Our CFO's review

Steve Buck
Group Chief Financial Officer

Financial highlights of the year

Underlying profitability improving

Full year underlying profit before tax of £16.8 million following losses in the second half of 2022/23.

More information on pages 47 to 50

Investing for growth

Group capital investment up c.80% versus 2022/23, with investment weighted towards the end of the AMP.

More information on page 49

Robust liquidity and flexible financing strategy

Pennon Group available liquidity in excess of £1 billion.

More information on pages 51 to 52

Acquisition of SES Water

The business acquired on 10th January 2024, representing our ambitions to be a leader in the UK water sector.

More information on pages 49 to 50

I am excited to have joined Pennon at this time in the Company's development. As I look back on the fourth year of our 2020-2025 business plan we continued to outperform the regulatory cost of equity, maintained financial discipline by managing gearing, raised debt to sustain liquidity and made an early start on cost reduction for K8. Furthermore, we are gaining momentum in the build out of our renewable energy generation sites through Pennon Power and see further positive progress in our non-household retail business, Pennon Water Services.

In addition to our organic development, soon after I joined the Company in January, we announced the acquisition of SES Water and the £180 million equity raising to fund the acquisition. This successful transaction represents the ambitions we have as a Company to grow and be a leader in the UK Water sector whilst maintaining our commitment to financial discipline.

Delivery of our regulatory programmes, the reinvestment of RORE, investing in Pennon Power and the acquisition of SES Water have resulted in the largest capital expenditure programme in one year. The level of regulatory investment demonstrates our capacity and capability to deliver at investment rates set out in our PR24 submission.

As I look ahead into the fifth and final year of the K7 plan, we are working to ensure that we are in a strong position financially to support our 2025-30 business plan. We will: diversify our debt portfolio, supported by our debut credit ratings; de-gear the SES Water balance sheet; continue to achieve outperformance on regulatory returns and deliver a step change in our cost base. We have already realised c.£9 million of total benefits in 2023/24 through our existing transformation programmes (including optimisation of sites to reduce power and chemical costs and enhancing contract management processes). We expect to continue and extend this programme, with targeted annualised savings of c. £55 million during K8. We expect further sustainable growth from Pennon Water Services and are expecting our first renewable energy site to start generation late in financial year 2024/25.

The improving performance, following a loss before tax in H2 2023, is expected to continue to the end of K7. The start of K8 will be a point of reset for the financial position of the Group, enabling a return to stronger income statement performance and recognition of the K7 true-ups to Regulated Capital Value^ (RCV). We continue to deliver regulatory outperformance and our investments have generated RCV growth of around 10% in the year, with overall RCV growth of c.65% since the start of K7. Despite the current low level of earnings per share, there is significant retained shareholder value in the regulated business.

Overall, our financial performance for 2023/24 is in line with our expectations. As we have said previously, the impact of high inflation on our cost base reduces our earnings, in particular due to power costs remaining high, and in part due to hedging our power at previous higher prices. The second half of 2023/24 experienced some of the highest levels of rainfall seen in recent times and this contributed to higher wastewater treatment costs. Despite this upward pressure on costs, we have managed to keep our regulated costs broadly flat year on year. Despite increased borrowing levels and rising base rates, our effective interest rate^, in South West Water, has remained broadly constant at 5.6%[5] (2022/23: 5.5%), with the inflationary impact on finance costs stabilising, in part through the £300 million RPI swaps that were put in place in 2022/23. Tariff increases have recovered previous inflationary cost increases. Underlying profit before tax for 2023/24 is up from £16.8 million to £19.3 million before the impact of the acquisition of SES Water, an increase of c.15% compared with 2022/23.

SES Water has contributed to the financial results since 10th January 2024 and is performing in line with our expectations, contributing £35.7 million of revenue and a £2.5 million loss before tax for the c.2.5 months of ownership. In late January 2024, the Competition and Markets Authority (CMA) stated that it did not consider a parallel formal investigation under the Enterprise Act for the non-household aspect of the acquisition to be needed. The regulated aspect of the acquisition of SES Water is progressing through the CMA review and as expected, has been referred for a Phase 2 review under the prescribed process. The CMA has indicated that there are reasonable grounds for believing that the undertakings offered by the parties under the process might be accepted. Whilst the CMA review is ongoing, SES Water and South West Water will continue to be operated independently of each other.

The merger of South West Water and Bristol Water completed on 1st February 2023 with the combined water business now operating under one licence held by South West Water Limited. Within this report, to aid comparability both now and ongoing, the results of South West Water include the operating performance of Bristol Water in both 2023/24 and the comparative period, 2022/23.

