raw water storage reservoirs and sludge pipelines) and non-network assets. PP&E is stated at cost (or at deemed cost in the case of network assets, being the fair value at the date of transition to IFRS) less accumulated depreciation and provision for impairment.

The Company capitalises the directly attributable costs of procuring and constructing PP&E in accordance with IAS16 *Property, Plant and Equipment*. These costs include labour and other internal costs incremental to the business due to the scale and nature of the capital implementation programme of the Company. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and its cost can be measured reliably.

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of the associated asset. All other borrowing costs are included as finance expenses within the income statement.

Where items of PP&E are transferred to the Company from customers or developers, generally in the form of adopted water mains, self-lay sewers or adopted pumping stations, the fair value of the asset transferred is recognised in the statement of financial position. Fair value is determined based on estimated replacement cost. Where the transfer is in exchange for connection to the network and there is no further obligation for ongoing services, the corresponding credit is recognised immediately within revenue. Where the transfer is considered to be linked to the provision of ongoing services, the corresponding credit is recorded in deferred income and is released to other operating income over the expected useful economic lives of the associated assets as shown below.

The gain or loss arising on the disposal or retirement of an item of PP&E is determined as the difference between the sale proceeds and the carrying amount of the asset at the date the transaction arises, and is recognised separately in the income statement.

PP&E 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 as these assets are not considered to commence their economic lives until they are commissioned, whereupon they are transferred into an appropriate category of PP&E.

The estimated useful economic lives are as follows and refer to non-current assets disclosed in note 12:

	Years
Network assets:	
Reservoirs	250
Strategic sewer components	200
Wastewater network assets	150
Water network assets	80-100
Raw water tunnels and aqueducts	80
Non-network assets:	
<i>Land and buildings:</i>	
Buildings	15-60
Operational structures	30-100
<i>Plant and equipment:</i>	
Other operational assets	7-40
Fixtures & fittings	5-7
Vehicles	4-5
Computers	3-5
Fixed and mobile plant	4-60

Grants and contributions

Contributions received in respect of certain infrastructure charges (where on connection of a new property to the network the Company receives cash from the developer towards the investment required to enhance network capacity, to meet new demand and maintain service levels) are treated as deferred income and released to other operating income over a 30 year period.

Contributions which are given in compensation for expenses incurred with no future related costs, including the cost of excavating, connecting and reinstating a new water supply to an existing mains connection, are recognised within other operating income in the period that they become receivable as no continuing obligation remains once the connection has been made.

Non-current intangible assets (excluding goodwill)

Separately acquired intangible assets are stated at cost, less accumulated amortisation and any provision for impairment.

Research expenditure is expensed to the income statement as incurred. Development expenditure is capitalised when appropriate criteria are met under *IAS 38 Intangible Assets*. Amortisation of the asset begins when development is complete and the asset is available for use. It is amortised over the period of expected future benefit on a project by project basis.

Amortisation is charged to the income statement on a straight-line basis over the estimated useful economic life of the intangible asset. These intangible assets are amortised from the date they become available for use. The estimated useful economic life is as follows:

	Years
Development expenditure	3-25
Software	5-10

Investment in subsidiaries

Investments in subsidiary undertakings are stated at cost, less any provision for impairment.

Assets held for sale

Non-current assets are reclassified as held for sale if all of the following criteria are satisfied:

- the carrying amount will be recovered principally through sale rather than through continuing use;
- the asset is available for immediate sale in its present condition; and
- a sale is considered to be highly probable.

On initial reclassification as held for sale, non-current assets are measured at the lower of the previous carrying amount and fair value less costs to sell, with any adjustments being recognised within the income statement. Once classified as held for sale no further depreciation or amortisation is recognised.

Inventories and current intangible assets

Inventories are stated at the lower of cost and net realisable value (NRV). Costs comprise direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Inventory is assessed for obsolescence on an item-by-item basis and when determined to be obsolete is written off immediately to the income statement.

Purchased carbon emission allowances (relating to the emission of carbon dioxide in the UK) are recorded as current intangible assets, stated at cost, less accumulated amortisation and any provision for impairment. A provision is simultaneously recorded in respect of the obligation to deliver emission allowances in the period in which the emissions are made and the associated charge is recognised as an operating expense within the income statement.

Leased assets

Leases where the Company obtains assets which transfer substantially all the risks and rewards of ownership to the Company are treated as finance leases. The lower of the fair value of the leased asset and 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 at the shorter of the estimated useful economic life and the lease period.

All other leases are classified as operating leases. Payments made under operating leases are recognised in the income statement on a straight line basis over the term of the lease. Lease incentives and premiums received are recognised in the income statement as an integral part of the total lease expense and are released to the income statement on a straight line basis over the term of the lease. Leases of land are ordinarily treated as operating leases, unless ownership is transferred to the Company at the end of the lease.

On completion of construction of the Thames Tideway Tunnel, substantially all the risks and rewards of ownership will lay with the Company. The Company will therefore account for the transaction arrangement with BTL post construction as a finance lease. The tunnel will be recognised as an asset within PP&E and depreciated over the life of the lease. On inception of the lease, the tunnel will be recognised at fair value, being the prepayment plus the present value of the minimum lease payments, with a corresponding liability being recognised as a finance lease payable. Interest will be recognised in the income statement over the period of the lease.

Provisions for liabilities and charges

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated.

The Group is subject to a number of legal claims which include commercial and contractual disputes, which are handled and defended in the ordinary course of business. The Company routinely assesses the likelihood of any adverse judgements or outcomes to these matters as well as ranges of probable and reasonably estimated losses. Reasonable estimates involve judgements made by management after considering available information including notifications, settlements, estimates performed by independent parties and legal counsel, available facts, identification of other potentially responsible entities and their ability to contribute, and prior experience.

Provisions for insured liabilities are recognised or released by assessing their adequacy using current estimates of future cash flows under insurance contracts.

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.

The Group is subject to Outcome Delivery Incentives (“ODIs”) where failure to achieve targets can lead to financial penalties and outperformance can result in financial rewards. These penalties and rewards are in the form of revenue adjustments or Regulated Capital Value (“RCV”) adjustments. The Group does not recognise a provision for penalties or rewards in the period in which they are incurred or achieved as the financial impact of these is taken in the following Asset Management Plan (“AMP”) period.

Risks, opportunities and innovation (“ROI”) funds

The Group has entered into certain alliance arrangements with a number of third parties. The alliance agreements include incentive mechanisms which result in the alliance partners sharing in any over or underspend on contracted works. Remuneration for services provided under the contract are also linked to TWUL’s performance commitments. During the year ended 31 March 2017 there were three alliances responsible for delivering works over AMP6.

A notional ROI fund for each alliance is created and built up over the AMP. The ROI fund is ultimately paid to alliance partners at contractual percentages. This occurs once certain conditions are satisfied, as specified in the alliance contracts between the Group and the alliance partners.

A provision for ROI amounts is recognised when the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated. Conversely, a receivable for ROI will be recognised when: the Group has a right to receive cash at a future date; the amount can be reliably estimated; and receipt is virtually certain.

ROI amounts arising from an over or underspend against the contracted cost for a capital project, where the spend is directly attributable to the asset created, are deemed to be an integral cost in bringing an asset into the condition and location for use as intended by management. They are therefore capitalised as part of the cost of the asset and depreciated over the asset’s useful life.

ROI amounts arising from operating expenditure over or underspend against the contracted cost, where spend cannot be directly attributed to a capital asset, are recognised directly in profit or loss as the spend is incurred.

ROI amounts linked to an ODI/SIM penalty or reward are recognised in the income statement at the point the penalty has been incurred or reward has been achieved.

Discontinued operations

Components of the Group will be classified as a discontinued operation if that component has either been disposed of, or is classified as held for sale. A component comprises operations that can be clearly distinguished, operationally and for financial reporting purposes from the rest of the Group. A component will only be classified as discontinued given that either: it represents a separate major line of business, or geographical area; or is part of a single co-ordinated plan to dispose of a separate major line of business.

Transfer of non-household retail customers to Castle Water

Following our decision in July 2016 to exit from the competitive non-household retail market from the date of market opening (1 April 2017), the Group entered an agreement to transfer its non-household customers to Castle Water from the date of market opening. The Group continues to recognise wholesale revenue from these customers. The non-household retail component does not represent a material portion of the activities of the Group and accordingly it is not presented as a discontinued operation.

Dividends

Dividends unpaid at the financial reporting date are only recognised as a liability at that date to the extent that they are appropriately authorised and are no longer at the discretion of the Company. This occurs when the shareholders right to receive payment has been established.

Unpaid dividends that do not meet these criteria are disclosed in the notes to the financial statements.

Financial guarantees

Five companies in the Group are part of a whole business securitisation group. Companies in the whole business securitisation group raise debt in external debt markets through the issuance of secured bonds and the issue of loans. Thames Water Utilities Holdings Limited, Thames Water Utilities Limited, Thames Water Utilities Finance Limited, Thames Water Utilities Cayman Finance Holdings Limited and Thames Water Utilities Cayman Finance Limited have guaranteed the principal and interest payments due under the terms of the bonds. Where a company enters into financial guarantee contracts to guarantee the indebtedness of other companies within this group, the company considers these to be insurance arrangements and accounts for them as such. In this respect, the company treats the guarantee contract as a contingent liability until such a time as it becomes probable that the company will be required to make a payment under the guarantee.

Retirement and other employment benefits

Defined benefit schemes

The Group operates three, independently administered, defined benefit pension schemes, all of which are closed to new employees. Actuarial valuations are carried out as determined by the Trustees, using the projected unit credit method for both schemes at intervals of not more than three years. The rates of contributions payable and the pension cost are determined on the advice of the actuaries, having regard to the results of these valuations.

The difference between the value of defined benefit pension scheme assets and liabilities is recorded within the statement of financial position as a retirement benefit or obligation. Defined benefit pension scheme assets are measured at fair value using the bid price for assets with quoted prices. Defined benefit pension scheme liabilities are measured at the reporting date by an independent actuary using the projected unit credit method and discounted at the current rate of return on high quality bonds of equivalent term and currency to the liability.

Service cost, representing the cost of employee service in the period, and scheme administration expenses are included within operating expenses in the income statement. The net finance cost is calculated by applying the discount rate used for the scheme liabilities to the net deficit.

Changes in the retirement benefit obligation may arise from:

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

Such changes are classified as re-measurements and are charged or credited to equity and recorded within the statement of comprehensive income in the period in which they arise.

Defined contribution schemes

The Group operates a Defined Contribution Stakeholder Pension Scheme ("DCSPS") managed through Standard Life Assurance Limited. From 1 April 2011 the DCSPS is the only scheme to which new employees of the Company are eligible. The assets of the DCSPS are held separately from those of the Group and obligations for contributions to the scheme are recognised as an expense in the income statement in the periods during which they fall due.

Long-term incentive plans ("LTIP") and bonus

Cash based LTIP awards are accrued in the financial statements for the duration of the award. The accrual is based on the values assessed for the applicable schemes, taking into account the duration of the individual scheme, and by comparing the Group's performance against the assumptions used to award payments. These are recognised as the present value of the benefit obligation.

Bonus payments are accrued in the period based on assessments of performance against targets set at the beginning of the financial year. Bonuses are paid in the following financial year, once performance has been measured against targets set.

During the year, the Company opened 'Share in Your Success 2016'. This follows the successful launch of 'Share in Your Success 2015' which enrolled employees in the financial year ended 31 March 2016. Both schemes are open to all employees. Employees are able to contribute between £20 and £250 per month from their salary into a savings account over a three year period. At the end of the three years, the employee is then entitled to all of the cash they have sacrificed during that period, plus interest that has accrued on that balance, and a 'bonus' element paid by the Company of up to 35% of the amount invested. If an employee is to leave the Company within the three year period, then they are entitled to the amount they have invested up until the point of departure, including the interest due in that period.

Non-derivative financial instruments

A financial instrument is any contract that gives rise to a financial asset in one entity and a financial liability or equity instrument in another entity. Non-derivative financial instruments comprise trade and other receivables, cash and cash equivalents, loans and borrowings and trade and other payables.

Trade and other receivables

Trade and other receivables are measured at fair value on initial recognition. Subsequent to initial recognition they are measured at amortised cost using the effective interest method. If there is objective evidence that the asset is impaired it is written down to its recoverable amount and the irrecoverable amount is recognised as an expense within operating costs. Debt is only written off after all available economic options for collecting the debt have been exhausted and the debt has been deemed to be uncollectable. This may be because the debt is considered to be impossible, impractical, inefficient or uneconomic to collect, and is assessed by management on a case-by-case basis.

Included within trade receivables is an assessment of the recoverability of debts which will ultimately be cancelled, and may or may not be rebilled, and of debts which have not yet been billed but are part of the metered sales accrual. This assessment is made by reference to the Company's historical collection experience, including comparisons of the relative age of the individual balance and consideration of the actual write-off history.

The provisioning rates applied in the calculation are reviewed on an annual basis to reflect the latest historical collection performance data and management's expectation of future performance and industry trends. A provision is also made against debts due from Water Only Companies ("WOCs") who bill their customers for sewerage services provided by the Group. As detailed information about the debt, including the ageing, is unavailable the level of provision is calculated with reference to the level of historical, current and forecast write-offs.

Included within prepayments are amounts paid and payable to Bazalgette Tunnel Limited which represent a prepayment for the use of the Thames Tideway Tunnel once the project is complete.

Trade and other payables

Trade and other payables are recognised initially at fair value. Subsequent to initial recognition they are measured at amortised cost using the effective interest method.

Trade and other payables include amounts owed to Bazalgette Tunnel Limited. Amounts owed to BTL represent revenue collected and passed across to BTL for the construction of the Thames Tideway Tunnel, which have not yet been paid at the reporting date.

Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and in hand and demand deposits and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes 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.

Bank overdrafts that are repayable on demand form an integral part of the Group's cash management and are also included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

Included within cash are amounts collected in relation to BTL revenue which have not yet been paid across to BTL at the reporting date.

Interest bearing borrowings

Interest bearing borrowings are financial liabilities recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition these are stated at amortised cost using the effective interest method. The amortisation is included within finance costs in the income statement and is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the effective interest rate. An exchange or modification of interest bearing borrowing with substantially different terms is accounted for as an extinguishment of the original financial liability and the recognition of new financial liability. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the financial liability and are amortised over the remaining term of the modified financial liability.

