

# Kemble Water Holdings Limited

Annual report and consolidated financial statements

For the year ended 31 March 2018



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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. The property business 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 2018 (“2017/18”).

## Directors and Advisors

### Directors

K Bradbury - Chairman  
S Deeley  
J Divoky  
A Hall  
G Lambert  
P Noble  
G Pestrak  
G Tucker  
Y Wang

### Registered auditor

KPMG LLP  
Chartered Accountants  
15 Canada Square  
London  
E14 5GL

### Company secretary and registered office

D J Hughes

Clearwater Court  
Vastern Road  
Reading  
Berkshire  
RG1 8DB

## Strategic report

The Directors present their strategic report of the Kemble Water Holdings Limited Group ("the Group") for the year ended 31 March 2018. This strategic report should be read in conjunction with the strategic report of Thames Water Utilities Limited, which can be found at [www.thameswater.co.uk/annualresults](http://www.thameswater.co.uk/annualresults) and provides a more detailed insight into the regulated business.

### 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, Thames Water Utilities Limited ("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:** comprises the household business segment and provides certain customer-facing activities including billing and revenue collection, including amounts relating to construction of the Thames Tideway Tunnel (TTT) that is shown separately in the financial statements.
- 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. From 1 April 2017, this business segment is also responsible for billing and cash collection of wholesale market charges to licensed non-household retailers for both water and wastewater, including amounts relating to construction of the TTT that is shown separately in the financial statements; and
- Wastewater:** responsible for all aspects of wastewater collection, treatment and safe disposal for household and non-household customers. Wastewater will be responsible for the construction of interface works for the TTT.

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.

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

#### 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

### Our risk management and governance framework

Our Board has ultimate responsibility for maintaining a sound system of risk management and internal control. This includes the determination of the nature and extent of the principal risks we are prepared to accept to achieve our strategic objectives, and for ensuring that an appropriate culture has been embedded throughout the organisation.

The Audit, Risk and Reporting Committee (the "ARRC") of the regulated business, evaluates the effectiveness of our overall risk management framework and makes recommendations for improvement.

### Our approach to risk management

Our risk management process is developed to align with the Risk Management International Standard, ISO 31000, which aids our compliance with the Financial Reporting Council's UK Corporate Governance Code guidance on risk management. Risks are identified, assessed and managed across all our operations, change programmes, support and corporate functions on a rolling basis and reported to the relevant committee regularly throughout the year.

### Principal risks and uncertainties

Our principal risks are all currently overseen by the Executive Team. As part of our improved governance arrangements across the Group the principal risks will be covered in specific board delegated committees going forward.

**Key:** ↑ Risk profile has increased                      → No change in risk profile                      ↓ Risk profile has decreased

<b>Health, safety, environment and security</b>	
<p><b>Description</b></p> <p>Failure to manage risks resulting from our operations could result in fatality or injury, significant environmental damage, personal health and safety lapses, crime and sabotage and internal security related attack.</p> <p><b>Movement in the period:</b> →</p> <p>There has been no significant change in the inherent risk profile during 2017/18.</p>	<p><b>Mitigation</b></p> <ul style="list-style-type: none"> <li>• Zero tolerance approach when safeguarding the health, safety and wellbeing of employees, partners and the public;</li> <li>• Clearly defined strategy, safety policies, protocols and standards that are set, monitored and reported;</li> <li>• Close work with partners and suppliers to ensure a safe environment; and</li> <li>• Continue to increase workforce competency through new and innovative training.</li> </ul> <p><b>Looking Forward</b></p> <ul style="list-style-type: none"> <li>• Continue to regularly review performance and inspection programme levels; and</li> <li>• Review and continuously improve business continuity and resilience programmes.</li> </ul>

<b>Customer Service</b>	
<p><b>Description</b></p> <p>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 complaints, and our performance commitments.</p> <p><b>Movement in the period:</b> →</p> <p>There has been no significant change in the inherent risk profile during 2017/18.</p>	<p><b>Mitigation</b></p> <ul style="list-style-type: none"> <li>• Incidents and events that arise are managed through Executive-led response teams with a new dedicated field based customer facing representative team;</li> <li>• Creation of a team to provide focus on customer insight and satisfaction measurement;</li> <li>• Improved customer case management capability to proactively manage and resolve follow on work; and</li> <li>• Engagement with the Customer Challenge Group ("CCG") to provide independent challenge to our business and independent assurance to Ofwat on the quality and results of our customer engagement.</li> </ul> <p><b>Looking Forward</b></p> <ul style="list-style-type: none"> <li>• Implement a new customer relationship management and billing system, as well as stabilising existing IT architecture; and</li> <li>• Engage with the CCG to deliver customer advocacy through our PR19 business plan.</li> </ul>

## Principal risks and uncertainties (continued)

Key: ↑ Risk profile has increased

→ No change in risk profile

↓ Risk profile has decreased

<b>Asset Management and Performance</b>	
<p><b>Description</b></p> <p>Maintenance, operational and weather issues affect the performance of existing aging assets and lead to potential interruptions to supply and services, environmental breaches, failure to achieve regulatory targets or health and safety threats. High levels of investment to ensure security and resilience are required for existing assets. Capital asset projects are vulnerable to becoming uneconomic and damage stakeholder relationships.</p> <p><b>Movement in the period:</b> ↑</p> <p>The inherent risk profile increased during 2017/18 following operational network issues, regulatory investigation and penalty and leakage target performance.</p>	<p><b>Mitigation</b></p> <ul style="list-style-type: none"> <li>• The Board takes a direct interest in ensuring the highest operational standards for significant assets;</li> <li>• Asset based risk assessment, forecasting, quality assurance procedures and structural integrity monitoring in place to inform investment decisions;</li> <li>• 2015-20 investment programme to maintain and improve network and asset resilience; and</li> <li>• Review business contingency plans for asset based incidents.</li> </ul> <p><b>Looking Forward</b></p> <ul style="list-style-type: none"> <li>• Continue to improve and invest in enhancing asset performance and resilience; and</li> <li>• Implement overarching coordinated approach to wholesale operations.</li> </ul>
<b>Trust and Reputation</b>	
<p><b>Description</b></p> <p>Future investor funding, regulatory requirements and stakeholder relationships are affected by our transparency of operations and reputation, including that of senior management and the Executive Team.</p> <p><b>Movement in the period:</b> ↑</p> <p>The inherent risk profile increased during 2017/18 following corporate scrutiny and a number of operational issues.</p>	<p><b>Mitigation</b></p> <ul style="list-style-type: none"> <li>• Engage with customer groups, political parties, regulators, and other stakeholders to understand views and concerns;</li> <li>• Customer service metrics and performance commitments regularly reviewed by Executive Team and the Board;</li> <li>• Work to deliver a fair, simplified and transparent offering to consumers; and</li> <li>• Protect the most vulnerable households through initiatives to improve water efficiency or with financial advice and aid.</li> </ul> <p><b>Looking Forward</b></p> <ul style="list-style-type: none"> <li>• Continue to build a robust business to move out of Ofwat's Company Monitoring Framework, Prescribed category; and</li> <li>• Align our governance framework with the revised UK Corporate Governance Code, 2018.</li> </ul>
<b>Climate and Societal</b>	
<p><b>Description</b></p> <p>Strategic execution, customer behaviour and demand can change due to external influences outside of our control, such as population growth, climate change, long-term weather patterns and new technologies.</p> <p><b>Movement in the period:</b> →</p> <p>There has been no significant change in the inherent risk profile during 2017/18.</p>	<p><b>Mitigation</b></p> <ul style="list-style-type: none"> <li>• Long-term investment in the network and assets to strengthen customer relationships, secure future water requirements, develop resilience and reduce the impact of adverse weather patterns and events, and population growth;</li> <li>• Work to manage the unavoidable impacts of climate change to the business and reduce carbon and greenhouse gas emissions;</li> <li>• Continue to find solutions that balance competing environmental, social and economic demands in a more sustainable way through the five-year business plan; and</li> <li>• Concentrate on demand reduction activity such as smart metering and water efficiency solutions to help build resilience within the network and assets.</li> </ul> <p><b>Looking Forward</b></p> <ul style="list-style-type: none"> <li>• Continue to regularly review our forecast planning and investment programme; and</li> <li>• Review the effect the UK leaving the European Union (EU) has on our people and market.</li> </ul>

## Principal risks and uncertainties (continued)

Key: ↑ Risk profile has increased

→ No change in risk profile

↓ Risk profile has decreased

<b>Business Planning, Forecasting and Execution</b>	
<p><b>Description</b></p> <p>Failure to maintain robust processes for business assumptions, business planning, accurate forecasting and reporting, price reviews, operational performance and change management adversely affect management and investment decisions, execution of strategic initiatives, benefit realisation and performance commitments.</p> <p><b>Movement in the period:</b> →</p> <p>There has been no significant change in the inherent risk profile during 2017/18.</p>	<p><b>Mitigation</b></p> <ul style="list-style-type: none"> <li>• Performance and financial management reporting process with an external audit provision and internal audit schedule;</li> <li>• Board, ARRC and Executive Team oversight and challenge;</li> <li>• Change management, investment and business planning processes in place; and</li> <li>• Our change activity is managed through a combination of project and programme boards with a dedicated Delivery Office in place and regular review at both business and Executive level.</li> </ul> <p><b>Looking Forward</b></p> <ul style="list-style-type: none"> <li>• Implement the new “One Thames Water” strategy and initiatives within the parameters of PR19 and our obligations; and</li> <li>• Continue to re-focus the business to deliver improved efficiency and customer advocacy.</li> </ul>
<b>Political, Regulatory and Economic Environment</b>	
<p><b>Description</b></p> <p>Oversight from various political and regulatory bodies in the UK that set and oversee the terms of our licences, and the conduct of our operations. We are also directly affected by the general economic outlook, including downturns and fluctuations. As a result, significant obligations or operational changes could be imposed and there may be a substantial increase in the estimated cost to fulfil our obligations and assumptions underlying our estimates may change or prove to be incorrect, affecting investment in current or new assets and markets.</p> <p><b>Movement in the period:</b> ↑</p> <p>The inherent risk profile increased during 2017/18 following heightened political and regulatory scrutiny and the advent of PR19.</p>	<p><b>Mitigation</b></p> <ul style="list-style-type: none"> <li>• Monitor for new and changing legislation with training provided to relevant individuals for key legislation;</li> <li>• Engage with regulators to find a better approach to intervention that agrees clear targets against which progress can be demonstrated;</li> <li>• Engage with political parties with the aim of moving towards water policy differences converging rather than polarising; and</li> <li>• Review effect on energy costs, water markets, investment and financial markets from the process of the UK leaving the EU.</li> </ul> <p><b>Looking Forward</b></p> <ul style="list-style-type: none"> <li>• Ofwat determine through PR19 the five-year price, service and incentive package that we will deliver between 2020 and 2025; and</li> <li>• Economic and market effects from the UK departure from the EU by the end of March 2019 and potential for a further UK General Election as a result.</li> </ul>
<b>Legal and Regulatory Compliance</b>	
<p><b>Description</b></p> <p>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. There is currently significant legislative and regulatory change and scrutiny which, along with the introduction of new or amended legislation, may require additional compliance and reporting arrangements as well as amendments to existing policies and procedures to be in place.</p> <p><b>Movement in the period:</b> →</p> <p>There has been no significant change in the inherent risk profile during 2017/18.</p>	<p><b>Mitigation</b></p> <ul style="list-style-type: none"> <li>• The Board promotes high ethical standards of behaviour and ensures the effective contribution of all Directors;</li> <li>• Honest and ethical behaviour policy, corporate responsibility approach and policy framework govern how we conduct our affairs;</li> <li>• Clear understanding of regulatory and key legal obligations and identify impending new legislation, and changes to existing legislation and licence conditions, with assurance programmes in place; and</li> <li>• Provide training programmes to employees and service delivery partners to ensure compliance with key laws such as data protection, competition, honest and ethical behaviour and cyber security.</li> </ul> <p><b>Looking Forward</b></p> <ul style="list-style-type: none"> <li>• Strengthening of our governance framework; and</li> <li>• Enhancing and embedding the internal risk, audit and assurance capability.</li> </ul>



## Principal risks and uncertainties (continued)

Key: ↑ Risk profile has increased

→ No change in risk profile

↓ Risk profile has decreased

<b>People</b>	
<p><b>Description</b></p> <p>Attraction, development, retention and succession of senior management and individuals with key skills are critical factors in the successful execution of our strategic initiatives, and business operations.</p> <p><b>Movement in the period:</b> →</p> <p>There has been no significant change in the inherent risk profile during 2017/18.</p>	<p><b>Mitigation</b></p> <ul style="list-style-type: none"> <li>• People strategy based on culture and engagement, equality and wellbeing, talent development, training, reward and recognition;</li> <li>• Regular review of organisational capability, reward strategies for key skills, talent management pipeline and learning and development programmes, which are externally benchmarked;</li> <li>• Recruitment pipelines and practices extended to attract a wider audience and promote a healthy work-life balance; and</li> <li>• Strong relationship maintained with trade unions, to ensure that issues are openly discussed and addressed, to promote an environment of trust and honesty.</li> </ul> <p><b>Looking Forward</b></p> <ul style="list-style-type: none"> <li>• Review effect of changes to organisational design on our people capability and engagement; and</li> <li>• Monitor effect of the volume of change management on employee engagement.</li> </ul>
<b>Technology Systems and Security</b>	
<p><b>Description</b></p> <p>Effective operations and protection of data relies on the availability, integrity and security of complex technology systems and networks. This includes those of our third-party service providers and alliance partners.</p> <p><b>Movement in the period:</b> →</p> <p>There has been no significant change in the inherent risk profile during 2017/18.</p>	<p><b>Mitigation</b></p> <ul style="list-style-type: none"> <li>• Collaborate across utility industry and public and private sectors to manage security threats to national infrastructure;</li> <li>• Information security strategy integrating data, physical and personnel security through the Security Board;</li> <li>• Solutions in place to detect and investigate security threats and incidents to ensure potentially vulnerable systems are identified and vulnerability gaps closed; and</li> <li>• Review adequacy and effectiveness of infrastructure and technology security controls, undertake employee security awareness training, and test contingency and recovery processes.</li> </ul> <p><b>Looking Forward</b></p> <ul style="list-style-type: none"> <li>• Develop and implement an improved technology function for our business; and</li> <li>• Review and continuously improve business continuity and resilience programmes.</li> </ul>
<b>Supply Chain Management</b>	
<p><b>Description</b></p> <p>Operations rely on the resilience, availability and cost-effective quality of the supply chain for outsourced capability, goods, services and third party infrastructure.</p> <p><b>Movement in the period:</b> →</p> <p>There has been no significant change in the inherent risk profile during 2017/18.</p>	<p><b>Mitigation</b></p> <ul style="list-style-type: none"> <li>• Executive-led Contracts Committee in place to review and approve contracts of significant value;</li> <li>• Policy requirement for compliance with OJEU and third party due diligence checks carried out prior to contract award;</li> <li>• Standard contract language and templates embedded to drive consistency; and</li> <li>• Contract management in place with responsibility for completing assurance checks on contract compliance.</li> </ul> <p><b>Looking Forward</b></p> <ul style="list-style-type: none"> <li>• Consider the most effective delivery route for our PR19 business plan objectives; and</li> <li>• Drive financial efficiency and effectiveness through our business wide improvement projects.</li> </ul>

## Principal risks and uncertainties (continued)

Key: ↑ Risk profile has increased

→ No change in risk profile

↓ Risk profile has decreased

Credit and Liquidity	
Description	Mitigation
<p>Sufficient liquidity is required to meet our significant funding requirement in the Asset Management Period ("AMP") and fund our investment programme. Inaccurate forecasting, exposure to adverse conditions in debt or capital markets, counterparty payment obligation default or adverse actuarial pension scheme valuation may hinder or prevent business activity.</p> <p><b>Movement in the period:</b> →</p> <p>There has been no significant change in the inherent risk profile during 2017/18.</p>	<ul style="list-style-type: none"> <li>Cash forecasts on liquidity requirements and assessed for different scenarios;</li> <li>Planning, committed facilities and investment processes in place;</li> <li>Long-term refinancing with staggered maturity dates to minimise the effect of short-term downturns; and</li> <li>Hedging strategies employed to stabilise market fluctuations.</li> </ul> <p><b>Looking Forward</b></p> <ul style="list-style-type: none"> <li>Continue to focus on improving operational performance and delivering further improvements within our business plan; and</li> <li>Monitor volatility in financial markets as the future trading and political relationship between the UK and the EU is redefined.</li> </ul>

## Financial review

Key financial performance indicators	2018			2017		
	Underlying	BTL	Total	Underlying	BTL	Total
	£m	£m	£m	£m	£m	£m
Revenue (£m)	2,018.3	26.9	2,045.2	2,031.6	33.0	2,064.6
Operating expenses (£m)	(1,621.3)	(0.4)	(1,621.7)	(1,543.1)	-	(1,543.1)
Operating profit (£m)	501.2	26.5	527.7	583.5	33.0	616.5
Net finance expense (£m)	(507.3)	-	(507.3)	(449.1)	-	(449.1)
Net gains/(losses) on financial instruments (£m)	41.0	-	41.0	(372.1)	-	(372.1)
Profit/(loss) before tax (£m)	124.6	26.5	151.1	(237.7)	33.0	(204.7)
Profit/(loss) after tax (£m)	94.5	24.9	119.4	(135.1)	30.8	(104.3)
Capital expenditure (£m)	1,148.8	-	1,148.8	1,219.8	-	1,219.8
Dividends paid	-	-	-	(22.8)	-	(22.8)
Statutory net debt (£m)	(12,345.7)	-	(12,345.7)	(11,840.1)	-	(11,840.1)
Interest cover (PMICR) *	1.3	n/a	n/a	1.4	n/a	n/a
Gearing (%) *	87.4	n/a	n/a	88.0	n/a	n/a
Credit rating **	n/a	n/a	Baa1 negative	n/a	n/a	Baa1 stable

\* As defined on page 37.

\*\* Representing the consolidated Corporate Family Rating assigned by Moody's for the Thames Water Utilities Limited securitisation group. Separately Moody's rated Kemble Water Finance Limited ("KWF") guaranteed debt as B1 (negative) and Fitch as BB- (rating watch negative). KWF is a wholly owned subsidiary.

### Overall performance

Total profit before tax for the year was £151.1 million (2017: loss of £204.7 million). This includes recognition of profit on the sale of the non-household business to Castle Water Limited of £89.7 million, which completed on 1 April 2017 – the date of the non-household retail market opening, and favourable movements on our financial instrument portfolio.

