We are committed to the highest standards of corporate governance

GOVERNANCE AND REMUNERATION

Chairman's letter to shareholders

"We are committed to carrying out our business in a responsible way for the benefit of all our stakeholders."

Sir John Parker
Chairman

Dear Shareholder

I am pleased to introduce the corporate governance report for 2018 on behalf of the Board. This is the principal method of reporting to our shareholders on the Board's governance policies and the practical application of the principles of good corporate governance.

At Pennon we consider that strong governance is central to our successful management of the Group. It provides the framework for effective delivery of our strategy, the creation of shareholder value and the ongoing development of our sustainable business. In my third year as Chairman of Pennon, I remain committed to ensuring that we continue to operate to the highest standards of corporate governance.

Additional complexity is added to Pennon's governance structure as a result of our ownership of a regulated water and wastewater business, South West Water, alongside our non-regulated businesses. In order to comply with the requirements of Ofwat, South West Water is required to have its own independent board of directors and to operate as if it were a publicly listed company in its own right.

We consider that our board and committee framework has enabled us successfully to streamline our decision-making processes such that we avoid duplication. The South West Water board, which includes all of the Pennon Non-Executive Directors, as well as three South West Water only non-executive directors, convenes before each Pennon Board meeting and considers South West Water strategy, performance and regulatory planning. In its meetings the Pennon Board concentrates on strategic forward-looking matters for all parts of the Group, as well as overseeing the Viridor businesses.

Role of the Board and its effectiveness

My primary role as Chairman is to provide leadership to the Board and to provide the right environment to enable each of the Directors and the Board as a whole to perform effectively to promote the success of the Company for the benefit of its stakeholders.

It is my view that the Board is highly effective with a good understanding of the Group's opportunities for growth as well as the threats facing the business. This view is supported by the results of this year's Board and Committee performance evaluations. Further details are provided on page 71 and 72.

Stakeholder engagement

The Board understands the part the Group can play in bringing resources to life and creating a more sustainable UK. We are committed to carrying out our business in a responsible way and remain focused on improving the provision of water and waste services for benefit of all of our stakeholders.

We actively engage with our customers, our communities, our people and our suppliers, as well as with our investors, and maintain appropriate and regular dialogue with those stakeholders to ensure that the rationale for our strategy and our performance objectives reflects their expectations. It also allows stakeholders to provide feedback on the matters they consider to be important and any issues which require addressing.

Further information about the stakeholder engagement mechanisms we use to gather feedback is available on our website.

READ MORE ONLINE
www.pennon-group.co.uk/sustainability

Our shareholders are a key stakeholder group and we have a comprehensive investor relations programme. During the year some 81 meetings and conference calls were held. Pennon attended eight city conferences and sales force briefings and six road shows, including in the USA and mainland Europe. This engagement covered both current and prospective shareholders, the majority of which are institutional, with the remainder being a selection of large private client investment managers.

The Chief Financial Officer continues to report to the Board regularly on major shareholders' views about the Group, and every six months the Company's corporate brokers present to the Board on equity market developments and shareholder perceptions. This ensures that the Board is fully briefed on the views and aspirations of shareholders.

It is always pleasing to be part of a well-attended AGM and I welcome questions on any business issues affecting the Group. At our 2018 AGM on 5 July, all of our Directors intend to be present together with a number of other senior executives of our businesses to meet shareholders and further explain developments at Pennon.

Compliance with the UK Corporate Governance Code and other requirements

I am pleased to report that throughout the year the Company complied with the provisions and applied the main principles set out in the UK Code with no exceptions to report. The UK Code is published on the Financial Reporting Council (FRC) website, www.frc.org.uk. In accordance with the FRC's requirements, we have reported against the April 2016 version of the Code, which is effective for reporting periods commencing on or after 17 June 2016.

In addition, as the holding company of South West Water Limited, the Company has complied with Ofwat's principles for holding companies in respect of Board leadership, transparency and governance.

My introduction to this corporate governance report and the following sections are made in compliance with the UK Code, Financial Conduct Authority (FCA) Listing Rule 9.8.6 and FCA Disclosure and Transparency Rules 7.1 and 7.2 and cover the work of our Board and its Committees, our internal control systems and procedures including risk management, our corporate governance statements relating to share capital and control, our confirmation of the Company as a going concern and Directors' responsibility statements. Finally, in accordance with reporting requirements, on page 105 the Board confirms to shareholders that the Annual Report and Accounts taken as a whole is fair, balanced and understandable and provides the information necessary to assess the Company's performance, business model and strategy.

Sir John Parker
Chairman

Pennon Group plc
24 May 2018


Beddington energy recovery facility

Board of Directors

Sir John Parker
Chairman

GBE, FREng, DSc (Eng), ScD (Hon), DSc (Hon), DUniv (Hon), FRINA

Sir John was appointed to the Board as Deputy Chairman on 1 April 2015 and became Chairman on 1 August 2015. He is also chairman of the Nomination Committee.

Skills and experience
Sir John is a highly experienced and independent chairman and brings a wealth of leadership experience across a range of industries. He is widely recognised for his policy work on the value of diversity in the boardroom, having chaired the Government's review on Ethnic Diversity on UK Boards in 2017. Prior to that, he was a member of the Davies Committee – Women on Boards.

He has chaired five FTSE 100 companies and was previously the chairman of Anglo American plc (until October 2017) and National Grid plc, senior non-executive director and chair of the Court of the Bank of England, deputy chairman of DP World, joint chair of Mondi and chair of BVT and P&O plc. He was also president of the Royal Academy of Engineering from 2011 to 2014 and is a Visiting Fellow of the University of Oxford.

Since his appointment as Chairman, Sir John has brought the Group together under a revised governance framework that features a new role of Group Chief Executive Officer and other senior positions. The new team is working together collaboratively to drive forward the Group's strategy.

External appointments
Sir John is the chairman of construction and engineering company Laing O'Rourke and of Advanced Plasma Power Limited. He is also a non-executive director of Carnival Corporation and Airbus Group. He is a senior adviser to Spencer Stuart and is the senior non-executive director on the Cabinet Office board.

Christopher Loughlin
Chief Executive Officer

BSc Hons, MICE, CEng, MBA

Chris was appointed to the Board on 1 August 2006 upon joining Pennon as Chief Executive of South West Water. He became the Group Chief Executive Officer on 1 January 2016. Chris is chairman of the Pennon Executive and a member of the Sustainability Committee.

Skills and experience
Chris has extensive experience of the regulated business environment and the management of major engineering and infrastructure services. He started his career as a chartered engineer working in both the consulting and contracting sectors and, after holding a number of senior positions with British Nuclear Fuels plc, joined its board as an executive director. Prior to joining Pennon, he was chief operating officer with Lloyds Register and before that, executive chairman of Magnox Electric plc. He was also a senior diplomat in the British Embassy, Tokyo.

Chris has a comprehensive understanding of the water industry. He was previously a board member (and, for a period, president) of the Institute of Water, and between April 2008 and March 2012 was chairman of Water UK.

Since his appointment as Group Chief Executive Officer, Chris has set Pennon on a path of closer collaboration in pursuit of delivery of its strategy, with the constituent parts of the Group now working together to identify synergies, reduce costs and exploit opportunities for growth.

External appointments
Chris is currently chairman of British Water, a director of Water UK and a trustee of the charity WaterAid. An enthusiastic advocate of local business, Chris is also vice chairman of the Cornwall Local Enterprise Partnership.

Susan Davy
Chief Financial Officer

BSc Hons, ACA

Susan joined the Board on 1 February 2015. She is a member of the Sustainability Committee and the Pennon Executive.

Skills and experience
Susan is a graduate qualified chartered accountant with 20 years' experience in the utility sector. Prior to her current appointment, Susan was Finance Director at South West Water between 2007 and 2015, during which time she was responsible for the company's Business Plan to 2020. She has also held a number of other senior finance roles in the water sector, including as Head of Regulation and Head of Finance (Wastewater) at Yorkshire Water.

Susan's knowledge of the industry coupled with her financial and regulatory expertise has supported the development of Pennon's strategy and her input has been invaluable to the Board in its deliberations. Susan is highly respected in the City and has been instrumental in building Pennon's reputation.

External appointments
Susan is chair of the CBI South West council and a member of the A4S (Accounting for Sustainability) CFO leadership network.

Board Committee members

- Pennon Executive
- Audit Committee
- Sustainability Committee
- Nomination Committee
- Remuneration Committee
- Chair of Committee

Gill Rider
Senior Independent Director (Non-Executive)

CB, PhD, CCIPD

Gill was appointed to the Board on 1 September 2012. She is chairman of the Sustainability Committee and a member of the Audit, Remuneration and Nomination Committees.

Skills and experience
Gill has a wealth of experience in leadership, governance and remuneration across a broad range of sectors, including professional services, education and government.

Formerly, she was head of the Civil Service Capability Group in the Cabinet Office, reporting to the Cabinet Secretary and prior to that held a number of senior positions with Accenture LLP, culminating in the post of chief leadership officer for the global firm. She was previously president of the Chartered Institute of Personnel and Development and a non-executive director of De La Rue plc.

As chairman of the Sustainability Committee, Gill has encouraged and supported executive management in the development of a sustainability programme that underpins the delivery of Pennon's strategy. At Accenture she chaired the global corporate responsibility and Foundation giving programme and was instrumental in building sustainability objectives into Accenture's worldwide human capital strategies.

External appointments
Gill currently holds non-executive directorships with Charles Taylor plc, where she is senior independent director, and Intertek Group plc. She is chairman of both their remuneration committees. She is also chair of the council (board) of the University of Southampton.

Martin Angle
Independent Non-Executive Director

BSc Hons, FCA, MCSI

Martin was appointed to the Board on 1 December 2008. He is chairman of the Remuneration Committee and a member of the Audit, Nomination and Sustainability Committees.

Skills and experience
Martin is an experienced non-executive director, bringing a wide range of knowledge and experience from a career in investment banking, private equity and industry.

Over a 20-year executive career in investment banking, Martin held senior roles with SG Warburg & Co. Ltd, Morgan Stanley and Dresdner Kleinwort Benson, before becoming the group finance director of TI Group plc, then a FTSE 100 company. He subsequently joined Terra Firma Capital Partners, where he held various senior roles in its portfolio companies, including the executive chairmanship of the Waste Recycling Group Limited, then a major participant in the UK waste sector, and Le Meridien Hotel Group, where he was executive deputy chairman.

Martin has also served as a non-executive director on a number of boards including Savills plc, where he was the senior independent director; National Exhibition Group, where he was chairman; Severstal; and Dubai International Capital.

As chairman of the Remuneration Committee, Martin has steered Pennon's approach on executive remuneration, ensuring that it is aligned with and supports the Group's strategy.

External appointments
During the year, Martin was vice chairman and non-executive director of the FIA Foundation, the adviser to the Board of the Commercial Bank of Dubai and the adviser to NGP, a private group based in the USA, which is building out a major platform in renewable energy in emerging markets.

Neil Cooper
Independent Non-Executive Director

BSc Hons, FCMA

Neil joined the Board on 1 September 2014. He is chairman of the Audit Committee and a member of the Remuneration and Nomination Committees.

Skills and experience
Neil brings to the Board extensive experience in a wide variety of corporate and financial matters. He is currently the chief financial officer of Currencies Direct, a foreign exchange broker and international payment provider. Previously, he was group finance director of Barratt Developments plc and, before that, group finance director of William Hill plc and Bovis Homes plc. He also held senior finance positions at Whitbread plc, worked for PricewaterhouseCoopers as a management consultant and held a number of roles with Reckitt & Colman plc.

As chairman of the Audit Committee, Neil has been influential in directing Pennon's approach on a number of significant matters, including internal control, governance and financial reporting.

External appointments
Executive Director, Currencies Direct.

Helen Barrett-Hague
Group General Counsel and Company Secretary

Solicitor, LLB Hons

Helen joined Pennon as Group General Counsel & Company Secretary to the Board in March 2016.

Skills and experience
Helen has extensive corporate experience, including capital raisings, initial public offerings, corporate restructuring, mergers and acquisitions, both in the UK and overseas. She began her career in private practice before moving in-house in 1999 and holding positions of increasing responsibility with PA Consulting, Generics Group AG, Aveva Group plc and Alent plc.

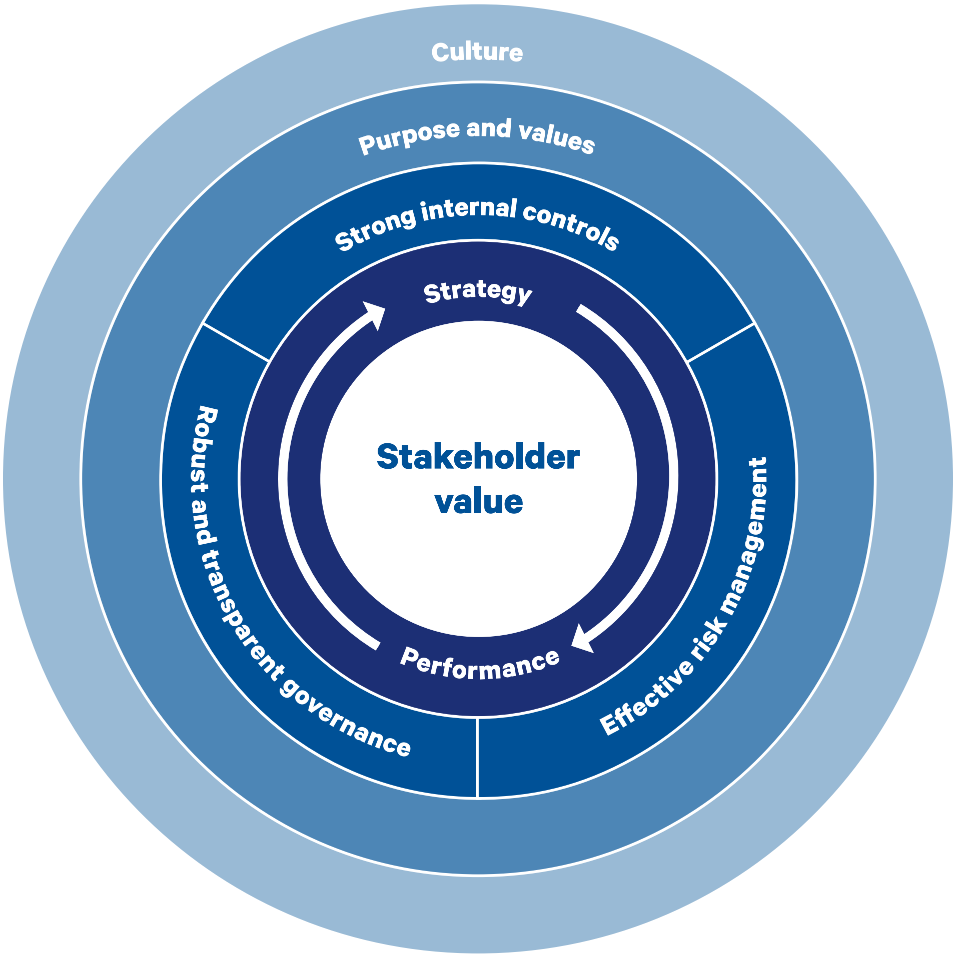
Helen is responsible for the provision of legal and company secretarial services to the Group, for statutory and regulatory compliance in terms of business conduct, and for supporting the Chairman and the Board in ensuring that Pennon's high standards of governance continue to be met. She is also chairman of the board of trustees of the Pennon Group Defined Contribution Pension Scheme.

External appointments
None.

The Board and its governance framework

The Board acts as the main governing body for the purpose of oversight for the Group with additional supervision of the regulated business of South West Water being provided by South West Water's own board. Our approach to governance is an integral part of our culture, guiding how we do business and create value for our stakeholders.

READ MORE ON PAGES 14 & 15



Stakeholder value
We deliver sustainable value for our stakeholders by providing high-quality environmental infrastructure and customer services.