Interest bearing loans issued to other group companies

Interest bearing loans issued to other group companies are initially recognised at fair value plus transaction costs that are directly attributable to the acquisition of the financial asset. They are subsequently measured at amortised cost using the effective interest rate method, less any provision for impairment. The amortisation is included within finance income in the income statement and is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the effective interest rate. An exchange or modification of interest bearing loans issued to other group companies with substantially different terms is accounted for as derecognition of the original financial asset and the recognition of new financial asset. If an exchange of loan or modification of terms is accounted for as derecognition, any costs or fees incurred are recognised as part of the gain or loss on derecognition. If the exchange or modification is not accounted for as derecognition, any costs or fees incurred adjust the carrying amount of the financial asset and are amortised over the remaining term of the modified financial asset.

Derivative financial instruments and hedging

Derivatives are used to manage exposure to movements in interest rates, foreign exchange rates and inflation. A financial instrument is classified as derivative if:

- its value changes in response to the change in a specified interest rate, foreign exchange rate or index of prices or rates;
- it requires no initial net investment or an initial net investment that is smaller than the underlying principal; and
- it is settled at a future date.

Derivative financial instruments not designated as hedging instruments

Derivative financial instruments are initially recognised at fair value with transaction costs being taken to the income statement. The gain or loss on re-measurement to fair value is recognised immediately in profit or loss.

Derivative financial instruments designated as hedging instruments

The Group uses derivative financial instruments, such as forward currency contracts and interest rate swaps to hedge its foreign currency risks and interest rate risks, respectively. At the inception of each hedge relationship the Group documents:

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

The Group continues to test and document the effectiveness of the hedge on an ongoing basis. Hedge accounting discontinues when the hedging instrument expires, is sold, terminated or exercised, or no longer qualifies for hedge accounting.

Cash flow hedges

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the effective part of any gain or loss on the derivative financial instrument is recognised directly in the cash flow hedge reserve. Any ineffective portion of the hedge is recognised immediately in the income statement.

When the forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, the associated cumulative gain or loss is removed from the cash flow hedge reserve and reclassified to the income statement in the same period or periods during which the asset acquired or liability assumed affects profit or loss, i.e. when interest income or expense is recognised.

When a hedging instrument expires or is sold, terminated or exercised, or the Company revokes designation of the hedge relationship but the hedged forecast transaction is still expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to take place, the cumulative unrealised gain or loss recognised in equity is recognised in the income statement immediately.

Embedded derivatives

Where a contract includes terms that cause some of its cash flows to vary in a similar way to a derivative financial instrument, that part of the contract is considered to be an embedded derivative. Embedded derivatives are separated from the contract and measured at fair value with gains and losses taken to the income statement if:

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

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

Fair value measurement

The Group measures financial instruments such as derivatives at fair value at each financial reporting date. Fair value is the price that would be received in selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value reflects the non-performance risk.

De-recognition of financial instruments

A financial asset is de-recognised when the rights to receive cash flows from the asset have expired.

A financial liability is de-recognised when the obligation under the liability is discharged, cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the de-recognition of the original liability and the recognition of a new liability. The difference between the carrying amount of the financial liability extinguished or transferred and the consideration paid is recognised in the income statement.

Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position if there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liabilities simultaneously.

Impairment (excluding inventories, goodwill and deferred tax assets)

Financial assets (including receivables)

A financial asset not carried at fair value through profit or loss is assessed at each financial reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset and can be measured reliably.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Interest on the impaired asset continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment is reversed through the income statement.

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 a similar age.

Non-financial assets

The carrying amounts of the Group's non-financial assets, other than inventories and deferred tax assets, are reviewed at each financial reporting date to determine whether there is any indication of impairment. If any such indication exists then the assets recoverable amount is estimated.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit").

An impairment loss is recognised if the carrying amount of an asset or its cash generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement. Impairment losses recognised in prior periods are assessed at each financial reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Taxation

Tax on the profit or loss for the period comprises current and deferred tax. Tax is recognised in the income statement except to the extent that it relates to items recognised directly within equity, in which case it is recognised within the statement of other comprehensive income.

Current tax

Current tax is the expected tax payable or receivable on the taxable income or loss for the period, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustments to tax payable in respect of previous periods.

Taxable profit differs from the profit on ordinary activities before tax as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other periods. This includes the effect of tax allowances.

Deferred tax

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax is measured on a non-discounted basis using tax rates enacted or substantively enacted at the balance sheet date and that are expected to apply in the period when the deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax liabilities are generally recognised for all taxable temporary difference and deferred tax assets are recognised only to the extent that it is probable that sufficient future taxable profits will be available against which deductible temporary differences can be utilised.

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

Uncertain tax positions

Tax rules can be subject to interpretation and a tax provision is recognised where it is considered more likely than not that an amount will be paid to the tax authorities. Management use their experience, and seek professional advice where appropriate, to prudently assess the likelihood of an outflow arising. The amount recognised is the single most likely outcome.

New accounting policies and financial reporting changes

There has been no material introduction, removal or amendment of accounting policies during the year other than the policy adopted to separately present the cash collection arrangement with BTL (see revenue recognition policy above).

No new financial reporting standards have been adopted by the Company that have a material impact on the financial statements in the current year. The following issued standards have not yet been adopted by the Company:

- IFRS 9: *Financial instruments*, which will be effective on 1 January 2018 (and thus to the Company 1 April 2018);
- IFRS 15 *Revenue from Contracts with Customers*, which will be effective on 1 January 2018 (and thus to the Company 1 April 2018); and
- IFRS 16 *Leases*, which will be effective on 1 January 2019 (and thus to the Company 1 April 2019), subject to EU endorsement.

In addition to these, there are a number of other amendments and annual improvement project recommendations that are not yet effective but which have been endorsed by the EU. These are not anticipated to have a material impact on the consolidated financial statements of the Company.

IFRS 9 impact assessment

Management are conducting the assessment of the impact of IFRS 9 Financial Instruments on the Company. A review of the three phases of IFRS 9 is being conducted; Classification and Measurement, Impairment Methodology, and Hedge Accounting.

Classification and Measurement:

The review has included an assessment of the contractual cash flow characteristics of financial instruments, in order to determine their classification and measurement under IFRS 9. There are currently no indications that reclassifications of financial instruments will have a material impact on the financial statements.

Impairment Methodology:

Management have assessed the current accounting policies (see "Impairment excluding inventories and deferred tax assets" page 49) in relation to financial assets not held at fair value through profit or loss, and specifically for financial assets held at amortised cost. This is in accordance with the treatment required for financial assets under IFRS 9. As a result there is no change expected in the Company's impairment methodology of financial assets, and therefore no material impact on the financial statements.

Hedge Accounting:

IFRS 9 provides increased flexibility for hedge accounting. An assessment is planned for the forthcoming financial year which will involve identifying and evaluating the potential impact of any existing contracts which are currently not hedge accounted, but may be eligible for hedge accounting under IFRS 9. Therefore, to date, it is not possible to estimate the impact of any changes in hedge accounting on the financial statements.

IFRS 15 impact assessment

Management have commenced a review of the contractual arrangements that comprise our current income streams to determine how IFRS 15 will impact the recognition and disclosure from these arrangements. The work performed to date has identified that, for the majority of the Company's income, the application of IFRS 15 will not have a material impact on the current revenue recognition under IAS 18: Revenue.

Further work is still required in 2017 to complete the reviews of certain revenue streams including those which relate to capital contributions. Final conclusions are being delayed whilst Ofwat consults on new development charging rules which look to formalise the definition of what infrastructure charges are intended to cover. The new charging rules framework is expected to come into effect on 1 April 2018.

The necessary processes required to capture adjustments and additional disclosures required under IFRS 15 will be considered in 2017.

IFRS 16 impact assessment

Management are conducting an impact assessment of IFRS 16 Leases on the Company's position and performance. The assessment involves a review for completeness that aims to identify agreements which are a lease, or contain a lease, as prescribed by IFRS 16. This has been done through a variety of methods, including contract reviews, data-mining, as well as departmental and onsite interviews and questionnaires.

The work performed to date has indicated that there will be a material impact to the statement of financial position primarily due to property leases for our major offices. The Company is subject to a loan covenant under which lease liabilities are classified as unsecured debt, the level of which cannot exceed a specified ratio. A risk that this covenant may be breached in future is being considered. Transition options on whether to apply IFRS 16 using a modified or fully retrospective approach are still being considered.

Work in this area is continuing. It is expected that final conclusions and quantitative results of the impact assessment will be completed during the year ending 31 March 2018.

Significant accounting judgements and key sources of estimation uncertainty

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

Significant accounting judgements

Significant accounting judgements and key sources of estimation uncertainty which are also considered significant risks as set out in the Audit, Risk and Regulatory Committee Report, and Independent Auditor's Report are as follows:

Property, plant and equipment

The Company capitalises expenditure relating to water and wastewater infrastructure where such expenditure enhances or increases the capacity of the network. Maintenance expenditure is taken to the income statement in the period in which it is incurred. Differentiating enhancement from maintenance expenditure is subjective, particularly where a single project may include a mix of both types of activities. Additionally management capitalises employee time and other expenses incurred by central functions on capital programmes and consequently judgement is applied concerning the capitalisation rate used. Property, plant and equipment additions for the year ended 31 March 2017 were £1,117.1 million (2016: £1,198.8 million).

Calculation of the depreciation charge requires estimates to be made regarding the useful economic lives of the assets. These estimates are based on engineering data and the Company's experience of similar assets. If management identifies that actual useful economic lives differ materially from the estimates used to calculate the depreciation charge, that charge will be adjusted prospectively. The total depreciation charge for the year ended 31 March 2017 was £513.4 million (2016: £479.4 million).

The Company is required to evaluate the carrying values of PP&E for impairment whenever the circumstances indicate that the carrying value of those assets may not be recoverable. An impairment review requires management to make subjective judgements regarding the recoverable value and value in use of the assets under review.

Provision for doubtful debt

Provisions are made against trade receivables based on an assessment of the recovery of debts including those which will ultimately be cancelled, and may or may not be rebilled, and of debts which have not yet been billed but are part of the metered sales accrual. This assessment is made by reference to the Company's historical collection experience, including comparisons of the relative age of the individual balance and consideration of the actual write-off history. The actual level of receivables collected may differ from the estimated level of recovery which could affect operating results positively or negatively. The bad debt provision at 31 March 2017 was £176.6 million (2016: £189.9 million) as shown within note 14.

Provisions for other liabilities and charges

Assessing the financial outcome of uncertain commercial and legal cases requires judgement to be made regarding the extent to which any claim against the Company is likely to be successful after considering available information including notifications, settlements, estimates performed by independent parties and legal counsel, available facts, identification of other potentially responsible entities and their ability to contribute, and prior experience.

The required provision may change in the future due to new developments and as additional information becomes available and in such instances the provision will be adjusted prospectively. Provisions for liabilities and charges totalled £113.9 million at 31 March 2017 (2016: £100.0 million). A further breakdown of provisions can be found within note 20.

Other areas of accounting judgement and estimation uncertainty

The key assumptions and other sources of estimation uncertainty that are not considered significant risks are as follows:

Unbilled revenue

Revenue reflects the fair value of the consideration received, or receivable, in the ordinary course of business, excluding value added tax and trade discounts, for goods and services provided. Revenue is recognised at the time of delivery of the service and consequently payments received in advance of revenue recognition are recorded as deferred income.

The Company raises bills in accordance with its entitlement to receive revenue in line with the limits established by the Periodic Review. For water and wastewater customers with water meters, the amount recognised depends on the volume supplied including an estimate of the sales value of units supplied between the date of the last meter reading and the financial reporting date. Amounts recognised within revenue but unbilled at the financial reporting date are included within accrued income. Meters are read on a cyclical basis and the Company recognises revenue for unbilled amounts based on estimated usage from the last billing to the financial reporting date. The estimated usage is based on historical data and assumptions. The unbilled revenue for the year ended 31 March 2017 was £244.6 million (2016: £245.0 million) as shown within note 14.

Where actual results differ from estimates used, revenue is adjusted in the period for which the revision to the estimate is determined.

Retirement benefit obligations

The Company operates defined benefit pension schemes for which full actuarial valuations are carried out as determined by the Trustees at intervals of not more than three years. Determining the amount of the Company's retirement benefit obligations and the net costs of providing such benefits requires assumptions to be made including, but not restricted to, long term interest rates, inflation and rate of increases to pensions in payment. These are assessed using the advice of an independent qualified actuary, market observations and assumptions from the latest actuarial valuation. Changes in these assumptions could significantly affect the amount of obligations recognised and the cost of providing such benefits. The total retirement benefit obligation at 31 March 2017 was £379.8 million (2016: £260.0 million) as shown within note 23.

Fair value of derivatives

The fair value of the derivatives is determined by discounting estimated future cash flows based on the terms and maturity of each contract and using market interest rates at the measurement date. The valuations are tested for reasonableness by comparing these to bank quotes. The fair value calculations have been adjusted to incorporate the Company's own and counterparty's credit risk where appropriate. A table detailing the fair value of financial assets and liabilities can be found within note 18.

Impairment of investment in subsidiaries and goodwill

Determining whether the Group's investments in subsidiaries or the carrying value of goodwill have been impaired requires estimations of the investment or cash generating unit's net realisable value. An enterprise valuation is derived through the application of an observable market multiplier uplift to the underlying entities Regulatory Capital Value ("RCV"). The recoverable amount is thus most sensitive to the uplift multiplier used in the valuation model. See notes 9 and 33 for the net carrying value of the investments and associated impairment provision.

Notes to the Group financial statements

1. Revenue

	2017			2016		
	Underlying £m	BTL £m	Total £m	Underlying £m	BTL £m	Total £m
Regulated water and wastewater services	2,026.4	-	2,026.4	2,033.3	-	2,033.3
Other services	51.1	33.6	84.7	51.2	-	51.2
Gross revenue	2,077.5	33.6	2,111.1	2,084.5	-	2,084.5
Charge for bad and doubtful debts	(45.9)	(0.6)	(46.5)	(37.7)	-	(37.7)
Net revenue	2,031.6	33.0	2,064.6	2,046.8	-	2,046.8

All revenue is derived from activities based in the UK.

Bazalgette Tunnel Limited ("BTL") is responsible for the construction of the Thames Tideway Tunnel. For the year ended 31 March 2017 the Company has included construction costs of the Thames Tideway Tunnel within its bills to wastewater customers. Cash collected on BTL's behalf is subsequently paid over to them. The revenue on this arrangement, which is excluded from our key performance indicators, has been disclosed separately to the Company's underlying performance in the table above.

