



WONDERFUL ON TAP

Highlights

Group turnover

£1,694.1m

2017: £1,638.0m

Group profit before interest and tax

£528.4m

2017: £536.7m

Group underlying profit before interest and tax¹

£541.0m

2017: £520.1m

Dividend per share

86.55p

2017: 81.5p

Basic earnings per share from continuing operations

102.2p

2017: 136.8p

Underlying basic earnings per share¹

121.0p

2017: 115.7p

Focus on operational improvement:

Net ODI outperformance

payment £80.2m

In 2012/13 prices pre-tax

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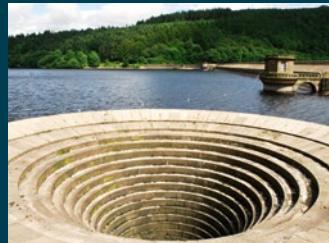
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Cautionary statement

This document contains statements that are, or may be deemed to be, 'forward-looking statements' with respect to Severn Trent's financial condition, results of operations and business and certain of Severn Trent's plans and objectives with respect to these items.

Forward-looking statements are sometimes, but not always, identified by their use of a date in the future or such words as 'anticipates', 'aims', 'due', 'could', 'may', 'will', 'would', 'should', 'expects', 'believes', 'intends', 'plans', 'projects', 'potential', 'reasonably possible', 'targets', 'goal' or 'estimates' and, in each case, their negative or other variations or comparable terminology. Any forward-looking statements in this document are based on Severn Trent's current expectations and, by their very nature, forward-looking statements are inherently unpredictable, speculative and involve risk and uncertainty because they relate to events and depend on circumstances that may or may not occur in the future.

Forward-looking statements are not guarantees of future performance and no assurances can be given that the forward-looking statements in this document will be realised. There are a number of factors, many of which are beyond Severn Trent's control, that could cause actual results, performance and developments to differ materially from those expressed or implied by these forward-looking statements. These factors include, but are not limited to, changes in the economies and markets in which the Group operates; changes in the regulatory and competition frameworks in which the Group operates; the impact of legal or other proceedings against or which affect the Group; and changes in interest and exchange rates.

All written or verbal forward-looking statements, made in this document or made subsequently, which are attributable to Severn Trent or any other member of the Group or persons acting on their behalf are expressly qualified in their entirety by the factors referred to above.

Subject to compliance with applicable laws and regulations, Severn Trent does not intend to update these forward-looking statements and does not undertake any obligation to do so.

Nothing in this document should be regarded as a profits forecast.

This document is not an offer to sell, exchange or transfer any securities of Severn Trent Plc or any of its subsidiaries and is not soliciting an offer to purchase, exchange or transfer such securities in any jurisdiction. Securities may not be offered, sold or transferred in the US absent registration or an applicable exemption from the registration requirements of the US Securities Act of 1933 (as amended).

¹ Alternative Performance Measures are defined in Note 46 to the group financial statements on pages 192 to 194

Welcome to the Severn Trent Annual Report 2018

OUR PURPOSE IS TO SERVE OUR COMMUNITIES AND BUILD A LASTING WATER LEGACY. THIS DRIVES OUR VISION TO BE THE MOST TRUSTED WATER COMPANY BY 2020, DELIVERING AN OUTSTANDING CUSTOMER EXPERIENCE, BEST VALUE SERVICE AND ENVIRONMENTAL LEADERSHIP.

This report highlights the progress we have made over the past year in achieving that vision through our strategic objectives and absolute focus on delivering value for all of our stakeholders.