Strategy
Our strategy is to lead in the UK's water and waste sectors, invest for sustainable growth and drive value through efficiency.

Performance
Our financial and operational performance is driven by our strategic sustainability objectives.

Robust and transparent governance
We are committed to operating to the highest standards of corporate governance.

Effective risk management
We have a mature integrated risk management framework which is embedded into existing governance structures and ways of working.

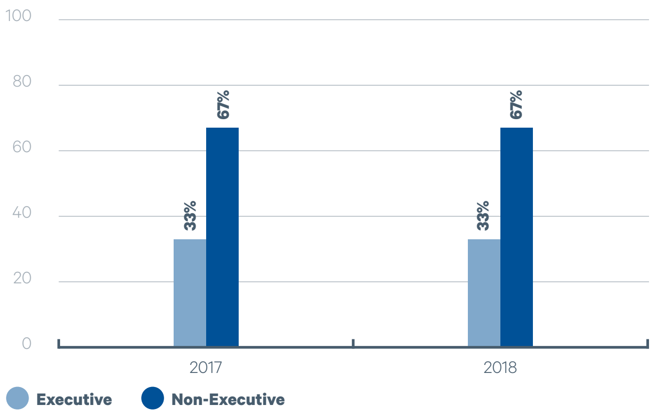
Strong internal controls
We keep the effectiveness of our internal control environment under regular review and seek continually to improve our approach.

Vision and values
Our Vision of 'Bringing resources to life' and supporting values of 'trusted, responsible, collaborative and progressive' will help drive our strategic priorities over the long term.

Culture
We are developing a culture that can be lived throughout the Group with integrity and transparency, ensuring Pennon is trusted and valued by all its stakeholders.

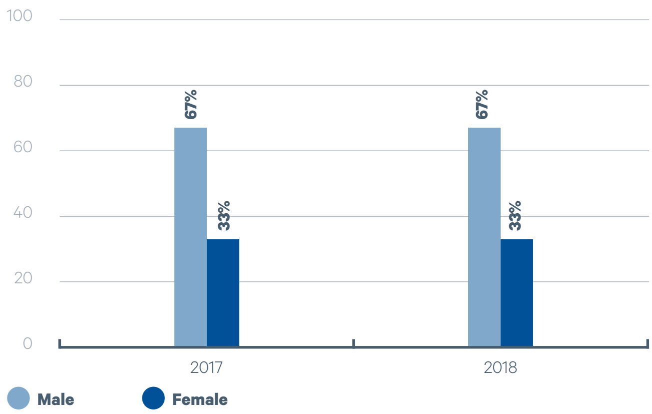
Pennon Board composition, independence and experience

Composition as at 31 March



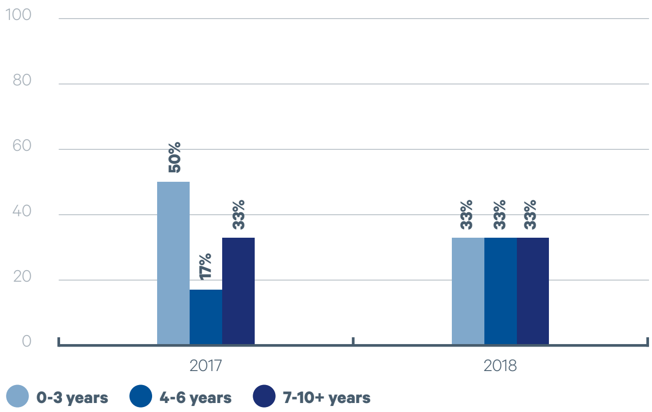
At the end of the year the Board of Directors comprised the Chairman, two Executive Directors and three Non-Executive Directors.

Diversity as at 31 March

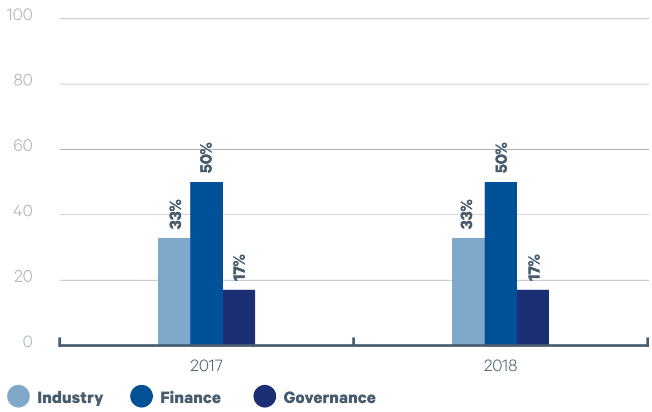


The Board continued to exceed its target of 25% female representation throughout the year and at the year end it was 33.3%

Tenure as at 31 March



Experience as at 31 March



All of the Non-Executive Directors were considered by the Board to be independent throughout the year. None of the relationships or circumstances set out in provision B.1.1 of the UK Corporate Governance Code (the UK Code) applied to the Non-Executive Directors listed on the following page. Given the longer service of Martin Angle and Gill Rider on the Board, a particularly rigorous review was undertaken in respect of their respective re-elections. Martin Angle will be stepping down from the Board in December 2018 in order to allow for continuity with a replacement. Gill Rider will soon reach the six-year anniversary of her appointment and the Board has agreed that her term be extended for a further three years, subject to annual re-election at each AGM. The Board is satisfied that, based on their participation at meetings and their contribution outside of the boardroom, both Martin Angle and Gill Rider continue to demonstrate independence of character and judgement in the performance of their role.

Sir John Parker met the independence criteria set out in provision B.1.1 of the UK Code on his appointment as Chairman and there have been no significant changes to his overall external commitments since his appointment.

All Directors are subject to re-election each year in accordance with provision B.7.1 of the UK Code.

All the Non-Executive Directors are considered to have the appropriate skills, experience in their respective disciplines and personality to bring independent and objective judgement to the Board's deliberations. Their biographies on pages 66 and 67 and the experience chart above demonstrates collectively a broad range of business, financial and other relevant experience.

Directors' roles

Neil Cooper is chairman of the Audit Committee and in accordance with the UK Code and FCA Disclosure and Transparency Rule 7.1.1 he has recent and relevant financial experience (as set out in his biography on page 67).

There is a clear separation of responsibilities between the Chairman and the CEO, divided between managing the Board and the business, while they of course maintain a close working relationship.

The Board and its governance framework continued

All the Directors are equally accountable for the proper stewardship of the Group's affairs but they do have specific roles, which include those set out below:

Position	Director	Role
Chairman	Sir John Parker	• Leading the Board and setting its agenda • Promoting the highest standards of integrity and probity and ensuring good and effective governance • Managing Board composition, performance and succession planning • Providing advice, support and guidance to the CEO • Representing the Group and being available to shareholders • Discussing separately with the Non-Executive Directors performance and strategic issues
Chief Executive Officer	Chris Loughlin	• Managing the Group and providing executive leadership • Developing and proposing Group strategy • Leading the operation of the Group in accordance with the decisions of the Board • Co-ordinating with the Chairman on important and strategic issues of the Group and providing input to the Board's agenda • Contributing to succession planning and implementing the organisational structure • Leading on acquisitions, disposals, business development and exploiting Group synergies • Managing shareholder relations
Senior Independent Director	Gill Rider	• Assisting the Chairman with shareholder communications and being available as an additional point of contact for shareholders • Being available to other Non-Executive Directors if they have any concerns that are not satisfactorily resolved by the Chairman • Leading the annual evaluation of performance of the Chairman with the other Non-Executive Directors
Chief Financial Officer	Susan Davy	• Supporting the CEO in providing executive leadership and developing Group strategy • Reporting to the Board on performance and developments across the business • Implementing decisions of the Board • Managing specific business responsibilities • Managing investor relations including financing and treasury activities
Non-Executive Directors	Martin Angle Neil Cooper Gill Rider	• Critically reviewing the strategies proposed for the Group • Critically examining the operational and financial performance of the Group • Evaluating proposals from management and constructively challenging management's recommendations • Contributing to corporate accountability through being active members of the Committees of the Board.

Board meetings and attendance

The Directors and their attendance at the nine scheduled meetings of the Board during 2017/18 are shown below:

Members	Appointment date	Attendance
Chairman		
Sir John Parker	April 2015	9/9
Non-Executive Directors		
Martin Angle	December 2008	8/9
Neil Cooper	September 2014	9/9
Gill Rider	September 2012	9/9
Executive Directors		
Susan Davy	February 2015	9/9
Christopher Loughlin	August 2006	9/9

In addition to the nine Board meetings we hold a strategy day in September of each year.

Managing the Group and its subsidiaries

The Board's responsibilities include overall leadership of the Group, setting the Group's values, policies and standards, approving Pennon's strategy and objectives and providing oversight of the Group's operations and its performance. The Board makes decisions in relation to the Group's business in accordance with its schedule of matters reserved. The South West Water board continues to operate as a separate independent board in accordance with its own schedule of matters reserved to ensure compliance with Ofwat's principles on board leadership, transparency and governance.

Detailed consideration of certain matters is delegated to Board Committees, to the Executive Directors and to the Group General Counsel and Company Secretary, as appropriate. In addition to the matters the Directors are required to decide by statute or regulation, the matters reserved to the Board include:

- all acquisitions and disposals
- major items of capital expenditure
- authority levels for other expenditure
- risk management process and monitoring of risks
- approval of the strategic plan and annual operating budgets
- Group policies, procedures and delegations
- appointments to the Board and its Committees.

The Board also ratifies certain decisions taken by the South West Water board, including major capital projects and investments, long-term objectives and commercial strategy, the five-year regulatory plan, annual budgets and certain decisions relating to financing. This approach is compatible with Ofwat's principles for holding companies in respect of Board leadership, transparency and governance.

Operation of the Board

The Board operates by receiving written reports circulated in advance of the meetings from the Executive Directors and the Group General Counsel & Company Secretary on matters within their respective business areas of the Group. The Board also receives presentations on key areas of the business and undertakes site visits to meet employees and gain a better understanding of the operation of business initiatives.

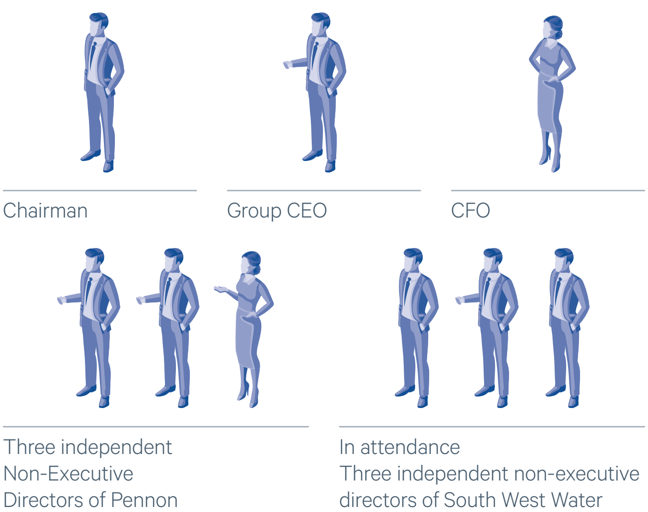
Board visit to Plymouth sites

In February 2018 the Board visited two sites in Plymouth; South West Water's innovative Mayflower water treatment works, which is due to become operational this autumn, and Viridor's materials recycling facility, the location of the first pilot for our new health and safety programme, HomeSafe. Further details on each of these projects are provided on pages 39 and 26.

Under the guidance of the Chairman, all matters before the Board are discussed openly. Presentations and advice are received frequently from other senior executives within the Group and from external advisers to facilitate the decision-making of the Board.

In arriving at decisions the Board takes into account the impact on stakeholder groups when considering what is in the best interests of shareholders as a whole.

Pennon Board composition



Pennon Executive management

The role of the Pennon Executive is to define and drive the business priorities that will achieve delivery of the strategy. It is responsible for ensuring, to the extent of the authority delegated by the Board, the proper and prudent management of Group resources to create and maximise shareholder value whilst protecting the interests of the wider stakeholder group.

Chaired by the Chief Executive Officer, the Pennon Executive meets formally on a monthly basis to review and refine recommendations to be presented to the Board.

Members of the Pennon Executive	
Chris Loughlin	Chief Executive Officer
Susan Davy	Chief Financial Officer
Stephen Bird	Managing Director, South West Water
Phil Piddington	Managing Director, Viridor
Helen Barrett-Hague	Group General Counsel and Company Secretary
Adele Barker	Group director of Human Resources
Steve Holmes	Director of Safety, Health, Quality & Sustainability (SHQS)
Ed Mitchell	Director of Environment and Operations director (Wastewater Services), South West Water
Sarah Heald	Director of Corporate Affairs & Investor Relations
Paul Ringham	Commercial director, Viridor
Bob Taylor	Operations director (Drinking Water Services), South West Water

Board support and training

Directors have access to the advice and services of the Group Company Secretary, and the Board has an established procedure whereby Directors, in order to fulfil their duties, may seek independent professional advice at the Company's expense.

Newly appointed Directors receive a formal induction, which includes an explanation of the Group structure, regulatory and legal issues, the Group governance framework and policies, the Group's approach to risk management and its principal risks (financial and non-financial, including environmental, social and governance (ESG) risks), duties and obligations (including protocols around conflicts of interest and dealing in shares), and the current activities of the Board and its Committees. Directors also visit operating facilities across the Group and meet with staff to receive briefings on key processes and systems.

The training needs of Directors are reviewed as part of the Board's performance evaluation process each year. Training consists of attendance at external courses organised by professional advisers and also internal presentations from senior management.

Performance evaluation

The Board undertakes a formal and rigorous review of its performance and that of its Committees and Directors each year. Having carried out an externally facilitated evaluation last year, this year the evaluation of the Board's and the Committees' performance was carried out in March 2018 by means of a questionnaire created internally by the Group General Counsel and Company Secretary in consultation with the Chairman and Chairs of the various committees. As well as the Directors, the questionnaire was completed by various members of the senior executive team, the external audit partner and the adviser to the Remuneration Committee.

The questions were designed to assess the effectiveness of the Board during the year in setting the Group's strategy, promoting Pennon's culture and values, ensuring that the Group's obligations to its shareholders and other stakeholders were understood and met, overseeing the use of the Group's resources, managing the risks inherent in the strategy, plans and the operating environment, and ensuring that the executive team had managed all the activities of the Company well.

The Board and its governance framework
continued

The Senior Independent Director separately conducted a review of the individual directors' performance and the Chairman's performance was evaluated separately by the Non-Executive Directors, led by the Senior Independent Director.

The review concluded that the Board, its Committees and its individual Directors had demonstrated a high degree of effectiveness and that the Board had a good understanding of opportunities for growth and the threats facing the business, as well as its role in setting Pennon's values and standards to ensure that its obligations to its stakeholders are met. The Board's commitment to promoting a strong health and safety culture across the Group was noted. The Board and each Committee considered the conclusions and recommendations arising from the evaluation process, which included areas specifically relating to diversity and succession planning, as well as continuing to address the Directors' training and development needs.

Board Committees' terms of reference

In accordance with Group policies, a range of key matters are delegated to the Board's Committees as set out on pages 73 to 83 of this governance report.

The terms of reference of each of the Board's Committees are set out on the Company's website **www.pennon-group.co.uk** and are also available from the Group Company Secretary upon request.

READ MORE ONLINE
www.pennon-group.co.uk/about-us/board-committees

Dealing with Directors' conflicts of interest

In accordance with the directors' interest provision of the Companies Act 2006 and the Company's Articles of Association, the Board has in place a procedure for the consideration and authorisation of Directors' conflicts or possible conflicts with the Company's interests. This has operated effectively during the year.

Risk management and the Group's system of internal control

The Board is responsible for maintaining the Group's system of internal control to safeguard shareholders' investment and the Group's assets and for reviewing its effectiveness. The system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss. There is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group that has been in place throughout 2017/18 and up to the date of the approval of this annual report and accounts.

The Group's system of internal control is consistent with the FRC's 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' (FRC Internal Control Guidance).