2. Operating expenses

	2017 £m	2016 £m
Wages and salaries	210.9	199.4
Social security costs	23.4	18.2
Pension costs – defined benefit schemes	24.1	23.6
Pension costs – defined contribution schemes	6.8	5.2
Severance costs	1.2	1.7
Release of restructuring provision	-	(5.4)
Total employee costs	266.4	242.7
Power	104.3	110.0
Carbon reduction commitment	6.6	6.2
Raw materials and consumables	53.5	45.0
Charge for bad and doubtful debts	3.9	27.4
Rates	94.5	93.6
Depreciation of property, plant and equipment	513.4	479.4
Amortisation of intangible assets	25.0	18.6
Write-off of costs from assets in development	3.1	-
Operating lease rental – hire of plant and machinery	0.9	1.8
Operating lease rental – other	15.1	9.1
Property development costs	3.6	-
Research and development expenditure	4.0	3.1
Other operating costs	637.0	554.1
Gross operating costs	1,731.3	1,591.0
Own work capitalised	(188.2)	(134.9)
Net operating expenses	1,543.1	1,456.1

2. Operating expenses (continued)

Amounts payable to the Group's auditor are shown below in respect of the following services to the Group:

	2017 £'000	2016 £'000
<i>Fees payable to the Group's auditor:</i>		
Fees payable for the audit of the Company's financial statements	37	36
Fees payable for the audit of the financial statements of subsidiaries pursuant to legislation	505	448
<i>Fees payable to the Group's auditor for other services:</i>		
Audit related assurance services	170	155
Other assurance services	403	761
Other tax advisory services	14	16
Corporate finance services	-	570
Other services	80	224
Total	1,209	2,210

Other assurance services include certain agreed upon procedures performed by KPMG LLP in connection with the Group's regulatory reporting requirements to Ofwat.

Fees for corporate finance services above include £nil (2016: £0.6m) in respect of advice on the Thames Tideway Tunnel. These costs have been capitalised as part of the design phase of the project. The contract was awarded to KPMG LLP in a prior year following a competitive tendering process in line with the Group's procurement processes.

No fees, other than those disclosed, were payable to KPMG LLP in respect of the Company, or Group, in the current or preceding financial year.

3. Employees and Directors

Employees

All Group employees are based in the United Kingdom. The average number of persons employed by the Group during the year (including Executive Directors), analysed by category, was as follows:

	2017 Number	2016 Number
<i>Employed by Thames Water Utilities Limited:</i>		
Retail	851	937
Wholesale Water	1,850	1,887
Wholesale Wastewater	1,861	1,746
Group services	405	487
	4,967	5,057
<i>Employed by other group companies:</i>		
Property services	7	7
Total	4,974	5,064

The Company has no employees (2016: none).

Directors

The Directors' emoluments were as follows:

	2017 £'000	2016 £'000
Salary	831	827

At 31 March 2017 no benefits were accruing to any Directors (2016: £nil) under the Group's defined benefit scheme in respect of services provided to the Group.

Highest paid Director

Total emoluments, including payments and accruals under long term incentive schemes of the highest paid Director in respect of work done for the Group during the year were £325,000 (2016: £325,000).

4. Other operating income

	2017 £m	2016 £m
Power income	10.1	8.0
Requisitions and diversions charges	21.7	22.6
Service connection charges	25.4	21.6
Release from deferred income – infrastructure charges	15.4	14.1
Rental income	8.1	7.9
Other income	10.2	-
Total	90.9	74.2

Power income comprises of income from the sale of internally generated electricity.

5. Finance income

	2017 £m	2016 £m
Interest income on bank deposits	2.8	2.8
Interest income on swaps	112.4	104.7
Total	115.2	107.5

6. Finance expense

	2017 £m	2016 £m
<i>Interest in relation to bank and other loans:</i>		
Interest expense	481.2	461.8
RPI accretion on loans	89.7	37.7
Interest expense on swaps	75.4	74.8
Swap termination expense	-	0.5
Amortisation	(11.6)	(11.6)
Net interest expense on defined benefit obligation	5.9	10.2
Gross finance expense	640.6	573.4
Capitalised borrowing costs	(76.3)	(114.4)
Total finance expense	564.3	459.0

7. Net (losses)/gains on financial instruments

	2017 £m	2016 £m
Exchange losses on other loans	(149.8)	(68.6)
(Loss)/gain arising on swaps where hedge accounting is not applied	(220.2)	91.3
Loss on cash flow hedge transferred from equity	(2.1)	-
Total	(372.1)	22.7

8. Taxation

Tax credit in the income statement

	Underlying £m	2017 BTL £m	Total £m	Underlying £m	2016 BTL £m	Total £m
Current tax:						
Current year amounts due in respect of corporation tax	-	-	-	-	-	-
Current year amounts due in respect of group relief	(2.2)	2.2	-	-	-	-
Adjustment in respect of prior periods	(1.0)	-	(1.0)	(6.0)	-	(6.0)
	(3.2)	2.2	(1.0)	(6.0)	-	(6.0)
Deferred tax:						
Origination and reversal of timing differences	(36.4)	-	(36.4)	75.8	-	75.8
Adjustment in respect of prior periods	(5.2)	-	(5.2)	(37.0)	-	(37.0)
Adjustment in respect of corporation tax rate changes	(57.8)	-	(57.8)	(118.7)	-	(118.7)
	(99.4)	-	(99.4)	(79.9)	-	(79.9)
Tax credit on (loss)/profit on ordinary activities	(102.6)	2.2	(100.4)	(85.9)	-	(85.9)

The current tax for the year ended 31 March 2017 is higher (2016: lower) than the standard rate of corporation tax in the UK. The differences are explained below:

	2017				2016			
	Underlying £m	BTL £m	Total £m	Effective tax rate %	Underlying £m	BTL £m	Total £m	Effective tax rate %
(Loss)/profit on ordinary activities before taxation	(237.7)	33.0	(204.7)		384.6	-	384.6	
Current tax at 20% (2016: 20%)	(47.5)	6.6	(40.9)	20.0%	76.9	-	76.9	20.0%
Effects of:								
<i>Recurring items:</i>								
Depreciation on assets that do not qualify for tax relief	4.0	-	4.0		4.1	-	4.1	
Disallowable expenditure ¹	1.8	-	1.8		2.4	-	2.4	
Non-taxable income ²	(5.2)	-	(5.2)		(4.3)	-	(4.3)	
Property disposals ³	(0.1)	-	(0.1)		(3.7)	-	(3.7)	
Tax differential on profits and losses of overseas subsidiaries	(0.4)	-	(0.4)		0.3	-	0.3	
Group relief not paid at standard rate ⁴	4.4	(4.4)	-		-	-	-	
Tax as adjusted for recurring items	(43.0)	2.2	(40.8)	19.9%	75.7	-	75.7	19.7%
<i>Non-recurring items:</i>								
Tax rate change on temporary timing differences ⁵	(53.4)	-	(53.4)		(118.6)	-	(118.6)	
Adjustments to tax charge in respect of prior periods – group relief ⁶	(1.0)	-	(1.0)		(6.0)	-	(6.0)	
Adjustments to tax charge in respect of prior periods – deferred tax ⁷	(5.2)	-	(5.2)		(37.0)	-	(37.0)	
Total tax charge/(credit)	(102.6)	2.2	(100.4)	49.0%	(85.9)	-	(85.9)	(22.3%)

¹ Disallowable expenditure primarily relates to fines included in operating expenses.

² Non-taxable income relates to income from new service connections. This income is reflected in the accounts as non-taxable income under IFRS principles; however, such income is ultimately taxed through capital allowances.

³ Tax chargeable on gains arising on property disposals is lower than the accounting profits recognised for these disposals because of additional deductions available for tax purposes.

8. Taxation (continued)

⁴ Thames Water Utilities Limited (TWUL) has decided to utilise tax losses available in its parent company for the year ended 31 March 2017. TWUL will pay £8.6 million to its parent Company for the tax losses, of which £2.2 million arises on the profits of BTL (which are included within TWUL) and accordingly is shown in the income statement as a current year current tax charge. TWUL is paying for the tax losses at a rate which is lower than the standard rate of corporation tax, which reflects the value of the tax losses to TWUL. Utilising tax losses in this way should ultimately benefit customers through lower tax funding in future regulatory settlements.

⁵ A reduction in the UK corporation tax rate from 21% to 20% (effective from 1 April 2015) was substantively enacted on 2 July 2013. Further reductions to 19% (effective from 1 April 2017) and to 18% (effective 1 April 2020) were substantively enacted on 26 October 2015, and an additional reduction to 17% (effective 1 April 2020) was substantively enacted on 6 September 2016. This will reduce the Group's future current tax charge accordingly. The net deferred tax liability at 31 March 2017 has been calculated based on these rates. This has resulted in an overall deferred tax credit in the income statement of £57.8 million, which comprises a deferred tax release/(charge) in respect of fixed assets, cash flow hedges, retirement benefit obligations and other temporary differences of £67.8 million, (£8.8 million), £1.9 million and (£3.1 million) respectively.

⁶ The provision for uncertain tax positions within current tax has been reduced from £1.0 million to £nil, resulting in a prior year current tax credit of £1.0 million. The provision was for an uncertain tax position relating to an overseas subsidiary, on which amounts are now unlikely to be paid. The release of the provision did not result in any tax payments or receipts. The prior year current tax credit for the year ended 31 March 2016 of £6.0 million arose on the reclassification of amounts provided from current tax to deferred tax, as it was considered that any liability arising from the uncertain positions would be more likely to arise as deferred tax.

⁷ Following the agreement of tax computations with HMRC up to and including 31 March 2014, the provision for uncertain tax positions within deferred tax has been reduced, resulting in a prior year deferred tax credit of £6.0 million, which is included in the total prior year deferred tax credit of £5.2 million.

The Group is not currently in a tax paying position with HMRC (although companies within the group do pay for group relief), primarily due to capital allowances on capital expenditure and tax deductions for borrowing costs. The differences between (loss)/profit on ordinary activities before taxation at the standard tax rate and the current tax (credit)/charge for the year are set out below.

	2017			2016		
	Underlying £m	BTL £m	Total £m	Underlying £m	BTL £m	Total £m
(Loss)/profit on ordinary activities before taxation	(237.7)	33.0	(204.7)	384.6	-	384.6
Tax at 20%	(47.5)	6.6	(40.9)	76.9	-	76.9
<i>Effects of:</i>						
Depreciation on assets that do not qualify for relief	4.0	-	4.0	4.1	-	4.1
Disallowable expenditure	1.8	-	1.8	2.4	-	2.4
Non-taxable income	(5.2)	-	(5.2)	(4.3)	-	(4.3)
Property disposals	(0.1)	-	(0.1)	(3.7)	-	(3.7)
Tax differential on profits and losses of overseas subsidiaries	(0.4)	-	(0.4)	0.3	-	0.3
Capital allowances for the year in excess of depreciation	(8.9)	-	(8.9)	13.5	-	13.5
Tax effect of transition to IFRS ⁸	-	-	-	(60.7)	-	(60.7)
Capitalised borrowing costs allowable for tax	(15.3)	-	(15.3)	(22.9)	-	(22.9)
Losses / (profits) on financial derivatives ⁹	65.9	-	65.9	(9.9)	-	(9.9)
Pension cost charge in excess of pension contributions	(6.3)	-	(6.3)	3.9	-	3.9
Other short term timing differences	5.4	-	5.4	0.4	-	0.4
Group relief not paid at standard rate	4.4	(4.4)	-	-	-	-
Adjustments in respect of prior periods ⁶	(1.0)	-	(1.0)	(6.0)	-	(6.0)
Current tax (credit) / charge for the year	(3.2)	2.2	(1.0)	(6.0)	-	(6.0)

⁸ A one off tax deduction of approximately £300 million arose in the year ended 31 March 2016 following the transition to IFRS, resulting in a current tax reduction of £60.7 million in that year.

⁹ Accounting fair value profits and losses arising on our derivatives are non-taxable and non-deductible respectively, as instead they are taxed as the cash flows arise. Deferred tax is provided on these temporary differences.

Effective tax rate

The effective tax rate, as adjusted for recurring tax items, of 19.9% is very similar to the standard rate of corporation tax for the year of 20.0%. Proposed changes in tax legislation which are expected to be effective from 1 April 2017 may provide greater flexibility (with some restrictions) for tax losses carried forward within Group companies. The recognition of deferred tax assets in relation to the carried forward losses would need to be evaluated, which could affect the effective tax rate of the Group. Corporate Interest Restriction rules, which are expected to be effective from 1 April 2017, are likely to result in an interest restriction in the group in the future, which would increase the effective tax rate.

8. Taxation (continued)

Uncertain tax positions

Provisions for uncertain corporation tax positions are included in the deferred tax liability as any liability is likely to crystallise as deferred tax. At 31 March 2017 the total value of these provisions was £0.3 million within deferred tax (2016: £1.0 million current tax and £6.3 million deferred tax). It is possible that amounts agreed will be different from the amount provided.

The deferred tax credited/(charged) directly to other comprehensive income during the year is as follows:

	2017 £m	2016 £m
<i>Deferred tax:</i>		
Tax on actuarial loss/(gain)	21.6	(30.8)
Tax on cash flow hedges	6.0	8.7
Total	27.6	(22.1)

9. Goodwill

The Directors have reviewed the carrying value of goodwill in line with the accounting policy on page 41 and do not consider there to be any impairment to this carrying value for the year ended 31 March 2017 (2016: £nil).

All purchased goodwill, which arose on acquisition of the Thames Water group in 2006, has been allocated to the regulated water and wastewater business. Impairment of this purchased goodwill occurs where the carrying value is in excess of the net realisable value, the expected sales value of the regulated business.

An equity valuation model has been used which takes an external, observable, market multiplier uplift to the Regulatory Capital Value ("RCV") of the regulated business. This model has also been informed by the three recent equity transactions, involving the sale of share in KWH by existing shareholders (see note 32). Ofwat, an external regulator, have developed the RCV as a measure of the capital value of the business, and the use of a multiplier reflects any premium to which the equity of publically listed water utilities is being traded.

The critical assumption is thus the multiple of RCV used. As at 31 March 2017, for the carrying amount of goodwill to exceed the recoverable amount, a 23% reduction to the multiplier used would be required.

10. Interests in associates

Thames Water Limited, a wholly owned subsidiary of the Group, controls 50% of the share capital of Foudry Properties Limited ("Foudry"), a property company incorporated in the United Kingdom. The company made a loss in 2017 of £0.4 million (2016: £0.7m) and has net liabilities of £10.0 million (2016: £9.6m). The Group's share of these losses relate solely to loan and associated interest balances owed to the Group, which have been fully provided for, and consequently no separate provision in respect of these losses has been recognised.

