

Severn Trent Water Limited

Report and financial statements
For the year ended 31 March 2017

Company number 2366686



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Severn Trent Water Limited

Strategic Report

For the year ended 31 March 2017

Our Vision

Our vision is to be the most trusted water company by 2020, delivering an outstanding customer experience, best value service and environmental leadership.

Our Purpose

Our purpose is to serve our communities and build a lasting water legacy.

Our Strategy

We aim to achieve these by meeting our strategic goals:

- Embed customers at the heart of all we do
- Drive operational excellence and continuous innovation
- Invest responsibly for sustainable growth
- Change the market for the better
- Create an awesome place to work

Our Values

While ensuring we live our values:

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

What we do

Our purpose is to serve our communities and build a lasting water legacy. We do this by providing clean water and waste water services and developing renewable energy solutions through our business Severn Trent Water.

The primary markets we focus on

- Wholesale operations and engineering
- Household customer services

About us

One of the largest 10 regulated water and waste water businesses in England and Wales. We provide high quality services to more than 4.5 million households and businesses in the Midlands and Wales.

Where we operate

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

Key Facts

Turnover £1,556.1m	Litres of drinking water supplied each day 1.85bn
Underlying profit before interest and tax £512.8m	Litres of waste water treated per day 2.6bn
Profit before interest and tax £540.4m	Employees 5,827
Households and businesses served 4.5m	Average during 2016/17

Alternative Performance Measures are defined in Note 3 to the financial statements on Page 107

Chairman's statement

CONTINUED PROGRESS

Group turnover

£1,556.1m

2016: £1,523.6m

Group underlying profit before interest and tax

£512.8m

2016: £498.5m

Group profit before interest and tax

£540.4m

2016: £499.5m

Group underlying profit before interest and tax up 2.9% year on year

Focus on operational improvement

Net Reward £47.6m in 2012/13 prices pre tax

Fellow shareholders, this past year has been a successful one for Severn Trent. We are building on delivering a fast start to Asset Management Plan 6 ('AMP6') and have seen excellent operational and financial performance. These strong results are built on the hard work of your management team in striving to deliver the best possible service to our customers and consistent returns to shareholders.

Strength in times of turbulence

The macro-economic environment of the past year has been turbulent, largely due to Brexit and the US election. Our Company has been relatively sheltered from the impact of these, and has continued to offer strength and stability. Our focus on delivering high quality service to customers and benefits to shareholders is showing significant results.

AMP6 has allowed a platform for there to be winners in a world of incentivisation and we have fully embraced this approach, driving operational performance higher, completing the year with excellent delivery of customer Outcome Delivery Incentives ('ODIs') of £47.6 million. Customer ODIs are making us think differently to ensure we continually improve the service we provide to our customers and this is helping us to achieve a step-change in, for example, sewer flooding performance.

Our waste water business has been at the frontier of sector efficiency and we have made strides in aiming for upper quartile performance in water and retail. Whilst this is a multi-year journey our progress so far is encouraging. Achieving upper quartile in all three areas will improve the service and experience we offer to our customers and enhance the returns we can make in the next regulatory period.

We continue to review the suppliers we work with to support us in delivery efficiencies. This means we have stronger relationships with contractors who are now more aligned with the way we work.

As regulation evolves we must continually look for ways to adopt and enhance our competitiveness and we have been successful in embracing new markets. Earlier this year we announced the completion of our acquisition of Dee Valley Water, a neighbouring water only company which operates in Wrexham, Chester and the surrounding areas. We welcome both Dee Valley Water's customers and staff. The integration of Dee Valley's operations is progressing well, and represents an exciting opportunity for us to deliver better service to all of our customers. Dee Valley's and Severn Trent's customers will benefit from sharing best practice from both businesses. The combined Severn Trent group will also benefit from a separate Welsh water licence and a stronger voice for our Welsh customers.

We have been successful in establishing Waterplus – our ground-breaking joint venture with United Utilities – in the non household retail market, which opened to competition in April 2017.

Our regulator has signalled that further competition, for example in the opening up of the water resources and bio-resources markets, will be considered in the coming years and we believe we will be in a strong position to respond to these opportunities.

This is an exciting time to be an engineer at Severn Trent; innovation in research and development is enabling further operational excellence, and we've reached major milestones in improving the resilience of our water network during the year. The first of two new reservoirs has been brought into service at Ambergate, where we are replacing and increasing the capacity of storage at the site. We have also seen the breakthrough of the 1.8 km Bleddfa tunnel boring element of the Birmingham Resilience Project. I personally visited the Elan Valley during the year to see the great work being carried out, which will secure the supply of water to Birmingham for the next 100 years.

I know I speak for all our employees when I say that, at Severn Trent, we take pride in our environmental, societal and governance credentials. We are making continued strategy progress on our renewables agenda.

Self-generation of energy is the right thing to do for the environment and makes good financial sense for Severn Trent. We are now generating the equivalent of 34% of our energy needs and are on track for our target of 50% by end of AMP.

Delivering returns

We delivered strong financial performance this past year and I am pleased to announce that total Severn Trent Water Group turnover increased by 2.1% to £1,556.1 million, while underlying PBIT increased by 2.9% to £512.8 million and reported PBIT increased by 8.2% to £540.4 million.

Investing for the benefit of customers

We are committed to investing for the benefit of customers and are pleased to have made progress in our plans to invest the £120 million we announced last year in enhancing water quality, assistance to vulnerable customers, and security.

Innovation in research and development is enabling further operational excellence and over the course of AMP6 we are investing over £3,000 million in our assets for the future of our network. We are also committed and on track to invest £190 million in our renewables business.

Our colleagues

The strong operational and financial performance delivered this year is the result of the hard work and dedication of my colleagues and reflects incentives being firmly aligned with Company objectives. I am also proud to report our progress on diversity. Our Board is now 44% female and the executive team 60%. However, we recognise that there is more work to be done to ensure that our leaders and our workforce are representative of the customers we serve, so we remain focused on increasing the numbers of women in operational leadership positions; women and BAME (Black, Asian and Minority Ethnic) people in engineering positions; and BAME people in technical operator positions.

Severn Trent has been voted as a Top 100 Apprenticeship Employer 2016 and we have been ranked 24th globally in the Equileap Gender Equality Global Report and Ranking. We were also regional winners in the National Apprentice awards.

During the year we bade farewell to two Board members and welcomed two more to the Board of Severn Trent. Martin Lamb and Gordon Fryett stepped down after many years of great service and we

welcomed Kevin Beeston as our Senior Independent Director and Dominique Reiniche as a Non-Executive Director.

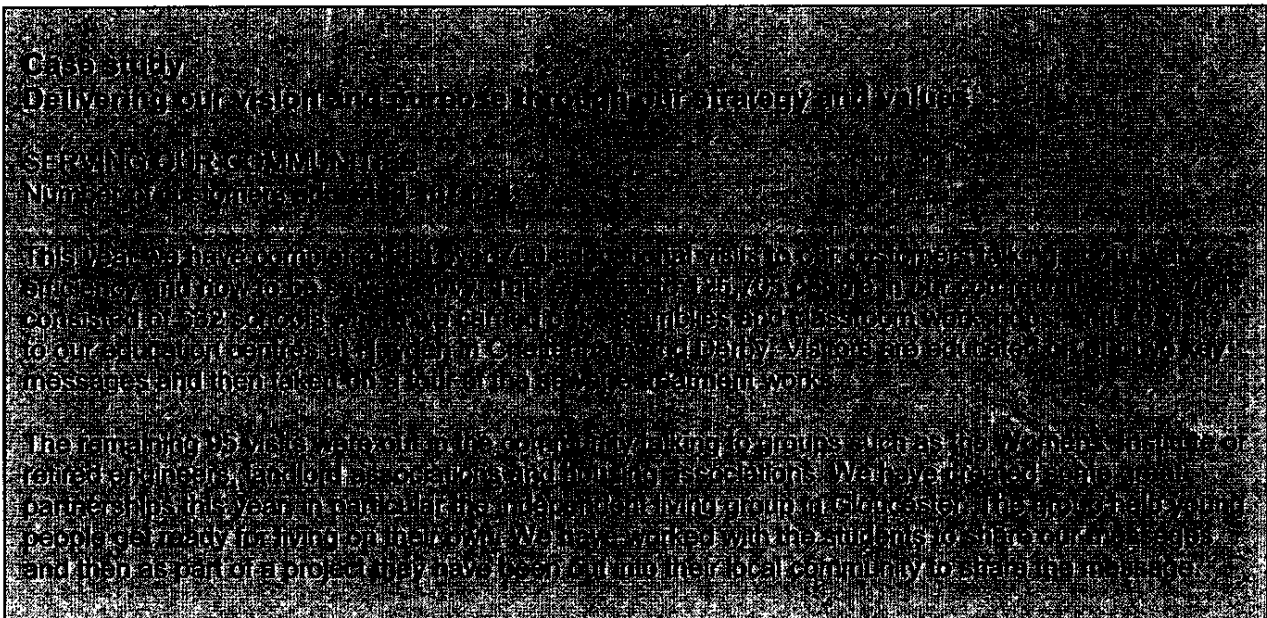
Looking forward

Being a part of the regulatory debate ensures Severn Trent is prepared for any changes on the horizon. We also believe that this helps ensure continuity and consistency in delivery. With two years of AMP6 now having passed we have started looking at the next regulatory period and driving to be in the right position now.

We begin our customer consultation shortly and want to continue to be shapers and changers of the regulatory world in which we operate.

There is much more to do. However, we are both ambitious and confident of achieving all the expectations of our stakeholders.

Andrew Duff,
Chairman



Market and industry overview

The water and waste water industry

The water and waste water industry in England and Wales is made up of 17 regional suppliers, who between them serve around 50 million household and non-household customers. Ten of these companies, including our regulated business, Severn Trent Water Limited, provide both water and waste water services. The remaining seven provide water only.

The challenges facing our industry

Since the industry was privatised in 1989, it has delivered real improvements for customers. The companies have invested hugely in their networks, found smart new ways of working and become more efficient. For example, since the mid 1990s industry-wide leakage is down by 35% and in the last 10 years sewer flooding is down by 75%, while 99.97% of drinking water and 98.6% of bathing waters now meet European Union ('EU') standards.

However, the industry still needs to tackle some major challenges in the coming years. First, customers' expectations are continuing to increase and we need to continue to improve the experience we deliver. People expect to be able to interact with their water companies at a time that's convenient for them, using the channels they prefer. That's why Severn Trent wants to lead in digital, so we can serve customers 24 hours a day and make best use of channels such as social media and webchat.

We also need to make sure our assets can withstand whatever the future may bring. Climate change is likely to cause more periods of drought and flooding, so the industry needs to ensure it can provide its services, no matter what the weather is like. Severn Trent's plans commit us to making our network more resilient, to cope with greater extremes in our climate. For example, our £300 million Birmingham Resilience Project will protect the water supply for the UK's second largest city.

Although the industry has invested more than £108 billion since privatisation, it still needs to repair and replace sewers, pipes and other assets that in some cases are more than a century old. During our current five year plan, Severn Trent will invest over £3,000 million in our assets, so the next generation can benefit from even better services.

We also need to cope with a growing population. The Office for National Statistics estimates that the population of England and Wales will increase by over 9 million people by 2040. At the same time, the government is looking to significantly increase house building over the next few years. All of this means that more homes and businesses will need our services. We have to invest carefully, to ensure we can meet those needs.

We are delighted to have received Utility of the Year from the Home Builders Federation in October 2016.

As we're working to overcome these challenges, we also need to keep bills affordable for customers, especially for those on the lowest incomes, and ensure we have the money we need to fund our investment over the long term. This will allow us to deliver for customers and create value for investors.

The industry's regulatory framework

The Government's approach to our industry is set by the Department for the Environment, Food and Rural Affairs ('Defra') in England and the Welsh Government in Wales.

Ofwat is the industry's economic regulator. This means it sets limits on the prices we can charge our customers over five year AMP cycles. This financial year was the second of AMP6, which runs from April 2015 to March 2020.

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

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

The continuing evolution of regulation

Ofwat's last review of the industry's pricing was in 2014. That price review resulted in the most important changes in the industry's economic regulation since privatisation. It gave customers a much stronger voice in determining companies' plans and introduced Outcome Delivery Incentives ('ODIs'), which encourage companies to deliver what customers want using performance-related rewards and penalties. Ofwat also encouraged companies to look at the whole life costs of their assets, rather than separately looking at how much to invest in them and how much they cost to run. This total cost is known as Totex. Companies also have stronger incentives to become even more efficient.

The next price review is in 2019 ('PR19') and Ofwat has already begun to shape its approach. In May 2016, it published its Water 2020 framework, which set out how it proposes to regulate the sector at PR19. This included increasing the number of price controls, to allow it to look at companies' cost bases in more detail and promote competition in areas such as water resources and bio-resources, as well as using the Consumer Price Index to index prices rather than the higher Retail Price Index.

Much of the industry's investment is funded by borrowing, so interest rates can have an important effect on companies' costs. In September 2016, Ofwat published its proposals on the cost of debt. This would automatically adjust prices for customers if interest rates are different from those Ofwat assumed for new debt. In December 2016, Ofwat outlined how ODIs could be made better in PR19. The proposal could include larger rewards for companies that perform well, with larger penalties for companies who fall short. Ofwat is expected to publish a consultation on its approach to the next price review in the summer of 2017.

The most significant change to regulation in this AMP has been the introduction of retail competition for non-household customers in England, from April 2017. This allows businesses and other non-household organisations to shop around for the best deal in water supply. We have responded by creating the Waterplus joint venture and making the necessary changes to our systems and processes to allow our wholesale water business to supply retail water providers (see page 26).

In the longer term, the household retail market could also be opened to competition in England. The UK Government has said it first wants to see how retail competition works for non-household customers before making any decisions.

Contributing to the regulatory debate

We believe it's important that we put forward our views about how regulations should develop and we have a long track record of helping to shape the future of our industry.

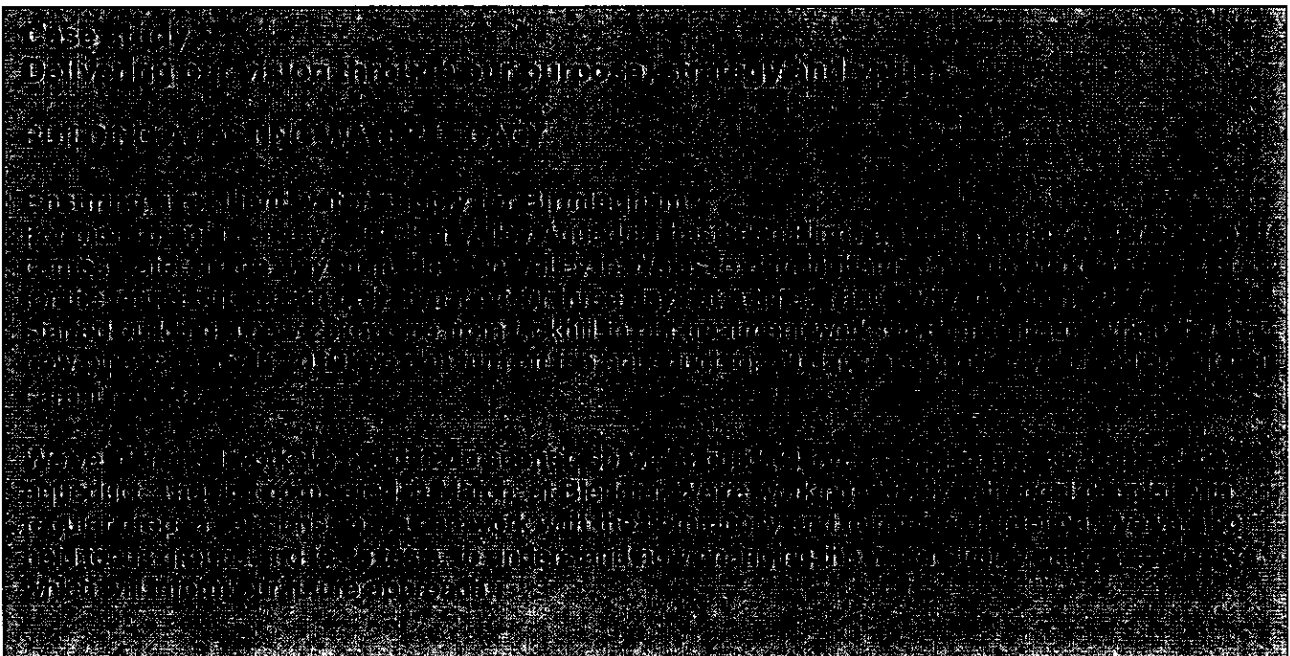
We remain very supportive of the general direction of Ofwat's proposals. We've embraced ODIs, so we're well placed as Ofwat looks to refine how they work. In April, we released the latest in our series of Charting a Sustainable Course publications, which sets out how we believe incentives can be made to work better at the next price review for all stakeholders, including customers. This builds on Ofwat's own consultation document.

We're also in favour of moves towards trading in bio-resources (a by-product of the sewage treatment process) and water resources. We're already exploring the potential for trading bio-resources with other water companies, and we see this area as an exciting opportunity for us and our customers. Trading water resources is a longer term prospect, which could provide a relatively low cost and environmentally friendly way of sharing water across regions. However, we also consider that any changes to how water is supplied need to form part of a wider package of measures including reducing demand for water.

How our customers and the external environment influence our strategy

Our strategy for AMP6 is designed to meet the challenges posed by our changing environment and regulation:

- Our strategy embeds customers at the heart of all we do. This ensures we continue to meet their needs as they evolve.
- Operational excellence and continued innovation help us to deliver the service customers rely on, while ensuring we keep bills affordable for all, both now and in the future.
- It is essential that we have a resilient, well-maintained network, which can meet the demands of a growing population and a changing climate, which is why we're investing responsibly for sustainable growth.
- Changing the market for the better means ensuring we help shape changes to regulations and are well prepared for the opportunities and challenges it brings.
- Delivering on all of the above requires us to have inspired, talented and engaged people, which is why we're creating an awesome place to work.



Chief Executive's Review

DELIVERING RESULTS

Liv Garfield, Chief Executive

Two years into the current regulatory period I'm pleased that, with the superb help and support of all my Severn Trent colleagues, we are becoming a truly customer focused business that continues to invest in our future and deliver strong and sustainable financial performance.

As a business we want to be the most trusted water company by 2020, and our customers have told us that means delivering an outstanding customer experience with the best value service and showing true environmental leadership.

In the last year we have made progress in all three areas but of course there is always more to do.

On customer experience we have made great progress in delivering against our agreed Customer Outcome Delivery Incentives (ODIs). For example, this year on two measures that customers care about most we have reduced supply interruptions by 17% and cases of external sewer flooding by 23% against our regulatory targets.

We have achieved this while making sure that we continue to offer the lowest average combined water and waste water bills in Britain, as well as increasing our commitment to support those customers most in need.

To help us focus on continuing to deliver best value service in the future we have worked hard to identify further efficiencies and have increased the targeted Totex savings by £100 million to £770 million. Making these savings will help us towards our further ambitions to be upper quartile in performance and cost in retail, water and waste.

Turning to environmental leadership, we are proud of the fact that we have had sector leading performance for two of the last four years. Furthermore, on renewable energy we are now generating the equivalent of 34% of our energy needs and are on track to self-generate 50% by 2020.

I would love to take this public opportunity to welcome our new customers and colleagues from Dee Valley Water. This strategic acquisition helps us grow our business and bring in new skills and expertise to the wider company. We look forward to continuing to integrate our two businesses over the coming months.

Consistency and progress

To make sure that we make the right progress through this regulatory period to becoming the most trusted water company, we use our strategic framework as our route map to success.

This framework focuses on five strategic objectives that we believe can deliver all of our ambitions, the five are: embed customers at the heart of all we do; drive operational excellence and continued innovation; invest responsibly for sustainable growth; change the market for the better; and create an awesome place to work.

Taking each of the five in turn, let me share some thoughts on how we are doing in each area.

Embed customers at the heart of all we do

We are proud of the fact that for the second year we have outperformed against the commitments ('ODIs') that our customers most care about. Our customer service and operational improvements have contributed to customer ODI rewards of £47.6 million. On top of the reduction in external sewer

floodings and supply interruptions, we have also sustained our improved performance on category 3 pollutions and leakage against our regulatory targets. Although we have seen tremendous progress across many aspects of the business this year, there is more we can do to improve customer experience. Whilst the number of customer complaints have declined since the start of the AMP there remains more scope for further improvements. As such we are taking a more active approach to reducing problems occurring in the first place. For example, we have worked with customers to come up with a re-designed bill which is easier to understand.

As we look to make contact easier and more efficient, we now have around a third of our customers using our 24/7 digital self-service, and we have also designed a new, easier to navigate customer website.

We are passionate about affordable bills for all and remain committed to supporting customers who most need our help. Through a range of schemes we have delivered our 'Help When You Need It' target that supported over 50,000 customers who were struggling with their payments.

Drive operational excellence and continuous innovation

We are improving the productivity of our workforce, through better devices, connectivity and apps. We are using digital technology and innovation to reduce risks through real-time water quality measurement and insight, along with active network modelling that helps us act quickly and reduce the number of bursts and cases of premature asset deterioration. We have continued to refine our use of sensors and improved analytics to prevent flooding and pollutions, as well as diagnosing and resolving jobs more effectively.

We have embraced research and development as a key enabler for operational excellence, and a great example of our innovation leadership is our world-leading phosphorous removal trials. Being leaders in this field is helping us save £10 million in this AMP.

Invest responsibly for sustainable growth

We promised to leave no stone unturned in the pursuit for Totex efficiencies during the year, and through the tremendous work of our colleagues to seek better ways to run the business, we have identified an additional £100m of efficiencies. This takes the total forecast efficiencies for this AMP to £770m (at 2012/13 prices). Of this £770m, we've been able to announce that a further £70 million of Totex efficiencies have been locked in over the last six months, building on the £540 million we'd previously announced, and taking the total amounts locked in to £610 million. We are adamant that the search does not stop here however. We will continue to seek opportunities throughout the business to drive further efficiencies for the benefit of our customers and our shareholders.

To help deliver improved customer service and a more efficient and resilient network, Severn Trent will be spending around £1,400 for every property in our region over the course of AMP6.

This year we have also taken steps to focus on to our core business with the acquisition of the Dee Valley Water Group. We have welcomed our colleagues from Dee Valley Water, which serves 125,000 properties, into the Severn Trent family, and we will spend the summer working through the integration of our two businesses. This acquisition is a natural fit, and we are enjoying learning new skills from each other as we look to collectively improve the customer experience.

Our role as custodians of our network for customers today and for future generations is right at the heart of our strategy. During the year we have seen great progress on the Birmingham Resilience Scheme, our largest ever asset-creation programme. Critical milestones such as the Bleddfa bypass have now been completed and we have also embarked on a large programme of customer engagement to support the next stage of the programme. We have also successfully met all DWI and EA obligation dates.

We have delivered some important milestones in our renewables plan, including the completion of our second food waste anaerobic digestion plant at Roundhill, Staffordshire.

We believe good businesses are socially responsible businesses and supporting our local community is central to our values. Highlights include the delivery of 12,000 water efficiency home checks to help customers save money, educating 167,024 people on sewer misuse and water efficiency and being recognised by the Drinking Water Inspectorate as industry leaders for our innovative approach to catchment management.

Change the market for the better

At the start of April 2017, we saw the opening of the non-household retail market and I am pleased with the future prospects of Waterplus, our joint venture with United Utilities.

We have engaged with all of our colleagues across the business to make sure they understand the new ways of working in this new world of competition, and our focus on being a fantastic wholesaler for all retailers operating in our region.

I was also very pleased that we have been recognised by our regulators for providing information to our customers and stakeholders that they can trust. We are one of only three companies to receive 'self-assured' status in Ofwat's annual review.

Create an awesome place to work

When I first joined the company I was struck by the hard work ethic and helpful nature of our colleagues. Having this culture as our foundation has helped us bring to life a customer-centric approach to everything we do.

As a team we are passionate about creating an awesome place to work and invest huge time and energy into our people plans. We were pleased to see our overall engagement score rise three percentage points, and continue to track above the global benchmark for employee engagement.

We have been building the required skills and capabilities for the future through the recruitment of record levels of apprentices and graduates, nearly trebling our intake of apprentices and doubling our graduate intake in 2016.

We are also focused on leadership and technical development across the whole organisation, and have delivered around a 20% increase in training days this year. We continue to recognise our colleagues' performance with a collective bonus scheme that encourages focus on key areas which benefit all of our stakeholders; health and safety, customer ODIs, and financial performance. Last year's "Bonus reveal" was a wonderful employee engagement moment.

I am also pleased that we have brought greater certainty to our pension schemes with £122 million of further deficit recovery payments by the end of AMP6, including an additional £42 million over previous commitments.

As we look to serve our communities and build a lasting water legacy, we recognise the importance of the communities in which we operate and how central they are to local life. Our volunteering scheme Community Champions is proving super popular with over 100 events planned and over 1,000 of our people signed up to take part in making a real difference to the communities in which we operate.

That completes my review of how we are doing against our Strategic Framework, after a busy but progressive year. I trust you have found it helpful.

Delivering returns

Before we take a look at the year ahead I am pleased to share that our hard work has resulted in strong levels of outperformance for customers and returns for our investors. In this past year we have performed well in all three areas which make up our allowed return on regulated equity (RoRE). I have mentioned our delivery of customer ODIs and Totex efficiencies, and James Bowling, our Chief Financial Officer, discusses our financial performance, which continues to improve, in more detail in his review.

We achieved RoRE of 11.0% this year, up from 8.4% last year. This is a very strong result which is the testament to the drive and focus of my colleagues, and it reflects the strong financial and operational health of our company.

Outlook

We remain committed to delivering high service levels to our customers in the year ahead, both as a sector leader on customer ODIs and also while improving customer experience. As an example, our 2017/18 employee bonus has been adapted to help us drive down complaints as well as deliver against our safety, customer ODI and financial targets.

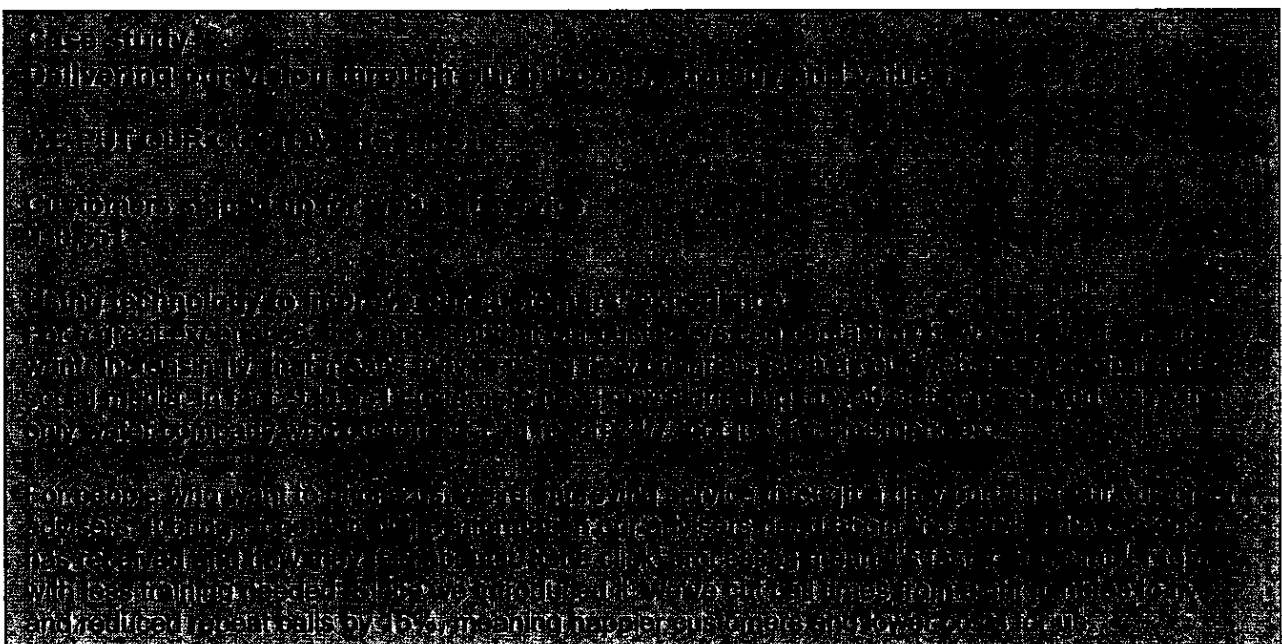
With draft determination submissions for AMP7 due in September 2018, we are working hard and collaboratively across all our teams to prepare the best possible plans which benefit all our stakeholders.

We are actively engaging with our customers to co-create the future business plans which we put forward as we prepare for the next price review.

Owat have also indicated that there will likely be further opening of the market to competition, in water resources and bio-resource trading. We firmly believe we have many strengths in these areas and are setting ourselves up for success.


So we have much to look forward to, and I relish working with my colleagues across the business as collectively we look to put customers at the heart of everything we do, and build trust with all of our stakeholders. Thank you for your ongoing support.


Liv Garfield
Chief Executive



How we are achieving our strategy

Our strategy has been in place for two years and we're making significant progress towards achieving our goals.






Embed customers at the heart of all we do


What we said we would do in 2016/17

- Embed customer experience in our product and service offerings
- Expand our customer service and recovery capabilities
- Improve customer and agent experience through digital and self-service channels
- Expand product and service offerings

Our progress in 2016/17

- Improved customer service through digital and self-service channels
- Offered new self-service channels for our customers and improved their experience with them
- Engaged with our customers through our new digital channels





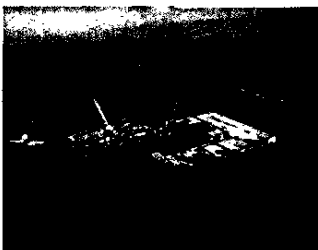
Drive operational excellence and continuous innovation


What we said we would do in 2016/17

- Drive operational excellence through digital and self-service channels
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- Drive operational excellence through digital and self-service channels

Our progress in 2016/17

- Drive operational excellence through digital and self-service channels
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Invest responsibly for sustainable growth


What we said we would do in 2016/17

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- Invest responsibly for sustainable growth

Our progress in 2016/17

- Invest responsibly for sustainable growth
- Invest responsibly for sustainable growth
- Invest responsibly for sustainable growth
- Invest responsibly for sustainable growth






Change the market for the better


What we said we would do in 2016/17

- Prepare for broader operational the retail market, followed by successful market opening
- Continue work on single market opening structures and models

Our progress in 2016/17

- Continued to contribute to the debate on future regulation, and supported Ofgem's proposals in areas such as storage trading and water resources
- Created non-household retail joint venture with United Utilities and prepared our wholesale business to support retailers in this market





Create an awesome place to work

What we said we would do in 2016/17

- Create an awesome place to work
- Create an awesome place to work
- Create an awesome place to work
- Create an awesome place to work

Our progress in 2016/17

- Create an awesome place to work
- Create an awesome place to work
- Create an awesome place to work
- Create an awesome place to work

- Launch new website, expanded our contact channels through LinkedIn, Twitter and our new 11 new direct contact contacts
- Delivered a new website that has support value to customers
- Improved the time to offer services to our new customer base (improving)

Areas of focus for 2017/18

- Maximise our capabilities and experience
- Continue to deliver on the regulatory matters of the water sector. Be the water utility that is awarded the most 7/7 annual customer ODRs
- Provide services that is able to offer a high support quality to our customers and staff (improving 80% of customers with their bills)

- Be the best used as an app for utility when it comes to the new smart use of data in the market
- Provide an industry standard experience for product development and customer who use the water and wastewater services

- Improve the way we monitor and report on our environment with the new Department for Environment, Food and Rural Affairs (DEFRA) Reporting Programme
- Manage our water and wastewater services in a sustainable manner
- Enhance and improve our digital and cyber security performance
- Manage the performance of our water and wastewater services
- Sustainable business performance that is leading in a customer focused and customer requirements targeted

Areas of focus for 2017/18

- Increase the number of projects completed in the River Wye and Avon
- Enhance the way we support our customers and staff by the use of digital
- Continue to improve and protect our water and wastewater services (EPA 407 status)
- Deliver on the regulatory matters of the water sector (improving 80% of customers with their bills)

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- Be the best used as an app for utility when it comes to the new smart use of data in the market

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- Continue to improve and protect our water and wastewater services (EPA 407 status)
- Deliver on the regulatory matters of the water sector (improving 80% of customers with their bills)

- Deliver on the regulatory matters of the water sector (improving 80% of customers with their bills)
- Provide an industry standard experience for product development and customer who use the water and wastewater services
- Be the best used as an app for utility when it comes to the new smart use of data in the market

- Invited by DWI to lead work to set a new industry standard for process control of critical water treatment works

Areas of focus for 2017/18

- Have a clear PR19 outline plan in place that evidences our leading status
- Produce compelling cases for investment that customers want to see, at PR19, that enables strong RCV growth over AMPs 7 and 8

- Design and implement the bio-resources change programme and business model
- Be seen as the water sector's thought leaders
- Create a strong Welsh entity focused on delivering local priorities

- Increase the number of projects completed in the River Wye and Avon
- Enhance the way we support our customers and staff by the use of digital
- Continue to improve and protect our water and wastewater services (EPA 407 status)
- Deliver on the regulatory matters of the water sector (improving 80% of customers with their bills)

Areas of focus for 2017/18

- Deliver a high range of our safety performance
- Improve the way we support our customers and staff by the use of digital
- Continue to improve and protect our water and wastewater services (EPA 407 status)
- Deliver on the regulatory matters of the water sector (improving 80% of customers with their bills)

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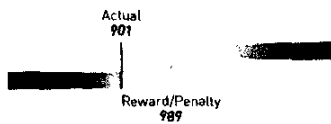
ODIs and KPIs

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

Progress against our Outcome Delivery Incentives

1. Embed customers at the heart of all we do

Internal sewer flooding



Rate of Reward/Penalty (per incident)

£42,820¹

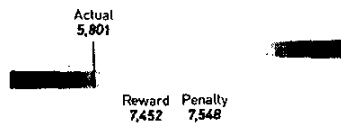
Why we measure it

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

Progress in the year

We are reporting a performance of 901 internal incidents, ahead of our committed performance level of 989 incidents

External sewer flooding



Rate of Reward/Penalty (per incident)

£19,779¹

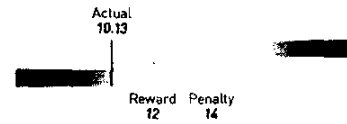
Why we measure it

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

Progress in the year

We are reporting a performance of 5,801 external incidents, ahead of our committed performance level of 7,548 incidents

Minutes without supply



Rate of Reward/Penalty (per minute)

£1.10m¹

Why we measure it

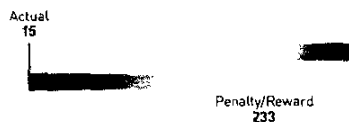
Our customers value water being there when they need it. This performance commitment ensures we are driving down the impact of any interruptions to supply across our network to minimise the impact on customers

Progress in the year

We interrupted customers' supplies for an average of 10.13 minutes (10m 8s) in 2016/17. We are ahead of our performance commitment of 12.2 minutes

2. Drive operational excellence and continuous innovation

Improvements to river water quality



Rate of Penalty/Reward (per unit)

£150,000¹

Why we measure it

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

Progress in the year

There were 15 individual points completed in 2016/17, and we are on track for our end of AMP target

Number of category 3 pollution incidents



Rate of Reward/Penalty (per incident)

£53,900¹

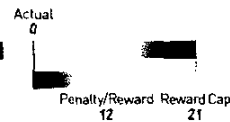
Why we measure it

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

Progress in the year

We are reporting 301 category 3 incidents against a committed performance level of 402, this is 101 ahead of target and 73 incidents ahead of our reward dead-band of 374 incidents.

Successful catchment management schemes



Rate of Penalty/Reward (per scheme)

£1.03m¹

Why we measure it

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

Progress in the year

We have made progress increasing our internal resources and agreeing a suite of performance indicators to demonstrate successful engagement and change in practice. As planned, no schemes have been fully delivered during 2016/17. Schemes are on track to be delivered in 2018/19

3. Invest responsibly for sustainable growth

See our Regulated Water and Waste Water performance review

4. Create an awesome place to work

Lost time incidents per 100,000 hrs worked

Severn Trent Water Limited

0.22 2015/16: 0.25

SIM - Customer experience

Not yet defined by Ofwat

83.61 SIM score

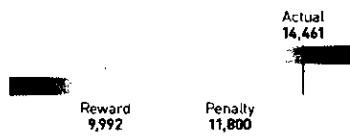
Why we measure it

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

Progress in the year

We have seen improvements in quantitative areas of our business although we have been inconsistent in our qualitative performance which has meant that we have reported a SIM score of 83.61 for 2016/17 which is behind our original upper quartile target

Complaints about water quality



Rate of Reward/Penalty (per complaint)

£900¹

Why we measure it

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

Progress in the year

In 2016, the number of drinking water quality complaints increased from 13,941 to 14,461, so we did not achieve our committed performance level of 10,995

Progress against our financial KPIs

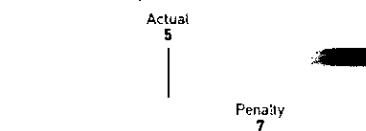
Group turnover

£1,556.1m
2015/16: £1,523.6m

Group underlying PBIT

£512.8m
2015/16: £498.5m

Asset Stewardship - coliform failures



Rate of Penalty

£463,000¹

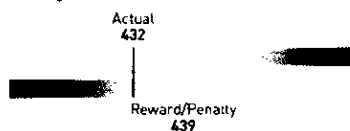
Why we measure it

The presence of coliforms in our drinking water is unacceptable so we continually monitor our works to ensure they are not being detected

Progress in the year

During 2016 we detected coliforms at five water treatment works sites, which is better than our committed performance level of seven or fewer works with coliform detections

Leakage



Rate of Reward/Penalty (per megalitre per day)

£123,000¹

Why we measure it

Customers see leakage as a waste of a key resource, our customers want us to reduce our level of leakage as a priority.