The Board confirms that it applies procedures in accordance with the UK Code and the FRC's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting, which brings together elements of best practice for risk management and internal control by companies. The Board's risk framework described on pages 52 to 54 in the strategic report provides for the identification of key risks, including ESG risks, in relation to the achievement of the business objectives of the Group, monitoring of such risks and ongoing and annual evaluation of the overall process. ESG risks identified and assessed by the Board cover areas such as health and safety, climate change, changes to government policy on waste and recycling, and tax compliance. Details of the key risks affecting the Group are set out in the strategic report on pages 55 to 60. KPIs are in place to enable the Board to measure the Company's ESG performance (pages 24, 25 and 28 to 40) and a number of these are linked to remuneration incentives (pages 91, 93 and 94).

As part of the review of the effectiveness of the system of risk management and internal control under the Group risk management policy, all Executive Directors and senior managers are required to certify on an annual basis that they have effective controls in place to manage risks and to operate in compliance with legislation and Group procedures.

The Group's processes and policies serve to ensure that a culture of effective control and risk management is embedded throughout the Group and that the Group is in a position to react appropriately to new risks as they arise. Details of key risks affecting the Group are set out in the strategic report on pages 55 to 60.

Code of Conduct and policies

The Group's Code of Conduct and related policies set out Pennon's commitment to promoting and maintaining the highest level of ethical standards. Areas covered include our impact on the environment and our communities, our workplace and our business conduct.

The Group's policy on anti-bribery and anti-corruption clearly prohibits any worker from offering or accepting bribes, facilitation payments and kickbacks and requires that due diligence checks be carried out before engaging a third party (including a corruption risk assessment including potential business partners of the third party and the nature of the proposed work and transaction). The policy also sets out the employment consequences for breach of the policy and potential legal sanctions under bribery laws. The policy places an obligation on workers to report any breach of the policy or any suspicions of fraud or other irregularities. The Group's whistleblowing policy ('Speak Up') encourages workers to raise concerns and explains how this should be done.

Allegations of misconduct and irregularity are thoroughly investigated and follow-up action in respect of the Group's control environment is taken when appropriate. In the normal course of business, investigations into irregularities may be ongoing as of the date of the approval of the financial statements.

Our Code of Conduct and our policies are available on our website.

READ MORE ONLINE
www.pennon-group.co.uk/sustainability

Board Committees' reports

Audit Committee report

"The role of the Audit Committee is to ensure that robust systems are in place for financial reporting, internal control and risk management."

Neil Cooper
Audit Committee Chairman

Dear Shareholder
I am pleased to introduce the Audit Committee's report on its activities during the year.

As in previous years, the principal responsibilities of the Committee continue to be focused in a number of key areas. Firstly, on ensuring the appropriateness of the Group's financial reporting; an activity that includes the testing of accounting judgements made in preparing financial reporting and the assessment of whether the presentation of the Group's activities is fair, balanced and understandable. Secondly, on reviewing and challenging the ongoing effectiveness of the internal control environment and thirdly, on the scope and adequacy of risk management processes across the Group. This includes monitoring the Group's risk appetite as well as acting as a forum for carrying out more detailed reviews of higher risk areas of the operation.

Monitoring and reviewing the effectiveness of the external auditor and the internal audit function is a further important ongoing element of the Committee's assurance activities. These responsibilities are discharged throughout the year in accordance with the calendar of business of the Committee, which is designed to allow sufficient time for their consideration whilst also permitting time to be spent on related key financial matters.

The Group's executive risk management forum continues to assess risk appetite and monitor key risks and their mitigation, with the Committee subsequently receiving detailed 'deep dive' presentations from senior management on individual principal risks. During the year, these included Group recruitment and retention risk, water resources and resilience risk, cyber security, and lastly financial resilience. More detail on our risk management processes, principal risks and their associated mitigation can be found on pages 52 to 60.

Together with this, we continue to assess the Company's viability over a period of five years, which we judge to be aligned with the longer-term nature of our business. It is also a reasonable period in terms of our ability to look forward with some certainty in the business and regulatory environment in which the Company operates. Our viability statement is reported on page 61.

The Committee acts as a forum carrying out more detailed reviews of higher-risk areas of the operation.

As part of the half-year and year-end reporting review process, we reviewed and challenged the key financial reporting judgements of management as set out on page 75. Significant matters considered by the Committee both during the year and in relation to the year-end financial statements are laid out in this report.

Finally, our long-serving Group Internal Audit Manager, Paul Ramsbottom, stepped down during the year, and I would like to thank him on behalf of the Committee for his service to the Group.

Neil Cooper
Audit Committee Chairman

Audit Committee report
continued

Audit Committee composition and meetings

	Date of appointment to Pennon Audit Committee	Attendance
Committee chairman		
Neil Cooper	September 2014	4/4
Committee members		
Martin Angle	December 2008	4/4
Gill Rider	September 2012	4/4

Other regular attendees to Committee meetings during the year included: Chief Executive Officer; Chief Financial Officer; Managing Directors of South West Water and Viridor; Group General Counsel & Company Secretary; Finance Directors of South West Water and Viridor; Director of Treasury, Tax and Group Finance; Group Audit Manager; and the external auditor.

In addition, the Board Chairman has an open invitation to attend the Committee meetings. In the last year he attended those meetings at which the Committee reviewed the half-year and full-year financial results of the Group.

In accordance with the UK Code, the Board is satisfied that Neil Cooper and Martin Angle have recent and relevant financial experience and also, in accordance with FCA Rule 7.1.1R of the FCA's Disclosure Guidance and Transparency Rules, have competence in accounting or auditing. Details of each Director's significant current and prior appointments are set out on pages 66 and 67.

All of the Committee members are also members of the Remuneration Committee, which allows them to provide input into both Committees on any Group performance matters and on the management of any risk factors relevant to remuneration matters.

Significant matters considered by the Committee

The calendar of business of the Committee sets in place a framework for ensuring that it manages its affairs efficiently and effectively throughout the year and is able to concentrate on the key matters that affect the Group.

The most significant matters that the Committee considered and made decisions on during the year and, where appropriate, since the year end, are set out below and opposite.

Financial reporting	• Monitored the integrity of the financial statements of the Group and the half-year and full-year results announcements relating to the Group's financial performance, including reviewing and discussing significant financial reporting judgements contained in the statements • After a detailed review in accordance with its established process, advised the Board that the presentation of the Annual Report and Accounts is fair, balanced and understandable in accordance with reporting requirements and recommended their approval for publication • Internal control and compliance • Review of internal audit reports on core systems and processes across the Group, for example, contract management, health and safety and an outsourced audit of Group Treasury • Reviewed our Tax Strategy prior to publication in line with the requirements set out in the Finance Act 2016 • Monitored the effectiveness of key strategic projects, including Viridor's Enterprise transformation and readiness for the new EU General Data Protection Regulations
External auditor	• Considered auditor's report on its review of the annual results focusing on key findings • Assessed external auditor effectiveness in respect of the previous year's external audit process • Recommended to the Board reappointment of the external auditor for approval at the Annual General Meeting with the Committee being authorised to agree the external auditor's remuneration • Considered and approved the audit plan and audit fee proposal for the external auditor • Reviewed the Group external audit policy and monitored the provision of non-audit services • Considered the auditor's report on control themes and observations for the year ended 2017, which did not identify any significant deficiencies
Risk management	• Reviewed the Group's risk management framework and compliance with that framework during the year and after the year end up until the publication of the Company's annual report • Reviewed the assessment of the risks by the Executive Directors and considered risk appetite • Reviewed the Group risk register and considered appropriate areas of focus and prioritisation for the audit work programme for the year which through 2017/18 has been aligned to the Group's financial year • Management of information security across the Group in mitigating key IT risks • Received as part of the risk management review the annual report on any whistleblowing • Carried out regular 'deep dives' at Committee meetings on principal risk areas
Governance	• Discussed the results of the performance evaluation of the Committee • Reviewed new annual report disclosure requirements, including the audit report • Considered and approved Group accounting policies, including the impact of new accounting standards, used in the preparation of the financial statements • Confirmed compliance with the UK Code • Regularly held separate meetings with the external auditor and the Group Internal Audit Manager without members of management being present

In respect of the monitoring of the integrity of the financial statements, which is a key responsibility of the Committee identified in the UK Code, the significant areas of judgement considered in relation to the financial statements for the year ended 31 March 2018 are set out in the following table, together with details of how each matter was addressed by the Committee. At the Committee's meetings throughout the year the Committee and the external auditor have discussed the significant matters arising in respect of financial reporting during the year, together with the areas of particular audit focus, as reported on in the independent auditor's report on pages 108 to 113. In addition to the significant matters set out in the table below, the Committee considered a range of other matters. These included presentational matters, in particular relating to the issuance and buy-back of perpetual capital securities, contingent liabilities and assets, the non-underlying disclosures and finally ensuring a fair presentation of statutory and non-statutory performance and financial measures.

During the year, the Committee's areas of focus have been:

Area of focus	How the matter was addressed by the Committee
Revenue recognition	Given the nature of the Group's business, there were a number of judgement areas in respect of revenue recognition relating to income from measured water services, estimates of timing of receipt of unmeasured revenue, accounting for revenue from long-term service concession arrangements under IFRIC 12, in particular for Glasgow Recycling and Renewable Energy Centre, where forecast construction spend has increased, and calculation of accrued income on waste management contracts and powergen. The Committee relied on South West Water's track record of assessing an appropriate level of accrual at previous year ends as compared to actual outturns and Viridor's internal processes for analysing complex long-term contracts. The Committee also closely considered the work in respect of these areas at year end by the external auditor as well as reviewing disclosures around revenue recognition accounting policies.
Non-current asset impairment review and Environmental provisions	Recognising that the value of certain non-current assets and long-term environmental provisions within Viridor can be sensitive to changes in assumptions over future discount rates and cash flow projections which require judgement, the Committee pays careful attention to asset impairment and provisions. The Committee noted the substantial headroom in the mandatory review of goodwill for impairment and management's review of evidence of indicators for potential impairment of non-current assets concluded that these areas were less sensitive to assumptions. Following a detailed review of the analysis undertaken, and consideration of management assumptions in relation to the value of environmental provisions the Committee was satisfied that a robust and consistent approach had been followed and with management's assertion that the carrying value of these liabilities remained reasonable, and therefore the Committee was able to approve the disclosures in the financial statements. This key area was also closely reviewed as part of the year-end audit by the external auditor.
South West Water bad and doubtful debts	Regular updates on progress against debt collection targets and other contractual payments due are received by the Board. Performance is monitored regularly against both South West Water's historical collection record and the track record of other companies in the sector. At the year end the external auditor reported on the work it had performed, which together with the detailed analysis reported, enabled the Committee to conclude that management's assessment of the year-end position was reasonable.
Greater Manchester contract reset	Following the renegotiation of the Greater Manchester contract and sale of the joint venture Viridor Laing (Greater Manchester) Holdings Limited to the Greater Manchester Waste Disposal Authority, judgement has been required to ensure all the various economic aspects of the reset have been fully considered in concluding the appropriate accounting treatment. In particular consideration was given to the fair value attributed to all aspects of the transaction in arriving at the amount of profit to be recognised at our TPSCo joint venture. The Committee has received detailed analysis from management in satisfying itself that this treatment is appropriate. In addition this has been a significant area of focus for the external auditor.
Glasgow Recycling and Renewable Energy Centre (GRREC) – outstanding contractual claims against Interserve	In November 2016 the lead construction contract for the GRREC was terminated due to delays and underperformance. Additional costs required to complete the project have been incurred and are now subject to claims including against the lead contractor, Interserve Construction Limited. The Committee has reviewed information on the background, quantum and likelihood of the claims recognised in accounting terms as an amount owing to the Group, considering both legal and financial analysis from management and expert third party opinions. The Committee is satisfied that the asset recognition criteria for this amount has been met and that appropriate disclosures have been made.
Going concern basis for the preparation of the financial statements and viability statement	A report from the Chief Financial Officer on the financial performance of the Group including forward-looking estimates of covenant compliance and funding levels under differing scenarios, is provided to the Board on a periodic basis. Rolling five-year strategy projections and the resultant headroom relative to borrowings is also regularly reviewed by the Board, including scenarios to enable the Committee to better understand the potential range of outcomes. At the end of each six month period the Chief Financial Officer prepares for consideration by the Committee a report focusing on the Group's liquidity over the 12-month period from the date of signing of either the annual report or half-year results. The Committee also considered a report from the Chief Financial Officer on the Group's financial viability over an appropriate period, which the Board considers to be five years, in connection with the UK Corporate Governance Code requirement for a viability statement to be given by the Board. Consideration of these reports and constructive challenge on the findings of the reports, including the scenario testing carried out by management, has enabled the Committee to form its assessment and satisfy itself that it remains appropriate for the Group to continue to adopt the going concern basis of accounting in the preparation of the financial statements and in addition advise the Board on providing the viability statement set out on page 61.

Audit Committee report
continued

Effectiveness of the external audit process

Receiving high-quality and effective audit services is of paramount importance to the Committee. We continue to monitor carefully the effectiveness of our external auditor as well as its independence, bearing in mind that it is recognised there is a need to use our external auditor's firm for certain non-audit services. We have full regard to the FRC's Ethical Standard and ensure that our procedures and safeguards meet these standards.

The current external auditor, Ernst & Young LLP, was appointed following a comprehensive audit tender process and approval by shareholders at the Company's 2014 AGM. Their reappointment was approved at the 2017 Annual General Meeting. Debbie O'Hanlon is the audit partner and has been in that role since Ernst & Young's appointment. The external auditor produced a detailed audit planning report in preparation for the year-end financial statements, which has assisted the auditor in delivering the timely audit of the Group's annual report and financial statements and which was shared with, and discussed by, the Committee in advance.

The effectiveness review of the external auditor is undertaken as part of the Committee's annual performance evaluation. Further details of the performance evaluation are provided on pages 71 and 72. No issues were raised during that review and the Committee concluded that the auditor was effective during the year.

The Committee considered that it is appropriate that the external auditor be re-appointed and has made this recommendation to the Board. The Committee chairman has also met privately with the external auditor.

Auditor independence

The Committee carefully reviews on an ongoing basis the relationship with the external auditor to ensure that the auditor's independence and objectivity is fully safeguarded.

The external auditor reported on their independence during the year and again since the year end, confirming to the Committee that they have complied with the FRC's Ethical Standard and, based on their assessment, that they were independent of the Group.

Provision of non-audit services

In line with the requirements of the EU Audit Directive and Regulation which came into force on 17 June 2016, the Committee continues to have a robust policy for the engagement of the external auditor's firm for non-audit work. The Committee receives a regular report covering the auditor's fees including details of non-audit fees incurred.

Recurrent fees typically relate to agreed procedures in relation to annual regulatory reporting obligations to Ofwat; work which is most efficiently and effectively performed by the statutory auditor. The policy is for non-audit fees not to exceed 70% of the audit fee for statutory work and for the Committee chairman to approve all non-audit work performed by the statutory auditor. The Committee carefully reviews non-audit work proposed for the statutory auditor, taking into consideration whether it was necessary for the auditor's firm to carry out such work and would only grant approval for the firm's appointment if it was satisfied that the auditor's independence and objectivity would be fully safeguarded. If there were another accounting firm that could provide the required cost-effective level of experience and expertise in respect of the non-audit services, then such firm would be chosen in preference to the external auditor.

The level of non-audit fees payable to the external auditor for the past year is 31.63% of the audit fee, which is well within the Group's 70% non-audit fee limit.

The Chief Financial Officer regularly reports to the Committee on the extent of services provided to the Company by the external auditor and the level of fees paid. The fees paid to the external auditor's firm for non-audit services and for audit services are set out in note 7 to the financial statements on page 131.

Internal audit

The internal audit activities of the Group are a key part of the internal control and risk management framework of the Group. At Group level there is a long-standing and effective centralised internal audit service which makes a significant contribution to the ability of the Committee to deliver its responsibilities.