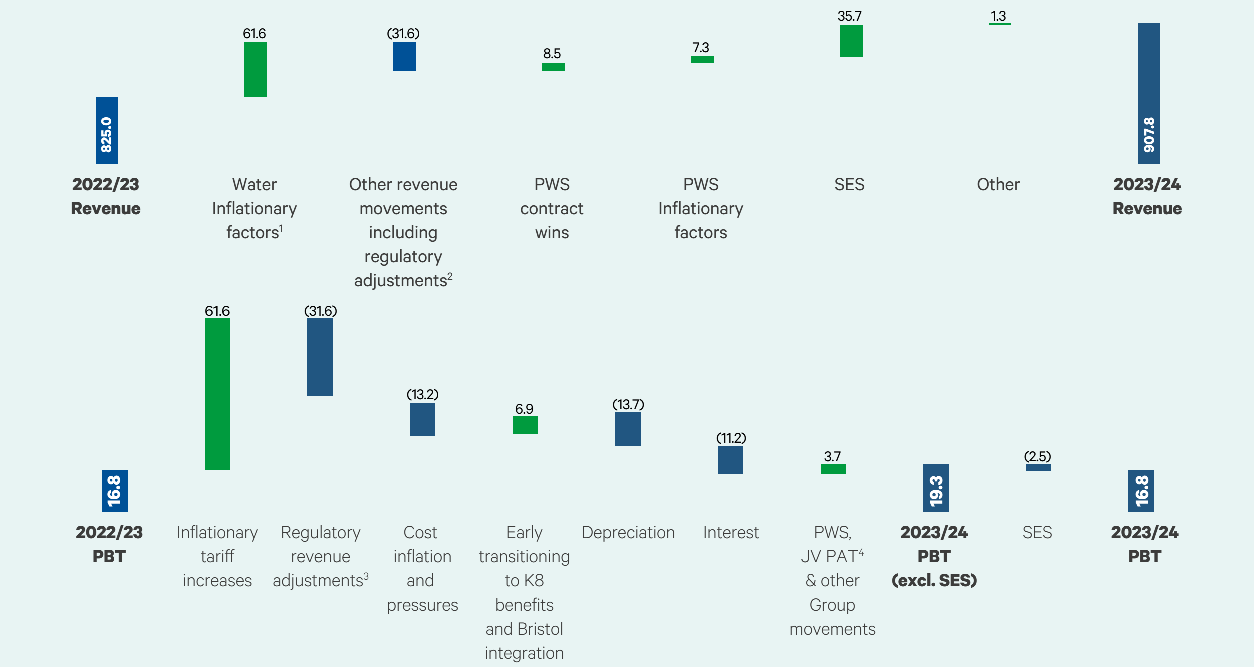
Group performance – summary

The Group's statutory revenue for 2023/24 was £907.8 million compared with £797.2 million in 2022/23 which included non-underlying reductions of £27.8 million in respect of the second issuance under WaterShare+ (£20.2 million) and our "Stop The Drop" demand reduction incentive (£7.6 million). Group underlying revenue increased by £82.8 million, or 10.0%, to £907.8 million, with SES Water contributing £35.7 million of the increase.

Organically[6], underlying revenue has increased by £47.1 million (5.7%) with South West Water's revenue increased by £28.5 million with inflationary tariff increases being offset by ODI penalties and prior year over recovery of revenue. Pennon Water Services' revenue increased by £15.8 million to £233.8 million, with new contracts, predominantly outside South West Water's regions, contributing c.£9 million to this increase.

Overall, underlying EBITDA has increased 9.9% from £307.8 million to £338.3 million with South West Water and Pennon Water Services contributing £332.5 million and £7.4 million respectively of this overall increase. SES Water contributed £3.6 million to the overall increase.

Revenue underlying^ (£m)



1. Includes K and inflation.
2. Includes ODI impacts and prior year revenue over recovery.
3. Includes K, ODI penalties and prior year over recovery of revenue.
4. PWS - 80:20 joint venture with South Staffs, Water2Business - 30% share of joint venture with Wessex Water.
5. Based on South West Water Group, including Bristol Water, excluding SES.
6. References to organic movements throughout this commentary refer to the performance of the business excluding the contribution from SES Water from 10th January 2024.

^ Measures with this symbol are defined in the alternative performance measures section of the annual report on pages 239 to 242.

Further details of the performance of South West Water, Pennon Water Services and SES Water are outlined below.

We recognise the pressure the ongoing cost-of-living crisis puts on our customers, so we are determined to continue to assist customers with access to a broad range of affordability measures to support those in financial need. Across all Group businesses, the potential impact of significant increases in the cost of living on affordability has been considered in assessing our expected credit loss charges.

Cash collections across the Group have remained robust during the financial year. Expected credit loss charges for 2023/24 of £6.3 million for South West Water (0.9% of revenue) are in line with previous levels (2022/23: 1.0%). For Pennon Water Services, the expected credit loss charge of £1.0 million (0.4% of revenue) is also in line with previous levels (2022/23: 0.4% of revenue).

The Group reported a statutory loss before tax of £9.1 million (2022/23: loss of £8.5 million) after net non-underlying costs of £25.9 million (2022/23: £25.3 million). Group underlying profit before tax is in line with prior year at £16.8 million (2022/23: £16.8 million) with SES Water contributing an underlying loss before tax of £2.5 million. Organically, Group underlying profit before tax increased by £2.5 million to £19.3 million. While this outturn reflects a marginal overall improvement in earnings compared with 2022/23, it represents an overall marked improvement in performance given the challenging operating conditions, caused by the excessive rainfall during the second half of 2023/24. Underlying, organic profit before tax in H2 2023/24 was £10.2 million compared to an underlying loss of £5.7m in H2 2022/23.

Segmental performance – Water

South West Water

Since 1st February 2023, the trade and the significant majority of assets and liabilities of Bristol Water plc were transferred to South West Water Limited under a statutory transfer mechanism set out in the Water Industry Act. The Bristol Water brand continues as a trading name of South West Water. As noted above, the financial performance of South West Water includes the performance of Bristol Water in both this financial year and the comparative year.

South West Water's statutory revenue for 2023/24 was £729.8 million compared with £673.5 million in 2022/23. Last year's revenue included non-underlying reductions of £27.8 million in respect of the second issuance under WaterShare+ (£20.2 million) and our 'Stop The Drop' demand reduction incentive (£7.6 million). Underlying revenue of £729.8 million for 2023/24 has increased by 4.1% compared with the prior period (2022/23: £701.3 million). The revenue growth of £28.5 million is explained above.