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

	2018
	£m
Loss before tax for the year ended 31 March 2017	(204.7)
Decrease in underlying revenue	(13.3)
Decrease in BTL revenue	(6.1)
Increase in operating expenses	(78.6)
Profit on the sale of retail non-household business	89.7
Increase in profit on sale of property, plant and equipment	7.3
Increase in other operating income	1.9
Increase in net finance expense	(58.2)
Movement in gains/(losses) on financial instruments	413.1
<b>Profit before tax for the year ended 31 March 2018</b>	<b>151.1</b>

## Revenue

As a regulated business, the amount we bill our customers was agreed by Ofwat through the price review process before the start of the current five year regulatory period. As such our underlying revenue does not significantly fluctuate year-on-year. Overall, underlying revenue for the year has decreased slightly compared to the previous year by 0.7% to £2,018.3 million.

Our bills include amounts relating to the construction of the Thames Tideway Tunnel (“TTT”) and therefore movements in our total revenue are affected by movements in these billings. As we collect the cash this is passed onto Bazalgette Tunnel Limited (“BTL”) and is excluded from our underlying results. Revenue related to BTL has decreased by 18.5% to £26.9 million. The reduction is due to the phasing of construction works.

## Capital expenditure

During the year, we invested a total of £1,148.8 million (2017: £1,219.8 million) in our assets, including £446.0 million on the water network, £395.1 million on the wastewater network, £81.7 million on our sludge assets and £38.7 million on the TTT. This spend includes the following key projects:

- Water network: Metering (£52.1 million), Infrastructure Alliance boundary capital works (£50.3 million);
- Wastewater network: Deephams sewage treatment works upgrade (£64.9 million), network capital works (£36.5 million);
- Sludge: Crossness sludge (£19.7 million); and
- TTT: TTT interface works (£38.7 million).

Our capital expenditure also includes amounts invested in our intangible assets including £32.5 million on the implementation of our new customer relationship management and billing (“CRMB”) system and £6.5 million on a new meter data management system.

Our capital expenditure has decreased by £71.0 million (5.8%) to £1,148.8 million (2017: £1,219.8 million) due to the phasing of our capital projects.

## Financing our investment

As we continue to invest heavily in the business, our statutory net debt (as defined on page 37) has increased by £505.6 million to £12,345.7 million (2017: £11,840.1 million). This has been accompanied by an increase in the Regulatory Capital Value (“RCV”) of £760.4 million to £13,704.8 million (2017: £12,944.4 million). Our covenant gearing has reduced by 0.6% to 87.4% (2017: 88.0%). Additionally, our PMICR in the current year is 1.3x (2017: 1.4x) and is above the mandated minimum of 1.05x.

We continue to borrow through external public and private debt capital markets and through financial institutions across a diverse range of currencies, geographies and sources. The last year has seen us focus on increasing diversity with the issue of a £705.1 million US Private Placement in March 2018, our green debt bond and our CAD 250 million (£143.6 million) inaugural Maple bond in the Canadian market.

The associated net finance expense has increased by £58.2 million to £507.3 million (2017: £449.1 million), which has been driven primarily by higher RPI accretion on borrowings, in addition to the increased borrowing levels. Some of our interest expense is incurred in relation to borrowings raised to deliver major capital projects. Under the IFRS accounting framework we capitalise the interest costs related to major capital projects with the finance expense in the income statement being shown net of these capitalised costs. Capitalised interest costs were £100.7 million this year (2017: £76.3 million). The increase in the capitalised borrowing costs is partly due to a higher effective rate, 5.58% (2017: 4.86%) as a result of higher RPI accretion.

## Bad debt

Bad debt arises predominantly from those who choose not to pay their bill, despite being financially able to, as opposed to those who cannot pay. This year we had an overall increase in bad debt cost of £7.1 million to £57.5 million (2017: £50.4 million). This is split between bad debt relating to current year bills of £28.7 million, which is shown as a deduction in revenue, and bad debt relating to bills from prior years of £28.8 million, which is shown within operating expenses. The overall increase in bad debt is due to a number of factors including:

- An increase in write offs for our waste only customers who are billed by other water companies, over which we have no control of collections
- Lower cash collection rates on our customer bills that have been cancelled and then rebilled. Where there has been a change of occupier and a bill is cancelled and split between incoming and outgoing occupier, the portion of debt associated with the outgoing occupier is more difficult to collect

## Operating expenses

Our underlying operating expenses have increased by £78.2 million (5.1%) to £1,621.3 million from 2016/17, driven mainly by:

- A £20.6 million increase in our business rates costs;
- A £19.1 million increase in our personnel costs, as we have increased employee numbers, particularly in the Customer Experience and Digital teams, to focus on improving customer satisfaction;
- A £24.5 million increase in the element of bad debt relating to operating expenses; and
- A £9.2 million increase in depreciation and amortisation, in line with our ongoing investment programme.

## Financial instruments

Our borrowings, revenue and total expenditure ("totex") (as defined on page 37) are exposed to fluctuations in external market variables such as changes in interest rates, inflation and foreign exchange rates. We manage these exposures by entering into derivative contracts in order to hedge against future changes in these external rates.

We have approximately £6.8 billion of derivative financial instruments (face value), which include £0.6 billion of forward starting interest rate swaps that have fixed a significant element of the cost of debt we expect to borrow before 31 March 2020. A total gain on financial instruments of £41.0 million was recognised in the income statement during the year (2017: loss of £372.1 million). This is primarily driven by a £84.3 million loss on cash flow hedge transferred from reserves, partially offset by £52.7 million fair value gains on swaps and £72.6 million net foreign exchange gain on foreign currency loans. The fair value gain on swaps includes a £64.0 million credit resulting from an improvement in the methodology that we use in our fair value calculations. Note 7 to the financial statements provides detail of the amounts charged to the income statement in relation to financial instruments.

## Credit rating

In May 2018, Moody's affirmed our Baa1 Corporate Family Rating ("CFR") for our securitisation group but placed us on negative outlook (2017: stable outlook).

This continues to be a strong investment grade credit rating supporting our ratings of A3 and Baa3 for our Class A and Class B debt respectively. The change to negative outlook was primarily driven by a change in assessment of the stability and predictability of the UK water regulatory regime rather than a reflection of our operational performance. In September 2017, S&P assigned our securitisation group companies a credit rating of BBB+ and BBB- (2017: A- and BBB) in respect of our Class A debt and our Class B debt respectively and placed us on stable outlook (2017: negative outlook). These ratings allow us to issue efficiently priced debt to fund our investment programmes, whilst keeping bills affordable for our customers.

Separately, Moody's rated KWF guaranteed debt at B1 (negative) and Fitch at BB- (rating watch negative).

## Dividends

No dividends or interest on shareholder debt was paid to external shareholders in 2017/18 after our Board decided to reinvest profits back into the business to improve our service to customers.

## Pensions

We operate four pension schemes for our employees – three defined benefit schemes and one defined contribution scheme. During 2017/18, we contributed £8.1 million (2017: £6.8 million) to the defined contribution scheme.

The most recent funding valuation of the defined benefit pension schemes as at 31 March 2016 resulted in a combined funding deficit for two of the schemes of £364.9 million. A recovery plan was agreed with the schemes' Trustees in June 2017 at which point, taking into account post valuation experience, the funding deficit was £351.3 million. Under this recovery plan the deficit would be fully repaid by 2027. In the current year the associated pension deficit repair payment was £22.0 million (2017: £20.8 million).

For the purposes of our financial statements, the latest funding valuation has been updated to 31 March 2018 on our behalf by independent consulting actuaries, Hymans Robertson LLP. This accounting valuation is different from the funding valuation due to the use of different assumptions and changes in market conditions from 31 March 2016 to 31 March 2018. The accounting valuation shows that overall there is a combined net deficit of £293.7 million across the three schemes (2017: £373.5 million). This decrease is mainly driven by a fall in RPI due to expectations of future inflation decreasing over the year, and an update to the mortality assumptions, which has resulted in a reduction in the expected future life expectancy of scheme members.

## Capital, financial and actuarial risk management policies and objectives

The Group's operations expose it to a variety of capital, financial and actuarial risks.

### *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 19. 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 Group 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.

## Capital, financial and actuarial risk management policies and objectives (continued)

### *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 19.

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.

#### (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 15.

#### (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 18 and 19, respectively.

### *Actuarial risks*

The defined benefit pension schemes are exposed to actuarial risks including investment risk, inflation risk and longevity risk. For further details of these risks, please refer to note 24.

The trustees continue to control the level of investment risk within the schemes by reducing the schemes' exposures to higher risk assets and increasing the level of protection against adverse movements in interest rates and inflation. The trustees also review the risk exposures taking into consideration the longer term objectives of the respective schemes.

## Viability statement

The Directors have assessed the longer-term viability of the Group over a ten year period to 31 March 2028. Due to the prolonged look-forward period, the level of certainty of the assumptions used reduces the further into the future we look. The high degree of confidence for the remainder of the current price control period to 31 March 2020 is followed by moderate confidence in the next five year price control period to 31 March 2025 based on our business plan for this period, and a lower level of confidence for the first three years of the following five year regulatory period. In spite of the reduced confidence levels in the later years of the look forward period, the Directors consider the ten year period to be appropriate given the long term nature of the business, and the necessity to adopt a sustainable approach.

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 its ability to maintain a strong investment grade credit rating, whilst having regard to the principal risks and uncertainties as described on pages 5 to 9.

The performance of the Group is mainly dependent on the appointed activities of TWUL which is responsible for the supply of water and wastewater services to customers in London, the Thames Valley and surrounding area. As such, this assessment takes into account the long-term viability of TWUL where the Directors of TWUL have a reasonable expectation that TWUL will be able to operate within its financial covenants and maintain sufficient liquidity facilities to meet its funding needs over the same ten year assessment period.

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 severe but plausible downside 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 and capital expenditure, which would increase costs and reduce cash flows;
- Operational underperformance leading to regulatory and legal penalties / fines; and
- Inability to secure new finance and/or delays in raising finance, reducing the cash available to deliver our investment programme.

The assessment showed, in the absence of any mitigating actions, that there are severe but plausible downsides which indicated the need to undertake mitigating actions to avoid non-compliance of financial covenants. It should be recognised that such pressure on the Group's viability is based on hypothetical sensitivities where the probability of these scenarios occurring is uncertain. The analysis showed pressures crystallising at a point in time well into the assessment period, thereby providing sufficient time to implement any mitigating actions if so required. As part of its risk management, the Directors regularly monitor compliance of financial covenants so as to ensure any issues are appropriately addressed to avoid or reduce the impact of occurrence of the underlying risk.

The Directors believe there are a number of options available, these include but are not limited to the following:

- Modifying or temporarily waiving existing financial covenants and debt amortisations;
- Improving liquidity by increasing the size of its existing £65 million bank facility. This would extend the period over which the Company is able to meet the interest payments of its external debt in the event that there are no distributions from TWUL or when the Company exceeds certain financial covenants. Currently the facility is expected to cover more than 12 months of interest payments; and
- Raising additional capital in the form of deeply subordinated instruments and / or equity from shareholders.

The viability of the Group is heavily influenced by the Company's ability to service external (non-shareholder) debt. Noticeably, these costs have been met by distributions from TWUL. In circumstances where distributions were not made available by TWUL, the Company, as mentioned above, has access to a £65 million bank facility which is sufficient to cover more than 12 months of interest payments. In the event where the absence period of such distributions exceeded that provided by the bank facility, the Company would be reliant on additional support from its shareholders to meet its obligations. The Directors of the Company have discussed this matter with the shareholders, whom they represent, and are confident that support would be available if required.

Taking account of the range of scenarios, the Directors consider that the Group has sufficient mitigating actions available to address particular circumstances and events, should they arise. 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 period of assessment.

Approved by the Board of Directors on 28 June 2018 and signed on its behalf by



Kenton Bradbury

**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 Holdings Limited (the "Company") and the audited consolidated financial statements of its group ("the Group") for the year ended 31 March 2018. 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 pages 5 to 9.

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 2018 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 2018 and to the date of this report were:

K Bradbury - Chairman	(appointed 31 May 2017)
Sir P Mason KBE - Chairman	(resigned 25 January 2018)
R Blomfield-Smith	(resigned 15 November 2017)
M Braithwaite	(resigned 31 May 2017)
S Deeley	(appointed 15 November 2017)
J Divoky	
R Greenleaf	(resigned 31 May 2017)
A Hall	(appointed 31 May 2017)
G Lambert	
P Noble	
A Osorio	(resigned 19 December 2017)
G Pestrak	(appointed 3 October 2017)
P Sochocki	(appointed 31 May 2017, resigned 3 October 2017)
G Tucker	
C Van Heijningen	(resigned 2 August 2017)
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 (2017: 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	
A Hall	M Bloch-Hansen	(appointed 20 March 2018)
J Divoky	L Webb	(resigned 23 January 2018)
	C Pham	(appointed 23 January 2018)
P Noble	E Lewis	
G Tucker	P Mulholland	
Y Wang	F Sheng	

### Share capital

As at 28 June 2018, 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 did not pay or declare any dividends in the current financial year (2017: £22.8 million).

## 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 TWUL and their operations are conducted entirely within the UK. These companies are (and have always been) resident in the UK for tax purposes. We are at an advanced stage of closing both of these companies.

## 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 TWUL, who also manage the 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 £0.4 million were made by the Group during the year (2017: £0.5 million).

## Intellectual property

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

## 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, delivering innovative technical solutions aligned with business needs to address challenges for AMP6 and beyond and also provide specialist technical support to the business.

The development and application of new techniques and technology is an important part of the Group's activities. The Group is a member of UK Water Industry Research ("UKWIR"), and participates and benefits from its research programme. The UKWIR research programme relating to Thames Water is currently divided into the following topics: drinking water quality and health; toxicology; water resources; climate change; water mains and services; leakage, customers, and regulatory issues. In addition, the Group carried out more specific research in the fields of large meters, metaldehyde removal, water quality monitoring and pipeline materials during the year.

Expenditure on research and development totalled £3.5 million for the year (2017: £4.0 million).



## Employee Involvement

We undertake significant levels of communication with our people, through regular business review conferences, team briefs and varied written communications. During the year the Executive Team launched a series of group-wide discussions sharing our Strategy, Vision and Values which built towards the announcements on our new strategic plan and organisational structure in early April 2018.

Thames Water recognises three trade unions, UNISON, GMB and Unite, working with them through an agreed Partnership approach. We regularly meet trade unions, and where appropriate non-union representatives, at senior and working levels, to discuss issues affecting employees. Significant work has been undertaken during the year in relation to developing proposals to make our pension schemes sustainable. This included town hall events and workshops with some 2,000 affected employees, as well as formal consultation meetings with trade union and scheme representatives. In addition specific groups consider issues relating to Health, Safety and Wellbeing, as well as undertaking reviews of Group policies. The Partnership trade unions, which in 2017/18 delivered a two year pay deal to June 2019, negotiate pay and conditions for non-managerial grades.

All Managers and Senior Leaders in the Group are incentivised to deliver performance against the same key objectives including measures designed to deliver critical customer, environmental, asset health, and financial performance outcomes as well as the delivery of strategic and personal objectives. During the year the Group also launched a plan for all non-managerial employees which will make a payment in 2020 for delivery of the same critical performance outcomes over the performance period April 2017 to March 2020.

Thames Water 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 customer, operational and financial performance which is communicated to every team. This session includes key messages from the CEO and other Executive Team members, typically in video format.

## Equal Opportunities

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 efficient 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.

Everyone has a part to play to ensure people feel comfortable to bring their whole self to work.

The attitude and behaviour of all our colleagues 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 including; age, disability, gender identity, marriage or civil partnership, pregnancy or maternity, race, religion and belief, sex or sexual orientation.

## Employees with disability

Thames Water are proud to be a Disability Confident accredited employer.

We were delighted to be invited to speak at a recent local government 'Stronger Together, Access to Work' careers event about our Give Someone a Start ("GSAS") scheme which offers those not in employment, education or training and those with mental and physical disabilities who may need extra support in finding a role, three weeks experience of working life at Thames Water. We have been supporting this programme for the past six years.

We are fully committed to ensuring that existing or potential future employees with disabilities are not treated less favourably than any other such person without a disability and that they are fully integrated into the work environment. This includes supporting individuals with their personal requirements and we currently have a programme of work to ensure our key buildings have disability friendly facilities.

As well as focussing on attracting, supporting and retaining people with disabilities we also raised awareness of physical disabilities via our own version of 'dining in the dark' at some of our key sites which generated money for Guide Dogs for the Blind as part of our celebration of International Day of Disabled Persons.

## Greenhouse gas emissions

We have continued to make strong progress throughout 2017/18 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 source Renewable Energy Guarantees of Origin ("REGO") accredited sourcing renewable electricity through a contract with Haven Power. As a result we have achieved our 2017/18 emissions targets.

In the last year we have reduced our emissions by 229.5 kTCO<sub>2</sub>e to 277.9 kTCO<sub>2</sub>e (2017: 245.9 kTCO<sub>2</sub>e to 507.4 kTCO<sub>2</sub>e). 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 ("CO<sub>2</sub>e").

## 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.

## 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. Profit on the sale of £89.7 million was recognised in the current financial year.

## Funding

On 3 May 2017, £550.0 million new class B sterling bonds were issued by Thames Water Utilities Cayman Finance Limited ("TWUCF") with a £300.0 million 2.38% tranche maturing in 2023 and £250.0 million 2.88% tranche maturing in 2027. The proceeds were used to fund the redemption of the £550.0 million class B bonds due to mature in 2025 but with a first call date in July 2017.

On 12 December 2017, TWUCF issued Canadian Dollar 250.0 million Class A bonds and swapped to £143.6 million at a weighted average interest rate of 2.30%. The bonds have a seven year maturity. The cash raised was used for general corporate purposes, as well as for repaying and servicing the financial indebtedness of TWUL.

On 22 March 2018, TWUL raised a total of £705.1 million Class A debt at a weighted average interest rate of 2.43% via the United States Private Placement market. The issue consisted of five tranches, 5-year (\$55.0 million swapped to £38.7 million), 7-year (\$285.0 million swapped to £200.4 million), 10-year (£216.0 million), 12-year (£210.0 million) and 15-year (£40.0 million). The transaction was the first to be issued under our Green Bond Framework, with proceeds used to refinance existing major investment projects that have a positive environmental impact such as our ongoing trunk mains replacement and metering work.

During the year, a total of £849.0 million was drawn down and repaid from the TWUCF, £950m revolving credit facility in various tranches. The amounts were used for general corporate purpose and to pre-finance long term debt issued in March 2018.