Progress in the year

Our culture position for 2016/17 was a total of 432 ML/day ahead of our committed performance level of 439 ML/day

Severn Trent engagement score improvement²

3 percentage points

Notes

- ¹ In 2012/13 prices after tax
- ² New engagement index used for the Group since 2015/16 to support benchmarking and gain better insight about us as an employer

Key

Actual
| Severn Trent Actual Performance 2016/17

Operational Review

Litres of drinking water supplied each day

1.85bn

Kilometres of sewerage pipes in our network

93,727

Households and businesses served

4.5m

Generating returns

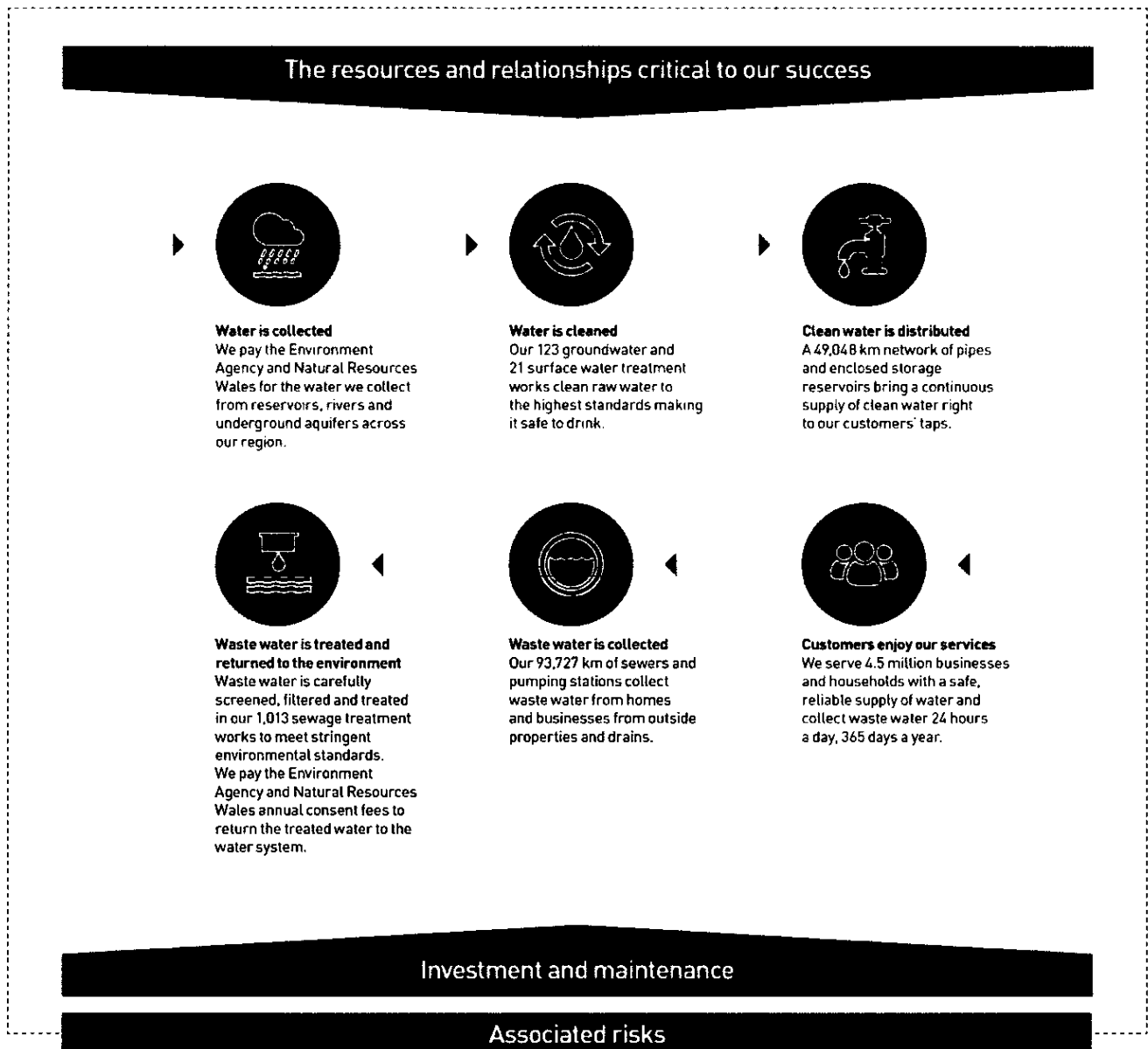
As described on page 7, Severn Trent Water's business works within five year planning cycles known as AMPs. Ofwat determines the prices we can charge our customers during each AMP, allowing us to earn a return on our asset base (known as the Regulatory Capital Value or RCV), to fund our investment programme and cover our operating costs. Our prices and asset base are adjusted by inflation each year. In certain circumstances, for example if there is a material change in costs for reasons beyond our control, we can request a price review during the AMP.

On 15 February 2017 Severn Trent Water completed the acquisition of Dee Valley Water, which is the licensed water undertaker for Wrexham, Chester and the surrounding areas. It has been supplying water to its community for more than 150 years. Dee Valley Water supplies drinking water to approximately 125,000 domestic and business customers in northeast Wales and in northwest Cheshire.

The performance commentary for the year ended 31 March 2016/17 which follows on pages 18 to 29 relates solely to Severn Trent Water.

The acquisition of Dee Valley Water was completed approximately six weeks before the end of the reporting year and did not have a material impact on the Group's financial performance for the period being reported.

Our business model



We aim to perform each stage of our work as efficiently and effectively as possible, so we meet the needs of customers and other stakeholders such as our regulators. The work we do enables us to meet 45 performance commitments we've agreed with Ofwat, several of which are unique to us. Of these, 33 customer ODIs reward us if we do the right thing for customers, by improving services and being more efficient, or penalise us if we don't. These customer ODIs incentivise us to do better in the areas that are most important to our customers. We also look to use innovative processes and technology, so we continually improve the way we work. During 2016/17, we earned a total reward of £47.6 million out of a potential reward of £70 million, and were the best performing company based on Ofwat's published results for 2015/16.

The amounts we invest in improving and maintaining our networks, together with the costs of running our operations, form our total expenditure or Totex. This year's customer bills take account of some of

our Totex and the remainder is added to our RCV, allowing us to earn a return on it in future years. We look to make savings against the Totex assumed in our final AMP6 plan, which was approved by Ofwat. Over the course of AMP6, we've identified £770 million of Totex efficiencies, which will see us save £360 million against our final determination. We've committed to reinvesting £120 million of this to benefit customers in three important areas: water quality, security and vulnerable customers.

Investment and maintenance

Included within our Totex is a wholesale capital programme totalling £539.6 million in 2016/17, which is an average of £1,400 per connected property. We spent this money in a range of areas, including our two major resilience schemes, as well as continuing to upgrade and renew our network and assets.

We fund this capital programme through customer bills. We generate profits through being efficient and borrowing from capital markets.

Our critical resources and relationships

Customers

We have 4.5 million household and business customers, in an area stretching from the Bristol Channel to the Humber, and from mid-Wales to the East Midlands. Our customers are at the heart of all we do and they were heavily involved in developing our plans for AMP6, to ensure we focus on the areas they value the most. We provide our customers with around 1.85 billion litres of high quality drinking water every day and treat around 2.6 billion litres of waste water, which we clean and return to the system.

Employees

To be the most trusted water company, we need great people. We therefore look to attract, develop and retain talented people, and to bring the next generation into the industry through our graduate and apprentice schemes. We recognise the benefits of diversity and look to have a workforce that *matches the diversity of our local communities. Keeping our people safe, healthy and well is a top priority. We aim to provide competitive and flexible rewards, which recognise our colleagues' performance.*

Suppliers

We work closely with our supply chain partners so we can achieve excellent operational performance for our customers and meet our efficiency targets. We created our One Supply Chain to make our capital programme more efficient. By choosing framework partners to work with over the five years of an AMP, we can give them greater certainty of work and achieve more competitive pricing. We can also be more innovative as we work together over time, to deliver even greater efficiencies.

Communities

Serving our communities is central to our purpose. We look to keep our communities informed and to *minimise disruption when we carry out planned work on our network. Through our education programme, we help our communities to save water and prevent blockages in our sewers and drains. We protect the environment around our communities and work with local people such as farmers to maintain the quality of the water we collect. We also aim to make a positive difference for our communities through volunteering and fundraising for charities.*

Regulators

How our industry is regulated is described in detail on page 8 of this report. We look to maintain positive and *constructive relationships with our regulators, and to share our knowledge to help them shape the future regulation of our industry. We aim to comply with our regulatory obligations at all times, so we continue to meet our commitments to our customers and other stakeholders.*

Associated risks

Each phase of the business model presents opportunities for us but also comes with risks. Our job is to maximise the opportunities while identifying, managing and mitigating the risks.

Water is collected

If one of our key assets fails, it could cause injuries, damage property or disrupt the water supply.

 Principal risks 6 and 7

Water is cleaned


During this phase, failure of key assets or processes could reduce water quality or disrupt our supply to customers.

We use potentially hazardous chemicals and processes, which can also result in injuries.

 Principal risks 5, 6 and 7


Clean water is distributed

If our distribution performance falls below the required standards, it could lead to poor customer service and increase the risk of leakage from our network.

 Principal risks 1 and 5


Customers enjoy our services

If we don't improve or maintain our performance, we could disappoint our customers.

 Principal risk 1


Waste water is collected

If we don't deal effectively with customer waste, it could lead to sewer flooding.

 Principal risk 6

Waste water is treated and returned to the environment

If we suffer an operational failure during this phase, we could damage the local environment.

 Principal risk 7

Potentially hazardous processes and substances could cause injuries to people.

Severn Trent Water performance review

In this section, we explain how our regulated business performed during the year, and the actions we're taking to deliver our strategy during this AMP.

Embedding customers at the heart of all we do

This was the second consecutive year in which we've outperformed against the commitments that our customers care most about. In particular, we've done better on external sewer flooding, interruptions to supply and pollutions. More information on how we've achieved this can be found in the section below on driving operational excellence and continued innovation.

Educating our customers helps us to perform better. Around 75% of our sewer blockages each year are caused by customers disposing of the wrong things down their toilets and drains. For example, fats, oils and greases solidify in our sewers and block them. During the year, we engaged with 167,024 customers about avoiding sewer misuse and how to use water efficiently. Educating future customers in schools and youth groups is a major part of this programme. By 2020, we've committed to engaging with 700,000 customers in total.

Our customers pay the lowest average combined water and waste water bills in Britain and will continue to do so throughout AMP6. Our average combined bill in 2016/17 was £329. We want water to be affordable for all and we've made real progress with helping customers who find it difficult to pay. As a result, we met our commitment to support 50,000 customers this year. Our Big Difference scheme is one of the largest social tariff schemes in the country, offering discounts of between 10% and 90%, depending on how much individual customers can afford to pay. During the year, it helped 35,343 people, which was more than three times the number in the previous year.

The WaterSure scheme supports people on benefits who have water meters, and people who use more water because of a large family or a medical condition. We also continue to work with the Severn Trent Trust Fund, which celebrates its 20th year in 2017. It helps people in arrears with their water bills and can also provide support with essential household bills or costs. Since 1997, we've donated more than £60 million to the Fund, for the benefit of 550,000 people across our region. In 2016/17, we donated £3.5 million.

In addition, we've invested in a care and assistance team, to support customers who are struggling with a broader range of problems. This can include help to resolve financial issues or assistance with other issues, such as their physical or mental health. In October 2016, we won the Utilities & Telecoms Best Vulnerable Customer Support Team award.

To keep bills affordable for all, we work hard to ensure that everyone who can pay does, so they don't increase the burden on others. During the year, we maintained our level of household consumer bad debts at 1.8% of turnover, which remains one of the best performances in the sector.

We've continued to improve how we communicate with our customers and keep them informed. This year, we fully rolled out the new design for our bills, which is clearer, simpler and easier to understand. We've also relaunched our website to improve customer interaction and allow them to carry out more tasks themselves. The new design followed extensive testing with users, to make it easy to find the most popular areas.

Our customers increasingly want to use digital channels to interact with us. In particular, we're seeing substantial growth in the use of webchat. We also offer 24/7 coverage on Twitter and get many customers interacting with us via Facebook.

Our emergency contact centre is open 24 hours a day, and we're now testing longer opening hours for non-urgent contacts, based on our analysis of when our customers want to talk to us. We have extended opening hours, which proved particularly helpful for customers during our main billing period.

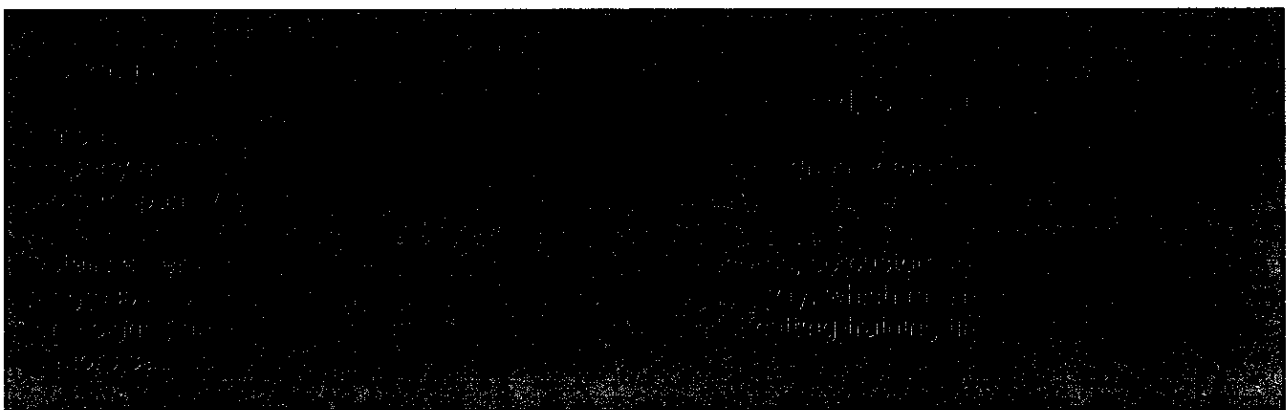
We've also further improved the ways we communicate with our customers so they don't have to contact us. If a water main bursts, for example, we look to reach affected customers by text or voicemail so they know what's going on and what we're doing to fix it. We also use our website and social media to spread these messages, so people have as much information as possible.

The new customer management portal for our contact agents went live in January 2017. This gives advisers a full picture of the customer, as soon as they call in. For example, it has indicators showing key information about water, waste, bills, whether the customer is up to date with payments, the experience they've reported through surveys and feedback, as well as a full contact history. The new system is reducing call times, which is better for customers and for us, and automating work that used to be done manually means there's less for our advisers to do once the call has ended.

Our customer ODI performance shows us that the overall level of service we are providing to customers continues to improve. For example, within the Severn Trent area we have seen improvements since the end of AMP5 with the number of customers impacted by a sewer flooding event having reduced by 40%, and this past year we were around 18% less likely to impact the environment by a category 3 pollution incident. However, we're taking longer than we would like to resolve issues in some areas, such as fixing complex leaks. We had a strong performance reducing household written complaints in 2015/16. This year, we have seen an overall increase, although complaints specific to billing have continued to reduce.

We improved our score in the Institute of Customer Service's Customer Service Index, moving us up to fifth out of 25 utility companies and third among the 11 water companies that obtained a result. Our overall performance against Ofwat's Service Incentive Mechanism ('SIM') has remained stable compared to last year. However, we recognise that other companies are improving. We know from our customers that our service standards are inconsistent and there is a lack of communication and ownership of customer relationships across the Company when a customer has a problem. Resolving these issues is a key priority for us in the coming year, and we will be introducing a new customer service measure into the short-term incentive plan.

Driving operational excellence and continued innovation



We aim to be a winner in a world of incentivisation. Customer ODIs make us think differently about how we work, to continually improve the service we provide to customers and increase our efficiency. We're in the top quarter of the industry for efficiency in water and leading the way for efficiency in waste.

When we developed our plans for AMP6, our customers told us that preventing internal and external sewer flooding was their number one priority. This year, we've outperformed our regulatory targets for internal sewer flooding by 9% and external sewer flooding by 23%. Over the first two years of AMP6, we've invested significantly in identifying the parts of our network that are prone to blockage and proactively cleaning those sewers to prevent flooding. We've also spent £14 million this year on

inspecting our flooding hotspots, and we're investigating and resolving issues at around 350 properties whose neighbours have experienced internal flooding in the last 10 years.

At the same time we're taking a new approach to flood prevention by working with local authorities who are responsible for surface drainage and the Environment Agency ('EA'), which is responsible for preventing river flooding. Together, we're identifying where we should invest to protect more people from flooding. For example, we secured funding from the Flood Defence Grant for a joint scheme with Birmingham City Council.

Interruptions to supply fell to an average of 10 minutes 8 seconds per property in 2016/17, which is 17% ahead of our regulatory target. We have also seen the lowest ever levels of customers without supply for more than 12 hours, 8.5% better than we had previously achieved. We're seeing the benefit of our consistent investment in the network. We've also improved our ability to respond when bursts do happen, for example using reactive logging technology to provide real-time information to our control rooms. This helps us to quickly understand the scale of the problem and which customers are affected, so we can restore their supplies as soon as possible. This technology also tells us how healthy our network is, identifying increases in water pressure which can lead to pipe bursts and enabling us to fix assets before they deteriorate. Reducing the volume of water that leaks from our pipes is important to us and we are testing the use of satellite technology to help identify leakage locations. Our performance this year improved by 0.5% to 432 MI/d compared to 2015/16, and 2.7% since the start of AMP6. Our performance takes account of actual water lost, changes to data and minor method improvements, and remains ahead of our regulatory target of 439 MI/d. We continue to make iterative improvements to our leakage performance by driving down the time to fix leaks, resolving bursts on private properties quicker and giving really clear prioritisation and focus to the biggest leaks.

We've sustained our improved performance on less serious (category 3) pollution incidents, with a total of 301 against our regulatory target of 402. We suffered seven serious and major pollution incidents (categories 1 and 2) in the year. While this is an increase from the exceptionally low number in the previous year, we remain committed to our long term aim of having zero incidents by 2020.

We continue our efforts to reduce pollution incidents, for example by preventing sewer flooding, and work closely with local authorities and the EA to limit the impact of the incidents that do occur.

Our Operational Effectiveness Programme is making sure that our large water treatment works run predictably and efficiently, so we provide a resilient supply of better quality water to our customers. The programme has shown us how all of our processes at these sites are working. Tracking of critical-to-quality performance measures helps us to more tightly control our processes and more proactively intervene where necessary to maintain control. This also allows us to proactively identify where we might have problems in the future, so we can strengthen our processes and invest where required.

As part of this programme, we met our commitment to the DWI to carry out diagnostics at our 16 largest sites. Overall, we broadly maintained our mean zonal compliance at 99.94% (2015/16: 9.96%), although this was below our target of 99.97%. We've given our teams a new app-based technology solution, Workmate, to give them all the information required to complete and record critical water quality tasks. This helps to maintain our assets in the best possible health.

We also maintained our outstanding performance on coliform detections at water treatment works. Coliforms are harmless bacteria but if we find them in our water it can be a sign that the water is below the quality we want. We had detections at five sites this year. This compares with 13 two years ago. The reduction is the result of activities such as the Operational Effectiveness Programme, described above.

In 2016/17, we had a total of 14,461 water quality complaints, which was more than our regulatory target of 10,995. We're investing more to achieve a sharp improvement and increasing our understanding of

where there are problem areas in our network. This will allow us to invest in those areas if necessary or to flush the network to remove sediment, which can discolour the water. We will also be learning from our colleagues at Dee Valley Water who have done well to reduce water quality complaints. We communicate proactively with customers on water quality issues, and give advice to customers when working in their area, and preventing leaks and other problems such as illegal use of hydrants also helps to protect water quality, as they can disturb the network and stir up sediment.

The number of our waste treatment works failing to comply with their EA permits fell from seven last year to one in 2016/17. We used a similar approach to our Operational Effectiveness Programme, to make sure that our processes at our waste treatment works allow us to meet our compliance targets.



Reducing our environmental impact is fundamental to how we work. This year, we improved our Asset Stewardship Environmental Compliance from 97.51% to 97.99%. We're also delivering on all schemes that are part of the National Environment Programme, to improve the quality of the water we return to the environment. Overall, we did better on six of the seven measures that go towards our Environmental Performance Assessment, which resulted in a provisional 3* rating from the EA. This was down from a 4* rating last year, as the EA significantly increased the required performance for a 4* rating this year. We are determined to regain a 4* rating next year.

In addition, we're making clever use of new technology. At some network sewage pumping stations, we're testing technology that learns as it goes along, so it can automatically and remotely pump sewage to parts of the network with spare capacity, helping to prevent flooding and serious pollutions.

We continually seek ways to improve our operational performance. This year, we created three state-of-the-art regional distribution centres through our stores transformation project. These make sure that our teams have access to the materials they need, when they need them.

Operational excellence includes providing high quality data about our business to those who need it. In Ofwat's annual review, we were one of only three companies to receive 'self-assured' status, recognising that we provide information to customers and other stakeholders that they can trust.

Investing responsibly for sustainable growth

Our capital programme saw us invest around £680 million this year to ensure our network is fit for the future. As part of this, we reached major milestones in improving the resilience of our network. The £300 million Birmingham Resilience Project is the largest capital project in the industry during AMP6. Due for completion by 2020, it will create a second major source of water for Birmingham, which is the UK's second largest city. This year we began work on the three tunnels required and saw the breakthrough of the 1.8 km Bleddfa tunnel, a key milestone for the project.

Ambergate reservoir is critical for serving customers in the East Midlands. We're replacing the reservoir and increasing capacity at the site. In November, we put the first of two new reservoirs into

service, a month ahead of schedule. Throughout the project, we'll be working closely with the local community to minimise disruption, and we've received positive feedback from the Chair of the Community Liaison Group for our approach, as well as a Bronze award at the Considerate Constructors Scheme's National Site Awards in April 2017.

New technology has an important part to play and we continue to invest where it will improve customer service or reduce costs. For example, we're investing to enable us to monitor coliforms in real time, compared with the current process which takes 24 hours to process a sample. We've also invested in new technologies to remove phosphorus, a major pollutant in rivers, from sewage. This has cut costs and could allow us to make money by turning the sludge into high quality agricultural fertiliser. Energy is a significant cost for us and we're reducing our energy use across the business, for example by introducing more efficient ways of using our pumps and blowers.

Through our Fit for Purpose programme, we work with our One Supply Chain partners to do things more effectively. It helps us to deliver our capital commitments as efficiently as possible, by ensuring we and our partners are incentivised to work towards the same objectives. We've also worked with suppliers to understand and influence their approach to responsible business. This includes introducing a supply chain charter, which covers the behaviours we want to see, what we expect in areas such as modern slavery, and a rigorous approach to measuring environmental performance.

Severn Trent continues to promote responsible catchment management, which helps to protect our water sources from contamination. More than 26,000 hectares of farmland are already covered by our Farmers as Producers of Clean Water scheme, which helps farmers to understand the impact of the way they run their businesses on the region's water courses. In particular, the scheme aims to prevent pollution from metaldehyde, which is used to kill pests. The DWI recognised us as industry leaders for catchment management in its last annual report.

We continue to work to reduce our carbon emissions, which fell by 3% during the year from 466 kilotonnes of CO₂e to 456 kilotonnes. However, we did not meet our stretching ODI target for the year. More information about our greenhouse gas emissions can be found on pages 55 and 56.

Changing the market for the better

Severn Trent has a long track record of contributing to the development of our industry. Information about our input to the future of regulation, and the potential for new markets such as bio-resource trading and water resources, can be found on page 9.

In April, we released the latest in our series of Charting a Sustainable Course publications, which sets out how we believe incentives can be made to work better at the next price review. This builds on Ofwat's Water 2020 framework and proposes how regulation could encourage innovation and efficiency whilst protecting customers' interests.

We continue to embrace new competitive markets. The non-household retail market opened to competition in April 2017. Our wholesale operations have been preparing to serve the retailers in this market, including our new joint venture 'Waterplus' with United Utilities. This has included agreeing service levels for the critical activities we'll provide to retailers and setting up processes for monitoring those service levels. We've also created a business retailer contact team.

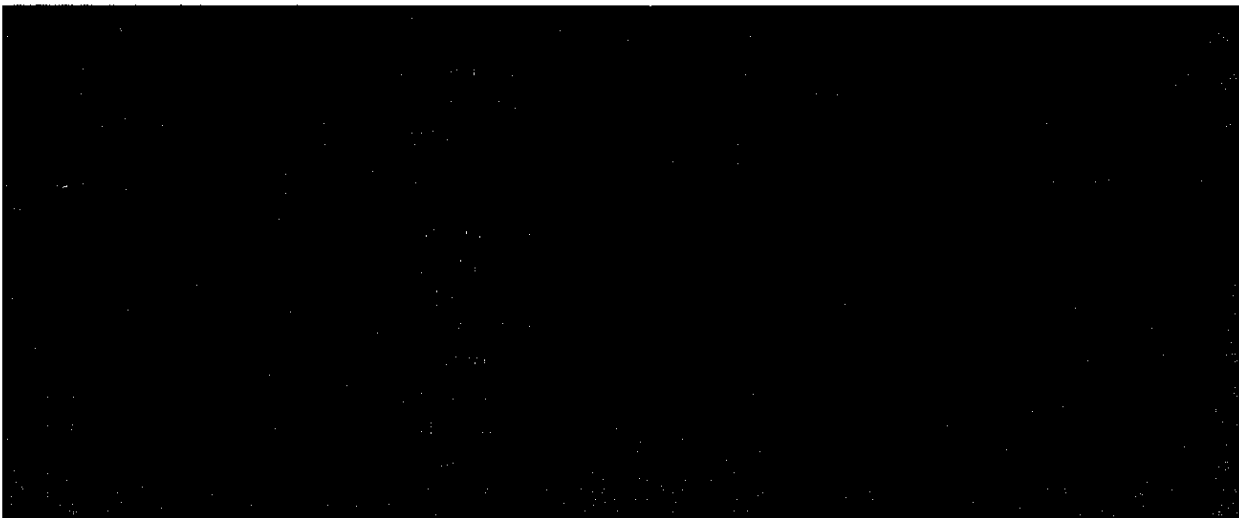
We also contribute to developing new ways of working that will benefit the broader industry. Following our improvements to processes at our large water treatment works, the DWI invited us to lead work to strengthen the resilience of sites that are 'too critical to fail', due to the large numbers of people they serve.

Creating an awesome place to work

We want our people to be part of an organisation that celebrates diversity and individual thinking, that provides recognition and reward whenever it's due, and offers opportunities to do satisfying work and to develop careers. We also look to achieve the highest possible standards of health, safety and wellbeing.

Safety is always a priority for us. In 2016/17 we reduced our lost time injury ('LTI') rate within Severn Trent Water Limited from 0.25 to 0.22 LTIs per 100,000 hours worked. This reduction was less than we aimed for and we are continuing to seek more engaging ways to deliver further sustainable improvements. In our supply chain, continued collaboration has seen further reduction to the lowest ever LTI rates, and we also reduced total accidents by another 7%, following a 25% reduction last year, sustaining and embedding improvements.

We are also proud of our progress in protecting our people's wellbeing this year, in particular in the area of mental health. Our campaign included #elephanttalks, aimed at breaking down the stigma associated with mental health, providing personal tools to help individuals identify their own mental health issues and training managers to spot the symptoms. This has been well received and has already begun to reduce levels of absenteeism.



Diversity and inclusion are important for success and we have always made them a priority. Our Severn Trent Water Limited workforce remains broadly in line with the sector averages, with female employees accounting for 31.3% of the total compared with 33% across the industry. 8.9% of our employees are Black, Asian or Minority Ethnic ('BAME'), against an industry average of 5%.

To help improve diversity, we've introduced an innovative approach to attracting and assessing candidates for our new talent schemes. Instead of looking at what experience candidates have, we now focus on their strengths. This helps people who have fewer opportunities to gain work experience, which can be an issue for BAME candidates and those from lower income households. It gives us a more balanced picture of candidates and more people from BAME backgrounds are coming through the process.

We also ran a pilot with a social mobility charity to give students who might not consider a career with Severn Trent the opportunity to learn more about the organisation. The programme offered the students an introduction into the world of work and gave them practical experience of the application and interview process. Several of the programme members secured graduate and apprentice positions with us.

Severn Trent has strong gender diversity among our most senior management. More information on diversity can be found within the Corporate Governance report on pages 73 and 74.

In 2016/17, we introduced a simplified bonus structure for all employees. Bonus levels depend on PBIT, achieving customer ODIs and our health and safety performance. This means that our employees' and managers' reward re based on the same measures right through the whole company, as explained in more detail on page 80. In addition, our all employee share scheme has a remarkable 70% take-up and our market leading pension scheme has 98% of employees enrolled. The Our Brilliant People recognition scheme is also proving successful, with our people being nominated 17,087 times for recognition for excellent work. In 2017/18, the bonus structure for all employees will introduce a further performance measure on customer satisfaction.

We invest significant sums in training and development and in total we delivered 20% more training days in 2016/17. Inspiring Great Performance is our approach to having great conversations about development, so we can create programmes that meet business and personal needs. We continued to run our Awesome Leaders Programme, which is our flagship programme for team managers. More than 400 people have now been through it. We also developed 65 middle managers, to help them embed this programme with their team leaders. This year, we rigorously reviewed the personal development plans for our senior and middle managers. As a result, we're developing a programme for our middle managers, which will cover areas such as building networks, improving stakeholder engagement and commercial knowledge. In addition, we've designed a programme of technical development for operational managers, which provides 15 days of training across 25 subject areas. We've also introduced a comprehensive training programme called Skilled by Choice, for team managers and staff at our water treatment works.

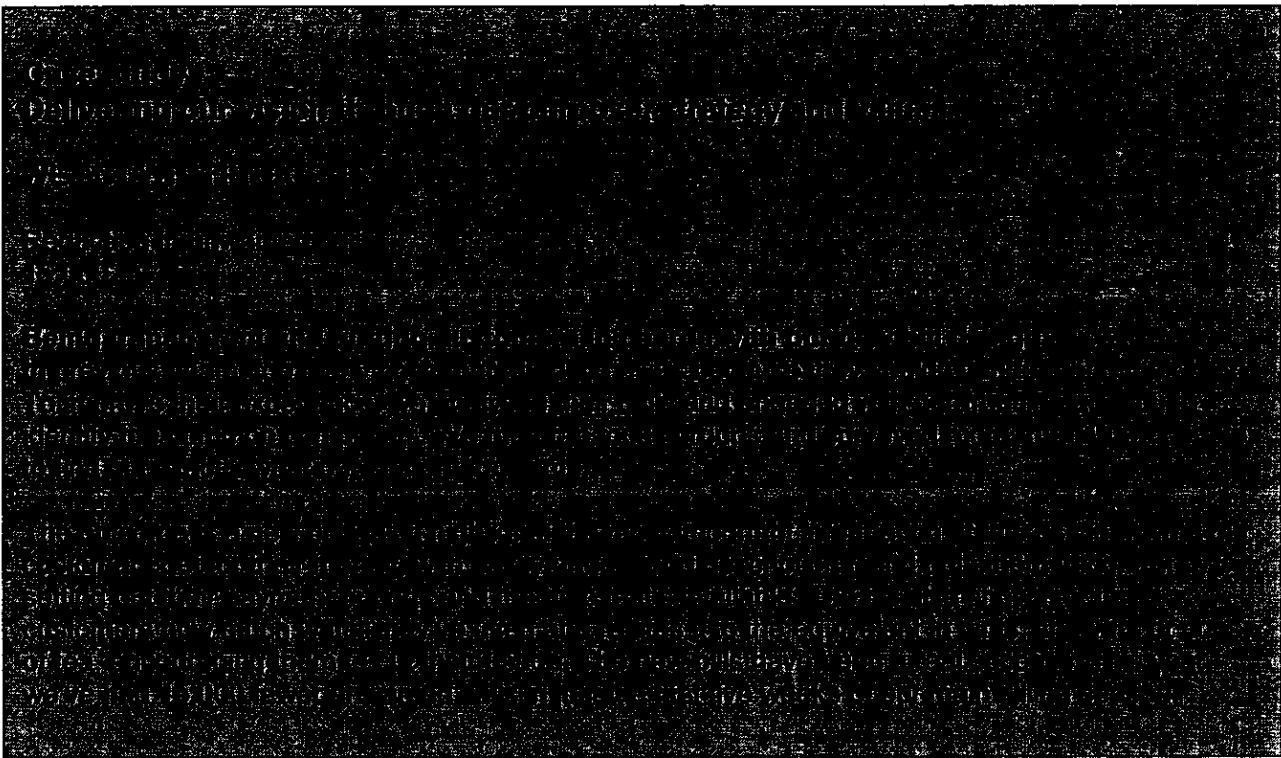
With many skilled people in our workforce set to retire in the next 10 years, bringing the next generation of talent through is critical. This year we therefore trebled the number of apprentices we took on and doubled our graduate intake. We were recognised for our work as regional winners in the National Apprenticeship Awards and Asian Apprenticeship Employer of the Year. We also run a wide range of careers events in schools, colleges and universities, to inspire young people to study science, technology, engineering and maths subjects, and consider a career with us.

The response rate to our annual employee survey increased from 80% to 84% and our people gave us higher scores in every category. Our overall engagement score improved by three percentage points and is above the global benchmark, reflecting our considerable efforts to respond to the findings of last year's survey. One third of our teams have a top quartile engagement score and we continue to receive high scores in health, safety and the environment; diversity and inclusion; and customer focus. Areas where we're looking to improve include collaboration across teams, career progression and employee recognition.

Outlook

While we're pleased with many aspects of this year's performance, we're aware that we have much more to do to achieve the high standards we, our customers and our other stakeholders expect.

In 2017/18, we'll continue to focus on our customer ODIs so we improve customer service. We'll look to do better for customers when things go wrong and reduce the level of water quality complaints. We'll also continue to strive to be the environmental leader in everything we do and to be a key player in helping the industry to strengthen its long term asset management approach.



Chief Financial Officer's review

The group has delivered strong financial performance in 2016/17, reflecting the hard work and dedication of all Severn Trent employees. Reduced operating costs as our efficiency programmes deliver results has strengthened our underlying performance.

Results

Turnover for our Severn Trent Water Group was £1,556.1 million (2015/16: £1,523.6 million) and underlying PBIT was £512.8 million (2015/16: £498.5 million). As noted in our announcement on 8 September, the prior year underlying PBIT has been restated by £20.2 million to reflect the share of results generated by Severn Trent Water Limited that were generated from the non-household retail operations transferred to Water Plus.

	2017	2016 (restated)	Better/(worse)	
	£m	£m	£m	%
Turnover	1,556.1	1,523.6	32.5	2.1
Net labour costs	(146.3)	(148.4)	2.1	1.4
Net hired and contracted costs	(163.2)	(160.9)	(2.3)	(1.4)
Bad debts	(20.6)	(20.3)	(0.3)	(1.5)
Power	(70.5)	(68.9)	(1.6)	(2.3)
Other costs	(186.4)	(190.4)	4.0	2.1
	(587.0)	(588.9)	1.9	0.3
Infrastructure renewals expenditure	(136.2)	(126.0)	(10.2)	(8.1)
Depreciation	(320.1)	(310.2)	(9.9)	(3.2)
Underlying PBIT	512.8	498.5	14.3	2.9

Turnover increased by 2.1%. Higher tariffs, including the impact of the annual RPI increase on prices, increased revenue by £22.6 million. Higher consumption added a further £3.1 million, offset by an increase in meter optants and other small movements that reduced revenue by £3.0m. Renewable energy sales increased by £9.8 million.

Net labour costs were £2.1 million (1.4%) lower. Gross employee costs increased by 7.0%, in part as a result of our strategy to bring more work in-house, but our teams have spent more time on capital projects and so the amount of labour capitalised was £25.5 million higher than in the previous year.

Net hired and contracted costs increased by £2.3 million as a result of increased sludge disposal by third parties.

The bad debt charge from household customers represents 1.8% of household revenue, a stable performance year-on-year (2015/16: 1.8%). Total bad debt charges were £0.3 million higher at 1.3% of turnover in the year. Following market opening, retailers now bear the credit risk for non-household customers and Severn Trent Water bears the credit risk on sales to retailers.

Power costs were £1.6 million greater year on year. We implemented a number of actions that successfully reduced consumption, despite higher water production driven by customer demand offsetting these savings. The group manages its power costs through a combination of demand management, self-generation and forward price contracts.

Other costs decreased by £4.0 million despite the previous year benefitting from a rebate of £4.4 million from the Environment Agency. This was due to greater cost control and additional amortisation of deferred credits in line with expectations.

Infrastructure maintenance expenditure was £10.2 million greater in the year reflecting a planned increase in activity, partially offset by operating efficiencies.

Depreciation, was £9.9 million greater as we grew our asset base by 4% on the previous year.

Return on Regulated Equity (RoRE)

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

Severn Trent Water's RoRE for the year ended 31 March 2017 and for the two years ended on that date is set out in the following table:

	2016/17 % ¹	AMP6 to Date % ¹
Base return ²	5.6	5.6
Totex outperformance ³	2.1	1.4
ODI outperformance ⁴	1.3	1.0
Financing outperformance ⁵	1.8	1.6
Other ⁶	0.2	0.1
Regulatory return for the year	11.0	9.7

- 1 Based on RCV of £7,413 million for 2016/17 and £7,324 million for AMP6 to date, both in 2012/13 prices.
- 2 Based on Final Determination, with an adjustment to the 2016/17 base return to exclude the non-household retail return that is now being earned by Water Plus.
- 3 Company share of totex outperformance in the year/AMP to date, adjusted for phasing.
- 4 Company assessment of performance – 2016/17 performance will be subject to Ofwat review in Autumn 2017.
- 5 Based on actual financing cost and net debt. The nominal finance cost from the Final Determination has been deflated to 2012/13 prices using the Final Determination average RPI inflation for the period. Ofwat have provided further clarificatory guidance on RoRE to ensure consistency across companies and will be reporting on this shortly. On this basis we estimate our RoRE would be 10%.
- 6 Includes land sales and disposals, other income, the Wholesale Revenue Forecasting Incentive Mechanism and element of non-household retail revenue performance earned before the Water Plus joint venture.

We have delivered strong returns of 11.0%, and our performance has been strong across the board – with exceptional Customer ODI performance, improved operational and investment efficiency service levels, and continuing outperformance on finance.

Following their review of the RoRE performance reported across the sector, Ofwat have provided further clarificatory guidance on RoRE and will be reporting on this shortly.

In line with this guidance, which mainly affects the calculation of financing outperformance, we estimate our RoRE would be 10.0% resulting in a cumulative RoRE of 8.2%.

Under either measure, we are pleased to be delivering sustained, balanced outperformance for the benefit of our customers and investors.