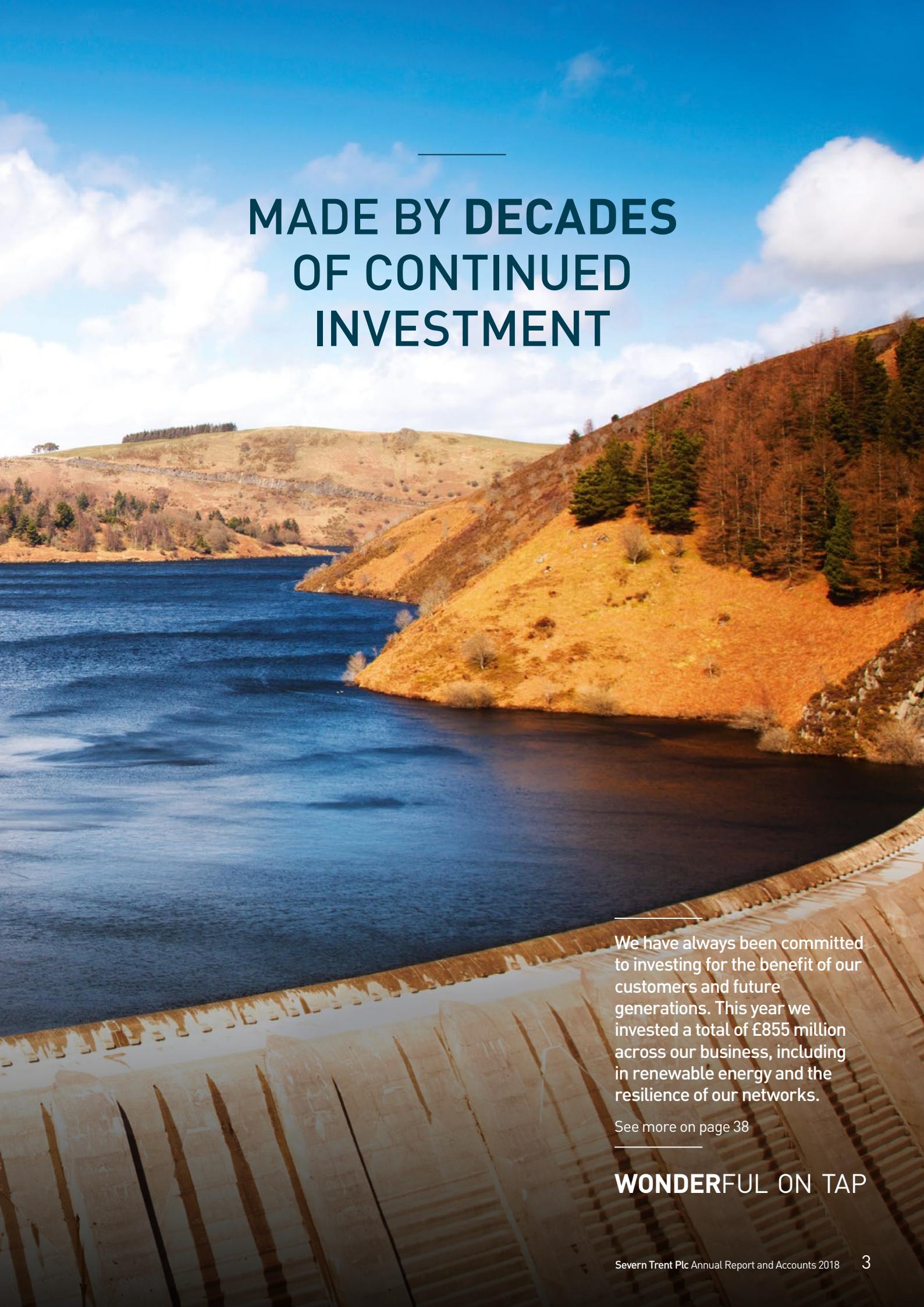
We're committed to keeping your water flowing clearly and making your waste water clean again, so you can carry on enjoying this force of nature in your very own home, for generations to come.

WONDERFUL ON TAP

**20 MINUTES
OF TRANQUILITY...**



MADE BY DECADES OF CONTINUED INVESTMENT



We have always been committed to investing for the benefit of our customers and future generations. This year we invested a total of £855 million across our business, including in renewable energy and the resilience of our networks.

See more on page 38

WONDERFUL ON TAP

1 MINUTE NURTURING...



A close-up photograph of a woman with blonde hair, wearing a blue baseball cap, safety glasses, and a bright yellow high-visibility vest over a grey shirt. She is wearing orange and black work gloves and appears to be working on something with her hands. The background is blurred, showing what might be industrial or construction equipment.

MADE BY 100% COMMITMENT

We are proud of the fact that we have outperformed against our commitments that our customers most care about. Our customer service and operational improvements have contributed to customer ODI rewards of £80.2 million.

See our 'ODIs' on page 32

WONDERFUL ON TAP

**240ml OF
PURE QUALITY...**



DELIVERED BY 49,000 km OF PIPES



Our drinking water is rated at 99.96% for quality. We distribute 1.6 billion litres of quality drinking water through 49,000 km of pipework. This, combined with 94,000 km of sewage pipework, is enough pipes to go around the world three and a half times.

See more on page 36

WONDERFUL ON TAP

What we do

We provide clean water and waste water services and develop renewable energy solutions through our businesses:

Regulated Water and Waste Water

Our Regulated Water and Waste Water business includes the wholesale and household retail activities of Severn Trent Water and Dee Valley Water.



The primary markets we focus on

- Wholesale operations and engineering
- Household customer services

About us

We are one of 10 largest regulated water and waste water businesses in England and Wales. We provide high quality services to more than 4.3 million households and businesses in the Midlands and Wales.

Where we operate

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



Turnover

£1,574.6m

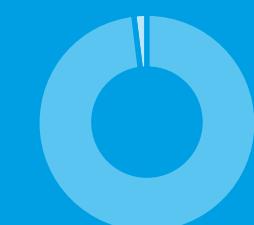
Profit before interest and tax

£503.8m

Underlying profit before interest and tax¹

£514.9m

Revenue split



- Severn Trent Water 98.2%
- Dee Valley Water 1.8%

Households and businesses served

4.3m

Litres of drinking water supplied each day

1.6bn

Litres of waste water treated per day

2.77bn

Employees

5,660

average during 2017/18
(see page 157)

► Read more on page 34

¹ Alternative Performance Measures are defined in Note 46 to the group financial statements on pages 192 to 194

Severn Trent Business Services



The markets we focus on

- Operating Services
- Renewable Energy

Where we operate

Business Services operates in the UK and Ireland.

There are two parts of Business Services:

UK Operating Services (including Ireland)

UK Operating Services provides contract services to municipal and industrial clients in the UK and Ireland and the UK Ministry of Defence ('MOD') for design, build and operation of water and waste water treatment facilities and networks, and services to developers.

Renewable Energy

Business Services generates renewable energy from anaerobic digestion, hydropower, wind turbines and solar technology.