A new Group internal audit plan was approved in January 2018, which aligns the annual internal audit programme with the Group's financial year. It takes account of the principal risks, the activities to be undertaken by the external auditor, and the Group's annual and ongoing risk management reviews. This approach seeks to ensure that there is a programme of internal and external audit reviews focused on identified key risk areas throughout the Group.

As in previous years, the Group Internal Audit Manager reported regularly to the Committee on audit reviews undertaken and their findings, and there were regular discussions, correspondence and private meetings between the Group Internal Audit Manager and the Committee chairman. During the year, the long-serving Group Internal Audit Manager stepped down. This presented a logical opportunity for the Group to review its organisation structure in this area. As a result, since the year end, a new senior management position of director of Risk and Assurance has been created, with specific responsibilities for keeping the Committee informed of internal audit activities.

An external assessment of the internal function that was performed by KPMG LLP in 2016 concluded that the Company's internal audit function conforms to IIA standards issued by the Institute of Internal Auditors but identified some areas for improvement including the alignment of the internal audit annual programme with the financial year and refreshed reporting content. These have been actioned.

Fair, balanced and understandable assessment

To enable the Committee to advise the Board in making its statement that it considered that the Company's Annual Report and Accounts is fair, balanced and understandable (FBU) on page 105, the Committee has applied a detailed FBU review framework that takes account of the Group's well-documented verification process undertaken in conjunction with the preparation of the Annual Report and Accounts. This is in addition to the formal process carried out by the external auditor to enable the preparation of the independent auditor's report, which is set out on pages 108 to 113.

In preparing and finalising the 2018 Annual Report and Accounts, the Committee considered a report on the actions taken by management in accordance with the FBU process and an FBU assessment undertaken by the Pennon Executive. This assisted the Committee in carrying out its own assessment and being able to advise the Board that it considered that the Annual Report and Accounts taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy.

Statement of compliance with CMA order

Having undertaken a competitive audit tender process in 2014, the Company is in compliance with the Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014.

Sustainability Committee report

“Our sustainability objectives are an essential part of our long-term strategy and create value for all our stakeholders.”

Gill Rider
Sustainability Committee Chairman

Dear Shareholder

I am pleased to introduce the Sustainability Committee’s report on its activities during the year. Sustainability remains an important and integral part of Pennon’s strategy, and the Group continues to take this responsibility seriously in all its business and operational practices. Our investment and our commitment to high levels of service and performance will contribute to meeting our communities’ long-term needs – for water, energy and waste management.

The role of the Sustainability Committee is to set and oversee the delivery of Pennon’s sustainability objectives, which our Chief Executive Officer sets out on page 22. We do this by bringing together and reviewing initiatives that drive sustainability, approving targets and monitoring the progress made in achieving them. Our sustainability objectives are truly ‘strategic’ in that they are an essential part of our overall long-term strategy and create value for all our stakeholders. On pages 14 to 17 we explain the relationship between our strategy, sustainability objectives, the measurement of performance and how we reward our Executive Directors. All of this is underpinned by our corporate values, as Pennon strives to be trusted, responsible, collaborative and progressive.

Through delivery of our sustainability objectives, we are able to uphold the highest standards of corporate responsibility for the benefit of all our stakeholders – our customers, our communities, our people and our suppliers, and our investors. The Committee has always played a central role in promoting and safeguarding stakeholder interests and is pleased to see that stakeholder engagement is now recognised as an essential aspect of corporate governance. Pennon and its subsidiaries have always taken a proactive and comprehensive approach to stakeholder engagement and we continue to monitor and refine the mechanisms we have in place to support continuing dialogue. More information on our approach to stakeholder engagement is provided on page 64.

Throughout this annual report we show how a thorough approach to sustainability helps us to draw together the needs of society with the delivery of commercial success. We are pleased to note the results achieved throughout the Group, which confirm sustainability is indeed integrated in all we do.

Gill Rider
Sustainability Committee Chairman

Sustainability Committee report
continued

Sustainability Committee composition and meetings

	Date of appointment to Pennon Sustainability Committee	Attendance
Committee chairman		
Gill Rider	September 2012	4/4
Committee members		
Martin Angle	December 2008	4/4
Susan Davy	March 2018	1/1
Chris Loughlin	November 2006	4/4

Susan Davy joined the Committee in March 2018. Her involvement reflects the growing and welcome interest of our investors in environmental, social and governance (ESG) matters and the relevance of ESG to Pennon's funding strategy and financial decision-making.

The Sustainability Committee sets a range of targets for the Group's subsidiaries as part of their business planning processes. Progress against these targets is reported to the Committee throughout the year. In addition, the South West Water sustainability committee continues to provide oversight of South West Water's performance against its sustainability targets that are core to the successful delivery of South West Water's K6 Business Plan 2015-2020. This is consistent with Ofwat's requirement for independent governance of our regulated business.

We aim to set stretching targets and as at 31 March 2018 South West Water had achieved six of its 12 targets for the year, and Viridor had also completed six out of 12 of its targets. Full details of the sustainability targets for South West Water and Viridor for 2017/18, and their performance against them, are given in their respective reports.

During the year the Committee continued to apply the best practice framework published by Business in the Community (BitC), a leading business-led charity that promotes responsible business. The structure provided through BitC's key areas of sustainability (marketplace, workplace, community and environment) is reflected in Pennon's sustainability objectives.

The Sustainability Committee balances the requirement to conduct business in a responsible manner (in relation to ESG matters) while at the same time delivering strong financial performance and lasting value for shareholders and other stakeholders. The Sustainability Committee reviews and approves as appropriate the strategies, policies, management, initiatives, targets and performance of the Pennon Group companies in the areas of occupational health and safety and security, environment, workplace policies, responsible and ethical business practice, customer service and engagement, and the role of the Group in society.

Since last year's report, the Committee has considered a wide range of matters in the course of fulfilling its duties in accordance with its terms of reference:

- the Group's health and safety performance and the effectiveness of health and safety policies and procedures
- environmental strategy and performance
- performance in respect of customer service and engagement
- the Group's approach to community relations and investment
- performance against the Group's workplace policy, including review of the results of the first Group-wide employee engagement survey
- the new Group HR strategy, 'Talented people doing great things for our customers and each other'
- sustainable procurement and practices within the supply chain
- sustainability reporting for 2017 and the associated verifier's reports and recommendations
- progress against the sustainability targets for 2017/18 and sustainability targets for 2018/19.

In addition, the Committee considered:

- the results of the Group's gender pay gap analysis and proposed action plan
- the implementation of a Group-wide compliance and ethics training programme
- recommendations arising from the first Group submission to BitC's Corporate Responsibility Index
- a strategic review of Pennon's approach to ESG reporting and disclosure, to support potential "green" funding initiatives.

Reporting and verification

In reporting on sustainability, the Company has sought to comply with the Investment Association Guidelines on Responsible Investment Disclosure.

Pennon's sustainability performance and reporting has been audited by Strategic Management Consultants Limited (SMC), an independent management consultancy specialising in technical assurance in the utility sector. Pennon considers that SMC's method of verification – which includes testing the assumptions, methods and procedures that are followed in the development of data and auditing that data to ensure accuracy and consistency – complements the best practice insight gained through the Group's membership of Business in the Community. Certain disclosures within this annual report that relate to the sustainability performance of South West Water and Bournemouth Water have been verified by SMC against the output of an independent audit of regulatory data conducted by Jacobs.

Benchmarking

Pennon is a constituent of the FTSE4Good Index, an equity index series that is designed to facilitate investment in companies that meet globally recognised corporate responsibility standards. Companies in the FTSE4Good Index Series have met stringent environmental, social and governance criteria, and are positioned to capitalise on the benefits of responsible business practice.

Pennon sustainability report

Pennon's sustainability reporting is integrated throughout the strategic report and specifically in the following sections:

- Chairman's statement (page 8)
- Business model (page 14)
- Strategic priorities (page 16)
- Review of the Chief Executive Officer (page 20)
- Key performance indicators (page 24)
- Our people (page 26)
- Our operations (pages 28 to 41).

South West Water and Viridor sustainability reports

The sustainability report for Viridor will be published in August 2018, and South West Water will incorporate its sustainability reporting in its company annual performance report and regulatory accounts, which will be published in July 2018. Both documents will be available to view at **www.pennon-group.co.uk** and also on the subsidiaries' websites.

Nomination Committee report

❝ Action is being taken to encourage the growth of a diverse workforce where individuals from different backgrounds can fulfil their potential. ❞

Sir John Parker
Nomination Committee Chairman

The Nomination Committee met three times during the year to fulfil the duties set out in its terms of reference.

Matters considered by the Committee during the year included:

- A revised policy on Diversity, Respect and Inclusion
- The Group's performance against its diversity and equality policies
- The recruitment and appointment of Jon Butterworth as a non-executive director of South West Water, to fill the vacancy arising from the resignation of Steve Johnson in April 2016
- The extension of Neil Cooper's term of office as a Non-Executive Director of Pennon Group plc for a second term of three years commencing on 1 September 2017 and expiring on 31 August 2020
- The confirmation of Adele Barker's appointment as Group director of Human Resources, a role which she had held on an interim basis during the recruitment process
- The appointment of Ed Mitchell as a director of Wastewater Services, South West Water
- A review of succession plans, the leadership needs of the Group and the Group's approach to succession planning
- A review of our gender pay disclosure and ongoing action plan
- The structure, size and composition of the Board, including the skills, knowledge, independence, diversity and experience of the Directors
- A review of the time spent by Non-Executive Directors in fulfilling their duties and the other directorships they hold.

It is the practice of the Committee, led by the Chairman, to appoint an external search consultancy to assist in Board appointments to ensure that an extensive and robust search can be made for suitable candidates. Buchannan Harvey & Co, who have no other connection with the Company, was engaged to assist with the recruitment of a Non-Executive director for the South West Water board.

Nomination Committee composition and meetings

	Date of appointment to Pennon Nomination Committee	Attendance
Committee chairman		
Sir John Parker	April 2015	3/3
Committee members		
Martin Angle	December 2008	3/3
Neil Cooper	September 2014	2/3
Gill Rider	September 2012	3/3

The CEO also attends meetings when invited.

Board diversity policy

The Committee is required by the Board to review and monitor compliance with the Board's diversity policy and report on the targets, achievement against those targets and overall compliance in the annual report each year.

The Board's diversity policy confirms that the Board is committed to:

- the search for Board candidates being conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of gender and ethnic diversity on the Board
- satisfying itself that plans are in place for orderly succession of appointments to the Board and to senior management to maintain an appropriate balance of skills and experience within the Group and on the Board and to ensure progressive refreshing of the Board. In addition, within the spirit of Principle B.2 of the UK Code, the Board endeavours to achieve and maintain:
  - a minimum of 25% female representation on the Board
  - a minimum of 25% female representation on the Group's senior management team.

The Committee is pleased to report that as at 31 March 2018 and, as disclosed on page 59, one third of the Board's Directors are women and as such the Group has exceeded 25% female representation at Board level.

As at the year end, 36% of Pennon Executive members are women. Action is being taken to improve diversity across the workforce, which will assist in increasing female representation at senior management level as described on page 27. In support of this aim, both our Chairman and our CEO have joined the 30% club, a UK campaign that supports the goal of women holding 30% of board seats and promotes initiatives to expand the female talent pipeline at all levels.

I am pleased to report that we received a favourable assessment in the Hampton-Alexander Review, published in November 2017, which looked at improving gender balance in FTSE Leadership. Pennon was placed 40th in the FTSE 250 and cited as one of the best improvers.

The Committee and the Board will continue to monitor and promote diversity across the Group with the aim of ensuring a diverse pipeline for succession to board and senior management positions. The Committee has approved an updated Diversity, Respect and Inclusion Policy for the Group, which encourages the growth of a diverse workforce where individuals from different backgrounds can fulfil their potential.

Our 2017 employee survey told us that 88% of our employees believe that people within Pennon Group are treated fairly regardless of race or ethnic origin. While we recognise this as good progress, we plan to increase our focus on ethnic diversity in the coming year. We continue to strive to ensure people with disabilities are given all the encouragement and support necessary and that Pennon is seen as a welcoming and inclusive place to work in all respects.

Information regarding the gender breakdown of the workforce is provided on page 27.

Sir John Parker
Nomination Committee Chairman

Remuneration Committee report

“The Committee is responsible for ensuring remuneration is aligned with and supports the Group’s strategy, reflects our values and optimises performance.”

Martin Angle
Remuneration Committee Chairman

The Committee met four times during the year to fulfil the duties set out in its terms of reference. In particular, the Committee is responsible for:

- Ensuring remuneration is aligned with and supports the Group’s strategy, reflects our values as a Group and optimises performance
- Maintaining and, in every third year, reviewing the remuneration policy and considering any changes necessary to ensure it remains appropriate and fulfils its purpose of attracting and retaining high-calibre people who are able to contribute to the success of the Group
- Advising the Board on the framework of executive remuneration for the Group
- Determining the remuneration and terms of engagement of the Chairman, the Executive Directors and senior executives of the Group.

The Committee’s activities during the financial year

The Committee engaged in the following activities during the year:

- Determining the remuneration policy and future arrangements for the annual bonus and LTIP, with a particular focus on performance metrics and incentive levels to ensure these are aligned with the new management structure and strategic objectives and placing the same before the shareholders at the AGM 2017
- Annual executive salary review
- Annual review of the Chairman’s fee
- Determining performance targets in respect of the Annual Incentive Bonus Plan for 2017/18
- Reviewing drafts of the Directors’ remuneration report for 2016/17 and recommending it to the Board for approval for inclusion in the 2017 annual report
- Determining bonuses and deferred bonus awards pursuant to the Company’s Annual Incentive Bonus Plan in respect of the year 2016/17
- Approving the long-term incentive plan (LTIP) awards for the year
- Approving the release of the 2014 deferred bonus share awards and the vesting of executive share options pursuant to the Annual Incentive Bonus Plan
- Determining the outcome of the 2014 Performance and Co-investment Plan awards
- Reviewing and agreeing to recommend the removal of the coinvestment obligation under the Performance and Co-investment Plan, and an increase in our shareholding guidelines
- Reviewing the results of the Committee’s performance evaluation and instigating appropriate changes.

The Committee’s focus for 2018/19

- Ensure that targets are stretching but also fair and achievable, so that they act to retain, motivate and incentivise the executive to deliver the Group’s strategic goals and to create long-term value for shareholders
- Monitor on an ongoing basis the alignment of executive pay and benefits with the strategic direction of the Group to ensure these support the long-term success of the Company and promote its values
- Improve the process around, and disclosure of, personal bonus targets
- Undertake a review of the Committee’s independent remuneration consultants
- Consider and respond to the remuneration-related changes included in the new version of the UK Corporate Governance Code, due to be published in June 2018.

Remuneration Committee composition and meetings

	Date of appointment to Pennon Remuneration Committee	Attendance
Committee chairman		
Martin Angle	December 2008	4/4
Committee members		
Neil Cooper	September 2014	3/4
Gill Rider	September 2012	4/4

In accordance with the Code, all of the Committee members are independent Non-Executive Directors. The Chairman of the Board attends from time to time but is not a member of the Committee. The CEO also attends meetings when invited except for such part of a meeting when matters concerning his own remuneration are to be discussed.

The Committee is advised by Deloitte, an independent remuneration consultant, to ensure remuneration is determined impartially. The Committee is also supported by the Group director of Human Resources and the Group General Counsel and Company Secretary.

Martin D Angle
Remuneration Committee Chairman

DIRECTORS' REMUNERATION REPORT

Commissioning Engineer, PWNT, Steve Dornan at Mayflower water treatment works

Directors' remuneration at a glance

Key components of Executive Directors' remuneration

Base salary
Set at a competitive level to attract and retain high-calibre people to meet Company's strategic objectives in an increasingly complex business environment.

Benefits
Benefits provided are consistent with the market and level of seniority and to aid retention of key skills to assist in meeting strategic objectives.