Exceptional items before tax

An exceptional gain of £16.6 million arose (2015/16: £nil) from the net benefit, after implementation costs, of a Pension Increase Exchange arrangement under which pensioners of the defined benefit schemes were offered the opportunity to exchange future non-statutory inflationary increases in a portion of their pensions earned prior to 1997 for a higher pension payment now.

The Group has also recorded exceptional profit on disposal of fixed assets of £11.0 million (2015/16: £nil) to other companies within the Severn Trent Plc group which it has classified as exceptional.

In 2015/16 there was a gain of £1.0 million arising from the release of a provision originally recorded as an exceptional charge.

Net finance costs

At the start of the AMP we took a series of actions to take advantage of low floating interest rates. The benefits of this approach are reflected in our net finance costs, of £199.6 million, £4.3 million lower than the prior year (£203.9 million). Lower costs on floating rate debt from lower interest rates were partially offset by higher inflation in the year, which led to higher finance costs on index-linked debt. Finance costs capitalised were higher than the prior year due to an increased level of capital activity in the year.

Our net interest charge, excluding net (losses)/gains on financial instruments and net finance costs from pensions, was covered 4.3 times (2015/16: 4.2 times) by profit before interest, tax, depreciation, profit on sale of fixed assets, deferred income release and exceptional items, and 2.7 times (2015/16: 2.6 times) by underlying PBIT.

Gains/losses on financial instruments

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

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

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

Where derivatives are held to their full term mismatches will net out over the life of the instrument. The changes in value that are recorded during the lives of the derivatives, unless crystallised, do not represent cash flows. Therefore we show underlying earnings figures that exclude these non-cash items. In exceptional circumstances we may terminate swap contracts before their maturity date. The payments or receipts arising from the cancellations are charged or credited against the liability or asset on the balance sheet.

We hold interest rate swaps with a net notional principal of £106.9 million and cross currency swaps with a sterling principal of £98.3 million which economically act to hedge the interest rate risk on floating rate debt or the exchange rate risk on certain foreign currency borrowings. However, the swaps do not meet the hedge accounting rules of IAS 39 and so the changes in fair value are taken to gains/losses on financial instruments in the income statement. During the year there was a credit of £11.2 million (2015/16: £47.7 million) in relation to these instruments.

Note 13 to the financial statements gives an analysis of the amounts charged to the income statement in relation to financial instruments.

As part of our power cost management strategy, we have fixed around 85% of our estimated wholesale energy usage for 2017/18.

Taxation

The total tax charge from continuing operations for the year was £9.4 million (2015/16: credit of £18.1 million).

Note 14 in the financial statements sets out the tax charges and credits in the period, which are described in more detail below.

The current tax charge from continuing operations for the year was £41.2 million before exceptional tax (2015/16: £51.2 million) and the deferred tax charge before exceptional tax was £20.2 million (2015/16: £9.5 million). There was an exceptional credit of £16.4 million (2015/16: nil) from adjustments following agreement with HMRC of prior years' tax matters.

In common with other utilities, we have a significant deferred tax provision that mainly relates to the benefits received in the past from tax allowances on capital expenditure before the depreciation on those assets was charged to our profits. This provision does not represent a liability for tax payable but is released to the income statement as the depreciation catches up with the tax allowances received. The provision is calculated at the rate of tax applicable when the provision is expected to reverse. In September 2016 the Government enacted legislation to reduce the rate of corporation tax to 17% from 2020. As a result we recorded an exceptional deferred tax credit of £39.6 million (2015/16: £78.8 million) because the provision was recalculated at the new lower tax rate.

Our underlying effective current tax rate was at 17.1% (2015/16: 18.5%). The effective rate is calculated as current tax on continuing operations, excluding prior year charges, exceptional tax, and current tax on exceptional items and on financial instruments, divided by profit before tax, exceptional items and net gains/(losses) on financial instruments.

Group cash flow

	2017 £m	2016 £m
Cash generated from operations	851.9	799.8
Net capital expenditure	(441.1)	(385.8)
Net interest paid	(175.5)	(184.0)
Tax paid	(37.9)	(20.0)
Investment in Dee Valley	(77.7)	–
Other cash flows	–	0.1
Free cash flow	119.7	210.1
Dividends	(195.5)	(310.0)
Net issue of shares	–	(4.0)
Change in net debt from cash flows	(75.8)	(103.9)
Non cash movements	(137.9)	(8.8)
Change in net debt	(213.7)	(112.7)
Net debt 1 April	(4,813.5)	(4,700.8)
Net debt at 31 March	(5,027.2)	(4,813.5)
Net debt comprises:		
Cash and cash equivalents	(3.4)	(2.8)
Loans payable to parent company	(6.4)	(53.0)
Bank loans	(1,036.9)	(1,212.2)
Other loans	(4,007.8)	(3,456.4)
Finance leases	(115.7)	(117.2)
Loans receivable from related parties	99.6	–
Cross currency swaps	43.4	28.1
	(5,027.2)	(4,813.5)

At 31 March 2017 the group held a net overdraft of £3.4 million (2015/16: £2.8 million) in cash and cash equivalents. Average debt maturity was around 15 years. Including committed facilities, our cash flow requirements are funded until January 2019.

Net debt at 31 March 2017 was £5,027.2 million (2015/16: £4,813.5 million) and balance sheet gearing (net debt/net debt plus equity) was 69.1% (2015/16: 84.1%). Net debt, expressed as a percentage of estimated Regulatory Capital Value at 31 March 2017 was 61.0% (2015/16: 61.5%).

The estimated fair value of debt at 31 March 2017 was £1,433.6 million higher than book value (2015/16: £861.7 million higher). The increase in the difference to book value is largely due to the decrease in the discount rates applied, driven by lower prevailing market interest rates.

Treasury management and liquidity

Our principal treasury management objectives are:

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

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

In November 2016 we took advantage of the low interest rates to issue a £400 million sterling bond with a maturity of 15 years. The proceeds were swapped to floating rate in line with our current strategy of increasing the proportion of floating rate debt in our mix. We also raised a further £100 million through a floating rate bank loan. This was drawn down in December 2016.

Our policy for the management of interest rates is that at least 40% of our borrowings in AMP6 should be at fixed interest rates, or hedged through the use of interest rate swaps or forward rate agreements. At 31 March 2017, interest rates for 52% (2015/16: 55%) of our net debt of £5,027.2 million (2015/16: £4,813.5 million) were fixed.

Our long term credit ratings are:

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

The outlook is stable for both agencies.

Pensions

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

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

- payments of £10 million for the three financial years ending 31 March 2019;
- further inflation-linked payments of £15 million per annum through a new asset-backed funding arrangement, potentially continuing to 31 March 2031, although these contributions will cease earlier should a subsequent valuation of the STPS show that these contributions are no longer needed;
- payments under the existing asset-backed funding arrangement which provides £8 million per annum will continue to 31 March 2032; and
- in addition to these payments, the company will directly pay the annual PPF levy incurred by the STPS (£1.2 million for 2017/18).

We have agreed with the Schemes' Trustees to enter into hedging arrangements to mitigate the impact of fluctuations in interest rates and inflation on the Schemes' liabilities without adversely impacting the expected return from the Schemes' assets.

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

On an IAS 19 basis, the net position (before deferred tax) of all of the Group's defined benefit pension schemes was a deficit of £574.6 million at 31 March 2017. This compares to a deficit of £711.7 million at 30 September 2016 (31 March 2016: £309.5 million). To calculate the pension deficit for accounting purposes, we are required to use corporate bond yields as the basis for the discount rate of our long-term liabilities, irrespective of the nature of the scheme's assets or their expected returns. The sharp decrease in corporate bond yields in the first half of the year has partially reversed in the second half and this, together with the continued good performance of the Schemes' assets, particularly equities, has driven a reduction in the pension deficit in the second half year.

The movements in the net deficit during the period were:

	2017 £m	2016 £m
Present value at 1 April	(309.5)	(468.9)
Acquisition of Dee Valley Water	9.8	–
Change in actuarial assumptions	(538.8)	194.2
Asset out/(under)performance	227.6	(45.9)
Contributions in excess of the income statement charge	36.3	11.1
Present value at 31 March	(574.6)	(309.5)

On an IAS 19 basis, the funding level was 80.4% (31 March 2016: 86.8%).

Accounting policies and presentation of the financial statements

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

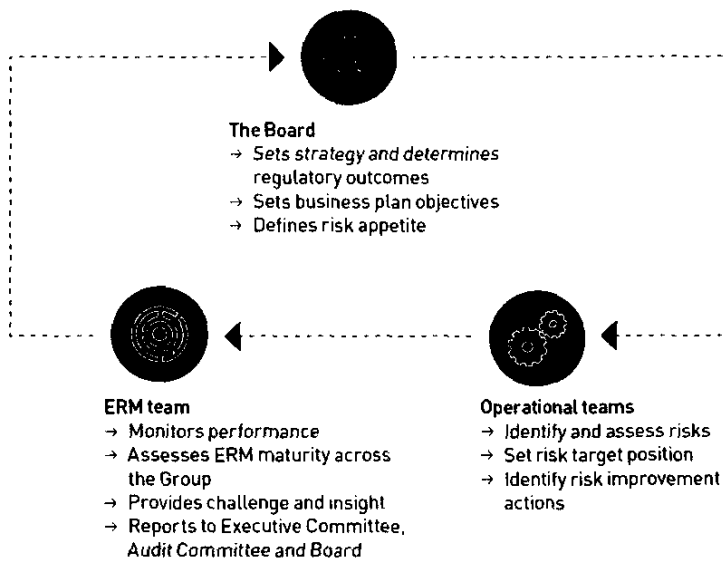
Risk management



Our approach to risk:

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

The ERM process



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

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

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

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

Within Severn Trent Water Limited, our approach reflects our status as a regulated utility providing essential services and operating as part of the Critical National Infrastructure for the UK. The nature of Severn Trent Water's business is such that there are some significant inherent risks, as illustrated on pages 41 to 46. We aim to have a strong control framework in place to enable us to understand and manage these risks in accordance with our risk tolerance and appetite.

Our Enterprise Risk Management process

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

This information is combined to form a consolidated view of risk across the Group and allows the risks to be prioritised. Our significant risks, in terms of likelihood and impact, form our Group risk profile which is reported to the Executive Committee for review and challenge ahead of final review and approval by the Audit Committee and Board half-yearly. In addition, individual risks or specific risk topics are also discussed by the Board during the year.

On a monthly basis, the status of open risk mitigation actions across the Group is reported into the Executive Committee by the central ERM team. The level of ERM maturity in each business unit is assessed half-yearly and reported to the Executive Committee. Where necessary, improvement plans are agreed to ensure ERM is fully embedded and effective, and during 2017/18 we will integrate Dee Valley into our risk management processes. An overview of accountability for our ERM process is illustrated in the diagram on page 38.

Risk appetite

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

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

Financial risks

Like all businesses, we need to plan future funding in line with business need. This is part of our normal business planning process (see principal risk 2). The Board receives regular updates relating to funding, solvency and liquidity matters via the Severn Trent Plc Treasury Committee so we can respond quickly to any changes in our ability to secure financing (see principal risk 10). The pension fund Trustees and Company regularly monitor our net pension deficit, with advice from investment managers and advisers. An annual pension fund review paper is produced for the Board to apprise them of fund performance and proposed initiatives to manage down pension liabilities and further improve investment returns (see principal risk 9).

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

Long Term Viability Statement

The Directors' assessment of the Group's current financial position is set out in the Chief Financial Officer's review on pages 30 to 36 and their assessment of the Group's principal risks is set out in the Principal risks section on pages 41 to 46.

Severn Trent Water Limited is a regulated long term business characterised by multi-year investment programmes and stable revenues. The water industry in England and Wales is currently subject to economic regulation rather than market competition and Ofwat, the economic regulator, has a statutory obligation to secure that water companies are able to finance their appointed activities. Ofwat meets this obligation by setting price controls for five year Asset Management Periods ('AMPs'). This mechanism reduces the potential for variability in revenues from the regulated business. The current AMP runs until March 2020.

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

The plan assessed the Group's prospects and considered the potential impacts of the principal risks and uncertainties. Stress tests were performed to assess the potential impacts of combinations of those risks and uncertainties. The plan also considered the mitigating actions that might be taken to

reduce the impact of such risks and uncertainties and their likely effectiveness.

The Group's investment programmes are largely funded through access to debt markets. The Group's strategic funding objectives reflect the long term nature of the Severn Trent Water Limited business and the Group seeks to obtain a balance of long term funding at the best possible economic cost. The Group's Treasury Policy requires that it maintains sufficient liquidity to cover cash flow requirements for a rolling period of 18 months in order to mitigate the risk of restricted access to capital markets.

The Group's debt maturity profile is actively managed by the Group Treasury department to spread the timing of refinancing requirements and to enable such requirements to be met under most market conditions. The weighted average maturity of debt at the balance sheet date was 15 years.

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

In making its assessment the Board has made the following key assumptions:

- Any period in which the Group is unable to access capital markets to raise finance during the period under review will be shorter than 18 months.
- There will not be a catastrophic disruption to our drinking water supplies arising from external factors during any such period of market disruption.

The Directors have assessed the viability of the Company over a three year period to 31 March 2020, taking into account the Company's current position and principal risks. Based on that assessment, the Directors have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the period to 31 March 2020.

Going Concern Statement

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

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

Principal risks

The Directors have carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity.

These have been categorised across:

- customer perception;
- legal and regulatory environment;
- operations, assets and people; and
- financial risks.

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

Customer perception

1 What is the risk?

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

Embed customers at the heart of all we do

We put our customers first

We are passionate about what we do

We act with integrity

ODIs

ODIs 24-27

What does it mean for us?

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

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

What are we doing to manage the risk?

The last 12 months have been a continuation of driving a culture to put customers first by improving proactive communication and getting things right first time. We have launched a new website which makes it easier for customers to self-serve and find the information they want. In the next year we will be extending this by launching our new web self-service offering. We have also seen an increase in usage of webchat, Facebook and Twitter.

We have continued to embed the performance and quality framework and expanded it to all contact centre teams driving the quality of the experience and conversation, not just the actions. An assessment and upskilling activity has taken place across all the contact centres to ensure we have the right capability when answering customer queries. The next year this will continue and be supported by a new customer management portal that will allow agents to have information about customers more visible so they can personalise the experience more. In addition to this we are in the process of multi-skilling a proportion of agents so we can cope with peaks in demand during the year, e.g. when an incident occurs.

Our voice of the customer programme has continued to feed insight to drive improvement. Over the next 12 months we will be implementing a new solution which will allow us to extend our channels so more customers' voices get heard. It will also give us the capability to develop a customer forum so we can get feedback on broader ideas before implementing them.

We recognise we need to focus on the full end to end customer journey and have some targeted improvement plans being delivered through the water, waste and retail upper quartile programmes. This includes a full end to end review of the water processes where we currently experience some customer experience challenges.

Movement in net risk exposure



Key:

- ⬆ Increase in net risk exposure
- ⬇ No change in net risk exposure
- ⬇ Decrease in net risk exposure

Legal and regulatory environment

2 What is the risk?

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

Group-wide

Change the market for the better

Invest responsibly for sustainable growth

We put our customers first

ODIs

N/A

3 What is the risk?

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

Group-wide

Drive operational excellence and continuous innovation

Change the market for the better

Invest responsibly for sustainable growth

We act with integrity

We protect our environment

ODIs

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

What does it mean for us?

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

What are we doing to manage the risk?

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

We have contributed to the establishment of Market Operator Services Ltd, the body which will oversee competition in the non-household retail market.

We continue to participate in discussions with Ofwat regarding the development of the future regulatory environment and their consultation documents relating to Water 2020. Engagement with our peers, other regulators, UK Government departments and other stakeholders, including the Welsh Government, helps us to influence the direction of regulatory policy where possible and put forward our own case for change in a constructive way.

Movement in net risk exposure



What does it mean for us?

Our policies and processes must reflect the current legal and regulatory environment and all relevant employees must be kept aware of new requirements. Due to the spread of our operations, and changes in activity and organisational structure, this is not always straightforward. The Group as a whole may face censure for non-compliance in an individual Group company or a specific region in which we operate.

What are we doing to manage the risk?

Our governance framework and related policies and internal controls are designed to ensure our ongoing compliance with all applicable laws and regulations.

The introduction of non-household retail competition meant we needed to refresh our policy framework. We have developed a control framework to establish the protocols, policies, systems, guidance and training necessary for the operation of separate Wholesale and Retail business units and to ensure ongoing compliance with the relevant legislation including Competition Law. We will continue to monitor the framework to ensure we remain compliant.

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

Movement in net risk exposure



Operations, assets and people

4

What is the risk?

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

Group-wide

Embed customers at the heart of all we do
Drive operational excellence and continuous innovation

We put our customers first

ODIs

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

What does it mean for us?

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

What are we doing to manage the risk?

We recognise that the cyber threat to the business is constantly evolving and one which we need to monitor and act on in a timely manner

Using guidance from the National Cyber Security Centre (NCSC) we added a number of additional cyber security controls during 2016 to improve our capability to prevent, detect and respond to external cyber attacks including greater protection of our customers' personal data.

IS teams have been working with Wholesale operations at our major water treatment works during 2016 to ensure that physical security and resilience for the technology is improved.

Whilst progress has been made during the year to ensure we are better prepared, due to the rapidly evolving nature and complexity of the threat this work will continue. Ongoing monitoring and reviews will ensure that our mitigating controls and plans continue to protect us and our customers.

Movement in net risk exposure



5

What is the risk?

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

Regulated Water and Waste Water business

Embed customers at the heart of all we do
Drive operational excellence and continuous innovation

Invest responsibly for sustainable growth

We put our customers first

We are passionate about what we do

We protect our environment

ODIs

ODIs 1-45

What does it mean for us?

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

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

What are we doing to manage the risk?

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

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

We target serviceability of our assets through prioritising and targeting our capital maintenance. We use asset deterioration models to do this, informed by our operational risk management systems. Our governance boards also regularly review investment needs against performance and balance the programme accordingly.

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

Movement in net risk exposure



6

What is the risk?

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

Group-wide

Embed customers at the heart of all we do

Drive operational excellence and continuous innovation

Invest responsibly for sustained growth

We put our customers first

We are passionate about what we do

ODIs

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

What does it mean for us?

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

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

Another example is our IT and telephony systems which are critical to our operations and failure of these systems, for example our remote monitoring system, could have a significant effect

What are we doing to manage the risk?

Our 2015-2020 business plan includes substantial investment in some of our largest strategic assets such as the Elan Valley and Derwent Valley Aqueducts, one of the major elements of which is the £300 million investment in one of our largest ever capital schemes to improve the resilience of our water supply to Birmingham.

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

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

We will continue to make significant investment into our network and processes but we accept there is always a risk of unexpected failures, the recent mains burst in Birmingham being a prime example. How we respond to these and learn from them is vital in keeping the likelihood of unexpected failures as low as possible.

Movement in net risk exposure



7

What is the risk?

Due to the nature of our operations a failure of our procedures could endanger the health and safety of our people, contractors and members of the public as well as harm our local and wider environment.

Group-wide

Drive operational excellence and continuous innovation

Invest responsibly for sustained growth

Create an awesome place to work

We protect our environment

We act with integrity

ODIs

ODIs 30-41, 42 & 43

What does it mean for us?

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

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

What are we doing to manage the risk?

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

We have a well-established Health, Safety & Wellbeing framework to ensure all of operations and processes are conducted in compliance with health and safety legislation and in the interests of the safety of our people and contractors. Our Goal Zero initiative clearly establishes our target that no one should be injured or made unwell as a result of what we do.

There are a number of ODI commitments we have made to protect our local environment, including river water quality, pollution incidents, biodiversity improvements and environmental compliance. In AMP6 we will be delivering our largest ever environment programme, spending over £300 million to deliver improvements to rivers throughout our region, a programme which is supported by our customers who wanted to see us do more to improve river water quality. We have been provisionally rated 3* this year by the Environment Agency in their Environmental Performance Assessment.

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

Movement in net risk exposure



8 What is the risk?

Failure to deal with the impact of extreme and unpredictable weather events on our assets and infrastructure and/or changes to future water resource supply and demand due to climate change.

Group-wide

Drive operational excellence and continuous innovation

Invest responsibly for sustained growth

We protect our environment

ODIs

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

What does it mean for us?

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

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

What are we doing to manage the risk?

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

Work is now gathering momentum on putting together our next water resources management plan. Understanding the impact of climate change is central to this process.

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

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

We are also adapting to climate change through innovation, with 21 catchment management projects and a doubling of our sustainable urban drainage (SUDs) projects planned for this AMP.

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

Movement in net risk exposure



Financial risks

9

What is the risk?

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

Group-wide

Invest responsibly for sustained growth

We act with integrity

ODIs

N/A

What does it mean for us?

We already provide significant funding but could be asked by the Trustee to provide more money to reduce pension deficits in our *defined benefit* schemes.

What are we doing to manage the risk?

Following the Brexit vote, our main defined benefit pension scheme has seen a significant growth in the accounting value of liabilities due to the fall in long term interest rates. These financial conditions are likely to remain for the foreseeable future. The growth in the accounting deficit has adversely impacted the headroom on some of our credit ratios, such as gearing, which are relevant for debt covenant and credit ratings purposes. It also has a reputational impact that could have a bearing on investment and distribution decisions. We have commenced the process of immunising our financial covenants from adverse movements in the accounting deficit, gaining approval from relevant banks and the European Investment Bank (EIB). We have also clarified with rating agencies that their focus is more on the impact of cash repair payments on credit metrics, rather than movements in the accounting value of the deficit. Importantly we have agreed cash repair payments with the Trustee until the next Triennial Valuation as at 31 March 2019. We have also commenced working with the Trustee to implement additional inflation and interest rate hedging and introduce downside protection to the fund's equity holdings. It is planned to complete the new hedging arrangements by the summer of 2017, from which point the potential volatility in terms of valuation will be reduced considerably.

Movement in net risk exposure



10

What is the risk?

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

Group-wide

Invest responsibly for sustained growth

We act with integrity

ODIs

N/A

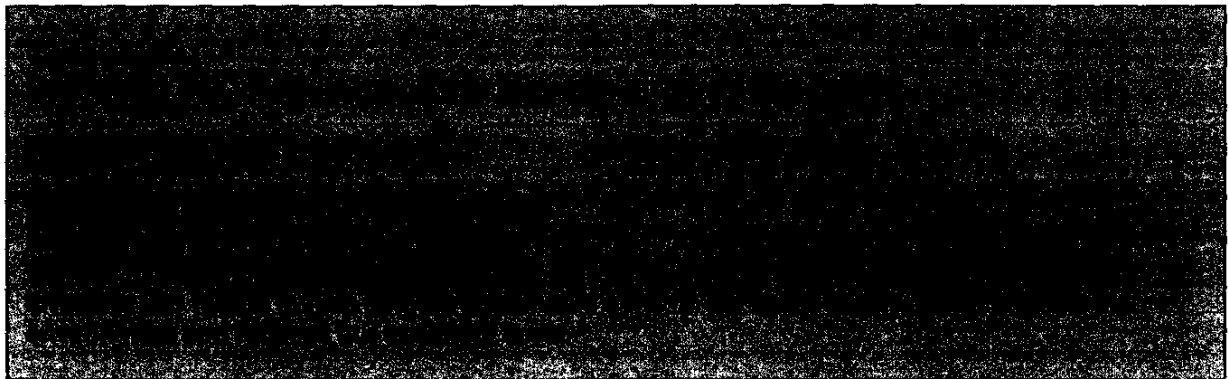
What does it mean for us?

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

What are we doing to manage the risk?

Whilst Brexit may impact our access to funding from the EIB, an attractive source of finance, we have other sources of funding we can call upon. In November 2015 we raised £471 million through a US Private Placement debt issue and in November 2016 we raised £400 million through a sterling bond issue. Despite some initial volatility following the Brexit vote, global debt capital markets continue to deliver substantial levels of liquidity, derived from the continuation of loose monetary policy in the G7.

Movement in net risk exposure



Corporate Responsibility report

Acting Responsibly

Building trust can't be achieved through a single activity, but we believe that by adopting responsible business practices, making sustainable choices and living our values, we will achieve our vision and purpose.

The nature of what we do means that we have an important role to play in protecting water as a precious resource and the wider environment, which drives our two Corporate Responsibility ambitions. We are also working closely with our suppliers to support our vision.

Highlights this year

Our approach to Corporate Responsibility is broad ranging, ensuring we are delivering the commitments expected of a leading socially and environmentally responsible business. Some of the highlights this year include:

- Delivering 12,000 home water efficiency checks, helping our customers to reduce their water use by an average of 10%.
- Supporting 50,903 vulnerable customers, through our various support mechanisms, including our social tariff.
- Engaging with over 640 farmers as part of our water catchment management scheme.
- Launching an innovative employee volunteering scheme, working in a consistent structure across the business alongside key partners to clean up across 40 km of riversides within our region.

Our vision

Our vision is to be the most trusted water company by 2020, delivering an outstanding customer experience, best value service and environmental leadership.

Our purpose

Our purpose is to serve our communities and build a lasting water legacy.

Ambition One

We will make our region the most water efficient in the UK

Ambition Two

We will play a leading role to help make our region's rivers even healthier

Values

1

Put our customers first

2

Be passionate about what we do

3

Act with integrity

4

Protect our environment

5

Be inspired to create an awesome company

Our suppliers support our values and ambitions

Our responsible commitments and our performance against them

Objective	Our commitment	How we are measuring our performance	This year's performance	2016/17 target	2020 target
Ambition One: We will make our region the most water efficient in the UK	We will empower our customers to save up to 25ML/d by 2020	Water efficiency level achieved	4.91ML/d	5ML/d	25ML/d
	We will improve understanding of our services through education	Number of customers we have educated from 2015 to 2020	167,024	160,000	700,000 (cumulative over AMP6)
Ambition Two: We will play a leading role to help make our region's rivers even healthier	We will work with landowners and partner organisations to reduce agricultural run-off in our region's rivers	Positive engagement with land managers in targeted areas by end of AMP6	44% (in 11 out of 12 catchments)	44% (in 12 catchments)	80% (in 12 catchments)
	We will do our fair share to achieve Water Framework Directive good ecological status in our region's failing water bodies, where it is cost-effective to do so	Number of Water Framework Directive classification improvement points (as monitored by the Environment Agency)	15	n/a	233 (cumulative over AMP6)
	We will improve biodiversity in our region by improving at least 75 hectares of Sites of Special Scientific Interest ('SSSI')	Number of hectares improved from unfavourable or deteriorating condition using Natural England's database of SSSIs	-29.7%	n/a	75
We put our customers first	We provide a service to our customers that is good value for money	% of customers who rate our service value for money in an independent quarterly survey	58%	47%	55%
	We help our customers who are in genuine need and struggling to pay their bills	Number of customers we help each year through social tariffs and assistance schemes	50,903	50,000	50,000
We are passionate about what we do	Our employees are passionate about what we do	Group % engagement score from our annual employee survey	55%	50%	-
We act with integrity	We involve our customers in our plans, and we're honest about how they think we're doing	We will invite the independent Water Forum to review and comment on our annual performance	4 meetings held this year	-	-
We protect our environment	We do everything we can to prevent polluting the environment	Number of Environment Agency Category 1 & 2 incidents (calendar year metric)	7	6	0
	<i>We reduce our carbon footprint</i>	% reduction in Group carbon emissions (scope 1 and 2 - our direct emissions and those from the energy we use)	8%	4%***	19%
We are inspired to create an awesome company	No one is hurt or made unwell by what we do	STW - LTI rate	0.22	0.18	-
		Business Services - LTI rate	0.04	-	-
	We believe a diverse and inclusive workforce is a key factor in being a successful business	STW - Total workforce % female	31.3%	33%**	-
		Group - Total workforce % female	29.5%	-	-
		STW - Total workforce % BAME	8.9%	5.0%**	-
Group - Total workforce % BAME	14.8%	-	-		
Our suppliers support our values and ambitions	We are a responsible payer	% invoices paid to terms, including self bill (12 month financial year average)	97%	97%	97%

Benchmark*

Benchmark**

* Global benchmark from ACF Hewitt

** Business in the community industry benchmark 2015

*** Severn Trent Water Limited 3DI target

Materiality of our Corporate Responsibility metrics

We recognise that our activities have broad ranging impacts on the social, economic and environmental wellbeing of our region and beyond. In order to build a lasting water legacy we need to consider these impacts across the broad spectrum which we operate, both now and in the future. As such, our Corporate Responsibility framework is centred on our customer ODIs, built on extensive customer research completed at the time of the last price review. This ensures that we are focused on issues that are most important to our customers and the communities we serve. They shape our day-to-day activities to underpin our performance as a sustainable business. Acting in a responsible manner isn't just important to our customers; our annual employee survey illustrates that working for a company 'Doing the Right Thing' and being socially and environmentally responsible is a

key motivational driver for our people. We also know our investors and wider stakeholders value our environmental, social and governance performance. Our Corporate Responsibility framework ensures that we reflect our values, for example creating an awesome place to work through supporting a diverse and inclusive workforce.

Our employees' reward is directly linked to our Corporate Responsibility performance, due to the significant proportion which both customer ODIs and health & safety, our key CR metrics, contribute to the bonus which our employees receive.

Performance and external recognition

We believe that by focusing on the issues most important to our customers our Corporate Responsibility framework has the right balance. We continue to support the UN Global Compact Principles.

Corporate Responsibility Risks

Our approach to Corporate Responsibility is aligned with our strategic framework. Corporate Responsibility and sustainability risks are treated in the same way as all our other company risks, and are captured at a local level by responsible teams and managed centrally through our established ERM process. By the nature of what we do several of our principal risks have a sustainability or environmental focus. You can find more details about the Group's approach to risk management and our principal risks on pages 37 to 46.

Corporate Responsibility Ambitions

In order to achieve our vision of being the most trusted water company by 2020, we seek to *demonstrate environmental leadership wherever we operate*. We have an important role to play in protecting and sustaining water as a natural resource and the environment as a whole. With challenges around water scarcity, meeting tightening environmental standards, coping with extreme weather events and a growing population, we need to be more efficient with our use of water, the sector's use as a whole, for example through water trading, and playing our part in ensuring the health of our region's rivers. These sustainability challenges form the basis of our two Corporate Responsibility ambitions.

The water sector has a huge role to play in improving our common environment, and although we are starting in a strong and improving position we're the first to admit there is more to do. The key for future environmental success is for us all to play our part; the water sector, Government, regulators, landowners, NGOs and the general public.

Assurance of Corporate Responsibility Metrics

All our customer ODI data, and therefore the majority of our Corporate Responsibility metrics, are independently assured by Jacobs. As our customer ODIs are our most material Corporate Responsibility commitments, the remaining Corporate Responsibility metrics, including health & safety and human resources metrics, have a proportionate level of assurance applied.

Ambition One: We will make our region the most water efficient

Securing long term access to water is a massive environmental and economic issue, which is essential to the long term future of our planet, and one in which we have an essential part to play. Some of the key ways in which we can help this are through reducing leakage and helping our customers use less water. Our objectives to achieve this ambition are set out below.

We will empower our customers to save up to 25MI/d by 2020

We have an important role in changing customer behaviours to use less water, and are committed to helping them to become more water efficient. We have set ourselves an ambitious target to help customers save 25 million litres per day (MI/d) by 2020. We can help our customers through advice and a range of free water efficiency products (<https://www.savewatersavemoney.co.uk/severntrent/free-water-saving-products>).

Ambition Two: We will play a leading role to help make our region's rivers even healthier

We know we have a responsibility to leave our environment in a better condition for future generations. Our objectives to achieve this ambition are set out below.

We will work with landowners and partner organisations to reduce agricultural run-off into our region's rivers

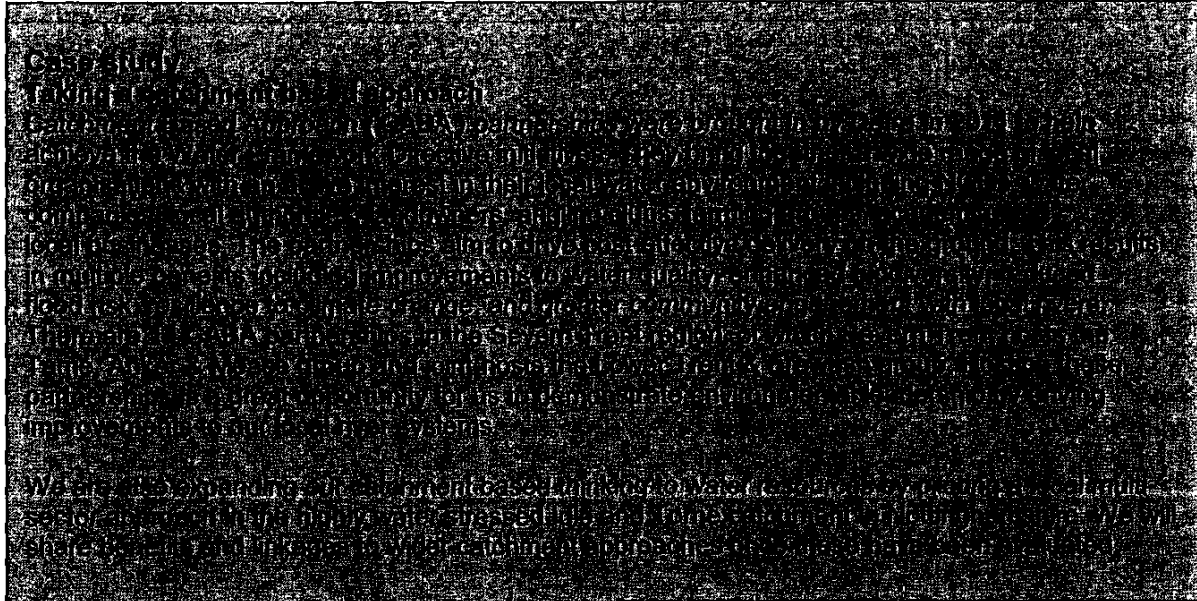
We're taking a more joined-up approach to making environmental improvements through a process we call catchment management, working in partnership with farmers and landowners to reduce agricultural run-off into our region's rivers. This includes preventing pesticides getting into the water and polluting it, thereby improving river quality, reducing treatment costs and improving the river environment as a whole. Our agricultural advisers have engaged with over 1,200 farms since the team formed last year, and are confident of delivering the target of working with 4,000 farms, covering an area of about 10,000km² over the next four years. Our farmer grant scheme, Severn Trent Environmental Protection Scheme ('STEPS'), offers grants to farmers to undertake infrastructure improvements and land management changes which will help reduce diffuse pollution, such as through the installation of bio beds. To date we have received over 500 applications. Farmers are also being rewarded for their contribution to reduced metaldehyde, from slug pellets, in farm run-off through our Farmers as Producers of Clean Water scheme. 26,000ha were signed up to this scheme in 2016. The environmental benefits of catchment management extend well beyond just water quality. The right behaviours promote conservation of soil and water, flood mitigation, sustaining landscapes, wildlife and aquatic ecosystems, biodiversity and reducing carbon footprints.

We will do our fair share to achieve Water Framework Directive (WFD) good ecological status in our region's failing water bodies, where it is cost effective to do so

Our WFD programme is targeting improvements in 1,500 km of river. We have started to contribute our fair share, completing five sewage treatment works projects this year, improving over 64 km of river length. In total we will be upgrading 10% of our sewage works, and over the next three years will be upgrading over 100 works to produce higher quality effluent. We have also finalised our proposals with the Environment Agency where abstraction has been proven to be unsustainable, and have revoked or varied abstraction licences at eight sites reducing our abstractions by 40MI/d, against a target of 85MI/d by 2020.

We will improve biodiversity in our region by improving at least 75 hectares of Sites of Special Scientific Interest

We have agreed with Natural England the actions and activities we will take at 11 Sites of Special Scientific Interest or Special Areas of Conservation to either improve or stop deterioration in biodiversity. For example, we have a forestry management regime at Dimminsdale to improve the broadleaved, mixed and yew woodland. The management of these species is vital as they support other notified species. Year one had a planning focus and from Year two and moving forward there is strong focus on implementing projects identified and monitoring progress with a completion date of 2020. We also have management plans at all our operational sites to ensure our activities have a minimal impact on the environment.



Value 1 - We put our customers first

We exist to serve our customers and we can earn their trust, focusing on their needs and delivering a service they can rely on and consider to be good value. We also have a responsibility to support those customers who struggle to pay their bills.

We put our customers and communities first when carrying out our work

We recognise that planned and unplanned work on our networks can cause disruption. That's why we developed our 'Customers and Communities First' guidelines to ensure we deliver a great customer experience every time we or our suppliers carry out planned work. It explains what we need to do and who we need to engage with before work begins, during and after our work is complete. We seek feedback from our customers at the end of every scheme to ensure we successfully learn from experiences, sharing areas for improvement and best practice.

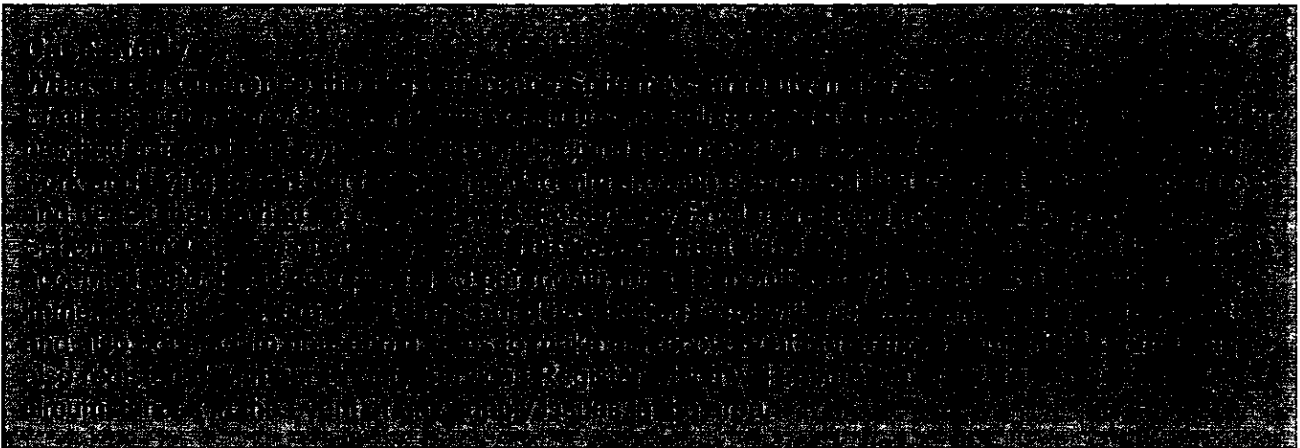
We provide a service to our customers that is good value for money

Our customers pay the lowest combined water and waste water bills in Britain. In an independent quarterly study of our customer base, 58% of our customers view our service as good or very good value for money. Our research suggests that our customers' perceptions around value for money are not only driven by the bill amount, but by their personal experience and customer service too.