Underlying operating costs of £397.3 million are largely flat year on year with a small increase of £4.4 million (2022/23: £392.9 million). Normal inflationary increases have been offset by early benefits from our transformation programme and continuing integration efficiencies. Energy unit prices, which were specifically impacted by high levels of inflation over the last two years are now stabilising with a year on year decrease of £1.0 million. However, in order to de-risk the business from the volatility of the wholesale energy markets, some of the recent higher power prices were locked in through our hedging strategy. We expect the impact of those to decline over the coming year.

South West Water's underlying EBITDA increased by 7.8% to £332.5 million. Underlying operating profit has increased by 6.7% reflecting the improved EBITDA performance and an increase in the depreciation charge of £13.4 million compared to last year as our accelerated capital investment programme starts to impact the depreciation charge.

Major categories of Capital expenditure (£m)

The net interest charge of £155.5 million is £10.2 million higher than prior year (2022/23: £145.3 million), reflecting an effective interest rate^ of 5.6%[1] (2022/23: 5.5%).

South West Water's statutory loss before tax was £1.0 million (2022/23: loss of £29.6 million) after non-underlying costs of £15.6 million (2022/23: £43.7 million).

South West Water's capital expenditure was £582.9 million, an increase of £224.7 million (62.7%) on the prior year (2022/23: £358.2 million). The final determination, Green Recovery, Defra accelerated delivery, and the RORE reinvestment were weighted towards the end of the K7.

Major categories of Capital expenditure (£m)
Enhancement spend has been pulled forward from year 5 to year 4 by c.£80 million due to our investment in water resources and network monitoring. This expenditure is delivering new water treatment works in Bournemouth, a desalination plant in Cornwall, additional reservoirs to improve resilience to drought, and enhanced network monitoring including acoustic loggers and sewer level monitors.

Base expenditure has increased by c.£80 million as a result of spend to mitigate the impact of the weather on our assets, and the expansion of our Quality First programme across the regions. The exceptional weather we have experienced over the year has resulted in spend to minimise pollutions and spills and to drive targeted reductions in leakage. We expect 50% (£40 million) of the increase to be recovered in our RCV in K8.

SES Water

SES Water has contributed to the financial results since 10th January 2024. Since that date, the business has contributed £35.7 million of revenue and £3.6 million of EBITDA to the Group results. The business continues to be impacted by high levels of financing costs which the Group intends to address where possible once it is able to leverage benefits from the Group's financing strategy, as and when CMA clearance is obtained. In the period since acquisition, the business has performed in line with our expectations.

Over the 12 month period to 31st March 2024, SES Water has benefited from higher revenues, mainly due to tariff rises allowed under the regulatory regime and increased non-household demand. Operating costs have increased in the year, mainly driven by supply chain pressures resulting in higher electricity costs and chemical spend. Financing costs continue to be adversely impacted by high inflation on the index linked bond although this pressure is starting to reduce as RPI comes down.

1. A measure of the mean average interest rate payable on net debt associated with South West Water Ltd's group of companies, which excludes interest costs not directly associated with net debt.

Segmental performance - non-household retail

Pennon Water Services[1]

Pennon Water Services has delivered a strong financial performance for the year through its continued focus on key strategic initiatives; growing through long-term contracts in targeted business sectors, good customer retention and strong control of operating costs despite additional cost pressures.

Non-household demand within our wholesale water region fell due to usage; however, year on year revenue, EBITDA and profit before tax have continued to grow throughout 2023/24.

The overall impact on revenues for Pennon Water Services, including the impact of new contract wins, is an increase of 7.2% compared to the prior year. New business wins have contributed £8.5 million of additional revenue compared to the last year, with inflation (net of customer attrition) contributing further to the increase.

The non-household market continues to be very competitive with low margins, as a result, a clear focus on cost control and efficiencies is critical to the success of the business. The business has improved its performance year on year, with underlying operating costs growing marginally behind improving revenues, the business has improved its underlying EBITDA by c.72% to £7.4 million (2022/23: £4.3 million). This strong performance has resulted in the business reporting a profit before tax of £4.7 million (2022/23: £1.8 million), an increase of 161%.

Group net finance costs

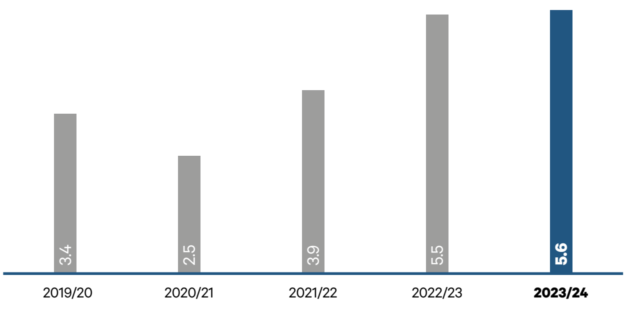
Total net finance costs were £150.2 million compared to £118.2 million in 2022/23, which included a non-underlying gain of £18.4 million resulting from the repayment of the Bristol Water plc index linked bond due 2041. There are no non-underlying finance costs in 2023/24.

Underlying net finance costs for the Group of £150.2 million are £13.6 million higher than last year (2022/23 £136.6 million) arising from: c.£29 million increased levels of net debt, including post-acquisition finance costs of the SES Group; continued rate rises (c.£9 million), offset by reduction in inflation (c.£15 million) and increased levels of capitalised interest on our capital programme (c.£9 million).

The non-cash element of our finance charges, which accretes to the debt principal, was c.£56 million (2022/23 c.£67 million).