Annual bonus
Incentivises the achievement of key performance objectives aligned to the strategy of the Company.

Long-term incentive plan
Provides alignment to the achievement of the Company's strategic objectives and the delivery of sustainable long-term value to shareholders.

Shareholding guidelines
Create alignment between executives and shareholders and promote long-term stewardship.

Pension
Provides funding for retirement and aids retention of key skills to assist in meeting the Company's strategic objectives.

All-employee share plans
Align the interests of all employees with Company share performance.

Summary of Directors' remuneration 2017/18

	Base salary/fees (£000)	Benefits (including Sharesave) (£000)	Annual bonus (cash and deferred shares) (£000)	Long-term incentive plan (£000)	Pension (£000)	Total remuneration (£000)
Executive Directors						
Chris Loughlin	518	30	450	–	155	1,153
Susan Davy	396	28	346	–	113	883
Non-Executive Directors						
Sir John Parker	270	–	–	–	–	270
Gill Rider	74	–	–	–	–	74
Martin Angle	67	–	–	–	–	67
Neil Cooper	66	–	–	–	–	66

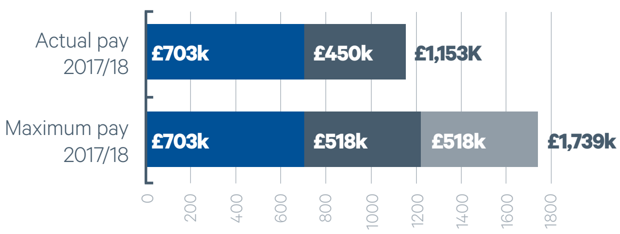
See the full single total figure of remuneration tables on page 93

READ MORE PAGES 93 TO 95

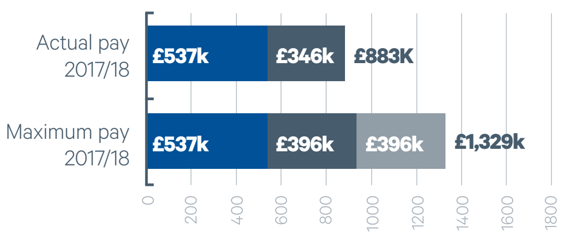
Total remuneration opportunity and outcome

Estimated zero vesting for LTIP reduces actual remuneration outcome for the year.

Chris Loughlin



Susan Davy



Fixed pay (salary, pension and benefits) **Annual bonus** **LTIP**

No adjustments have been made for share price movements or payment of dividends.

READ OUR REMUNERATION POLICY
www.pennon-group.co.uk/about-us/governance-and-remuneration

Annual Statement from the Chairman of the Remuneration Committee

“ The Committee appreciated our shareholders’ strong endorsement of the revised remuneration policy prepared during the year. ”

Martin Angle
Remuneration Committee Chairman

READ MORE ABOUT OUR STRATEGIC PRIORITIES ON PAGES 16 AND 17

Dear Shareholder

Introduction

I am pleased to present, on behalf of our Board, the Remuneration Committee’s Directors’ Remuneration Report for the year ended 31 March 2018.

At our 2017 AGM, shareholders approved our revised remuneration policy with 98% of votes cast in favour of the resolution. The policy is available in full on our website at **www.pennon-group.co.uk/about-us/governance-and-remuneration** and a summary of the policy is provided on pages 88 to 90. We are not proposing any changes to the policy at this year’s AGM.

A significant proportion of the Executive Directors’ remuneration is provided as variable pay that rewards the achievement of stretching annual and long-term performance targets, which in turn are designed to ensure delivery of Pennon’s strategy and create shareholder value. The relationship between our strategy, performance and the remuneration of our Executive Directors is summarised opposite on page 87.

On pages 91 to 101 we set out our annual report on remuneration which contains the remuneration of the Directors for the year 2017/18. We also provide details of how our policy will be applied for 2018/19. This section of the report, together with this letter, is subject to an advisory shareholder vote at this year’s AGM.

Review of the year

Performance against bonus targets

The bonus outturns for the Executive Directors for 2017/18 reflect the Company’s strong achievements against corporate financial and operational targets and the Executive Directors’ performance against personal targets. Half of the bonus is deferred and held as shares.

Strong earnings growth was maintained across the Group and Pennon continued to make good progress towards delivering its long-term strategic priorities. Group underlying profit before tax was £259 million, an increase of 3.5% compared with 2016/17. Adjusted earnings per share (EPS) before deferred tax and non-underlying items was up 8.3% at 50.9p reflecting strong earnings from both South West Water and Viridor, supported by sector leading efficiencies in the water business and a full year increase in Viridor’s ERF operational capacity. South West Water’s cumulative return on regulated equity (RoRE) at 11.8% continues to lead the sector and Viridor generated EBITDA of £150.2 million during the year.

Our operational metrics incentivise our Executives to focus on the issues that really matter to our customers and other stakeholders. In our water business, the year-end outturn has been affected by the extreme cold weather in early March 2018, which caused an increase in supply interruptions, and while South West Water met its Outcome Delivery Incentive (ODI) leakage target of 84 megalitres per day, it did not achieve the additional stretch target of 82 megalitres a day.

In the waste business, although the ERF portfolio performed strongly throughout the year, various headwinds, particularly around commodity pricing of paper, meant that the recycling action plan was not delivered in full. Viridor increased its customer base from 31,990 customers in 2016/17 to 32,292 in 2017/18.

While personal targets amount to only 20% of overall performance, the Executive Directors performed extremely well in 2017/18. Their leadership and drive has resulted in excellent progress towards delivery of our strategic priorities. There have been many challenges and successes during the year and the resolution of our negotiations on the Greater Manchester waste contract, which resulted in a positive financial outcome and the preservation of our relationship with the Authority, was a highlight for the team. Preparatory work on our PR19 business plan has produced the building blocks for a coherent and compelling submission, which will demonstrate our commitment to outstanding customer service and sharing reward.

The Committee recognises that positive steps have been taken during the year in relation to health and safety, with the development of HomeSafe and a 28% reduction in lost time injuries. Environmental performance has also improved, with a 6% reduction in wastewater pollution incidents in South West Water. The Committee and the Executive expect these trends to continue, as we strive towards a step change in performance in both areas.

Chris and Susan each completed actions that have established an effective Group structure, continuing the integration of the Group's shared support functions under a single Pennon umbrella, developing and embedding the high-calibre executive team put in place last year and ensuring succession plans are in place. This year saw the Group's transformation take a step further, with the successful implementation of business and financial systems and processes, which ensure we have the capability to face future commercial challenges.

Further details of bonus targets, measures and performance are set out on pages 93 and 94.

Long-term incentive plan outturn

We are disappointed that the overall estimated outturn for awards vesting in 2018 under the old Performance and Co-investment Plan is zero. This reflects that the Company's total shareholder return (TSR) for the three-year performance period is anticipated to be below the comparator index performance and the median of the FTSE 250, with the Company's share price having been affected by external market and political considerations.

In 2017 we were pleased that shareholders voted in favour of a new long-term incentive plan, which has allowed us to move away from TSR and introduce a set of new performance measures that are aligned with our strategic objectives.

Key remuneration decisions

For 2018/19, salaries for Executive Directors were increased by 2%, which will be lower than the pay increase awarded to the wider employee population.

Looking ahead to the annual bonus for 2018/19, we are maintaining our approach of setting measurable financial and customer-focused operational objectives. These objectives will support the delivery of our strategy and create value for our stakeholders.

Looking forward

The Committee will continue to monitor the proposed changes to the UK Corporate Governance Code with interest, including proposals to strengthen the employee voice, as well as the Government's intention to introduce mandatory pay ratio reporting.

We are constantly reviewing our remuneration arrangements and performance measures to ensure they are aligned with our strategy, best practice and provide shareholders with an appropriate level of transparency. The Committee appreciated the strong endorsement of last year's revised remuneration policy and we hope we can continue to rely on shareholders' support.

Martin D Angle
Remuneration Committee chairman

Link between strategy, 2018 performance and remuneration

Strategic priority	Performance measures	Remuneration impacts
Leadership in UK Water and Waste	TSR performance against comparator index (50% weighting) and FTSE 250 (50% weighting)	Performance and Co-Investment Plan outturn for awards granted in 2015 and 2016 (due to vest in 2018 and 2019 respectively)
	• EPS growth per annum (40% weighting) • Dividend growth per annum and dividend cover (40% weighting) • Average return on capital employed (20% weighting)	LTIP outturn for awards granted in 2017 onwards
Leadership in cost base efficiency	Profit before tax (PBT) & RoRE	Annual bonus outturn – 50% PBT / 10% RoRE
Driving sustainable growth	Performance against operational metrics and personal measures that are key to meeting the needs of our customers, communities, employees and other stakeholders	Annual bonus outturn – 20% customer and operational targets / 20% personal objectives

Directors' remuneration policy

Introduction

The current Directors' remuneration policy was approved by shareholders at the Company's AGM held on 6 July 2017.

The Committee's intention is to seek approval for the Company's remuneration policy at the end of the usual three-year cycle, in accordance with section 439A of the Companies Act 2006. Unless the Directors wish to amend the remuneration policy in the meantime, it will be submitted for shareholder approval at the 2020 AGM, following a review to be carried out by the Committee in 2019/20.

The remuneration policy tables for Executive and Non-Executive Directors are set out below for information. The policy is displayed in its entirety on the Company's website at **www.pennon-group.co.uk/about-us/governance-and-remuneration** and is available upon request from the Group Company Secretary.

Policy table – Executive Directors

The table below sets out the elements of the total remuneration package for the Executive Directors which are comprised in this Directors' remuneration policy. Where it is intended that certain provisions of the 2014 remuneration policy will continue to apply, this is indicated in the policy table below.

How the components support the strategic objectives of the Company	How the component operates (including provisions for recovery or withholding of any payment)	Maximum potential value of the component	Description of framework used to assess performance
Base salary			
Set at a competitive level to attract and retain high calibre people to meet the Company's strategic objectives in an increasingly complex business environment. Base salary reflects the scope and responsibility of the role as well as the skills and experience of the individual.	Salaries are generally reviewed annually and any changes are normally effective from 1 April each year. In normal circumstances, salary increases will not be materially different to general employee pay increases. However, the Committee reserves the right to make increases above those made to general employees, for example in circumstances including (but not limited to) an increase in the scope of the role.	When reviewing salaries the Committee has regard to the following factors: • Salary increases generally for all employees in the Company and the Group • Market rates • Performance of individual and the Company • Other factors it considers relevant. There is no overall maximum.	None, although personal and Company performance are factors considered when reviewing salaries.
Benefits			
Benefits provided are consistent with the market and level of seniority to aid retention of key skills to assist in meeting strategic objectives.	Benefits currently include the provision of a company vehicle, fuel, health insurance and life assurance. Other benefits may be provided if the Committee considers it appropriate. In the event that an Executive Director is required to relocate, relocation benefits may be provided.	The cost of insurance benefits may vary from year to year depending on the individual's circumstances. There is no overall maximum benefit value but the Committee aims to ensure that the total value of benefits remain proportionate.	None.
Annual bonus			
Incentivises the achievement of key performance objectives aligned to the strategy of the Company.	Annual bonuses are calculated following finalisation of the financial results for the year to which they relate and are usually paid three months after the end of the financial year. A portion of any bonus is deferred into shares in the Company which are normally released after three years. Normally 50% is deferred. Any dividends on the shares during this period are paid to the Directors. Malus and clawback provisions apply which permit net cash bonuses and/or deferred bonus shares to be forfeited, repaid or made subject to further conditions where the Committee considers it appropriate in the event of any significant adverse circumstances, including (but not limited to) a material failure of risk management, serious reputational damage, a financial misstatement or misconduct. Clawback may be applied for the period of three years following determination of the cash bonus.	The maximum bonus potential for each Director is 100% of base salary.	Performance targets relate to corporate and personal objectives which are reviewed each year. For 2018/19, in relation to the financial and operational measures of the annual bonus framework there will be an 80% overall weighting of which 50% will be profit before tax, 10% return on regulated equity and 20% operational measures. All of these measures will be subject to defined quantitative targets. The measures, weighting and threshold levels may be adjusted for future years. Following the financial year end the Committee, with advice from the Chairman of the Board and following consideration of the outturn against target by the chairman of the Audit Committee, assesses to what extent the targets are met and determines bonus levels accordingly. In doing so the Committee takes into account overall Company performance and in exceptional circumstances may exercise its discretion and adjust the bonus to reflect any specific factors.

How the components support the strategic objectives of the Company	How the component operates (including provisions for recovery or withholding of any payment)	Maximum potential value of the component	Description of framework used to assess performance
Long-term incentive plan (LTIP)			
Provides alignment to the achievement of the Company's strategic objectives and the delivery of sustainable long-term value to shareholders.	Annual grant of conditional shares (or equivalent). Share awards vest subject to the achievement of specific performance conditions measured over a performance period of no less than three years. Dividend equivalents (including dividend reinvestment) may be paid on vested awards. An 'underpin' applies which allows the Committee to reduce or withhold vesting if the Committee is not satisfied with the underlying operational and economic performance of the Company. For grants made in 2015 and 2016 onwards under the PCP, as well as all grants made from 2017 under the LTIP, malus and clawback provisions apply which permit shares to be forfeited, repaid or made subject to further conditions where the Committee considers it appropriate in certain circumstances. The circumstances in which malus may be applied include (but are not limited to) material misstatement, serious reputational damage, or the participant's misconduct. The circumstances in which clawback may be applied are material misstatement or serious misconduct. In addition a two year holding period will apply in respect of any shares which vest at the end of the three year performance period. Malus may be applied during the three year performance period and clawback may be applied up until the end of the holding period.	The maximum annual award is 150% of base salary.	The current performance measures for the LTIP are based on a combination of growth in earnings per share (EPS), sustainable dividend growth and dividend cover, and return on capital. For 2018/19 awards, performance measures will be weighted as follows: • 40% based on EPS growth • 40% based on a combination of dividend growth and a dividend cover metric • 20% based on return on capital employed. The 'underpin' evaluation includes consideration of safety, environmental, social and governance (ESG) factors as well as financial performance. No more than 25% of maximum vests for minimum performance. The Committee will keep the performance measures and weightings under review and may change the performance condition for future awards if this were considered to be aligned with the Company's interests and strategic objectives, as well as the impact of regulatory changes. However, the Committee would consult with major shareholders in advance of any proposed material change in performance measures. **Commitments made under the 2014 policy** Performance conditions set under the previous remuneration policy (approved at the 2014 AGM) will continue to apply to awards granted in 2015 and 2016. These awards are due to vest in 2018 and 2019 respectively. Previous performance conditions were based on total shareholder return (TSR) against the performance of a water/waste peer group index and constituents of the FTSE 250 index (excluding investment trusts). For awards granted under the 2014 remuneration policy, no more than 30% of the maximum vests for minimum performance.
Shareholding requirements			
Create alignment between executives and shareholders and promote long-term stewardship.	200% of salary for both the CEO and CFO.		

Directors' remuneration policy
continued

How the components support the strategic objectives of the Company	How the component operates (including provisions for recovery or withholding of any payment)	Maximum potential value of the component	Description of framework used to assess performance
Pension			
Provides funding for retirement and aids retention of key skills to assist in meeting the Company's strategic objectives.	Defined benefit pension arrangements are closed to new entrants. Defined contribution pension arrangements have been available to new staff since 2008. A cash allowance may be provided as an alternative and/or in addition where pension limits have been reached.	The maximum annual pension contribution or cash allowance is 20% of salary. For Executive Directors who commenced employment prior to April 2013, the maximum annual pension contribution or cash allowance is 30% of salary. Legacy defined benefit pension arrangements will continue to be honoured. Whilst one Executive Director is a pension member there are no further prospective accruals in respect of defined benefit pension arrangements.	None.
All-employee share plans			
Align the interests of all employees with Company share performance.	Executive Directors may participate in HMRC approved all-employee plans on the same basis as employees.	The maximum is as prescribed under the relevant HMRC legislation governing the plans.	None.