Turnover

£138.7m

Profit before interest and tax

£34.2m

Underlying profit before interest and tax¹

£36.0m

Employees in continuing operations

596

average during 2017/18
(see page 157)

► Read more on page 42

¹ Alternative Performance Measures are defined in Note 46 to the group financial statements on pages 192 to 194

Our business model

Running an efficient water business

Severn Trent provides clean water every time our customers turn on the tap and removes their waste water in an affordable, sustainable and reliable way.

It does so through its regulated subsidiaries and draws upon its skills in water and waste treatment to provide services to other organisations through its Business Services division.

Critical inputs

Natural resources

Water from reservoirs, rivers and underground aquifers

► Read more on page 45

Power

The treatment and distribution of clean and waste water consumes significant energy.

► Read more on page 43

The Water Cycle



Water is collected

We pay the Environment Agency and Natural Resources Wales for the water we collect from reservoirs, rivers and underground aquifers across our region.



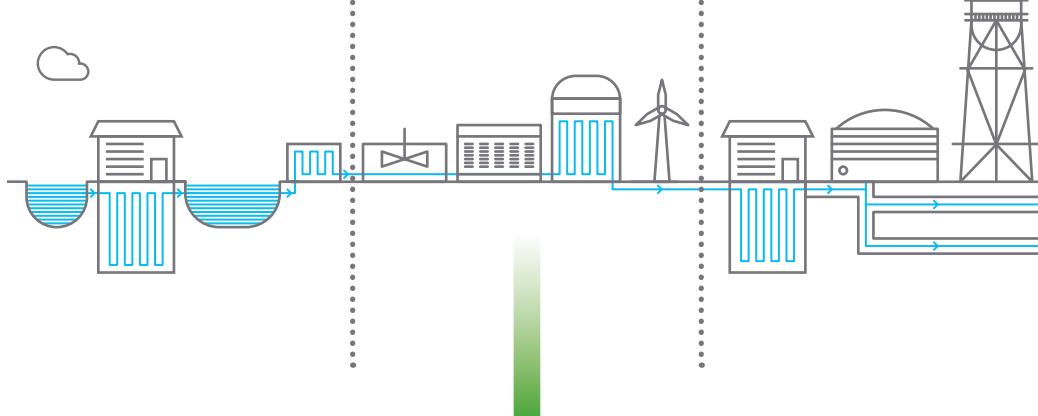
Water is cleaned

Our 116 groundwater and 23 surface water treatment works clean raw water to the highest standards, making it safe to drink.



Clean water is distributed

Our 49,167 km network of pipes and enclosed storage reservoirs bring a continuous supply of clean water right to our customers' taps.



Our investments in renewable energy production

Cleaning waste water is an 'energy hungry' process so we are utilising waste and renewables to help us power our operations.

We are on track to produce 50% of our own energy needs by 2020



Food waste anaerobic digestion plants

Outcomes

Natural resources

- Clean water for 4.3 million homes and businesses
- Clean gas produced from anaerobic digestion plants, contributing to the decarbonisation of the UK economy

Physical assets

- Efficient and reliable services: 1.6 billion litres of drinking water supplied each day and 2.8 billion litres of wastewater treated each day

Physical assets

A resilient, well maintained network of clean water pipes and reservoirs, sewers and pumping stations

 Read more on page 47

Our people

We look to attract, develop and retain talented people, and to bring the next generation of water experts into the industry

 Read more on page 48

Relationships**• Our suppliers and partners**

Joint ventures and strong supplier relationships

• Our customers and communities

The heart of our business

• Our regulators

Our industry is regulated by Ofwat and several other regulators and public bodies

 Read more on page 50

**Customers enjoy our services**

We serve 4.3 million businesses and households with a safe, reliable supply of water and collect waste water 24 hours a day, 365 days a year.

**Waste water is collected**

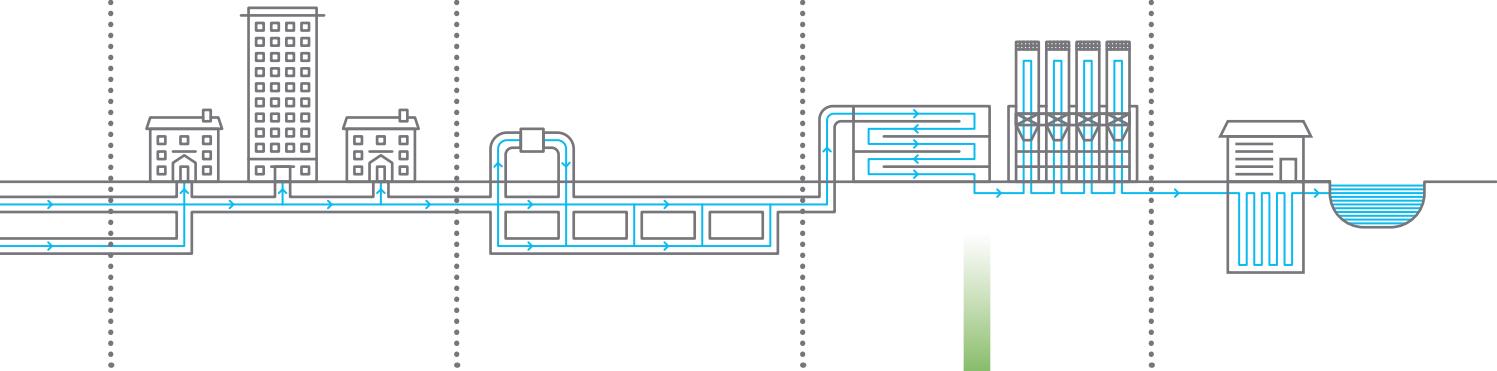
Our 94,027 km of sewers and pumping stations collect waste water from homes and businesses and take it to our treatment works.