As at 31 March 2017 the associate did not have any significant contingent liabilities to which the Group was exposed and the Group did not have any significant contingent liabilities in relation to its interests in associates (2016: £nil). The Group had no capital commitments in relation to its interests in associates as at 31 March 2017 (2016: £nil).

11. Intangible assets

	Software £m	Other £m	Assets in development £m	Total £m
<i>Cost:</i>				
At 1 April 2015	141.6	1.3	-	142.9
Additions	10.4	-	16.9	27.3
At 31 March 2016	152.0	1.3	16.9	170.2
Additions	-	-	102.7	102.7
Transfers	37.6	-	(37.6)	-
Write-off of costs from assets in development	-	-	(3.1)	(3.1)
At 31 March 2017	189.6	1.3	78.9	269.8
<i>Amortisation:</i>				
At 1 April 2015	(84.5)	(0.7)	-	(85.2)
Amortisation charge	(18.5)	(0.1)	-	(18.6)
At 31 March 2016	(103.0)	(0.8)	-	(103.8)
Amortisation charge	(25.0)	-	-	(25.0)
At 31 March 2017	(128.0)	(0.8)	-	(128.8)
<i>Net book value:</i>				
At 31 March 2017	61.6	0.5	78.9	141.0
At 31 March 2016	49.0	0.5	16.9	66.4

Other intangible assets include concessions, licences and similar rights and assets.

The write-off of costs in the year ended 31 March 2017 relates to software under development that is no longer required as a result of the transfer of non-household customers to Castle Water.

12. Property, plant and equipment

	Land & buildings £m	Plant & equipment £m	Network assets £m	Assets under construction £m	Total £m
<i>Cost:</i>					
At 1 April 2015	3,551.9	6,331.1	5,368.0	2,312.0	17,563.0
Additions	0.2	-	5.1	1,193.5	1,198.8
Transfers between categories	47.8	364.1	1,102.2	(1,514.1)	-
Disposals	(27.2)	(2.2)	(0.1)	-	(29.5)
At 31 March 2016	3,572.7	6,693.0	6,475.2	1,991.4	18,732.3
Additions	0.3	24.2	15.9	1,076.7	1,117.1
Transfers between categories	95.0	626.3	255.9	(977.2)	-
Disposals	(3.7)	(3.8)	-	-	(7.5)
At 31 March 2017	3,664.3	7,339.7	6,747.0	2,090.9	19,841.9
<i>Depreciation:</i>					
At 1 April 2015	(871.4)	(3,263.5)	(120.8)	-	(4,255.7)
Depreciation charge	(56.2)	(299.6)	(123.6)	-	(479.4)
Disposals	26.0	1.8	0.1	-	27.9
At 31 March 2016	(901.6)	(3,561.3)	(244.3)	-	(4,707.2)
Depreciation charge	(59.9)	(333.0)	(120.5)	-	(513.4)
Disposals	2.0	3.7	-	-	5.7
At 31 March 2017	(959.5)	(3,890.6)	(364.8)	-	(5,214.9)
<i>Net book value:</i>					
At 31 March 2017	2,704.8	3,449.1	6,382.2	2,090.9	14,627.0
At 31 March 2016	2,671.1	3,131.7	6,230.9	1,991.4	14,025.1

£76.3 million borrowing costs were capitalised during the period (2016: £114.4 million). The effective rate of borrowing costs for the year was 4.86% (2016: 4.22%).

13. Inventories and current intangible assets

	2017 £m	2016 £m
Raw materials and consumables	14.1	12.6
Current intangible assets – emissions allowances	7.6	9.4
Total	21.7	22.0

Emission allowances represent purchased carbon emission allowances (relating to the emission of carbon dioxide in the UK). A provision (see note 20) is simultaneously recorded in respect of the obligation to deliver emission allowances in the period in which the emissions are made and the associated charge is recognised as an operating expense within the income statement.

14. Trade and other receivables

	2017			2016		
	Underlying £m	BTL £m	Total £m	Underlying £m	BTL £m	Total £m
<i>Non-current:</i>						
Prepayments and accrued income	-	30.4	30.4	-	1.3	1.3
Other receivables	2.8	-	2.8	2.5	-	2.5
	2.8	30.4	33.2	2.5	1.3	3.8
<i>Current:</i>						
Gross trade receivables	421.9	3.2	425.1	409.3	-	409.3
Less doubtful debt provision	(176.0)	(0.6)	(176.6)	(189.9)	-	(189.9)
Net trade receivables	245.9	2.6	248.5	219.4	-	219.4
Amounts owed by associated undertakings	2.8	-	2.8	2.8	-	2.8
Amounts receivable in respect of group relief	2.2	(2.2)	-	-	-	-
Insurance claims receivable	36.0	-	36.0	16.9	-	16.9
Prepayments and accrued income	286.7	0.4	287.1	278.9	-	278.9
Other receivables	70.4	-	70.4	52.2	-	52.2
	644.0	0.8	644.8	570.2	-	570.2
Total	646.8	31.2	678.0	572.7	1.3	574.0

The Directors consider that the carrying amount of trade and other receivables is approximately equal to their fair value.

Prepayments and accrued income at 31 March 2017 includes water and wastewater income not yet billed of £244.6 million (2016: £245.0m).

Doubtful debts provision

Movements in the doubtful debts provision were as follows:

	2017 £m	2016 £m
At 1 April	(189.9)	(179.0)
Charge for bad and doubtful debts – charged against revenue	(46.5)	(37.7)
Charge for bad and doubtful debts – included within operating expenses	(3.9)	(27.4)
Amounts written off	63.7	54.2
Total at 31 March	(176.6)	(189.9)

The ageing of debt past its due date but not yet impaired cannot be performed. Ageing of gross receivables is as follows:

	2017 £m	2016 £m
Up to 365 days	252.0	230.2
1 – 2 years	77.4	79.5
2 – 3 years	41.5	37.3
More than 3 years	54.2	62.3
Total	425.1	409.3

All gross BTL receivables are due within 365 days.

14. Trade and other receivables (continued)

A collective provision is recorded against assets which are past due but for which no individual provision is made. This is calculated based on historical experience of levels of recovery. Ageing of impaired receivables is as follows:

	2017 £m	2016 £m
Up to 365 days	71.7	79.5
1 – 2 years	32.7	37.0
2 – 3 years	23.7	20.9
More than 3 years	48.5	52.5
Total	176.6	189.9

The bad debt provision for BTL receivables of £0.6 million relates to receivables within 365 days.

Trade and other receivables are part of the Group's financial exposure to credit risk as explained on page 25.

15. Cash and cash equivalents

	Underlying £m	2017 BTL £m	Total £m	Underlying £m	2016 BTL £m	Total £m
Cash at bank and in hand	5.0	3.8	8.8	7.0	-	7.0
Short-term deposits	94.0	0.0	94.0	560.3	-	560.3
Total	99.0	3.8	102.8	567.3	-	567.3

BTL cash represents amounts collected from wastewater customers, for the construction costs of the Thames Tideway Tunnel, which has not yet been paid at the reporting date.

16. Trade and other payables

	Underlying £m	2017 BTL £m	Total £m	Underlying £m	2016 BTL £m	Total £m
<i>Non-current:</i>						
Accruals and deferred income	404.9	-	404.9	362.2	-	362.2
<i>Current:</i>						
Trade payables	463.2	-	463.2	509.3	-	509.3
Amounts owed to Bazalgette Tunnel Limited	-	4.2	4.2	-	1.5	1.5
Accruals and deferred income	432.5	0.2	432.7	287.1	-	287.1
Corporation tax payable	-	-	-	1.0	-	1.0
Other taxation and social security	6.7	-	6.7	5.7	-	5.7
Other payables	10.9	-	10.9	9.9	-	9.9
	913.3	4.4	917.7	813.0	1.5	814.5
Total	1,318.2	4.4	1,322.6	1,175.2	1.5	1,176.7

Accruals and deferred income at 31 March 2017 includes £81.1 million (31 March 2016: £85.7 million) of receipts in advance from customers for water and wastewater charges, and £97.3 million (31 March 2016: £nil) of net proceeds in relation to the transfer of all non-household retail customers to Castle Water.

The Directors consider that the carrying amount of trade and other payables is approximately equal to their fair value.

17. Borrowings

	2017 £m	2016 £m
Secured bank loans	2,160.7	2,489.2
Other financing	9,601.7	9,313.1
	11,762.4	11,802.3
Interest payable on secured bank loans and other financing	181.5	240.5
Total	11,943.9	12,042.8
Disclosed within current liabilities	381.5	1,037.4
Disclosed within non-current liabilities	11,562.4	11,005.4

Breakdown of secured bank loans:

	2017 £m	2016 £m
Thames Water Utilities Limited:		
£200.0m floating rate loan due 2016 (a), (g)	-	200.0
£150.0m floating rate loan due 2017	150.0	150.0
£200.0m 0% Index linked loan due 2017	-	200.5
£100.0m floating rate loan due 2018 (a)	99.9	99.8
£60.0m 1.23% Index linked loan due 2019	73.9	72.0
£60.0m 1.415% Index linked loan due 2020	73.7	71.8
£60.0m 1.513% Index linked loan due 2020	73.3	71.4
£60.0m 1.38% Index linked loan due 2020	73.1	71.2
£60.0m 1.356% Index linked loan due 2020	73.1	71.3
£100.0m floating rate loan due 2020 (a), (c)	99.8	99.7
£75.0m 1.35% Index linked loan due 2021 (e)	83.7	81.6
£100.0m floating rate loan due 2021 (a), (c)	99.7	99.6
£215.0m 0.46% Index linked loan due 2023 (a)	232.6	226.8
£125.0m 0.598% index linked loan due 2026 (a), (c)	128.2	125.0
£70.0m Class B 3.867% fixed rate loan due 2026 (a)	69.7	69.4
£50.0m Class B 3.875% fixed rate loan due 2026 (a)	49.8	50.0
£20.0m Class B floating rate loan due 2026 (a)	19.9	19.9
£215.0m 0.38% Index linked loan due 2032 (a), (b)	227.0	221.3
£100.0m 3.28% index linked loan due 2043 (a), (d)	121.5	118.4
£100.0m 0.790% Index linked loan due 2025 (a), (e)	103.1	100.5
£39.0m Class B 3.918% fixed rate loan due 2026 (a)	38.8	-
Thames Water Utilities Limited total	1,890.8	2,220.2
Kemble Water Finance Limited:		
£75m floating rate due 2022 (a)	73.3	72.9
£200m floating rate due 2025 (a)	196.6	196.1
Kemble Water Finance Limited total	269.9	269.0
Total secured bank loans	2,160.7	2,489.2

- (a) These loans are shown net of issue costs.
- (b) This debt amortises in equal tranches from 2017 onwards.
- (c) The interest margins of these two loans are based on a ratings grid and will increase should the Securitisation Group Senior Debt credit rating be downgraded by both Standard & Poor's and Moody's.
- (d) This debt amortises from 2023 to 2033 in tranches of £3.0 million, followed by tranches of £750,000 until maturity where there will be a bullet payment of £25.0 million.
- (e) These loans contain a collar mechanism that limits total accretion repayment within a predetermined range.
- (f) All loans are Class A except where highlighted.
- (g) This loan facility was originally due in 2015 but was subsequently extended to 2017.

17. Borrowings (continued)

Breakdown of other financing

	2017 £m	2016 £m
Thames Water Utilities Limited Group		
€500m Euro 3.25% Fixed rate bond due 2016 (a)	-	395.4
£200m 5.05% Fixed rate bond due 2020 (c), (g)	202.4	203.1
£225m 6.59% Fixed rate bond due 2021 (k)	244.0	247.4
£175m 3.38% Index linked bond due 2021 (b), (e)	263.9	259.0
£550m 5.37% Class B fixed rate bond due 2025 (b), (l)	548.5	547.9
£330m 6.75% Fixed rate bond due 2028 (b), (h)	392.5	396.0
£300m 5.75% Class B Fixed rate bond due 2030 (a), (b), (m)	297.5	297.2
£200m 6.5% Fixed rate bond due 2032 (b), (c), (j)	248.4	250.4
£300m 4.37% Fixed rate bond due 2034 (b)	295.3	295.1
£600m 5.13% Fixed rate bond due 2037 (b), (c), (j)	658.3	659.9
€113m 2.30% CPI IL bond due 2022 (a), (c)	100.6	91.6
20bn Yen 3.28% Fixed rate bond due 2038 (b), (c)	143.2	123.5
£50m 3.85% Index linked bond due 2040 (e)	60.9	59.3
£500m 5.5% Fixed rate bond due 2041 (b)	489.4	489.1
£50m 1.98% Index linked bond due 2042 (e)	64.4	62.9
£55m 2.09% Index linked bond due 2042 (b), (e)	68.2	66.5
£40m 1.97% Index linked bond due 2045 (b), (e)	45.6	45.5
£300m 4.625% Fixed rate bond due 2046 (b)	293.0	292.9
£100m 1.85% Index linked bond due 2047 (e)	128.9	125.8
£200m 1.819% Index linked bond due 2049 (b), (e)	257.3	251.0
£300m 1.68% Index linked bond due 2053 (b), (e)	406.9	399.4
£300m 1.68% Index linked bond due 2055 (b), (e)	406.9	399.4
£200m 1.77% Index linked bond due 2057 (b), (e)	257.3	251.0
£400m 7.241% Fixed rate bond due 2058 (d)	-	399.3
£350m 1.76% Index linked bond due 2062 (b), (e)	450.2	439.2
\$150m 4.69% Class B USPP due 2019 (a), (b)	119.2	103.3
\$150m 3.87% USPP due 2022 (a)	119.8	104.2
\$200m 4.020% USPP due 2024 (a)	159.8	138.9
\$250m 4.22% USPP due 2027 (a)	199.6	173.7
£500m 4.00% Fixed rate bond due 2025 (b)	494.9	494.3
£40m 0.75% index linked bond due 2034 (b)	40.8	39.8
£45m 0.721% index linked bond due 2027 (b)	45.9	44.6
£300m 3.5% fixed rate bond due 2028 (b)	296.0	295.9
£400m 7.738% fixed rate bond due 2058 (b), (d)	393.8	-
£250m 1.875% fixed rate bond due 2024 (b)	247.4	-
£250m 2.625% fixed rate bond due 2032 (b)	247.0	-
£42m floating rate loan due 2017	42.0	-
Fees	(9.9)	(10.1)
	8,719.9	8,432.4
Thames Water (Kemble) Finance plc		
£400m 7.75% fixed rate bond due 2019 (b)	398.0	397.1
£175m 5.75% fixed rate bond due 2022 (b)	173.4	173.2
	571.4	570.3
Kemble Water Eurobond plc		
£310m Shareholder loan due 2021	310.4	310.4
	9,601.7	9,313.1
Total other financing		

- (a) The Group has entered into swap agreements which eliminate the risk of currency fluctuations in relation to the US Dollar, Euro and Yen loans.
- (b) These loans are shown net of issue costs.
- (c) The Group has entered into swap agreements that convert this debt into index-linked debt.
- (d) During the year, the £400.0m Class A Puttable, Callable, Resetable ("PCR") bond issued by Thames Water Utilities Cayman Finance Limited with a final maturity of 9 April 2058 was exchanged for a new £400.0m Class A 2058 bond with the same final maturity.
- (e) The value of the capital and interest elements of the index-linked loans is linked to movements in the Retail Price Index ("RPI").
- (f) Amounts repayable wholly within one year.
- (g) This bond includes £2.4m (2016: £3.1m) fair value adjustment to carrying value at acquisition by Kemble Water Holdings Group.
- (h) This bond includes £65.2m (2016: £68.8m) fair value adjustment to carrying value at acquisition by Kemble Water Holdings Group.