Overall, the efficient funding mix and hedging strategy has resulted in an effective interest rate of 5.6% (2022/23 5.5%) for South West Water. The Group continues to efficiently secure funding for South West Water through its Sustainable Financing Framework and to ensure c.60% of its interest rate risk is mitigated in line with the Group Treasury Policy, which is achieved both through issuing fixed rate debt and effective interest rate hedging, with a further element being index-linked.

Progression of effective interest rates



Share of post-tax profit from associated companies

The Group has a 30% interest in Water2Business Limited (W2B), a water retailer joint venture with Wessex Water. This investment is accounted for under the equity method and following a period of losses as the business reached scale, we are pleased to recognise £0.7 million of profit after tax from our associated company, in our 2023/24 results (2022/23: £0.3 million), an increase of 133%.

1. PWS - 80:20 joint venture with South Staffordshire.

Acquisition accounting

As part of the requirements of acquisition accounting, we have determined the provisional fair values of the acquired balance sheet of SES Water. Goodwill arising from the acquisition of £15.6 million, based on these provisional fair values, has been recorded in the Group consolidated balance sheet and is attributable to the recognition of deferred tax liabilities on fair value gains recognised as part of the acquisition. The acquisition of the SES Water Group provides a strategic fit for Pennon Group plc as the Group expands its presence in water supply across Southern England.

These provisional values will continue to be reviewed and will be finalised within 12 months from the date of the acquisition. The most material areas of adjustment relate to the fair value of acquired property, plant and equipment, including the network infrastructure, and the fair value of SES Water's debt portfolio.

Non-underlying items

Non-underlying items for 2023/24 were a net charge before tax of £25.9 million (2022/23: net charge of £25.3 million). Non-underlying items are those that in the Directors' view should be separately identified by virtue of their size, nature or incidence and where they believe excluding non-underlying items provides a more useful comparison of business trends and performance.

The non-underlying charge includes:

- £13.9 million of costs in connection with the setting up of a business transformation programme in South West Water following the merger of Bristol Water into South West Water.
- £0.6 million of expenses in connection with the strategic review of renewable energy generating investments, not directly attributable to the intangible assets acquired.
- £9.6 million of expenses in connection with the acquisition of SES Water and the related merger review by the CMA.
- £1.8 million of further specifically identifiable costs in respect of mitigating measures and one-off expenditure to address the impacts of severe drought conditions following costs of £17.0 million incurred in 2022/23.

The non-underlying charges in 2023/24 give rise to a net tax credit of £4.9 million in relation to the above items.

Responsible approach to tax

We are proud of our responsible approach to tax. The Group has maintained the Fair Tax Mark accreditation for the year, having been the first water company to achieve this status and holding the award continuously since 2018.

The overall 2023/24 tax credit for the Group is £0.6 million (2022/23: credit of £8.9 million). On an underlying basis, the net tax charge for 2023/24 for the Group of £4.3 million (2022/23: credit of £3.6 million) consists of:

- Current tax credit of £0.6 million, reflecting an effective tax credit rate of 3.6% (2022/23: credit of £2.7 million, 16.1%). The reduction in rate is due to the Group generating tax losses, all of which are carried forward for future relief. These tax losses reflect the enhanced capital allowances available because of full expensing and first year allowances, along with pension payments made during recent years where tax relief is now due, and capitalised interest which for tax purposes is deductible in the year incurred. Around 50% of the Group's capital additions qualify for enhanced capital allowances. This current tax credit relates to prior year adjustments in respect of additional interest deductions due in accordance with UK tax legislation.
- Deferred tax charge of £4.9 million (2022/23: credit of £0.9 million). This primarily reflects a current year deferred tax charge in relation to capital allowances in excess of depreciation charged across the Group, largely due to full expensing, and a charge in respect of pension payments paid in previous years and where tax relief is now due. These are offset by a credit for tax losses carried forward for utilisation in later periods. The prior year deferred tax charge is £nil.

There is also a non-underlying deferred tax credit of £4.9 million in 2023/24 relating to the non-underlying items set out above. This relates to losses carried forward for utilisation in later years.

Full expensing deductions which originally applied for the three years from 1st April 2023 to 31st March 2026 together with 50% first year allowances on long life assets and integral features, were made permanent in the recent Autumn Statement. Given the Group's continued capital investment programme, these changes mean that the Group does not expect to generate taxable profits for the foreseeable future, and therefore does not expect to make any corporation tax payments during this time.

Earnings per share

The earnings per share calculations reflect an increase in average shares due to the equity raise in January 2024. The Group has recorded a statutory loss per share of 3.6 pence per share for the year ended 31st March 2024 (2022/23: earnings of nil pence per share). This includes a net non-underlying charge before tax of £25.9 million (2022/23: £25.3 million) and a net non-underlying tax credit of £4.9 million (2022/23: credit of £5.3 million).

Our adjusted earnings per share excludes the impact of deferred tax charges and non-underlying items. For the Group, we have generated adjusted earnings per share^ for 2023/24 of 6.2 pence (2022/23: 7.3 pence). Excluding the impact of the loss generated by SES Water in the period post acquisition, our adjusted earnings per share would be 7.2 pence.

Net debt movements

The Group's cash flow from operating activities for 2023/24 was £261.7 million (2022/23: £313.7 million). Cash collections have remained robust and we continue to monitor these closely and are focused on providing a broad range of affordability measures to support those in financial need. The reduction in operating cashflow reflects the lower levels of underlying profitability in the last two financial years, caused by inflationary pressures, alongside the cash impact of our Watershare+ and 'Stop the Drop' bill credits which were recognised the income statement in H2 2022/23.

Net interest payments were £109.1 million (2022/23: £154.8 million) with the higher payment in 2022/23 driven by £51.5 million of interest paid on lease settlements relating to interest which accretes to the lease principal.