**Waste water is cleaned**

Waste water is carefully screened, filtered and treated in our 1,010 sewage treatment works to meet stringent environmental standards.

**Water is recycled to the environment**

We pay the Environment Agency and Natural Resources Wales annual consent fees to return the treated water to the water system.

**Solar and wind turbines****Clean gas from our sludge anaerobic digestion plants****Our people**

- An awesome place to work
- A diverse, skilled and talented workforce

Relationships**• Our suppliers and partners**

A robust supply chain. We work with partners over the five years of an AMP, which means more competitive pricing

• Our customers and communities

The lowest average combined water and waste water bills in Britain. Educational visits on water efficiency and being sewer savvy

• Our regulators

Positive and constructive relationships and industry-leading ODIs and KPIs

Chairman's statement



PROVIDING RESPONSIBLE LEADERSHIP

"High levels of customer service create financial rewards. This means we are able to share the benefits of our work with shareholders as well as with our customers and other stakeholders."

Andrew Duff, Chairman

Dividend per share

86.55p

2017: 81.50p

Group turnover

£1,694.1m

2017: £1,638.0m

Group profit before interest and tax

£528.4m

2017: £536.7m

This has been a good year for our customers and therefore for Severn Trent. Our operational performance is discussed in detail in our Chief Executive's statement. Here, I want to take the opportunity to look at the bigger picture by highlighting the improvements we have made to customers' lives in the last 25 years – and to underline our commitment to running a responsible business.

Water services in England and Wales have been transformed for the better over the last 25 years – leakage is down by over a third since its peak in 1994/95, service quality is up, as evidenced by a 65% reduction in written complaints since its peak in 2007/08 and environmental performance is unrecognisable from that which we inherited from the nationalised industry in 1989, with an 86% reduction in serious pollution incidents in England and Wales. These changes have not happened by accident; they are the direct result of the near doubling of investment that has been pumped into the sector since privatisation.

At Severn Trent, we have played a major role in this step-change, investing £21 billion in today's money in infrastructure improvements over the last quarter of a century. We are proud of the achievements that this investment has generated for our customers. They drink and wash in cleaner water, experience fewer supply interruptions and floods, and enjoy healthier and more pleasant surroundings, all thanks to our work. At the same time, and despite the huge capital investments we have made, we have been able to keep prices down. This last year, as in the previous seven years, the average price paid by a customer in the Severn Trent region was the lowest anywhere in England or Wales.

Our team is absolutely committed to continuing this good work – and a key aspect of that is demonstrating the highest standards of governance and behaviour. Our values of: putting customers first; creating an awesome place to work; being passionate about what we do; acting with integrity; and protecting our environment sit right at the heart of our decision making. We fully support the governance changes that the regulator and Government wish to see – indeed, as a listed company these standards of transparency and responsible behaviour are already in place at Severn Trent: we are prudent in how we manage financial risk and even-handed in the way we share the returns from our outperformance with customers and shareholders; we pay our taxes in full and on time; we pay dividends and executive salaries that are reasonable and sustainable and linked to the delivery of outcomes to customers; avoid complex offshore financial vehicles; and we communicate progress on all of these matters in the Annual Report which we provide to stakeholders and to the public at large on our website every year.

Having strong and transparent corporate governance is the right way to carry out our activities. It will ensure the long-term sustainability of our business and reinforce our legitimacy in the eyes of the communities we serve.

Sharing the rewards

Under our industry's regulatory regime, high levels of customer service create financial rewards. This means we are able to share the benefits of our work with shareholders as well as with customers and other stakeholders. In this five year period we are reinvesting £220 million of Totex outperformance back into our business, with a further £120 million of outperformance being shared with customers in the form of lower bills in AMP7.

Our investors too have benefited through our base dividend commitment of growth at RPI+4%, and this has all been achieved whilst maintaining a sustainable, resilient financial structure.

We delivered a 3.4% increase in Group turnover to £1,694.1 million, Group PBIT of £528.4 million, down 1.5% from the prior year, and underlying basic earnings per share of 121.0 pence, up 4.6% from the prior year.

We are therefore proposing a final dividend of 51.92 pence per share to be paid on 20th July 2018. This will take the total dividend for the year to 86.55 pence.

Your Board

Emma FitzGerald stepped down from her position as a Director during the year. On behalf of the Board, I thank her for her insight, professionalism and dedication. It has been a privilege to work alongside her.

We have worked with regulators to successfully realign our English and Welsh licences along national boundaries. From 1 July 2018, all our Welsh interests will sit under a single licence, and we will rebrand Dee Valley Water as Hafren Dyfrdwy after the two main rivers which supply the region. Hafren Dyfrdwy will serve the interests of all our Welsh customers, and we are pleased to have made positive progress to ensure the robust governance of that company through the appointment to its Board of three new independent non-executive directors with a wealth of experience in business, public services and Welsh public policy. I am delighted that they all enhance the already diverse make up of our business.

A diverse team doing great work

Severn Trent's people are a significant asset. We have a fantastic team here who worked tirelessly through the year, often in severe weather conditions, to deliver extraordinary service. They are rightly proud of both their efforts and the outcomes.