We help our customers who are in genuine need and struggling to pay their bills

We work hard to ensure our bills are affordable for all and we have the lowest combined water and sewerage charges in Britain. However, we understand that some customers may need additional help. In 2016/17 we are proud to have supported 50,903 customers through our assistance schemes – such as metering, Watersure or our social tariff the Big Difference Scheme – three times more than last year. We have also created a dedicated care and assistance team who are specially trained to support customers who may be suffering from financial hardship, diminished mental wellbeing or experiencing a difficult time in their lives. The Big Difference Scheme is designed for anyone who is struggling to pay their bills, regardless of their employment status. If accepted, customers can qualify for a reduction in charges of between 10-90% of our average bills. In addition, the Severn Trent Trust Fund, which is an independent charity providing financial assistance to those most in financial difficulty, has been able to assist 3,474 customers either by a grant to help clear water bill arrears or through the purchase of essential household items.

You can find out more information about how we are meeting our customers' changing needs on pages 22 and 23.



We involve our customers in our future plans, and we're honest about how they think we're doing

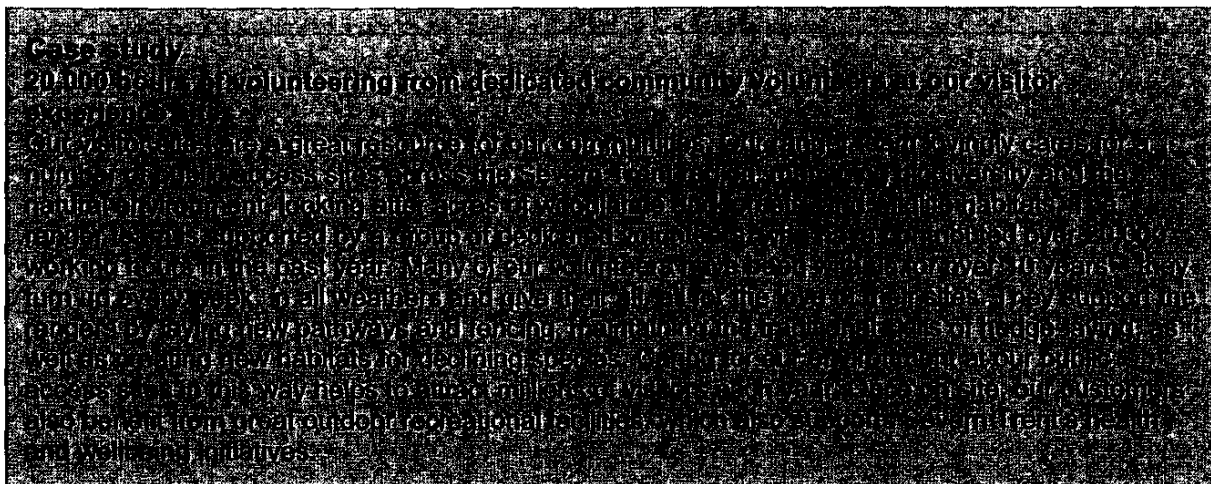
The Water Forum is an independently chaired, multi-stakeholder group that has a continuing role to challenge how well we engage with our customers on our future plans and whether we're delivering our current commitments. This year we worked with the Chair to further strengthen and expand the expertise of the Water Forum by recruiting new members with expertise in customer research, capital project appraisal, environmental economics and social responsibility. These four new experts joined existing members over the course of the year and took part in discussions ranging from our current performance to how we develop investment plans. A principal focus for the Forum this year was how we'll engage with our customers as we develop our business plan for 2020-25. The Forum has constructively challenged and contributed to both the content and form of our research, drawing on its wide-ranging expertise. Over the coming year the Forum will be reviewing the outcome of our research and how we are using it to develop the services we offer to our customers in the future.

Value 2 – We are passionate about what we do

We have a wide diversity of skills, abilities and talents in our business. We're united and fired up about what we do – so that we truly build a lasting legacy.

Our people make a positive difference in the community through volunteering

In February 2017, we launched our new employee volunteering programme 'Community Champions'. Closely aligned to our Corporate Responsibility ambitions, our employees will have the opportunity to use their two annual volunteering days working alongside key partners: the Canal and River Trust, Waterside Care, the Severn Rivers Trust and the Trent Rivers Trust, to help clean up across 40 km of riversides within our region. 15% of the workforce signed up within the first month and lots of teams have already been out making a difference in our communities. In March 2017, a number of our people spent a day working alongside our contract partners BNM Alliance, clearing up a stretch of the River Trent in Newark, where we are carrying out a £60 million waste and water improvement scheme. Wayne Ball, volunteer development coordinator for the Canal and River Trust, said: "The volunteers did a fantastic job and we're really grateful for all their hard work. As a charity, the support they've given us is invaluable and really helps in our efforts to make the river a more attractive, welcoming place for the local community. We'll now be able to plant up the hedgerow which will make it even more attractive – and a better place for wildlife."



We support our corporate charities

Severn Trent was one of the founding members of WaterAid in 1981 and we have been committed in our support ever since. WaterAid's vision is to see access to safe water, hygiene and sanitation for all by 2030. Fundraising balls, the Severn Trent Mountain Challenge, bill inserts and cakes sales are just some of the ways our staff raise money for this cause, which is so close to our hearts. We also support WaterAid through awareness raising and campaigning. Our staff have taken part in the Water Innovators training scheme, developing real life solutions, and have visited country programmes. This year we raised £140,945, with the first £100,000 contributing to projects in Ethiopia, which is our chosen country to support.

This year our employees also helped to support Comic Relief, through fundraising activities and by once again manning a National Red Nose Day Call Centre. Our team of 230 volunteers gave up their time to take calls throughout the night.

Value 3 - We act with integrity

Acting with integrity and 'Doing the Right Thing' for our customers, communities, investors, regulators and colleagues is an essential part of being trusted. Our Company values are at the heart of any decision we make, and we will only work with suppliers and partners who care about this as much as we do.

We act in line with our values

Acting in line with our values is key to ensuring we act as a responsible business and achieve our vision and purpose. This year we've increased our focus on our Company values, communicating our revised code of conduct which guides us to do the right thing all of the time, and rolling out training for our people to make responsibilities clear. This training forms an important part of our employee induction, so our values are really embedded from day one. Our employee recognition scheme, 'Our Brilliant People', is now also aligned with our Company values to further promote and celebrate the right behaviours.

Our suppliers support our values

Our impact on the environment and society extends well beyond our own operations into our supply chain. We want our supply chain to both live by and reflect our values, and all suppliers are required to adhere to our code of conduct, 'Doing the Right Thing'. This year, to firmly establish our intent and ambition we have created a 'Sustainable Supply Chain Charter' which acts as a call to action to our suppliers to engage with us, align efforts and drive our Corporate Responsibility agenda. We've made good progress this year developing targets on waste to landfill and delivering joint community and

volunteering projects. We have also made changes within our tendering process to ensure sustainability has a rating in our decision for onboarding new suppliers. We recognise that we have a role to play to be a responsible client and are committed to paying our suppliers to agreed terms. Working collaboratively with our suppliers on sustainability will remain a focus, progressing to tangible goals on key issues such as water efficiency, carbon emissions and community impact.

We have a zero tolerance to modern slavery

We strive to take all reasonable efforts to play our part in eradicating modern slavery and take our obligations under the Modern Slavery Act 2015 seriously. This year, in line with our revised code of conduct, we have built on our processes and taken further steps to mitigate the risk of slavery and trafficking within both our business, and our supply chain. Our approach has focused on ensuring we have the appropriate policies and procedures in place to make our zero tolerance position clear in all that we do. We have taken a risk-based approach, using guidance set out by the Chartered Institute of Procurement, with an initial focus on our Tier One supply chain. Our scope will broaden as our approach matures. We have focused on establishing appropriate due diligence, reporting, training and communication. Our full statement is available on our website (www.stwater.co.uk/aboutus/responsibility/modern-slaverystatement/).

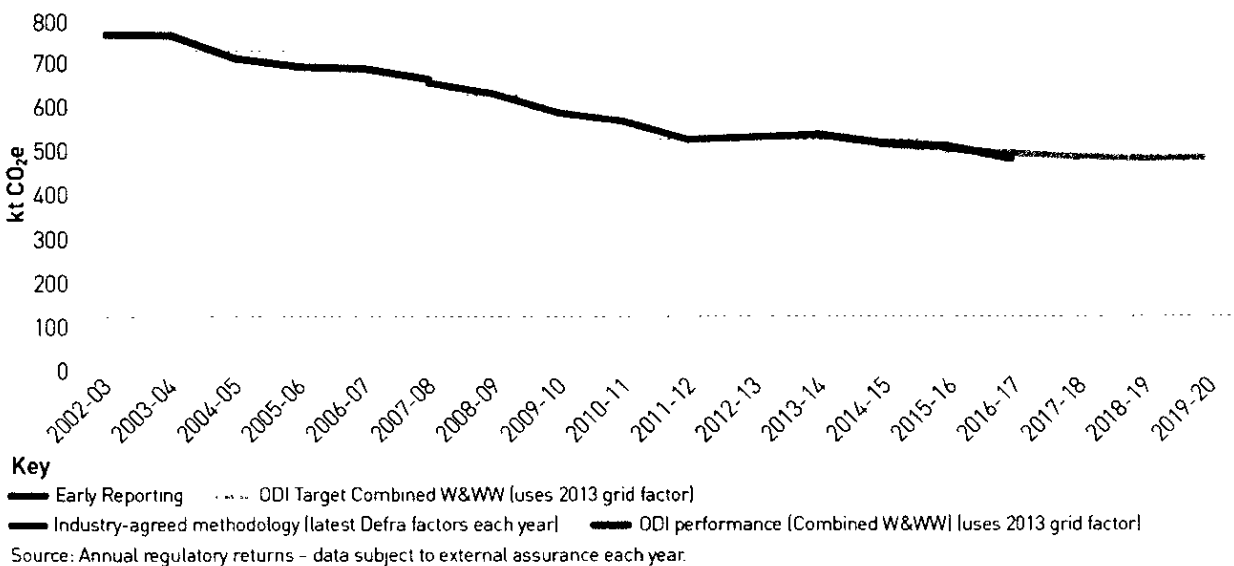
Value 4 - We protect our environment

We're always aiming to minimise our impact on the environment, produce the cleanest water and generate more renewable energy, so that we make a positive contribution to the future and fully embrace sustainability.

We are committed to reducing our carbon footprint

The UK is playing a leading part in reducing carbon emissions. As the majority of our carbon emissions are driven by our use of energy, managing carbon means managing costs. We therefore aim to reduce carbon emissions and increase our generation of renewable energy. We are achieving both of these aims, and this year we have seen another reduction in overall carbon emissions, although we did not achieve our ODI target. We've seen a consistent reduction since 2002 when we began publicly reporting on our greenhouse gas emissions.

Severn Trent Water Carbon Emissions



We have held the Carbon Trust Standard since 2009 in recognition of consistent emission reductions and effective carbon management processes. Our performance against the standard is in the top 15% of all organisations. We also continue to report to the Carbon Disclosure Project ('CDP') for investors each year. During the year, we increased renewable energy generation and across Severn Trent we now generate an equivalent of 34% of Severn Trent Water Limited's energy needs. We continue to lead the UK water industry, and we are on track to meet our target of generating the equivalent of 50% of our energy needs by 2020. We plan to continue to reduce our emissions within our regulated Water and Waste Water business by a further 5% by 2020, primarily by reducing our energy use and to continue to increase renewable energy generation mainly by our Business Services division. Pursuing these measures will continue to reduce our key sources of emissions, reduce our reliance on the electricity grid and bring financial benefits for our customers and investors.

Reducing our Greenhouse gas emissions

This is the fourth year Severn Trent has been required to report on greenhouse gas ('GHG') emissions. For Severn Trent Water we have been publicly reporting on our emissions since 2002. In that time we have reduced our emissions primarily by being more energy efficient and generating more renewable energy. Our GHG emissions are reported in tonnes of carbon dioxide equivalent (tCO₂e), for the year 1 April 2016 to 31 March 2017. Our total net emissions have fallen this year, due to our reduction in energy use since last year, our increased generation of renewable energy and in part due to reducing fuel and process emissions. A decrease in the emissions intensity of grid electricity in the UK has also had a significant impact this year. Our GHG data is reported internally during the year to the Severn Trent Plc Corporate Responsibility Committee and to the Board. We have subjected our GHG data and processes to external independent assurance by Jacobs.

Operational Greenhouse Gas Emissions (Tonnes CO ₂ e)	2013-14	2014-15	2015-16	2016-17
Scope 1 Emissions (Combustion of fuel and operation of facilities)	123,940	122,282.00	126,009.00	128,584.20
Scope 2 Emissions (Electricity purchased for own use)	333,721	357,700.62	340,483.96	298,872.07
Total Annual Gross Operational Emissions	457,661	479,983	466,493	427,456
Emissions benefit of the renewable energy we export (including biogas for which we hold green gas certificates)	18,638	24,247	24,887	22,790
Total Annual Net Operational Emissions	439,023	455,735	441,606	404,666

Annual GHG intensity ratio (t CO ₂ /unit)	2013-14	2014-15	2015-16	2015-16
Gross Operational GHG emissions of Severn Trent per £m turnover	247	258	243	222

This year we have revised our Scope 1 process emissions to correct a historic over-estimation of the amount of methane released to atmosphere from our digestion process. This has reduced our total emissions for each year. The restated values for previous years are shown in the table.

Our approach to reporting is based on the GHG Protocol Corporate Accounting and Reporting Standard and we have included only emissions from the assets which we own and operate and which we can directly influence and reduce, known as the financial control boundary. In accordance with the reporting regulations, we have not reported on emissions we can influence, but which we are not responsible for, referred to as indirect emissions. We have used the 'location based' methodology rather than the newly introduced 'market-based' method in order to ensure consistency with previous years. For Severn Trent Water Limited, we have calculated our emissions using the 'Carbon accounting in the UK Water Industry: methodology for estimating operational emissions, Version 11' (released April 2017). This is a peer

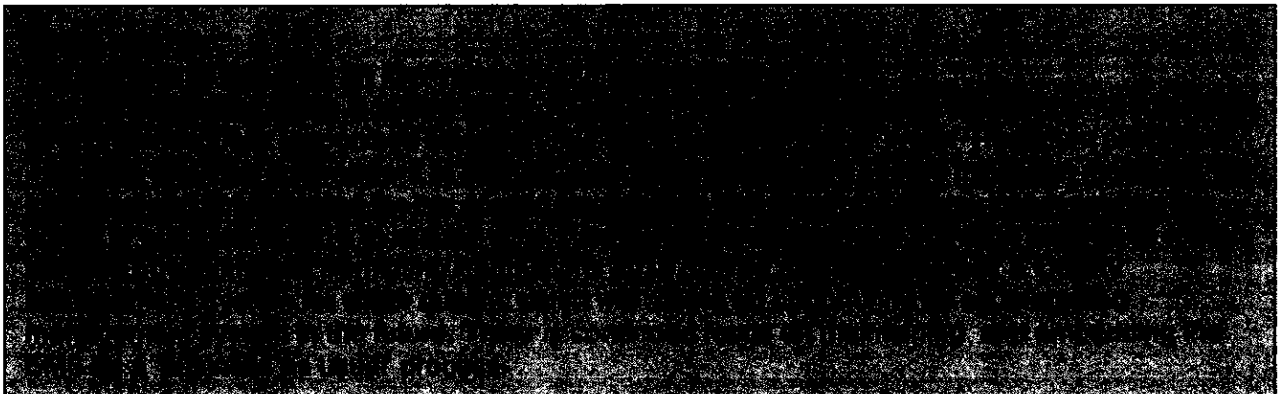
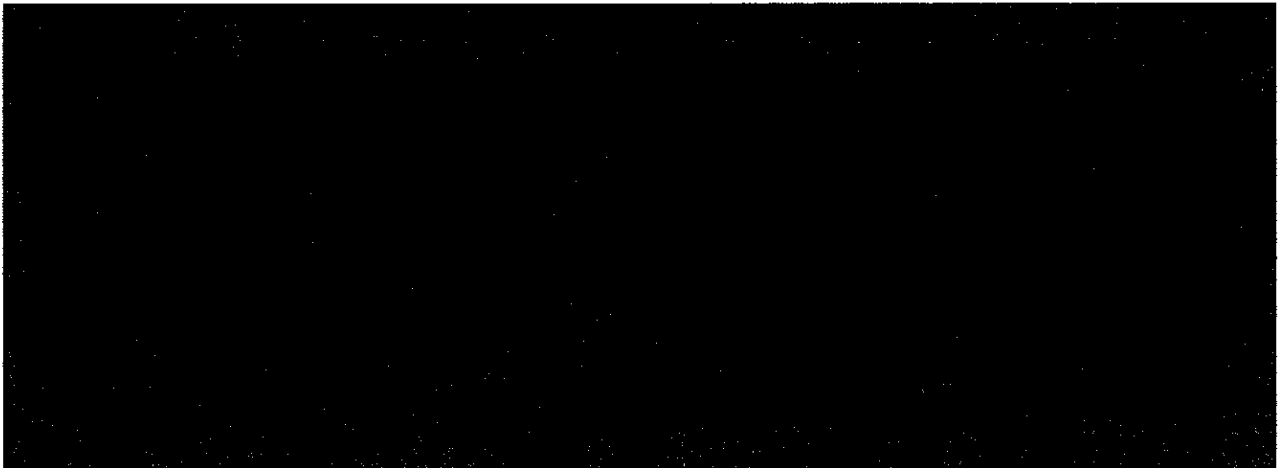
reviewed calculation tool developed and used by all the major water companies in the UK. It is updated each year to include the latest available emissions factors.

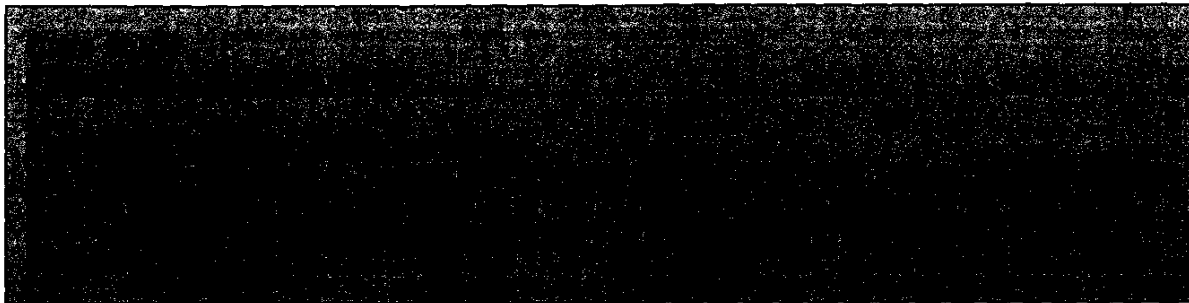
We are committed to reducing the amount of waste we produce

As a company we produce large amounts of waste – 2.6 billion litres of waste water per day which is treated and returned to the environment, 147.4 tonnes of bio-solids which are recycled to land, material on sites, retired assets, and our staff produce office waste too. We are committed to reducing the amount of waste we produce and to minimising our impact on the environment. This year we have started a new contract with Biffa, and have an aspirational ‘zero waste to landfill’ target. A key part of reducing waste is understanding what we produce and where and therefore we have focused on collecting robust data at each site, and have developed a live portal, making data management easier for site managers. The benefits have included the ability to monitor waste production and recycling at site level, enabling sites to identify low use containers that may not be needed on-site. Challenges have been cultural change to what we have always done. Going forward we are focusing on increasing recycling and moving to a more co-ordinated waste management approach on-site.

We do everything we can to prevent polluting the environment

We continue to drive hard for improved environmental performance. Six of our environmental performance metrics have improved this year. This year we have significantly reduced our number of category 3 pollutions against our regulatory target, but were disappointed to finish the year with one serious pollution ahead of our target. We complete an in-depth root cause for each pollution regardless of category and severity to ensure we build the learnings into the way we run the business, as we are committed to reducing our impact on the environment.





Value 5 - We are inspired to create an awesome Company

Our brilliant people are vital to our success and we care about each and every one of them. We aim to create an awesome place to work, in part by looking after employee health, safety and wellbeing and encouraging diversity and inclusiveness.

No one is hurt or made unwell by what we do

Our vision is that *no one gets hurt or made unwell by what we do*, and that includes our supply chain partners, customers and the communities in which we work. We have a clearly defined strategy to achieve this, which includes focusing on: people knowing what is safe, ensuring compliance with our standards, understanding the risks, and creating a culture in which everyone cares about health, safety and wellbeing. During the year we focused on compliance with our standards and ensuring our colleagues have easy access to the right information and training to show them how to work in a safe way. We are now focusing on how we ensure that people are working in the right way. We have agreed an assurance framework that enables us to identify where we can improve our health and safety performance, and then quickly take steps to change our ways of working. The framework includes proactive steps to prevent incidents happening in the first place, and from reoccurring. For example, we regularly check our sites for safety issues and application of our standards, with a view to removing and fixing issues before they cause an incident. You can find out more information about our Health, Safety & Wellbeing strategy/performance on page 27.

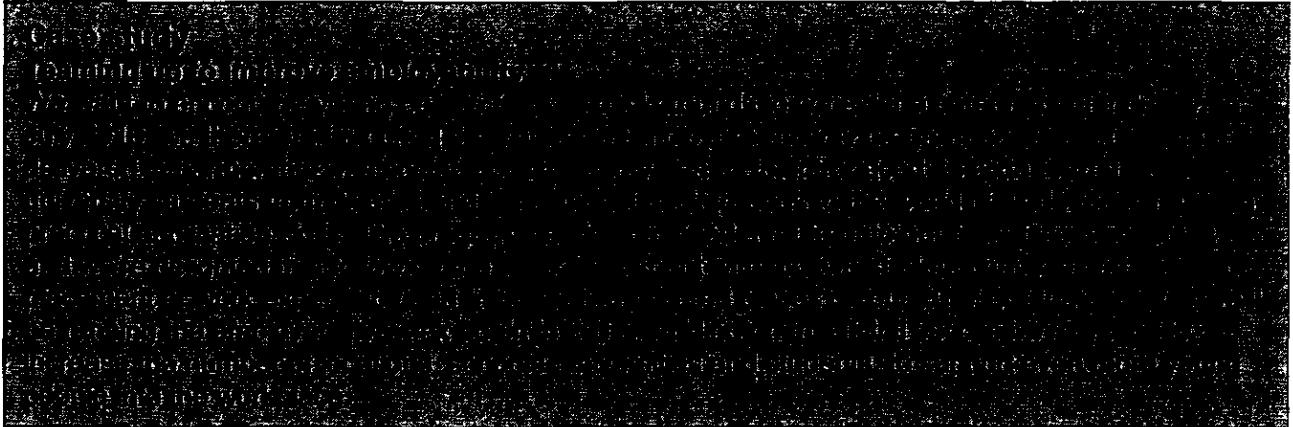
We are investing in the wellbeing of our colleagues

We're proud of our Occupational Health programme, which is dedicated to the physical, social and mental wellbeing of our colleagues and we'll always make sure that our workplaces are safe, enjoyable places to be. We are committed to supporting the wellbeing of our employees and, in particular, to promoting good mental wellbeing. We want our employees to feel comfortable talking about mental health and we are passionate about helping to remove any stigma and discrimination. See page 27 for more information.

We believe a diverse and inclusive workforce is a key factor in being a successful business

Diversity and inclusion are business imperatives, and we aim to have a workforce that reflects the diversity of our local communities. Our priorities remain the same: encouraging more women into operational leadership roles, increasing women and BAME (Black, Asian and Minority Ethnic) representation in engineering positions and increasing BAME representation in technical operator positions.

For more information about our diversity statistics, please see pages 73 to 74. You can find out more details about our focus on skills, talent and career development on page 28.



The strategic report, as set out from page 3 through to page 59, has been approved by the Board.

By order of the Board

Bronagh Kennedy
Group General Counsel and Company Secretary
22 May 2017

Chairman's Introduction to Governance

UK Corporate Governance Code Compliance Statement

The version of the Corporate Governance Code applicable to the current reporting period is the September 2014 UK Corporate Governance Code (the 'Code'). The Code is available on the Financial Reporting Council's website (www.frc.org.uk).

We are pleased to confirm that Severn Trent Plc was compliant with all of the provisions set out in the Code for the period under review.

A new edition of the Code was published in April 2016 which applies to reporting periods beginning on or after 17 June 2016. As our 2016 reporting period began before this date, we are continuing to report against the 2014 edition of the Code, although we have adopted some of the new provisions earlier than required.

Dear Shareholder

I am pleased to introduce our Governance report for 2017 on behalf of your Board in accordance with the Code. Following your feedback on our 2016 report, we have again structured our report to reflect the themes of the Code. As such, the pages that follow provide details on the activities and governance processes of the Board, and its Committees.

During the year, the Board spent a significant proportion of its time on operational delivery, retail market opening, risk management and future strategy development. Further detail on the scope of the Board's activities, discussions and resulting actions can be found on page 72 of this report.

My role, together with your Board, is to make sure that Severn Trent operates to the highest standards of corporate governance within a solid governance framework to effectively deliver the Group's strategic objectives and to meet its obligations to the Company's stakeholders, as required by our Charter of Expectations.

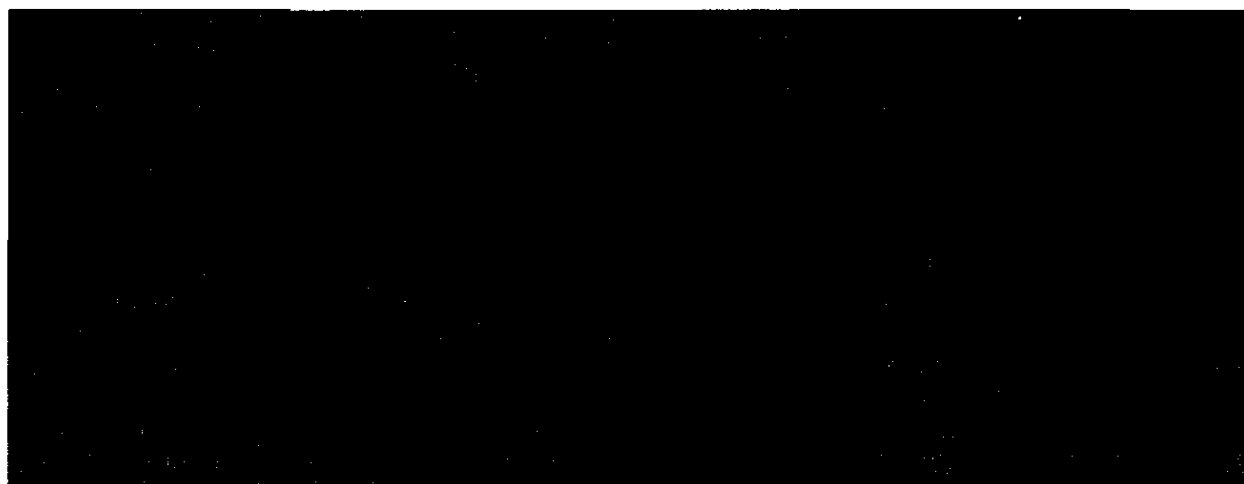
The Board sets the Group's long term strategy and monitors, challenges and supports the work of the Executive Committee in delivering that strategy. During 2016, the Board held a dedicated strategy day along with the Executive Committee to consider areas of future value creation across the Group. Topics included asset strategy and potential future disruptors, regulatory strategy and growth strategies across our portfolio of businesses.

You can find additional details on our strategy and our progress on pages 14 and 15 of the Strategic report. The Board continues to focus on the Group's risk management and internal control systems during the year, with Board and Audit Committee discussion, and challenge centred on ensuring adequate mitigation of risks faced by the Group. In addition, there were two dedicated Board risk workshops in October 2016 and March 2017. You can read more about how we identify and manage risks on pages 37 to 46 of our Strategic report and further detail of how we carried out our risk assessment activities in the Audit Committee report on pages 85 to 90 of the Severn Trent Plc Annual Report and Accounts.

Severn Trent's strength lies in the quality of its people, wherever they work in the Group and whatever their role is. We have clearly defined values and standards of behaviour which we expect from everyone who works for Severn Trent. During the year, we have relaunched our code of conduct 'Doing the Right Thing – the Severn Trent Way' across the Group, through an all-employee training programme, to make sure that all of our people embody Severn Trent's values: we put our customers first; we are passionate about what we do; we act with integrity; we protect our environment; and we are inspired to create an awesome company, to help us to achieve our vision of being the most trusted water company by 2020.

We know that the right culture must be set from the top and we have conducted an annual review of the key metrics which indicate what kind of culture exists in Severn Trent. My focus continues to be on maintaining a strong, value adding team, with a broad range of professional backgrounds, skills and perspectives. Succession planning continues to be a key priority for the Board and Nominations Committee. Following the retirement of Martin Lamb and Gordon Fryett after the 2016 Annual General Meeting ('AGM'), Kevin Beeston and Dominique Reiniche were appointed to the Board on 1 June and 20 July 2016. Both Kevin and Dominique benefited from a bespoke, tailored induction programme.

During the year, the induction process has been reviewed in light of their feedback, to keep it refreshed, effective and informative. Further details of their induction programmes can be found on page 73.



The Board and Nominations Committee continue to drive the agenda of diversity across the Group and we are proud of the progress made, particularly in regards to female representation on the Board and Executive Committee (now at 44% and 60%). There is also a continual focus on promoting wider diversity. We believe that our Company should reflect our communities and customers, and embrace a diverse range of perspectives, experiences and expertise to support our long term viability and commercial success.

We are committed to developing our talent pipeline, to make sure we have appropriate representation from minority ethnic candidates, as well as other relevant diverse groups. You can find additional details on our progress and ambitions on pages 82 to 84 of the Nominations Committee report in the Severn Trent Plc Annual Report and details of diversity across the Severn Trent Group on pages 73 and 74.

This Annual Report remains the principal means of reporting to our shareholders on the Board's governance policies and sets out how our approach to good corporate governance has been applied in practice. We welcome any feedback on this report and I would like to encourage our shareholders to attend the Severn Trent Plc AGM. We look forward to the opportunity to meet with you and I hope you will take the opportunity to do so this year.

Andrew Duff
Chairman

Introduction

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

The version of the Code applicable to the current reporting period is the 2014 edition of the Code. The Code is available on the Financial Reporting Council's website (www.frc.org.uk). A new edition of the Code was published in April 2016 and applies to reporting periods beginning on or after 17 June 2016. As our 2016 reporting period began before this date, we are continuing to report against the 2014 edition of the Code, although the Board has adopted some of the new provisions in the revised Code earlier than required.

The Boards of Severn Trent Water and Severn Trent Plc have the same Directors. This structure was implemented in 2007 to ensure that the highest standards of corporate governance were applied at the regulated subsidiary level and to promulgate greater visibility and supervision of Severn Trent Water Limited by the Plc Board. Severn Trent Water Limited is therefore voluntarily complying with the 2014 Code to ensure these high standards also apply to it.

For the whole of the financial year ended 31 March 2017, Severn Trent Water Limited was compliant with the Code, with the following exceptions:

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

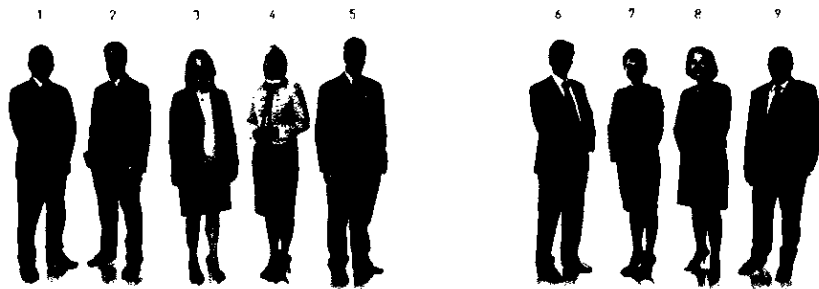
The two companies operate as distinct legal entities. The Boards comply with the Severn Trent Plc Board governance framework and the respective Matters Reserved to the Board. They are assisted through the management of separate agendas, meetings and minutes by Company Secretariat and advised in their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

Governance Code

The Code sets out five key principles: Leadership, Effectiveness, Accountability, Relations with Shareholders and Remuneration. This report is structured against each of these principles which, together with the Nominations Committee report, Audit Committee report and Remuneration Committee report, detailed in the Annual Report and Accounts for Severn Trent Plc, describe how we have complied with the relevant provisions of the Code throughout the year.

Leadership & Effectiveness
Board of Directors

**STRONG
LEADERSHIP**



1. John Coghlan BCom, ACA (59) A, D, F
Independent Non-Executive Director
Appointed to the Board on 23 May 2014
Chairman of the Audit and Treasury Committees

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

External appointments

- Non-Executive Director of Associated British Ports Companies
- Chairman of Freight Transport Association Ireland Limited

2. James Bowling BA (Hons) Econ, ACA (48) C, F, G
Chief Financial Officer
Appointed to the Board on 1 April 2015

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

3. Dr. Angela Strank BSc PhD, CEng, FIChemE (64) B, D, E
Independent Non-Executive Director
Appointed to the Board on 24 January 2014
Chairman of the Corporate Responsibility Committee

Angela brings a wealth of strategic, technical and commercial experience to the Board. Angela is Head of Downstream Technology and Group Chief Scientist at BP plc. She is a member of the Downstream Executive Leadership Team. Angela is responsible for enabling delivery of the Downstream strategic agenda through the development of differentiated technology advantage across the refining, fuels, lubricants and petrochemicals businesses. Since joining BP in 1982, she has held many senior leadership roles around the world in business development, commercial and technology, including in 2012 Vice President and Head of the Chief Executive's Office. In 2010, Angela was the winner of the UK First Woman's Award in Science and Technology in recognition of pioneering UK women in business and industry. Her track record and experience in strategy, operations, technology and transformational change are a complementary addition to the Board's skill set.

External appointments

- Board Governor of The University of Manchester

4. Olivia Garfield BA (Hons) (41) B, C

Chief Executive

Appointed to the Board on 11 April 2014

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

External appointments

–Director of Water Plus Limited – joint venture with United Utilities

5. Andrew Duff BSc FEI (58) B, D, E

Non-Executive Chairman

Appointed to the Board on 10 May 2010 and Chairman on 20 July 2010

Chairman of the Nominations Committee

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

External appointments

–Non-Executive Chairman and Chairman of the Nomination Committee of Elementis plc

–Member of the CBI President's Committee

–Trustee of Macmillan Cancer Support and Earth Trust

–Fellow of the Energy Institute

6. The Hon. Philip Remnant CBE FCA MA (62) A, D, E, F

Independent Non-Executive Director

Appointed to the Board on 31 March 2014

Chairman of the Remuneration Committee

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

External appointments

- Senior Independent Director and member of the Audit, Nomination and Remuneration Committees of Prudential Plc
- Chairman of M&G Group Limited
- Deputy Chairman of the Takeover Panel
- Non-Executive Director of UK Financial Investments Limited
- Non-Executive Chairman of City of London Investment Trust plc
- Governor of Goodenough College
- Director and Trustee of St Paul's Cathedral Foundation

7. Emma FitzGerald MA, DPhil Oxon, MBA (50) C

Managing Director, Wholesale Operations
Appointed to the Board on 1 April 2016

Emma joined Severn Trent in July 2015 as Managing Director, Wholesale Operations. Emma was previously CEO of Gas Distribution at National Grid. Prior to joining National Grid, she pursued a 20 year career with Royal Dutch Shell where she held a variety of technical, strategic and general management positions based in Asia and Europe, including Vice President Global Retail Network and Managing Director of Shell China/ Hong Kong Lubricants based in Beijing. Emma's experience and expertise brings a huge amount of value in ensuring the delivery of the commitments we have made in our business plan.

External appointments

- BUPA – Association Member
- Non-Executive Director of DCC plc

8. Dominique Reiniche MBA (61) B, D

Independent Non-Executive Director
Appointed to the Board on 20 July 2016

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

External appointments

- Non-Executive Director of Mondi Plc
- Non-Executive Director of PayPal (Europe)
- Independent Vice Chairman of CHR Hansen Holdings A/S

9. Kevin Beeston FCMA (54) A, D, E

Senior Independent Director
Appointed to the Board from 1 June 2016

Kevin has a wealth of commercial, financial and high level management experience. Kevin is Chairman of Taylor Wimpey plc and Equiniti plc and also a Non-Executive Director of The Football Association Premier League Limited and Marston Corporate Limited. Previously Kevin spent 25 years at Serco plc, where he held the roles of Finance Director, Chief Executive and finally Chairman until

2010. Kevin was previously Chairman of Domestic & General Limited and Partnerships in Care Limited and a Non-Executive Director of IMI plc.

External appointments

–Chairman of Taylor Wimpey plc

–Chairman of Equiniti plc

–Non-Executive Director of The Football Association Premier League Limited

–Non-Executive Director of Marston Corporate Limited

Group Authorisation Arrangements

The Group Authorisation Arrangements ('GAA') are the framework through which the Severn Trent Plc Board authorises the right people, at the right level, to take important decisions to effectively control and manage legal, financial and administrative decisions throughout the Group. These arrangements are reviewed annually, with the last review undertaken in March 2017. The flow of authority is from the Severn Trent Plc Board to the Chief Executive and the Severn Trent Executive Committee. In respect of certain decisions, the delegated authority is subject to an obligation to work with specialist business service areas (such as Tax, Treasury, Group Finance, Group Commercial and General Counsel), which provides additional expertise and a Group-wide perspective.

Governance framework

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

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

The Group's principal decision-making body is the Board. In line with the Code, the Board delegates certain roles and responsibilities to its various Committees. The Committees assist the Board by fulfilling their roles and responsibilities, focusing on their respective activities, reporting to the Board on decisions and actions taken, and making any necessary recommendations in line with their Terms of Reference. The Terms of Reference of each Committee comply with the provisions of the Code and have been updated to take account of best practice, and reflect the requirements of the revised UK Corporate Governance Code April 2016, as part of their annual review in March 2017.