Capital expenditure has resulted in an increase in capital investment cash outflows of £267.6 million to £598.1 million (2022/23: £330.5 million). This includes c.£49 million of cash outlay from the total £59 million investment recognised in Pennon Power.

The acquisition of SES Water resulted in net cash outflows of £62.7 million being £90.2 million gross consideration, net of £27.5 million cash acquired. The Group's net debt is further increased by the £360.1 million book value of SES Water's net debt including fair value adjustments of c.£15 million at the point of acquisition. In addition, £9.6 million of acquisition transaction costs and costs associated with the CMA review have been recognised as non-underlying operating costs and cash flows.

In connection with the acquisition, we completed an equity capital raise in order to ensure we maintain financial discipline with the leverage and capital structure for the Group. Proceeds from the equity raise, net of associated expenses, were £175.7 million.

Other significant movements in net debt in 2023/24 include payment of our interim and final dividends for 2022/23 (£111.7 million) and £46.8 million of non-cash indexation on our loan instruments.

The Group's IFRS net debt at 31st March 2024 was £3,809.2 million (31st March 2023 £2,965.4 million). This includes fair value adjustments on acquired debt of £125.7 million which are released over the life of the related debt instruments. The Group's net debt position excluding these adjustments is £3,683.5 million.

Sustainable net debt

Pennon Group – summarised net debt flow (£m)	2023/24 flows
Net debt excluding fair value uplifts 1 April	(2,841.4)
Opening balance 1 April	**(2,965.4)**
Cash generated from operations	261.7
Corporation tax received	3.4
Net interest paid	(109.1)
Capital investment	(598.1)
SES acquisition, net of cash acquired[1]	(62.7)
Debt acquired on acquisition including fair value adjustments	(360.1)
Proceeds from share issue	175.7
Ordinary dividends paid	(111.7)
Non-cash index-linked accretion	(46.8)
Other movements[2]	3.9
Closing balance 31 March	**(3,809.2)**
Net debt excluding fair value uplifts 31 March	(3,683.5)[3]

Robust liquidity and flexible funding strategy

As at 31st March 2024, the Group has £601.4 million of cash and committed facilities. This consists of cash and cash deposits of £171 million (including £26 million of restricted funds representing deposits with lessors against future lease obligations) and £335 million of undrawn committed facilities. A further £500 million has been raised since March 2024, providing the Group with in excess of c.£1 billion of available liquidity, providing enough funding to support its obligations for at least the next 18 months.

Since 31st March 2023, the Group has secured c.£675 million of new debt, through its diverse portfolio of debt, consisting of:

- £475 million in private placements with an average maturity of 13 years
- £100 million of new term loans and leasing with an average maturity of 9 years
- £100 million bilateral facility to support Group investments.

In addition, further pre-funding of £500 million has been secured.

The issuance of private placements signals the move to more benchmark-sized transactions in both the private placement and public bond markets, as the capital expenditure and ongoing refinancing continues. Our most recent private placements were at least 4.5 times oversubscribed, showing continued support for the Group.

This will see South West Water obtain two strong investment grade credit ratings during 2024 and it plans to establish a EMTN[4] programme to facilitate further public issuances and maintain our diverse financing portfolio.

We look to raise all new and renewed facilities under our Sustainable Financing Framework where possible with 82% achieved in 2023/24.

The Group took steps during the previous financial year to re-balance the proportion of index-linked debt to align with previously maintained levels for the longer-term. Whilst the current level is around 20% including SES Water we expect this to increase in March 2025 as the swaps mature.

Resulting from the changes above and drawing of new debt during the year, South West Water gross debt at 31st March 2024 was £3,323 million (31st March 2023 £2,918 million). The debt has a maturity of up to 33 years with a weighted average maturity of 13 years.

1. Reflecting £90.2 million on acquisition of SES Water, offset by £27.5 million cash acquired.
2. Includes unwind of fair value adjustments.
3. Carrying value of fair value acquisition adjustments to net debt as at 31st March 2024 – £32.8 million Bournemouth Water, £79.3 million Bristol Water and SES Water £13.6 million.
4. Euro Medium Term Note.

South West Water[1] net debt at 31st March 2024 is a mix of fixed / swapped (£2,147 million, 65%), floating (£696 million, 21%) and index-linked borrowings (£452 million, 14%), which reflects our diverse debt portfolio and compares to an industry average[2] of fixed / swapped 40%, floating 7% and index-linked 53%. New debt raised during this regulatory period has been fixed to align to iBoxx indices in line with Ofwat's approach to allowed cost of debt. Where appropriate, derivatives are used to fix the rate on floating rate debt.

At 31st March 2024, South West Water's net debt to RCV ratio[3] stood at 63.5% (31st March 2023 60.8%). This is due to increased capital expenditure and reduced operating cashflows.

South West Water's cost of finance, with an effective interest rate in 2023/24 of 5.6%[1], continues to benefit from the diverse portfolio of debt.

Strong investment grade gearing levels

As we progress through the remainder of K7, we expect the mix of our debt portfolio to evolve. We are currently considering the most effective debt structure to provide best value for our shareholders whilst maintaining the flexibility to adjust to market challenges and to remain within our treasury policy of at least 60% fixed rate debt throughout the current regulatory period.

As the Group continues to grow through capital investment in our infrastructure so will our funding requirements. In the coming years, we expect the Group to manage its portfolio with larger, and more diverse debt instruments, taking advantage of the public ratings once established. The Group plans to raise c.£500 million in new funding by March 2025 to complete the K7 business plan.

We will continue to maintain a diverse portfolio of debt to support flexibility and growth opportunities. In the long term, this investment will provide returns through K8 revenues and a higher RCV.