It is important that the makeup of our workforce is representative of the communities we serve. So I am pleased to report that 21% of the 124 graduates, placement students and apprentices who joined us during the year came from black or minority ethnic backgrounds. We are also mindful of the role that gender diversity plays in supporting a successful team.

The representation of women on our Board led to us again being recognised by the Hampton-Alexander Review in 2017, which placed us second among FTSE 100 companies for representation of women on boards and in leadership. In addition, 40% of the members of our Executive Committee are female and, at 2.4%, our mean hourly pay gap is one of the lowest in the FTSE index.

Looking ahead

We are now working hard to continue to position the business for success during the next regulatory period. Our draft business plans are well advanced and will be submitted to Ofwat in September 2018. We look forward to continuing to outperform against our service commitments through the rest of this AMP and into the next.



Andrew Duff, Chairman

Market and industry overview

Our context and peers

A total of 17 regional businesses supply water services to 50 million household and non-household customers in England and Wales. Ten of these, including our regulated business Severn Trent Water Limited, also provide waste water services. The remaining seven, including our regulated business Dee Valley Water Limited, provide water only.

Over 25 years of continuous improvement...

Water services in England and Wales have been transformed in recent years, with a total investment of around £130 billion driving significant increases in reliability, efficiency and quality.

We're very proud of our industry's achievements. For example, whilst adverse weather such as that encountered last winter and spring can skew the picture, customers are still five times less likely to be without water than they were 25 years ago and eight times less likely to be affected by sewer flooding. Leakage has fallen by 35% since the mid-1990s, and 99.6% of drinking water as well as 98.6% of bathing waters now meet EU standards.

As discussed below, our regulatory framework is continuing to evolve. We believe that improving this existing mechanism, for example, by encouraging lower gearing and greater openness and transparency, is a more viable way forwards than embarking on a disruptive course of action that would distract attention from our industry's core priorities.

...but there's still more to do

We're excited about the opportunities to continue the good work the industry has recorded so far. But although we've taken huge strides in embedding customers right at the heart of what we do, we recognise that there's still room for improvement. Customers rightly expect the highest standards of water quality and waste water treatment, 24 hours a day and seven days a week, and while these are continuing to move in the right direction there's absolutely no room for complacency. We have to target capital investment programmes wisely in order to make sure our network – parts of which originate in the late 19th Century – is equipped to meet the demands of 21st Century living. That's no easy matter, in light of an increasing population and more housing, as well as all the challenges to water supplies and drainage caused by the droughts and floods associated with climate change. It requires experience, expertise and a great deal of money – in fact Severn Trent alone will have invested some £3,000 million in assets over the five years to March 2020.

Customers also want to be able to contact us whenever and however they want, whether that's to ask for advice, question a bill or notify us of a leak. Digital technology is playing a major role here at Severn Trent, helping us interact with customers via nine different channels, ensuring we are always there to talk to in person over the phone, or in writing.

Regional businesses

17

Number of households and
non-household customers

50 million

Total investment
for transformation

£130 billion

"Water quality... waste water treatment... reliability and efficiency... service and support... all delivered with great value... these are the things our customers expect."

And, of course, customers rightly expect all this while enjoying great value for money. Bills matter to everybody – and while we're pleased that yet again Severn Trent Water's customers benefited from the lowest bills in England and Wales over the last year, we're also committed to doing even more to support those vulnerable members of our local communities who struggle to pay.

Water quality... waste water treatment... reliability and efficiency... service and support... all delivered with great value... these are the things our customers expect. We've made terrific progress in the last quarter of a century and we know there's more to do – and we're committed to working with our peers in the industry and with our regulators to give our customers a service to be proud of.

Our regulatory framework

The Government's approach to our industry is set by the Department for the Environment, Food and Rural Affairs ('Defra') in England and the Welsh Government in Wales. Ofwat is the industry's economic regulator. This means it sets limits on the prices we can charge our customers over five year Asset Management Plan ('AMP') cycles. This financial year was the third of AMP6, which runs from April 2015 to March 2020.

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

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



Market and industry overview continued

Moving into the next phase of regulation

Every five years, our regulator Ofwat reviews industry pricing. The most recent price review – known as PR14 – was in 2014 and heralded sweeping changes. PR14 gave customers a greater voice in setting our priorities and also introduced a performance-related reward and penalty system, called Outcome Delivery Incentives (ODIs). We welcomed these initiatives and believe they're playing an important part in driving greater efficiency across the industry.

Now we're moving towards the next price review, which will take place in 2019. In December 2017, Ofwat published its methodology for the 2019 price review, known as PR19. This provided us with guidance on expectations for our business plans, which we'll submit in September 2018. In our view, the methodology sets out a challenging environment, but also one where high performing companies can succeed. We're fully supportive of Ofwat's reform agenda, which includes stronger ODIs – and although they're currently still in development, our business plans will lay out our ambitions in four key areas:

Customers

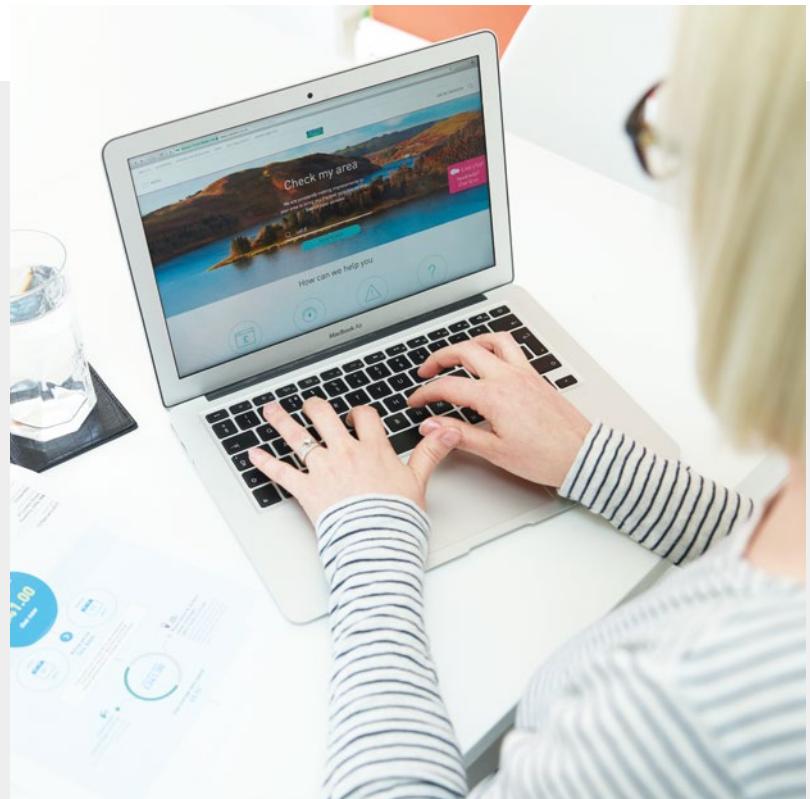
Our preparation work for PR19 has included the most comprehensive customer engagement activity and research programme in our history, in conjunction with insight from our everyday interactions with them. The result is a new level of understanding about the issues that are most important to our customers. In brief, they want us to go beyond just balancing supply and demand, providing clean drinking water and taking waste water away. They see us as key influencers in the everyday lives of their local communities. And they want us to step up and play our role to the full.

So, among other initiatives, we're investing in better communications and also redoubling our efforts around customer education, especially of children – for example on what not to put down their toilets – as well as supporting our people to do more volunteering to benefit the communities which we serve.

Affordability

In 2017, and for the 8th year running, Severn Trent Water's customers had the lowest bills in England and Wales. That's an achievement in its own right, but we're committed to making sure that those bills are affordable for all our customers – including the most vulnerable. Struggling to pay a water bill can be an indication of other issues in a customer's life, so we're working with partners in local communities to identify those who may need some extra help.

"Reliable supplies and services depend on reliable infrastructure. But to us 'resilience' is a broader issue than just having good quality pipes, reservoirs and treatment works. It means being operationally resilient, so our people are sufficiently well trained to carry out the tasks we need them to do."



Resilience

It goes without saying that reliable supplies and services depend on a reliable infrastructure. But to us 'resilience' is a broader issue than just having good quality pipes, reservoirs and treatment works. It means being operationally resilient, so our people are sufficiently well trained to carry out the tasks we need them to do, both in a steady state and in an emergency. And it means financially resilient, with a stress-tested capital structure to maintain an investment-grade rating for our regulated business and the appropriate equity strength to effectively manage risks. It also means having corporate resilience, with the right governance processes ensuring that we're fair and transparent at all times, and recognised as a responsible and trusted business by society at large. We're rightly regarded as a public service company and we'll do everything in our power to deliver a service that the public can be proud of.

Innovation

You can't deliver outstanding customer service, keep bills affordable or run a resilient business without innovation. We're pleased to see that Ofwat's PR19 methodology embraces the role of markets, not only in bioresources but also in water resources through water trading.

In fact we're working with United Utilities to engage with Thames Water on the evaluation of a project to build a super interconnector that would enable us to transfer and trade water between the Severn and Thames catchment areas.

What happens next?

Ofwat's timetable for PR19 is as follows:

Submission of business plans – 3 September 2018

Initial assessment of plans – late January 2019

Fast-tracked draft determinations – March/April 2019

Remaining draft determinations – July 2019

Final determinations – December 2019

Playing our part in the debate

We agree with the general direction in which Ofwat is taking the industry and have continued to add our voice to the debate wherever and whenever possible.

For example, in addition to evaluating the possibilities of water trading, we worked with a number of our peers and the Social Market Foundation to publish a report into the likely implications of renationalisation on public sector debt levels.

We've also stepped up our consumer-facing communications, including launching our new brand – 'Wonderful on tap' – to improve understanding of what we do and how we do it. Please see our website for more details.

How our market environment influences our five strategic priorities



Embedding customers at the heart of all we do

we'll continue to anticipate and to meet changing customers' and wider societal needs (see page 22)



Driving operational excellence and continuous innovation

innovation helps us to deliver the services customers need and keep bills affordable (see page 24)



Investing responsibly for sustainable growth

we invest to make sure we continue to benefit from a resilient, well-maintained network that meets the demands of a growing population and a changing climate (see page 26)



Changing the market for the better

we work constructively with regulators, helping to prepare the industry for the opportunities and challenges of the future (see page 28)



Creating an awesome place to work

we can only succeed if we have the support of inspired, talented, diverse and engaged people (see page 30)

GETTING THE BALANCE RIGHT

“What truly matters is balance...
balance between today and tomorrow,
between making improvements
where customers value them
most, keeping bills affordable
and providing a fair return
to our investors.”