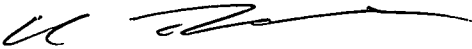
## **Disclosure of information to the auditor**

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**

KPMG LLP is the Company's auditor at the date of this report. PricewaterhouseCoopers LLP ("PwC") will replace KPMG LLP following the approval of these accounts at which time KPMG LLP will resign. PwC will be appointed by the Directors as auditors for the financial year ending 31 March 2019 onwards, and their appointment is subject to shareholder approval at the next Annual General Meeting.

Approved by the Board of Directors on 28 June 2018 and signed on its behalf by



**Kenton Bradbury**

**Chairman**  
Clearwater Court  
Vastern Road  
Reading  
Berkshire  
RG1 8DB

## Statement of Directors' responsibilities in respect of the strategic report, the Directors' report and the financial statements

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law 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 Company and of the profit or loss of the Company 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 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 taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

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

## Opinion

We have audited the financial statements of Kemble Water Holdings Limited ("the Company") for the year ended 31 March 2018 which comprise the consolidated income statement, consolidated statement of other comprehensive income, consolidated and company statement of financial position, statement of changes in equity and statement of cash flows and related notes, including the accounting policies.

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2018 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (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
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

## Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the group in accordance with, UK ethical requirements including the FRC Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

## Going concern

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least twelve months from the date of approval of the financial statements. We have nothing to report in these respects.

## Strategic report and directors' report

The directors are responsible for the strategic report and the directors' report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the strategic report and the directors' report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; 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

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

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

We have nothing to report in these respects.

## Directors' responsibilities

As explained more fully in their statement set out on page 19, the directors are responsible for: the preparation of the financial statements and for being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the group and parent company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

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# Independent auditor's report to the members of Kemble Water Holdings Limited (continued)

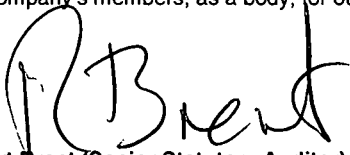
## Auditor's responsibilities

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

A fuller description of our responsibilities is provided on the FRC's website at [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities).

## The purpose of our audit work and to whom we owe our responsibilities

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.



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

28 June 2018

## Consolidated income statement

For the year ended 31 March

	Note	Underlying £m	2018 BTL £m	Total £m	Underlying £m	2017 BTL £m	Total £m
Revenue	1	2,018.3	26.9	2,045.2	2,031.6	33.0	2,064.6
Operating expenses	2	(1,621.3)	(0.4)	(1,621.7)	(1,543.1)	-	(1,543.1)
Profit on the sale of property, plant and equipment		11.4	-	11.4	4.1	-	4.1
Other operating income	4	92.8	-	92.8	90.9	-	90.9
<b>Operating profit</b>		<b>501.2</b>	<b>26.5</b>	<b>527.7</b>	<b>583.5</b>	<b>33.0</b>	<b>616.5</b>
Profit on the sale of retail non-household business	5	89.7	-	89.7	-	-	-
Finance income	6	116.0	-	116.0	115.2	-	115.2
Finance expense	7	(623.3)	-	(623.3)	(564.3)	-	(564.3)
Net gains/(losses) on financial instruments	8	41.0	-	41.0	(372.1)	-	(372.1)
<b>Profit/(loss) on ordinary activities before taxation</b>		<b>124.6</b>	<b>26.5</b>	<b>151.1</b>	<b>(237.7)</b>	<b>33.0</b>	<b>(204.7)</b>
Taxation on (profit)/loss on ordinary activities	9	(30.1)	(1.6)	(31.7)	102.6	(2.2)	100.4
<b>Profit/(loss) for the year</b>		<b>94.5</b>	<b>24.9</b>	<b>119.4</b>	<b>(135.1)</b>	<b>30.8</b>	<b>(104.3)</b>

## Consolidated statement of other comprehensive income

For the year ended 31 March

	Note	Underlying £m	2018 BTL £m	Total £m	Underlying £m	2017 BTL £m	Total £m
<b>Profit/(loss) for the year</b>		<b>94.5</b>	<b>24.9</b>	<b>119.4</b>	<b>(135.1)</b>	<b>30.8</b>	<b>(104.3)</b>
<b>Other comprehensive income</b>							
<i>Will not be reclassified to the income statement:</i>							
Net actuarial gains/(losses) on pension schemes	24	74.2	-	74.2	(151.5)	-	(151.5)
Deferred tax (charge)/credit on net actuarial gain/loss	20	(12.6)	-	(12.6)	21.6	-	21.6
<i>May be reclassified to the income statement:</i>							
Gains/(losses) on cash flow hedges		16.3	-	16.3	(50.7)	-	(50.7)
Cash flow hedges transferred to income statement	8	84.3	-	84.3	2.1	-	2.1
Deferred tax (charge)/credit on cash flow hedges	20	(17.1)	-	(17.1)	6.0	-	6.0
<b>Other comprehensive income/(loss) for the year</b>		<b>145.1</b>	<b>-</b>	<b>145.1</b>	<b>(172.5)</b>	<b>-</b>	<b>(172.5)</b>
<b>Total comprehensive income/(loss) for the year</b>		<b>239.6</b>	<b>24.9</b>	<b>264.5</b>	<b>(307.6)</b>	<b>30.8</b>	<b>(276.8)</b>

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

Bazalgette Tunnel Limited ("BTL") is an independent company un-related to the Group, and was appointed in 2015 to construct the Thames Tideway Tunnel. 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 current and preceding financial year. 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 an associated cost representing non-current bad debt on amounts billed, this also gives rise to reporting profit which is taxable. This non-appointed revenue is excluded from our key performance indicators, which is consistent with our banking covenants. The revenue, cost and resulting profit on this arrangement have 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 Group as BTL will transfer the use of the tunnel to the Group once construction is complete under a finance lease arrangement.

The accounting policies and notes on pages 29 to 77 are an integral part of these financial statements.

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 2018 the Company generated a loss after taxation of £3.1 million (2017: profit of £198.3 million).



## Consolidated statement of financial position

As at 31 March

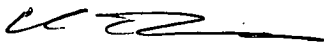
	Note	Underlying £m	2018 BTL £m	Total £m	Underlying £m	2017 BTL £m	Total £m
<b>Non-current assets</b>							
Goodwill	10	1,468.1	-	1,468.1	1,468.1	-	1,468.1
Interest in associates	11	-	-	-	-	-	-
Intangible assets	12	169.0	-	169.0	141.0	-	141.0
Property, plant and equipment	13	15,185.6	-	15,185.6	14,627.0	-	14,627.0
Trade and other receivables	15	3.0	56.7	59.7	2.8	30.4	33.2
Retirement benefit surplus	24	7.1	-	7.1	6.3	-	6.3
Derivative financial assets	19	76.4	-	76.4	170.6	-	170.6
		<b>16,909.2</b>	<b>56.7</b>	<b>16,965.9</b>	<b>16,415.8</b>	<b>30.4</b>	<b>16,446.2</b>
<b>Current assets</b>							
Inventories and current intangible assets	14	18.1	-	18.1	21.7	-	21.7
Assets held for sale		-	-	-	1.0	-	1.0
Trade and other receivables	15	624.8	3.8	628.6	644.0	0.8	644.8
Short term investments	19	-	-	-	1.0	-	1.0
Derivative financial assets	19	8.5	-	8.5	-	-	-
Cash and cash equivalents	16	159.8	2.6	162.4	99.0	3.8	102.8
		<b>811.2</b>	<b>6.4</b>	<b>817.6</b>	<b>766.7</b>	<b>4.6</b>	<b>771.3</b>
<b>Current liabilities</b>							
Trade and other payables	17	(809.2)	(7.6)	(816.8)	(913.3)	(4.4)	(917.7)
Borrowings	18	(356.1)	-	(356.1)	(381.5)	-	(381.5)
Derivative financial liabilities	19	(12.3)	-	(12.3)	(23.8)	-	(23.8)
		<b>(1,177.6)</b>	<b>(7.6)</b>	<b>(1,185.2)</b>	<b>(1,318.6)</b>	<b>(4.4)</b>	<b>(1,323.0)</b>
<b>Net current (liabilities)/assets</b>		<b>(366.4)</b>	<b>(1.2)</b>	<b>(367.6)</b>	<b>(551.9)</b>	<b>0.2</b>	<b>(551.7)</b>
<b>Non-current liabilities</b>							
Trade and other payables	17	(445.8)	-	(445.8)	(404.9)	-	(404.9)
Borrowings	18	(12,152.0)	-	(12,152.0)	(11,562.4)	-	(11,562.4)
Derivative financial liabilities	19	(1,225.9)	-	(1,225.9)	(1,398.0)	-	(1,398.0)
Deferred tax	20	(898.0)	-	(898.0)	(836.6)	-	(836.6)
Provisions for liabilities and charges	21	(112.4)	-	(112.4)	(113.9)	-	(113.9)
Retirement benefit obligations	24	(300.8)	-	(300.8)	(379.8)	-	(379.8)
		<b>(15,134.9)</b>	<b>-</b>	<b>(15,134.9)</b>	<b>(14,695.6)</b>	<b>-</b>	<b>(14,695.6)</b>
<b>Net assets</b>		<b>1,407.9</b>	<b>55.5</b>	<b>1,463.4</b>	<b>1,168.3</b>	<b>30.6</b>	<b>1,198.9</b>
<b>Equity</b>							
Called up share capital	22	1,991.6	-	1,991.6	1,991.6	-	1,991.6
Cash flow hedge reserve	22	(139.0)	-	(139.0)	(222.5)	-	(222.5)
Retained earnings	22	(444.7)	55.5	(389.2)	(600.8)	30.6	(570.2)
<b>Total equity</b>		<b>1,407.9</b>	<b>55.5</b>	<b>1,463.4</b>	<b>1,168.3</b>	<b>30.6</b>	<b>1,198.9</b>

Bazalgette Tunnel Limited ("BTL") is an independent company un-related to the Group, and was appointed in 2015 to construct the Thames Tideway Tunnel. We have recognised revenue, cost and profit on the arrangement with BTL and so we have disclosed our underlying performance separately.

BTL is responsible for the construction of the Thames Tideway Tunnel. In the current and preceding financial year, 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, cost and resulting profit on this arrangement, which are excluded from our key performance indicators in line with our banking covenants, has been disclosed separately to the Group's underlying performance in the income statement. 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 29 to 77 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 28 June 2018 and signed on its behalf by:



K Bradbury  
Chairman

## Company statement of financial position

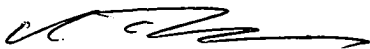
As at 31 March

	Note	2018 £m	2017 £m
<b>Non-current assets</b>			
Investment in subsidiaries	34	1.0	1.0
Intercompany loans receivable	35	3,868.0	-
		<b>3,869.0</b>	<b>1.0</b>
<b>Current assets</b>			
Intercompany loans receivable	35	-	3,927.6
<b>Current liabilities</b>			
Trade and other payables	36	(282.8)	(206.3)
<b>Net current (liabilities)/assets</b>		<b>(282.8)</b>	<b>3,721.3</b>
<b>Net assets</b>		<b>3,586.2</b>	<b>3,722.3</b>
<b>Equity</b>			
Called-up share capital	22	1,991.6	1,991.6
Retained earnings		1,594.6	1,730.7
<b>Total equity</b>		<b>3,586.2</b>	<b>3,722.3</b>

The accounting policies and notes on pages 29 to 77 are an integral part of these financial statements.

The financial statements were approved by the Board of Directors on 28 June 2018 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 28 June 2018 and signed on its behalf by:



K Bradbury  
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
<b>At 1 April 2016</b>	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 credit on cash flow hedge	-	6.0	-	6.0
Actuarial loss on pension schemes	-	-	(151.5)	(151.5)
Deferred tax credit on actuarial loss	-	-	21.6	21.6
Dividends paid	-	-	(22.8)	(22.8)
<b>At 31 March 2017</b>	1,991.6	(222.5)	(570.2)	1,198.9
Profit for the year	-	-	119.4	119.4
Gain on cash flow hedges	-	16.3	-	16.3
Cash flow hedges transferred to income statement	-	84.3	-	84.3
Deferred tax charge on cash flow hedge	-	(17.1)	-	(17.1)
Actuarial gain on pension schemes	-	-	74.2	74.2
Deferred tax charge on actuarial gain	-	-	(12.6)	(12.6)
<b>At 31 March 2018</b>	1,991.6	(139.0)	(389.2)	1,463.4

## Company statement of changes in equity

For the year ended 31 March

	Share capital £m	Retained earnings £m	Total equity £m
<b>At 1 April 2016</b>	1,991.6	1,555.2	3,546.8
Profit for the year	-	198.3	198.3
Dividends paid	-	(22.8)	(22.8)
<b>At 31 March 2017</b>	1,991.6	1,730.7	3,722.3
Loss for the year	-	(136.1)	(136.1)
<b>At 31 March 2018</b>	1,991.6	1,594.6	3,586.2

The accounting policies and notes on pages 29 to 77 are an integral part of these financial statements.

## Consolidated statement of cash flows

For the year ended 31 March

	Note	Underlying £m	2018 BTL £m	Total £m	Underlying £m	2017 BTL £m	Total £m
Cash generated from operations	30	1,092.4	(1.2)	1,091.2	1,098.9	3.8	1,102.7
Tax paid		-	-	-	-	-	-
<b>Net cash generated by operating activities</b>		<b>1,092.4</b>	<b>(1.2)</b>	<b>1,091.2</b>	<b>1,098.9</b>	<b>3.8</b>	<b>1,102.7</b>
<b>Investing activities:</b>							
Interest received		106.8	-	106.8	119.7	-	119.7
Decrease in current asset investments		1.0	-	1.0	288.5	-	288.5
Increase in deferred income - retail non-household sale		-	-	-	97.3	-	97.3
Purchase of property, plant and equipment		(1,100.6)	-	(1,100.6)	(1,145.2)	-	(1,145.2)
Purchase of intangible assets		(61.7)	-	(61.7)	(102.7)	-	(102.7)
Proceeds from sale of property, plant and equipment		18.8	-	18.8	5.6	-	5.6
<b>Net cash used in investing activities</b>		<b>(1,035.7)</b>	<b>-</b>	<b>(1,035.7)</b>	<b>(736.8)</b>	<b>-</b>	<b>(736.8)</b>
<b>Financing activities:</b>							
New loans raised		2,238.3	-	2,238.3	568.1	-	568.1
Repayment of borrowings		(1,799.8)	-	(1,799.8)	(843.4)	-	(843.4)
Interest paid		(401.6)	-	(401.6)	(530.1)	-	(530.1)
Facility fees paid		(4.4)	-	(4.4)	(4.6)	-	(4.6)
Derivative settlements		(28.4)	-	(28.4)	2.4	-	2.4
Dividends paid		-	-	-	(22.8)	-	(22.8)
<b>Net cash generated by/(used in) financing activities</b>		<b>4.1</b>	<b>-</b>	<b>4.1</b>	<b>(830.4)</b>	<b>-</b>	<b>(830.4)</b>
Net increase/(decrease) in cash and cash equivalents		60.8	(1.2)	59.6	(468.3)	3.8	(464.5)
Net cash and cash equivalents at beginning of year		99.0	3.8	102.8	567.3	-	567.3
<b>Net cash and cash equivalents at end of year</b>		<b>159.8</b>	<b>2.6</b>	<b>162.4</b>	<b>99.0</b>	<b>3.8</b>	<b>102.8</b>

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

Bazalgette Tunnel Limited ("BTL") is an independent company un-related to the Group, and was appointed in 2015 to construct the Thames Tideway Tunnel. BTL is responsible for the construction of the Thames Tideway Tunnel. In the current and preceding financial year, 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, cost and resulting profit on this arrangement, which are excluded from our key performance indicators in line with our banking covenants, have 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 29 to 77 are an integral part of these financial statements.

## Company statement of cash flows

For the year ended 31 March

	Note	2018 £m	2017 £m
Cash generated from operations	38	-	-
<b>Net cash used in operating activities</b>		-	-
<i>Investing activities:</i>			
Interest received		-	22.8
<b>Net cash generated by investing activities</b>		-	22.8
<i>Financing activities:</i>			
Dividends paid		-	(22.8)
<b>Net cash used in financing activities</b>		-	(22.8)
Net change in cash and cash equivalents		-	-
Net cash and cash equivalents at beginning of the year		-	-
<b>Net cash and cash equivalents at end of the year</b>		-	-

The accounting policies and notes on pages 29 to 77 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, unless otherwise stated.

### 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 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 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 trading address and the address of the registered office of both the Company and the Group 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 2018.

### Basis of preparation

The financial statements for the Group and Company for the year ended 31 March 2018, set out on pages 22 to 77, 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.

Goodwill impairment reviews are undertaken annually or more frequently if events or changes in circumstances indicate a potential impairment. For the purpose of impairment testing, the carrying value goodwill acquired in a business combination 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.

### 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.

## Foreign currency (continued)

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

Underlying 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 IAS 18 *Revenue*. Revenue is recognised at the time of delivery of the service. Should the Group 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 Group 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 Group identifies the occupants the bill is cancelled and re-billed in the customer's name. If the Group has not identified an occupant within six months, and the bill remains unpaid, 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 ("BTL"), the Group (in its capacity as principal) is responsible for the billing and collection of cash. The Group passes the associated cash on to BTL within 50 working days after the month end in which the cash is collected. Under the 'pay when paid' principle, the cost of any bad debt is borne by BTL in the current year, however this can be recovered from customers in future years and therefore overall BTL and the Group do not suffer bad debt. Accounting standards require the Group to present the amounts billed as revenue in our financial statements and, with an associated cost of non-current bad debt, this also gives rise to reporting profit which is taxable. The cash collected is not retained by the Group and accordingly the revenue, cost and resulting profit on this arrangement has been disclosed separately in the Group's financial statements, and is excluded from our key performance indicators. As a result of this arrangement with no cash retained, an asset is created and recorded by the Group as BTL will transfer the use of the tunnel to the Group once construction is complete under a finance lease arrangement.

## Interest income

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 (including buildings, operational structures and fixtures & fittings). 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 Group capitalises the directly attributable costs of procuring and constructing PP&E, which include labour and other internal costs incremental to the business. 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 Group 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 Group 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.

## Property, plant and equipment (continued)

The estimated useful economic lives are as follows and refer to non-current assets disclosed in note 13:

	Years
<b>Network assets:</b>	
Reservoirs	250
Strategic sewer components	200
Wastewater network assets	150
Water network assets	80-100
Raw water tunnels and aqueducts	80
<b>Non-network assets:</b>	
<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 made as a result of new connections to the water or sewerage networks, 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, are recognised within other operating income in the period that they become receivable.

## Non-current intangible assets (excluding goodwill)

Separately acquired intangible assets are stated at cost, less accumulated amortisation and any provision for impairment. Amortisation is charged to the income statement on a straight-line basis over the estimated useful economic life of the intangible asset from the date the intangible asset becomes available for use. The estimated useful economic lives are as follows:

	Years
Other intangible assets	18-20
Software	5-10

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

## Inventories and current intangible assets

Inventories are stated at the lower of cost and net realisable value ("NRV").