The sub-committee structure is detailed in the governance framework overleaf and key responsibilities are set out on page 69.

Governance framework

CHAIRMAN – Andrew Duff

Leads our unified Board, ensuring that the principles and processes of the Board are maintained in line with our Code of Conduct and Charter of Expectations

BOARD

5 4

The Board's role is to: understand and meet its obligations to the Company's stakeholders, lead the Group within a framework of practical and effective controls which enable risk to be assessed and managed; approve the Group's strategic objectives and ensure that sufficient resources are available to enable it to meet those objectives; and monitor and review the operating and financial performance of the Group. It has responsibility and accountability for the long term success of the Group.

BOARD COMMITTEES

AUDIT COMMITTEE

Chair – John Coghlan

3

The Audit Committee assists the Board in discharging its responsibilities for the integrity of the Company's financial statements, the assessment of the effectiveness of the systems of Internal Controls, Risk Management and the internal and external Auditors. It also reviews the adequacy of the Company's whistleblowing arrangements

TREASURY COMMITTEE*

Chair – John Coghlan

4

The Treasury Committee provides oversight of treasury activities in implementing the policies, funding and treasury risk management plan approved by the Board. These include inter alia: the measurement and management of risks in respect of interest rates; funding; counterparty credit; liquidity and treasury operations; funding proposals; relationship with rating agencies; debt investor relations; bank relationship management; and treasury internal controls

REMUNERATION COMMITTEE

Chair – Philip Remnant

3 1

On behalf of the Board, the Remuneration Committee determines the Company's policy on the remuneration of Executive Directors, other members of the Executive Committee and the Chairman of the Board

CORPORATE RESPONSIBILITY COMMITTEE

Chair – Dr. Angela Strank

1 3

The Corporate Responsibility Committee provides guidance and direction to the Company's Corporate Responsibility and sustainability programme based on our values. It also reviews the Group's non-financial risks and opportunities

NOMINATIONS COMMITTEE

Chair – Andrew Duff

4 2

The Nominations Committee assists the Board by keeping the structure, size, composition and succession needs of the Board under review. It also assists the Board on issues of Directors' conflicts of interest and independence

CEO – Liv Garfield

Delegated responsibility for the development and implementation of the Group's strategy and overall commercial objectives.

Responsible for the day-to-day management of the business and the communication of Board agreed objectives to employees.

SEVERN TRENT EXECUTIVE COMMITTEE ('STEC')

4 6

STEC operates under the direction and authority of the CEO overseeing the development and execution of strategy. It also has accountability for achieving financial and operational performance.

EXECUTIVE SUB-COMMITTEE

DISCLOSURE COMMITTEE

Chair – James Bowling

2 2

The Disclosure Committee oversees the Company's compliance with its disclosure obligations and considers the materiality, accuracy, reliability and timeliness of information disclosed.

Each Board Committee has written Terms of Reference reviewed annually and approved by the Board, which are available on the Company's website

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

Male Female

Indicates membership of each Committee, including gender

Key Board responsibilities

Chairman – Andrew Duff

- Leads our unified Board and is responsible for its effectiveness.
- Responsible for setting agendas for Board meetings and for the timely dissemination of information to the Board, in consultation with CEO, CFO and the Company Secretary.
- Responsible for scrutinising the performance of the Executive Committee.
- Facilitates contribution from our Directors.
- Ensures effective communication with our shareholders and other stakeholders.

Chief Executive (CEO) – Liv Garfield

- Develops and implements the Group's strategy, as approved by the Board.
- Responsible for the overall commercial objectives of the Group.
- Promotes and conducts the affairs of the Group with the highest standards of integrity, probity and corporate governance, and sets the cultural tone of the organisation.

Chief Financial Officer (CFO) – James Bowling

- Manages the Group's financial affairs.
- Supports the CEO in the implementation and achievement of the Group's strategic objectives.

Senior Independent Non-Executive Director (‘SID’) – Kevin Beeston

In addition to his responsibilities as a NED, Kevin Beeston:

- supports the Chairman in delivery of his objectives;
- is available to all shareholders should they have a concern, in the event the normal channels of Chairman, CEO and CFO have failed to resolve it;
- leads the appraisal of the Chairman's performance with the Non-Executive Directors; and
- together with the Board Committees, Chairman, and NEDs, has a key role in succession planning for the Board.

Independent Non-Executive Directors (‘NEDs’) – John Coghlan, Dominique Reiniche, Dr Angela Strank, Philip Remnant

- Constructively challenge our Executive Directors in all areas.
- Monitor the delivery of strategy by the Executive Committee within the risk and control framework set by the Board.
- Satisfy themselves that internal controls are robust and that the External Audit is undertaken properly.
- Responsible for agreeing appropriate levels of remuneration for Executive Directors.
- Together with the Board Committees, Chairman, and SID, have a key role in succession planning for the Board.

Executive Director – Emma FitzGerald

- Responsible for the Group's wholesale business.
- Supports the CEO in the implementation and achievement of the Group's strategic objectives.

Group General Counsel and Company Secretary – Bronagh Kennedy

- Acts as Secretary to our Board and its Committees, ensuring sound information flows to the Board and between senior management and the Non-Executive Directors.
- Responsible for advising the Board on all corporate governance matters.
- Facilitates a comprehensive induction for newly appointed Directors, tailored to individual requirements.
- Responsible for compliance with Board procedures.
- Co-ordinates the performance evaluation of Board members and the annual effectiveness review of the Board and its Committees.
- Provides advice and services to the Board.

Additional information on the role of the Board, its Committees and further information in relation to each of the roles outlined above, can be found on the corporate governance section of our website.

Board meetings and attendance

The composition and attendance of members at Board meetings, as at year end, was as follows:

Board meetings and attendance

The composition and attendance of members at Board meetings, as at year end, was as follows:

Director	Meetings attended	Max possible
Andrew Duff	7	7
James Bowling	7	7
John Coghlan	7	7
Dominique Reiniche (Appointed 20 July 16)	4	4
Liv Garfield	7	7
Kevin Beeston (Appointed 1 June 16)	5	5
Emma FitzGerald	7	7
Philip Remnant	7	7
Dr. Angela Strank	7	7
Martin Lamb (Retired 20 July 16)	3	3
Gordon Fryett (Retired 20 July 16)	3	3

The Board held seven scheduled meetings during the year, and individual attendance is set out above. For additional information on the activities of the Board, see page 72. As part of this year's Board effectiveness review, full consideration was given to the number of external positions held by each Non-Executive Director. As a result of this review, the Board did not identify any instances of overboarding, and confirmed that all individual Directors have sufficient time to commit to their role as a Director of Severn Trent Plc.

In addition to the seven standing Board meetings, there were 12 additional ad hoc meetings of the Board or Committee of the Board convened throughout the year to consider such matters as the operation of the non-household retail market, our joint venture with United Utilities, the acquisition of Dee Valley Plc, Severn Trent Plc's preliminary and interim results, quarterly management statements and regulatory disclosures.

Board Strategy Day

In addition to formal meetings at which strategic items are regularly received, in October 2016 the Board held a dedicated strategy meeting along with the Executive Committee to consider areas of future value creation across the Group and spent time considering asset strategy and potential future disruptors, regulatory strategy and growth strategies across our portfolio of businesses.

Independence of NEDs

The independence of our Non-Executive Directors is formally reviewed annually by the Nominations Committee, and as part of the Board evaluation exercise. Further details can be found on page 75 and 76. The Nominations Committee and Board consider that there are no business or other circumstances that are likely to affect the independence of any Non-Executive Director and that all Non-Executive Directors continue to demonstrate independence. The Board recognises the Code's recommendation that Directors serve a fixed term of appointment and considers plans for orderly succession to the Board to maintain an appropriate balance of skills and experience within the Company. As such, the Company maintains a clear framework of Non-Executive Director tenure and the skill sets that each Director provides. Individual Director biographies can be found on pages 63 to 66.

In accordance with the Code, all the Directors will retire at this year's Severn Trent Plc AGM and submit themselves for reappointment by shareholders. Each of the Non-Executive Directors seeking reappointment are considered to be independent in character and judgement.

Conflicts

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

Board activities

The table below sets out the main matters considered by the Board in 2016/17 at its scheduled Board meetings. The Board's agenda is ordinarily structured as follows:

- performance review (including health and safety, operational, customer and financial matters);
- strategic items;
- matters for approval;
- matters to note;
- governance and regulatory matters; and
- committee reports.

This structure ensures that Matters Reserved for the Board are addressed appropriately and that the Board's time is spent effectively.

Topic	Activities/Disussions
Customers	<ul style="list-style-type: none"> • Discussion and review of performance and engagement reports at every meeting. • Discussion and review of digital technology • SIM performance discussions • Discussion and review customer strategy updates.
Shareholders	<ul style="list-style-type: none"> • Review and discussion of feedback following stakeholder meetings with CEO and CFO, investor roadshows, conferences and Capital Markets Day
Strategy	<ul style="list-style-type: none"> • Approach in respect of contract and materials management. • Review and discussion of capital programme management. • Review and discussion of the Group's security and resilience strategy, including physical, cyber and people. • Review and discussion of shareholder feedback.
Environment, Health & Safety	<ul style="list-style-type: none"> • Discussion and review of health and safety performance at every meeting. • Discussion and review of environmental matters • Discussion and review of renewables updates.
Governance & Risk	<ul style="list-style-type: none"> • Review of Severn Trent's governance framework. • Review of the GAA. • Board Committee reports. • Board and Committee effectiveness review - including the Board, its Committees and individual Directors. • Annual review of Terms of Reference for all Board Committees. • Reappointment of the External Auditor. • Review of the effectiveness of the Group's internal controls and risk management processes. • Bi-annual Enterprise Risk Management and Assurance Map review. • Regular governance report provided by the Company Secretary, including annual review of compliance with the Code. • Bi-annual review of the Group's disclosure requirements. • Gifts and Hospitality register, conflicts of interest and interest of Directors. • Material Litigation. • Cyber Security reports from the Audit Committee.
Financial	<ul style="list-style-type: none"> • Review of annual performance, including approval of full year, half-year results and trading updates. • Distributions to shareholders. • Annual Report and Accounts. • Regular Treasury funding discussions. • Group Budget 2016/17, medium term financial plan and regulated business ODIs. • Disposal of Operating Services Italy. • Review of the Group's financial performance against budget and forecast.
Regulation	<ul style="list-style-type: none"> • Regulatory reporting and annual submissions to Ofwat. • Non-household retail market opening discussions at every meeting • Regulatory business discussions at every meeting. • Engagement with regulators, including Consumer Council for Water and Drinking Water Inspectorate • Discussion and review of water quality and environmental performance updates. • Acquisition of Dee Valley plc.
Employees & Leadership	<ul style="list-style-type: none"> • Discussion and review of employee engagement across the Group from the results of the employee engagement [QUEST] survey. • Regular discussion and review of talent development and succession planning across the Group • Regular pension fund discussions. • Review the composition and succession of the Board and its Committees.
Ethics	<ul style="list-style-type: none"> • Discussion and review of the Group's ethics culture

Training and Continuing Professional Development

As well as Board agenda items, training sessions in relation to specific topics of interest that were presented to Directors during the year are set out below. The aim of the training sessions is to continually refresh and expand the Board's knowledge and skills to enable them to effectively fulfil their roles on the Board and its Committees and contribute to discussions on technical and regulatory matters. The sessions also serve as an opportunity for the Board to discuss strategy and risks with management below Executive Committee level and gain further insight into our businesses and management capability.

Directors' resources

An online resource library and Continuing Professional Development ('CPD') repository is available for use by the Directors, which is constantly reviewed and updated. The library includes a Corporate Governance Manual, a Results Centre and Investor Relations section, Strategy Day materials and details of Board training sessions. It also contains a further reading section which covers updates and guidance on changes to legislation and corporate governance best practice. The Directors also have access to professional development provided by external bodies and our advisers. CPD requirements were considered, through individual performance review meetings between the Chairman and each Director, as part of the Board effectiveness review in 2016/17.

Succession

Director Inductions – Kevin Beeston and Dominique Reiniche Induction.

The induction programmes for Kevin and Dominique were comprehensive and tailored to their individual understanding of the Group and Board Committee membership. They were facilitated by the Company Secretary and covered the below topics, with supporting meetings with members of Executive management and external advisers as appropriate. In addition, Kevin and Dominique took part in an extensive tour of our key operational and office sites in order to understand our water treatment and distribution processes, and the customer journey, in a live environment, as follows:

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

We will continue to enhance the Board's induction process following feedback from Kevin and Dominique.

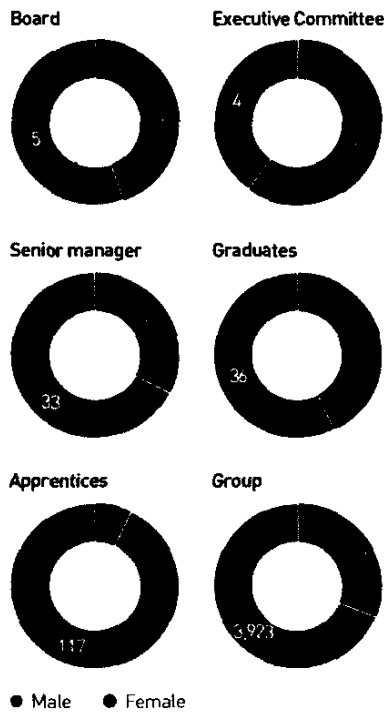
Additional sessions were held with Kevin and Dominique to reflect their individual Board Committee membership as follows:

- Kevin – Insight into key Internal Audits and areas of focus.
- Dominique – Corporate Responsibility Framework and Strategy.

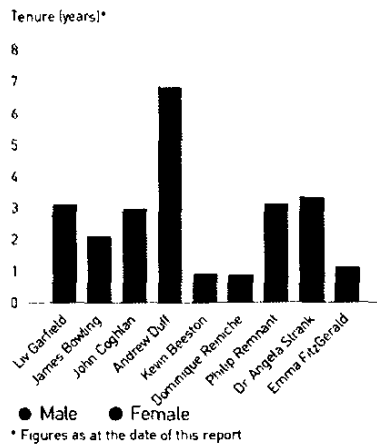
Diversity and Succession Planning

As highlighted earlier in the report, the Board and Nominations Committee continue to drive the agenda of diversity across the Group and are proud of the progress made, especially in respect of female representation on the Board and Executive Committee (now at 44% and 60% respectively). A breakdown by gender of the number of persons who were Directors of the Company, senior managers and other employees as at 31 March 2017 is set out below.

Gender diversity as at 31 March 2017



Severn Trent Board diversity figures



The Board also remains focused on promoting broader diversity, and creating an inclusive culture. A diverse organisation benefits from differences in skills, regional and industry experience, background, race, gender, sexual orientation, religion, belief and age, as well as culture and personality. The Board is committed to building on existing graduate, apprentice and leadership programmes to embed inclusivity in our succession planning and talent development work to strengthen our talent pipeline, with an enhanced focus on ensuring appropriate representation from minority ethnic candidates, as well as other relevant diverse cohorts.

At Board level, the Nominations Committee reviews the Board's effectiveness and composition each year and, in particular, considers the balance of skills, experience and independence of the Board. It considers the benefits of all aspects of diversity when identifying candidates for appointment. The selection of candidates to join the Board will continue to be made based on merit and the individual's ability to contribute to the effectiveness of the Board, which in turn will be dependent on the pool of candidates available. To support this, we continue only to engage with executive search firms who have signed up to the voluntary Code of Conduct on gender diversity and best practice.

Talent Development

Severn Trent recognises the importance of developing our people, and talent management remained a key topic of discussion. During the year, the Committee reviewed progress against the Group's five year talent plan, which focuses on building both technical and leadership capability within the Group. We have a total of 63 graduates and 126 apprentices in training and a significant programme of STEM (Science, Technology, Engineering and Maths) activities was undertaken through Engineering UK to further support our future technical talent pipeline and encourage young people to maintain an interest in science and technology courses at schools and universities.

Our Awesome Leaders Programme, aimed at our team leaders and team managers, continues to nurture and develop our internal talent, particularly in relation to succession planning for senior positions within the Company.

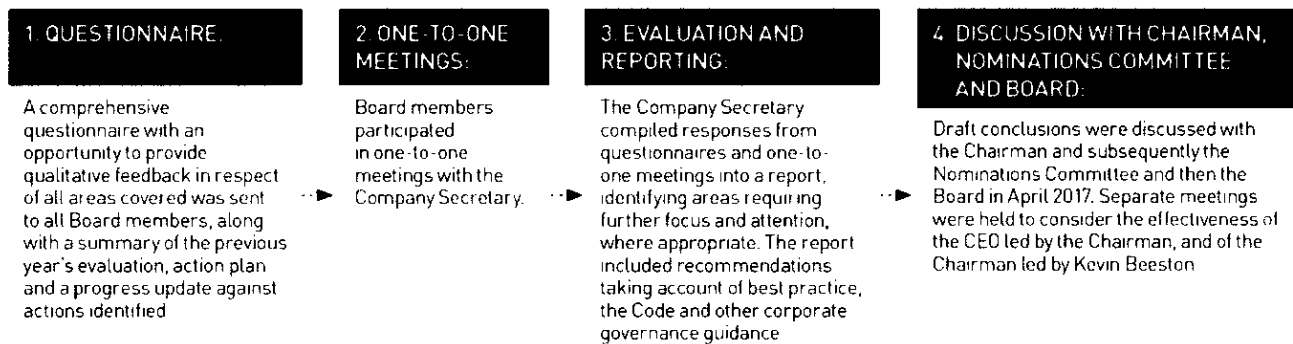
Development for Executive Directors and high performing individuals below Board level continues to be an area of focus. Coaching and mentoring is provided to develop and enhance specific skill sets, and the Committee believes the benefits of this approach are critical for developing our own talent for the future.

Details can be found on page 28.

Evaluation of the Board

The effectiveness of the Board is reviewed at least annually, and conducted according to the guidance set out in the Code. The last externally facilitated evaluation was conducted by Manchester Square Partners in 2015, with the next externally facilitated session scheduled for 2018.

The 2016/17 evaluation was internally conducted by the Chairman with support from the Company Secretary through a series of one-to-one meetings in February and March 2017 and supported by a questionnaire.



Board evaluation highlights 2016/17

The evaluation concluded that excellent progress had been made in respect of areas for further focus identified in the 2016 review as detailed below. It also concluded that the effectiveness of the Board and its Committees remained strong, and that the planned succession and induction process for Non-Executive Directors was operating effectively.

The following matters were identified during the 2016/17 internally facilitated review as requiring further focus and attention:

- Continue development of talent management and succession planning below Executive Committee level;
- Whilst excellent progress had been made in respect of diversity, including skills, experience and gender across the Group, there remained an opportunity to further consider opportunities to enhance the ethnic diversity of the Board;
- Further development of the NED induction programme to include one-to-one follow up sessions on regulatory topics;
- Board and Committee forward plans to be reviewed against strategic priorities identified as part of the 2017 review and used to refine focus areas for debate at future meetings;
- External facilitation to be investigated for future Board strategy days; and
- More detailed discussion on communication of Board Committee proceedings to the Board as a whole.

The evaluation also concluded that the Board and its Committees were effective and that all Directors were considered to have demonstrated considerable commitment and time to their roles, well in excess of that required by the Charter of Expectations notwithstanding any other positions held by them outside of Severn Trent.

In addition, the review concluded that all Non-Executive Directors continued to demonstrate their independence and objectively challenge management. In addition, the review concluded that all Non-Executive Directors were considered to be independent in judgement and there were no relationships or circumstances which were likely to affect, or could affect this. This was also the case for those Directors who had served a term in excess of six years by the time the AGM notice was issued.

As part of the evaluation, full consideration was given to the number of external positions held by the Non-Executive Directors. We reviewed Directors' other appointments, including the time commitment required for each, as part of the evaluation exercise. The outcome of which can be found below:

Director	Number of Listed Company Appointments as Chairman (including Severn Trent Plc)	Number of Listed Company Appointments as Non-Executive Director (including Severn Trent Plc)
Kevin Beeston	2	1
James Bowling	0	0
John Coghlan	0	2
Andrew Duff	2	0
Emma FitzGerald	0	1
Liv Garfield	0	0
Dominique Reiniche*	0	3
Philip Remnant	1	2
Dr. Angela Strank	0	1

* Dominique Reiniche was a Non-Executive Director of AXASA until April 2017, and retired from the AXA Board at their 26 April AGM

As a result of this review, the Committee did not identify any instances of overboarding and confirms that all individual Directors have sufficient time to commit to their appointment as a Director of Severn Trent plc. The full list of external appointments held by our Non-Executive Directors can be found on pages 63 to 66.

Progress Against 2015/16 Action Plan

The following matters were identified during the 2015/16 internally facilitated review as requiring further focus and attention:

Area for further focus identified in 2015/16 internal review	Progress against areas for further focus identified in 2015/16 internal review
Talent management and succession planning below Executive Committee level to remain a regular Board agenda topic.	Regular discussion and review of talent and succession at 2016/17 Board meetings. 2017 plan submitted to the Nominations Committee.
Board strategy day to be scheduled outside of the normal Board meeting calendar and preferably off-site.	2016 Board Strategy Day held outside of the normal Board meeting calendar. 2017 Board Strategy Day held off-site outside the Board meeting calendar.
Ensure a breadth of skills and general business experience to balance subject matter expert members on the Board going forward.	Kevin Beeston and Dominique Reiniche, appointed to the Board on 1 June and 20 July 2016 respectively, broadened the range of skills, business experience and perspectives on the Board.
Additional Board time to be spent on health, safety and ethics.	Discussion and review of health and safety held at all 2016/17 Board meetings. Ethics culture discussed at the Board during the year with a dedicated Board training session scheduled for 2017/18.

Directors' remuneration report

Remuneration details

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

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

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

Directors' remuneration and annual bonus scheme

Remuneration for Executive Directors comprises the following elements:

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

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

Base salaries and benefits

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

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

Annual Bonus 2016/17

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

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

A clawback mechanism applies to allow the recoupment within three years of the payment of the cash bonus or the grant of deferred shares in the event of financial misstatement, error in the calculation or gross misconduct.

Annual bonus performance is measured over a single financial year. An annual bonus was awarded of 75.8% of the maximum for the Chief Executive Officer, 75.3% of the maximum for the Chief Financial Officer and 75.5% for the Managing Director, Wholesale Operations.

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

Measure	Weighting	Threshold (0% payable)	Target (50% payable)	Stretch (100% payable)	Actual Performance ⁽ⁱ⁾	% Payable
Severn Trent Water Limited Group PBIT ⁽ⁱ⁾	47%	£493.5m	£506.6m	£519.9m	£512.8m	73%
STW Customer ODIs ⁽ⁱⁱ⁾	25% <i>(35% in respect of the Managing Director, Wholesale Operations)</i>	£10.0m	£15.0m	£20.0m	£47.6m	100.0%
Health and safety ⁽ⁱⁱⁱ⁾	8%	0.18	0.16	0.14	0.22	0.0%
Personal Performance	10%	Detailed overleaf				Chief Executive Officer –95% Chief Financial Officer - 90% Managing Director, Wholesale Operations - 60%

(i) The outturn figures shown in the table above include six weeks of Dee Valley's revenue and costs. These are immaterial with a net £0.4 million loss for the period. STW PBIT shown pre exceptional items.

(ii) Based on 2012/13 prices pre tax.

(iii) Measured as no. of lost time incidents divided by no. of hours worked by multiplied by 100,000.

The 2016/17 targets were set on the basis of delivering Severn Trent Water Limited PBIT (pre exceptional items) growth in a lower RPI environment decreasing revenue growth, and required us to absorb a number of headwinds such as inflation, increasing energy costs and the costs of setting up our Non-household Retail operation. Against a challenging target in excess of the Final Determination and better than consensus expectations, we delivered Severn Trent Water Limited Group PBIT of £512.8 million (pre exceptional items). The customer ODI targets are reset at the beginning of each year and the

targets for 2016/17 were significantly more challenging, with reduced deadbands and improved performance levels, compared with 2015/16. Delivery of the target would represent improved operational performance on last year, when we delivered exceptionally strong performance and benefitted from mild weather. Our outturn of £47.6 million represents an outstanding result, driven by significant improvements in sewer flooding, supply interruptions and sustained performance on category 3 pollutions, while continuing to benefit from another year of relatively benign weather. We assume normal weather patterns will return in the future. In Severn Trent Water we have experienced 22 LTIs resulting in an LTI rate of 0.22, higher than our threshold target of 0.18 and therefore this portion of the bonus lapses.

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

Liv Garfield's key objectives related to improving the financial health and performance of the business, maintaining excellent customer service, ensuring the business is ready for market opening and PR19, supporting industry thinking and creating an awesome place to work. The Committee awarded Liv Garfield a personal performance rating at 95% of the maximum. This is based on the following: Identification of a further £100m in total expenditure efficiencies and strong year on year RCV growth; improved customer service resulting in an ODI reward of £47.6m; on time delivery of Water Plus, our joint venture with United Utilities, and setting up our Severn Trent Wholesale Market Unit, in readiness for non-household competition; on track delivery of the AMP6 asset management strategy; building and maintaining constructive regulatory relationships, contributing to the thinking on opportunities for developing the customer ODI framework and PR19; delivery of a three percentage point increase in employee engagement, which continues to track above the global benchmark. Whilst acknowledging a strong financial performance and an exceptional operational year, the Board noted that there remains more to do in relation to health and safety and SIM.

James Bowling's key objectives related to strengthening the wider Finance team, including Internal Audit and Enterprise Risk Management, development and delivery of key financial plans, minimising risk and liability in relation to pensions enhancing investor relationships and creating value in Business Services. The Committee awarded James Bowling a personal performance rating at 90% of the maximum. This is based on the following: Transformation of the Internal Audit and Enterprise Risk Management teams, developing a strong co-source function to embed great risk management and controls into the way we work; successful development and delivery of our investor engagement plan, cash enhancement plan, and balanced and floating finance plan; management of the defined benefit pension liability through the development of a revised plan, following the triennial valuation; successful delivery of Business Services business plans, including the sale of Severn Trent Italia and growth in Energy and Renewables; improved development planning within the Finance team to identify and build talent breadth and depth at all levels. Whilst acknowledging a strong financial performance, the Board noted that there remains more to do in relation to financing risk management.

Emma FitzGerald's key objectives related to maximising value from key contracts and capital expenditure, ensuring Wholesale is ready for market opening and PR19, improving customer experience and improving leadership succession planning for operational roles. The Committee awarded Emma FitzGerald a personal performance rating at 60% of the maximum. This is based on the following: Implementation of a contract management framework, in collaboration with Group Commercial, to maximise value from key contracts, sustain efficiencies across the capital programme and embed new capital prioritisation mechanisms; delivery of functional separation in readiness for market opening; on track delivery of PR19 work streams including proactive asset management and partnerships with the

Environment Agency and Drinking Water Inspectorate; and improved development planning across Wholesale to strengthen leadership development. Whilst acknowledging an exceptional operational year, the Board noted there remains more to do in relation to health and safety, customer complaints and SIM.

The bonuses awarded for 2016/17 were 91.0% of base salary for Liv Garfield (£615,800), 90.4% of base salary for James Bowling (£368,700) and 90.6% of base salary for Emma FitzGerald (£360,200). Please note that the bonuses incorporate amounts in respect of the achievement of Severn Trent Business Services targets (with the exception of the Managing Director, Wholesale Operations) and personal performance targets. Annual bonus payments to Executive Directors are not pensionable.

Annual Bonus 2017/18

We have reviewed the current bonus measures against our vision and how we operate, and whilst they remain well aligned to our key strategic drivers, we believe the addition of a specific customer experience measure will serve to strengthen the link between what our people do and desired outcomes for customers. The metric will assess reduction in written complaints. Driving a reduction in written complaints is important as it ensures we are resolving issues earlier for customers and ultimately building strong customer focus into all our processes to minimise complaints at any stage. It is a measure which is well understood by all key stakeholders (employees, customers, investors and regulators) and the Consumer Council for Water (CCW) report on the reduction in customer complaints in their annual report on water companies, making it an externally recognised measure. Customer Experience will make up 8% of the bonus with a corresponding reduction in the Customer ODI measure from 25% to 20% (in respect of the Chief Executive Officer and Chief Financial Officer) and from 35% to 30% (in respect of the Managing Director, Wholesale Operations) and in the personal objectives weighting from 10% to 7% will also apply.

In summary, the annual bonus performance measures and weightings for 2017/18 financial year will be as follows:

- STW Profit Before Interest & Tax – 47%
- STW Customer Outcome Delivery Incentives – 20% (30% in respect of the Managing Director, Wholesale Operations)
- Business Services Profit Before Interest & Tax – 10% (excluding the Managing Director, Wholesale Operations)
- Health and Safety (Lost Time Incidents) – 8%
- Personal Objectives – 7%
- Customer Experience – 8%

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

Long Term Incentive Plan

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

A clawback mechanism applies to allow the recoupment of vested incentive awards within three years of vesting in the event of financial misstatement, an error in calculating the level of vesting or gross negligence, fraud or gross misconduct.

2014 LTIP Awards

The 2014 LTIP awards were granted as conditional shares and are subject to an RoRCV performance condition measured over three financial years. RoRCV is calculated as current cost operating profit less tax paid divided by our average regulatory capital value. 0% of each award vests if average RoRCV equals that set in the Final Determination, increasing on a straight-line basis to 50% vesting for 1.02 times the Final Determination and 100% vesting for 1.07 times the Final Determination. Ofwat is no longer publishing a baseline RoRCV figure in AMP6 which impacts the final two years of the 2014 LTIP award. However, an equivalent baseline figure can be constructed using the component numbers set out in the Ofwat model giving a baseline figure of 3.49% for 2015/16 and 3.60% for 2016/17.

The three year performance period for the 2014 LTIP award ended on 31 March 2017. Our final RoRCV of 1.27 times the Final Determination results in a vesting of 100% of the maximum. This is representative of outstanding performance in financing and total expenditure delivering RoRCV of 5.03% up by 0.67% year on year. Further details can be found in the Severn Trent Plc Annual Report and Accounts.

Recruitment Awards

The third tranche of the Recruitment Award made to James Bowling and the second tranche of the Recruitment Award made to Emma FitzGerald vested in respect of the performance period ended 31 March 2017. The performance measures for these awards reflected those under the 2014 LTIP and therefore both awards vested in full.

2015, 2016 & 2017 LTIP Awards

Awards granted from 2015 onwards are subject to a Return on Regulated Equity (RoRE) performance condition measured over three financial years. Average RoRE performance is compared with the baseline RoRE figure set by Ofwat in our Final Determination. 25% of the award will vest if average RoRE matches the baseline figure of 5.65%, increasing on a straight line basis to full vesting for outperforming the baseline by 1.29 times (equivalent to 7.29%) for the 2015 LTIP award and 1.39 times (7.86%) for the 2016 and 2017 LTIP awards.

The grant level for the 2017 LTIP award is 150% of base salary for the Chief Executive Officer, 100% of base salary for the Chief Financial Officer and 80% of base salary for the Managing Director, Wholesale Operations, which remain unchanged.

Shareholding guidelines

The Company operates shareholding guidelines under which Executive Directors are expected to build and maintain a shareholding in the Company. The Chief Executive Officer is expected to build and maintain a holding of shares to the value of 200% of salary, and other Executive Directors 125% of salary. Executive Directors are expected to retain all of the net of tax number of shares they receive through the LTIP and deferred share bonus until the shareholding guidelines have been met.

The Chief Executive Officer and the Managing Director, Wholesale Operations have now exceeded the shareholding requirement of 200% and 125% of base salary. The Chief Financial Officer is on track to meet his shareholding requirement of 125% of base salary in 2017.

Severn Trent Water Limited

Directors' Report

For the year ended 31 March 2017

The Directors present their report and the audited financial statements for the Company, for the year ended 31 March 2017. The performance review of the Company can be found within the Strategic report on pages 3 to 59. This provides detailed information relating to the Group, its business models and strategy, the operation of its businesses, future developments and the results and financial position for the year ended 31 March 2017. The governance section set out on pages 60 to 81 is incorporated by reference into this report and, accordingly, should be read as part of this report. Details of the Group's policy on addressing the principal risks and uncertainties facing the Group are set out in the risk management section on pages 37 to 46.

Principal activity

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

Directors and their interests

Biographies of the Directors currently serving on the Board are set out on pages 63 to 66.

All of the Directors at the year-end are also Directors of Severn Trent Plc, they will all be offering themselves for appointment or reappointment at the Severn Trent Plc AGM, as set out in the Governance report on pages 70 to 71.

Details of Directors' service contracts are set out in the Directors' Remuneration Report on page 112 of the Severn Trent Plc Annual Report. The interests of the Directors in the shares of Severn Trent Plc are disclosed in the Annual Report and Accounts for that Company for the year ended 31 March 2017. The Board has a documented process in place in respect of conflicts which is described on page 71.

Insurance and indemnities

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

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

Employees

The average number of employees within the Group is shown in note 9 to the financial statements on page 111.

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

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

crucial importance to Severn Trent with the aim of keeping our employees fit, healthy and well, including an employee assistance programme.

Employee engagement

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

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

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

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

Over 70% of Severn Trent's UK employees participate in one or more of our schemes, with the average participant contributing £265 each month.

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

Research and development

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

Expenditure on research and development is set out in note 7 to the financial statements on pages 109 to 110.

Post balance sheet events

Details of post balance sheet events are set out in note 42 to the financial statements on page 150.

Contributions for political and charitable purposes

Donations to charitable organisations during the year amounted to £312,588 (2016: £86,864). Donations are given to charities whose projects align closely with our aim to promote the responsible use of water resources and waste water services which provide the opportunity for longer term partnerships. In addition, we provide donations to employee nominated charities through a matched funding scheme and health and safety reward schemes. We are also committed to supporting WaterAid, the UK's only major charity dedicated to improving access to safe water, hygiene and sanitation in the world's poorest countries.

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

At the 2016 AGM, shareholders gave the Company authority to make political donations or to incur political expenditure in the EU (which would not ordinarily be regarded as political donations) up to an aggregate annual limit of £150,000 for the Company and its subsidiaries. Pursuant to those authorities, during the year ended 31 March 2017 the Group incurred costs of £nil (2016: £nil). Those authorities will expire at the 2017 AGM and, in line with market practice to renew the authorities on an annual basis, the Board has decided to put forward a resolution to this year's AGM to renew the authorities to make donations to political organisations and to incur political expenditure up to a maximum aggregate of £150,000 p.a. As permitted under the Companies Act 2006, this resolution also covers any political donations made or political expenditure incurred by any subsidiaries of the Company.

Supplier payment policy

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

Internal controls

The Board is responsible for the Group's Internal Control systems and for reviewing their effectiveness. The Audit Committee regularly monitors and reviews the effectiveness of the systems of Internal Control, including Risk Management, financial, operational and compliance aspects, in accordance with the requirements of the Code and the Guidance, and these systems have been in place for the year ending 31 March 2017 and up to the date of the Annual Report. This is described in the Severn Trent Plc Audit Committee report on page 88 of the Severn Trent Plc Annual Report.

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

External Auditor

Having carried out a review of their effectiveness during the year, described in the Severn Trent Plc Audit Committee report on page 88 of the Severn Trent Plc Annual Report, the Severn Trent Plc Audit Committee has recommended to the Board the reappointment of Deloitte LLP.

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

Severn Trent Relevant audit information

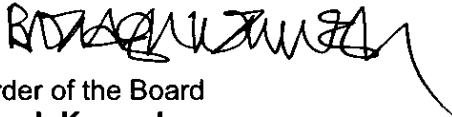
The Directors confirm that:

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

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

Annual Performance Report of Severn Trent Water Limited

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



By order of the Board

Bronagh Kennedy

Group General Counsel and Company Secretary

22 May 2017

Directors' responsibilities statement

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

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

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

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

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

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

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

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

Responsibility statement


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

- the financial statements, prepared in accordance with the relevant financial reporting framework, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole;
- the Strategic report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face; and
- The Annual Report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's position and performance, business model and strategy.

This Responsibility Statement was approved by the Board of Directors on 22 May 2017 and is signed on its behalf by:



Andrew Duff
Chairman



James Bowling
Chief Financial Officer

Opinion on financial statements of Severn Trent Water Limited

In our opinion:

- **the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2017 and of the group's profit for the year then ended;**
- **the group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;**
- **the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including FRS 101 "Reduced Disclosure Framework"; and**
- **the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.**

The financial statements that we have audited comprise:

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

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

Summary of our audit approach

Key risks	<p>The key risks that we identified in the current year were:</p> <ul style="list-style-type: none"> • Determination of the provision for impairment of trade receivables; • Revenue recognition risk in relation to the estimation of metered unbilled revenue; • Determining the classification of costs between operating expenditure and capital expenditure; • Determining the amount of the group's retirement benefit obligations; and • Determination of current and deferred tax balances.
Materiality	<p>The materiality that we used in the current year was £16 million (2016: £16 million) which was determined on the basis of profit before tax, losses/gains on financial instruments and exceptional items.</p>
Scoping	<p>Our audit scoping has resulted in 100% of the group's turnover and over 90% of the group's net operating assets and profit before tax, gains/losses on financial instruments and exceptional items being subject to audit procedures</p>
Significant changes in our approach	<p>The change to our scoping approach includes audit of the acquisition balance sheet of Dee Valley Group plc.</p>

Going concern and the directors' assessment of the principal risks that would threaten the solvency or liquidity of the group

We have reviewed the directors' statement regarding the appropriateness of the going concern basis of accounting contained within note 2 to the financial statements and the directors' statement on the longer-term viability of the group contained within the strategic report on pages 39 to 40.

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

We are required to state whether we have anything material to add or draw attention to in relation to:

We agreed with the directors' adoption of the going concern basis of accounting and we did not identify any such material uncertainties. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the group's ability to continue as a going concern.

- the directors' confirmation on page 41 that they have carried out a robust assessment of the principal risks facing the group, including those that would threaten its business model, future performance, solvency or liquidity;
- the disclosures on pages 41 to 46 that describe those risks and explain how they are being managed or mitigated;
- the directors' statement in note 2 to the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the group's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements; and
- the directors' explanation on page 39 to 40 as to how they have assessed the prospects of the group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Independence

We are required to comply with the Financial Reporting Council's Ethical Standards for Auditors and confirm that we are independent of the group and we have fulfilled our other ethical responsibilities in accordance with those standards.