As we look to obtain strong investment grade credit ratings during the year, a target gearing level of below 72% will need to be maintained and South West Water remains well within the level.

As the year progresses, further clarity will be provided through the draft and final determinations. The Group and Water business balance sheets will be optimised post SES Water CMA clearance and the PR24 outcomes. The start of the new PR24 business plans, in April 2025, will provide a point of re-set and policy review.

Retaining value in the regulated business

In the first four years of K7, South West Water has created c.£820 million of value for the Group from base returns, RORE outperformance and the growth in RCV. The South West Water Board has taken a prudent approach to its dividend payments in making distributions to Pennon Group and as result c.£250 million has been distributed in K7 to date. This results in over £500 million of retained value in South West Water, which the South West Water Board will consider as K7 closes.

Internal borrowing

South West Water's funding is treated for regulatory purposes as ring-fenced. This means that funds raised by South West Water are not available for other areas of the Group.

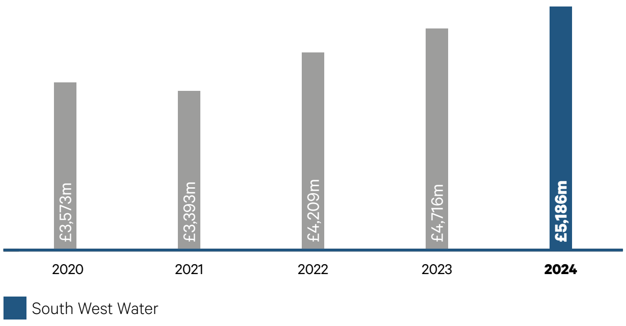
Bristol Water was transferred to South West Water in February 2023 and all the debt is now managed on the South West Water standard covenant package as unsecured and unrated.

Following its acquisition, SES Water continues to maintain its current Group structure, which will be reviewed as part of the integration process.

Pennon Water Services funding is predominantly provided by Pennon. Pennon will continue to use funds to support the Group's ongoing operations as appropriate.

1. Based on South West Water Group, including Bristol Water excl. SES.
2. UK water position as at 31st March 2023 as per published Annual Performance Reports – weighted average.
3. Based on South West Water group including Bristol Water net debt/shadow RCV.

South West Water RCV^



Taxation strategy

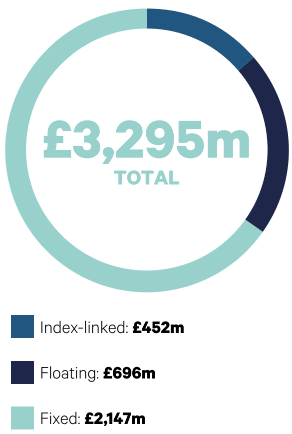
Transparency remains a critical component of our approach, recognising that openness and honesty with our customers is essential. Optimising our tax position benefits them, for example by keeping water bills down, but we do not enter into artificial tax arrangements, use tax havens or take an aggressive stance in the interpretation of tax legislation. As a long-term business with a long-term approach to financial management, there have been no changes to the Group's overall tax strategy this year compared to last.

We continue to hold the Fair Tax Mark. Launched in 2014, the Fair Tax Foundation's purpose is to encourage and recognise businesses through their Fair Tax Mark accreditation scheme. This is an independent accreditation scheme for businesses paying their fair share of corporation tax and reporting on their tax practices transparently. We have also inspired other water companies to apply for the accreditation, thereby improving the tax transparency of the sector in which we operate.

Under our tax strategy we:

- At all times, consider the Group's corporate and social responsibilities in relation to its tax affairs.
- Operate appropriate tax risk governance processes to ensure that the policies are applied throughout the Group.
- Comply with our legal requirements, file all appropriate returns on time and make all tax payments by the due date.
- Consider all taxes as part of ongoing decisions.
- Do not enter into artificial tax arrangements nor take an aggressive stance in the interpretation of tax legislation.
- Do not undertake transactions that are outside the Group's low-risk appetite for tax or not in line with the Group's Code of Conduct.
- Engage with HMRC in a proactive and transparent way and discuss our interpretation of tax laws in real time, such interpretations following both the letter and spirit of the laws.

South West Water Net Debt Structure (£m)



- Do not have any connections with tax havens unless it is necessary for the purposes of trading within those jurisdictions.
- As a long-term business with a long-term approach to financial management, there have been no changes to the tax strategy which is reviewed and reaffirmed on an annual basis.

Further details are given in the Group's tax strategy report available on the Pennon Group website www.pennon-group.co.uk

Tax contribution 2023/24 – borne/collected

The Group's total tax contribution (TTC) for 2023/24 amounted to £100 million (excluding £144 million of VAT receipts) (2022/23 £95 million excluding £150 million of VAT receipts). TTC is a standardised measure of a group's total tax contribution, having been developed by PwC and the 100 Group (FTSE 100 Finance Directors). It is acknowledged as being a fair and comparable representation of total tax cost.

TTC looks at taxes borne, and taxes collected. Taxes borne includes all taxes which are a cost to the Group, such as business rates, corporation tax and employers' National Insurance contributions (NICs). Taxes collected and recovered highlights where the business is collecting tax on behalf of HMRC.

Employment taxes totalled £52 million (2022/23 £41 million) including employees' Pay As You Earn (PAYE) and total NICs. The total amount of £52 million includes PAYE of £5 million (2022/23 £4 million) on pension payments made by the Group pension scheme. A net amount of £37 million (2022/23 £30 million) was collected on behalf of the authorities for employee payroll taxes.

Business rates of £30 million (2022/23 £35 million) were paid to local authorities. This is a direct cost to the Group and reduces profit before tax.