Liv Garfield,
Chief Executive



Times have changed. Today, all of us, across all walks of life expect the companies that serve us to be socially responsible. It's time for leading businesses to step up to the challenges of running a sustainable operation and to embrace all aspects of their performance: social and environmental as well as financial.

Success is not as easy to quantify as it was in the past. Gone are the days when a company was judged purely on its balance sheet and income statement. At Severn Trent, this is a change we welcome wholeheartedly.

That's not to say that financial performance no longer matters. It does, and we're extremely proud of our track record in that respect, as you can see from the figures for 2017/18 that you'll find elsewhere on these pages, notably in James' financial report. What truly matters is balance... balance between today and tomorrow, between making improvements where customers value them the most, keeping bills affordable and providing a fair return to our investors.

We can debate what has caused this shift of opinion well into the early hours; whether it's the financial crisis or global political unrest, government action or the poor behaviour of a handful of companies, or something else entirely. What is undeniable is that this change has happened. And that the new world it's ushered in is here to stay.

So, instead of a traditional CEO review, I want to use these 1,500 words or so to tell you what I'm really proud of and what makes Severn Trent different, through the lens of social responsibility. I want to show you how we have performed when the metrics of success are extended beyond financial returns.

Our environment: everybody's most important priority

Climate change has focused everybody's minds on the need to look after the planet we call home. At Severn Trent we're fortunate that our estate, which is one of the largest corporate land-holdings in the UK at over 53,000 acres, includes several Sites of Special Scientific Interest ('SSSIs') as well as many other areas that are important for plants and wildlife. But with great fortune comes great responsibility – more than most companies, we're in a position to have significant impacts on these wonderful environments.

So we work very hard to make sure that these impacts are as positive as possible. That means encouraging greater biodiversity by working with groups such as The Wildlife Trust and farmers. Over the last year, we improved biodiversity on 9.86 hectares of SSSIs and are targeting many more by 2020. We also encourage and empower our people to focus their volunteering efforts on local rivers and other habitats near their homes. And last year, 40% of our colleagues chose to clean up 50 km of riverbank through our volunteering scheme.

Environmental responsibility also means reducing sewer flooding – where we reduced the number of external flooding events by around 2,000, which is a 49% outperformance against our target – and serious pollution incidents, which came down from seven to two. We continued to improve the quality of water entering our rivers, for example by working in partnership with farmers and rewarding them for using less metaldehyde on their fields. It was great to see all these achievements come together and we believe they will help us regain the mark of exceptional environmental performance in our sector, the coveted 4* status from the Environment Agency.

Looking to the long-term future of the environment, we're continuing to invest heavily in renewable energy – and I was delighted that we generated the equivalent of 38% of the energy we consumed last year, and also sold green gas back into the grid.

Group PBIT

£528.4m

2017: £536.7m

Group turnover

£1,694.1m

2017: £1,638.0m

Dividend increase

6.2%

2017: 1.0%

Net ODI outperformance payment

£80.2m

2017: £47.6m

Underlying Group PBIT

£541.0m

2017: £520.1m

Chief Executive's review continued

Our customers: the reason why we're all here

There are two ways of behaving when you're a natural monopoly. You can simply take advantage of the opportunities your situation presents, or you can work night and day to create a service that's so good that your customers would still choose you, if they had the choice. We firmly believe that this is vital for any business that wants to still be a business in the years ahead.

So how do we do that? Firstly by striving to give customers what they tell us they want – low bills, less sewer flooding and high quality water at the turn of a tap. Our Upper Quartile positioning in the UK Customer Service Index and our Customer ODI performance show that we're making good progress.

Affordability is right at the top of our agenda and I'm delighted to report that at an average of £348 in 2018/19, Severn Trent Water's bills will once again be the lowest in England and Wales. That's £57 lower than the average household bill, £35 lower than the next cheapest and – if we look beyond the UK – half those in Berlin and a quarter of those in Copenhagen.

We're also increasing our efforts to support the most vulnerable people in our communities. As well as providing discounts to customers who are struggling to pay their bills, we've started to work more closely with other agencies and use our close relationship with local communities to identify where a little bit of extra understanding and financial help can go a long way to easing pressure on customers facing difficulties. This isn't the best way to improve our bottom line – but it is demonstrably the right thing to do.

As I've already mentioned, the number of sewer floodings are one of a number of measures in which we have outperformed, but it is disappointing when our customers are left with nothing coming out of their taps, as happened too often this year. Our performance on supply interruptions was our worst performance in five years and the first time we've missed our target on that measure during that time. Some of these interruptions to supply can be explained away by the extreme freeze-thaw-freeze cycles of the bitter winter, which also meant that we missed our challenging target on leakage – despite strong performance for 11 months of the year. But the fact remains that we know we have let some of our customers down in an area that really matters to them. Although small succour for these performance failures, customers are rightly compensated for them through compensation when our performance falls below regulatory standards and by virtue of the ODI penalty system, through reductions in future bills.

We're working really hard to improve our ability to cope with extreme weather, as this is a fact of life for us all now, through initiatives like leakage detector robots and other high tech tools that can give us extra 'eyes' on the network.

Customers also tell us that it's important that we're available for them when they need to talk to us. We all lead busy lives, and we all know how frustrating it is when you can't talk to somebody when you need to in the five minute slot that you have in between dealing with more important work or family matters. So we've extended and improved our contact channels. We're now the only water company that customers can contact at any time of day or night, on any issue – not just for emergencies.