17. Borrowings (continued)

- (i) This bond includes £50.8m (2016: £52.9m) fair value adjustment to carrying value at of acquisition by Kemble Water Holdings Group.
- (j) This bond includes £62.0m (2016: £63.7m) fair value adjustment to carrying value at acquisition by Kemble Water Holdings Group.
- (k) This bond includes £19.0m (2016: £22.4m) fair value adjustment to carrying value at acquisition by Kemble Water Holdings Group.
- (l) In July 2017 this Class B bond has a 'Step Up and Call' meaning the interest rate changes to 3 months LIBOR plus 7.96% at which point the issuer can exercise a call option to redeem the nominal value of the debt at par value.
- (m) In September 2022 this Class B bond has a 'Step Up and Call' meaning the interest rate changes to 3 months LIBOR plus 7.97% at which point the issuer can exercise a call option to redeem the nominal value of the debt at par value.

The total carrying value of the fair value adjustment to the debt on acquisition of the Thames Water Group by Kemble is £201.3 million (2016: £212.9 million). Capitalised debt issuance costs in relation to the debt portfolio are £85.1 million (2016: £79.9 million).

18. Financial instruments

Categories of financial instruments

The carrying values of the primary financial assets and liabilities are as follows:

	2017 £m	2016 £m
Financial assets:		
<i>Fair value through profit and loss</i>		
Options	-	336.4
Cross currency swaps	72.6	16.1
Index-linked swaps	97.4	14.1
Interest rate swaps	0.6	-
	170.6	366.6
<i>Loans and receivables (including cash and cash equivalents)</i>		
Trade and other receivables	678.0	574.0
Short term investments	1.0	289.5
Cash and cash equivalents	102.8	567.3
Total	952.4	1,797.4
Financial liabilities:		
<i>Fair value through profit and loss</i>		
Options	-	(336.4)
Cross currency swaps	(75.2)	(139.0)
Interest rate swaps	(108.4)	(2.2)
Index-linked swaps	(1,082.9)	(647.5)
<i>Derivatives designated as hedging instruments</i>		
Forward starting interest rate swaps – cash flow hedges	(155.3)	(219.4)
	(1,421.8)	(1,344.5)
<i>Other financial liabilities</i>		
Trade and other payables	(1,322.6)	(1,176.7)
Borrowings	(11,943.9)	(12,042.8)
Total	(14,688.3)	(14,564.0)

18. Financial instruments (continued)

Fair value measurements

The fair value of financial assets and liabilities represents the price that would be received to sell an asset or paid to transfer a liability between informed and willing parties, other than in a forced or liquidation sale at the measurement date. The techniques for determining the fair value of financial instruments are classified under the hierarchy defined in IFRS 13 *Fair Value Measurement* which categorises inputs to valuation techniques into Levels 1-3 based on the degree to which the fair value is observable. Unless otherwise stated all of the Group's inputs to valuation techniques are Level 2 - the fair value is determined from inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. The table below sets out the valuation basis of financial instruments held at fair value as at 31 March:

	2017 £m	2016 £m
<i>Financial assets - derivative financial instruments:</i>		
Options	-	336.4
Cross currency swaps	72.6	16.1
Index-linked swaps	97.4	14.1
Interest rate swaps	0.6	-
	170.6	366.6
<i>Financial liabilities - derivative financial instruments:</i>		
Cross currency swaps	(75.2)	(139.0)
Interest rate swaps	(108.4)	(2.2)
Index-linked swaps	(1,082.9)	(647.5)
Forward starting interest rate swaps	(155.3)	(219.4)
Options	-	(336.4)
	(1,421.8)	(1,344.5)
Net total	(1,251.2)	(977.9)

The fair value of derivative financial instruments, including interest rate swaps, cross currency swaps, index-linked swaps and options, are measured using discounted cash flows. The future cash flows are estimated based on forward interest rates from observable yield curves at the period end and discounted at a rate that reflects the credit risk of the Company and the counterparties. Currency cash flows are translated at spot rate.

As at 31 March 2016, the Group held two offsetting options with equal and opposite values of £336.4m. The Low Strike Call Option ("LSCO") was recognised as a financial liability equal to the cost to the Company of settling the option in cash. An Assignable Call Option ("ACO") was recognised as a financial asset equal to the reciprocal value to the Company of, instead, choosing to remarket the original bond for a 40 year period. During the year, holders of the LSCO exercised their right to have the ACO assigned to them; TWUL then assigned the ACO to the LSCO holders. On assignment, TWUL de-recognised both, the financial liability in relation to LSCO and the financial asset in relation to ACO.

In mid-2014 the Company executed £2.25 billion of forward-starting fixed to floating interest rate swaps of a 5-7 year maturity with various financial institutions to fix the future interest costs of an element of the new debt to be issued from 2017 to 2020. £500.0 million of forward-starting swaps commenced on 13 September 2016 and were reclassified from forward starting interest rate swaps to interest rate swaps. Subsequent to 13 September 2016 the fair value movement on these swaps has been recognised as changes in fair value through the income statement and the cash flow hedge has been discontinued prospectively. As at 13 September 2016, £54.8 million was recognised within the cash flow hedge reserve related to these swaps. On 24 January 2017, Thames Water Utilities Cayman Finance Limited issued new bonds totalling £500.0 million and lent the proceeds to TWUL. As at 31 March 2017, £2.1 million out of £54.8 million has been recycled to the income statement.

On 16 March 2017 a further £400.0 million of forward-starting swaps commenced and were reclassified from forward starting interest rate swaps to interest rate swaps. Subsequent to 16 March 2017 the fair value movement on these swaps has been recognised as changes in fair value through the income statement and the cash flow hedge has been discontinued prospectively.

18. Financial instruments (continued)

Comparison of fair value of financial instruments with their carrying amounts

The carrying amounts of the Group's trade and other receivables and trade and other payables are considered to be approximate to their fair values. The fair values and carrying values of the Group's other financial assets and financial liabilities are set out in the table below:

	2017		2016	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Financial assets:				
<i>Non-current</i>				
Derivative financial instruments				
Options	-	-	336.4	336.4
Cross currency swaps	72.6	72.6	16.1	16.1
Index-linked swaps	97.4	97.4	14.1	14.1
Interest rate swaps	0.6	0.6	-	-
<i>Current</i>				
Short term investments	1.0	1.0	289.5	289.5
Cash and cash equivalents	102.8	102.8	567.3	567.3
Total	274.4	274.4	1,223.4	1,223.4
Financial liabilities:				
<i>Non-current</i>				
Borrowings:				
Floating rate	(589.3)	(589.3)	(738.1)	(738.1)
Index-linked	(3,853.1)	(5,421.4)	(3,766.3)	(4,337.8)
Fixed rate	(7,120.0)	(9,053.9)	(6,501.0)	(7,653.4)
Derivative financial instruments:				
Cross currency swaps	(75.2)	(75.2)	(96.6)	(96.6)
Interest rate swaps	(107.3)	(107.3)	(2.2)	(2.2)
Index-linked swaps	(1,060.2)	(1,060.2)	(647.5)	(647.5)
Forward starting interest rate swaps	(155.3)	(155.3)	(219.4)	(219.4)
Options	-	-	(336.4)	(336.4)
<i>Current</i>				
Borrowings:				
Floating rate	(192.1)	(192.1)	(200.0)	(200.0)
Index-linked	(7.9)	(7.9)	(200.5)	(200.5)
Fixed rate	-	-	(396.4)	(403.0)
Interest payable	(181.5)	(181.5)	(240.5)	(240.5)
Derivative financial instruments:				
Cross currency swaps	-	-	(42.4)	(42.4)
Index-linked swaps	(22.7)	(22.7)	-	-
Interest rate swaps	(1.1)	(1.1)	-	-
Total	(13,365.7)	(16,867.8)	(13,387.3)	(15,117.8)

The fair value of floating rate debt instruments is assumed to be the nominal value of the primary loan and adjusted for credit risk if this is significant. The fair value of index-linked debt instruments is based on the nominal value of the debt plus accretion already accrued and accretion expected to accrue to maturity.

18. Financial instruments (continued)

Capital risk management

Details of the Group's capital risk management strategy can be found on page 25.

The capital structure of the Group consists of net debt and equity as follows:

	2017 £m	2016 £m
Cash and cash equivalent	102.8	567.3
Short term investments	1.0	289.5
Secured bank loans and other financing	(11,762.4)	(11,802.3)
Interest payable on secured bank loans and other financing	(181.5)	(240.5)
Net debt	(11,840.1)	(11,186.0)
Shareholder loan	310.5	310.4
Interest payable on secured bank loans and other financing	181.5	240.5
Unamortised debt issuance costs and discount	(85.1)	(79.9)
Derivative financial liabilities	(121.2)	(226.0)
Fair value adjustment on acquisition to loans	201.3	212.9
Cash held by non-covenant entities	(25.9)	(9.5)
Net debt (covenant basis)	(11,379.0)	(10,737.6)

Net debt includes accrued interest on debt and excludes derivative accretion and foreign exchange. In the prior year financial statements, we disclosed net debt of £11,171.5 million. This net debt excluded £240.5 million accrued interest on debt and included £226.0 million relating solely to accretion on index-linked swaps and the effect of movement in foreign exchange rate on cross currency swaps held by the Group. After including interest on debt and excluding derivative accretion and foreign exchange net debt as at 31 March 2016 would have been £11,186.0 million.

Net debt (covenant basis) excludes parent company loans, accrued interest, unamortised debt issuance costs and discounts, fair value adjustment made to the Thames Water Group's borrowing on acquisition by the Kemble Water consortium, cash held by non-covenant entities and includes derivative financial liabilities related solely to accretion on index-linked swaps and the effect of movement in foreign exchange rate to cross currency swaps.

A summary of the Group's net debt (covenant basis) by different types of debt is as follows:

	2017 £m	2016 £m
Securitised Class A debt	(9,481.4)	(9,648.3)
Securitised Class B debt	(1,125.6)	(1,086.6)
Subordinated debt	(850.0)	(850.0)
Cash net of cash held by non-covenant entities	78.0	847.3
Net debt (covenant basis)	(11,379.0)	(10,737.6)

Financial risk management

The Group's activities expose it to a number of financial risks: market risk (including interest rate risk and exchange rate risk), credit risk, liquidity risk and inflation risk. Details of the nature of each of these risks along with the steps the Group has taken to manage them is described on page 25.

(a) Market risk

Below is the effective interest rate and foreign currency risk profile of the debt held by the Group after taking into account the derivative financial instruments used to manage market risk:

As at 31 March 2017:	Total at fixed rates £m	Total at floating rates £m	Total at index linked rates £m	Total £m
Interest bearing loans and borrowings				
Net of corresponding swap assets				
- £ Sterling	6,119.9	346.3	5,216.4	11,682.6
Total	6,119.9	346.3	5,216.4	11,682.6

18. Financial instruments (continued)

(b) Market risk

Below is the effective interest rate and foreign currency risk profile of the debt held by the Group after taking into account the derivative financial instruments used to manage market risk:

As at 31 March 2016:	Total at fixed rates £m	Total at floating rates £m	Total at index linked rates £m	Total £m
Interest bearing loans and borrowings Net of corresponding swap assets - £ Sterling	5,752.3	903.1	5,168.4	11,823.8
Total	5,752.3	903.1	5,168.4	11,823.8

The weighted average interest rates of the debt held by the Company after taking into account the derivative financial instruments used to manage market risk and the period until maturity for which the rate is fixed or index linked are given below:

	Weighted average interest rate		Weighted average period until maturity	
	2017 %	2016 %	2017 Years	2016 Years
Fixed	5.6	5.6	12.3	12.9
Index-Linked	3.9	2.7	23.7	23.1

(i) Interest rate risk sensitivity analysis

The table below summarises the impact, on pre-tax profits, of 1% increase or decrease in interest rate at 31 March 2017. This analysis considers effect of variable interest rate instruments and assumes that all other variables, in particular exchange rates, remain constant.

	2017		2016	
	+1% £m	-1% £m	+1% £m	-1% £m
Profit	325.6	(386.5)	251.7	(319.5)
Equity	404.3	(469.5)	385.5	(464.5)

(ii) Exchange rate risk sensitivity analysis

The table below summarises the impact of changes in the year end valuations of financial assets and liabilities denominated in foreign currency on pre-tax profits of a 10% strengthening or weakening of GBP (£) against the respective currencies in which the financial assets and liabilities are denominated at 31 March 2017. This analysis assumes that all other variables in the valuation remain constant.

	2017		2016	
	+10% £m	-10% £m	+10% £m	-10% £m
Profit	(11.2)	13.0	(22.2)	19.6
Equity	(11.2)	13.0	(22.2)	19.6

(iii) Inflation risk sensitivity analysis

The table below summarises the impact on pre-tax profits of a 1% increase or decrease in inflation rates at 31 March 2017. This analysis assumes that all other variables, in particular exchange rates, remain constant.