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.

## Investment in subsidiaries

Investments in subsidiary undertakings are stated at cost, less any provision for impairment. Impairment reviews are performed on an annual basis.

## 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.

## Leased assets

Leases where the Group obtains assets which transfer substantially all the risks and rewards of ownership to the Group are treated as finance leases.

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 Group 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 Group. The Group 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 BTL prepayment (see revenue policy) plus the present value of the future 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.

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 2018 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 spent 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.

## 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 Group. 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.

Dividends receivable are recognised when the Company’s right to receive payment is established.

## Financial guarantees

Five companies in the Group are part of a whole business securitisation (“WBS”) group. Companies in the WBS 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 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 Group 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.

The Group also operates two closed defined contribution pension schemes. The Group has no further payment obligations, however defined funds for individuals are held within these schemes.

### 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.

## Defined benefit schemes (continued)

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.

## 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. Where Group performance does not meet the criteria for the LTIP to be awarded, no accruals are recognised.

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.

In the previous year, the Group opened 'Share in Your Success 2016' which enrolled employees in the financial year ended 31 March 2017. 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 Group of up to 35% of the amount invested.

Share in You Success 2020 was launched during the year. The scheme's performance period runs from April 2017 to March 2020 and is open to all non-manager grade employees. The scheme entitles eligible employees to earn an amount of up to 5% of their salary following the end of the performance 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 Group'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 the bills relate to services provided by the Group, and the WOCs are acting in an agent capacity, any associated bad debt rests with the Group. As detailed information about the debt, including the ageing, is not readily available 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 BTL which represent a prepayment for the use of the Thames Tideway Tunnel once the tunnel has been constructed and is available for use.

## Trade and other payables

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

## Cash and cash equivalents

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

## Interest bearing borrowings including those issued to other group companies

Interest bearing borrowings are financial liabilities recognised initially at fair value less attributable transaction costs and subsequently at amortised cost using the effective interest method, 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, with any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. Otherwise, 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.

## Derivative financial instruments and hedging

Derivatives are used to manage exposure to movements in interest rates, foreign exchange rates and inflation. Derivatives are measured at fair value at each financial reporting date, using the methodology described in note 19.

### 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

The effective part of any gain or loss on the derivative financial instrument designated as a cash flow hedge is recognised directly in the cash flow hedge reserve. Any ineffective portion of the hedge is recognised immediately in the income statement.

When the underlying transaction results in the recognition of a non-financial asset or liability, the associated cumulative gain or loss is removed from the cash flow hedge reserve and reclassified to the income statement.

When a hedging instrument expires or is sold, terminated or exercised, or the Group 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 the cash flow hedge reserve within 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.

## Impairment of 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 recoverable amount of the asset is estimated, which 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 generate 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, and those recognised in prior periods are assessed at each financial reporting date for any indications that the loss has decreased or no longer exists.

## 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 (continued)

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.

## 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.

## New accounting policies and financial reporting changes

There has been no material introduction, removal or amendment of accounting policies during the year.

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

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

## IFRS 9 impact assessment

IFRS 9 *Financial Instruments*, which replaces IAS 39 *Financial Instruments: Recognition and Measurement*, introduces new requirements for recognition, classification and measurement, a new impairment model for financial assets based on expected credit losses, and simplified hedge accounting. The Group will adopt IFRS 9 as at 1 April 2018 and apply the new rules retrospectively, including the practical expedients permitted in the standard. As a result, comparatives for 2017/18 in our 31 March 2019 accounts will not be restated. Management has conducted an assessment of the impact of IFRS 9 and is expecting the following impact:

### 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. Management does not expect any changes in classification or measurement of its assets and liabilities as a result of adopting IFRS 9.

Trade receivables will continue to be measured at amortised costs as they are held to collect contractual cash flows which represent solely payment of principal and interest, in accordance with the Group's business model.

There will be no impact on classification and measurement of financial liabilities as the new requirements only affect the accounting for financial liabilities which are designated at fair value through profit and loss, of which the Group has none. However, the International Accounting Standards Board ("IASB") has confirmed that under IFRS 9 when a financial liability measured at amortised cost is modified and does not result in de-recognition, a gain or loss should be recognised in the income statement. If this standard had been adopted in the current year £26.2m would have been recognised within retained earnings.

Derivative assets and liabilities will continue to be recognised at fair value with movement recognised in the income statement or the cash flow hedge reserve where the instrument has been designated in a hedge relationship.

### Impairment Methodology

IFRS 9 introduces a new impairment model which requires the recognition of impairment provisions based on expected credit losses rather than incurred credit losses, as was required under IAS 39. Management has assessed the impact on trade receivables and expect no significant change in the Group's impairment methodology, and therefore no material impact on the provision for losses against trade receivables presented in the financial statements.

### Hedge Accounting

IFRS 9 provides increased flexibility for hedge accounting, introducing a new, simpler hedge accounting model with a principles-based approach designed to align the accounting result with the economic hedging strategy. The Group currently uses cash flow hedge relationships to hedge interest rate risk and foreign currency risk on borrowings. Management has confirmed that the current hedge relationships will continue to qualify as hedges upon the adoption of IFRS 9.

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

IFRS 15 *Revenue from Contracts with Customers* addresses the recognition of revenue and replaces IAS 18 *Revenue* and IFRIC 18 *Transfer of Assets from Customers*. The standard requires the identification of performance obligations in contracts with customers and allocation of the total contractual value to each of the performance obligations identified. Revenue is recognised as each performance obligation is satisfied either at a point in time or over time.

Management has reviewed 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 Group's main source of income, which accounts for 96.1% of the Group's income in 2017/18 (being that disclosed as total revenue and other operating income in the income statement) and is derived from the enforceable right of the Group to bill customers, there is no impact on the revenue recognition of adopting IFRS 15. The timing and the amount of revenue recognised for these activities under the new standard will be unchanged, but we will include a further disaggregation of revenue.

Management's review has not identified any contracts with customers which contain, at the outset of the contract, a significant financing component. An example of a significant financing component is when a customer is given an extended credit period (e.g. 12 months interest-free).

Further work is still required in 2018 to complete the impact assessment of IFRS 15 on certain revenue streams which relate to capital contributions. Discussions are continuing within the industry and the accounting profession. Management's current view is that income associated with service connections, requisitions and diversions will continue to be recognised at a point in time in the income statement, whilst infrastructure charges will continue to be deferred on the balance sheet and amortised to the income statement over time. However management will continue to actively participate in industry discussion and await further guidance from the accounting profession. Infrastructure charges deferred on the balance sheet as at 31 March 2018 are £353.6 million.

## IFRS 16 impact assessment

IFRS 16 *Leases* replaces IAS 17 *Leases* and related interpretations and sets out the principles for the classification, measurement, presentation and disclosure of lease arrangements. Under the provisions of IFRS 16, most leases, including those previously classified as operating leases, will be recognised in the statement of financial position as both a right-of-use asset and a largely offsetting lease liability. The right-of-use asset and lease liability are both based on the present value of lease payments due over the term of the lease, with the asset being depreciated in accordance with IAS 16 *Property, Plant and Equipment* and the liability increased for the accretion of interest and reduced by lease payments.

Management anticipates that the Group will adopt this standard on its effective date and has no plans for early adoption. In considering the transition options available under IFRS 16, it is likely that the Group will adopt the fully retrospective method which has the advantage of having, in the first reporting period, a comparative period prepared on the same basis.

Management have substantially completed the project to assess the impact of the implementation of IFRS 16 on the Group. The work performed to date has indicated that there will be a material impact to the statement of financial position primarily due to the Group's property lease portfolio. Initial assessments of the Group's property leases estimate an additional aggregate lease liability of at least £65m under the fully retrospective method will be recognised on transition to the new standard. We will continue to review relevant contracts during the period to adoption.

The Group 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 has been identified. As this change in accounting standard is outside of the control of the Group, management will address the risk of covenant breach through seeking that accounting changes are not reflected in the covenant calculations.

The actual impact of applying IFRS 16 will depend on the composition of the Group's lease portfolio at the adoption date and the extent to which the Group chooses to use practical expedients and recognition exemption. It is anticipated that under IFRS 16, the Group will continue to account for short-term (under 12 months) and immaterial leases on the same basis as is required for operating leases under IAS 17. That is, recognising the lease payments as an expense on a straight-line basis over the lease term.

The actual impact of applying IFRS 16 will depend on the composition of the Group's lease portfolio at the adoption date and the extent to which the Group chooses to use practical expedients and recognition exemption. It is anticipated that under IFRS 16, the Group will continue to account for short-term (under 12 months) and immaterial leases on the same basis as is required for operating leases under IAS 17. That is, recognising the lease payments as an expense on a straight-line basis over the lease term.

## Alternative performance measures

In the reporting of financial information, the Directors have adopted various Alternative Performance Measures (“APMs”). These measures are not defined by IFRS and therefore may not be directly comparable with other companies’ APMs, including those in the Group’s industry. These APMs are not intended to be a substitute for, or superior to, IFRS measurements. Directors and management use APMs to provide additional useful information on the performance and position of the Group, and to enhance the comparability of information between reporting periods.

### Underlying operating profit excluding depreciation and amortisation

This measure consists of the Group’s operating profit excluding BTL, depreciation and amortisation, and hence also excludes tax, net finance expenses, net fair value movements on derivatives and the profit on sale of the retail non-household business (which is a one-off item in 2017/18). Management use this metric to analyse the performance of the underlying business, as one-off items and fair value movements, which can be high volatile, have been removed.

### Total expenditure (“totex”)

Totex encompasses both capital and operational spend, and under AMP6 is a key driver of regulatory performance. Management use this measure to monitor performance against the objective of the Group to achieve the optimum combination of expenditure to deliver the required business plan. Totex differs from IFRS where the distinction between operating and capital expenditure remains, and therefore it is important that expenditure is accounted for correctly.

### Capital expenditure (“capex”)

In addition to monitoring totex, management review capex, which is the expenditure to acquire or upgrade tangible and intangible assets such as property, pipes, treatment works and software. The capex measure equates to intangible and tangible asset additions in the financial year including capitalised borrowing costs (see notes 12 and 13 respectively).

## Net debt

Net debt is presented in note 19 on both a statutory and covenant basis. The covenant basis of net debt is the measure used when assessing the Group’s gearing (see below) against the level stipulated in the banking covenants. Net debt on a statutory basis consists of borrowings less cash. Net debt on a covenant basis consists of borrowings less cash, excluding amounts owed to other group companies for which there is no related external debt, accrued interest, unamortised debt issuance costs and discounts, and including certain derivative financial liabilities as explained in note 19.

## Regulatory Capital Value (“RCV”)

The RCV has been developed for regulatory purposes by Ofwat and is one of the critical components for setting our customers’ bills. When assessing the revenues that the Group needs, Ofwat consider the return on capital invested in the business, and the RCV is the capital base used in this assessment.

## Gearing

Gearing is the percentage of the Group’s covenant net debt to RCV, and is a key covenant ratio for the Group’s financing arrangements with its lenders.

## Post Maintenance Interest Cover Ratio (“PMICR”)

PMICR measures the amount of cash that the Group generates from the revenues it earns, excluding costs associated with long-term investment (capex) relative to the gross interest paid on the Group’s debt. This ratio is used by rating agencies when determining credit ratings and is another key covenant set by our lenders.

## Credit rating

The Group must maintain an investment grade credit rating in accordance with our licence of appointment as a water and wastewater service provider. An investment grade rating equates to BBB- or higher from Standard & Poor’s and Baa3 or higher from Moody’s. The assessment by these two agencies provides an independent view of the Group’s performance and future prospects.

## Significant accounting judgements and key sources of estimation uncertainty

In the process of applying the Group's accounting policies, the Directors are required to make certain judgements, estimates and assumptions that they believe are reasonable based on available information at the time. These judgements, estimates and assumptions can have a significant effect on the amounts recognised in the financial statements and therefore any changes to these could have a material impact on the financial statements.

On an ongoing basis, management evaluate their estimates, judgements and assumptions using current information, historical experience, consultation with experts and other reasonable methods. Subsequently, actual figures may differ materially from the estimates, with the difference being recognised in the period in which the facts give rise to the difference become known. If the revision only affects that period (or previous periods), or in the period of the revision and future periods if the revision affects both the current and future periods.

The following paragraphs detail the judgements, estimates and assumptions management believe to have the most significant impact on the financial statements.

### Revenue recognition and allowance for doubtful debt

#### Accounting judgement – revenue recognition

The Group bills customers in accordance with its entitlement to receive revenue in line with the limits established by the periodic regulatory review processes. Revenue is recognised when performance obligations are met and when collection of the resulting receivable is reasonably certain. When the criteria for revenue recognition for a transaction are not met, recognition of the revenue is delayed until collectability is reasonably certain. Payments received in advance of entitlement are recorded as deferred income. The deferred income for the year ended 31 March 2018 was £75.6 million (2017: £81.1 million).

#### Accounting estimate - 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 Group'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 2018 was £174.3 million (2017: £176.6 million). The actual level of receivables collected may differ from the estimated level of recovery which could have a positive or negative impact on financial statements.

#### Accounting estimate - unbilled revenue

For water and wastewater customers with water meters, the amount billed is the sales value of the volume supplied including an estimate of the volume supplied between the date of the last meter reading and the billing date. Meters are read on a cyclical basis and the Group recognises revenue for unbilled amounts based on the estimated usage from the last billing date to the financial reporting date with these amounts being included within accrued income. The estimated usage is based on historical data, looking at the most recent actual consumption and any difference in the prior year estimate, and management assumptions. When a new property is connected to the infrastructure network, an estimate is made of the sales value of water supplied and wastewater charged incurred between the date of connection and the financial reporting date. The actual consumption may differ from management's estimates which would result in revenues being adjusted in the period in which the difference is identified. The unbilled revenue for the year ended 31 March 2018 was £218.7 million (2017: £244.6 million).

### Property, plant and equipment and intangible assets

#### Accounting judgement – capitalisation of costs

The Group's activities involve significant investment in construction and engineering projects and assessing the classification of these costs between capital expenditure and operating expenditure requires management to make judgements. The Group capitalises expenditure relating to water and wastewater infrastructure where such expenditure enhances assets or increases the capacity of the network. Maintenance expenditure is taken to the income statement in the period in which it is incurred. Differentiating between enhancement and maintenance works is subjective, particularly in the instances where a single project may include a combination of both types of activities. Property, plant and equipment additions for the year ended 31 March 2018 were £1,087.0 million (2017: £1,117.1 million), including capitalised overheads and capitalised borrowing costs.

Management capitalises employee time and other expenses incurred by central functions on capital programmes and consequently judgement is applied concerning the capitalisation rate used. In addition, management capitalises borrowing costs incurred for significant projects that meet certain criteria and judgement is required to identify which projects qualify for this. The capitalised borrowing costs for the year ended 31 March 2018 were £100.7 million (2017: £76.3 million).

#### Accounting estimate – depreciation and amortisation

Calculation of the depreciation and amortisation charges requires management to make estimates regarding the useful economic lives (UELs) of the assets. These estimates are based on the Group's experience of similar assets and engineering data. Where management identifies that actual UEL materially differs from the estimate used to calculate the charge, that charge will be adjusted in the period that the difference occurred and future periods. The total depreciation charge for the year ended 31 March 2018 was £520.1 million (2017: £513.4 million). As the Group makes significant investment in property, plant & equipment and intangible assets, the differences between the estimated and actual UELs could have a positive or negative impact on the financial statements.

### Accounting estimate - impairment

When circumstances indicate that the carrying amount of property, plant and equipment or intangible assets may not be recoverable management is required to evaluate these assets for impairment. In undertaking this impairment review management make estimates of the recoverable value of the assets and their value in use. In order to estimate the value in use of the asset, management estimate the future cash flows that the asset is expected to generate and then discount these back to their present value. The higher of the recoverable value and the value in use is then compared to the current carrying amount of the asset. If it is found that this value is lower than the carrying amount, an impairment loss is recognised immediately.

### Provisions for other liabilities and charges

#### Accounting judgement – recognition of liabilities

A provision is recognised when it is probable that the Group has an obligation for which a reliable estimate can be made of the amount of the obligation. The Group is subject to commercial and legal claims that are incidental to the day-to-day operation of its business. These include contractual, employment and environmental matters which are defended and managed in the ordinary course of business. Assessing the outcome of uncertain commercial and legal cases requires judgement to be made regarding the extent to which any claim against the Group is likely to be successful. On a case-by-case basis, management evaluates the likelihood of adverse verdicts or outcomes to these matters and makes a judgement about whether or not a provision should be recognised. For situations where the obligation is possible or the amount of the obligation cannot reliably be estimated these are disclosed as contingent liabilities unless the probable outflow of economic benefits is remote.

#### Accounting estimate – valuation of liabilities

Assessing the financial outcome of uncertain commercial and legal cases requires estimates to be made regarding the amount by which the Group is liable. These estimates are made 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 amount provided may change in the future due to new developments and as additional information becomes available and in such instances the provision will be adjusted in the period it is identified and in future periods should they also be affected. Provisions for liabilities and charges as at 31 March 2018 totalled £112.4 million (2017: £113.9 million).

### Retirement benefit obligations

#### Accounting estimate – actuarial valuations

The Group operates three 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. The pension liability and net cost recognised under IAS 19 *Employee Benefits* are assessed using the advice of an independent, qualified actuary based on the latest actuarial valuation and assumptions determined by the actuary. These assumptions are based on information supplied to the actuary by the Group, supplemented by discussions between the actuary and management and are used to estimate the present value of defined benefit obligations.

### Accounting estimate – actuarial assumptions

The actuarial assumptions used in determining the pension obligations and net costs recognised affect the profit before tax figure in the Income Statement and the net asset figure in the Statement of Financial Position and are a source of estimate. These assumptions include:

- the discount rate;
- pay growth;
- mortality; and
- increases to pensions in payment.

The actual rates may materially differ from the assumptions due to changes in economic conditions and changes in the life expectancy of the members of the pension schemes. This could have a positive or negative impact on the financial statements. The total net retirement benefit obligation for the three schemes as at 31 March 2018 was £293.7 million (2017: £373.5 million).

### Derivative financial assets and liabilities

#### Accounting estimate – valuation of derivatives

The Group holds derivative financial instruments that fall into the following categories:

- index-linked swaps;
- cross currency swaps; and
- options

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. 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. 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. This technique uses discounted future cash flows to value the financial assets and liabilities. The future cash flows are estimated based on observable forward interest rates and inflation rates and are discounted at a rate that reflects the credit risk of the Group and counterparties. Currency cash flows are translated at spot rate. The net total of derivative financial assets and liabilities as at 31 March 2018 was a liability of £1,153.3 million (2017: liability of £1,251.2 million).