We confirm that we are independent of the group and we have fulfilled our other ethical responsibilities in accordance with those standards. We also confirm we have not provided any of the prohibited non-audit services referred to in those standards.

Our assessment of risks of material misstatement

The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team.

There have been no changes to the risks identified in the prior year.

Determination of the provision for impairment of trade receivables (£125.4 million) (note 21)

Risk description



A proportion of Severn Trent Water Limited's customers do not or cannot pay their bills which results in the need for provisions to be made for non-payment of the customer balance. Management makes estimates regarding future cash collection when calculating the bad debt provision.

Provisions are made against Severn Trent Water Limited's trade receivables based on historical experience of levels of recovery from accounts in particular ageing categories. The risk has been focussed on the determination of the ageing of the trade receivables balance as this determines the level of provisioning to be recorded.

Management has included this as a key source of estimation uncertainty in note 5 to the financial statements.

How the scope of our audit responded to the risk



We reviewed and challenged the information used to determine the bad debt provision by considering cash collection performance against historical trends and the level of bad debt charges over time.

Specifically, we reviewed the actual history of slow paying customers in Severn Trent Water Limited in the year using data analytics to understand the collection of previously aged trade receivables and to recompute the ageing analysis.

We evaluated the design and implementation of key management review controls and those relating to the production of the data used in the bad debt model.

Key observations



We are satisfied that the assumptions applied in assessing the impairment of trade receivables and the calculation of the ageing of trade receivable are appropriate and no additional provision was identified from the audit work performed.

Revenue recognition risk in relation to the estimation of unbilled metered revenue (£113.4m million of the £143m in Severn Trent Water Limited) (note 21)

Risk description



For water and waste water customers with water meters, the amount of unbilled revenue recognised depends upon the volume supplied, including an estimate of the sales value of units supplied between the date of the last meter reading and the year end. There is a risk that these estimates are incorrect.

The risk has been focussed on the usage estimate, because this is based on historical data and assumptions around consumption patterns upon which management then recognises unbilled revenue.

Management has included this as a key source of estimation uncertainty in note 5 to the financial statements.

How the scope of our audit responded to the risk



We used data analytics to recompute the total level of unbilled revenue for the current year in Severn Trent Water Limited as well as evaluating the design and implementation of key management review controls and those relating to the key data inputs to the model.

In addition, we challenged the validity of management's estimate of current year accrued revenue by comparing actual amounts billed to the estimate made in the prior year to determine the accuracy of the estimation techniques.

Key observations

We are satisfied that management's assumptions around the recognition of unbilled revenue are appropriate.



Determining the classification of costs between operating expenditure and capital expenditure (note 18)

Risk description



Severn Trent Water Limited has a substantial capital programme (property, plant and equipment additions in the year were £466.4 million) which has been agreed with the regulator ('Ofwat') and therefore incurs significant expenditure in relation to the development and maintenance of both infrastructure and non-infrastructure assets.

Expenditure in relation to increasing the capacity or enhancing the network is treated as capital expenditure. Expenditure incurred in maintaining the operating capability of the network is expensed in the year (£136.2 million) in which it is incurred. Capital projects often contain a combination of enhancement and maintenance activity which are not distinct and therefore the risk has been focused on the allocation of costs between capital and operating expenditure as this process is inherently judgemental.

Whilst under AMP 6, total expenditure, or 'Totex', is a key driver of regulatory performance rather than capital expenditure which was monitored under AMP 5, the accounting distinction between operating and capital expenditure remains, and therefore it is important that capital project expenditure is accounted for correctly in accordance with International Financial Reporting Standards.

Management has included this as a critical judgement in note 5 to the financial statements.

How the scope of our audit responded to the risk

We assessed the group's capitalisation policy to determine compliance with relevant accounting standards and evaluated the design and implementation and tested the operating effectiveness of controls over the application of the policy to expenditure incurred on projects within the group's capital programme during the year. This includes consideration of the allocation of costs between capital and operating expenditure.



In addition, for a sample of capital projects, we assessed the application of the capitalisation policy to the costs incurred by understanding the initial business case for the project and ensuring that it had been approved by the relevant capital programme board. We also agreed a sample of costs to third party invoices and assessed whether the split between capital and operating expenditure split is aligned to the original approved business plan.

Key observations

Based on our audit of a sample of capital projects, and our review of the project budgets, we consider that the classification of costs between operating and capital expenditure is appropriate.








Determining the amount of the group's retirement benefit obligations (£574.6 million net deficit) (note 28)

Risk description



This is an area involving significant estimation because the process is complex and requires management (after taking advice from their actuarial advisers) to make a number of assumptions concerning the discount rate, inflation and pension increases, along with investment returns and the longevity of current pensioners in order to determine the value of the scheme's liabilities.

Management has included this as a key source of estimation uncertainty in note 5 to the financial statements.

<p>How the scope of our audit responded to the risk</p> 	<p>We evaluated the design and implementation of key controls and with support from the pension specialists within our audit team, we challenged the assumptions used in the calculation of the pension scheme deficit as detailed in note 28, specifically challenging the change in methodology in calculating the discount rate, inflation rate and mortality assumptions with reference to comparable market and other third party data.</p>
<p>Key observations</p> 	<p>We are satisfied that management's assumptions in the valuation of the retirement benefit obligation, including discount rates are appropriate and within a reasonable range.</p>
<p>Determination of current and deferred tax balances (£9.4 million charge) (note 14)</p>	
<p>Risk description</p> 	<p>The group has entered into a number of one-off transactions during the year, which involve complex tax accounting considerations. The risk has been focused on the tax accounting consequences for these one-off transactions, specifically in relation to the acquisition of Dee Valley Group plc and the asset-backed funding structure for the group's pension scheme.</p> <p>Management has included this as a key source of estimation uncertainty in note 5 to the financial statements.</p>
<p>How the scope of our audit responded to the risk</p> 	<p>We evaluated the design and implementation of key controls and with support from the tax specialists within our audit team, using our technical expertise, we have assessed the tax accounting consequences for the one-off transactions in order to test whether the tax outcome is appropriate and the accounting is in compliance with IAS 12 <i>Income taxes</i>.</p>
<p>Key observations</p> 	<p>We are satisfied that the tax outcome is appropriate and the accounting for tax related to the one-off transactions is in compliance with IAS 12 <i>Income taxes</i>.</p>

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

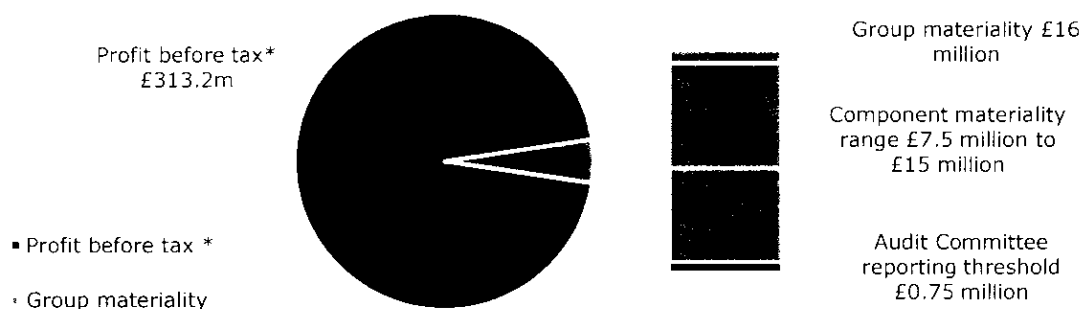
Our application of materiality

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

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

Group materiality	£16 million (2016: £16 million)
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Basis for determining materiality	Approximately 5% (2016: approximately 5%) of profit before tax, losses/gains on financial instruments and exceptional items.
Rationale for the benchmark applied	As in 2016, profit before tax, losses/gains on financial instruments and exceptional items has been used in order to focus on the group's underlying trading performance consistent with the group's internal and external reporting.



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

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £750,000 (2016: £750,000), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

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

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

Severn Trent Water Limited and Severn Trent Utilities Finance plc were subject to full statutory audits using component materialities of £15 million (2016: £15 million), £9 million (2016: £11.2 million) respectively and together account for 100% of the group's turnover (2016: 100%), and over 90% (2016: over 90%) of the group's net assets and profit before tax, gains/losses on financial instruments and exceptional items.

The group audit team performs the audits of Severn Trent Water Limited and Severn Trent Utilities Finance plc without the involvement of a component audit team.

The audit procedures on Dee Valley Group plc were focussed on performing an audit on the acquisition balance sheet and analytical reviews on the income statement from acquisition date to the year end to component materiality of £7.5 million.

Parent company and consolidation

At the parent entity level we also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances.

Opinion on other matters prescribed by the Companies Act 2006

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

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

-
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report and the Directors' Report.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

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

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

We have nothing to report in respect of these matters.

Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made.

We have nothing to report arising from these matters.

Corporate Governance Statement

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

We have nothing to report arising from our review.

Our duty to read other information in the Annual Report

Under International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the annual report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the group acquired in the course of performing our audit; or
- otherwise misleading.

We confirm that we have not identified any such inconsistencies or misleading statements.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the annual report is fair, balanced and understandable and whether the annual report appropriately discloses those matters that we communicated to the audit committee which we consider should have been disclosed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). We also comply with International Standard on Quality Control 1 (UK and Ireland). Our audit methodology and tools aim to ensure that our quality control

procedures are effective, understood and applied. Our quality controls and systems include our dedicated professional standards review team and independent partner reviews.

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.

Scope of the audit of the financial statements

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

Jane Whitlock, ACA (Senior statutory auditor)

for and on behalf of Deloitte LLP

Chartered Accountants and Statutory Auditor

Birmingham, United Kingdom

22 May 2017

Severn Trent Water Limited

Group and company income statement

For the year ended 31 March 2017

	Note	Group		Company	
		2017 £m	2016 (restated) £m	2017 £m	2016 (restated) £m
Turnover	6	1,556.1	1,523.6	1,554.0	1,523.6
Operating costs before exceptional items	7	(1,043.3)	(1,025.1)	(1,041.3)	(1,025.1)
Exceptional items	8	27.6	1.0	27.6	1.0
Total operating costs	7	(1,015.7)	(1,024.1)	(1,013.7)	(1,024.1)
Profit before interest, tax and exceptional items		512.8	498.5	512.7	498.5
Exceptional items	8	27.6	1.0	27.6	1.0
Profit before interest and tax		540.4	499.5	540.3	499.5
Finance income	11	73.6	68.6	84.6	80.0
Finance costs	12	(273.2)	(272.5)	(294.6)	(295.0)
Net finance costs		(199.6)	(203.9)	(210.0)	(215.0)
Net (losses)/gains on financial instruments	13	(6.6)	4.0	(6.6)	4.9
Profit on ordinary activities before taxation		334.2	299.6	323.7	289.4
Current tax	14	(41.2)	(51.2)	(39.4)	(49.7)
Deferred tax	14	(20.2)	(9.5)	(5.5)	(9.3)
Exceptional tax	14	52.0	78.8	52.8	80.0
Taxation on profit on ordinary activities	14	(9.4)	18.1	7.9	21.0
Profit for the year from continuing operations		324.8	317.7	331.6	310.4
(Loss)/profit for the year from discontinued operations	38	(0.2)	16.2	(0.2)	16.2
Profit for the year		324.6	333.9	331.4	326.6

Severn Trent Water Limited

Group and company statement of comprehensive income

For the year ended 31 March 2017

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Profit for the year	324.6	333.9	331.4	326.6
Other comprehensive (loss)/income				
Items that will not be reclassified to the income statement:				
Net actuarial (losses)/gains	(311.2)	150.3	(311.2)	150.3
Tax on net actuarial losses/gains	56.5	(28.5)	56.5	(28.5)
Deferred tax arising on change of rate	(2.6)	(8.8)	(2.6)	(8.3)
	(257.3)	113.0	(257.3)	113.5
Items that may be reclassified to the income statement:				
Losses on cash flow hedges	(8.0)	(2.4)	(8.0)	(2.4)
Deferred tax on losses on cash flow hedges	1.4	0.4	1.4	0.4
Amounts on cash flow hedges transferred to the income statement	3.3	9.3	3.3	9.3
Deferred tax on transfer to the income statement	(0.7)	(1.7)	(0.7)	(1.6)
	(4.0)	5.6	(4.0)	5.7
Other comprehensive (loss)/income for the year	(261.3)	118.6	(261.3)	119.2
Total comprehensive income for the year	63.3	452.5	70.1	445.8

Severn Trent Water Limited

Group statement of changes in equity

For the year ended 31 March 2017

	Equity attributable to owners of the company						
	Share capital	Share premium	Hedging reserve	Retained earnings	Total	Non-controlling interests	Total equity
	£m	£m	£m	£m	£m	£m	£m
At 1 April 2015	100.0	–	(98.3)	750.4	752.1	10.6	762.7
Profit for the year	–	–	–	333.9	333.9	–	333.9
Losses on cash flow hedges	–	–	(2.4)	–	(2.4)	–	(2.4)
Deferred tax on losses on cash flow hedges	–	–	0.4	–	0.4	–	0.4
Amounts on cash flow hedges transferred to the income statement	–	–	9.3	–	9.3	–	9.3
Deferred tax on transfer to the income statement	–	–	(1.7)	–	(1.7)	–	(1.7)
Net actuarial gains	–	–	–	150.3	150.3	–	150.3
Tax on net actuarial gains	–	–	–	(28.5)	(28.5)	–	(28.5)
Deferred tax arising on change of rate	–	–	–	(8.8)	(8.8)	–	(8.8)
Total comprehensive income for the year	–	–	5.6	446.9	452.5	–	452.5
Share options and LTIPs							
- value of employees' services	–	–	–	5.0	5.0	–	5.0
- own shares purchased	–	–	–	(4.0)	(4.0)	–	(4.0)
Current tax on share based payments	–	–	–	1.7	1.7	–	1.7
Deferred tax on share based payments	–	–	–	(0.9)	(0.9)	–	(0.9)
Dividends paid	–	–	–	(310.0)	(310.0)	–	(310.0)
At 31 March 2016	100.0	–	(92.7)	889.1	896.4	10.6	907.0
Profit for the year	–	–	–	324.6	324.6	–	324.6
Losses on cash flow hedges	–	–	(8.0)	–	(8.0)	–	(8.0)
Deferred tax on losses on cash flow hedges	–	–	1.4	–	1.4	–	1.4
Amounts on cash flow hedges transferred to the income statement	–	–	3.3	–	3.3	–	3.3
Deferred tax on transfer to the income statement	–	–	(0.7)	–	(0.7)	–	(0.7)
Net actuarial losses	–	–	–	(311.2)	(311.2)	–	(311.2)
Tax on net actuarial losses	–	–	–	56.5	56.5	–	56.5
Deferred tax arising from rate change	–	–	–	(2.6)	(2.6)	–	(2.6)
Transfer net of deferred tax	–	–	7.0	(7.0)	–	–	–
Total comprehensive income for the year	–	–	3.0	60.3	63.3	–	63.3
Share options and LTIPs							
- value of employees' services	–	–	–	6.0	6.0	–	6.0
Current tax on share based payments	–	–	–	0.8	0.8	–	0.8
Deferred tax on share based payments	–	–	–	0.1	0.1	–	0.1
Capital injection	–	1,470.0	–	–	1,470.0	–	1,470.0
Reduction in capital	(99.0)	(1,470.0)	–	1,569.0	–	–	–
Dividends paid	–	–	–	(195.5)	(195.5)	–	(195.5)
At 31 March 2017	1.0	–	(89.7)	2,329.8	2,241.1	10.6	2,251.7

Severn Trent Water Limited

Company statement of changes in equity

For the year ended 31 March 2017

	Equity attributable to owners of the company				
	Share capital £m	Share premium £m	Hedging reserve £m	Retained earnings £m	Total £m
At 1 April 2015	100.0	–	(98.4)	800.7	802.3
Profit for the year	–	–	–	326.6	326.6
Losses on cash flow hedges	–	–	(2.4)	–	(2.4)
Deferred tax on losses on cash flow hedges	–	–	0.4	–	0.4
Amounts on cash flow hedges transferred to the income statement	–	–	9.3	–	9.3
Deferred tax on transfer to the income statement	–	–	(1.6)	–	(1.6)
Net actuarial gains	–	–	–	150.3	150.3
Tax on net actuarial gains	–	–	–	(28.5)	(28.5)
Deferred tax arising on change of rate	–	–	–	(8.3)	(8.3)
Total comprehensive income for the year	–	–	5.7	440.1	445.8
Share options and LTIPs					
- value of employees' services	–	–	–	5.0	5.0
- own shares purchased	–	–	–	(4.0)	(4.0)
Current tax on share based payments	–	–	–	1.6	1.6
Deferred tax on share based payments	–	–	–	(0.9)	(0.9)
Dividends paid	–	–	–	(310.0)	(310.0)
At 31 March 2016	100.0	–	(92.7)	932.5	939.8
Profit for the year	–	–	–	331.4	331.4
Losses on cash flow hedges	–	–	(8.0)	–	(8.0)
Deferred tax on losses on cash flow hedges	–	–	1.4	–	1.4
Amounts on cash flow hedges transferred to the income statement	–	–	3.3	–	3.3
Deferred tax on transfer to the income statement	–	–	(0.7)	–	(0.7)
Net actuarial losses	–	–	–	(311.2)	(311.2)
Tax on net actuarial losses	–	–	–	56.5	56.5
Deferred tax arising on change of rate	–	–	–	(2.6)	(2.6)
Transfer net of deferred tax	–	–	7.0	(7.0)	–
Total comprehensive income for the year	–	–	3.0	67.1	70.1
Share options and LTIPs					
- value of employees' services	–	–	–	6.0	6.0
Current tax on share based payments	–	–	–	0.8	0.8
Deferred tax on share based payments	–	–	–	0.1	0.1
Capital injection	–	1,470.0	–	–	1,470.0
Reduction in capital	(99.0)	(1,470.0)	–	1,569.0	–
Dividends paid	–	–	–	(195.5)	(195.5)
At 31 March 2017	1.0	–	(89.7)	2,380.0	2,291.3

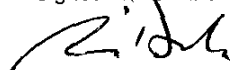
Severn Trent Water Limited

Group and company balance sheet

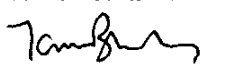
At 31 March 2017

	Note	2017 £m	Group 2016 £m	2017 £m	Company 2016 £m
Non-current assets					
Goodwill	16	67.3	1.3	1.3	1.3
Other intangible assets	17	75.7	67.0	75.7	67.0
Property, plant and equipment	18	8,003.6	7,641.7	7,876.4	7,641.7
Investments in subsidiaries, joint ventures and associates	19	1,470.0	–	1,948.1	347.9
Derivative financial instruments	20	67.0	40.2	67.0	40.2
Trade and other receivables	21	–	–	154.3	291.8
Retirement benefit surplus	28	9.8	–	–	–
		9,693.4	7,750.2	10,122.8	8,389.9
Current assets					
Inventory		6.6	6.0	6.3	5.9
Trade and other receivables	21	497.1	432.9	472.8	437.8
Current tax receivable		–	–	2.8	–
Cash and cash equivalents		0.2	–	–	–
		503.9	438.9	481.9	443.7
Total assets		10,197.3	8,189.1	10,604.7	8,833.6
Current liabilities					
Borrowings	23	(565.3)	(332.4)	(584.6)	(351.3)
Derivative financial instruments	25	(0.5)	(0.4)	(0.5)	(0.4)
Trade and other payables	26	(420.1)	(387.3)	(391.0)	(398.5)
Current tax payable		(0.3)	(28.8)	–	(18.2)
Provisions for liabilities and charges	29	(8.0)	(1.2)	(8.0)	(1.2)
		(994.2)	(750.1)	(984.1)	(769.6)
Non-current liabilities					
Borrowings	23	(4,605.1)	(4,509.2)	(5,282.3)	(5,086.1)
Derivative financial instruments	25	(174.2)	(167.7)	(174.2)	(167.7)
Trade and other payables	26	(954.3)	(869.5)	(943.9)	(869.4)
Deferred tax	27	(626.6)	(670.2)	(614.0)	(685.6)
Retirement benefit obligations	28	(584.4)	(309.5)	(308.1)	(309.5)
Provisions for liabilities and charges	29	(6.8)	(5.9)	(6.8)	(5.9)
		(6,951.4)	(6,532.0)	(7,329.3)	(7,124.2)
Total liabilities		(7,945.6)	(7,282.1)	(8,313.4)	(7,893.8)
Net assets		2,251.7	907.0	2,291.3	939.8
Equity					
Called up share capital	30	1.0	100.0	1.0	100.0
Hedging reserve		(89.7)	(92.7)	(89.7)	(92.7)
Retained earnings		2,329.8	889.1	2,380.0	932.5
Equity attributable to owners of the company		2,241.1	896.4	2,291.3	939.8
Non-controlling interests		10.6	10.6	–	–
Total equity		2,251.7	907.0	2,291.3	939.8

Signed on behalf of the Board who approved the accounts on 22 May 2017.



Andrew Duff
Chairman



James Bowling
Chief Financial Officer

Company number: 02366686

Severn Trent Water Limited

Group and company cash flow statement

For the year ended 31 March 2017

	Note	Group		Company	
		2017 £m	2016 £m	2017 £m	2016 £m
Cash generated from operations	39	851.9	799.8	854.6	808.7
Tax paid		(37.9)	(20.0)	(36.3)	(19.3)
Net cash generated from operating activities		814.0	779.8	818.3	789.4
Purchases of subsidiary, net of cash acquired		(77.7)	–	(79.0)	–
Purchases of property, plant and equipment		(467.0)	(411.5)	(466.4)	(411.5)
Purchases of intangible assets and goodwill		(26.1)	(21.9)	(26.1)	(21.9)
Contributions and grants received		39.5	35.0	39.5	35.0
Proceeds on disposal of property, plant and equipment		12.5	12.6	12.5	12.6
Net loans advanced to related parties		(99.7)	–	(99.7)	–
Interest received		1.6	0.5	2.8	0.8
Interest received from intercompany finance leases		–	–	5.1	5.1
Net cash from investing activities		(616.9)	(385.3)	(611.3)	(379.9)
Interest paid		(171.3)	(177.7)	(176.9)	(187.7)
Interest element of finance lease payments		(5.8)	(6.8)	(5.8)	(8.5)
Interest element of intercompany finance lease payments		–	–	(10.9)	(11.0)
Dividends paid to shareholders of the parent		(195.5)	(310.0)	(195.5)	(310.0)
Repayments of borrowings		(275.0)	(908.5)	(275.0)	(485.0)
Repayments of intercompany borrowings		–	–	–	(423.9)
Repayments of obligations under finance leases		(1.5)	(62.8)	(16.1)	(74.2)
New loans raised		498.0	926.4	497.9	926.4
Net intercompany loans (repaid)/raised		(46.6)	26.0	(22.9)	47.4
(Payments)/receipts from intercompany finance lease		–	–	0.6	0.5
Repayments of obligations under intercompany finance leases		–	–	(3.1)	(2.8)
Purchase of shares in ultimate parent company		–	(4.0)	–	(4.0)
Net cash flow from financing activities		(197.7)	(517.4)	(207.7)	(532.8)
Net movement in cash and cash equivalents		(0.6)	(122.9)	(0.7)	(123.3)
Net cash and cash equivalents at the beginning of the year		(2.8)	120.1	(4.2)	119.1
Net cash and cash equivalents at end of the year		(3.4)	(2.8)	(4.9)	(4.2)
Cash		0.2	–	–	–
Bank overdrafts		(3.6)	(2.8)	(4.9)	(4.2)
Net cash and cash equivalents at end of the year		(3.4)	(2.8)	(4.9)	(4.2)

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

1 General information

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

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

2 Accounting policies

a) Basis of preparation

The financial statements have been prepared on the going concern basis (see Directors' report on page 38) under the historical cost convention as modified by the revaluation of certain financial assets and liabilities (including derivative instruments) at fair value.

i) Group financial statements

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

ii) Company financial statements

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

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

As permitted by FRS 101, the company has taken advantage of the disclosure exemptions available under that standard in relation to share based payments, financial instruments, capital management, presentation of comparative information in respect of certain assets, standards not yet effective, impairment of assets and related party transactions. Where required, equivalent disclosures are given in the consolidated financial statements and also where required, equivalent disclosures are given in the group accounts of Severn Trent Plc. The group accounts of Severn Trent Plc are available to the public and can be obtained as set out in note 44.

iii) Prior year restatement

Prior year figures in the group and company income statements and related notes have been restated to present separately amounts relating to operations classified as discontinued in the current year. For details, see note 38.

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

b) Basis of consolidation

The consolidated financial statements include the results of

Severn Trent Water Limited and its subsidiaries. Results are included from the date of acquisition or incorporation and excluded from the date of disposal.

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

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

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

c) Revenue recognition

Revenue includes turnover and interest income.

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

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

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

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

d) Exceptional items

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

e) Taxation

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

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

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

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

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

2 Accounting policies (continued)

f) Goodwill

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

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

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

g) Other intangible and non-current assets

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

Finite life intangible assets are amortised on a straight-line basis over their estimated useful economic lives as follows:

	Years
Software	3 - 10
Other assets	2 - 20

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

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

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

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

Research expenditure is expensed when it is incurred.

h) Property, plant and equipment

Property, plant and equipment is held at cost (or at deemed cost for infrastructure assets on transition to IFRS/FRS 101) less accumulated depreciation. Expenditure on property, plant and equipment relating to research and development projects is capitalised and depreciated over the expected useful life of those assets.

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

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

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

Property, plant and equipment is depreciated to its estimated residual value over its estimated useful life, with the exception of freehold land which is not depreciated. Assets under construction are not depreciated until commissioned.

The estimated useful lives are:

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

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

2 Accounting policies (continued)

i) Leased assets

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

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

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

j) Grants and contributions

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

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

k) Impairment of non-current assets

If the recoverable amount of goodwill, an item of property, plant and equipment or any other non-current asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Where the asset does not generate cash flows that are independent from other assets, the group estimates the recoverable amount of the cash-generating unit to which the asset belongs. *Severn Trent Water and Dee Valley Water* are considered to be a single cash-generating units. Therefore where the asset does not generate cash flows that are independent from other assets, the company estimates the recoverable amount of the company as a

whole. Recoverable amount is the higher of fair value less costs to sell or estimated value in use at the date the *impairment review is undertaken.* Fair value less costs to sell represents the amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing third parties, less costs of disposal. Value in use represents the present value of future cash flows expected to be derived from a cash-generating unit, discounted using a pre-tax discount rate that reflects current market assessments of the cost of *capital of the cash-generating unit or asset.*

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

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

Impairments are recognised in the income statement.

l) Company investments in subsidiaries

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

m) Inventory

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

n) Loans receivable

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

o) Trade and other receivables

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

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

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

2 Accounting policies (continued)

p) Retirement benefits

(i) Defined benefit schemes

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

Defined benefit pension scheme assets are measured at fair value using bid price for assets with quoted prices. Defined benefit pension scheme liabilities are measured at the balance sheet date by an independent actuary using the projected unit method and discounted at the current rate of return on high quality corporate bonds of equivalent term and currency to the liability.

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

Changes in the retirement benefit obligation that arise from:

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

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

There is no contractual agreement, or stated policy, for charging the net defined benefit cost for the Severn Trent schemes to participating group companies of the ultimate parent. As the net defined benefit cost for these schemes is recognised by the sponsoring employer, Severn Trent Water Limited, the full net defined benefit cost is disclosed in the Severn Trent Water group financial statements. For the company financial statements, contributions made by other Severn Trent group companies are disclosed within actuarial gains and losses in the statement of comprehensive income.

(ii) Defined contribution scheme

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

q) Provisions

Provisions are recognised where:

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

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

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

r) Borrowings

The accounting policy for borrowings that are the hedged

item in a fair value hedge is set out in note 2 s).

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

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

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

s) Derivative financial instruments

Derivative financial instruments are stated at fair value, including accrued interest. Fair value is determined using the methodology described in note 33 a). The accounting policy for changes in fair value depends on whether the derivative is designated as a hedging instrument. The various accounting policies are described below.

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

Derivatives not designated as hedging instruments

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

Derivatives designated as hedging instruments

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

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

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

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

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

Fair value hedges

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

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

2 Accounting policies (continued)

s) Derivative financial instruments (continued)

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

Cash flow hedges

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

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

Embedded derivatives

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

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

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

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

t) Share based payments

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

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

The grant of awards of shares of the ultimate parent company is treated as a capital contribution and credited to

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

u) Cash flow statement

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

Net cash and cash equivalents include overdrafts repayable on demand.

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

v) Net debt

Net debt comprises borrowings, cross currency swaps that are used to fix the sterling liability of foreign currency borrowings (whether hedge accounted or not) net cash and cash equivalents and loans to related parties.

w) Foreign exchange

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

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

3 Alternative performance measures

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

a) Exceptional items

See note 2 d).

b) Underlying PBIT

Underlying profit before interest and tax is profit before interest and tax excluding exceptional items.

c) Net debt

See note 2 v).

d) Effective interest rate

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

e) Effective cash cost of interest

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

f) PBITDA interest cover

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

g) PBIT interest cover

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

h) Underlying effective tax rate

Current tax charge for the year from continuing operations, excluding prior year charges, exceptional current tax, and current tax on exceptional items and on financial instruments, divided by profit from continuing operations before tax, net gains/losses on financial instruments and exceptional items.

4 New accounting policies and future requirements

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

At the date of approval of these financial statements, the following Standards and Interpretations were in issue but not yet effective:

IFRS 9 'Financial Instruments' will supersede IAS 39 'Financial Instruments: Recognition and Measurement' and is effective for annual periods beginning on or after 1 January 2018. IFRS 9 covers classification and measurement of financial assets and financial liabilities, impairment of financial assets and hedge accounting.

IFRS 15 'Revenue from Contracts with Customers' provides a single model for accounting for revenue arising from contracts with customers, focusing on the identification and satisfaction of performance obligations, and is effective for annual periods beginning on or after 1 January 2018. IFRS 15 will supersede IAS 18 'Revenue'.

IFRS 16 'Leases' provides a new model for lessee accounting in which all leases, other than short-term and small-ticket-item leases, will be accounted for by the recognition on the balance sheet of a right-to-use asset and a lease liability, and the subsequent amortisation of the right-to use asset over the lease term. IFRS 16 will be effective for annual periods beginning on or after 1 January 2019.

The group's evaluation of the effect of adoption of these standards is ongoing but it is not currently anticipated that neither IFRS 9, IFRS 15 nor IFRS 16 will have a material effect on the financial statements. The EU has adopted both IFRS 9 and IFRS 15 but has not yet adopted IFRS 16.

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

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

5 Significant accounting judgements and key sources of estimation uncertainty

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

The more significant judgements were:

a) Tax provisions

Assessing the outcome of uncertain tax positions requires judgements to be made regarding the result of negotiations with and enquiries from tax authorities. The assessments made are based on advice from independent tax advisers and the status of ongoing discussions with the relevant tax authorities.

b) Classification of costs between operating expenditure and capital expenditure

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

The key accounting estimates were:

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

Calculating the depreciation charge and hence the carrying value for property, plant and equipment requires estimates to be made of the useful lives of the assets. The estimates are based on engineering data and the group's experience of similar assets. Details are set out in note 2h). A one year change in the average remaining useful lives of property plant and equipment would result in a £7 million change in the depreciation charge.

b) Retirement benefit obligations

As the sponsoring employer of the Severn Trent group's defined benefit pension scheme, the company recognises the full cost and net deficit relating to the schemes. Determining the amount of retirement benefit obligations and the net costs of providing such benefits requires assumptions to be made concerning long term interest rates, inflation, pension increases and longevity of current and future pensioners. Changes in these assumptions could significantly impact the amount of the obligations or the cost of providing such benefits. The company makes assumptions concerning these matters with the assistance of advice from independent qualified actuaries. Details of the assumptions made are set out in note 28 to the financial statements.

c) Unbilled revenue

Severn Trent Water raises bills and recognises revenue in accordance with its right to receive revenue in line with the limits established by the periodic regulatory price review processes. For water and waste water customers with water meters, the amount recognised depends on the volume supplied including an estimate of the sales value of units supplied between the date of the last meter read and the year end. Meters are read on a cyclical basis and the group recognises revenue for unbilled volumes based on estimated usage from the last billing to the end of the financial year. The estimated usage is based on historical data, judgement and assumptions.

d) Provision for impairment of trade receivables

Provisions are made against Severn Trent Water's trade receivables based on historical experience of levels of recovery from accounts in a particular ageing category. The actual amounts collected could differ from the estimated level of recovery which could impact operating results.

e) Goodwill arising on acquisition of Dee Valley Water

As set out in note 39, the fair values attributed to the assets and liabilities acquired are provisional and will be finalised in the year ending 31 March 2018. Any change to these estimates will result in an equal and opposite adjustment in the carrying value of the goodwill.

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

6 Revenue

	Group		Company	
	2017	2016 (restated)	2017	2016 (restated)
	£m	£m	£m	£m
Water and waste water services	1,527.6	1,504.4	1,525.5	1,504.4
Other services	28.5	19.2	28.5	19.2
Turnover	1,556.1	1,523.6	1,554.0	1,523.6
Finance income	1.7	0.9	12.8	12.3
	1,557.8	1,524.5	1,566.8	1,535.9

7 Net operating costs

Group

	2017			2016 (restated)		
	Before exceptional costs	Exceptional costs	Total	Before exceptional costs	Exceptional costs	Total
	£m	£m	£m	£m	£m	£m
Wages and salaries	204.3	–	204.3	191.4	(0.3)	191.1
Social security costs	20.6	–	20.6	19.6	–	19.6
Pension costs	19.7	(16.6)	3.1	18.1	(0.7)	17.4
Share based payments	6.0	–	6.0	5.0	–	5.0
Total employee costs	250.6	(16.6)	234.0	234.1	(1.0)	233.1
Power	70.5	–	70.5	68.9	–	68.9
Carbon Reduction Commitment	6.3	–	6.3	7.3	–	7.3
Raw materials and consumables	44.7	–	44.7	47.2	–	47.2
Rates	77.4	–	77.4	76.7	–	76.7
Charge for bad and doubtful debts	20.6	–	20.6	20.3	–	20.3
Services charges	33.1	–	33.1	32.4	–	32.4
Depreciation of tangible fixed assets	302.7	–	302.7	290.3	–	290.3
Amortisation of intangible fixed assets	17.4	–	17.4	19.9	–	19.9
Hired and contracted services	178.1	–	178.1	168.9	–	168.9
Operating lease rentals						
- land and buildings	0.4	–	0.4	0.3	–	0.3
- other	0.3	–	0.3	0.3	–	0.3
Hire of plant and machinery	3.3	–	3.3	3.4	–	3.4
Research and development expenditure	2.2	–	2.2	3.5	–	3.5
Profit on disposal of tangible fixed assets	0.8	(11.0)	(10.2)	(2.9)	–	(2.9)
Infrastructure maintenance expenditure	136.2	–	136.2	126.0	–	126.0
Ofwat licence fees	3.6	–	3.6	2.7	–	2.7
Net other operating costs	28.2	–	28.2	30.0	–	30.0
	1,176.4	(27.6)	1,148.8	1,129.3	(1.0)	1,128.3
Release from deferred credits	(13.9)	–	(13.9)	(10.5)	–	(10.5)
Own work capitalised	(119.2)	–	(119.2)	(93.7)	–	(93.7)
	1,043.3	(27.6)	1,015.7	1,025.1	(1.0)	1,024.1

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

7 Net operating costs (continued)

Company

	2017			2016 (restated)		
	Before exceptional costs	Exceptional costs	Total	Before exceptional costs	Exceptional costs	Total
	£m	£m	£m	£m	£m	£m
Wages and salaries	203.8	–	203.8	191.4	(0.3)	191.1
Social security costs	20.6	–	20.6	19.6	–	19.6
Pension costs	19.6	(16.6)	3.0	18.1	(0.7)	17.4
Share based payments	6.0	–	6.0	5.0	–	5.0
Total employee costs	250.0	(16.6)	233.4	234.1	(1.0)	233.1
Power	70.3	–	70.3	68.9	–	68.9
Carbon Reduction Commitment	6.3	–	6.3	7.3	–	7.3
Raw materials and consumables	44.6	–	44.6	47.2	–	47.2
Rates	77.4	–	77.4	76.8	–	76.8
Charge for bad and doubtful debts	20.5	–	20.5	20.3	–	20.3
Services charges	33.1	–	33.1	32.4	–	32.4
Depreciation of tangible fixed assets	302.6	–	302.6	290.3	–	290.3
Amortisation of intangible fixed assets	17.4	–	17.4	19.9	–	19.9
Hired and contracted services	178.4	–	178.4	168.9	–	168.9
Operating lease rentals						
- land and buildings	0.4	–	0.4	0.3	–	0.3
- other	0.3	–	0.3	0.3	–	0.3
Hire of plant and machinery	3.3	–	3.3	3.4	–	3.4
Research and development expenditure	2.2	–	2.2	3.5	–	3.5
Profit on disposal of tangible fixed assets	0.8	(11.0)	(10.2)	(2.9)	–	(2.9)
Infrastructure maintenance expenditure	136.2	–	136.2	126.0	–	126.0
Owat licence fees	3.6	–	3.6	2.7	–	2.7
Net other operating costs	27.3	–	27.3	29.9	–	29.9
	1,174.7	(27.6)	1,147.1	1,129.3	(1.0)	1,128.3
Release from deferred credits	(13.9)	–	(13.9)	(10.5)	–	(10.5)
Own work capitalised	(119.5)	–	(119.5)	(93.7)	–	(93.7)
	1,041.3	(27.6)	1,013.7	1,025.1	(1.0)	1,024.1

Further details of exceptional costs are given in note 8.

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

	Group and company	
	2017 £m	2016 £m
Fees payable to the company's auditors for:		
- the audit of the company's annual accounts	0.3	0.2
Total audit fees	0.3	0.2
Fees payable to the company's auditors and their associates for other services to the group:		
- other assurance services	0.3	0.2
- other services relating to taxation	0.1	
Total non-audit fees	0.4	0.2

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

8 Exceptional items before tax

	Group and company	
	2017	2016
	£m	£m
Restructuring costs	–	(1.0)
Profit on disposal of fixed assets	(11.0)	–
Gain arising on pension increase arrangement	(16.6)	–
	(27.6)	(1.0)

Exceptional tax is disclosed in note 14.