	2017		2016	
	+1% £m	-1% £m	+1% £m	-1% £m
Profit	(747.5)	578.5	(725.2)	605.4
Equity	(747.5)	578.5	(725.2)	605.4

18. Financial instruments (continued)

(c) Credit risk

The Group's maximum exposure to credit risk is the carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, less collateral cash held under the terms of the whole business securitisation agreement explained on page 45.

The following table summarises amounts held on short term investments by credit rating of counterparties.

	2017 £m	2016 £m
AA-	-	17.0
A+	-	60.0
A	1.0	212.5
Total	1.0	289.5

The following table summarises fair value of derivatives assets by credit rating of counterparties.

	2017 £m	2016 £m
A+	107.1	2.0
A	14.5	184.4
AA-	49.0	10.7
BBB+	-	169.5
Total	170.6	366.6

(d) Liquidity risk

Details of the nature and management of the Group's liquidity risk is provided on page 25.

The maturity profile of interest bearing loans and borrowings disclosed in the statement of financial position are given below.

	2017 £m	2016 £m
Within one year	199.9	796.9
Between one and two years	234.0	150.0
Between two and three years	879.7	203.1
Between three and four years	627.4	854.6
Between four and five years	726.4	613.1
After more than five years	9,095.0	9,184.6
Total	11,762.4	11,802.3

(i) Cash flows from non-derivative financial liabilities

The maturity profile of the anticipated future cash flows including interest in relation to the Company's non-derivative financial liabilities on an undiscounted basis (excluding non-current trade payables), which, therefore, differs from both the carrying value disclosed in the statement of financial position and fair values, is as follows:

	2017 £m	2016 £m
Undiscounted amounts payable		
Within one year	(1,570.0)	(2,096.6)
Between one and two years	(724.6)	(603.6)
Between two and three years	(1,396.4)	(677.5)
Between three and four years	(1,069.2)	(1,378.0)
Between four and five years	(1,178.4)	(1,038.8)
After more than five years	(21,931.2)	(21,268.3)
Total	(27,869.8)	(27,062.8)

18. Financial instruments (continued)

(ii) Cash flows from derivative financial instruments

The maturity profile of the Group's financial derivatives (which include interest rate swaps and cross currency swaps), based on undiscounted cash flows, is as follows:

Undiscounted amounts payable	2017 £m	2016 £m
Within one year	(11.5)	(7.4)
Between one and two years	34.4	(31.4)
Between two and three years	(33.2)	15.2
Between three and four years	(0.1)	(16.4)
Between four and five years	50.2	14.2
After more than five years	(1,761.0)	(1,188.1)
Total	(1,721.2)	(1,213.9)

Cash flow hedges

The Group has designated a number of contracts which qualify as hedges in accordance with IAS 39 *Financial Instruments: recognition and Measurement*, as cash flow hedges. The accounting policy on cash flow hedges is explained on page 48.

In mid-2014 the Company executed £2.25 billion of forward-starting fixed to floating interest rate swaps of a 5-7 year maturity with various financial institutions to fix the future interest costs of an element of the new debt to be issued from 2017 to 2020. This protects the Company against adverse movements in underlying interest rates by matching debt issuance against a derivative instrument with fixed cash flow.

During the year £900.0m of forward starting swaps commenced. These were reclassified from forward starting interest rate swaps to interest rate swaps and the cash flow hedge for these swaps has been discontinued prospectively, see *Fair value measurements* section above for more details.

The expected cash flows of the Group's cash flow hedges are as follows:

Undiscounted amounts payable	2017 £m	2016 £m
Within one year	(4.6)	(2.2)
Between one and two years	(15.3)	(12.8)
Between two and three years	(23.1)	(20.2)
Between three and four years	(25.5)	(25.4)
Between four and five years	(25.5)	(27.1)
After more than five years	(45.7)	(66.9)
Total	(139.7)	(154.6)

In respect of the above cash flow hedges, a loss of £50.7 million was recognised in other comprehensive income in the year (2016: loss of £65.0m). The amount reclassified from equity to profit or loss for the year was £2.1 million (2016: £nil).

19. Deferred tax

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

	Accelerated tax depreciation £m	Retirement benefit obligations £m	Cash flow hedge £m	Other £m	Total £m
At 1 April 2015	(1,312.0)	69.7	151.2	69.8	(1,021.3)
Credit/(charge) to income	107.5	6.8	(21.0)	(13.5)	79.8
Credit/(charge) to equity	-	(30.8)	8.7	-	(22.1)
At 31 March 2016	(1,204.5)	45.7	138.9	56.3	(963.6)
Credit/(charge) to income	52.1	(3.8)	50.5	0.6	99.4
Credit/(charge) to equity	-	21.6	6.0	-	27.6
At 31 March 2017 (liability)/asset	(1,152.4)	63.5	195.4	56.9	(836.6)

19. Deferred tax (continued)

A deferred tax liability arises in respect of accelerated tax depreciation, because the rate of tax relief specified in UK tax legislation on most of our capital expenditure is quicker than the rate of accounting depreciation on that expenditure. These temporary differences unwind and affect current tax over the life of the relevant assets, but the continued high levels of capital investment within TWUL mean that the temporary differences currently tend to increase every year. The deferred tax liability is also affected by the UK corporation tax rate. The deferred tax credit of £52.1 million shown above comprises a deferred tax charge of £15.7 million on the net increase in temporary differences in the year, less a deferred tax credit of £67.8 million which arose from the enactment of the announced change of the future corporation tax rate from 18% to 17%.

Deferred tax assets have arisen on the following temporary differences:

- **Retirement benefit obligations:** A deferred tax asset is provided on the net retirement benefit obligations booked in the accounts. Current tax relief will be available in the future for pension contributions paid to reduce these obligations. Deferred tax movements will also arise on any non-cash changes in the obligations, for example those arising from actuarial valuations.
- **Cash flow hedge:** A deferred tax asset is provided on certain fair values booked in respect of financial instruments in the accounts. Current tax relief will be available in the future as the cash flows arise over the lives of the derivatives. Deferred tax movements will also arise on any non-cash changes in the fair value of the derivatives.
- **Other:** A deferred tax asset is provided on the temporary differences arising on amounts for which a tax deduction is spread over a number of years in accordance with tax legislation, including certain pension contributions. Current tax relief will be available in future when tax relief is available in accordance with the legislation. A deferred tax asset is also provided on fair values on loans booked on consolidation; there will be no current tax impact in future but deferred tax charges will arise as these fair values are amortised in the accounts.

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:

	2017 £m	2016 £m
Deferred tax asset	315.8	240.9
Deferred tax liability	(1,152.4)	(1,204.5)
Total	(836.6)	(963.6)

There is an unrecognised deferred tax asset in respect of tax losses where the Group does not anticipate taxable profits in the immediate future. The amount of deferred tax asset not recognised at 17% (2016: 18%) is:

	2017 £m	2016 £m
Deferred tax asset not recognised in respect of tax losses	6.1	6.4

20. Provisions for liabilities and charges

	Emissions provision £m	Insured liabilities £m	Restructuring provision £m	AMP4 provision £m	Other provisions £m	Total £m
At 1 April 2015	-	45.7	12.3	7.7	35.0	100.7
Utilised during the year	-	-	(6.3)	(1.4)	(1.8)	(9.5)
Charge/(credit) to income statement	7.0	(0.3)	(5.4)	-	9.9	11.2
Transfer to current liabilities	-	-	-	(2.4)	-	(2.4)
At 31 March 2016	7.0	45.4	0.6	3.9	43.1	100.0
Utilised during the period	(6.5)	-	(0.4)	(2.2)	(13.5)	(22.6)
Charge/(credit) to income statement	6.5	22.0	0.5	-	3.2	32.2
Transfer to current liabilities	-	-	-	(0.2)	4.5	4.3
At 31 March 2017	7.0	67.4	0.7	1.5	37.3	113.9

Emissions provisions relate to the obligation to purchase carbon emissions allowances, see note 13.

The insured liability provision arises from insurance claims from third parties received by the Group, and represents the estimated cost of settlement. Where we have insurance cover for these claims, we recognise the reimbursement value from captive and third party insurance companies net of retentions. The receivable is disclosed in note 13. Timing of settlement for these claims is uncertain and therefore amounts provided have been classified as non-current.

20. Provisions for liabilities and charges (continued)

The AMP4 provision represents agreed settlement in respect of an information request received from Ofwat issued under section 203 of the Water Industry Act 1991 concerning the properties claimed as safeguarded from internal sewer flooding by capital schemes completed in 2009/10. The provision is utilised against contributions made to various charity schemes. The associated outflows are expected to arise over AMP6.

Other provisions principally relate to a number of contractual and legal claims against the Group and potential fines for non-compliance with the various regulations the Group is obliged to meet. The amount recorded and represents management's best estimate of the value of settlement and associated costs. Timing of settlement for these claims is uncertain and therefore amounts provided have been classified as non-current.

21. Share capital and other reserves

Share capital

	2017 £m	2016 £m
<i>Allotted, called up and fully paid:</i>		
1,991,600,000 ordinary shares of £1 each	1,991.6	1,991.6

The Company has one class of ordinary share which carries no right to fixed income. The holders of ordinary shares are entitled to receive dividends as declared and are entitled to one vote per share at meetings of the Company.

Other reserves

	2017 £m	2016 £m
Cash flow hedge reserve	(222.5)	(179.9)
Retained earnings	(570.2)	(313.2)
Total	(792.7)	(493.1)

The cash flow hedge reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

22. Dividends

	2017 £m	2016 £m
Dividend paid (2017: 1.15p per share; 2016: 0p per share)	22.8	-

23. Retirement benefit obligations

Background

The Group operates four material pension schemes, one of which is a defined contribution scheme and the other three are defined benefit.

In addition to the cost of the UK Pension arrangements, the Group operates arrangements under which it augments benefits on retirement in certain cases of redundancy. These augmentations are funded by way of additional employer contributions to the schemes. In the year to 31 March 2017 these related payments amounted to £0.5 million (2016: £2.2 million).

The defined contribution scheme was set up in April 2011, managed through Standard Life, and is open to all new employees of the Group. The pension charge for the period represents contributions payable by the Group to the scheme and amounted to £6.8 million (2016: £5.2 million). These were paid in the following financial year in line with the scheme rules. Defined benefit arrangements for the Group's eligible employees are provided through three defined benefit Group pension schemes:

- Thames Water Pension Scheme ("TWPS");
- Thames Water Mirror Image Pension Scheme ("TWMIPS"); and
- The SUURBS Arrangement ("SUURBS").

23. Retirement benefit obligations (continued)

The assets of all three schemes are held separately from the rest of the Group in independently administered funds in the United Kingdom. The Trustees of these schemes are required to act in the best interest of the scheme beneficiaries.

The SUURBS Arrangement provides retirement benefits to a previous director, and their spouse, of Thames Water Limited, a subsidiary entity in the Group. The scheme is an unfunded arrangement but is secured against assets held by Thames Water Limited. The latest full valuation was carried out at 31 March 2013 on behalf of the pension Trustees by Mercer Limited, the independent and professionally qualified consulting actuaries to the scheme.

Both the TWPS and TWMIPS schemes represent career average pension schemes. On 1 April 2011 the defined benefit arrangements were closed to new entrants and replaced with a defined contribution scheme. The most recent full actuarial valuation was at 31 December 2013 on behalf of the Trustees by AON Hewitt Limited, the independent and professionally qualified consulting actuary to the schemes.

For all three schemes the 2013 valuations were updated to 31 March 2017 by PricewaterhouseCoopers LLP, an independent and professionally qualified consulting actuary, using revised assumptions that are consistent with the requirements of IAS 19R *Employee Benefits* and shown in this note to the financial statements. The Group expects to contribute approximately £41.1 million in aggregate to the defined benefit pension schemes in the next financial year.

Amounts included in statement of financial position in respect of defined benefit pension schemes

The net pension liability recognised within the statement of financial position is as follows:

	2017			2016		
	TWPS £m	TWMIPS £m	SUURBS £m	TWPS £m	TWMIPS £m	SUURBS £m
Equities	533.5	212.0	-	430.1	146.4	-
Corporate bonds	185.1	71.2	-	74.5	68.7	-
LDI portfolio	607.6	495.1	-	571.8	488.0	-
Index linked government bonds	-	-	12.1	-	-	11.2
Property	61.4	45.8	-	62.5	46.6	-
Cash	23.8	4.4	2.2	3.9	3.5	2.0
Fair value of scheme assets	1,411.4	828.5	14.3	1,142.8	753.2	13.2
Present value of defined benefit obligations	(1,776.2)	(806.8)	(8.0)	(1,385.1)	(694.8)	(7.1)
(Deficit)/surplus	(364.8)	21.7	6.3	(242.3)	58.4	6.1
Effect of asset limit	-	(36.7)	-	-	(76.1)	-
Retirement benefit (obligations)/surplus	(364.8)	(15.0)	6.3	(242.3)	(17.7)	6.1

The Directors have reviewed the scheme rules of the defined benefit pension schemes and have concluded that, for the TWMIPS scheme, as the Company does not have an unconditional right to a refund of any surplus, including as a deduction to future contributions payable, the provisions of IFRIC 14 *IAS 19 – The limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* apply. Consequently the surplus for this scheme has been restricted with an obligation recognised for the present value of deficit funding contributions payable to the scheme.