### 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 10 and 34 for the net carrying value of the investments and associated impairment provision.



## Notes to the Group financial statements

### 1. Revenue

	Underlying £m	2018 BTL £m	Total £m	Underlying £m	2017 BTL £m	Total £m
Regulated water and wastewater services	2,004.3	-	2,004.3	2,026.4	-	2,026.4
Other services	42.0	27.6	69.6	51.1	33.6	84.7
Gross revenue	2,046.3	27.6	2,073.9	2,077.5	33.6	2,111.1
Charge for bad and doubtful debts	(28.0)	(0.7)	(28.7)	(45.9)	(0.6)	(46.5)
Net revenue	2,018.3	26.9	2,045.2	2,031.6	33.0	2,064.6

All revenue is derived from activities based in the UK.

Bazalgette Tunnel Limited ("BTL") is responsible for the construction of the Thames Tideway Tunnel. In the current and preceding financial year, the Group has included construction costs of the Thames Tideway Tunnel within its bills to wastewater customers. Cash collected in respect of Thames Tideway Tunnel construction costs is passed over to BTL under the 'pay when paid' principal. The revenue on this arrangement, which is excluded from our key performance indicators, has been disclosed separately to the Group's underlying performance in the table above.

### 2. Operating expenses

	Underlying £m	BTL £m	Total £m	Underlying £m	BTL £m	Total £m
Wages and salaries	223.3	-	223.3	210.9	-	210.9
Social security costs	23.9	-	23.9	23.4	-	23.4
Pension costs – defined benefit schemes	28.0	-	28.0	24.1	-	24.1
Pension costs – defined contribution schemes	8.1	-	8.1	6.8	-	6.8
Severance costs	0.8	-	0.8	1.2	-	1.2
Apprenticeship Levy	1.0	-	1.0	-	-	-
Total employee costs	285.1	-	285.1	266.4	-	266.4
Power	108.4	-	108.4	104.3	-	104.3
Carbon reduction commitment	4.8	-	4.8	6.6	-	6.6
Raw materials and consumables	55.2	-	55.2	53.5	-	53.5
Charge for bad and doubtful debts	28.4	0.4	28.8	3.9	-	3.9
Rates	115.1	-	115.1	94.5	-	94.5
Write-off of costs from assets in development	-	-	-	3.1	-	3.1
Operating lease rental – hire of plant and machinery	5.2	-	5.2	0.9	-	0.9
Operating lease rental – other	5.6	-	5.6	15.1	-	15.1
Research and development expenditure	3.5	-	3.5	4.0	-	4.0
Insurance	37.1	-	37.1	35.6	-	35.6
Legal and professional fees	22.1	-	22.1	24.3	-	24.3
Other operating costs	597.7	-	597.7	577.1	-	577.1
Property development costs	3.6	-	3.6	3.6	-	3.6
Own work capitalised	(198.2)	-	(198.2)	(188.2)	-	(188.2)
Net operating expenses before depreciation and amortisation	1,073.6	0.4	1,074.0	1,004.7	-	1,004.7
Depreciation of property, plant and equipment	520.1	-	520.1	513.4	-	513.4
Amortisation of intangible assets	27.6	-	27.6	25.0	-	25.0
Net operating expenses	1,621.3	0.4	1,621.7	1,543.1	-	1,543.1

## 2. Operating expenses (continued)

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

	2018 £m	2017 £m
<i>Fees payable to the Group's auditor:</i>		
Fees payable for the audit of the Company's financial statements	38	37
Fees payable for the audit of the financial statements of subsidiaries pursuant to legislation	497	505
<i>Fees payable to the Group's auditor for other services:</i>		
Audit related assurance services	205	170
Other assurance services	370	403
Other tax advisory services	-	14
Other services	-	80
<b>Net operating expenses</b>	<b>1,110</b>	<b>1,209</b>

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

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:

	2018 Number	2017 Number
<i>Employed by Thames Water Utilities Limited:</i>		
Retail	961	851
Wholesale Water	1,947	1,850
Wholesale Wastewater	1,937	1,861
Group services	576	405
	<b>5,421</b>	<b>4,967</b>
<i>Employed by other group companies:</i>		
Property services	5	7
<b>Total</b>	<b>5,426</b>	<b>4,974</b>

The Company has no employees (2017: none).

### Directors

The Directors' emoluments were as follows:

	2018 £'000	2017 £'000
Salary	833	831

In the current and preceding financial years no amounts were accruing to any Directors under the Group's defined benefit scheme in respect of services 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 (2017: £325,000).

#### 4. Other operating income

	2018 £m	2017 £m
Power income	10.1	10.1
Requisitions and diversions charges	25.5	21.7
Service connection charges	23.4	25.4
Release from deferred income – infrastructure charges	18.8	15.4
Rental income	4.3	8.1
Other income	10.7	10.2
<b>Total</b>	<b>92.8</b>	<b>90.9</b>

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

#### 5. Profit on sale of non-household business

From 1 April 2017 the Water Act 2014 allows all non-household customers to choose their supplier of water and wastewater retail services. On 1 April 2017 we disposed of our economic interest in the retail non-household business and transferred our non-household customers to Castle Water Limited, which resulted in the recognition of a profit on sale of the business. The profit on sale of the business of £89.7 million has been recognised within the income statement, and consists of the amounts below:

	2018 £m	2017 £m
Proceeds	98.8	-
Legal fees	(1.3)	-
Asset impairment	(6.2)	-
Transfer/handover costs	(2.6)	-
<b>Profit on sale of non-household business</b>	<b>89.7</b>	<b>-</b>

#### 6. Finance income

	2018 £m	2017 £m
Interest income on bank deposits	0.7	2.8
Interest income on swaps	114.8	112.4
External trading interest income	0.5	-
<b>Total</b>	<b>116.0</b>	<b>115.2</b>

#### 7. Finance expense

	2018 £m	2017 £m
<i>Interest in relation to bank and other loans:</i>		
Interest expense	472.6	481.2
RPI accretion on loans	148.6	89.7
Interest expense on swaps	105.6	75.4
Amortisation	(11.6)	(11.6)
Net interest expense on defined benefit obligation	8.8	5.9
Gross finance expense	724.0	640.6
Capitalised borrowing costs	(100.7)	(76.3)
<b>Total finance expense</b>	<b>623.3</b>	<b>564.3</b>

## 8. Net gains/(losses) on financial instruments

	2018 £m	2017 £m
Exchange gains/(losses) on foreign currency loans	72.6	(149.8)
Gains/(losses) arising on swaps where hedge accounting is not applied	52.7	(220.2)
Loss on cash flow hedge transferred from equity	(84.3)	(2.1)
<b>Total</b>	<b>41.0</b>	<b>(372.1)</b>

## 9. Taxation

### Tax charge/(credit) in the income statement

	Underlying £m	2018 BTL £m	Total £m	Underlying £m	2017 BTL £m	Total £m
<b>Current tax:</b>						
Current year amounts due in respect of group relief	(1.6)	1.6	-	(2.2)	2.2	-
Adjustment in respect of prior periods	-	-	-	(1.0)	-	(1.0)
	(1.6)	1.6	-	(3.2)	2.2	(1.0)
<b>Deferred tax:</b>						
Origination and reversal of timing differences	30.7	-	30.7	(36.4)	-	(36.4)
Adjustment in respect of prior periods	1.0	-	1.0	(5.2)	-	(5.2)
Adjustment in respect of corporation tax rate changes	-	-	-	(57.8)	-	(57.8)
	31.7	-	31.7	(99.4)	-	(99.4)
<b>Tax charge/(credit) on profit/(loss) on ordinary activities</b>	<b>30.1</b>	<b>1.6</b>	<b>31.7</b>	<b>(102.6)</b>	<b>2.2</b>	<b>(100.4)</b>

The total tax for the year ended 31 March 2018 is higher (2017: higher) than the standard rate of corporation tax in the UK. The differences are explained below:

	2018				2017			
	Underlying £m	BTL £m	Total £m	Effective tax rate %	Underlying £m	BTL £m	Total £m	Effective tax rate %
Profit/(loss) on ordinary activities before taxation	124.4	26.5	150.9		(237.7)	33.0	(204.7)	
Current tax at 19% (2017: 20%)	23.7	5.0	28.7	19.0%	(47.5)	6.6	(40.9)	20.0%
<b>Effects of:</b>								
<i>Recurring items:</i>								
Depreciation on assets that do not qualify for tax relief	4.4	-	4.4		4.0	-	4.0	
Disallowable expenditure <sup>1</sup>	0.9	-	0.9		1.8	-	1.8	
Interest payable not allowable for tax <sup>2</sup>	7.2	-	7.2		-	-	-	
Non-taxable income <sup>3</sup>	(4.9)	-	(4.9)		(5.2)	-	(5.2)	
Property disposals <sup>4</sup>	(2.2)	-	(2.2)		(0.1)	-	(0.1)	
Tax differential on profits and losses of overseas subsidiaries	0.1	-	0.1		(0.4)	-	(0.4)	
Group relief not paid at standard rate <sup>5</sup>	3.4	(3.4)	-		4.4	(4.4)	-	
<b>Tax as adjusted for recurring items</b>	<b>32.6</b>	<b>1.6</b>	<b>34.2</b>	<b>22.7%</b>	<b>(43.0)</b>	<b>2.2</b>	<b>(40.8)</b>	<b>19.9%</b>
<i>Non-recurring items:</i>								
Tax rate change on temporary timing differences <sup>6</sup>	(3.5)	-	(3.5)		(53.4)	-	(53.4)	
Adjustments to tax charge in respect of prior periods – group relief	-	-	-		(1.0)	-	(1.0)	
Adjustments to tax charge in respect of prior periods – deferred tax <sup>7</sup>	1.0	-	1.0		(5.2)	-	(5.2)	
<b>Total tax charge/(credit)</b>	<b>30.1</b>	<b>1.6</b>	<b>31.7</b>	<b>21.0%</b>	<b>(102.6)</b>	<b>2.2</b>	<b>(100.4)</b>	<b>49.0%</b>

## 9. Taxation (continued)

<sup>1</sup> Disallowable expenditure primarily relates to fines included in operating expenses.

<sup>2</sup> Under new Corporate Interest Restriction tax legislation effective from 1 April 2017, some interest payable by the group is not allowable for corporation tax.

<sup>3</sup> 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.

<sup>4</sup> 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.

<sup>5</sup> Thames Water Utilities Limited ("TWUL") has decided to utilise tax losses available in its immediate parent company for the year ended 31 March 2018. TWUL will pay £4.3 million to its parent Company for the tax losses, of which £1.6 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.

<sup>6</sup> A reduction in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) was substantively enacted on 26 October 2015. A further reduction to the UK corporation tax rate to 17% (effective from 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 2018 has been calculated at 17%. Opening deferred tax balances at 1 April 2017 were also calculated at 17%. The effect of temporary differences in the year in current tax calculated at 19% and deferred tax calculated at 17% produces a net £3.5m tax credit which is included in the total tax charge for the year. The 1% rate change to 17% enacted in the prior year resulted in a deferred tax credit in the income statement in the prior year of £57.8 million.

<sup>7</sup> Following the agreement of tax computations with HMRC up to and including 31 March 2016, the provision for uncertain tax positions within deferred tax has been reduced to £nil, resulting in a prior year deferred tax credit of £0.3 million, which is included in the total prior year deferred tax charge of £1.0 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 profit/(loss) on ordinary activities before taxation at the standard tax rate and the current tax (credit)/charge for the year are set out below.

	Underlying £m	2018 BTL £m	Total £m	Underlying £m	2017 BTL £m	Total £m
Profit/(loss) on ordinary activities before taxation	124.4	26.5	150.9	(237.7)	33.0	(204.7)
Tax at 19% (2017: 20%)	23.7	5.0	28.7	(47.5)	6.6	(40.9)
<i>Effects of:</i>						
Depreciation on assets that do not qualify for relief	4.4	-	4.4	4.0	-	4.0
Disallowable expenditure	0.9	-	0.9	1.8	-	1.8
Interest payable not allowable for tax	7.2	-	7.2			
Non-taxable income	(4.9)	-	(4.9)	(5.2)	-	(5.2)
Property disposals	(2.2)	-	(2.2)	(0.1)	-	(0.1)
Tax differential on profits and losses of overseas subsidiaries	0.1	-	0.1	(0.4)	-	(0.4)
Capital allowances for the year less than/(in excess of) depreciation	9.0	-	9.0	(8.9)	-	(8.9)
Capitalised borrowing costs allowable for tax <sup>8</sup>	(19.1)	-	(19.1)	(15.3)	-	(15.3)
Losses/(profits) on financial derivatives <sup>9</sup>	(21.9)	-	(21.9)	65.9	-	65.9
Pension cost charge in excess of pension contributions	(1.0)	-	(1.0)	(6.3)	-	(6.3)
Other short term timing differences	(1.2)	-	(1.2)	5.4	-	5.4
Group relief not paid at standard rate	3.4	(3.4)	-	4.4	(4.4)	-
Adjustments in respect of prior periods	-	-	-	(1.0)	-	(1.0)
<b>Current tax (credit)/charge for the year</b>	<b>(1.6)</b>	<b>1.6</b>	<b>-</b>	<b>(3.2)</b>	<b>2.2</b>	<b>(1.0)</b>

<sup>8</sup> Capitalised borrowing costs are eligible for a full tax deduction in the year.

<sup>9</sup> 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.

## 9. Taxation (continued)

### Effective tax rate

The effective tax rate, as adjusted for recurring tax items, of 22.7% is higher than the standard rate of corporation tax for the year of 19.0%. Corporate Interest Restriction rules, which became effective from 1 April 2017, have resulted in an interest restriction in the group, which has increased the effective tax rate.

### Uncertain tax positions

At 31 March 2018 the total value of provisions for uncertain corporation tax positions was £nil (2017: £nil current tax and £0.3 million deferred tax). It is possible that amounts agreed will be different from the amount provided.

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

	2018 £m	2017 £m
<i>Deferred tax:</i>		
Tax (charge)/credit on actuarial gain/loss	(12.6)	21.6
Tax (charge)/credit on cash flow hedges	(17.1)	6.0
<b>Total</b>	<b>(29.7)</b>	<b>27.6</b>

## 10. Goodwill

The Directors have reviewed the carrying value of goodwill in line with the accounting policy on page 29 and do not consider there to be any impairment to this carrying value for the year ended 31 March 2018 (2017: £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 recent equity transactions, involving the sale of shares in KWH by existing shareholders. 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 2018, for the carrying amount of goodwill to exceed the recoverable amount, a reduction of 15% (2017: 23%) to the multiplier used would be required.

## 11. 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. Foudry made a loss in 2018 of £0.4 million (2017: £0.4m) and has net liabilities of £10.4 million (2017: £10.0m). 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 2018 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 (2017: £nil). The Group had no capital commitments in relation to its interests in associates as at 31 March 2018 (2017: £nil).

## 12. Intangible assets

	Software £m	Other £m	Assets in development £m	Total £m
<i>Cost:</i>				
At 1 April 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
Additions	-	-	61.8	61.8
Transfers	24.8	-	(24.8)	-
Write-off of costs from assets in development	-	-	(6.2)	(6.2)
At 31 March 2018	214.4	1.3	109.7	325.4
<i>Amortisation:</i>				
At 1 April 2016	(103.0)	(0.8)	-	(103.8)
Amortisation charge	(25.0)	-	-	(25.0)
At 31 March 2017	(128.0)	(0.8)	-	(128.8)
Amortisation charge	(27.5)	(0.1)	-	(27.6)
At 31 March 2018	(155.5)	(0.9)	-	(156.4)
<i>Net book value:</i>				
At 31 March 2018	58.9	0.4	109.7	169.0
At 31 March 2017	61.6	0.5	78.9	141.0

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

The write-off of costs relate to software under development that is no longer required as a result of the transfer of non-household customers to Castle Water. Additions related to IT projects undertaken include the implementation of new customer relationship management and billing ("CRMB") system and a new meter data management system. £4.3 million borrowing costs were capitalised during the year (2017: £2.1 million). The effective rate of borrowing costs for the year was 5.58% (2017: 4.86%).

### 13. 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 2016	3,572.7	6,693.0	6,475.2	1,991.4	<b>18,732.3</b>
Additions	0.3	24.2	15.9	1,076.7	<b>1,117.1</b>
Transfers between categories	95.0	626.3	255.9	(977.2)	-
Disposals	(3.7)	(3.8)	-	-	<b>(7.5)</b>
At 31 March 2017	3,664.3	7,339.7	6,747.0	2,090.9	<b>19,841.9</b>
Additions	1.1	-	13.2	1,072.7	<b>1,087.0</b>
Transfers between categories	18.7	382.4	323.4	(724.5)	-
Disposals	(2.6)	(13.1)	(1.8)	-	<b>(17.5)</b>
At 31 March 2018	3,681.5	7,709.0	7,081.8	2,439.1	<b>20,911.4</b>
<i>Depreciation:</i>					
At 1 April 2016	(901.6)	(3,561.3)	(244.3)	-	<b>(4,707.2)</b>
Depreciation charge	(59.9)	(333.0)	(120.5)	-	<b>(513.4)</b>
Disposals	2.0	3.7	-	-	<b>5.7</b>
At 31 March 2017	(959.5)	(3,890.6)	(364.8)	-	<b>(5,214.9)</b>
Depreciation charge	(59.3)	(332.7)	(128.1)	-	<b>(520.1)</b>
Disposals	0.3	8.9	-	-	<b>9.2</b>
At 31 March 2018	(1,018.5)	(4,214.4)	(492.9)	-	<b>(5,725.8)</b>
<i>Net book value:</i>					
At 31 March 2018	2,663.0	3,494.6	6,588.9	2,439.1	<b>15,185.6</b>
At 31 March 2017	2,704.8	3,449.1	6,382.2	2,090.9	<b>14,627.0</b>

£94.8 million borrowing costs, net of commissioning, were capitalised during the year (2017: £76.3 million). The effective rate of borrowing costs for the year was 5.58% (2017: 4.86%).

### 14. Inventories and current intangible assets

	2018 £m	2017 £m
Raw materials and consumables	11.5	14.1
Current intangible assets – emissions allowances	6.6	7.6
<b>Total</b>	<b>18.1</b>	<b>21.7</b>

Emission allowances represent purchased carbon emission allowances (relating to the emission of carbon dioxide in the UK). A provision (see note 21) 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.