UK Corporation Tax receipts from HMRC in the year were £3 million (2022/23 £1 million payment) in relation to over-payments made in prior years. There were no payments due in respect of 2023/24 as the Group has generated tax losses in the year.

Payments to the Environment Agency and other regulatory bodies total £20 million (2022/23 £17 million). This reduces profit before tax.

Fuel excise duty of £1 million (2022/23 £1 million) related to transport costs. This reduces profit before tax.

VAT repayments of £144 million (2022/23 £150 million) have been received by the Group from HMRC. VAT has no material impact on profit and is excluded from the TTC figure to avoid distortions in this.

Contingencies

Ofwat and the Environment Agency (EA) announced an industry-wide investigation into sewage treatment works on 18th November 2021. On 27th June 2022, as part of its ongoing investigation, Ofwat announced enforcement action against South West Water Limited, the company is now included alongside five other companies which received enforcement notices in March 2022. The Group continues to work openly with Ofwat to comply with the notice as part of this ongoing investigation. The Group has undertaken its own internal investigation and investment interventions have been undertaken at a small number of our sites. In addition, the Group has looked for opportunities for additional future investment to include further storm storage and an extension of its sewer misuse programme which has been shared with Ofwat. Ofwat have yet to formally respond on the investigation and the timing of a response is unknown, although has been potentially indicated for Summer 2024.

Until such time that an initial response is received, the potential outcome of these investigations continues to be unknown. Ofwat has a range of options that it could apply from closing the investigation with no further action, agreeing to formal S.19 undertakings through to fining the Group up to 10% of its revenue in relation to the regulated wastewater business. Given the wide range of possible outcomes therefore the potential outcome of this investigation continues to be unknown, and it is not possible to estimate any obligations arising from the investigation with any certainty.

On 23rd May 2023 Ofwat announced an investigation into South West Water's 2021/22 operational performance data relating to leakage and per capita consumption. This operational performance data was reported in South

Total Tax Contribution

- Employment taxes: **£52m**
- Business rates: **£30m**
- Corporation tax: **£-3m**
- Environmental payments: **£14m**
- Fuel excise duty: **£1m**
- Other: **£6m**

West Water's Annual Performance Report 2021/22. This report is subject to assurance processes which include independent checks and balances carried out by an external technical auditor. The Group continues to work openly and constructively with Ofwat to comply with the formal notice issued to South West Water as part of this investigation. The Group has undertaken its own internal investigation into the data and third party experts have concluded the calculations are within a tolerance as reported, as a result there were no detrimental impacts to customers through Outcome Delivery Incentives ('ODIs'). The Group recognises opportunities to enhance data quality to improve the estimation process and these have been shared with Ofwat.

Until such time that an initial response is received, the potential outcome of these investigations continues to be unknown. Ofwat has a range of options that it could apply from closing the investigation with no further action, agreeing to formal S.19 undertakings through to fining the Group up to 10% of its revenue in relation to the regulated drinking water business. Given the wide range of possible outcomes therefore the potential outcome of this investigation continues to be unknown, and it is not possible to estimate any obligations arising from the investigation with any certainty.

Pensions

At 31st March 2024, the overall surplus on retirement obligations of £26.6 million compares to a surplus of £29.3 million at 31st March 2023.

The small reduction in the overall Group surplus in 2023/24 of c.£3 million reflects:

- c. £8 million net reduction in surplus of the Group's principal pension scheme, Pennon Group Pension Scheme (PGPS), recognised in other comprehensive income, reflecting adverse experience losses on deferred revaluation and pension increases, offset by favourable movements in gains in demographic assumptions.
- c. £3 million recognition of net pension surplus acquired with SES Water.
- c. £2 million increase on Bristol Water scheme surplus arising from change in income tax rate which is applied to restrict the surplus recognised.

The triennial valuation of PGPS as at 31st March 2022 was finalised in March 2023 and no deficit recovery contributions were required. The ongoing funding requirements for the Company to the scheme are limited to the continuing administration expenses.

The Group pension surplus includes a net surplus of c.£9 million (31st March 2023: c.£7 million) relating to the Bristol Water Section of the Water Companies Pension Scheme (WCPS). The gross surplus remains largely unchanged as the liabilities of the scheme are fully insured through a bulk annuity policy. The net surplus has increased as the tax rate on the restriction applied to the surplus under UK tax legislation has reduced from 35% to 25%. The trustee of WCPS continues to work through the process to wind up the Bristol Water section of WCPS and has indicated its intention to return the surplus to the Company.

The net surplus recognised from the SES Water acquisition reflects the surplus in the SES Water section of WCPS. The trustee of WCPS has recently fully insured the liabilities of the scheme through a bulk annuity policy. The surplus has been restricted for income tax, consistent with the Bristol Water scheme.

Dividends

The Group continues to strive to deliver on its commitments to customers, shareholders and stakeholders as our investments drive strong and sustainable results. Around 50% of Pennon's shareholders are UK-based investors including individuals, pension funds, and charities. Over a third of the Group's c.3,500 employees (excluding SES Water) are shareholders and following the second issuance of our unique WaterShare+ initiative, around 90,000 customers are now also shareholders.

Pennon's 2020-2025 dividend policy of growth of CPIH +2% reflects the Board's ongoing confidence in the Group's strategy and is underpinned by continued RORE outperformance in South West Water.