The movements in the fair value of scheme assets were as follows:

	2017			2016		
	TWPS £m	TWMIPS £m	SUURBS £m	TWPS £m	TWMIPS £m	SUURBS £m
At 1 April	1,142.8	753.2	13.2	1,146.2	773.9	13.1
Interest income on scheme assets	41.8	25.8	0.5	37.9	24.2	0.4
Contributions by sponsoring employers	51.6	10.0	0.4	12.1	2.3	0.3
Contributions from scheme members	0.1	-	-	0.1	-	-
Administration costs paid from scheme assets	(3.4)	(1.1)	-	(2.5)	(1.4)	-
Benefits paid	(45.5)	(39.9)	(0.4)	(40.4)	(37.7)	(0.3)
Contributions for termination benefits	0.5	-	-	1.4	0.9	-
Gains/(losses) on assets above interest	223.5	80.5	0.6	(12.0)	(9.0)	(0.3)
At 31 March	1,411.4	828.5	14.3	1,142.8	753.2	13.2

23. Retirement benefit obligations (continued)

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

	2017			2016		
	TWPS £m	TWMIPS £m	SUURBS £m	TWPS £m	TWMIPS £m	SUURBS £m
At 1 April	1,385.1	694.8	7.1	1,478.8	748.8	7.4
Current service cost	13.9	3.0	-	14.9	3.2	-
Interest cost	50.0	23.7	0.3	49.1	23.4	0.2
Contributions from scheme members	0.1	-	-	0.1	-	-
Benefits paid	(45.5)	(39.9)	(0.4)	(40.4)	(37.7)	(0.3)
Termination benefits	0.5	-	-	1.4	0.9	-
Actuarial losses/(gains)	372.1	125.2	1.0	(118.8)	(43.8)	(0.2)
At 31 March	1,776.2	806.8	8.0	1,385.1	694.8	7.1

Amounts recognised in the income statement in respect of defined benefit pension schemes

	2017			2016		
	TWPS £m	TWMIPS £m	SUURBS £m	TWPS £m	TWMIPS £m	SUURBS £m
Current service cost	13.9	3.0	-	14.9	3.2	-
Scheme administration expenses	3.4	1.1	-	2.5	1.4	-
Effect of restriction of surplus	-	2.7	-	-	1.5	-
Net interest cost	8.2	(2.1)	(0.2)	11.2	(0.8)	(0.2)
Total	25.5	4.7	(0.2)	28.6	5.3	(0.2)

The net expense is recognised in the following captions within the income statement:

	2017			2016		
	TWPS £m	TWMIPS £m	SUURBS £m	TWPS £m	TWMIPS £m	SUURBS £m
Operating expenses	17.3	6.8	-	17.4	6.1	-
Finance expenses	8.2	(2.1)	(0.2)	11.2	(0.8)	(0.2)
Total	25.5	4.7	(0.2)	28.6	5.3	(0.2)

Actuarial gains and losses have been recognised within other comprehensive income. An analysis of the amount presented is set out below:

	2017 £m	2016 £m
Cumulative actuarial gains recognised at 1 April	(406.3)	(519.5)
Actual return less expected return on pension scheme assets	304.6	(21.4)
Experience gain arising on scheme liabilities	28.7	39.7
(Loss)/gain arising due to change in assumptions	(526.9)	123.1
Change in asset ceiling	42.1	(28.2)
Total actuarial (loss)/gain	(151.5)	113.2
Cumulative actuarial losses recognised	(557.8)	(406.3)

Actuarial risk factors

The schemes are exposed to actuarial risks including investment risk, inflation risk and longevity risk.

Investment risk arises because the Group's contributions to the schemes are based on expected returns from scheme assets based on actuarial assumptions. If these assets underperform a deficit will be created against the scheme liabilities.

The benefits payable to the members of the schemes are linked to inflation and as such higher inflation will lead to higher liabilities. The Group's contributions to the schemes are based on assumptions about the future levels of inflation. Therefore an increase in inflation above that assumed in the actuarial calculations will create a deficit.

The schemes' obligations are dependent on the assumptions about the life expectancy of the members after retirement. If scheme members live longer than assumed in the actuarial calculations, a deficit will be created.

23. Retirement benefit obligations (continued)

Actuarial assumptions

The main financial assumptions used in the valuation of these schemes are as follows:

	2017			2016		
	TWPS	TWMIPS	SUURBS	TWPS	TWMIPS	SUURBS
Price inflation – RPI	3.35%	3.30%	3.30%	3.05%	2.95%	2.95%
Price inflation – CPI	2.35%	2.30%	-	2.05%	1.95%	1.95%
Rate of increase to pensions in payment – RPI	3.35%	3.30%	2.30%	3.05%	2.95%	2.95%
Rate of increase to pensions in payment – CPI	2.35%	2.30%	-	2.05%	1.95%	N/A
Discount rate	2.65%	2.55%	2.55%	3.65%	3.50%	3.50%

Both the TWPS and TWMIPS schemes provide benefits on a Career Average (“CARE”) benefit structure whereby past entitlements are linked to movements in CPI therefore an assumption for increase in salary is not required. In valuing the liabilities of the pension schemes at 31 March 2017, mortality assumptions have been made as indicated below, however in respect of the SUURBS Arrangement as mortality assumptions have been made regarding the schemes only member and their spouse they have not been disclosed. These mortality assumptions are based on standard mortality tables and the recent actual mortality experience of members within the schemes. The assumptions also allow for future improvements to mortality rates.

	2017		2016	
	TWPS Years	TWMIPS Years	TWPS Years	TWMIPS Years
<i>Life expectancy from age 60:</i>				
Male	27.9	26.9	28.3	27.3
Female	29.4	29.3	29.7	29.7
<i>Life expectancy from age 60 currently age 40:</i>				
Male	29.8	28.8	30.4	30.4
Female	31.4	31.3	31.8	31.8

23. Retirement benefit obligations (continued)

The sensitivity of the present value of scheme liabilities to changes in the principle assumptions used is set out below:

	2017			2016		
	TWPS £m	TWMIPS £m	SUURBS £m	TWPS £m	TWMIPS £m	SUURBS £m
Change in discount rate (+ 1% p.a.)	380.0	120.0	0.8	260.0	100.0	0.8
Change in rate of inflation (-1% p.a.)	280.0	80.0	0.8	220.0	60.0	0.8
Change in life expectancy (-1 year)	50.0	25.0	0.3	40.0	20.0	0.3

24. Capital commitments

	2017 £m	2016 £m
Contracted for but not provided	305.6	489.9

In addition to these commitments, the Group has long-term capital investment plans, under its business plan submitted to Ofwat, to provide for future growth and maintenance of the infrastructure network.

25. Contingent liabilities

There are claims arising in the normal course of business, which are in the process of negotiation. The Group has set aside amounts considered appropriate for all legal and similar claims.

The 31 March 2016 financial statements disclosed a contingent liability in relation to the low strike call option. During the year, the related £400.0 million bond with a final maturity of 9 April 2058 was exchanged for a new £400.0 million bond with the same final maturity (see note 17). The financial liability in relation to the low strike call option and the financial asset in relation to the assignable call option were both derecognised (see note 18).

In a prior period a debt to one of Thames Water Utilities Limited ("TWUL") defined benefit pension schemes under section 75 of the Pensions Act 1995 arose in Thames Water Limited ("TWL"), an intermediary entity between the Company's immediate and ultimate parent, for the TWMIPS pension scheme as a result of a trigger event under that legislation. During the year, the Company and TWL entered into a "Flexible Apportionment Agreement" whereby the debt, estimated at between £1.0 million and £2.0 million by Aon Hewitt Limited, actuarial advisers to the TWMIPS trustees, was transferred to the Company. There are no changes to reported pension liabilities in the Company as a result of this agreement.

26. Operating leases

Lease payments under operating leases of £16.1 million (2016: £10.9 million) were recognised as an expense in the year.

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

	2017 £m	2016 £m
Within one year	7.6	6.8
Between one and five years	28.6	27.2
After more than five years	60.1	66.7
Total	96.3	100.7

Operating lease payments represent rentals payable by the Group for certain office properties, and plant and equipment.

27. Off-balance sheet arrangements

The Group is party to a number of contractual arrangements for the purposes of its principal activities that are not required to be included within the statement of financial position. These are: operating leases, outsourcing contracts and guarantees.

In respect of outsourcing contracts, the Group has entered into various arrangements to outsource the provision of certain back-office and operational functions with third party providers. These outsourced arrangements include aspects of IT support, legal services, supply chain, metering and capital delivery. These arrangements are on commercial terms and no associated penalty or termination clauses will have a material effect on the financial position of the Group.

28. Guarantees

Thames Water Utilities Holdings Limited, Thames Water Utilities Limited and its direct subsidiaries are Obligors under the whole business securitisation entered into in 2007. The Obligors have all entered into a Security Trust and Inter-creditor Deed. Under this document each Obligor will guarantee the obligations of each other Obligor with their future cash flows. The guaranteed debt at 31 March 2017 was £10.6 billion (2016: £10.7 billion).

At 31 March 2017 the Group has secured the overdrafts and loans of certain subsidiaries up to a maximum of £20.0 million (2016: £20.0m). The Group has also guaranteed facilities for contract bonding on behalf of certain subsidiaries amounting to £0.8 million (2016: £0.8m) at 31 March 2017.

The Group has provided security by way of a debenture over its assets in relation to monies owed by the Group under its credit facility agreement with RBS as Facility Agent. This facility amounted to £425.0 million (2016: £525.0 million), the amount outstanding at 31 March 2017 was £275.0 million (2016: £340.0 million). The chargee is RBS as Facility Agent. The Company has also entered into an inter-creditor agreement guaranteeing the obligations of its subsidiary, Thames Water Kemble Finance Plc under its £1 billion debt issuance programme. The guaranteed debt outstanding at 31 March 2017 is £575.0 million (2016: £575.0 million).

Thames Water Insurance Company Limited, a wholly owned subsidiary of the Group, has letters of credit in issue totalling £0.75 million (2016: £3.9 million).

In addition there are a number of parent company guarantees in respect of subsidiary company contractual obligations that have been entered into in the normal course of business. No un-provided loss is expected to arise under these arrangements.

29. Statement of cash flows

Reconciliation of operating profit to operating cash flows

	2017			2016		
	Underlying £m	BTL £m	Total £m	Underlying £m	BTL £m	Total £m
(Loss)/profit for the financial year	(135.1)	30.8	(104.3)	470.5	-	470.5
Less finance income	(115.2)	-	(115.2)	(107.5)	-	(107.5)
Add finance expense	564.3	-	564.3	459.0	-	459.0
Add loss/(less gains) on fair value of financial instruments	372.1	-	372.1	(22.7)	-	(22.7)
Less taxation credit on (loss)/profit on ordinary activities	(102.6)	2.2	(100.4)	(85.9)	-	(85.9)
Operating profit	583.5	33.0	616.5	713.4	-	713.4
Depreciation on property, plant and equipment	513.4	-	513.4	479.4	-	479.4
Amortisation of intangible assets	25.0	-	25.0	18.6	-	18.6
Write-off of costs from assets in development	3.1	-	3.1	-	-	-
Profit on sale of property, plant and equipment	(4.1)	-	(4.1)	(48.5)	-	(48.5)
Difference between pension charge and cash contribution	(37.4)	-	(37.4)	8.8	-	8.8
Increase in inventory	(1.0)	-	(1.0)	(12.0)	-	(12.0)
Increase in trade and other receivables	(70.2)	(32.9)	(103.1)	(6.0)	-	(6.0)
Increase in trade and other payables	72.7	3.7	76.4	16.5	-	16.5
Increase/(decrease) in provisions	13.9	-	13.9	(0.6)	-	(0.6)
Cash generated from operations	1,098.9	3.8	1,102.7	1,169.6	-	1,169.6

Non-cash transactions

No additions to property, plant and equipment during the year, or the immediately preceding year, were financed through new finance leases. Assets transferred from developers and customers for nil consideration were recognised at their fair value.

Movement in cash and cash equivalents

	2017 £m	2016 £m
Unrestricted cash movement	1.8	(6.6)
Restricted cash movement	-	(7.6)
Movement in short-term deposits	(466.3)	9.8
Total	(464.5)	4.4

The restricted cash above relates to collateral posted by derivative counterparties that have failed to meet minimum credit rating criteria assigned by Moody's.

30. Ultimate parent company and controlling party

Kemble Water Holdings Limited is owned by a consortium of investors led by Macquarie European Infrastructure Fund II LP ("MEIF 2"), wholesale investment funds which make long-term investments in infrastructure and related businesses located across Europe. On 31 May 2017, MEIF 2 sold their shareholding in Kemble Water Holdings Limited (see note 32). The Directors do not consider there to be an ultimate parent or controlling party. Kemble Water Holdings Limited is the largest group to consolidate these financial statements. The address of the registered office of Kemble Water Holdings Limited is Clearwater Court, Vastern Road, Reading, Berkshire, RG1 8DB.

The Company's other shareholders are international pension funds and institutional investors.

MEIF 2 invests in businesses which:

- Provide an essential service to the community.
- Have a strong competitive position.
- Generate stable cash flows over the long term.

MEIF 2 aims to deliver sustainable cash yields and moderate capital growth from their diversified portfolios of quality infrastructure investments. MEIF 2 is managed by Macquarie Infrastructure and Real Assets (Europe) Limited ("MIRAEL"). MIRAEL is a wholly owned member of the Macquarie Group, and is authorised and regulated by the Financial Conduct Authority. MIRAEL is resourced by executives of Macquarie Infrastructure and Real Assets.

31. Related party transactions

Transactions between subsidiaries within the Group, which are related parties, have been eliminated on consolidation and are not included in this note. The following transactions took place during the year between the Group and its related parties:

	2017		2016	
	Services provided by £m	Services provided to £m	Services provided by £m	Services provided to £m
<i>External parties to the Kemble Water Holdings Group:</i>				
Alder & Allan Group Ltd	-	-	-	0.2
Arqiva Limited	-	22.5	-	15.7
Cranfield University	-	0.1	-	0.1
Museum of London Archaeology	-	0.1	-	-
Royal Mail plc	-	-	-	0.1
Water UK	-	0.6	-	0.6
Total	-	23.3	-	16.7

The related party transactions were made on terms equivalent to those that prevail in arm's length transactions.

In addition to the above the Group paid Macquarie Infrastructure and Real Assets (Europe) Limited a sum of £3.9 million for advisory fees (2016: £3.8 million). There were no Directors of the Group that were also Directors of Macquarie Infrastructure and Assets (Europe) Limited during both the year ended 31 March 2017 and the year ended 31 March 2016, however we are disclosing this payment in the interests of transparency.

Outstanding balances

The following amounts were outstanding at the balance sheet date:

	2017		2016	
	Amounts owed to £m	Amounts owed by £m	Services provided by £m	Services provided to £m
<i>External parties to the Kemble Water Finance Group:</i>				
Arqiva Limited	-	1.2	-	4.8
Water UK	-	-	-	0.2
Total	-	1.2	-	5.0

The related parties are associates of the Group's key management personnel. The amounts outstanding are unsecured and will be settled in cash. Provisions have been made for doubtful debts in respect of the amounts owed by related parties.

Key management personnel

Key management personnel comprise the members of the Board of Directors and the Executive Committee of the Group's principal trading subsidiary Thames Water Utilities Limited during the year. Information regarding transactions with post-employment benefits plans is included in note 23.

	2017 £'000	2016 £'000
Short term employee benefits	3,716	3,363
Post-employment benefits	411	475
Other long-term benefits	561	2,519
Termination benefits	2,103	321
Other	726	135
Total	7,517	6,813

Company

The Company receives dividend income and pays and receives interest to and from subsidiary undertakings in the normal course of business. Total dividend income received during the year amounted to £22.8 million (2016: £nil) and total net interest receivable during the year was £367.9 million (2016: £335.2 million).