## 15. Trade and other receivables

	Underlying £m	2018 BTL £m	Total £m	Underlying £m	2017 BTL £m	Total £m
<i>Non-current:</i>						
Prepayments and accrued income	-	56.7	56.7	-	30.4	30.4
Other receivables	3.0	-	3.0	2.8	-	2.8
	<b>3.0</b>	<b>56.7</b>	<b>59.7</b>	<b>2.8</b>	<b>30.4</b>	<b>33.2</b>
<i>Current:</i>						
Gross trade receivables	462.5	6.4	468.9	421.9	3.2	425.1
Less doubtful debt provision	(172.6)	(1.7)	(174.3)	(176.0)	(0.6)	(176.6)
Net trade receivables	289.9	4.7	294.6	245.9	2.6	248.5
Amounts owed by associated undertakings	2.8	-	2.8	2.8	-	2.8
Amounts receivable in respect of group relief	1.6	(1.6)	-	2.2	(2.2)	-
Insurance claims receivable	32.7	-	32.7	36.0	-	36.0
Prepayments and accrued income	253.4	0.4	253.8	286.7	0.4	287.1
Other receivables	44.4	0.3	44.7	70.4	-	70.4
	<b>624.8</b>	<b>3.8</b>	<b>628.6</b>	<b>644.0</b>	<b>0.8</b>	<b>644.8</b>
<b>Total</b>	<b>627.8</b>	<b>60.5</b>	<b>688.3</b>	<b>646.8</b>	<b>31.2</b>	<b>678.0</b>

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 2018 includes £218.7 million (31 March 2017: £244.6 million) of water and wastewater income not billed.

### Doubtful debts provision

Movements in the doubtful debts provision were as follows:

	2018 £m	2017 £m
At 1 April	(176.6)	(189.9)
Charge for bad and doubtful debts – charged against revenue	(28.7)	(46.5)
Charge for bad and doubtful debts – included within operating expenses	(28.8)	(3.9)
Amounts written off	59.8	63.7
<b>Total at 31 March</b>	<b>(174.3)</b>	<b>(176.6)</b>

The ageing of receivables which are past due but not impaired cannot be performed. Ageing of gross receivables is as follows:

	2018 £m	2017 £m
Up to 365 days	281.8	252.0
1 – 2 years	83.5	77.4
2 – 3 years	47.4	41.5
More than 3 years	56.2	54.2
<b>Total</b>	<b>468.9</b>	<b>425.1</b>

The ageing of gross BTL receivables is as follows:

	2018 £m	2017 £m
Up to 365 days	4.9	3.2
1 – 2 years	1.5	-
<b>Total</b>	<b>6.4</b>	<b>3.2</b>

## 15. 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:

	2018 £m	2017 £m
Up to 365 days	66.2	71.7
1 – 2 years	40.9	32.7
2 – 3 years	23.9	23.7
More than 3 years	43.3	48.5
<b>Total</b>	<b>174.3</b>	<b>176.6</b>

The ageing of impaired BTL receivables is as follows:

	2018 £m	2017 £m
Up to 365 days	0.7	0.6
1 – 2 years	1.0	-
<b>Total</b>	<b>1.7</b>	<b>0.6</b>

Trade and other receivables are part of the Group's financial exposure to credit risk as explained on page 59.

## 16. Cash and cash equivalents

	Underlying £m	2018 BTL £m	Total £m	Underlying £m	2017 BTL £m	Total £m
Cash at bank and in hand	17.8	0.1	17.9	5.0	3.8	8.8
Short-term deposits	142.0	2.5	144.5	94.0	-	94.0
<b>Total</b>	<b>159.8</b>	<b>2.6</b>	<b>162.4</b>	<b>99.0</b>	<b>3.8</b>	<b>102.8</b>

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.

## 17. Trade and other payables

	Underlying £m	2018 BTL £m	Total £m	Underlying £m	2017 BTL £m	Total £m
<i>Non-current:</i>						
Accruals and deferred income	445.8	-	445.8	404.9	-	404.9
<i>Current:</i>						
Trade payables - operating	307.0	-	307.0	283.7	-	283.7
Trade payables - capital	141.1	-	141.1	179.5	-	179.5
Amounts owed to Bazalgette Tunnel Limited	-	3.5	3.5	-	4.2	4.2
Accruals and deferred income	312.1	4.1	316.2	432.5	0.2	432.7
Other taxation and social security	6.5	-	6.5	6.7	-	6.7
Other payables	42.5	-	42.5	10.9	-	10.9
<b>Total</b>	<b>809.2</b>	<b>7.6</b>	<b>816.8</b>	<b>913.3</b>	<b>4.4</b>	<b>917.7</b>
<b>Total</b>	<b>1,255.0</b>	<b>7.6</b>	<b>1,262.6</b>	<b>1,318.2</b>	<b>4.4</b>	<b>1,322.6</b>

Accruals and deferred income at 31 March 2018 includes £75.6 million (31 March 2017: £81.1 million) of receipts in advance from customers for water and wastewater charges, and £nil (31 March 2017: £97.3 million) of net proceeds in relation to the transfer of all non-household retail customers to Castle Water. Other payables includes excess credits, where customers have overpaid, which is all recognised as a current liability as at 31 March 2018.

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

## 18. Borrowings

	2018 £m	2017 £m
Secured bank loans	1,854.6	2,160.7
Private placements	1,240.8	598.4
Other financing	9,178.1	9,003.3
	<b>12,273.5</b>	<b>11,762.4</b>
Interest payable on secured bank loans, private placements and other financing	234.6	181.5
<b>Total</b>	<b>12,508.1</b>	<b>11,943.9</b>
Disclosed within current liabilities	356.1	381.5
Disclosed within non-current liabilities	12,152.0	11,562.4

### Breakdown of secured bank loans:

	2018 £m	2017 £m
<b>Thames Water Utilities Limited:</b>		
£150.0m floating rate loan due 2017	-	150.0
£100.0m floating rate loan due 2018 (a), (f)	-	99.9
£60.0m 1.230% Index linked loan due 2019	76.8	73.9
£60.0m 1.415% Index linked loan due 2020	76.6	73.7
£60.0m 1.513% index linked loan due 2020	76.2	73.3
£60.0m 1.380% index linked loan due 2020	76.0	73.1
£60.0m 1.356% index linked loan due 2020	76.0	73.1
£100.0m floating rate loan due 2020 (a), (c)	99.9	99.8
£75.0m 1.350% index linked loan due 2021 (e)	87.0	83.7
£100.0m floating rate loan due 2021 (a), (c), (f)	-	99.7
£215.0m 0.460% index linked loan due 2023 (a)	241.9	232.6
£215.0m 0.380% index linked loan due 2032 (a), (b)	228.4	227.0
£100.0m 3.280% index linked loan due 2043 (a), (d)	126.4	121.5
£100.0m 0.790% index linked loan due 2025 (a), (e)	107.2	103.1
£125.0m 0.598% index linked loan due 2026 (a), (e)	133.3	128.2
£70.0m Class B 3.867% fixed rate loan due 2026 (a)	69.7	69.7
£50.0m Class B 3.875% fixed rate loan due 2026 (a)	49.8	49.8
£20.0m Class B floating rate loan due 2026 (a)	19.9	19.9
£39.0m Class B 3.918% fixed rate loan due 2026 (a)	38.8	38.8
<b>Thames Water Utilities Limited total</b>	<b>1,583.9</b>	<b>1,890.8</b>
<b>Kemble Water Finance Limited:</b>		
£75m floating rate due 2022 (a)	73.7	73.3
£200m floating rate due 2025 (a)	197.0	196.6
<b>Kemble Water Finance Limited total</b>	<b>270.7</b>	<b>269.9</b>
<b>Total secured bank loans</b>	<b>1,854.6</b>	<b>2,160.7</b>

All loans are Class A except where highlighted.

- (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 and 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) These loans were repaid early on 22 March 2018.

## 18. Borrowings (continued)

### Breakdown of private placements:

	2018 £m	2017 £m
<b>Thames Water Utilities Limited</b>		
\$55.0m 3.380% private placement due 2023 (a), (b)	39.2	-
\$285.0m 3.570% private placement due 2025 (a), (b)	202.8	-
£216.0m 2.450% private placement due 2028 (a)	215.3	-
£210m 2.550% private placement due 2030 (a)	209.2	-
£40m 2.620% private placement due 2033 (a)	39.8	-
<b>Thames Water Utilities Limited total</b>	<b>706.3</b>	<b>-</b>
<b>Thames Water Utilities Cayman Finance Limited</b>		
\$150m 4.690% Class B private placement due 2019 (a), (b)	106.7	119.2
\$150m 3.870% private placement due 2022 (b)	106.9	119.8
\$200m 4.020% private placement 2024 (b)	142.6	159.8
\$250m 4.220% private placement due 2027 (b)	178.3	199.6
<b>Thames Water Utilities Cayman Finance Limited total</b>	<b>534.5</b>	<b>598.4</b>
<b>Total private placements</b>	<b>1,240.8</b>	<b>598.4</b>

All private placements are Class A except where highlighted.

- (a) These private placements are shown net of issue costs.  
 (b) The Group has entered into Cross currency swap agreements which convert these USD debt into £ debt.

## 18. Borrowings (continued)

### Breakdown of other financing:

	2018 £m	2017 £m
<b>Thames Water Utilities Cayman Finance Limited</b>		
£550m 5.375% Class B fixed rate bond due 2025 (b), (k)	-	548.5
£300m 5.750% Class B Fixed rate bond due 2030 (b), (l)	297.8	297.5
£300m 4.375% Fixed rate bond due 2034 (b)	295.5	295.3
£113m 2.300% CPI IL bond due 2022 (a), (c)	104.6	100.6
20bn Yen 3.280% Fixed rate bond due 2038 (a), (b), (c)	134.2	143.2
£50m 3.853% Index linked bond due 2040 (e)	63.3	60.9
£500m 5.500% Fixed rate bond due 2041 (b)	489.6	489.4
£50m 1.980% Index linked bond due 2042 (e)	67.1	64.4
£55m 2.091% Index linked bond due 2042 (b), (e)	71.0	68.2
£40m 1.974% Index linked bond due 2045 (b), (e)	46.3	45.6
£300m 4.625% Fixed rate bond due 2046 (b)	293.1	293.0
£100m 1.846% Index linked bond due 2047 (e)	134.2	128.9
£200m 1.819% Index linked bond due 2049 (b), (e)	267.9	257.3
£200m 1.771% Index linked bond due 2057 (b), (e)	267.9	257.3
£350m 1.760% Index linked bond due 2062 (b), (e)	468.8	450.2
£500m 4.000% Fixed rate bond due 2025 (b)	495.3	494.8
£40m 0.750% index linked bond due 2034 (b), (e)	42.4	40.8
£45m 0.721% index linked bond due 2027 (b), (e)	47.7	45.9
£300m 3.500% fixed rate bond due 2028 (b)	296.3	296.0
£400m 7.738% fixed rate bond due 2058 (b)	394.1	393.8
£250m 1.875% fixed rate bond due 2024 (b)	247.8	247.4
£250m 2.625% fixed rate bond due 2032 (b)	247.2	247.0
£42m floating rate loan due 2017 (d)	-	42.0
£300m 2.375% class B Fixed rate bond due 2023 (b)	298.5	-
£250m 2.875% class B Fixed rate bond due 2027 (b)	246.6	-
CAD 250m 2.875% fixed rate bond due 2024 (a), (b)	136.3	-
Fees	(9.7)	(9.9)
<b>Thames Water Utilities Cayman Finance Limited total</b>	<b>5,443.8</b>	<b>5,298.1</b>
<b>Thames Water Utilities Finance Limited</b>		
£200m 5.050% Fixed rate bond due 2020 (c), (f)	201.7	202.4
£225m 6.590% Fixed rate bond due 2021 (j)	240.5	244.0
£175m 3.375% Index linked bond due 2021 (b), (e)	273.5	263.9
£330m 6.750% Fixed rate bond due 2028 (b), (g)	389.0	392.5
£200m 6.500% Fixed rate bond due 2032 (b), (c), (h)	246.4	248.4
£600m 5.125% Fixed rate bond due 2037 (b), (c), (i)	656.8	658.3
£300m 1.680% Index linked bond due 2053 (b), (e)	421.7	406.9
£300m 1.681% Index linked bond due 2055 (b), (e)	421.6	406.9
<b>Thames Water Utilities Finance Limited total</b>	<b>2,851.2</b>	<b>2,823.3</b>
<b>Thames Water (Kemble) Finance plc</b>		
£400m 7.75% fixed rate bond due 2019 (b)	399.0	398.0
£175m 5.75% fixed rate bond due 2022 (b)	173.7	173.4
<b>Thames Water (Kemble) Finance plc total</b>	<b>572.7</b>	<b>571.4</b>
<b>Kemble Water Eurobond plc</b>		
£310.4m Shareholder loan due 2021	310.4	310.4
<b>Kemble Water Eurobond plc total</b>	<b>310.4</b>	<b>310.4</b>
<b>Total other financing</b>	<b>9,178.1</b>	<b>9,003.3</b>

All bonds are Class A except where highlighted.

- (a) The Group has entered into swap agreements which eliminate the risk of currency fluctuations in relation to the Canadian 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) In March 2017 £42 million was drawn out of the £950 million revolving credit facility in TWUCF and repaid in April 2017. During the year ended 31 March 2018, a total of £849.0 million was drawn in various tranches and repaid using revolving credit facility.
- (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) This bond includes £1.7 million (2017: £2.4 million) fair value adjustment to carrying value at acquisition by Kemble Water Holdings Group.
- (g) This bond includes £61.6 million (2017: £65.2 million) fair value adjustment to carrying value at acquisition by Kemble Water Holdings Group.

## 18. Borrowings (continued)

### Breakdown of other financing (continued)

- (h) This bond includes £48.7 million (2017: £50.8 million) fair value adjustment to carrying value at of acquisition by Kemble Water Holdings Group.  
 (i) This bond includes £60.4 million (2017: £62.0 million) fair value adjustment to carrying value at acquisition by Kemble Water Holdings Group.  
 (j) This bond includes £15.5 million (2017: £19.0 million) fair value adjustment to carrying value at acquisition by Kemble Water Holdings Group.  
 (k) In July 2017 this Class B bond had a 'Step Up and Call' meaning the interest rate changed to 3 months LIBOR plus 7.96% at which point the issuer exercised a call option to redeem the nominal value of the debt at par value.  
 (l) 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 £189.7 million (2017: £201.3 million). Capitalised debt issuance costs in relation to the debt portfolio are £86.2 million (2017: £85.1 million).

## 19. Financial instruments

### Categories of financial instruments

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

	2018 £m	2017 £m
<b>Financial assets:</b>		
<i>Fair value through profit and loss</i>		
Cross currency swaps	13.2	72.6
Index-linked swaps	71.7	97.4
Interest rate swaps	-	0.6
	<b>84.9</b>	<b>170.6</b>
<i>Loans and receivables (including cash and cash equivalents)</i>		
Trade and other receivables	688.3	678.0
Short term investments	-	1.0
Cash and cash equivalents	162.4	102.8
<b>Total</b>	<b>935.6</b>	<b>952.4</b>
<b>Financial liabilities:</b>		
<i>Fair value through profit and loss</i>		
Cross currency swaps	(69.6)	(75.2)
Interest rate swaps	(176.2)	(108.4)
Index-linked swaps	(947.1)	(1,082.9)
<i>Derivatives designated as hedging instruments</i>		
Forward starting interest rate swaps – cash flow hedges	(45.3)	(155.3)
	<b>(1,238.2)</b>	<b>(1,421.8)</b>
<i>Other financial liabilities</i>		
Trade and other payables	(1,262.6)	(1,322.6)
Borrowings	(12,508.1)	(11,943.9)
<b>Total</b>	<b>(15,008.9)</b>	<b>(14,688.3)</b>

## 19. 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 fair values of interest rate and index linked swaps are determined, in part, from unobservable inputs but the use of these unobservable inputs does not significantly impact the result. As a result we have concluded that it is appropriate to continue to classify the derivatives instruments as Level 2. The table below sets out the valuation basis of financial instruments held at fair value as at 31 March:

	2018 £m	2017 £m
<i>Financial assets - derivative financial instruments:</i>		
Cross currency swaps	13.2	72.6
Index-linked swaps	71.7	97.4
Interest rate swaps	-	0.6
	<b>84.9</b>	<b>170.6</b>
<i>Financial liabilities - derivative financial instruments:</i>		
Cross currency swaps	(69.6)	(75.2)
Interest rate swaps	(176.2)	(108.4)
Index-linked swaps	(947.1)	(1,082.9)
Forward starting interest rate swaps	(45.3)	(155.3)
	<b>(1,238.2)</b>	<b>(1,421.8)</b>
<b>Net total</b>	<b>(1,153.3)</b>	<b>(1,251.2)</b>

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 inflation rates and interest rates from observable yield curves at the period end and discounted at a rate that reflects the credit risk of the Group and the counterparties. Currency cash flows are translated at spot rate.

During the year, the Group has introduced more sophisticated modelling techniques to calculate credit risk adjustments that are required when valuing derivative financial instruments. These address changes in market practice. The fair value gain on swaps includes a £64.0m credit resulting from use of these improvements.

In mid-2014 the Group 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. £800.0 million of these swaps commenced during the year (2017: £900.0 million). On commencement these swap were reclassified from forward starting interest rate swaps to interest rate swaps. The fair value movements till commencement were recognised on cash flow hedge reserve. Subsequent to commencement 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. During the year a £16.3 million gain (2017: loss of £50.7 million) was recognised on cash flow hedge reserve and £84.3 million (2017: £2.1 million) was recycled from cash flow hedge reserve to income statement, see Statement of changes in equity. The loss of £84.3m consisted of £23.5m loss related to hedged exposure that crystallised during the year and a £60.8m loss due to hedge accounting discontinuation.