Policy table – Non-Executive Directors

The table below sets out the Company's policy in respect of the setting of fees for Non-Executive Directors.

How the components support the strategic objectives of the Company	How the component operates	Maximum potential value of the component
Fees		
Set at a market level to attract Non-Executive Directors who have appropriate experience and skills to assist in determining the Group's strategy.	Fees are set by the Board with the Chairman's fees being set by the Committee. The relevant Directors are not present at the meetings when their fees are being determined. Non-Executive Directors normally receive a basic fee and an additional fee for any specific Board responsibility such as membership or chairmanship of a Committee or occupying the role of Senior Independent Director. In reviewing the fees the Board, or Committee as appropriate, consider the level of fees payable to Non-Executive Directors in other companies of similar scale and complexity.	Total fees paid to Non-Executive Directors will remain within the limits stated in the Articles of Association.
Benefits		
The benefits provided for the Chairman are consistent with the market and level of seniority.	Expenses incurred in the performance of non-executive duties for the Company may be reimbursed or paid for directly by the Company (including any tax due on the expenses). The Chairman's benefits include the provision of a driver and vehicle, when appropriate for the efficient carrying out of his duties.	None.

Annual report on remuneration

Introduction

This section sets out how the Company has applied its remuneration policy in the year, and details how the new policy will be implemented for the year 2018/19.

In accordance with section 439 of the Companies Act, this section will be put to an advisory vote at the Company's AGM, which is scheduled to be held on 5 July 2018.

Operation of the remuneration policy for 2018/19

A summary of the specific remuneration arrangements for Executive Directors in 2018/19 is described below:

Base salary	2018/19 salaries are: • Chris Loughlin: £528,003 • Susan Davy: £403,767 Salaries were increased by 2%, which was lower than increases for all employees.
Pension and benefits	No changes. Salary supplement cash allowance of 30% for Chris Loughlin and 25% for Susan Davy, from which is deducted the employer's contribution to the defined benefit pension scheme.
Annual bonus	No change to maximum opportunity of 100% of salary. No change to operation of deferral, with 50% of the bonus to be deferred into shares for three years. For 2018/19, the annual bonus will be based on the following performance measures: 60% based on Group financial metrics (50% PBT, 10% RoRE). 20% based on customer and operational metrics, weighted equally between Waste and Water. These measures will be quantitative and measurable, and are key to meeting the needs of our customers, our regulator, and wider stakeholders.
	Water metrics • Service incentive mechanism (SIM) • Bathing water quality • Leakage • Wastewater pollution incidents • Duration of interruptions to supply • Water and wastewater asset reliability. **Waste metrics** • ERF availability • Delivery against recycling action plan • Growth in customer base
	20% based on personal objectives. These will be relevant to the individual, and will include the following: • Lead and develop an innovative PR19 business plan to maximise the potential of a positive outcome for South West Water, its customers and other stakeholders and work with government to achieve the same, gaining Board approval and submitting a high quality bid to Ofwat; • Undertake a strategic review of our recycling businesses in light of the Government's waste strategy, developing and gaining Board approval for an appropriate strategy for Viridor; • Build on the trust and engagement of our 5,000 employees to support the delivery of our strategy; • Continue to refine and extend the reach of the organisation's succession and talent management processes; • Continue to embed HomeSafe across the entire Group and drive further improvement in health and safety performance; In addition, the CFO has objectives around the delivery of a sustainable financing strategy and the embedding of new financial systems and processes. For bonuses paid in respect of 2014/15 onwards, both malus and clawback apply as described in the remuneration policy.

Annual report on remuneration
continued

Long-term incentive plan	Maximum award of 150% of base salary for both the Chief Executive Officer and the Chief Financial Officer. For 2018/19, performance measures will be EPS growth, a sustainable dividend measure and RoCE, with targets set as follows:

EPS growth – 40% weighting

	EPS growth pa	Vesting
Threshold	6%	25%
Maximum	10%	100%

Straight-line vesting between threshold and maximum.

Sustainable dividend measure (dividend growth and dividend cover) – 40% weighting

The performance measure comprises two performance targets, both of which need to be achieved. There is a 'gateway' dividend growth target of RPI+4% per annum. There is then an EBITDA dividend cover target which operates as follows:

	EBITDA dividend cover	Vesting
Threshold	2.6	25%
Maximum	3.6	100%

Straight-line vesting between threshold and maximum.

As an additional underpin the Board must also be satisfied with the level of EPS dividend cover. EBITDA dividend cover will be based on adjusted EBITDA calculated as (underlying EBITDA + share of JV dividends & interest receivable + IFRIC12 interest receivable).

For the purpose of the calculation, dividend cover would be based on the policy of 4% pa above RPI.

Return on capital employed (RoCE)* – 20% weighting

	Average RoCE	Vesting
Threshold	8%	25%
Maximum	10%	100%

* RoCE is defined as: (underlying operating profit + JV profit after tax + interest receivable) divided by capital employed (debt + equity including hybrid).

Straight-line vesting between threshold and maximum.

The LTIP award will be subject to an 'underpin' relating to overall Group performance including consideration of environmental, social and governance factors and safety performance, as well as financial performance.

For awards made from 2015/16 both malus and clawback apply and a holding period applies in respect of any shares that vest at the end of the three-year performance period, as described in the remuneration policy report.

Performance is measured over three years and a two-year holding period applies.

Shareholding guideline	200% of salary for both the CEO and CFO.

Non-Executive Director fees

Non-Executive Director fees for 2018/19 are set out below. They include an increase of 2% approved by the Board for the Non-Executive Directors, effective from 1 April 2018. The Chairman declined to accept an increase for 2018/19.

Role	Fees £
Chairman	270,331
Basic Non-Executive Director fee	48,141
Additional fees	
Senior Independent Director fee	7,140
Additional fee for chairman of the Audit Committee	14,495
Additional fee for chairman of the Remuneration Committee	10,353
Additional fee for chairman of the Sustainability Committee	10,353
Committee fee	5,177

Single total figure of remuneration tables (audited information)

	Base salary/fees (£000)		Benefits(i) (including Sharesave) (£000)		Annual bonus (cash and deferred shares) (£000)		Long-term incentive plan (£000)		Pension(iii) (£000)		Total remuneration (£000)	
	2017/18	2016/17	**2017/18**	2016/17	**2017/18**	2016/17	**2017/18**(ii)	2016/17	**2017/18**	2016/17	**2017/18**	2016/17
Executive Directors												
Chris Loughlin	518	510	30	27	450	429	–	92	155	153	1,153	1,211
Susan Davy	396	390	28	18	346	332	–	34	113	109	883	883
Non-Executive Directors												
Sir John Parker	270	266	–	–	–	–	–	–	–	–	270	266
Gill Rider	74	72	–	–	–	–	–	–	–	–	74	72
Martin Angle	67	67	–	–	–	–	–	–	–	–	67	67
Neil Cooper	66	66	–	–	–	–	–	–	–	–	66	66

(i) Benefits comprise a car allowance and medical insurance.
(ii) Based on an estimated 0% vesting as referred to on page 95.
(iii) See page 95 for further information.

Annual bonus outturn for 2017/18

The performance targets set and the performance achieved in respect of the annual bonus for 2017/18 for both Executive Directors is set out below. In line with the Committee's policy, 50% of any bonus is payable in shares, the release of which is deferred for a three-year restricted period.

Chris Loughlin

Measure	Threshold	Target	Maximum	Actual outturn	Bonus outturn
Underlying profit before tax (50% weighting)					
	£242.7m	£247.7m	£260.1m	£258.8m	47.0%
RoRE (10% weighting)					
	8.0%	9.0%	11.0%	11.8%	10.0%

Customer and operational metrics (20% weighting)	Target	Actual outturn	Target achieved	
Water metrics				
Service incentive mechanism (SIM)				
• South West Water	85	85	Yes	
• Bournemouth Water	87	88		
Bathing water quality	< 5 beaches failing	0 beaches failing	Yes	
Leakage	82 megalitres per day	83 megalitres per day	No	5.0%
Wastewater pollution incidents				
• Category 1-2	2	3	No	
• Category 3-4	218	237		
Average duration of supply interruptions	0.228 hours per property	0.369 hours per property	No	
Wastewater and waste asset reliability	Stable	Stable	Yes	
Waste metrics				
ERF availability	92%	92%	Yes	
Delivery against recycling action plan		Recycling action plan was not met in full	No	7.0%
Growth in customer base		See page 86 for details	Yes	
Personal objectives (20% weighting)				
A summary of achievements in the year is as follows: • Championed and supported the HomeSafe health and safety improvement programme. Rolled out across the organisation through e-learning and facilitated deployment at prioritised locations. Brand, vision, materials and plan have been established and well received by the organisation. Lost time injuries have reduced by 28% during the year • Delivered on a series of Board priorities, achieved targeted synergies, delivered a positive outcome on the negotiations on the Greater Manchester waste contract, delivered the organic growth mandate, embedded and developed the Pennon Group Executive • Initiated the strategy behind the PR19 business plan to ensure the production of a high quality submission to Ofwat • Delivered a succession and talent plan approved by the Board • Led the successful implementation of the revised Project Enterprise and other governance improvements.				18.0%
Total outturn				**87.0%**

Annual report on remuneration
continued

Susan Davy

Measure	Threshold	Target	Maximum	Actual outturn	Bonus outturn
Underlying profit before tax (50% weighting)					
	£242.7m	£247.7m	£260.1m	£258.8m	47.0%
RoRE (10% weighting)					
	8.0%	9.0%	11.0%	11.8%	10.0%

Customer and operational metrics (20% weighting)	Target	Actual outturn	Target achieved	
Water metrics				
Service incentive mechanism (SIM)				
• South West Water	85	85	Yes	
• Bournemouth Water	87	88		
Bathing water quality	< 5 beaches failing	0 beaches failing	Yes	
Leakage	82 megalitres per day	83 megalitres per day	No	5.0%
Wastewater pollution incidents				
• Category 1-2	2	3	No	
• Category 3-4	218	237		
Average duration of supply interruptions	0.228 hours per property	0.369 hours per property	No	
Wastewater and waste asset reliability	Stable	Stable	Yes	
Waste metrics				
ERF availability	92%	92%	Yes	7.0%
Delivery against recycling action plan		Recycling action plan was not met in full	No	
Growth in customer base		See page 86 for details	Yes	
Personal objectives (20% weighting)				
A summary of achievements in the year is as follows: • Developed financial systems and processes to support a modern commercial culture including the successful implementation of the revised Project Enterprise. Group-wide enterprise resource planning (ERP) successfully delivered to time and budget • Launched Pennon's tax strategy ahead of schedule • Initiated the strategy behind the PR19 business plan to ensure the production of a high quality submission to Ofwat • Outperformed shared service targets for 2017/18 • Delivered against the funding and treasury strategy – successful hybrid issuance • Championed and supported the HomeSafe health and safety improvement programme • Delivered on a series of Board priorities, achieved targeted synergies, Greater Manchester contract resolution, supported the delivery of the organic growth mandate.				18.5%
Total outturn				**87.5%**

Performance and Co-investment Plan outturn for 2017/18

The PCP awards made on 1 July 2015, which are due to vest on 1 July 2018, are the awards included in the single figure table and currently it is estimated that the outturn will result in a zero vesting as set out in the table below.

The extent to which the awards will vest is subject to the satisfaction of the performance conditions that were in place at the time the awards were made:

- 50% of the award vests subject to the Company's TSR performance measured against an index made up of the following six listed comparator companies:
  - National Grid Plc
  - Séché Environnement
  - Severn Trent
  - Shanks Group
  - Suez Environnement
  - United Utilities
- The remaining 50% of the award vests subject to the Company's ranked TSR performance against the constituents of the FTSE 250 (excluding investment trusts).

The calculation of TSR performance from the start of the performance period on 1 April 2015 to 9 May 2018 was undertaken by Deloitte LLP for the Committee.

	Threshold (30% of maximum vests)	Maximum (100% of maximum vests)	Achievement in the period to 1 April 2018*	Vesting outturn*
Comparator index (50% of award)	Equal to index	15% above the index	Below the index	0%
FTSE 250 (excluding investment trusts) (50% of award)	Above 50th percentile	At or above 75th percentile	31.9%	0%
Total				**0%**

Straight-line vesting between points.
For below threshold performance for either performance condition, 0% vests in respect of that performance condition.
* As the calculation requires averaging TSR performance over the first three months of the performance period and comparing it to the average over the three months following the end of the performance period (1 April 2018 to 30 June 2018) the achievement and the outturn is an estimate at the date of calculation (9 May 2018).

Vesting of an award is also subject to the 'underpin' described in the remuneration policy tables on page 89, which the Committee has determined to the date of this report would be satisfied, if any award was to vest.

Vested awards are subject to a two-year holding period during which clawback may be applied where the Committee considers it appropriate in certain circumstances. The circumstances in which clawback may be applied are material misstatement or serious misconduct. The holding period ends on 30 June 2020.

Retirement benefits and entitlements (audited information)

Details of the Directors' pension entitlements and pension-related benefits during the year are as follows:

	Value of defined benefit pension (i) (£000)	Company contributions to defined contribution arrangements (£000)	Cash allowances in lieu of pension (£000)	Total value for the year (£000)	Normal retirement age and date (for pension purposes)	Accrued pension at 31 March 2018 (£000)
Chris Loughlin	–	–	155	155	67 (20 August 2019)	–
Susan Davy	28	–	85	113	65 (17 May 2034)	20 (ii)

(i) The value of the defined benefit pension accrued over the period comprises the total pension input amount (which has been calculated in line with regulatory requirements) less the pension contributions paid by the Director.
(ii) Accrued pension is based on service to the year end and final pensionable salary at that date.

Chris Loughlin is not a member of any of the Pennon Group's pension schemes and receives a sum in lieu of pension entitlement equivalent to 30% of salary.

Susan Davy receives an overall pension benefit from the Company equivalent to 25% of her salary which, in 2017/18 comprised an employer's contribution of £13,878 and a cash sum of £85,085. She is a member of Pennon Group's defined benefit pension arrangements and is entitled to normal retirement pension payable from age 65 of broadly 1/80th of pensionable remuneration for each year of pensionable service completed.

The employer's contribution to the pension for Susan Davy is deducted from the overall pension allowance.

Pensions in payment are guaranteed to increase at a rate of 5% p.a. or RPI if lower for service accrued in the period up to 30 June 2014 and at a rate of 2.5% pa or CPI if lower for service accrued in the period after this date. If a Director dies within five years of retiring, a lump sum equal to the balance of five years' pension payments is paid plus a spouse's pension of one half of the member's pension. Pensions may also be payable to dependants and children.

No additional benefits will become receivable by a Director in the event that the Director retires early.

Annual report on remuneration
continued

Outside appointments

Executive Directors may accept one board appointment in another company. Board approval must be sought before accepting an appointment. Fees may be retained by the Director. Currently, no Executive Directors hold outside company appointments other than with industry bodies or governmental or quasi-governmental agencies.

Directors' service contracts and letters of appointment

The dates of Directors' service contracts and letters of appointment and details of the unexpired term are shown below.

Executive Directors	Date of service contract	Expiry date of service contract
Chris Loughlin*	1 January 2016	At age 67 (20 August 2019)
Susan Davy*	1 February 2015	At age 67 (17 May 2036)

* Each of the Executive Directors' service contracts is subject to 12 months' notice on either side.

Non-Executive Directors	Date of initial letter of appointment	Expiry date of appointment
Sir John Parker	19 March 2015	31 March 2021
Martin Angle	28 November 2008	31 December 2018
Neil Cooper	17 July 2014	30 August 2020
Gill Rider	22 June 2012	30 August 2018

The policy is for Executive Directors' service contracts to provide for 12 months' notice from either side.

The policy is for Non-Executive Directors' letters of appointment to contain three-month notice period from either side and for the Chairman's letter of appointment to contain a 12-month notice period from either side.

All Non-Executive Directors are subject to annual re-election and letters of appointment are for an initial three-year term.