As at 31 March 2017 net amounts owed to the Company from subsidiary undertakings were £3,927.6 million (2016: £3,678.5 million). As at 31 March 2017 and 31 March 2016, no related party receivables and payables were secured and no guarantees were issued. Balances will be settled in accordance with normal credit terms. No allowance for doubtful receivables has been made for amounts owed by subsidiary undertakings.

32. Post balance sheet events

Shareholder changes in the ultimate parent company

During the year ended 31 March 2017 Kemble Water International Holdings Limited, an entity managed by the Macquarie Group, agreed to sell its full 26.315% shareholding in Kemble Water Holdings Limited, the ultimate parent company of the Company.

The legal transfer of shares was made on 31 May 2017 from Kemble Water International Holdings Limited, a company registered in Guernsey. Of the total shareholding in Kemble Water Holdings Limited, Farmoor Holdings B.V., an entity registered in the Netherlands and managed by Borealis Infrastructure Management Inc., a Canadian investment manager of the Ontario Municipal Employees Retirement System, received 17.543%, and Wren House Infrastructure Management Limited, the investment manager of the Kuwait Investment Authority, received 8.772%.

During the year ended 31 March 2017 SAS Trustee Corporation, agreed to sell its 2.389% shareholding in Kemble Water Holdings Limited to Aquila GP Inc., a Canadian entity managed by the Aquila Sonnet Limited Partnership. The legal transfer of shares was made on 25 April 2017. Following the transfer Aquila GP Inc. holds 4.995% of the total shareholding in Kemble Water Holdings Limited.

During the year ended 31 March 2017 QIC Diversified Infrastructure Limited, a company registered in Jersey, agreed to sell 3.336% of the total shareholding in Kemble Water Holdings Limited to QS Infrastructure Pty Ltd, an entity registered in Australia and managed by the QS UK Infrastructure Trust No. 1. The legal transfer of shares was made on 28 April 2017. At the same time QIC Diversified Infrastructure Limited transferred the remainder of their holding, 5.352% to QIC Infrastructure Management Pty Limited.

There will be no direct financial effect on the financial statements of the Company.

Transfer of non-household retail customers to Castle Water

From 1 April 2017 the Water Act 2014 allows all non-household customers to choose their supplier of water and wastewater retail services. On 18 July 2016, we announced our decision to exit the non-household retail market, and transfer our non-household customers to Castle Water Limited from the date of retail non-household water market opening. The Company continues to recognise wholesale revenue from these customers. On 1 April 2017 all non-household retail customers of Thames Water were transferred to Castle Water Limited which will result in the recognition of a profit on sale of the business. The sale did not become unconditional until the date of market opening (post year-end) and therefore the profit on sale, which we expect to be between £85.0 million and £87.0 million, will be recognised during the next financial year.

New bonds issued

A total of £550.0 million in new class B sterling bonds were issued by Thames Water Utilities Cayman Finance Limited on 3 May 2017, with a £300.0 million tranche maturing in 2023 and £250.0 million maturing in 2027. The proceeds are expected to be used to fund the redemption of the existing £550.0 million class B bonds which mature in 2025 but have their first call date in July 2017.

Notes to the Company financial statements

33. Investment in subsidiaries

	2017 £m	2016 £m
Cost of shares in subsidiary undertakings	1.0	1.0
Provision for impairment	-	-
Net book value	1.0	1.0

A full listing of direct and indirect subsidiary and associated undertakings has been included in note 38 to these financial statements.

34. Intercompany loans receivable

	2017 £m	2016 £m
Intercompany loans receivable:		
Due from Kemble Water Eurobond Plc	1,990.6	1,990.6
Interest on intercompany loans receivable:		
Due from Kemble Water Eurobond Plc	2,033.0	1,687.9
Impairment of interest receivable	(96.0)	-
	1,937.0	1,687.9
Total	3,927.6	3,678.5

The loan due from Kemble Water Eurobond Plc, the Company's immediate subsidiary entity, is unsecured, repayable on demand and charges interest at 10%.

During the year the Company impaired the carrying value of the interest receivable on a loan to its direct subsidiary Kemble Water Eurobond Plc.

35. Trade and other payables

	2017 £m	2016 £m
Amounts payable in respect of group relief	206.3	132.7

All amounts owed to group undertakings are unsecured, interest free and repayable on demand.

36. Financial instruments

Details of the significant accounting policies and methods adopted (including the criteria for recognition, the basis of measurement and the basis for recognition of income and expenses) for each class of financial asset, financial liability and equity instrument are disclosed in the accounting policies. The Company does not hold any derivative financial assets or liabilities (2016: none).

Categories of financial instruments

The carrying values of the financial assets and liabilities are as follows:

	2017 £m	2016 £m
Financial assets:		
<i>Loans and receivables (including cash and cash equivalents)</i>		
Intercompany loans receivable	3,927.6	3,678.5
Total	3,927.6	3,678.5
Financial liabilities:		
<i>Other financial liabilities</i>		
Trade and other payables	(206.3)	(132.7)
Total	(206.3)	(132.7)

Fair value measurements

The fair value of financial assets and liabilities represents the price that would be received to sell an asset or paid to transfer a liability between informed and willing parties, other than in a forced or liquidation sale at the measurement date. The techniques for determining the fair value of financial instruments are classified under the hierarchy defined in IFRS 13 *Fair Value Measurement* which categorises inputs to valuation techniques into Levels 1-3 based on the degree to which the fair value is observable. Unless otherwise stated all of the Company's inputs to valuation techniques are Level 2 - the fair value is determined from inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly.

Comparison of fair value of financial instruments with their carrying amounts

The carrying amounts of the Company's intercompany loan receivables and trade payables are considered to be approximate to their fair values.

Capital risk management

Details of the Group's capital risk management strategy can be found on page 25. The capital structure of the Company is as follows:

	2017 £m	2016 £m
Net debt	-	-
Equity attributable to the owners of the Group	3,722.3	3,546.8

Financial risk management

The Group's activities expose it to a number of financial risks: market risk (including interest rate risk and exchange rate risk), credit risk, liquidity risk and inflation risk. Details of the nature of each of these risks along with the steps the Group has taken to manage them is described on page 25. The Company's activities expose it to credit and liquidity risk.

(a) Credit risk

The Company's maximum exposure to credit risk is the carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, therefore the maximum exposure to credit risk at the year-end date was £3,927.6 million (2016: £3,678.5 million).

36. Financial instruments (continued)

(b) Liquidity risk

Details of the nature and management of the Group's liquidity risk is provided on page 25.

The maturity profile of the Company's financial liabilities disclosed in the statement of financial position are given below.

	2017 £m	2016 £m
Within one year	206.3	132.7
Between one and two years	-	-
Between two and three years	-	-
Between three and four years	-	-
Between four and five years	-	-
After more than five years	-	-
Total	206.3	132.7

37. Statement of cash flows

Reconciliation of operating profit to operating cash flows

	2017 £m	2016 £m
Profit for the financial year	198.3	268.2
Less finance income	(367.9)	(335.2)
Add impairment of interest receivable from Kemble Water Eurobond Plc	96.0	-
Add taxation on profit on ordinary activities	73.6	67.0
Cash generated from operations	-	-

38. Subsidiaries, associated undertakings, and significant holdings other than subsidiary undertakings

	Principal undertaking	Country of incorporation	Class of shares held	Proportion of voting rights and shares held
Direct				
Kemble Water Eurobond Plc	Holding Company	United Kingdom	Ordinary	100%
Indirect				
Kemble Water Liberty Limited	Dormant Company	United Kingdom	Ordinary	100%
Kemble Water Structure Limited	Dormant Company	United Kingdom	Ordinary	100%
Kemble Water Investments Limited	Dormant Company	United Kingdom	Ordinary	100%
Kemble Water Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Holdings Limited	Dormant Company	United Kingdom	Ordinary	100%
Kemble Water Finance Limited	Holding Company	United Kingdom	Ordinary	100%
Thames Water Commercial Ventures Finance Limited	Holding Company	United Kingdom	Ordinary	100%
Thames Water Commercial Ventures Holdings Limited	Holding Company	United Kingdom	Ordinary	100%
Thames Water Commercial Services Limited	Commercial Water	United Kingdom	Ordinary	100%
Thames Water (Kemble) Finance Plc	Finance Company	United Kingdom	Ordinary	100%
Thames Water Insurance Company Limited	Insurance Company	Guernsey	Ordinary	100%
Thames Water Limited	Holding Company	United Kingdom	Ordinary	100%
Thames Water Utilities Limited	Water & wastewater	United Kingdom	Ordinary	100%
Kennet Properties Limited	Property Company	United Kingdom	Ordinary	100%
Thames Water Utilities Cayman Finance Limited	Finance Company	Cayman Islands	Ordinary	100%
Thames Water Utilities Finance Limited	Finance Company	United Kingdom	Ordinary	100%
Thames Water Limited	Holding Company	United Kingdom	Ordinary	100%
Thames Water Utilities Holdings Limited	Holding Company	United Kingdom	Ordinary	100%
Thames Water Utilities Cayman Finance Holdings Limited	Holding Company	Cayman Islands	Ordinary	100%
Country Wide Collections Limited	Dormant Company	United Kingdom	Ordinary	100%
Foudry properties Limited	Property Company	United Kingdom	Ordinary	50%
Shapeshare Limited	Property Company	United Kingdom	Ordinary	100%
PCI Membrane Systems Limited	Dormant Company	United Kingdom	Ordinary	100%
Portacel Limited	Holding Company	United Kingdom	Ordinary	100%
Chlorination Equipment Limited	Dormant Company	United Kingdom	Ordinary	100%
Simon N-Viro Limited	Dormant Company	United Kingdom	Ordinary	100%
Stella Meta-Filters Limited	Holding Company	United Kingdom	Ordinary	100%
Thames Water Products FWT Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Products Overseas Limited	Holding Company	United Kingdom	Ordinary	100%
PWT Projects Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water (UK) Pension Trustees Limited	Pension Trustees	United Kingdom	Ordinary	100%
Thames Water Developments Limited	Property Company	United Kingdom	Ordinary	100%
Innova Park Management Company Limited	Property Company	United Kingdom	Ordinary	100%
Thames Water Drainage Services Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Environmental Services Limited	Dormant Company	United Kingdom	Ordinary	100%
Sub-Scan Limited	Dormant Company	United Kingdom	Ordinary	100%
S Holdings Limited	Dormant Company	United Kingdom	Ordinary	100%
Subtronic Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Pipeline Solutions Limited	Dormant Company	United Kingdom	Ordinary	100%
Total Pipeline Solutions Limited	Dormant Company	United Kingdom	Ordinary	100%

38. Subsidiaries, associated undertakings, and significant holdings other than subsidiary undertakings (continued)

	Principal undertaking	Country of incorporation	Class of shares held	Proportion of voting rights and shares held
Indirect				
Thames Water Dorm 1 Limited	Dormant Company	United Kingdom	Ordinary	100%
B O P Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Healthcare Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water International Service Holdings Limited	Holding Company	United Kingdom	Ordinary	100%
Thames Water Overseas Limited	Holding Company	United Kingdom	Ordinary	100%
Thames Water Asia PTE Limited	Legacy Investment	Singapore	Ordinary	100%
Thames Water International (Thailand) Limited	Legacy Investment	Thailand	Ordinary	100%
Thames Water DO Brasil Limitada	Legacy Investment	Brazil	Ordinary	100%
Thames Water International Services Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Investments Limited	Property Company	United Kingdom	Ordinary	100%
Trans4M Limited	Legacy Investment	United Kingdom	Ordinary	25%
Thames Water Nominees Limited	Pension Trustees	United Kingdom	Ordinary	100%
Thames Water Overseas Consultancy Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Pension Trustees (MIS) Limited	Pension Trustees	United Kingdom	Ordinary	100%
Thames Water Pension Trustees Limited	Pension Trustees	United Kingdom	Ordinary	100%
Thames Water Procurement Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Products Limited	Dormant Company	United Kingdom	Ordinary	100%
Memtech (UK) Limited	Dormant Company	United Kingdom	Ordinary	100%
T M Products Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Products SH Limited	Dormant Company	United Kingdom	Ordinary	100%
Coplastix Limited	Dormant Company	United Kingdom	Ordinary	100%
Stockdale Filtration Systems Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Products UPE Limited	Dormant Company	United Kingdom	Ordinary	100%
Haymills Engineering Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Products Castings Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Products Coatings Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Products SGE Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Products UPEI Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water property Services Limited	Dormant Company	United Kingdom	Ordinary	100%
Surta Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Retail Limited	Dormant Company	United Kingdom	Ordinary	100%
The Water Quality Centre Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Puerto Rico Inc	Legacy Investment	Puerto Rico	Ordinary	100%
Thames-Dick Superaqueduct Partners Inc	Legacy Investment	Puerto Rico	Ordinary	99.9%
Thames Water Senior Executive Pension Trustees Limited	Pension Trustees	United Kingdom	Ordinary	100%
Thames Water Share Scheme Trustees Limited	Pension Trustees	United Kingdom	Ordinary	100%
Water Projects International Limited	Legacy Investment	United Kingdom	Ordinary	100%

38. Subsidiaries, associated undertakings, and significant holdings other than subsidiary undertakings (continued)

The address of the registered office of all the above companies is Clearwater Court, Vastern Road, Reading, Berkshire, RG1 8DB with the exception of:

- Thames Water Asia Pte Limited (80 Robinson Road #02-00, Singapore, 68898)
- Thames-Dick Superaqueduct Partners Inc (1018 Ashord Avenue, Suite 206, San Juan, 00907, Puerto Rico)
- Thames Water Puerto Rico Inc (FGR Corporate Services Inc, PO Box 363507, San Juan, 009363507, Puerto Rico)
- Thames Water Utilities Cayman Finance Holdings Limited and Thames Water Utilities Cayman Finance Limited (PO Box 309GT, Uglund House, South Church Street, George Town, Grand Cayman, Cayman Islands)
- Thames Water International (Thailand) Limited (999/9 The offices at Central World, 29th Floor, Unit 2973K, Rama I Road, Kwaeng Pathumwan, Khet Pathumwan, Bangkok)
- Thames Water DO Brasil Limitada (Praia De Botafogo, 501 10 Andar Parte- Torre Pao De Acucar, Botafogo, Rio De Janeiro -CEP22250-000RJ, Brazil)

Both Thames Water Utilities Cayman Finance Holdings Limited and Thames Water Utilities Cayman Finance Limited are and always have been residents in the United Kingdom for tax purposes.