9 Employee numbers

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

	Group		Company	
	2017	2016	2017	2016
	number	number	number	number
	5,844	5,236	5,827	5,236

10 Directors' interests and remuneration – group and company

a) Directors' interests

All of the directors as at the end of the year are also directors of Severn Trent Plc, the ultimate parent undertaking, and their interests in the share capital of that company are disclosed in the Severn Trent Plc Annual Report and Accounts of that company for the year ended 31 March 2017. Share options were granted and exercised in accordance with the Severn Trent Sharesave Scheme as appropriate.

The executive directors have further interests in Severn Trent Plc ordinary shares of 97¹⁷/₁₉p each by virtue of having received contingent awards of shares under the Severn Trent Long Term Incentive Plan (LTIP), deferred shares under the Severn Trent Annual Bonus Scheme and contingent shares under the Share Matching Plan.

The individual interests, which represent the maximum aggregate number of shares to which each individual could become entitled, are disclosed in the Annual Report and Accounts of Severn Trent Plc for the year ended 31 March 2017.

b) Directors' remuneration

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

	2017	2016
	£m	£m
Short term employee benefits	3.9	3.0
Post employment benefits	–	0.1
Share based payments	1.6	1.2
	5.5	4.3

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

There were no retirement benefits accruing to directors (2016: none) under a defined benefit scheme and one director (2016: one director) under a defined contribution scheme.

Three directors (2016: two directors) exercised share options or received LTIP awards which vested during the year.

c) Highest paid director

	2017	2016
	£m	£m
Aggregate emoluments (excluding pension contributions)	2.4	2.0
Pension contributions	–	0.1
	2.4	2.1

The highest paid director at 31 March 2017 and 31 March 2016 was not a member of the defined benefit pension scheme.

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

11 Finance income

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Interest income earned on:				
Bank deposits	0.1	0.2	0.1	0.2
Amounts due from group undertakings	0.9	–	2.3	1.7
Amounts due from group undertakings under finance leases	–	–	5.1	5.2
Other finance income	0.8	0.7	5.3	5.2
Total interest receivable	1.8	0.9	12.8	12.3
Interest income on defined benefit scheme assets	71.8	67.7	71.8	67.7
	73.6	68.6	84.6	80.0

12 Finance costs

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Interest expense charged on:				
Bank loans and overdrafts	20.1	19.3	19.8	21.9
Other loans	166.0	162.9	13.0	–
Finance leases	4.2	6.8	5.5	8.4
Amounts payable to group undertakings	0.1	–	162.7	170.7
Amounts payable to group undertakings on finance	–	–	10.8	11.0
Total borrowing costs	190.4	189.0	211.8	212.0
Other finance expenses	0.1	0.7	0.1	0.2
Interest expense on defined benefit scheme liabilities	82.7	82.8	82.7	82.8
	273.2	272.5	294.6	295.0

Borrowing costs of £17.4 million (2016: £16.2 million) incurred funding eligible capital projects have been capitalised at an interest rate of 3.94% (2016: 4.41%). Tax relief of £3.5 million (2016: £3.3 million) was claimed on these costs which was credited to the income statement, offset by a related deferred tax charge of £3.0 million (2016: £2.9 million).

13 (Losses)/gains on financial instruments

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Gain on swaps used as hedging instruments in fair value hedges	17.6	0.7	17.6	0.7
(Loss)/gain arising on debt in fair value hedges	(16.9)	(2.5)	(16.9)	0.5
Exchange loss on other loans	(15.4)	(32.6)	(15.4)	(5.9)
Loss on cash flow hedges transferred from equity	(3.2)	(9.3)	(3.2)	(9.3)
Hedge ineffectiveness on cash flow hedges	(0.4)	–	(0.4)	–
Gain arising on swaps where hedge accounting is not applied	11.2	47.7	11.2	18.9
Amortisation of fair value adjustment on debt	0.5	–	0.5	–
	(6.6)	4.0	(6.6)	4.9

The group's hedge accounting arrangements are described in note 35.

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

14 Taxation

a) Analysis of tax charge/(credit) in the year

Group

	2017			2016 (restated)		
	Before exceptional tax £m	Exceptional tax £m	Total £m	Before exceptional tax £m	Exceptional tax £m	Total £m
Current tax at 20%						
Current year	49.9	–	49.9	54.0	–	54.0
Prior years	(8.7)	(16.4)	(25.1)	(2.8)	–	(2.8)
Total current tax	41.2	(16.4)	24.8	51.2	–	51.2
Deferred tax						
Origination and reversal of temporary differences:						
Current year	14.6	–	14.6	7.1	–	7.1
Prior years	5.6	4.0	9.6	2.4	–	2.4
Exceptional credit from rate change	–	(39.6)	(39.6)	–	(78.8)	(78.8)
Total deferred tax	20.2	(35.6)	(15.4)	9.5	(78.8)	(69.3)
	61.4	(52.0)	9.4	60.7	(78.8)	(18.1)

The group current tax charge before exceptional tax was £41.2 million (2016: £51.2 million) and the deferred tax charge before exceptional tax was £20.2 million (2016: £9.5 million). The exceptional current tax credit of £16.4 million (2016: nil) arises from adjustments following agreement with HMRC of tax matters from several prior years.

Company

	2017			2016 (restated)		
	Before exceptional tax £m	Exceptional tax £m	Total £m	Before exceptional tax £m	Exceptional tax £m	Total £m
Current tax at 20%						
Current year	48.1	–	48.1	52.5	–	52.5
Prior years	(8.7)	(16.4)	(25.1)	(2.8)	–	(2.8)
Total current tax	39.4	(16.4)	23.0	49.7	–	49.7
Deferred tax						
Origination and reversal of temporary differences:						
Current year	–	–	–	6.6	–	6.6
Prior years	5.5	4.0	9.5	2.7	–	2.7
Exceptional credit from rate change	–	(40.4)	(40.4)	–	(80.0)	(80.0)
Total deferred tax	5.5	(36.4)	(30.9)	9.3	(80.0)	(70.7)
	44.9	(52.8)	(7.9)	59.0	(80.0)	(21.0)

The company current tax charge before exceptional tax was £39.4 million (2016: £49.7 million) and the deferred tax charge before exceptional tax was £20.2 million (2016: £9.5 million). The exceptional current tax credit of £16.4 million (2016: nil) arises from adjustments following agreement with HMRC of tax matters from several prior years.

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

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

14 Taxation (continued)

a) Analysis of tax charge/(credit) in the year (continued)

The Government has announced that the main rate of corporation tax will reduce to 19% with effect from 1 April 2017 and 17% with effect from 1 April 2020. These rates had been substantively enacted at the year end and therefore deferred tax assets and liabilities have been remeasured to the rates that are expected to apply when the assets are realised or the liabilities settled. This has resulted in an exceptional tax credit in the period.

b) Factors affecting the tax charge/(credit) in the year

The group and company tax expense for the current year is lower (2016: lower) than the standard rate of corporation tax in the UK of 20% (2016: 20%). The differences are explained below:

Group

	2017	2016 (restated)
	£m	£m
Profit on ordinary activities before tax from continuing operations	334.2	299.6
Tax at the standard rate of corporation tax in the UK 20% (2016: 20%)	66.9	59.9
Tax effect of depreciation on non-qualifying assets	2.3	3.7
Tax effect of income not taxable in determining taxable profits	(1.4)	(1.8)
Current year impact of rate change	(3.3)	(0.7)
Adjustments in respect of prior years	(15.5)	(0.4)
Exceptional deferred tax credit arising from rate change	(39.6)	(78.8)
Total tax charge/(credit)	9.4	(18.1)

Company

	2017	2016 (restated)
	£m	£m
Profit on ordinary activities before tax from continuing operations	323.7	289.4
Tax at the standard rate of corporation tax in the UK 20% (2016: 20%)	64.7	57.9
Tax effect of depreciation on non-qualifying assets	2.3	3.7
Tax effect of income not taxable in determining taxable profits	(0.9)	(1.8)
Deferred tax only movement	(17.2)	–
Current year impact of rate change	(0.8)	(0.7)
Adjustments in respect of prior years	(15.6)	(0.1)
Exceptional deferred tax credit arising from rate change	(40.4)	(80.0)
Total tax credit	(7.9)	(21.0)

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

14 Taxation (continued)

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

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

Group

	2017	2016
	£m	£m
Current tax		
Tax on share based payments	(0.8)	(1.7)
Tax on pension contributions in excess of income statement charge	(14.1)	–
Total current tax credited to other comprehensive income or equity	(14.9)	(1.7)
Deferred tax		
Tax on actuarial gain/loss	(42.4)	28.5
Tax on cash flow hedges	(1.4)	(0.4)
Tax on share based payments	(0.1)	0.9
Tax on transfers to the income statement	0.7	1.7
Effect of change in tax rate	2.6	8.8
Total deferred tax (credited)/charged to other comprehensive income or equity	(40.6)	39.5

Company

	2017	2016
	£m	£m
Current tax		
Tax on share based payments	(0.8)	(1.6)
Tax on pension contributions in excess of income statement charge	(14.1)	–
Total current tax credited to other comprehensive income or equity	(14.9)	(1.6)
Deferred tax		
Tax on actuarial gain/loss	(42.4)	28.5
Tax on cash flow hedges	(1.4)	(0.4)
Tax on share based payments	(0.1)	0.9
Tax on transfers to the income statement account	0.7	1.6
Effect of change in tax rate	2.6	8.3
Total deferred tax (credited)/charged to other comprehensive income or equity	(40.6)	38.9

15 Dividends – group and company

Amounts recognised as distributions to equity holders in the period:

	2017		2016	
	Pence per share	£m	Pence per share	£m
Interim dividend for the year ended 31 March 2017 (2016)	19.55	195.5	31.00	310.0

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

16 Goodwill - group

	2017 £m	2016 £m
Cost and net book value		
At 1 April	1.3	1.3
Acquisition of subsidiary	66.0	–
At 31 March	67.3	1.3

Goodwill impairment tests

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

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

	2017 £m	2016 £m
Severn Trent Water	1.3	1.3
Dee Valley Water Group	66.0	–
	67.3	1.3

The group has reviewed the carrying value of goodwill for impairment in accordance with the policy stated in note 2 k).

The value in use calculation for the Dee Valley Water CGU is based on the financial model used in the acquisition but restricted to the remaining three years of the current AMP. The key assumptions underlying this model are: RPI inflation in the final three years of the AMP and the operating cost efficiencies achieved. The discount rate of 4.7% was based on an estimate for the weighted average cost of capital at the year end date based on the market rate for the cost of debt and the cost of equity included in the Dee Valley Water Final Determination for AMP6. The equivalent pre-tax rate is 5.9%.

Cash flows beyond the three year period are extrapolated using an estimate of 2% for long term CPI and zero real growth.

Changes in the growth rate outside the five year period or in the discount rate applied to the cash flows may cause a CGU's carrying value to exceed its recoverable amount. However, in the opinion of the directors, the changes in growth rate or discount rate that would be required to reduce the recoverable amount of the CGUs below their carrying value are not reasonably possible. Therefore no sensitivity analysis has been presented.

Goodwill in the company was £1.3 million (2016: £1.3 million).

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

17 Other intangible assets – group and company

	Computer software		Capitalised development costs and patents £m	Total £m
	Internally generated £m	Purchased £m		
Cost				
At 1 April 2015	176.2	81.3	12.0	269.5
Additions	9.9	11.9	–	21.8
At 1 April 2016	186.1	93.2	12.0	291.3
Additions	13.3	12.8	–	26.1
At 31 March 2017	199.4	106.0	12.0	317.4
Amortisation				
At 1 April 2015	(146.8)	(46.9)	(10.7)	(204.4)
Amortisation for the year	(9.2)	(10.1)	(0.6)	(19.9)
At 1 April 2016	(156.0)	(57.0)	(11.3)	(224.3)
Amortisation for the year	(7.5)	(9.3)	(0.6)	(17.4)
At 31 March 2017	(163.5)	(66.3)	(11.9)	(241.7)
Net book value				
At 31 March 2017	35.9	39.7	0.1	75.7
At 31 March 2016	30.1	36.2	0.7	67.0

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

18 Property, plant and equipment

Group

	Land and buildings £m	Infrastructure assets £m	Fixed plant and equipment £m	Moveable plant £m	Assets under construction £m	Total £m
Cost						
At 1 April 2015	2,961.9	4,762.0	3,570.2	49.0	669.9	12,013.0
Additions	2.7	21.4	14.7	4.8	415.5	459.1
Transfers on commissioning	194.8	156.7	209.7	–	(561.2)	–
Disposals	(10.7)	(0.2)	(15.7)	(3.4)	(4.1)	(34.1)
At 1 April 2016	3,148.7	4,939.9	3,778.9	50.4	520.1	12,438.0
Additions	15.5	73.7	11.3	–	441.6	542.1
Transfers on commissioning	134.1	39.9	190.4	6.3	(370.7)	–
Disposals	(5.7)	(0.7)	(21.9)	(3.1)	–	(31.4)
Acquisition of Dee Valley	0.8	61.4	64.3	–	–	126.5
At 31 March 2017	3,293.4	5,114.2	4,023.0	53.6	591.0	13,075.2
Depreciation						
At 1 April 2015	(1,043.6)	(1,226.3)	(2,229.2)	(31.3)	–	(4,530.4)
Charge for the year	(76.7)	(31.5)	(177.3)	(4.8)	–	(290.3)
Disposals	6.1	–	15.1	3.2	–	24.4
At 1 April 2016	(1,114.2)	(1,257.8)	(2,391.4)	(32.9)	–	(4,796.3)
Charge for the year	(81.2)	(42.6)	(173.8)	(5.1)	–	(302.7)
Disposals	3.7	0.2	20.7	2.8	–	27.4
At 31 March 2017	(1,191.7)	(1,300.2)	(2,544.5)	(35.2)	–	(5,071.6)
Net book value						
At 31 March 2017	2,101.7	3,814.0	1,478.5	18.4	591.0	8,003.6
At 31 March 2016	2,034.5	3,682.1	1,387.5	17.5	520.1	7,641.7

Company	Land and buildings £m	Infrastructure assets £m	Fixed plant and equipment £m	Moveable plant £m	Assets under construction £m	Total £m
Cost						
At 1 April 2015	2,961.9	4,762.0	3,570.2	49.0	669.9	12,013.0
Additions	2.7	21.4	14.7	4.8	415.5	459.1
Transfers on commissioning	194.8	156.7	209.7	–	(561.2)	–
Disposals	(10.7)	(0.2)	(15.7)	(3.4)	(4.1)	(34.1)
At 1 April 2016	3,148.7	4,939.9	3,778.9	50.4	520.1	12,438.0
Additions	15.5	73.4	11.0	–	441.6	541.5
Transfers on commissioning	134.1	39.9	190.4	6.3	(370.7)	–
Disposals	(5.7)	(0.7)	(21.9)	(3.1)	–	(31.4)
At 31 March 2017	3,292.6	5,052.5	3,958.4	53.6	591.0	12,948.1
Depreciation						
At 1 April 2015	(1,043.6)	(1,226.3)	(2,229.2)	(31.3)	–	(4,530.4)
Charge for the year	(76.7)	(31.5)	(177.3)	(4.8)	–	(290.3)
Disposals	6.1	–	15.1	3.2	–	24.4
At 1 April 2016	(1,114.2)	(1,257.8)	(2,391.4)	(32.9)	–	(4,796.3)
Charge for the year	(81.2)	(42.6)	(173.7)	(5.1)	–	(302.6)
Disposals	3.7	–	20.7	2.8	–	27.2
At 31 March 2017	(1,191.7)	(1,300.4)	(2,544.4)	(35.2)	–	(5,071.7)
Net book value						
At 31 March 2017	2,100.9	3,752.1	1,414.0	18.4	591.0	7,876.4
At 31 March 2016	2,034.5	3,682.1	1,387.5	17.5	520.1	7,641.7

The depreciation charge for the year includes £5.0 million (2016: £nil) in respect of the write off of redundant plant and equipment.

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

18 Property, plant and equipment (continued)

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

Group

	Infrastructure assets £m	Fixed plant and equipment £m	Total £m
Net book value			
At 31 March 2017	118.8	10.2	129.0
At 31 March 2016	119.8	16.4	136.2

Company

	Land and buildings £m	Infrastructure assets £m	Fixed plant and equipment £m	Total £m
Net book value				
At 31 March 2017	169.7	118.8	10.2	298.7
At 31 March 2016	173.4	119.8	16.4	309.6

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

Group

	2017 £m	2016 £m
Freehold	2,101.4	2,034.2
Short leasehold	0.3	0.3
	2,101.7	2,034.5

Company

	2017 £m	2016 £m
Freehold	2,100.6	2,034.2
Short leasehold	0.3	0.3
	2,100.9	2,034.5

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

19 Investments

	Group			Company
	Associates £m	Subsidiaries £m	Associates £m	Total £m
As at 1 April 2016	–	347.9	–	347.9
Additions	1,470.0	130.2	1,470.0	1,600.2
As at 31 March 2017	1,470.0	478.1	1,470.0	1,948.1

The company has the following subsidiary undertakings:

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

The company has the following associated undertaking:

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

On 24 March 2017, the company acquired 49% of the ordinary share capital of Severn Trent Trimpley Limited, a fellow subsidiary undertaking of Severn Trent Draycote Limited, for consideration of £1,470.0 million. The company also has an indirect investment in Severn Trent Limited Partnership and Severn Trent Limited Partnership 2, limited partnerships registered in Scotland, as a result of Severn Trent General Partnership Limited being the general partner in each partnership.

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

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

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

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

Aqua Deva Limited	Dee Valley Water (Holdings) Limited
Chester Water Limited	Dee Valley Water plc
Dee Valley Group Limited	North Wales Gas Limited
Dee Valley plc	Northern Gas Supplies Limited
Dee Valley Services Limited	

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

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

20 Categories of financial assets - group

	Note	2017 £m	2016 £m
Fair value through profit and loss			
Cross currency swaps - not hedge accounted		23.6	10.4
Interest rate swaps - not hedge accounted		23.6	–
		47.2	10.4
Derivatives designated as hedging instruments			
Cross currency swaps - fair value hedges		19.8	17.7
Interest rate swaps - fair value hedges		–	12.1
		19.8	29.8
Total derivative financial assets		67.0	40.2
Loans and receivables (including cash and cash equivalents)			
Trade receivables	21	193.1	160.8
Amounts due from related parties	21	99.6	–
Amounts due from group undertakings	21	6.4	8.4
Cash at bank and in hand		0.2	–
Total loans and receivables		299.3	169.2
Total financial assets		366.3	209.4
Disclosed in the balance sheet as:			
Non-current assets			
Derivative financial assets		67.0	40.2
		67.0	40.2
Current assets			
Trade and other receivables		193.1	160.8
Amounts due from related parties		99.6	–
Amounts due from group undertakings		6.4	8.4
Cash and cash equivalents		0.2	–
		299.3	169.2
		366.3	209.4

21 Trade and other receivables

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Current assets				
Trade receivables	321.4	285.1	313.9	285.1
Bad debt provision	(128.3)	(124.3)	(125.4)	(124.3)
Net trade receivables	193.1	160.8	188.5	160.8
Other amounts receivable	40.1	42.4	23.2	42.4
Prepayments	10.5	14.7	10.5	19.8
Accrued income	147.4	206.6	143.3	203.4
Loan receivable from related parties	99.6	–	99.6	–
Receivables due from group undertakings	6.4	8.4	7.1	10.8
Receivables due from group undertakings under finance leases	–	–	0.6	0.6
	497.1	432.9	472.8	437.8
Non-current assets				
Prepayments	–	–	–	82.5
Receivables due from group undertakings under finance leases	–	–	99.1	99.7
Receivables due from group undertakings under loan	–	–	55.2	109.6
	–	–	154.3	291.8
	497.1	432.9	627.1	729.6

Prior year company prepayments included £85.9m which represents a contribution made to Severn Trent Limited Partnership as part of an asset backed funding arrangement. In the current year this prepayment is included as an asset of the STPS pension scheme.

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

21 Trade and other receivables (continued)

Doubtful debt provision

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

By far the most significant business unit of the group is Severn Trent Water Limited, which has a statutory obligation to provide water and sewerage waste water to customers within its region. Therefore there is no concentration of credit risk with respect to its trade receivables from these services and the credit quality of its customer base reflects the wealth and prosperity of all of the domestic households within its region. None of the other business units are individually significant to the group.

Movements on the doubtful debts provision were as follows:

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
At 1 April	124.3	122.5	124.3	122.5
Charge for bad and doubtful debts (continuing and discontinued operations)	20.6	23.7	20.5	23.7
Acquisition of Dee Valley Water	2.9	–	–	–
Amounts written off during the year	(19.5)	(21.9)	(19.4)	(21.9)
At 31 March	128.3	124.3	125.4	124.3

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

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Up to 90 days	0.7	–	0.6	–
91 - 365 days	4.7	1.8	4.4	1.8
1 - 2 years	2.5	4.9	1.8	4.9
2 - 3 years	3.9	3.2	3.2	3.2
More than 3 years	6.9	4.9	5.9	4.9
	18.7	14.8	15.9	14.8

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

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

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Up to 90 days	56.6	38.6	55.3	38.6
91 - 365 days	85.8	83.1	84.0	83.1
1 - 2 years	57.2	51.0	56.6	51.0
2 - 3 years	35.1	32.4	34.9	32.4
More than 3 years	68.0	65.2	67.2	65.2
	302.7	270.3	298.0	270.3

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

Group	2017			2016		
	Gross £m	Provision £m	Net £m	Gross £m	Provision £m	Net £m
Overdue not specifically provided	302.7	(109.6)	193.1	270.3	(109.5)	160.8
Overdue and specifically provided	18.7	(18.7)	–	14.8	(14.8)	–
	321.4	(128.3)	193.1	285.1	(124.3)	160.8
Company	2017			2016		
	Gross £m	Provision £m	Net £m	Gross £m	Provision £m	Net £m
Overdue not specifically provided	298.0	(109.5)	188.5	270.3	(109.5)	160.8
Overdue and specifically provided	15.9	(15.9)	–	14.8	(14.8)	–
	313.9	(125.4)	188.5	285.1	(124.3)	160.8

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

22 Finance lease receivables - company

Minimum lease payments receivable are as follows:

	2017 £m	2016 £m
Within 1 year	5.7	5.7
1 - 2 years	5.7	5.7
2 - 5 years	17.0	17.0
After more than 5 years	232.8	238.4
Gross obligations under finance leases	261.2	266.8
Less: unearned interest receivable	(161.5)	(166.5)
	99.7	100.3

The present value of minimum lease payments receivable are as follows:

	2017 £m	2016 £m
Within 1 year	0.6	0.6
1 - 2 years	0.6	0.6
2 - 5 years	2.0	1.9
After more than 5 years	96.5	97.2
Included in non-current liabilities	99.1	99.7
	99.7	100.3

The company has granted finance leases of between 44 and 57 years in respect of concrete settling tanks. The interest terms were set at the inception of the leases. Leases bear interest at a weighted average interest rate of 5.1% (2016: 5.1%).

23 Borrowings

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Current liabilities				
Bank overdraft	3.6	2.8	4.9	4.2
Bank loans	147.1	275.0	147.1	275.0
Other loans	406.1	-	5.3	-
Loans due to parent and fellow subsidiary undertakings	6.4	53.0	406.4	53.0
Finance leases	2.1	1.6	17.7	16.1
Finance leases payable to other group companies	-	-	3.2	3.0
	565.3	332.4	584.6	351.3
Non-current liabilities				
Bank loans	889.8	937.2	889.8	937.2
Other loans	3,601.7	3,456.4	556.0	474.6
Loans due to parent and fellow subsidiary undertakings	-	-	3,470.5	3,287.3
Finance leases	113.6	115.6	167.0	184.7
Finance leases payable to other group companies	-	-	199.0	202.3
	4,605.1	4,509.2	5,282.3	5,086.1
	5,170.4	4,841.6	5,866.9	5,437.4

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

24 Finance leases

Obligations under finance leases are as follows:

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Within 1 year	6.1	5.7	26.0	36.0
1 - 2 years	6.5	6.1	38.6	37.7
2 - 5 years	22.6	21.1	101.7	120.4
After more than 5 years	121.9	129.8	401.4	415.2
Gross obligations under finance leases	157.1	162.7	567.7	609.3
Less future finance charges	(41.4)	(45.5)	(180.7)	(203.2)
Present value of leases obligations	115.7	117.2	387.0	406.1

Net obligations under finance leases fall due as follows:

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Within 1 year	2.1	1.6	20.9	19.1
1 - 2 years	2.6	2.1	22.6	20.9
2 - 5 years	11.5	9.6	59.4	73.6
After more than 5 years	99.5	103.9	284.1	292.5
Included in non-current liabilities	113.6	115.6	366.1	387.0
	115.7	117.2	387.0	406.1

The remaining terms of finance leases ranged from 1 to 15 years at 31 March 2017. Interest terms are set at the inception of the leases. Leases with capital outstanding of £115.7 million (2016: £117.2 million) bear fixed interest at a weighted average rate of 5.34% (2016: 5.35%) for the group. Leases which bear fixed interest at a weighted average rate of 5.2% (2016: 5.2%) have capital outstanding of £318.0 million (2016: £322.4 million) for the company. The lease obligations are secured against the related assets.

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

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

25 Categories of financial liabilities - group

	Note	2017 £m	2016 £m
Fair value through profit and loss			
Interest rate swaps - not hedge accounted		163.1	164.9
		163.1	164.9
Derivatives designated as hedging instruments			
Interest rate swaps - fair value hedges		10.8	-
Energy hedges - fair value hedges		0.8	3.2
		11.6	3.2
Total derivative financial liabilities		174.7	168.1
Other financial liabilities			
Borrowings	23	5,170.4	4,841.6
Trade payables	26	15.0	9.6
Amounts due to group undertakings	26	1.7	2.2
Total other financial liabilities		5,187.1	4,853.4
Total financial liabilities		5,361.8	5,021.5
Disclosed in the balance sheet as:			
Non-current liabilities			
Derivative financial liabilities		174.2	167.7
Borrowings		4,605.1	4,509.2
		4,779.3	4,676.9
Current liabilities			
Derivative financial liabilities		0.5	0.4
Borrowings		565.3	332.4
Trade payables		15.0	9.6
Amounts due to group undertakings		1.7	2.2
		582.5	344.6
		5,361.8	5,021.5

26 Trade and other payables

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Current liabilities				
Trade payables	15.0	9.6	10.2	9.6
Social security and other taxes	5.6	5.3	5.6	5.3
Other payables	24.8	6.9	6.5	6.9
Deferred income	12.4	10.9	12.2	10.9
Accruals	360.6	352.4	310.0	313.5
Amounts due to group undertakings	1.7	2.2	46.5	52.3
	420.1	387.3	391.0	398.5
Non-current liabilities				
Deferred income	953.6	867.4	943.1	867.4
Accruals	0.7	2.1	0.8	2.0
	954.3	869.5	943.9	869.4
	1,374.2	1,256.8	1,334.9	1,267.9

The directors consider that the carrying value of trade payables is not materially different from their fair values.

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

27 Deferred tax

Group

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

	Accelerated tax depreciation £m	Retirement benefit obligations £m	Fair value of financial instruments £m	Other £m	Total £m
At 1 April 2015	838.9	(93.8)	(58.1)	13.0	700.0
Charge/(credit) to income	9.2	–	1.2	(0.9)	9.5
(Credit)/charge to income arising from rate change	(83.9)	2.3	4.1	(1.3)	(78.8)
Charge to equity	–	28.5	1.3	0.9	30.7
Charge to equity arising from rate change	–	7.1	1.7	–	8.8
At 1 April 2016	764.2	(55.9)	(49.8)	11.7	670.2
Reclassification	–	15.5	–	(15.5)	–
Acquired through business combinations	11.9	1.7	–	(1.1)	12.5
Charge/(credit) to income	21.8	0.1	3.0	(0.7)	24.2
(Credit)/charge to income arising from rate change	(42.5)	0.5	2.2	0.2	(39.6)
(Credit)/charge to equity	–	(42.4)	(0.8)	(0.1)	(43.3)
Charge to equity arising from rate change	–	1.7	0.8	0.1	2.6
At 31 March 2017	755.4	(78.8)	(44.6)	(5.4)	626.6

Company

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

	Accelerated tax depreciation £m	Retirement benefit obligations £m	Fair value of financial instruments £m	Other £m	Total £m
At 1 April 2015	838.8	(93.7)	(58.2)	30.5	717.4
Charge/(credit) to income	9.3	–	1.3	(1.3)	9.3
(Credit)/charge to income arising from rate change	(83.9)	2.5	4.4	(3.0)	(80.0)
Charge to equity	–	28.5	1.2	0.9	30.6
Charge to equity arising from rate change	–	6.9	1.4	–	8.3
At 1 April 2016	764.2	(55.8)	(49.9)	27.1	685.6
Reclassification	–	30.9	–	(30.9)	–
Charge/(credit) to income	21.8	(14.5)	3.0	(0.8)	9.5
(Credit)/charge to income arising from rate change	(42.5)	(0.4)	2.3	0.2	(40.4)
Credit to equity	–	(42.4)	(0.8)	(0.1)	(43.3)
Charge to equity arising from rate change	–	1.7	0.8	0.1	2.6
At 31 March 2017	743.5	(80.5)	(44.6)	(4.4)	614.0

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

27 Deferred tax (continued)

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

Group

	2017 £m	2016 £m
Deferred tax asset	(128.7)	(105.7)
Deferred tax liability	755.3	775.9
	626.6	670.2

Company

	2017 £m	2016 £m
Deferred tax asset	(129.5)	(105.7)
Deferred tax liability	743.5	791.3
	614.0	685.6

28 Retirement benefit schemes

a) Defined benefit pension schemes

i) Background

The Severn Trent group operates a number of defined benefit pension schemes in the UK which closed to future accrual on 31 March 2015. The defined benefit pension schemes cover increases in accrued benefits arising from inflation and future pension increases. Their assets are held in separate funds administered by trustees. The trustees are required to act in the best interests of the schemes' beneficiaries. A formal actuarial valuation of each scheme is carried out on behalf of the trustees at triennial intervals by an independent professionally qualified actuary. Under the defined benefit pension schemes, members are entitled to retirement benefits calculated as a proportion (varying between 1/30 and 1/80 for each year of service) of their salary for the final year of employment with the group or, if higher, the average of the highest three consecutive years' salary in the last ten years of membership, up to 31 March 2015.

Dee Valley Water ('DVW') participates in the Water Companies Pension Scheme, which is a defined benefit sectionalised scheme. DVW participates in the Dee Valley Water plc Section of the scheme ('the Section'). The Section funds are administered by trustees and are held separately from the assets of the group. Contributions are paid to the Section in accordance with the recommendations of an independent professionally qualified actuary, who carries out a formal actuarial valuation at triennial intervals. Members are entitled to retirement benefits calculated by reference to their pensionable service and pensionable salary history.

The UK defined benefit pension schemes and the date of their last formal actuarial valuation are as follows:

	Date of last formal actuarial valuation
Severn Trent Pension Scheme (STPS)*	31 March 2016
Severn Trent Mirror Image Pension Scheme (STMIPS)	31 March 2016
Water Companies Pension Scheme – Dee Valley Water plc Section (DVWS)	31 March 2014

* The STPS is by far the largest of the group's UK defined benefit schemes.

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

			2017	2016
	STWPS and STMIPS £m	DVWS £m	Total £m	Total £m
Fair value of assets	2,281.9	70.9	2,352.8	2,039.8
Present value of the defined benefit obligations - funded schemes	(2,855.8)	(61.1)	(2,916.9)	(2,339.9)
	(573.9)	9.8	(564.1)	(300.1)
Present value of the defined benefit obligations - unfunded schemes	(10.5)	–	(10.5)	(9.4)
Net retirement benefit obligation recognised in the balance sheet	(584.4)	9.8	(574.6)	(309.5)

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

28 Retirement benefit schemes (continued)

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

	Group		Company	
	2017	2016	2017	2016
	STPS and STMIPS £m	STPS and STMIPS £m	STPS and STMIPS £m	STPS and STMIPS £m
Fair value of scheme assets				
Equities	897.9	922.4	897.9	922.4
Gilts	412.6	283.0	412.6	283.0
Corporate bonds	670.8	570.7	670.8	570.7
Property	174.9	171.4	174.9	171.4
Hedge funds	1.2	11.8	1.2	11.8
Contributions due from the Scottish Limited Partnership	–	–	276.3	–
Cash	124.5	80.5	124.5	80.5
Total fair value of assets	2,281.9	2,039.8	2,558.2	2,039.8

	2017 DVWS £m
Fair value of scheme assets	
Equities	16.4
Diversified growth funds	5.3
Liquidity driven investment funds	42.6
Emerging markets multi-asset funds	3.3
High yield bonds	3.3
Total fair value of assets	70.9

Company

	2017 £m	2016 £m
Fair value of assets	2,558.2	2,039.8
Present value of the defined benefit obligations - funded schemes	(2,855.8)	(2,339.9)
	(297.6)	(300.1)
Present value of the defined benefit obligations - unfunded schemes	(10.5)	(9.4)
Retirement benefit obligation recognised in the balance sheet	(308.1)	(309.5)

The equities, gilts, corporate bonds and hedge funds have quoted prices in active markets.

Movements in the fair value of the schemes' assets were as follows:

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Fair value at 1 April	2,039.8	2,086.8	2,039.8	2,086.8
Interest income on scheme assets	71.8	67.7	71.8	67.7
Group contributions	33.2	25.7	33.2	25.7
Other contributions from other Severn Trent group companies	–	2.1	–	2.1
Contributions from scheme members	–	0.3	–	0.3
Return on plan assets (excluding amounts included in finance income)	227.6	(45.9)	227.6	(45.9)
Scheme administration costs	(3.3)	(2.3)	(3.3)	(2.3)
Benefits paid	(87.2)	(94.6)	(87.2)	(94.6)
Movement in the contribution due from the Scottish Limited Partnerships ¹	–	–	276.3	–
Acquisition of Dee Valley Water	70.9	–	–	–
Fair value at 31 March	2,352.8	2,039.8	2,558.2	2,039.8

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

28 Retirement benefit schemes (continued)

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

1 - The Scottish Limited Partnerships are subsidiaries of Severn Trent Water and therefore the contribution due is eliminated on consolidation. In the prior year company accounts a contribution made to Severn Trent Limited Partnership as part of an asset backed funding arrangement was included in prepayments. In the current year this prepayment is included as an asset of the STPS pension scheme along with a further contribution made in the current year.

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

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Present value at 1 April	(2,349.3)	(2,555.7)	(2,349.3)	(2,555.7)
Exceptional past service credit	17.3	0.7	17.3	0.7
Interest cost	(82.7)	(82.8)	(82.7)	(82.8)
Contributions from scheme members	-	(0.3)	-	(0.3)
Actuarial gains arising from changes in demographic assumptions	16.6	-	16.6	-
Actuarial losses/(gains) arising from changes in financial assumptions	(470.6)	147.9	(470.6)	147.9
Actuarial losses/(gains) arising from experience adjustments	(84.8)	46.3	(84.8)	46.3
Benefits paid	87.2	94.6	87.2	94.6
Acquisition of Dee Valley Water	(61.1)	-	-	-
Present value at 31 March	(2,927.4)	(2,349.3)	(2,866.3)	(2,349.3)

Of which:

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Amounts relating to funded schemes	2,916.9	2,339.9	2,855.8	2,339.9
Amounts relating to unfunded schemes	10.5	9.4	10.5	9.4
Present value at 31 March	2,927.4	2,349.3	2,866.3	2,349.3

The group has an obligation to pay pensions to a number of former employees, whose benefits would otherwise have been restricted by the Finance Act 1989 earnings cap. Provision for such benefits amounting to £10.5 million (2016: £9.4 million) is included as an unfunded scheme within the retirement benefit obligation.

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

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

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Amounts credited/(charged) to operating costs				
Current service cost	-	-	-	-
Exceptional past service credit	17.3	0.7	17.3	0.7
Scheme administration costs	(3.3)	(2.3)	(3.3)	(2.3)
	14.0	(1.6)	14.0	(1.6)
Amounts charged to finance costs				
Interest cost	(82.7)	(82.8)	(82.7)	(82.8)
Amounts credited to finance income				
Interest income on scheme assets	71.8	67.7	71.8	67.7
Total amount credited/(charged) to the income statement	3.1	(16.7)	3.1	(16.7)

The actual return on scheme assets was a gain of £301.4 million (2016: £21.8 million).

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

28 Retirement benefit schemes (continued)

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

Actuarial gains and losses have been reported in the statement of comprehensive income. The cumulative amount of actuarial gains and losses recognised in the statement of comprehensive income since the adoption of IFRS is a net loss of £622.0 million (2016: £310.8 million).

(iv) Actuarial risk factors

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

Investment risk

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

Inflation risk

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

Longevity risk

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

(v) Actuarial assumptions

The major assumptions used in the valuation of the STPS and STMIPS schemes were as follows:

	2017 %	2016 %
Price inflation – RPI	3.1	3.0
Price inflation – CPI	2.1	2.0
Discount rate	2.7	3.6
Pension increases in payment	3.1	3.0
Pension increases in deferment	3.1	3.0

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

We have revised our methodology for setting the discount rate to better reflect the credit risk for long dated bond yields where there is insufficient market data available. We now adjust the yield on long dated gilts for the market-implied spread that would be expected for an AA bond of similar term. Short dated yields are taken from market rates for AA corporate bonds. We project the expected cash flows of the schemes and adopt a single equivalent cash flow weighted discount rate based on this constructed yield curve.

The mortality assumptions are based on those used in the triennial valuation of the STPS as at 31 March 2016.