## 19. 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:

	2018		2017	
	Book value £m	Fair value £m	Book value £m	Fair value £m
<b>Financial assets:</b>				
<i>Non-current</i>				
Derivative financial instruments				
Cross currency swaps	4.7	4.7	72.6	72.6
Index-linked swaps	71.7	71.7	97.4	97.4
Interest rate swaps	-	-	0.6	0.6
	<b>76.4</b>	<b>76.4</b>	<b>170.6</b>	<b>170.6</b>
<i>Current</i>				
Short term investments				
Cash and cash equivalents	162.4	162.4	102.8	102.8
Derivative financial instruments				
Cross currency swaps	8.5	8.5	-	-
<b>Total</b>	<b>247.3</b>	<b>247.3</b>	<b>274.4</b>	<b>274.4</b>
<b>Financial liabilities:</b>				
<i>Non-current</i>				
Borrowings:				
Floating rate				
Index-linked	(390.5)	(395.0)	(589.3)	(589.3)
Fixed rate	(3,988.7)	(5,320.6)	(3,853.1)	(5,421.4)
Fixed rate	(7,772.7)	(8,714.9)	(7,120.0)	(9,053.9)
Derivative financial instruments:				
Cross currency swaps	(69.6)	(69.6)	(75.2)	(75.2)
Interest rate swaps	(176.2)	(176.2)	(107.3)	(107.3)
Index-linked swaps	(934.8)	(934.8)	(1,060.2)	(1,060.2)
Forward starting interest rate swaps	(45.3)	(45.3)	(155.3)	(155.3)
	<b>(13,377.8)</b>	<b>(15,656.4)</b>	<b>(12,960.4)</b>	<b>(16,462.6)</b>
<i>Current</i>				
Borrowings:				
Floating rate				
Index-linked	-	-	(192.1)	(192.1)
Fixed rate	(14.9)	(14.9)	(7.9)	(7.9)
Fixed rate	(106.7)	(108.2)	-	-
Interest payable	(234.6)	(234.6)	(181.5)	(181.5)
Derivative financial instruments:				
Cross currency swaps	-	-	-	-
Index-linked swaps	(12.3)	(12.3)	(22.7)	(22.7)
Interest rate swaps	-	-	(1.1)	(1.1)
<b>Total</b>	<b>(13,746.3)</b>	<b>(16,026.4)</b>	<b>(13,365.7)</b>	<b>(16,867.8)</b>

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.



## 19. Financial instruments (continued)

### Capital risk management

Details of the Group's capital risk management strategy can be found on page 11.

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

	2018 £m	2017 £m
Cash and cash equivalent	162.4	102.8
Short term investments	-	1.0
Secured bank loans, private placements and other financing	(12,273.5)	(11,762.4)
Interest payable on secured bank loans, private placements and other financing	(234.6)	(181.5)
<b>Net debt (statutory basis)</b>	<b>(12,345.7)</b>	<b>(11,840.1)</b>
Shareholder loan	310.4	310.5
Interest payable on secured bank loans, private placements and other financing	234.6	181.5
Unamortised debt issuance costs and discount	(86.2)	(85.1)
Derivative financial liabilities	(237.8)	(121.2)
Fair value adjustment on acquisition to loans	189.7	201.3
Cash held by non-covenant entities	(33.9)	(25.9)
<b>Net debt (covenant basis)</b>	<b>(11,968.9)</b>	<b>(11,379.0)</b>

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:

	2018 £m	2017 £m
Securitised Class A debt	(10,121.8)	(9,481.4)
Securitised Class B debt	(1,125.6)	(1,125.6)
Subordinated debt	(850.0)	(850.0)
Cash net of cash held by non-covenant entities	128.5	78.0
<b>Net debt (covenant basis)</b>	<b>(11,968.9)</b>	<b>(11,379.0)</b>

## 19. Financial instruments (continued)

### Reconciliation of liabilities arising from financing activities

The reconciliation below between the opening and closing balances for liabilities arising from financing activities evaluates changes in liabilities including both changes arising from cash flow and non-cash changes.

	2018		2017	
	Borrowings	Derivative financial liabilities	Borrowings	Derivative financial liabilities
	£m	£m	£m	£m
<b>Opening balance</b>	<b>(11,943.9)</b>	<b>(1,421.8)</b>	<b>(12,402.8)</b>	<b>(1,344.5)</b>
Non-Current	(11,562.4)	(1,398.0)	(11,005.4)	(1,302.1)
Current	(381.5)	(23.8)	(1,037.4)	(42.4)
<b>Cash flows</b>				
New loans raised	(2,238.3)	-	(568.1)	-
Repayment of borrowings	1,799.8	-	843.6	-
Derivative settlement	-	28.4	-	(2.4)
Interest paid	405.2	97.1	527.0	79.3
Interest received	-	(105.6)	-	(116.8)
	(33.3)	19.9	802.5	(39.9)
<b>Non-cash changes</b>				
Net interest (charge)/income and fees amortisation	(467.5)	9.2	(475.6)	37.1
Foreign exchange movement	72.6	-	(149.8)	-
Accretion	(148.6)	-	(89.7)	-
Fair value changes	-	154.5	-	(74.5)
FV amortisation	11.6	-	11.6	-
Other	1.0	-	(0.1)	-
	(530.9)	163.7	(703.6)	(37.4)
<b>Closing balance</b>	<b>(12,508.1)</b>	<b>(1,238.2)</b>	<b>(11,943.9)</b>	<b>(1,421.8)</b>
Non-Current	(12,152.0)	(1,225.9)	(11,562.4)	(1,398.0)
Current	(356.1)	(12.3)	(381.5)	(23.8)

### 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 12.

#### (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 excluding fair value adjustment on acquisition to loans:

	Total at fixed rates	Total at floating rates	Total at index linked rates	Total
	£m	£m	£m	£m
<b>As at 31 March 2018:</b>				
Interest bearing loans and borrowings				
Net of corresponding swap assets				
- £ Sterling	6,562.6	364.1	5,394.9	12,321.6
<b>Total</b>	<b>6,562.6</b>	<b>364.1</b>	<b>5,394.9</b>	<b>12,321.6</b>
<b>As at 31 March 2017:</b>				
Interest bearing loans and borrowings				
Net of corresponding swap assets				
- £ Sterling	6,119.9	346.3	5,216.4	11,682.6
<b>Total</b>	<b>6,119.9</b>	<b>346.3</b>	<b>5,216.4</b>	<b>11,682.6</b>

## 19. Financial instruments (continued)

### Financial risk management (continued)

The weighted average interest rates of the debt held by the Group 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	
	2018 %	2017 %	2018 Years	2017 Years
Fixed	5.4	5.6	11.1	12.3
Index-Linked	5.7	3.9	21.9	23.7

#### (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 2018. This analysis considers effect of variable interest rate instruments and assumes that all other variables, in particular exchange rates, remain constant.

	2018		2017	
	+1% £m	-1% £m	+1% £m	-1% £m
Profit	276.6	(328.0)	325.6	(386.5)
Equity	300.7	(354.2)	404.3	(469.5)

#### (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 2018. This analysis assumes that all other variables in the valuation remain constant.

	2018		2017	
	+10% £m	-10% £m	+10% £m	-10% £m
Profit	(5.4)	2.0	(11.2)	13.0
Equity	(5.4)	2.0	(11.2)	13.0

#### (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 2018. This analysis assumes that all other variables, in particular exchange rates, remain constant.

	2018		2017	
	+1% £m	-1% £m	+1% £m	-1% £m
Profit	(607.3)	515.1	(747.5)	578.5
Equity	(607.3)	515.1	(747.5)	578.5

## 19. Financial instruments (continued)

### Financial risk management (continued)

#### (b) 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 32.

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

	2018 £m	2017 £m
A	-	1.0
<b>Total</b>	<b>-</b>	<b>1.0</b>

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

	2018 £m	2017 £m
A+	61.0	107.1
A	15.8	14.5
AA-	8.1	49.0
<b>Total</b>	<b>84.9</b>	<b>170.6</b>

#### (c) Liquidity risk

Details of the nature and management of the Group's liquidity risk is provided on page 12.

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

	2018 £m	2017 £m
Within one year	121.6	199.9
Between one and two years	895.3	234.0
Between two and three years	527.0	879.7
Between three and four years	722.8	627.4
Between four and five years	406.1	726.4
After more than five years	9,600.7	9,095.0
<b>Total</b>	<b>12,273.5</b>	<b>11,762.4</b>

## 19. Financial instruments (continued)

### (i) Cash flows from non-derivative financial liabilities

The maturity profile of the anticipated future cash flows including interest in relation to the Group'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:

<b>Undiscounted amounts payable</b>	<b>2018</b>	<b>2017</b>
	<b>£m</b>	<b>£m</b>
Within one year	(1,854.7)	(1,570.0)
Between one and two years	(1,378.6)	(724.6)
Between two and three years	(951.8)	(1,396.4)
Between three and four years	(1,149.9)	(1,069.2)
Between four and five years	(794.9)	(1,178.4)
After more than five years	(21,741.8)	(21,931.2)
<b>Total</b>	<b>(27,871.7)</b>	<b>(27,869.8)</b>

### (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:

<b>Undiscounted amounts payable</b>	<b>2018</b>	<b>2017</b>
	<b>£m</b>	<b>£m</b>
Within one year	5.2	(11.5)
Between one and two years	(48.4)	34.4
Between two and three years	(15.7)	(33.2)
Between three and four years	17.7	(0.1)
Between four and five years	(48.4)	50.2
After more than five years	(1,690.0)	(1,761.0)
<b>Total</b>	<b>(1,779.6)</b>	<b>(1,721.2)</b>

## 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 34.

In mid-2014 the Group 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 Group against adverse movements in underlying interest rates by matching debt issuance against a derivative instrument with fixed cash flow.

During the year £800.0 million (2017: £900.0 million) 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:

<b>Undiscounted amounts payable</b>	<b>2018</b>	<b>2017</b>
	<b>£m</b>	<b>£m</b>
Within one year	-	(4.6)
Between one and two years	(6.5)	(15.3)
Between two and three years	(8.4)	(23.1)
Between three and four years	(8.4)	(25.5)
Between four and five years	(8.4)	(25.5)
After more than five years	(10.4)	(45.7)
<b>Total</b>	<b>(42.1)</b>	<b>(139.7)</b>

In respect of the above cash flow hedges, a gain of £16.3 million was recognised in other comprehensive income in the year (2017: loss of £50.7 million). The amount reclassified from equity to income statement for the year was £84.3 million (2017: £2.1 million).

## 20. 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 2016	(1,204.5)	45.7	138.9	56.3	<b>(963.6)</b>
Credit/(charge) to income	52.1	(3.8)	50.5	0.6	<b>99.4</b>
Credit to equity	-	21.6	6.0	-	<b>27.6</b>
At 31 March 2017 (liability)/asset	(1,152.4)	63.5	195.4	56.9	<b>(836.6)</b>
Credit/(charge) to income	(6.6)	(1.0)	(19.5)	(4.6)	<b>(31.7)</b>
Credit/(charge) to equity	-	(12.6)	(17.1)	-	<b>(29.7)</b>
At 31 March 2018 (liability)/asset	(1,159.0)	49.9	158.8	52.3	<b>(898.0)</b>

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.

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:

	2018 £m	2017 £m
Deferred tax asset	261.0	315.8
Deferred tax liability	<b>(1,159.0)</b>	<b>(1,152.4)</b>
Total	<b>(898.0)</b>	<b>(836.6)</b>

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% (2017: 17%) is:

	2018 £m	2017 £m
Deferred tax asset not recognised in respect of tax losses	6.2	6.1

## 21. 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 2016	7.0	45.4	0.6	3.9	43.1	100.0
Utilised during the year	(6.5)	-	(0.4)	(2.2)	(13.5)	(22.6)
Charge to income statement	6.5	22.0	0.5	-	3.2	32.2
Transfer (to)/from current liabilities	-	-	-	(0.2)	4.5	4.3
At 31 March 2017	7.0	67.4	0.7	1.5	37.3	113.9
Utilised during the period	(7.0)	-	(0.5)	(1.7)	(8.7)	(17.9)
Charge/(credit) to income statement	5.7	(3.8)	-	-	13.2	15.1
Transfer to current liabilities	-	-	-	1.3	-	1.3
At 31 March 2018	5.7	63.6	0.2	1.1	41.8	112.4

Emissions provisions relate to the obligation to purchase carbon emissions allowances, see note 14.

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 15. Timing of settlement for these claims is uncertain and therefore amounts provided have been classified as non-current.

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.

## 22. Share capital and other reserves

### Share capital

	2018 £m	2017 £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

	2018 £m	2017 £m
Cash flow hedge reserve	(139.0)	(222.5)
Retained earnings	(389.2)	(570.2)
<b>Total</b>	<b>(528.2)</b>	<b>(792.7)</b>

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.

## 23. Dividends

	2018 £m	2017 £m
Dividend paid (2018: £nil per share, 2017: 1.15p per share)	-	22.8

## 24. 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.

	What are they?	How do they impact the Group's financial statements?
<p><b>Defined Contribution Scheme</b></p> <p>This scheme was set up in April 2011, is managed through Standard Life, and is open to all new employees of the Group.</p>	<p>In a defined contribution pension scheme the benefits are linked to:</p> <ul style="list-style-type: none"> <li>• contributions paid;</li> <li>• the performance of the individual's chosen investments; and</li> <li>• the form of benefits</li> </ul>	<p>A charge of £8.1 million (2017: £6.8 million) was recognised in the income statement relating to the contributions payable by the Group based upon a fixed percentage of employees' pay.</p> <p>There were £1.1 million (2017: £0.9 million) of outstanding contributions at the year-end recognised in the statement of financial position. These were paid in the following financial year.</p> <p>The Group has no exposure to investment and other experience risks.</p>
<p><b>Defined Benefit Schemes</b></p> <p>Defined benefit arrangements for the Group's eligible employees are provided through three defined benefit pension schemes:</p> <ul style="list-style-type: none"> <li>• Thames Water Mirror Image Pension Scheme ("TWMIPS"). Thames Water Pension Scheme ("TWPS");</li> <li>• Thames Water Mirror Image Pension Scheme ("TWMIPS"); and</li> <li>• The SUURBS Arrangement ("SUURBS").</li> </ul> <p>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.</p> <p>Both TWMIPS and TWPS are career average pension schemes. Their assets are held separately from the rest of the Group in funds in the United Kingdom which are independently administered by the Pension Trustees. TWMIPS has been closed to new entrants since 1989 and on 1 April 2011 TWPS closed to new entrants, who now join the defined contribution scheme.</p>	<p>In a defined benefit pension scheme the benefits:</p> <ul style="list-style-type: none"> <li>• are defined by the scheme rules</li> <li>• depend on a number of factors including age, years of service and pensionable pay; and</li> <li>• do not depend on contributions made by the members or the Group</li> </ul>	<p>A charge was recognised in the income statement of £36.8 million (2017: £30.0 million) relating to the following:</p> <ul style="list-style-type: none"> <li>• service cost representing the increase in the defined benefit liability arising from pension benefits earned by active members in the current period;</li> <li>• administrative expenses for the pension schemes;</li> <li>• the net interest expense on pension scheme assets and liabilities; and</li> <li>• the effect of restriction in the surplus.</li> </ul> <p>A gain of £74.2 million (2017: loss of £151.5 million) on the value of the pension scheme was recognised in the statement of other comprehensive income. This reflects the impact of changes in financial assumptions and the demographic of the scheme members when compared with those at the start of the year, as well as the return on the schemes' assets over and above the amount included in the net interest expense.</p> <p>The net pension liability of £293.7 million (2017: £373.5 million) is recognised in the statement of financial position.</p> <p>The Group is exposed to investment and other experience risks. Where it is estimated that the benefits will not be met by regular contributions, assets held or expected investment income, additional contributions are being made by the Group.</p>

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 2018 these related payments amounted to £0.5 million (2017: £0.5 million).

The defined benefit pension schemes are subject to a full actuarial valuation every three years using assumptions agreed between the Trustees of the pension schemes and the Group. The purpose of this triennial valuation is to evaluate and if necessary modify the funding plans of the pension schemes to ensure the pension schemes have sufficient funds to meet future benefit payments.

The most recent full valuation of the SUURBS Arrangement was carried out at 28 February 2018 on behalf of the pension Trustees by Mercer Limited, the independent and professionally qualified consulting actuaries to the scheme. This resulted in a funding surplus of £1.2 million (2017: £0.7 million) with the market value of the assets being £14.2 million (2017: £14.3 million).



## 24. Retirement benefit obligations (continued)

The most recent full actuarial valuation of TWMIPS and TWPS was carried out at 31 March 2016 on behalf of the Trustees by David Gardner of Aon Hewitt Limited, the independent and professionally qualified consulting actuary to the schemes. This resulted in a combined funding deficit across the three schemes of £364.9 million (2013: £288.3 million) with the market value of the assets being £1,905.5 million (2013: £1,699.8 million).

This funding valuation is different from the accounting valuation presented in the financial statements due to the use of different assumptions and changes in market conditions from the time of the most recent valuation to 31 March 2018. The 2016 and 2018 funding valuations have been updated to an accounting valuation as at 31 March 2018 by Hymans Robertson LLP, an independent and professionally qualified consulting actuary, using revised assumptions that are consistent with the requirements of IAS 19 *Employee Benefits* and shown in this note to the financial statements.

### Amounts included in the financial statements

#### Income Statement

The amounts recognised in the income statement with respect to the defined benefit pension schemes are detailed below:

	2018			2017		
	TWPS £m	TWMIPS £m	SUURBS £m	TWPS £m	TWMIPS £m	SUURBS £m
Current service cost	19.4	3.8	-	13.9	3.0	-
Scheme administration expenses	2.7	1.2	-	3.4	1.1	-
Effect of restriction of surplus	-	0.9	-	-	2.7	-
Net interest cost/(income)	9.5	(0.5)	(0.2)	8.2	(2.1)	(0.2)
<b>Total</b>	<b>31.6</b>	<b>5.4</b>	<b>(0.2)</b>	<b>25.5</b>	<b>4.7</b>	<b>(0.2)</b>

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

	2018			2017		
	TWPS £m	TWMIPS £m	SUURBS £m	TWPS £m	TWMIPS £m	SUURBS £m
Operating expenses	22.1	5.9	-	17.3	6.8	-
Net finance expense/(income)	9.5	(0.5)	(0.2)	8.2	(2.1)	(0.2)
<b>Total</b>	<b>31.6</b>	<b>5.4</b>	<b>(0.2)</b>	<b>25.5</b>	<b>5.3</b>	<b>(0.2)</b>

#### Statement of other comprehensive income

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

	2018 £m	2017 £m
Cumulative actuarial losses recognised at 1 April	(557.8)	(406.3)
Actual return less expected return on pension scheme assets	2.6	304.6
Experience (loss)/gain arising on scheme liabilities	(10.9)	28.7
Gain/(loss) arising due to change in assumptions	95.5	(526.9)
Change in asset ceiling	(13.0)	42.1
<b>Total actuarial gain/(loss)</b>	<b>74.2</b>	<b>(151.5)</b>
<b>Cumulative actuarial losses recognised at 31 March</b>	<b>(483.6)</b>	<b>(557.8)</b>

## 24. Retirement benefit obligations (continued)

### Statement of financial position

The net pension (liability)/asset recognised within the statement of financial position is as follows:

	2018			2017		
	TWPS £m	TWMIPS £m	SUURBS £m	TWPS £m	TWMIPS £m	SUURBS £m
Fair value of scheme assets	1,442.9	805.6	14.6	1,411.4	828.5	14.3
Present value of defined benefit obligations	(1,743.7)	(755.0)	(7.5)	(1,776.2)	(806.8)	(8.0)
(Deficit)/surplus	(300.8)	50.6	7.1	(364.8)	21.7	6.3
Effect of asset limit	-	(50.6)	-	-	(36.7)	-
Retirement benefit (obligations)/surplus	(300.8)	-	7.1	(364.8)	(15.0)	6.3

### IFRIC 14 considerations

For some defined benefit pension schemes IFRIC 14: *The limit on a defined benefit asset, minimum funding requirements and their interaction* potentially limits the surplus that can be recognised on the balance sheet or requires additional liabilities to be recognised where future deficit contributions are greater than the unadjusted accounting deficit.