The Board has recommended a final dividend of 30.33 pence per share for the year ended 31st March 2024. Together with the interim dividend of 14.04 pence per share paid on 5th April 2024 this gives a total dividend for the year of 44.37 pence. This represents an increase of 3.84% on 2022/23 which is per our policy (March 2024 CPIH + 2%) with a 1.96% reduction for the £2.4 million fine from the Environment Agency. Pennon offers shareholders the opportunity to invest their dividend in a Dividend Reinvestment Plan (DRIP).

The proposed dividends totalling £126.9 million are covered 2.7 times by underlying EBITDA (2022/23 2.8 times). Pennon Group plc has substantial retained earnings and a sustainable balance sheet to support its stated dividend policy. The strong fundamentals of its principal operating subsidiary, South West Water Limited, underpin this policy with its strong RORE and growing RCV. Dividends are charged against retained earnings in the year in which they are paid.

Investing for sustainable growth – renewable energy generation

In line with both our long-term sustainable growth strategy in UK environmental infrastructure and our commitment to deliver Net Zero by 2030, we have committed c.£145 million for investment in renewable energy generation. This strategy will also benefit the Group by reducing our exposure to future volatility in wholesale power markets and will deliver attractive and sustainable financial returns.

Pennon Power, a wholly owned subsidiary to Pennon Group plc, has acquired the rights to build four solar farms, one of which includes a co-located battery storage asset in the UK. Specifically these investments include:

- A co-located solar (45 MWp) and battery storage (60 MWh) site in Fife, acquired in May 2023. This is a ready to build site, with consents in place, with total build costs expected to be c.£60 million. Solar generation is expected to be c.39 GWh commencing at the end of next financial year 2024/25.
- A further three sites, located in Aberdeenshire, Cumbria and Buckinghamshire, acquired in July 2023. These sites, with total anticipated build costs of c.£85 million, are expected to provide a further 98.5MWp of generation capacity, generating c.96 GWh and are targeted to be operational during 2025 and first half of 2026.

Of this overall commitment, we have incurred total costs of c.£59 million for the acquisition of these sites and construction costs to date on our first project at Fife. This is expected to commence energy generation late in financial year 2024/25. Aberdeenshire and Cumbria sites will enter construction during late summer 2024 and Buckinghamshire in 2025. The financial contribution will accelerate in financial year 2025/26 and all four sites will generate income during 2026/27.

1. On track or ahead of target, or within regulatory tolerances (deadband).
2. All guidance measured on an underlying basis.
3. Excludes impact of Per Capita Consumption, as under review by Ofwat
4. Based on current market pricing and current hedged position of c.85% for 2024/25 and c.30% for 2025/26

Return on Regulated Equity^

During K7 to date we have continued to deliver South West Water group RORE performance (excluding SES Water) of 7.3% cumulatively, equating to c.£160 million of outperformance. This consists of c.£255 million financing outperformance, net of c.£60 million totex^ overspend, and c.£35 million ODI net penalty impact. This has enabled the funding of additional capital investment initiatives as noted above.

The cumulative benefits from the structure of our debt book on financing costs persist, but have reduced due to the impact of falling inflation. Totex performance has been impacted in year due to peak levels of capital expenditure following past outperformance.

ODI performance across the South West Water group in 2023/24 has been impacted by the extreme weather events, including heavy rainfall through to March 2024. As a consequence, South West Water has incurred a penalty of c. £12.1m[3] (FY2022/23: penalty c. £4.2m). South West Water continues to build on its ODI performance with c.70% either on track or ahead of target[1] across a broad range of challenging bespoke, common, and comparative measures. This performance will contribute to the potential ODI award at the end of K7. ODI performance for Bristol Water is on track to achieve c. 70% of its ODIs and has resulted in a net financial penalty of c. £1.7m[9] (FY2022/23: penalty of c. £5.9m).

Financial outlook[2]

Looking to 2024/25, we expect overall organic revenue growth with the combined impact of inflation on our 2024/25 tariffs (net of the year on year impact of regulatory adjustments and ODI penalties) and ongoing expected growth in our non-household retail business. The full year impact of trading at SES Water will improve this further.

Overall, we expect total operating costs in South West Water to be broadly flat compared to 2023/24 levels. Total power costs[4] in 2023/24 were £110 million (wholesale costs £73 million, non-commodity costs £37 million). Whilst wholesale power cost levels are falling, we anticipate a more modest improvement in our overall power costs as the impact of hedging over the last two years continues to unwind. These expected reductions coupled with other efficiencies from our transformation programmes will be largely offset by normal inflationary pressures on other input costs. In particular we continue to recognise the pressures of the cost of living on our colleagues and pay increases of c.4% have been agreed. Total Group operating costs will increase overall, with growth in the non-household retail business outside our region increasing wholesale water costs, and the impact of an additional nine months of trading at SES Water.

Further increases in depreciation are expected as a result of our capital investment programme and the full year impact of SES Water.

Increased debt levels to support our capital investment profile are expected to result in an overall increase in net finance costs. The total Group net finance costs are also expected to increase with the full year impact of SES.

Overall capital expenditure is expected to reduce in 2024/25. In South West Water, following the peak in 2023/24, we expect overall capital expenditure of c.£930 million in the last two years of K7. However we will continue to assess the benefits of early start expenditure for K8. The build-out of our Pennon Power renewable energy sites will continue. The full year impact of SES Water will represent a small increase in our overall capital expenditure.

We remain in a strong position from a liquidity perspective with additional facilities already raised in the early part of the year, and with further programmes planned, supported by our plan to have two strong public ratings by the end of the year.

The Group's RCV is expected to increase in line with K7 business plan levels of investment in addition to additional and accelerated investment, regulatory true-ups ad inflationary impacts. SES Water's RCV at 31st March 2024 was c.£0.4 billion.

Steve Buck
Group Chief Financial Officer

20th May 2024