The mortality assumptions adopted at the year end and the life expectancies at age 65 implied by the assumptions are as follows for STPS and STMIPS:

	2017		2016	
	Men	Women	Men	Women
Mortality table used	S2NM A	S2NF A	'SAPS' S1NMA _L	S1NFA_ L
Mortality table compared with standard table	95%	99%	116%	92%
Future improvement per annum	1.0%	1.0%	1.0%	1.0%
Remaining life expectancy for members currently aged 65 (years)	22.5	24.1	21.4	24.6
Remaining life expectancy at age 65 for members currently aged 45 (years)	23.6	25.3	22.8	26.1

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

28 Retirement benefit schemes (continued)

(v) Actuarial assumptions (continued)

The assumptions used in the valuation of the DVWS scheme were as follows:

	2017
Price inflation - RPI	3.4%
Price inflation - CPI	2.4%
Discount rate	2.5%
Pension increases in payment – uncapped CPI	2.5%
Pension increases in payment – CPI capped at 5% per annum	2.4%
Pension increases in deferment	2.5%
Pension salary increases (capped at 2% per annum)	1.9%
Life expectancy of a male aged 60 at the balance sheet date (years)	27.9
Life expectancy of a female aged 60 at the balance sheet date (years)	29.8
Life expectancy of a male aged 60, twenty five years after the balance sheet date (years)	30.9
Life expectancy of a female aged 60, twenty five years after the balance sheet date (years)	32.3

The mortality table used to calculate the DVWS assumptions were SAPS S2NA (1.5% for men, 1.25% for women)

The calculation of the scheme liabilities is sensitive to the actuarial assumptions and in particular to the assumptions relating to discount rate, price inflation and mortality. The following table summarises the estimated impact on STWPS and STMIPS scheme liabilities from changes to key actuarial assumptions whilst holding all other assumptions constant.

Assumption	Change in assumption	Impact on scheme liabilities
Discount rate	Increase/decrease by 0.1%	Decrease/increase by £53 million
Price inflation	Increase/decrease by 0.1%	Increase/decrease by £46 million
Mortality	Increase in life expectancy by 1 year	Increase by £106 million

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

Assumption	Change in assumption	Impact on scheme liabilities
Discount rate	Increase/decrease by 0.1%	Decrease/increase by £1 million
Price inflation*	Increase/decrease by 0.1%	Increase/decrease by £0.8 million
Mortality	Increase in life expectancy by 1 year	Increase by £2 million

*The impact of pension increases is not material

In reality, inter-relationships exist between the assumptions, particularly between the discount rate and price inflation. The above analysis does not take into account the effect of these inter-relationships.

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

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

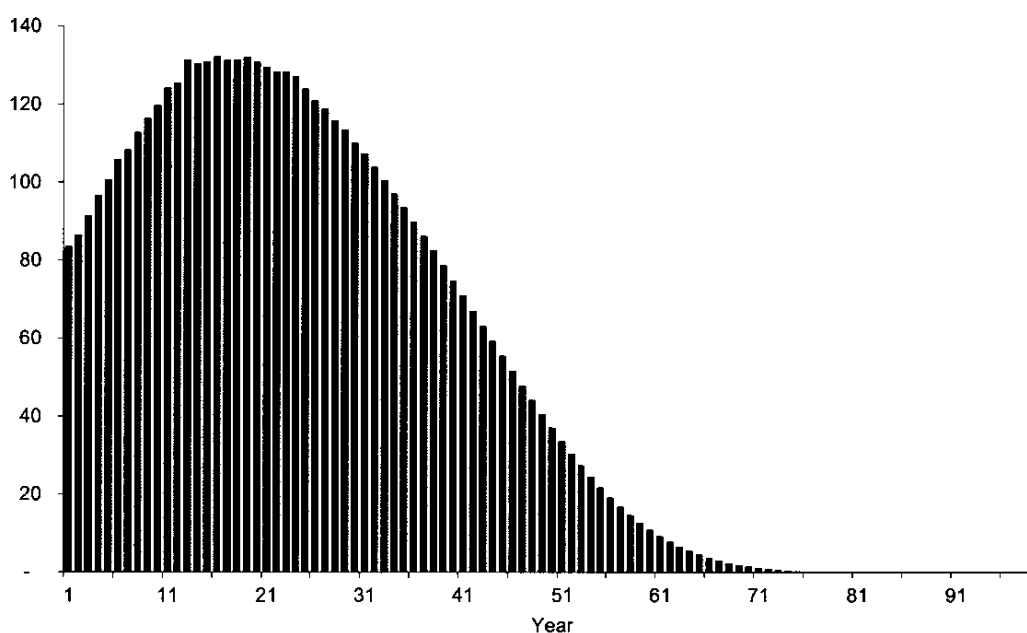
28 Retirement benefit schemes (continued)

(vi) Effect on future cash flows

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

The average duration of the benefit obligation at the end of the year is 20 years for STPS and STMIPS (2016: 18 years) and 17 years for DVWS. The expected cash flows payable from the schemes are presented in the graph below:

Expected benefit payments (£millions)



The most recent formal triennial actuarial valuations and funding agreements were carried out as at 31 March 2016 for the STPS and STMIPS schemes and 31 March 2014 for DVWS. As a result of the STPS and STMIPS actuarial valuations, deficit reduction contributions of £10 million for the two financial years ending 31 March 2019 were agreed. Payments of £8 million per annum through an asset backed funding arrangement will continue to 31 March 2032. Further inflation linked payments of £15 million per annum will be made through a new asset backed funding arrangement, starting in the financial year ending 31 March 2018 and continuing to 31 March 2031. These contributions will cease earlier should a subsequent valuation of the STPS show that these contributions are no longer needed.

b) Defined contribution pension schemes

The group also operates defined contribution arrangements for certain of its UK employees.

The Severn Trent Pension Scheme, Choices section was replaced by the Severn Trent Group Personal Pension from 1 April 2015 and all members of other pension schemes were transferred. This scheme has been open since 1 April 2012 and new employees were automatically enrolled from this date.

The total cost charged to operating costs of £19.7 million (2016: £18.1 million) represents contributions payable to these schemes by the group at rates specified in the rules of the schemes. As at 31 March 2017, contributions amounting to £2.2 million (2016: £1.5 million) in respect of the current reporting period were owed to the schemes.

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

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

29 Provisions – group and company

	Restructuring £m	Insurance £m	Other £m	Total £m
At 1 April 2016	0.1	4.6	2.4	7.1
Charged to income statement	–	4.1	5.3	9.4
Utilisation of provision	(0.1)	(1.5)	(0.1)	(1.7)
At 31 March 2017	–	7.2	7.6	14.8

	2017 £m	2016 £m
Included in:		
Current liabilities	8.0	1.2
Non-current liabilities	6.8	5.9
	14.8	7.1

The restructuring provision reflects costs to be incurred in respect of committed restructuring programmes.

The insurance provision relates to self-insurance. The associated outflows are estimated to arise over a period of up to five years from the balance sheet date.

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

30 Share capital

	2017 £m	2016 £m
Total issued and fully paid share capital		
1,000,100,000 ordinary shares of 0.1p (2016: 1,000,000,000 of 10p)	1.0	100.0

On 24 March 2017 the company issued 100,000 ordinary shares of 10p each to its parent company for consideration of £1,470.0 million. The company then completed a capital reduction to redenominate the ordinary shares of 10p each as ordinary shares of 0.1p each generating distributable reserves of £1,569.0 million in the entity.

31 Hedging reserve – group and company

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

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

32 Capital management – group

The group's principal objectives in managing capital are:

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

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

The group has continued to increase exposure to currently low floating interest rates, primarily through raising £400 million of finance through a bond with a maturity of 15 years. The group has entered into a series of interest rate swaps in relation to this bond, to take advantage of low floating interest rates. The group also raised a further £100 million through a floating rate bank loan.

The group's dividend policy is to declare dividends which are consistent with the group's regulatory obligations and at a level which is decided each year after consideration of a number of factors, including regulatory uncertainty, future cash flow requirements and balance sheet considerations. The amount declared is expected to vary each year as the impact of these factors changes.

The group's capital at 31 March 2017 was:

	2017	2016
	£m	£m
Cash and cash equivalents	0.2	–
Bank overdrafts	(3.6)	(2.8)
Bank loans	(1,036.9)	(1,212.2)
Other loans	(4,007.8)	(3,456.4)
Loans from parent company	(6.4)	(53.0)
Obligations under finance leases	(115.7)	(117.2)
Cross currency swaps	43.4	28.1
Loans due from related parties	99.6	–
Net debt	(5,027.2)	(4,813.5)
Equity attributable to owners of the company	(2,241.1)	(896.4)
Total capital	(7,268.3)	(5,709.9)

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

33 Fair values of financial instruments – group

a) Fair value measurements

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

	2017 £m	2016 £m	Valuation techniques and key inputs
Cross currency swaps			Discounted cash flow
Assets	43.4	28.1	Future cash flows are estimated based on forward interest rates from observable yield curves at the year end and contract interest rates discounted at a rate that reflects the credit risk of counterparties. The currency cash flows are translated at the spot rate.
Liabilities	–	–	
Interest rate swaps			Discounted cash flow
Assets	23.6	12.1	Future cash flows are estimated based on forward interest rates from observable yield curves at the year end and contract interest rates discounted at a rate that reflects the credit risk of counterparties.
Liabilities	(173.9)	(164.9)	
Energy swaps			Discounted cash flow
Assets	–	–	Future cash flows are estimated based on forward electricity prices from observable indices at the year end and contract prices discounted at a rate that reflects the credit risk of counterparties.
Liabilities	(0.8)	(3.2)	

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

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

	2017		2016	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Floating rate debt				
Bank loans	776.3	782.0	958.6	958.5
Currency bonds	40.1	40.1	36.6	36.6
Floating rate notes	147.7	156.4	147.6	150.3
Loan from parent company	6.4	6.4	53.0	53.0
	970.5	984.9	1,195.8	1,198.4
Fixed rate debt				
Bank loans	150.0	150.0	150.0	150.0
Sterling bonds	2,257.3	2,746.2	1,857.3	2,221.8
Fixed rate notes	355.2	397.4	326.9	399.0
Other loans	6.5	6.5	–	–
Finance leases	115.7	130.5	117.2	125.4
	2,884.7	3,430.6	2,451.4	2,896.2
Index-linked debt				
Bank loans	110.6	126.7	107.8	116.1
Sterling bonds	1,113.7	1,970.9	1,088.0	1,494.0
Other loans	87.3	87.3	–	–
	1,311.6	2,184.9	1,195.8	1,610.1
	5,166.8	6,600.4	4,843.0	5,704.7

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

Fixed rate sterling and currency bonds are valued using market prices, which is a Level 1 valuation technique.

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

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

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Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

34 Risks arising from financial instruments – group

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

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

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

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

Interest rate swaps are held to mitigate the group's exposure to changes in market interest rates. Further details are set out in sections a) (i) and note 35 below.

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

Energy swaps are held to mitigate the group's exposure to changes in electricity prices. Further details are provided in note 35 below.

Severn Trent Water and Dee Valley Water operate under a regulatory environment where sales prices are linked to inflation measured by RPI. In order to mitigate the risks to cash flow and earnings arising from fluctuations in RPI, the group holds debt instruments where the principal repayable and interest cost is linked to RPI.

a) Market risk

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

(i) Interest rate risk

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

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

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

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

	2017 £m	2016 £m
Net debt (note 39)	5,027.2	4,813.5
Cash and cash equivalents	0.2	–
Loans receivable from related parties	99.6	–
Cross currency swaps included in net debt at fair value	43.4	28.1
Fair value hedge accounting adjustments	(31.5)	(15.2)
Exchange on currency debt not hedge accounted	(21.2)	(5.9)
Interest bearing financial liabilities	5,117.7	4,820.5

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

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

34 Risks arising from financial instruments – group (continued)

(i) Interest rate risk (continued)

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

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

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

	Floating rate £m	Fixed rate £m	Index- linked £m	Total £m
2017				
Overdrafts	(3.6)	–	–	(3.6)
Bank loans	(776.3)	(150.0)	(110.6)	(1,036.9)
Other loans	(167.6)	(2,586.5)	(1,201.0)	(3,955.1)
Loans due to parent company	(6.4)	–	–	(6.4)
Finance leases	–	(115.7)	–	(115.7)
	(953.9)	(2,852.2)	(1,311.6)	(5,117.7)
Impact of swaps not matched against specific debt instruments	(205.3)	205.3	–	–
Interest bearing financial liabilities	(1,159.2)	(2,646.9)	(1,311.6)	(5,117.7)
Proportion of interest bearing financial liabilities that are fixed		52%		
Weighted average interest rate of fixed rate debt		5.22%		
Weighted average period for which interest is fixed (years)		9.2		
2016				
Overdrafts	(2.8)	–	–	(2.8)
Bank loans	(954.4)	(150.0)	(107.8)	(1,212.2)
Other loans	(392.0)	(1,955.5)	(1,087.8)	(3,435.3)
Loans due to parent company	(53.0)	–	–	(53.0)
Finance leases	–	(117.2)	–	(117.2)
	(1,402.2)	(2,222.7)	(1,195.6)	(4,820.5)
Impact of swaps not matched against specific debt instruments	419.8	(419.8)	–	–
Interest bearing financial liabilities	(982.4)	(2,642.5)	(1,195.6)	(4,820.5)
Proportion of interest bearing financial liabilities that are fixed		55%		
Weighted average interest rate of fixed rate debt		5.22%		
Weighted average period for which interest is fixed (years)		10.2		

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

34 Risks arising from financial instruments – group (continued)

(i) Interest rate risk (continued)

Interest rate swaps not hedge accounted

The group has a number of interest rate swaps which are not accounted for as cash flow or fair value hedges. Economically these swaps act to fix the interest cost of debt within the group which is denominated as floating rate, but do not achieve hedge accounting under the strict criteria of IAS 39. This has led to a charge of £3.3 million (2016: credit of £8.6 million) in the income statement.

	Average contract fixed interest rate		Notional principal amount		Fair value	
	2017	2016	2017	2016	2017	2016
	%	%	£m	£m	£m	£m
Pay fixed rate interest						
5 - 10 years	5.06	5.06	(450.0)	(450.0)	(125.3)	(129.2)
10 - 20 years	5.45	5.45	(68.1)	(68.1)	(37.8)	(35.7)
	5.11	5.11	(518.1)	(518.1)	(163.1)	(164.9)
Receive fixed rate interest						
5 - 10 years	3.34	–	75.0	–	5.8	–
10 - 20 years	2.92	–	550.0	–	17.8	–
	2.97	–	625.0	–	23.6	–
			106.9	(518.1)	(139.5)	(164.9)

Interest rate sensitivity analysis

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

	2017		2016	
	1.0% £m	-1.0% £m	1.0% £m	-1.0% £m
Profit or loss	(36.5)	54.6	42.4	(47.4)
Cash flow	9.2	(9.2)	6.6	(6.6)
Equity	(36.5)	54.6	42.4	(47.4)

(ii) Exchange rate risk

Except for debt raised in foreign currency, which is hedged, the group's business does not involve significant exposure to foreign exchange transactions and therefore the sensitivity of the group's results to changes in exchange rates is not material.

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

Where the terms of the receivable leg of the swap closely match the terms of the underlying debt, the swaps are expected to be effective hedges, hence the swaps have been accounted for as fair value hedges. The notional value and fair value of these swaps is shown in note 35 a).

The group also has fixed to floating rate cross currency swaps with a notional sterling value of £98.3 million (2016: £98.3 million) which are not accounted for as fair value hedges. Economically these swaps act to mitigate the exchange rate risk of debt within the group which is denominated in foreign currency, but they do not achieve hedge accounting under the strict criteria of IAS 39. This has led to a credit of £13.1 million (2016: £39.1 million) in the income statement which is offset by the exchange loss of £15.4 million (2016: £32.6 million) on the underlying debt.

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

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

34 Risks arising from financial instruments – group (continued)

(ii) Exchange rate risk (continued)

2017	Euro €m	US Dollar \$m	Yen ¥Bn
Borrowings by currency	(19.9)	(150.0)	(2.0)
Cross currency swaps - hedge accounted	19.9	–	2.0
Cross currency swaps - not hedge accounted	–	150.0	–
Net currency exposure	–	–	–

2016	Euro €m	US Dollar \$m	Yen ¥Bn
Borrowings by currency	(19.9)	(150.0)	(2.0)
Cross currency swaps - hedge accounted	19.9	–	2.0
Cross currency swaps - not hedge accounted	–	150.0	–
Net currency exposure	–	–	–

b) Credit risk

Operationally the group has no significant concentrations of credit risk. Severn Trent Water Limited and Dee Valley Water Group Limited's operating licences oblige them to supply domestic customers even in cases where bills are not paid. Amounts provided against accounts receivable and movements on the provision during the year are disclosed in note 21.

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

Credit risk analysis

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

	Credit limit		Amount deposited	
	2017 £m	2016 £m	2017 £m	2016 £m
AAA	5.0	5.0	–	–
Double A range	100.0	100.0	–	–
Single A range	625.0	615.0	–	–
Triple B range	10.0	20.0	–	–
	740.0	740.0	–	–

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

	Derivative assets	
	2017 £m	2016 £m
Double A range	0.8	–
Single A range	66.2	32.3
Triple B range	–	7.9
	67.0	40.2

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

34 Risks arising from financial instruments – group (continued)

c) Liquidity risk

(i) Committed facilities

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

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

	2017	2016
	£m	£m
2 - 5 years	900.0	775.0

(ii) Cash flows from non-derivative financial instruments

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

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

2017 Undiscounted amounts payable:	Floating rate	Fixed rate	Index linked	Trade payables	Payments on financial liabilities
	£m	£m	£m	£m	£m
Within 1 year	(165.4)	(538.6)	(25.0)	(15.0)	(744.0)
1 - 2 years	(9.9)	(108.7)	(26.0)	–	(144.6)
2 - 5 years	(35.3)	(469.8)	(82.1)	–	(587.2)
5 - 10 years	(725.5)	(1,383.4)	(314.0)	–	(2,422.9)
10 - 15 years	(105.7)	(1,110.0)	(347.1)	–	(1,562.8)
15 - 20 years	–	(60.9)	(221.3)	–	(282.2)
20 - 25 years	–	(310.9)	(160.3)	–	(471.2)
25 - 30 years	–	–	(190.1)	–	(190.1)
30 - 35 years	–	–	(643.2)	–	(643.2)
35 - 40 years	–	–	(1,226.5)	–	(1,226.5)
40 - 45 years	–	–	(2,089.7)	–	(2,089.7)
45 - 50 years	–	–	(365.0)	–	(365.0)
Total	(1,041.8)	(3,982.3)	(5,690.3)	(15.0)	(10,729.4)

Undiscounted amounts receivable:	Loans due from related parties	Trade receivables	Cash and short term deposits	Receipts from financial assets
	£m	£m	£m	£m
Within 1 year	99.6	193.1	0.2	292.9

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

34 Risks arising from financial instruments – group (continued)

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

2016 Undiscounted amounts payable:	Floating rate	Fixed rate	Index linked	Trade payables	Payments on financial liabilities
	£m	£m	£m	£m	£m
Within 1 year	(285.9)	(119.2)	(23.9)	(9.6)	(438.6)
1 - 2 years	(163.2)	(519.7)	(24.3)	–	(707.2)
2 - 5 years	(38.1)	(437.4)	(75.9)	–	(551.4)
5 - 10 years	(614.5)	(1,230.8)	(299.0)	–	(2,144.3)
10 - 15 years	(178.4)	(768.9)	(334.0)	–	(1,281.3)
15 - 20 years	–	(76.9)	(125.7)	–	(202.6)
20 - 25 years	–	(60.9)	(153.1)	–	(214.0)
25 - 30 years	–	(262.2)	(183.0)	–	(445.2)
30 - 35 years	–	–	(217.8)	–	(217.8)
35 - 40 years	–	–	(646.6)	–	(646.6)
40 - 45 years	–	–	(3,163.9)	–	(3,163.9)
45 - 50 years	–	–	(29.4)	–	(29.4)
50 - 55 years	–	–	(426.5)	–	(426.5)
Total	(1,280.1)	(3,476.0)	(5,703.1)	(9.6)	(10,468.8)

Undiscounted amounts receivable:	Loans due from joint ventures	Trade receivables	Cash and short term deposits	Receipts from financial assets
	£m	£m	£m	£m
Within 1 year	–	160.8	–	160.8

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

(iii) Cash flows from derivative financial instruments

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

2017	Derivative liabilities		Derivative assets			Total £m
	Interest rate swaps	Energy swaps	Interest rate swaps	Cross currency swaps		
				Cash receipts	Cash payments	
£m	£m	£m	£m	£m	£m	
Within 1 year	(23.7)	(0.2)	6.9	1.1	(0.2)	(16.1)
1 - 2 years	(23.3)	(0.5)	6.2	1.1	(0.2)	(16.7)
2 - 5 years	(70.0)	(0.3)	13.1	3.4	(0.8)	(54.6)
5 - 10 Years	(57.8)	–	4.3	23.9	(13.1)	(42.7)
10 - 15 Years	(11.4)	–	(6.4)	18.1	(9.0)	(8.7)
	(186.2)	(1.0)	24.1	47.6	(23.3)	(138.8)

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

34 Risks arising from financial instruments – group (continued)

(iii) Cash flows from derivative financial instruments (continued)

2016	Derivative liabilities		Derivative assets			Total £m
	Cross currency swaps		Interest rate swaps £m	Cross currency swaps		
	Interest rate swaps £m	Energy swaps £m		Cash receipts £m	Cash payments £m	
Within 1 year	(22.6)	(0.4)	2.8	1.0	(0.2)	(19.4)
1 - 2 years	(22.3)	(0.8)	2.6	1.0	(0.2)	(19.7)
2 - 5 years	(63.0)	(2.9)	6.0	3.1	(0.9)	(57.7)
5 - 10 Years	(62.1)	–	1.7	23.5	(13.6)	(50.5)
10 - 15 Years	(12.0)	–	(0.4)	16.7	(9.3)	(5.0)
15 - 20 Years	(0.7)	–	–	–	–	(0.7)
	(182.7)	(4.1)	12.7	45.3	(24.2)	(153.0)

d) Inflation risk

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

Inflation rate sensitivity analysis

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

	2017		2016	
	+1.0% £m	-1.0% £m	+1.0% £m	-1.0% £m
Profit or loss	(10.5)	10.5	(9.6)	9.6
Equity	(10.5)	10.5	(9.6)	9.6

35 Hedge accounting – group

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

a) Fair value hedges

(i) Cross currency swaps

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

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

	Notional principal amount		Fair value	
	2017 £m	2016 £m	2017 £m	2016 £m
Euro	11.4	11.4	10.4	9.8
Yen	8.5	8.5	9.4	7.9
	19.9	19.9	19.8	17.7

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Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

35 Hedge accounting – group (continued)

(ii) Interest rate swaps

Hedge accounting for swaps previously designated in fair value hedging relationships have been discontinued, as they no longer meet the criteria set out in IAS 39. These swaps continue to economically increase the portion of debt within the group at floating rates.

Period to maturity	Average contract fixed interest rate		Notional principal amount		Fair value	
	2017	2016	2017	2016	2017	2016
	%	%	£m	£m	£m	£m
10 - 20 years	–	3.36%	–	225.0	–	12.1

b) Cash flow hedges

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

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

Period to maturity	Average contract fixed interest rate		Notional principal amount		Fair value	
	2017	2016	2017	2016	2017	2016
	%	%	£m	£m	£m	£m
5 - 10 years	1.70%	–	50.0	–	(1.1)	–
10 - 20 years	1.82%	–	348.0	–	(9.7)	–
	1.80%	–	398.0	–	(10.8)	–

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

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

Period to maturity	Average contract price		Notional contracted amount		Fair value	
	2017	2016	2017	2016	2017	2016
	£/MWh	£/MWh	MWh	MWh	£m	£m
Less than 1 year	43.6	49.8	66,272	21,960	(0.2)	(0.4)
1 - 2 years	48.5	43.6	205,296	66,272	(0.5)	(0.8)
2 - 5 years	48.6	48.5	21,955	227,221	(0.1)	(2.0)
	47.4	47.6	293,523	315,453	(0.8)	(3.2)

36 Share based payments – group

The group operates a number of share based remuneration schemes for employees. During the year, the group recognised total expenses of £6.0 million (2016: £5.0 million) related to equity settled share based payment transactions.

The weighted average share price during the period was £22.98 (2016: £21.44).

At 31 March 2017, there were no options exercisable (2016: none) under any of the share based remuneration schemes.

a) Long Term Incentive Plans ('LTIPs')

Under the LTIPs, conditional awards of shares may be made to executive directors and senior staff. Awards are subject to performance conditions and continued employment throughout the vesting period.

Awards outstanding

Awards made under the LTIP

The 2013 and 2014 LTIP awards were subject to Severn Trent Water's achievement of Return on Regulatory Capital Value in excess of the level included in the Severn Trent Water AMP5 business plan over a three year vesting period. The 2015 LTIP awards onwards are subject to Severn Trent Water's achievement of Return on Regulated Equity in excess of the level included in the Severn Trent Water AMP6 business plan over a three year vesting period. It has been assumed that performance against the LTIP non-market conditions will be 100% (2016: 100%).

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Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

36 Share based payments – group (continued)

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

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

	Number of awards
Outstanding at 1 April 2015	408,431
Granted during the year	235,670
Vested during the year	(132,597)
Lapsed during the year	(57,825)
Outstanding at 1 April 2016	453,679
Granted during the year	187,549
Vested during the year	(132,697)
Lapsed during the year	(21,122)
Outstanding at 31 March 2017	487,409

Details of LTIP awards outstanding at 31 March 2017 were as follows:

Date of grant	Normal Date of Vesting	Number of awards	
		2017	2016
July 2013	2016	–	136,784
July 2014	2017	140,251	157,286
July 2015	2018	159,609	159,609
July 2016	2019	187,549	–
		487,409	453,679

b) Employee Sharesave Scheme

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

Options outstanding

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

	Number of share options	Weighted average exercise price
Outstanding at 1 April 2015	2,929,596	1,321p
Granted during the year	719,826	1,724p
Forfeited during the year	(99,635)	1,399p
Cancelled during the year	(63,461)	1,487p
Exercised during the year	(682,463)	1,029p
Lapsed during the year	(18,286)	1,216p
Outstanding at 1 April 2016	2,785,577	1,491p
Granted during the year	840,566	1,663p
Forfeited during the year	(64,219)	1,571p
Cancelled during the year	(90,990)	1,635p
Exercised during the year	(436,170)	1,225p
Lapsed during the year	(7,557)	1,367p
Outstanding at 31 March 2017	3,027,207	1,572p

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Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

36 Share based payments – group (continued)

b) Employee Sharesave Scheme (continued)

Sharesave options outstanding at 31 March 2016 were as follows:

Date of grant	Normal date of exercise	Option price	Number of share options	
			2017	2016
January 2011	2016	1,137p	–	95,183
January 2012	2017	1,177p	85,345	88,193
January 2013	2016 or 2018	1,241p	110,206	440,110
January 2014	2017 or 2019	1,331p	480,969	512,207
January 2015	2018 or 2020	1,584p	867,375	931,560
January 2016	2019 or 2021	1,724p	648,300	718,324
January 2017	2020 or 2022	1,663p	835,012	–
			3,027,207	2,785,577

c) Share Matching Plan ('SMP')

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

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

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

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

	Number of awards
Outstanding at 1 April 2015	49,730
Cancelled during the year	(22,117)
Outstanding at 1 April 2016	27,613
Cancelled during the year	(24,682)
Vested during the year	(2,931)
Outstanding at 31 March 2017	–

Details of share matching awards outstanding at 31 March 2017 were as follows:

Date of grant	Normal Date of Vesting	Number of awards	
		2017	2016
May 2013	May 2016	–	27,613

d) Fair value calculations

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

	2017			2016		
	LTIP	3 year scheme	SAYE 5 year scheme	LTIP	3 year scheme	SAYE 5 year scheme
Share price at grant date (pence)	2,236	2,222	2,222	2,167	2,151	2,151
Option life (years)	3	3½	5½	3	3½	5½
Vesting period (years)	3	3	5	3	3	5
Expected volatility (%)	18.2	18.2	18.2	18.2	18.2	18.2
Expected dividend yield (%)	3.7	3.7	3.7	3.7	3.7	3.7
Risk free rate (%)	n/a	0.1	0.5	n/a	0.8	1.3
Fair value per share (pence)	2,224	407	429	1,938	363	362

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Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

36 Share based payments – group (continued)

d) Fair value calculations (continued)

Expected volatility is measured over the three years prior to the date of grant of the awards or share options. Volatility has been calculated based on historical share price movements.

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

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

37 Acquisitions – group

On 15 February 2017, Severn Trent Water Limited acquired Dee Valley Group plc and all of its subsidiaries including the regulated water company Dee Valley Water plc. This acquisition was made through a scheme of arrangement under which Severn Trent Water Limited acquired 100% of the issued share capital of Dee Valley Group plc for total consideration of £84.2 million, comprising £79.0 million in cash and £5.2 million in loan notes redeemable on demand.

The acquisition represents an opportunity for the group to deliver attractive returns to its shareholders through applying its successful operating model across an enlarged asset based, in a contiguous geographic area.

The acquisition has been accounted for using the acquisition method. Goodwill of £66.0 million has been capitalised attributable to the anticipated future synergies and outperformance arising as a result of the acquisition.

No goodwill related to these acquisitions is expected to be deductible for tax purposes.

The residual excess over the net assets acquired has been recognised as goodwill.

	£m
Fair values on acquisition	
Property, plant and equipment	126.5
Inventories	0.4
Trade and other receivables	16.2
Cash and cash deposits	1.3
Retirement benefit surplus	9.8
Borrowings	(87.9)
Trade and other payables	(16.1)
Deferred income	(19.8)
Current tax	0.3
Deferred tax	(12.5)
Net assets acquired	18.2
Goodwill	66.0
Total consideration	84.2
Satisfied by:	
Cash	79.0
Loan notes issued	5.2
	84.2
Net cash flows arising on acquisition:	
Cash consideration	(79.0)
Cash and cash deposits acquired	1.3
	(77.7)

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

37 Acquisitions – group (continued)

	£m
Dee Valley Group plc for the period since acquisition to 31 March 2017:	
Revenue	2.2
Loss before tax	(0.4)
Severn Trent Water group combined for the year ended 31 March 2017 if acquisition happened on 1 April 2016:	
Revenue	1,578.3
Profit before tax	335.0

The fair values included above are based on management's best estimates of the values as at 15 February 2017 based on all available data that has been received since that date. Given the proximity to the year end, full detailed fair value exercises have not yet been completed on all assets and liabilities acquired. Therefore, the amounts recognised for these assets and liabilities are provisional.

As outlined by IFRS 3, management has until the earliest of the date at which all information required is received or one year from the acquisition date in order to satisfy the measurement period criteria.

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

38 Discontinued operations

Water Plus joint venture

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

The results of the discontinued operations were as follows:

	2017	2016
	Non-household retail £m	Non-household retail £m
Turnover	3.8	26.6
Total operating costs	(4.1)	(6.4)
(Loss)/profit before tax	(0.3)	20.2
Attributable tax credit/(charge)	0.1	(4.0)
(Loss)/profit for the year	(0.2)	16.2
Attributable to:		
Owners of the company	(0.2)	16.2
Non-controlling interests	–	–
	(0.2)	16.2

The group and company did not dispose of any assets during this disposal.

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

	2017	2016
	Non-household retail £m	Non-household retail £m
Cash flow from operating activities	0.2	16.2

The group and company did not recognise any cash flows from the disposal.

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Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

39 Cash flow statement

a) Reconciliation of operating profit to operating cash flows

	Group		Company	
	2017 £m	2016 £m	2017 £m	2016 £m
Profit before interest and tax from continuing operations	540.4	499.5	540.3	499.5
(Loss)/profit before interest and tax from discontinued operations	(0.3)	20.2	(0.3)	20.2
Profit before interest and tax	540.1	519.7	540.0	519.7
Depreciation of property, plant and equipment	302.7	290.3	302.6	290.3
Amortisation of intangible assets	17.4	19.9	17.4	19.9
Exceptional pension service credit	(17.3)	(0.7)	(17.3)	(0.7)
Defined benefit pension scheme administration costs	3.3	2.3	3.3	2.3
Defined benefit pension scheme contributions	(33.2)	(25.7)	(33.2)	(17.5)
Share based payments charge	6.0	5.0	6.0	5.0
Profit on sale of property, plant and equipment and intangible assets	(10.2)	(2.9)	(10.2)	(2.9)
Deferred income movement	(13.9)	(10.5)	(13.9)	(10.5)
Provisions charged to the income statement	9.4	4.8	9.4	4.8
Utilisation of provisions for liabilities and charges	(1.7)	(2.2)	(1.7)	(2.2)
Operating cash flows before movements in working capital	802.6	800.0	802.4	808.2
(Increase)/decrease in inventory	(0.3)	0.3	(0.3)	0.3
Decrease in amounts receivable from related companies	2.9	4.8	2.9	4.8
Decrease/(increase) in amounts receivable	58.4	(13.7)	57.6	(15.4)
(Decrease)/increase in amounts payable	(11.7)	8.4	(8.0)	10.8
Cash generated from operations	851.9	799.8	854.6	808.7
Tax paid	(37.9)	(20.0)	(36.3)	(19.3)
Net cash generated from operating activities	814.0	779.8	818.3	789.4

b) Non-cash transactions

No additions to property, plant and equipment during the year were financed by new finance leases (2016: nil). Assets transferred from developers and under the Private Drains and Sewers legislation at no cost were recognised at their fair value of £51.4 million (2016: £24.8 million).

c) Exceptional cash flows

	Group and company	
	2017 £m	2016 £m
Restructuring costs	–	(3.0)
Disposal of fixed assets	11.0	–
Costs of pension exchange arrangement	(0.7)	–
	10.3	(3.0)

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

39 Cash flow statement

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

Group

	As at 1 April 2016	Cash flow	Fair value adjustments	RPI uplift on index-linked debt	Foreign exchange	Other non- cash movements	As at 31 March 2017
Cash and cash equivalents	–	0.2	–	–	–	–	0.2
Bank overdraft	(2.8)	(0.8)	–	–	–	–	(3.6)
Net cash and cash equivalents	(2.8)	(0.6)	–	–	–	–	(3.4)
Loans payable to parent	(53.0)	46.6	–	–	–	–	(6.4)
Bank loans	(1,212.2)	175.0	–	(2.8)	–	3.1	(1,036.9)
Other loans	(3,456.4)	(398.0)	(16.3)	(25.9)	(15.4)	(95.8)	(4,007.8)
Finance leases	(117.2)	1.5	–	–	–	–	(115.7)
Cross currency swaps	28.1	–	15.1	–	–	0.2	43.4
Loans due from joint ventures	–	99.7	–	–	–	(0.1)	99.6
Net debt	(4,813.5)	(75.8)	(1.2)	(28.7)	(15.4)	(92.6)	(5,027.2)

Other non-cash movements on other loans includes £87.9m debt on acquisition of Dee Valley (note 37).

Company

	As at 1 April 2016	Cash flow	Fair value adjustments	RPI uplift on index-linked debt	Foreign exchange	Other non- cash movements	As at 31 March 2017
Bank overdraft	(4.2)	(0.7)	–	–	–	–	(4.9)
Loans receivable from other group companies	109.6	22.9	–	–	–	(77.3)	55.2
Loans payable to other group companies	(3,340.3)	(397.9)	(3.5)	(25.9)	–	(109.3)	(3,876.9)
Bank loans	(1,212.2)	175.0	–	(2.8)	–	3.1	(1,036.9)
Other loans	(474.6)	–	(12.8)	–	(15.4)	(58.5)	(561.3)
Finance leases payable	(200.8)	16.1	–	–	–	–	(184.7)
Intercompany finance leases payable	(205.3)	3.1	–	–	–	–	(202.2)
Finance leases receivable from other group companies	100.3	(0.6)	–	–	–	–	99.7
Cross currency swaps	28.1	–	15.1	–	–	0.2	43.4
Loans due from joint ventures	–	99.7	–	–	–	(0.1)	99.6
Net debt	(5,199.4)	(82.4)	(1.2)	(28.7)	(15.4)	(241.9)	(5,569.0)

Other non-cash movements include the carrying value of Dee Valley debt on acquisition and the balances associated with the new asset backed funding arrangement.

40 Contingent liabilities – group and company

a) Bonds and guarantees

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

b) Banking arrangements

The banking arrangements of the group operate on a pooled basis with certain fellow group undertakings. Under these arrangements participating companies guarantee each others balances only to the extent that their credit balances can be offset against overdrawn balances of other Severn Trent group companies.

At 31 March 2017 the group's maximum liability under these arrangements was £nil million (2016: £1.4 million). At 31 March 2017 the company's maximum liability under these arrangements was £nil million (2016: £nil million).

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Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

41 Financial and other commitments – group and company

a) Investment expenditure commitments

Capital commitments are as follows:

	2017 £m	2016 £m
Contracted for but not authorised in the financial statements	221.0	130.8

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

b) Leasing commitments

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

	2017 £m	2016 £m
Within 1 year	1.1	1.4
1 - 5 years	3.1	4.7
After more than 5 years	4.1	5.1
	8.3	11.2

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

42 Post balance sheet events – group and company

There are no post balance sheet events.

43 Related party transactions – group and company

Transactions between the company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not included in this note. Transactions between the group, joint ventures and ultimate parent Severn Trent Plc are disclosed below.

Trading transactions

	Transactions with fellow subsidiary undertakings		Transactions with ultimate parent		Transactions with related parties	
	2017 £m	2016 £m	2017 £m	2016 £m	2017 £m	2016 £m
Sale of services	1.6	1.7	–	–	310.5	–
Purchase of services	6.9	7.3	–	1.4	–	–
Net interest income/(expense)	–	–	0.9	(0.2)	0.9	–
Amounts due from related parties	6.4	8.3	3.2	1.7	34.1	–
Amounts due to related parties	(1.7)	(2.1)	(0.7)	(0.3)	(8.8)	–
Net interest charge due to related parties	–	–	–	(0.1)	–	–
Loans due from related parties	–	–	–	–	100.0	–
Loans due to related parties	–	–	(6.5)	(53.0)	–	–
Dividends payable to related parties	(195.5)	(310.0)	–	–	–	–
	(182.3)	(294.8)	(3.1)	(50.5)	436.7	–

The related parties are fellow subsidiary undertakings of the ultimate parent Severn Trent Plc. All outstanding balances will be settled within one year, including loans.

Severn Trent Water Limited

Notes to the group and company financial statements (continued)

For the year ended 31 March 2017

43 Related party transactions – group and company (continued)

Remuneration of key management personnel

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

The remuneration of the directors is included within the amounts disclosed below.

	2017	2016
	£m	£m
Short term employee benefits	7.2	6.0
Post employment benefits	–	0.1
Share based payments	3.1	2.7
	10.3	8.8

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

44 Ultimate parent undertaking

The immediate parent undertaking is Severn Trent Draycote Limited.

The ultimate parent undertaking and controlling party is Severn Trent Plc, which is the parent undertaking and controlling party of the smallest and largest group to consolidate these financial statements. Copies of the Severn Trent Plc consolidated financial statements can be obtained from Severn Trent Plc's registrars at Equiniti, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6DA.