The Directors have reviewed the scheme rules of the defined benefit pension schemes and have concluded that, for the TWMIPS scheme, as the Group 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 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.

### Reconciliation of defined benefit plan assets and liabilities

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

	2018			2017		
	TWPS £m	TWMIPS £m	SUURBS £m	TWPS £m	TWMIPS £m	SUURBS £m
At 1 April	1,776.2	806.8	8.0	1,385.1	694.8	7.1
Current service cost	19.4	3.8	-	13.9	3.0	-
Interest cost	46.4	20.1	0.2	50.0	23.7	0.3
Contributions from scheme members	0.4	-	-	0.1	-	-
Benefits paid	(52.8)	(37.8)	(0.4)	(45.5)	(39.9)	(0.4)
Termination benefits	0.5	-	-	0.5	-	-
Actuarial (gains)/losses	(46.4)	(37.9)	(0.3)	372.1	125.2	1.0
At 31 March	1,743.7	755.0	7.5	1,776.2	806.8	8.0

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

	2018			2017		
	TWPS £m	TWMIPS £m	SUURBS £m	TWPS £m	TWMIPS £m	SUURBS £m
At 1 April	1,411.4	828.5	14.3	1,142.8	753.2	13.2
Interest income on scheme assets	36.9	20.6	0.4	41.8	25.8	0.5
Contributions by sponsoring employers	41.3	0.7	0.4	51.6	10.0	0.4
Contributions from scheme members	0.4	-	-	0.1	-	-
Administration costs paid from scheme assets	(2.7)	(1.2)	-	(3.4)	(1.1)	-
Benefits paid	(52.8)	(37.8)	(0.4)	(45.5)	(39.9)	(0.4)
Contributions for termination benefits	0.5	-	-	0.5	-	-
Gains/(losses) on assets above interest	7.9	(5.2)	(0.1)	223.5	80.5	0.6
At 31 March	1,442.9	805.6	14.6	1,411.4	828.5	14.3

## 24. Retirement benefit obligations (continued)

### Analysis of assets

	2018				2017			
	Quoted £m	Unquoted £m	Total £m	Total (%)	Quoted £m	Unquoted £m	Total £m	Total (%)
<b>Equities</b>								
UK	34.8	-	34.8	1.5%	29.6	-	29.6	1.3%
Rest of World	344.0	1.8	345.8	15.3%	338.2	-	338.2	15.0%
Private Equity	-	1.1	1.1	0.0%	-	34.3	34.3	1.5%
<b>Bonds</b>								
Government – UK	47.0	-	47.0	2.1%	104.6	-	104.6	4.6%
Government – Rest of World	195.3	-	195.3	8.6%	112.7	-	112.7	5.0%
Corporates – UK	9.4	-	9.4	0.4%	9.4	-	9.4	0.4%
Corporates – Rest of World	193.6	-	193.6	8.6%	216.4	-	216.4	9.6%
<b>Property</b>								
UK	5.7	103.4	109.1	4.8%	9.2	106.5	115.7	5.1%
Rest of world	3.9	-	3.9	0.2%	4.2	-	4.2	0.2%
<b>Alternative assets</b>								
Liability driven instruments	1,105.5	-	1,105.5	48.8%	1,102.9	-	1,102.9	48.9%
Other (including derivatives)	106.5	3.1	109.6	4.8%	61.8	4.0	65.8	2.9%
<b>Cash</b>	108.0	-	108.0	4.8%	120.4	-	120.4	5.3%
<b>Total market value of assets</b>	<b>2,153.7</b>	<b>109.4</b>	<b>2,263.1</b>	<b>100.0%</b>	<b>2,109.4</b>	<b>144.8</b>	<b>2,254.2</b>	<b>100.0%</b>

### IAS 19 Assumptions

The approach used to set the IAS 19 assumptions is detailed below:

#### Approach to set the assumptions

<b>Discount rate</b>	As per IAS 19, the discount rate is determined using the market yields on high quality corporate bonds as at the reporting date with the currency and term of these bonds being consistent with the currency and term of the pension liabilities. The discount rate is calculated by applying the projected cash flows of these schemes to an AA-corporate bond yield curve as at 31 March 2018.
<b>RPI inflation</b>	The RPI inflation assumption uses the inflation curve weighted by projected future cash flows with an adjustment made for an inflation risk premium.
<b>CPI inflation</b>	This CPI inflation assumption is taken at a margin below RPI factoring in market forces and third party estimates of the difference expected.
<b>Salary increases</b>	Both TWPS and TWMIPS 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.
<b>Pension increases</b>	It is assumed that benefits will increase in line with the RPI and CPI inflation assumptions detailed above, based on the appropriate index for increasing benefits.
<b>Longevity</b>	The 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.

## 24. Retirement benefit obligations (continued)

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

	2018			2017		
	TWPS	TWMIPS	SUURBS	TWPS	TWMIPS	SUURBS
Price inflation – RPI	3.15%	3.15%	3.15%	3.35%	3.30%	3.30%
Price inflation – CPI	2.15%	2.15%	2.15%	2.35%	2.30%	-
Rate of increases in salaries	-	-	-	-	-	-
Rate of increase to pensions in payment – RPI	3.15%	3.15%	3.15%	3.35%	3.30%	2.30%
Rate of increase to pensions in payment – CPI	2.15%	2.15%	2.15%	2.35%	2.30%	-
Discount rate	2.65%	2.60%	2.60%	2.65%	2.55%	2.55%

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, 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.

	2018		2017	
	TWPS Years	TWMIPS Years	TWPS Years	TWMIPS Years
<i>Life expectancy from age 60:</i>				
Male	27.4	26.6	27.9	26.9
Female	29.4	29.0	29.4	29.3
<i>Life expectancy from age 60 currently age 40:</i>				
Male	29.0	28.1	29.8	28.8
Female	31.0	30.6	31.4	31.3

### Actuarial risk factors

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

Definition of risk	
<b>Investment risk</b>	Assumptions are made about the returns expected from the schemes’ investments. If the investments underperform these assumptions in the long term then additional contributions will need to be made to the schemes in order to fund the payment of future benefits.
<b>Discount rate risk</b>	A fall in AA-rated corporate bond yields, which are used to set the discount rate, will increase the value of the scheme’s liabilities. This may be partially offset by an increase in the value of the scheme’s bond holdings.
<b>Inflation risk</b>	The benefits payable to the members of the schemes are linked to inflation and as such higher inflation will lead to higher liabilities. Additionally, 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.
<b>Longevity risk</b>	An increase in the life expectancy of scheme members will result in benefits being paid out for longer, leading to an increase in the defined benefit schemes’ liabilities.

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

	Reduction in liability					
	2018			2017		
	TWPS £m	TWMIPS £m	SUURBS £m	TWPS £m	TWMIPS £m	SUURBS £m
Change in discount rate (+ 1% p.a.)	315.0	90.0	0.8	380.0	120.0	0.8
Change in rate of inflation (-1% p.a.)	205.0	75.0	0.8	280.0	80.0	0.8
Change in life expectancy (-1 year)	70.0	30.0	0.3	50.0	25.0	0.3

## 24. Retirement benefit obligations (continued)

### Future expected cash flows

The Group made a pension deficit repair payment of £22.0 million during March 2018 in relation to 2017/18 having made a similar payment of £20.8 million on 31 March 2017 in relation to 2016/17. The Group expects to contribute approximately £42.0 million in aggregate to the defined benefit pension schemes in the next financial year. The average duration of the benefit obligation at the end of the year is 20 years for TWPS and 13 years for TWMIPS (2017: 20 years for TWPS and 13 years for TWMIPS).

In June 2017, the funding valuation as at 31 March 2016 for TWMIPS and TWPS was finalised and agreed with the scheme Trustees and actuaries. In order to address the combined funding deficit the Group is scheduled to make future deficit repair payments in line with the table below:

Year to 31 March	2019	2020	2021	2022	2023	2024	2025	2026	2027
<b>Deficit contribution (£m)</b>	22.6	22.8	23.1	23.3	23.5	23.7	24.0	24.2	17.9

## 25. Capital commitments

	2018 £m	2017 £m
Contracted for but not provided	<b>392.5</b>	<b>305.6</b>

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.

## 26. Contingent liabilities

The Company needs to determine the merit of any litigation against it and the chances of a claim successfully being made, the likelihood of an outflow of economic benefits occurring and whether there is a need to disclose a contingent liability or whether a provision is required based on this assessment.

Contingent liabilities represent potential future cash outflows which are either not probable or cannot be measured reliably.

There are claims against the Company arising in the normal course of business, which are in the process of negotiation. Judgement is required in measuring and recognising provisions related to pending litigation or other outstanding claims that are subject to negotiated settlement or Court assessment. This includes evaluating the likelihood that an outstanding claim will succeed and to quantify the possible range of any financial settlement and outflow of economic benefits.

The Directors have undertaken such an assessment and based on the outcome has set aside amounts considered appropriate for all legal and similar claims. However because of the inherent uncertainty in this evaluation process, there is always a possibility that actual losses may be materially different from the originally estimated provision.

## 27. Operating leases

Lease payments under operating leases of £10.8 million (2017: £16.0 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:

	2018 £m	Restated 2017 £m
Within one year	10.1	10.5
Between one and five years	34.8	38.2
After more than five years	67.6	74.3
<b>Total</b>	<b>112.5</b>	<b>123.0</b>

Operating lease payments represent rentals payable by the Group for certain office properties, and plant and equipment. Where the Group has the ability and intent to exit a property lease prior to the term end date and it is probable that this option will be exercised, we have only included lease payments up to the assumed lease exit date.

The Group's project to prepare for adopting IFRS 16 Leases has initiated a comprehensive review of all lease arrangements and how these should be disclosed within this lease commitment note. This review included a wide-ranging search of all leases and highlighted certain properties that were omitted from the disclosed commitments in the prior year. The comparatives have been restated by £26.7 million from £96.3 million to £123.0 million.

## 28. 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.

## 29. 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 2018 was £11.2 billion (2017: £10.6 billion).

At 31 March 2018 the Group has secured the overdrafts and loans of certain subsidiaries up to a maximum of £20.0 million (2017: £20.0m). The Group has also guaranteed facilities for contract bonding on behalf of certain subsidiaries amounting to £0.8 million (2017: £0.8m) at 31 March 2018.

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 million (2017: £425 million), the amount outstanding at 31 March 2018 was £275 million (2017: £275 million). The chargee is RBS as Facility Agent. The Group 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 2018 is £575 million (2017: £575 million).

Thames Water Insurance Company Limited, a wholly owned subsidiary of the Group, has letters of credit in issue totalling £0.75 million (2017: £0.75 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.

## 30. Statement of cash flows

### Reconciliation of operating profit to operating cash flows

	Underlying £m	2018 BTL £m	Total £m	Underlying £m	2017 BTL £m	Total £m
Profit/(loss) for the financial year	94.5	24.9	119.4	(135.1)	30.8	(104.3)
Less profit on the sale of non-household retail business	(89.7)	-	(89.7)	-	-	-
Less finance income	(116.0)	-	(116.0)	(115.2)	-	(115.2)
Add finance expense	623.3	-	623.3	564.3	-	564.3
(Less gains)/add losses on fair value of financial instruments	(41.0)	-	(41.0)	372.1	-	372.1
Taxation on profit/(loss) on ordinary activities	30.1	1.6	31.7	(102.6)	2.2	(100.4)
Operating profit	501.2	26.5	527.7	583.5	33.0	616.5
Depreciation on property, plant and equipment	520.1	-	520.1	513.4	-	513.4
Amortisation of intangible assets	27.6	-	27.6	25.0	-	25.0
Write-off of costs from assets in development	-	-	-	3.1	-	3.1
Profit on sale of property, plant and equipment	(11.4)	-	(11.4)	(4.1)	-	(4.1)
Difference between pension charge and cash contribution	(14.4)	-	(14.4)	(37.4)	-	(37.4)
Decrease/(increase) in inventory	3.6	-	3.6	(1.0)	-	(1.0)
Decrease/(increase) in trade and other receivables	21.2	(28.7)	(7.5)	(70.2)	(32.9)	(103.1)
Increase in trade and other payables	43.7	3.2	46.9	72.7	3.7	76.4
Decrease in group relief payable	2.2	(2.2)	-	-	-	-
(Decrease)/increase in provisions	(1.4)	-	(1.4)	13.9	-	13.9
Cash generated from operations	1,092.4	(1.2)	1,091.2	1,098.9	3.8	1,102.7

### 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

	2018 £m	2017 £m
Movement in cash	9.1	1.8
Movement in short-term deposits	50.5	(466.3)
Total	59.6	(464.5)

## 31. Ultimate parent company and controlling party

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.

## 32. Related party transactions

As at 31 March 2017, the Macquarie Group held a 26.3% shareholding in the Kemble Water Holdings (“KWH”) Group and qualified as an entity related to the KWH Group. During the year ended 31 March 2018, the Macquarie Group sold their entire shareholding in the Group and therefore ceased to be a related party.

During the year Macquarie Infrastructure and Real Assets (Europe) Limited, a wholly owned member of the Macquarie Group, provided Thames Water Utilities Limited with advisory services of £0.8 (2017: £3.9m).

During the year the Group paid £nil (2017: £20.3 million) in respect of interest on a loan issued from Kemble Water International Holdings Limited, a company managed by the Macquarie Group. As at 31 March 2018 the Group had an outstanding payable balance in relation to loan principal and interest, of £nil (2017: £86.2 million) with Kemble Water International Holdings Limited.

As at 31 March 2018, 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, held a 27.4% shareholding in the KWH Group and qualified as an entity related to the KWH Group. The Group had an outstanding payable balance in relation to loan principal and interest of £99.9 million as at 31 March 2018 with Farmoor Holdings B.V. (2017: £nil).

### 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 24.

	2018 £'000	2017 £'000
Short term employee benefits	6,553	3,716
Post-employment benefits	451	411
Other long-term benefits	31	561
Termination benefits	222	2,103
Other	999	726
<b>Total</b>	<b>8,256</b>	<b>7,517</b>

### 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 £nil (2017: £22.8 million) and total net interest receivable during the year was £402.3 million (2017: £367.9 million).

As at 31 March 2018 net amounts owed to the Company from subsidiary undertakings were £4,001.0 million (2017: £3,927.6 million). As at 31 March 2018 and 31 March 2017, 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.

## 33. Post balance sheet events

On 23 November 2017, the intention to close the Group’s undertakings in the Cayman Islands (Thames Water Utilities Cayman Finance Limited (“TWUCF”) and Thames Water Utilities Cayman Finance Holdings Limited) was announced, as part of a review of the Group’s corporate structure and governance, on the basis that these entities no longer serve their original purpose of enabling smoother access to the global bond markets.

On 4 June 2018, the bond holders’ consent process was launched to transfer TWUCF’s assets and liabilities at fair value to Thames Water Utilities Finance Limited (“TWUF”), a Group undertaking registered in the United Kingdom.

On 26 June 2018, all public and private placement debt currently issued by TWUCF have consented to their substitution to TWUF and Deutsche (acting in its capacity as Security Trustee), has confirmed that sufficient creditor support has been provided to implement the proposed amendments to support the removal of TWUCF from the Thames Water financing group.

As the transfer of assets and liabilities will take place between two Group companies, any resulting changes in fair values will be eliminated in future consolidated financial statements.



## Notes to the Company financial statements

### 34. Investment in subsidiaries

	2018 £m	2017 £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 39 to these financial statements.

### 35. Intercompany loans receivable

	2018 £m	2017 £m
<i>Intercompany loans receivable:</i>		
Due from Kemble Water Eurobond Plc	1,990.6	1,990.6
<i>Interest on intercompany loans receivable:</i>		
Due from Kemble Water Eurobond Plc	2,435.4	2,033.0
Impairment of interest receivable	(558.0)	(96.0)
	1,877.4	1,937.0
Total	3,868.0	3,927.6
Disclosed within non-current assets	3,868.0	-
Disclosed within current assets	-	3,927.6

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, management have reviewed the classification of intercompany receivables and have taken the decision to reclassify some balances from current to non-current.

### 36. Trade and other payables

	2018 £m	2017 £m
Amounts payable in respect of group relief	282.8	206.3

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

## 37. 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 (2017: none).

### Categories of financial instruments

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

	2018 £m	2017 £m
<b>Financial assets:</b>		
<i>Loans and receivables (including cash and cash equivalents)</i>		
Intercompany loans receivable	3,868.0	3,927.6
<b>Total</b>	<b>3,868.0</b>	<b>3,927.6</b>
<b>Financial liabilities:</b>		
<i>Other financial liabilities</i>		
Trade and other payables	(282.8)	(206.3)
<b>Total</b>	<b>(282.8)</b>	<b>(206.3)</b>

### 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 11. The capital structure of the Company is as follows:

	2018 £m	2017 £m
Net debt	-	-
Equity attributable to the owners of the Group	3,719.2	3,722.3

### 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 12. 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 £3,868.0 million (2017: £3,927.6 million).

## 37. Financial instruments (continued)

### (b) Liquidity risk

Details of the nature and management of the Group's liquidity risk is provided on page 12.

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

	2018 £m	2017 £m
Within one year	282.8	206.3
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	-	-
<b>Total</b>	<b>282.8</b>	<b>206.3</b>

## 38. Statement of cash flows

### Reconciliation of operating profit to operating cash flows

	2018 £m	2017 £m
(Loss)/profit for the financial year	(136.1)	198.3
Less finance income	(402.3)	(367.9)
Add impairment of interest receivable from Kemble Water Eurobond Plc	462.0	96.0
Add taxation on profit on ordinary activities	76.4	73.6
<b>Cash generated from operations</b>	<b>-</b>	<b>-</b>

### 39. Subsidiaries, associated undertakings, and significant holdings other than subsidiary undertakings

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

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

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

### 39. 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, Umland 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)
- Thames Water Insurance Company Limited (St. Martin's House, Le Bordage, St Peter Port, GY1 4AU, Guernsey)

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.

Management are undertaking a review of the Group's corporate structure with the intention of reducing the number of undertakings.