Copies of Executive Directors' service contracts and Non-Executive Directors' letters of appointment are available for inspection at the Company's registered office.

Non-Executive Director fees and benefits

The Non-Executive Directors' fees were increased by the Board for 2017/18 by 1.5%. The Chairman's increase approved by the Committee was also 1.5%.

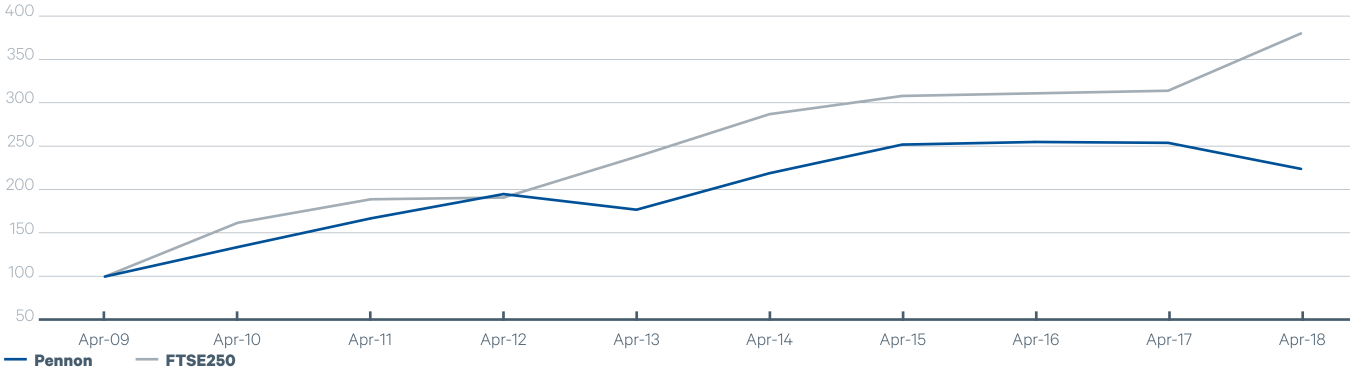
The Chairman's benefits comprise provision of a driver and vehicle, when appropriate for the efficient conduct of his duties. He is entitled to expenses on the same basis as for the other Non-Executive Directors.

All employee, performance and other contextual information

Historical TSR

The graph below shows the value, over the nine-year period ended on 31 March 2018, of £100 invested in Pennon Group on 1 April 2009 compared with the value of £100 invested in the FTSE 250 Index. The FTSE 250 index is a broad equity market index of which the Company is a constituent. In 2017 new long-term performance conditions were introduced.

Total shareholder return – Since April 2009



Equivalent chief executive officer remuneration

As the Company did not have a Group Chief Executive Officer until 1 January 2016, the Committee has provided historic single figure information in the form of the average remuneration of the Executive Directors for years up to and including 2014/15. Their remuneration was considered to be the most appropriate to use as they were the most senior executives in the Company.

For 2015/16 the Committee has provided the average remuneration for the Executive Directors (excluding the Group CEO) and the Group CEO's remuneration for the year, as explained in footnotes (i) and (ii) below. For 2016/17 and 2017/18, the Group CEO's remuneration for the year is shown.

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16(i)	2015/16(ii)	2016/17(iii)	2017/18
Average Executive Director single figure of remuneration (£000)	916	1,091	1,221	894	962	762	738	1,119	1,318	1,153
Annual bonus payout (% of maximum)	91.79	94.69	72.87	47.00	67.56	68.20	66.37	83.98	84.05	87.00
LTIP vesting (% of maximum) (iv)	67.30	50.00	79.30	50.00	30.20	0.00	37.90	37.90	20.40	0.00(v)

(i) The average of the Executive Directors, excluding the Group CEO.
(ii) Group CEO for the year, including remuneration received between 1 April 2015 and 31 December 2015 when in position as Chief Executive of South West Water.
(iii) Group CEO – first complete year in role.
(iv) The long-term incentive plan (LTIP) vesting percentage excludes accrued dividends which are added on vesting.
(v) The LTIP vesting percentage is an estimate as at 9 May 2018.

Comparison of CEO remuneration to employee remuneration

The table below shows the percentage change between 2016/17 and 2017/18 in base salary, benefits and annual bonus for the Group CEO, and all employees.

The percentage increase in average remuneration for employees is calculated using wages and salaries (excluding share-based payments) of £170.6 million (2016/17 £157.1 million), analysed into the three components in the table and the average number of employees of 5,014 (2016/17 4,799) both as detailed in note 13 to the Group financial statements.

	Percentage change in salary	Percentage change in benefits	Percentage change in annual bonus
CEO remuneration	1.5%	9.87%	4.90%
All employees	2.7%	-5.6%(1)	13.5%

(1) The differential is driven predominantly by a change in how we record mileage, rather than a reduction in benefits..

The increase in the CEO's bonus outturn as a percentage of maximum was 2.95%. The CEO's salary increase for 2018/19 is 2.0%.

Annual report on remuneration
continued

Relative importance of spend on pay

	2017/18 (£ million)	2016/17 (£ million)	Percentage change
Overall expenditure on pay(i)	**192.9**	179.9	7.2%
Distributions to ordinary shareholders	**149.5**	138.5	7.9%
Distributions to perpetual capital security holders	**25.3**	20.3	24.6%
Purchase of property, plant and equipment (cash flow)	**390.6**	354.1	10.3%

(i) Excludes non-underlying items.

The above table illustrates the relative importance of spend on pay compared with distributions to equity holders. The purchase of property, plant and equipment (cash flow) has also been included as this was the most significant outgoing for the Company in the past financial year.

Share award and shareholding disclosures (audited information)

Share awards granted during 2017/18

The table below sets out details of share awards made in the year to Executive Directors.

Executive Director	Type of interest	Basis of award	Face value £000	Percentage vesting at threshold performance	Performance /restricted period end date
Chris Loughlin	LTIP	150% of salary	776	25% of maximum	31 March 2020
Susan Davy	LTIP	150% of salary	594	25% of maximum	31 March 2020
Chris Loughlin	Deferred bonus	50% of bonus awarded	214	n/a	29 August 2020
Susan Davy	Deferred bonus	50% of bonus awarded	166	n/a	29 August 2020

LTIP awards were calculated using the share price of £8.027 being the average closing price over the five dealing days preceding the date of grant, which was 25 August 2017. Deferred bonus awards were calculated using the average share price at which shares were purchased on the market on 25 and 29 August 2017 in order to satisfy the award, which was £8.08691.

Directors' shareholding and interest in shares

The Remuneration Committee believes that the interests of Executive Directors and senior management should be closely aligned with the interests of shareholders.

To support this, the Committee operates shareholding guidelines. From 2017/18 the Committee has significantly increased these guidelines from 100% to 200% of salary for both the CEO and CFO. This may be built up over a period of no more than five years. Once obtained, the shareholding is then expected to be maintained by each Director and is revalued each year in accordance with the then prevailing share price and the Executive Director's salary.

The beneficial interests of the Executive Directors in the ordinary shares (40.7p each) of the Company as at 31 March 2018 (or date of cessation, if earlier) and 31 March 2017 together with their shareholding guideline obligation and interest are shown in the table below:

					Unvested awards		
	Share interests (including connected parties) at 31 March 2018	Share interests (including connected parties) at 31 March 2017	Shareholding guideline	Shareholding guideline met?	Performance shares (subject to performance conditions)	SAYE	Deferred bonus shares
Chris Loughlin	324,935	290,323	200%	Yes	201,519	4,984	64,387
Susan Davy	63,658	57,119	200%	No	156,461	2,635	42,836

Since 31 March 2018, 7,132 additional ordinary shares in the Company have been acquired by Chris Loughlin as a result of participation in the Company's Dividend Reinvestment Plan (DRIP) and the Company's Share Incentive Plan; and 86 additional ordinary shares in the Company have been acquired by Susan Davy as a result of participation in the Company's Share Incentive Plan. There have been no other changes in the beneficial interests or the non-beneficial interests of the above Directors in the ordinary shares of the Company between 1 April 2018 and 23 May 2018.

Non-Executive Directors' shareholding

The beneficial interests of the Non-Executive Directors, including the beneficial interests of their spouses, civil partners, children and stepchildren, in the ordinary shares (40.7p) of the Company are shown in the table below:

Director	Shares held at 31 March 2018	Shares held at 31 March 2017
Sir John Parker	27,027	10,000
Martin Angle	–	–
Neil Cooper	–	–
Gill Rider	2,500	2,500

There have been no changes in the beneficial interests or the non-beneficial interests of the above Directors in the ordinary shares of the Company between 1 April 2018 and 23 May 2018.

There is no formal shareholding guideline for the Non-Executive Directors; however, they are encouraged to purchase shares in the Company.

Shareholder dilution

The Company can satisfy awards under its share plans with new issue shares or shares issued from treasury up to a maximum of 10% of its issued share capital in a rolling 10-year period to employees under its share plans. Within this 10% limit the Company can only issue (as newly issued shares or from treasury) 5% of its issued share capital to satisfy awards under discretionary or executive plans. The percentage of shares awarded within these guidelines and the headroom remaining available as at 23 May 2018 is as set out below:

	Awarded	Headroom	Total
Discretionary schemes	1.50%	3.50%	5%
All schemes	3.92%	6.08%	10%

Details of share awards

(a) Long-term Incentive Plan

In addition to the above beneficial interests, the following Directors have or had a contingent interest in the number of ordinary shares (40.7p each) of the Company shown below, representing the maximum number of shares to which they would become entitled under the plan should the relevant criteria be met in full:

Director and date of award	Conditional awards held at 1 April 2017	Conditional awards made in year	Market price upon award in year	Vesting in year(i)	Value of shares upon vesting (before tax) £000	Conditional awards held at 31 March 2018	Date of end of period for qualifying conditions to be fulfilled	Expected date of release(ii)
Chris Loughlin								
14/07/14	48,465	–	798.50p	11,437	92	–	13/07/17	–
01/07/15	49,352	–	810.50p	–	–	49,352	30/06/18	30/06/20
01/07/16	55,434	–	920.00p	–	–	55,434	30/06/19	30/06/19
25/08/17	–	96,733	802.70p	–	–	96,733	24/08/20	24/08/22
Susan Davy(iii)								
14/07/14	17,893	–	798.50p	4,222	34	–	13/07/17	–
01/07/15	40,098	–	810.50p	–	–	40,098	30/06/18	30/06/20
01/07/16	42,391	–	920.00p	–	–	42,391	30/06/19	30/06/19
25/08/17	–	73,972	802.70p	–	–	73,972	24/08/20	24/08/22

(i) 20.4% of the July 2014 award shares vested on 24 August 2017 at a market price of 806.84p per share. The total number of shares that vested included additional shares equivalent in value to such number of shares as could have been acquired by reinvesting the dividends which would otherwise have been received on the vested shares during the restricted period of three years. The balance of the award lapsed.
(ii) Awards granted from 2015 onwards are subject to a two-year holding period following vesting.
(iii) A portion of Susan Davy's share awards are those she received in her previous position as finance and regulatory director, South West Water, up to 31 January 2015, in which she retains an interest in her role as Chief Financial Officer.

Payments to past Directors

No payments to past Directors were made during the year.

Annual report on remuneration
continued

(b) Annual Incentive Bonus Plan – deferred bonus shares (long-term incentive element)

The following Directors had or have a contingent interest in the number of ordinary shares (40.7p each) of the Company shown below, representing the total number of shares to which they have or would become entitled under the deferred bonus element of the Annual Incentive Bonus Plan (the bonus plan) at the end of the relevant qualifying period:

Director and date of award	Conditional awards held at 1 April 2017	Conditional awards made in year	Market price of each share upon award in year	Vesting in year	Value of shares upon vesting (before tax) £000	Conditional awards held at 31 March 2018	Date of end of period for qualifying conditions to be fulfilled
Chris Loughlin							
27/08/14	19,552	–	821.50p	19,552[ii]	155	–	26/08/17
27/07/15	19,124	–	791.00p	–	–	19,124	26/07/18
04/07/16	18,759	–	950.14p	–	–	18,759	03/07/19
30/08/17	–	26,504	808.691p	–	–	26,504	29/08/20
Susan Davy[i]							
27/08/14	7,543	–	821.50p	7,543[ii]	60	–	26/08/17
27/07/15	9,809	–	791.00p	–	–	9,809	26/07/18
04/07/16	12,524	–	950.14p	–	–	12,524	03/07/19
30/08/17	–	20,503	808.691p	–	–	20,503	29/08/20

(i) A portion of Susan Davy's share awards are those she received in her previous position as finance and regulatory director, South West Water, up to 31 January 2015, in which she retains an interest in her position as Chief Financial Officer.
(ii) These shares were released on 15 September 2017 at 792.29p per share.

During the year the Directors received dividends on the above shares in accordance with the conditions of the bonus plan as follows: Chris Loughlin £20,654*; Susan Davy £10,743.

* Chris Loughlin received his dividend in the form of ordinary shares (40.7p each) in the Company as a result of participation in the Company's scrip dividend alternative (which was withdrawn by the Board in November 2017 and replaced with a DRIP). These shares are included in the figure given for the additional ordinary shares (40.7p each) in the Company that he acquired since 31 March 2017 given on page 98.

(c) Sharesave scheme

Details of options to subscribe for ordinary shares (40.7p each) of the Company under the all-employee Sharesave scheme were:

Date of award	Options held at 1 April 2017	Granted in year	Exercised in year	Exercise price per share	Market price of each share on exercising	Market value of each share at 31 March 2018	Options held at 31 March 2018	Exercise period/ maturity date
Chris Loughlin								
03/07/13	2,788	–	–	538.00p	–	643.40p	2,788	01/09/18 – 28/02/19
24/06/15	2,196	–	–	683.00p	–	643.40p	2,196	01/09/20 – 28/02/21
Susan Davy								
24/06/15	2,635	–	–	683.00p	–	643.40p	2,635	01/09/18 – 28/02/19

The Remuneration Committee and its advisers

Martin Angle (Committee chairman), Neil Cooper and Gill Rider were members of the Committee throughout the year and at any time when the Committee considered any matter relating to Directors' remuneration during the year.

During the year the Committee received advice or services which materially assisted the Committee in the consideration of remuneration matters from Sir John Parker (Chairman of the Board), Helen Barrett-Hague (Group General Counsel and Company Secretary), Adele Barker (Group director of Human Resources), and from Deloitte LLP. Deloitte LLP was appointed directly by the Committee.

Deloitte LLP assisted in calculating the Company's total shareholder return compared with two comparator groups for the Company's long-term incentive plan, as well as providing advice on remuneration trends and market practice. Deloitte LLP's fees in respect of advice which materially assisted the Committee during 2017/18 were £72,200 (arrived at from an hourly rate basis of charging). During the year, Deloitte LLP also provided tax, corporate finance and risk advisory services to the Group. Deloitte LLP is a member of the Remuneration Consultants Group and as such voluntarily operates under the code of conduct in relation to executive remuneration consulting in the UK. The Committee is satisfied that the advice it has received from Deloitte LLP has been objective and independent.

Statement of voting at general meeting

The table below sets out the voting by the Company's shareholders on the resolutions to approve the Directors' remuneration report and the remuneration policy at the Annual General Meeting held on 6 July 2017, including votes for, against and withheld.

Annual report on remuneration	
For % (including votes at the Chairman's discretion)	98.79
Against %	1.21
Withheld number	223,594
Remuneration policy	
For % (including votes at the Chairman's discretion)	97.92
Against %	2.08
Withheld number	237,155

A vote withheld is not counted in the calculation of the proportion of votes 'for' and 'against' a resolution.

The Remuneration Committee is pleased to note that 99% of shareholders who voted approved the 2016/17 Directors' remuneration report and 98% voted in favour of the revised remuneration policy introduced last year. The Committee appreciates the continuing support of its shareholders.

Directors' remuneration report compliance

This Directors' remuneration report has been prepared in accordance with the provisions of the Companies Act 2006 and the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013. It also complies with the requirements of the Financial Conduct Authority's Listing Rules and the Disclosure and Transparency Rules. The UK Corporate Governance Code also sets out principles of good governance relating to directors' remuneration, and this report describes how these principles are applied in practice. The Committee confirms that throughout the financial year the Company has complied with these governance rules and best practice provisions. The above regulations also require the external auditor to report to shareholders on the audited information within the annual report on remuneration which is part of the Directors' remuneration report. The external auditor is obliged to state whether, in its opinion, the relevant sections have been prepared in accordance with the Companies Act 2006. The external auditor's opinion is set out on page 108 and the audited sections of the annual report on remuneration are identified in this report.

On behalf of the Board

Martin D Angle
Chairman of the Remuneration Committee
24 May 2018

Directors' report – other statutory disclosures

Introduction

This Directors' report is prepared in accordance with the provisions of the Companies Act 2006 and regulations made thereunder. It comprises pages 64 to 83 and 102 to 105 as well as the following matters which the Board considers are of strategic importance and, as permitted by legislation, has chosen to include in the strategic report rather than the Directors' report:

- risk management systems (pages 52 to 54 of the strategic report)
- likely future developments of the Company (page 23 of the strategic report)
- certain employee matters (page 26 and 27 of the strategic report), as well as the disclosures below.

In addition, there are a number of disclosures which are included in the Directors' report by reference, including:

- financial risk management (note 3 of the notes to the financial statements)
- financial instruments (pages 42 to 51 of the strategic report and notes 2(o) and 18 of the notes to the financial statements).

Board of Directors

The Directors in office as at the date of this report (all of whom served during the year) are named on pages 66 and 67.

Financial results and dividend

The Directors recommend a final dividend of 26.62 pence per ordinary share to be paid on 4 September 2018 to shareholders on the register on 6 July 2018, making a total dividend for the year of 38.59 pence, the cost of which will be £162 million, resulting in a transfer to reserves of £38 million. The strategic report on pages 42 to 51 analyses the Group's financial results in more detail and sets out other financial information.

Directors' insurance and indemnities

The Directors have the benefit of the indemnity provisions contained in the Company's Articles of Association ('Articles'), and the Company has maintained throughout the year Directors' and officers' liability insurance for the benefit of the Company, the Directors and its officers. The Company has entered into qualifying third-party indemnity arrangements for the benefit of all its Directors in a form and scope that comply with the requirements of the Companies Act 2006 and which were in force throughout the year and remain in force.

Employment policies and employee involvement

The Group has a culture of continuous improvement through investment in people at all levels within the Group. The Group is committed to pursuing equality and diversity in all its employment activities including recruitment, training, career development and promotion and ensuring there is no bias or discrimination in the treatment of people. In particular, applications for employment are welcomed from persons with disabilities, and special arrangements and adjustments as necessary are made to ensure that applicants are treated fairly when attending for interview or for pre-employment aptitude tests. Wherever possible the opportunity is taken to retrain people who become disabled during their employment in order to maintain their employment within the Group.

The Group has policies in place covering health and safety, equal opportunities, diversity and inclusion, ethics and employee relations. In addition, the Board has a diversity policy details of which are set out in the report of the Nomination Committee on page 81. Information regarding the diversity of the workforce is provided on page 27.

Pennon respects the right to freedom of association and employees are consulted regularly about changes which may affect them either through their trade union-appointed representatives, through consultation groups or by means of the elected staff council which operates in South West Water for staff employees. These forums, together with regular meetings with particular groups of employees, are used to ensure that employees are kept up to date with the business performance of their employer and the financial and economic factors affecting the performance of the Group. The Group also cascades information monthly to all employees to provide them with important and up-to-date information about key events and to obtain feedback from them. Further information about workforce engagement and employment matters relating to the Group is set out on pages 26 and 27 of the strategic report.

The Group encourages share ownership among its employees by operating an HM Revenue & Customs approved Sharesave scheme and Share Incentive Plan. Following shareholder approval at the 2014 AGM, these were amended to provide for the increased savings limits approved by government. At 31 March 2018 around 38% of the Group's employees were participating in these plans.

Greenhouse gas emissions

Change in emissions

Gross greenhouse gas emissions for the Group increased by 11% primarily as a result of Viridor's recently commissioned energy recovery facilities reaching their full operating capacity. 92% of our gross emissions are due to Viridor operations, 93% of which relate to landfill and ERFs. Our ERFs are fuelled by waste, composing of more than 50% biogenic or renewable carbon, which would otherwise have gone to landfill. This has a clear resulting carbon benefit, as a greater proportion of the energy embedded in the residual waste is extracted and methane generation from landfills is avoided.

Following a reduction last year, emissions from landfill increased by 12% because of higher waste inputs to these sites during 2017/18. This is due to an ongoing gap in alternative residual waste treatment capacity in the UK.

Our water businesses' energy usage has stayed effectively flat at 305 GWh compared to 307 GWh the previous year. This represents a balance between our continued significant efforts to improve energy efficiency in the face of some energy-intensive additional process equipment being installed to maintain compliance with regulation.

All Group companies benefitted from a continued reduction in the UK's average electricity grid emissions conversion factor, which fell from 0.44932 $kgCO_2e/kWh$ to 0.38443 $kgCO_2e/kWh$ between 2016/17 and 2017/18. This resulted in an overall reduction in the Group's Scope 2 emissions over the year and has helped both South West Water and Bournemouth Water to reduce their overall carbon footprint by around 8%.

The intensity metric has increased from 127 to 138 tCO_2e/£100,000 turnover reflecting an overall rise in Scope 1 and 2 emissions, as described above, which have grown at a faster rate than our increase in turnover.

Methodology and approach
We have adopted the 'equity share' approach for Viridor companies. This means that emissions from joint venture operations can be accurately attributed to the company in proportion to the percentage of Viridor's holding. The remaining companies in the Group continue to use the 'financial control' approach. This is the conventional method for parent companies and subsidiaries within a group that have the ability to direct financial and operating policies and retain the majority of the organisation's risk and rewards.

The methodology will be reviewed next year in light of the disposal by Viridor of its interest in Viridor Laing (Greater Manchester) Holdings Limited following the reset of the Greater Manchester contract.

Quantification and reporting
We have followed the Government's guidelines for mandatory greenhouse gas emissions reporting published by DEFRA in June 2013 (and updated in October 2013). In calculating our emissions we have used the Greenhouse Gas Protocol Corporate Accounting and Reporting Standard (revised edition) and the web-based conversion factors provided by DEFRA.

'Market' and 'Location' based methodology
In 2015 the Greenhouse Gas Protocol introduced the 'market-based' and 'location-based' methodologies for reporting Scope 2 emissions from imported energy. This change of reporting guidance allows organisations that contractually purchase electricity from generators where the supply is backed by appropriate certificates or other instruments to use an emission factor that is specific to the electricity being purchased. No such qualifying supply was procured by Pennon Group companies for 2017/18 and therefore we have decided to continue to report using only the location-based methodology this year. We intend to review this approach again next year.

Organisational boundary
The emissions listed here cover the Pennon Group of companies, each of which uses the financial control approach, except where Viridor uses an equity share approach where a joint venture exists.

Operational Scopes
We have measured our Scope 1, 2 and certain Scope 3 emissions where information is available.

Intensity measurement
We have chosen an intensity measure of Scope 1 and 2 gross emissions in tCO_2e per £100,000 revenue

External assurance statement
Our greenhouse gas emissions data has been independently verified by Strategic Management Consultants. Certain aspects that relate to the disclosures of South West Water and Bournemouth Water's emissions have been subject to an independent audit of regulatory data conducted by Jacobs. The assumptions methods and procedures that are followed in the development of the reported data have been tested and the data audited for accuracy and consistency.

Carbon offsets
We rely on self-generated renewable energy to reduce our overall Scope 2 emissions and supplement this with power purchase contracts with third parties for renewable energy through private wire where it is available near our sites.

Renewable energy export
Pennon Group self-generates more electricity than it uses and much of its renewable electricity generation is exported to the grid. We account for this exported renewable electricity in our net emissions measure where we subtract 'emissions credits' up to the limit of our gross volume of Scope 2 emissions.

Pennon Group plc greenhouse gas emissions

	2017/18	2016/17
Scope 1	**1,797,147**	1,576,428
Scope 2	**123,665**	144,707
Scope 3	**65,186**	60,760
Total gross emissions	**1,985,997**	1,781,895
Green tariff electricity offset	**(1,738)**	(1,774)
Exported renewable energy reduction (up to total amount of electricity purchased and consumed by organisation)	**(121,927)**	(142,933)
Total annual net emissions	**1,862,333**	1,637,188
Biogenic emissions outside of scopes	**1,520,021**	1,692,423
Intensity measure: tCO_2e (gross Scope 1+2)/£100,000 revenue	**137.9**	127.1

Scope 1 (direct emissions) Activities owned or controlled by our organisation that release emissions straight into the atmosphere, for example the combustion of fuels in company-owned and controlled stationary equipment and transportation, emissions from site-based processes and site-based fugitive emissions.

Scope 2 (indirect emissions) Emissions released into the atmosphere associated with our consumption of purchased electricity, heat, steam and cooling. These are indirect emissions that are a consequence of our activities but which occur at sources we do not own or control.

Scope 3 (other indirect emissions) Emissions that are a consequence of our actions, which occur at sources which we do not own or control and which are not classed as Scope 2 emissions.

Human rights and anti-slavery
The Group is fully supportive of the principles set out in the UN Declaration of Human Rights, and the Group's Code of Conduct outlines the high standards of employment practice with which everyone in Pennon Group is expected to comply. The Group also supports the International Labour Organization's core conventions for the protection and safety of workforces wherever they may be throughout the Group.

The Group's commitment to ensuring the human rights of its employees are not infringed extends to those of its suppliers. Supplier codes of conduct are in place to ensure that people are treated fairly and with respect and dignity.

In addition, we have in place policies and procedures to assess, monitor and reduce the risk of forced labour and human trafficking occurring in our businesses and supply chains. Risk assessments of any high risk supply partners have been completed by Viridor, South West Water and Bournemouth Water to ensure compliance with the Modern Slavery Act across the Group and our anti-slavery and human trafficking web-based statement for the year is available at **www.pennon-group.co.uk**.

Research and development
Research and development within the Group involving water and waste treatment processes amounted to £0.1 million during the year (2016/17 £0.2 million).

Overseas branches
The Company has no overseas branches.

Pennon Group donations
During 2017/18 the Group provided a total of £151,000 in charitable donations.

No political donations were made or political expenditure incurred and no contributions were made to a non-EU political party (2016/17 nil).

Directors' report – other statutory disclosures continued

Purchase of own ordinary shares

The Company has authority from shareholders to purchase up to 10% of its own ordinary shares (as renewed at the Annual General Meeting in 2017), which was valid as at 31 March 2018 and remains currently valid. No purchases were made during the year. As at 1 April 2017, 8,443 shares were held in treasury, with a nominal value of £3,436 and representing 0.002% of issued share capital. No treasury shares were reissued during the year.

Disclosures required by publicly traded companies

The following disclosures are made pursuant to Part 6 of Schedule 7 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and Rule 7.2.6.R of the UK Listing Authority's Disclosure and Transparency Rules (DTR).

As at 31 March 2018:

a) Details of the Company's issued share capital, which consists of ordinary shares of nominal value 40.7 pence each, are set out in note 33 to the financial statements on page 156. All of the Company's issued shares are fully paid up, rank equally in all respects and are listed on the Official List and traded on the London Stock Exchange. The rights and obligations attaching to the Company's shares, in addition to those conferred on their holders by law, are set out in the Company's Articles, copies of which can be obtained from Companies House in the UK or by writing to the Group Company Secretary at the Company's registered office;

b) There are no restrictions on the transfer of issued shares of the Company or on the exercise of voting rights attached to them, except where the Company has exercised its right to suspend their voting rights or to prohibit their transfer following the omission of their holder or any person interested in them to provide the Company with information requested by it in accordance with Part 22 of the Companies Act 2006 or where their holder is precluded from exercising voting rights by the Financial Conduct Authority's Listing Rules or the City Code on Takeovers and Mergers. There are no persons with special rights regarding control of the Company. No shares issued under the employee share schemes have rights with regard to control of the Company that are not exercisable directly by the employees;

c) Details of significant direct or indirect holdings of securities of the Company are set out in the shareholder analysis on page 170. The Company is not aware of any agreements between shareholders which may result in restrictions on the transfer of securities or on voting rights;

d) The Company's rules about the appointment and replacement of Directors are contained in the Articles and accord with usual English company law provisions. The powers of Directors are determined by UK legislation and the Articles in force from time to time. Changes to the Articles must be approved by the Company's shareholders by passing a special resolution;

e) The Directors have the power to make purchases of the Company's own shares in issue as set out above. The Directors also have the authority to allot shares up to an aggregate nominal value of: (i) £56,498,376 (such amount to be reduced by any shares allotted or rights granted under (ii) below in excess of £56,498,376); and (ii) £112,996,752 by way of a rights issue (such amount to be reduced by any shares allotted or rights granted from (i) above), which was approved by shareholders at the 2017 Annual General Meeting (AGM). In addition, shareholders approved a resolution giving the Directors a limited authority to allot shares for cash other than pro rata to existing shareholders. These resolutions remain valid until the conclusion of this year's AGM. Similar resolutions will be proposed at this year's AGM. The Directors have no present intention to issue ordinary shares other than pursuant to the Company's employee share schemes;

f) There are a number of agreements that take effect, alter or terminate upon a change of control of the Company following a takeover bid, such as bank loan agreements, Eurobond documentation, hybrid capital securities documentation, private placement debt and employees' share plans. This may result in certain funding agreements being altered or repaid early. The impact on employees' share plans is not considered significant; and

g) There are no agreements between the Company and its Directors or employees providing for compensation for loss of office or employment that occurs because of a takeover bid.

There is no information to be disclosed under Listing Rule (LR) 9.8.4R. The Company has no long-term incentive arrangements in place under LR 9.4.2R (2) where the only participant is a Director and the arrangement is established specifically to facilitate, in unusual circumstances, the recruitment or retention of the individual.

Going concern

Having considered the Group's funding position and financial projections, the Directors have a reasonable expectation that the Group has adequate resource to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the financial statements.

Statement of Directors' responsibilities

The Directors are responsible for preparing the annual report, the Directors' remuneration report and the financial statements in accordance with applicable law and regulations. Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the Group and Company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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

In preparing these financial statements the Directors are required to:

- select suitable accounting policies and then apply them consistently
- make judgements and accounting estimates which are reasonable and prudent
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements. The Directors confirm that they have complied with the above requirements in preparing the financial statements.

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 Group and the Company; and enable them to ensure that the financial statements and the Directors' remuneration report comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the International Accounting Standards (IAS) Regulation. They are also responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Each of the Directors, whose names and functions are listed on pages 66 and 67, confirms that, to the best of his or her knowledge:

i) The financial statements, which have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit of the Group and of the Company.

ii) The strategic report (pages 1 to 61) and the Directors' report include a fair review of the development and performance of the business during the year and the position of the Company and the Group at the year end, together with a description of the principal risks and uncertainties they face.

iii) Following receipt of advice from the Audit Committee, that the annual report, taken as a whole, is fair, balanced and understandable, and provides the information necessary for the shareholders to assess the Group's position and performance, business model and strategy.

The Directors are responsible for the maintenance and integrity of the Company's website **www.pennon-group.co.uk**. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Statement as to disclosure of information to the auditor

i) So far as each of the Directors in office at the date of the signing of the report is aware, there is no relevant audit information of which the Company's auditor is unaware; and

ii) each of the Directors has taken all the steps each Director ought to have taken individually as a Director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

The Directors' report consisting of pages 64 to 83 and 102 to 105 was approved by the Board on 24 May 2018.

By Order of the Board

Helen Barrett-Hague
Group General Counsel and Company Secretary

24 May 2018