We need to help our customers understand what they should and shouldn't put down the loo or the sink, and how to use water more efficiently. While I passionately believe that most people want to do their best for the environment, they don't always have the right knowledge to do so. That's why we spend so much time and effort on education, particularly in schools. If we can get young people to value water and support what we're doing to preserve and supply it, then we will all be in a much better place as well as our children and grandchildren in years to come.

Our people: the assets that make it all happen

Severn Trent is its people. They're the ones on the front line, the ones who talk to customers, the ones who innovate and implement the bright ideas that help us deliver a service you would choose to have.

To be your best, you have to be happy and supported in your workplace. So we're constantly looking for new and better ways to help them thrive, fulfil their potential and show them how much we value their expertise and commitment. Over the last year we've increased our focus on training. Ours is a technical, engineering-led industry where there's absolutely no substitute for the right expertise. Of course, investing in training is good for our business, because it helps us be more technically competent. But it's also good for our colleagues, because it gives them a platform for growth, promotion and more rewarding careers – and it's good for local communities and industry too, because it improves the skills base across the Midlands. This is what businesses like Severn Trent can and should be doing... building our employees' talents and playing our part as members of society to benefit everybody.

As a significant employer in our region and presence in local communities across the Midlands, we can also do a lot to help change general attitudes towards issues that affect individuals everywhere. For example, according to the World Health Organization, one in four people in the world will be impacted by mental or neurological disorders at some point in their lives. So last year we decided that we needed to remove the stigma associated with mental health, particularly for men. We now have over 400 qualified mental health first aiders at Severn Trent, who have undertaken formal training programmes and also listened to first-hand stories of how mental health can affect lives – including personal contributions from my senior team. Now we're turning our attention to the menopause, which is another area that is a bit of a taboo in society at large but which can have a massively detrimental impact on women and their families.

Our employee engagement score rose by a full six percentage points last year, proving that the things we're doing for our people are appreciated, and we are turning Severn Trent into an even better place to work. Our teams respond to the sense of belonging and community that we're trying to create here – and an incredible 40% of them turned out to volunteer their time to improve their local environment during the last 12 months.

Dee Valley Water is now substantially integrated, and the people there are already a vital part of the Severn Trent family. I'm so proud of the fact that they haven't missed a beat in delivering a great year from an operational perspective, with zero coliforms (an important feature of water quality) at their sites probably being the standout achievement. We're learning from each other and adopting each other's best practices in order to provide better services to our customers and the environment.

I'd like to thank all 6,000 of our people for the passion they've applied to all they do over the year, sometimes in difficult circumstances, but always with a smile on their faces. They make it an honour to have my job. Thank you!

Our outlook: lots to look forward to, but more hard work lies ahead

In September, we'll submit our plans to Ofwat for our next five year business plan. Make no mistake, from an industry perspective this is going to be tough.

But for customers, this is the right thing at the right time. Putting the focus fairly and squarely on customer service, affordability and long term resilience is absolutely the correct thing to do and we fully support Ofwat's goals.

We've been working hard over the last few years to make sure we're in good shape to rise to these challenges. As this report highlights, Severn Trent Water's customers again had the lowest bills in England and Wales, and we're making good progress in most other areas of the business. Are we getting it right all the time? No. But we know where and how we can improve – and we have a total determination with our people's support to get there.



Liv Garfield
Chief Executive

How we are doing against our strategic objectives

Embed customers at the heart of all we do



What do we mean by this?

We'll improve the way in which customers engage with us through improved insight and understanding of what's important to them.

What we said we would do in 2017/18

- Make a step change in customer service.
- Continue to deliver on the things that matter most to our customers to achieve a substantial reward of around £23 million in customer ODIs.
- Provide a service that is affordable for all and support our financially vulnerable customers by assisting 50,000 customers with their bills.
- Be recognised as an upper quartile wholesaler in the new non-household retail market.
- Provide an industry leading experience for property developers and customers who need new water and waste connections.



Lowest bills in the land – yet again

Research tells us that with so many competing demands on household budgets, affordability is one of the biggest concerns for our customers. Which is why it was great to see that our efforts to keep water bills down yet again proved so worthwhile.

For the 8th year running, Severn Trent Water's customers have the lowest bills in England and Wales. Our average combined bill for 2018/19 will be £348. That's £57 below the average across the two nations and £35 less than the next cheapest.

Nevertheless, we know that some vulnerable customers still struggle to make ends meet – so over the last 12 months, we used our Big Difference scheme to give discounts of up to 90% to 36,000 people.

Protecting the interests of our customers

From investing in robotic leakage detectors to encouraging farmers and fast food chains to be more careful about what they put on fields or down drains, we work tirelessly to make Severn Trent water as clean, available and affordable as possible.

Although customers certainly appreciate what we do – in fact water quality complaints are down 12% year-on-year – not everybody buys into the need to look after this precious resource. We don't enjoy taking people to court, but sometimes it's the only way to protect the interests of all those who pay their bills and play by the rules. Since the start of 2016, we've successfully prosecuted over 50 companies that have been caught illegally using hydrants to access our network. And to prevent future misuse, we've now fitted 30,000 locking caps to hydrants across our network.

Our progress 2017/18

- Achieved upper quartile position in the UK Customer Service Index and reduced customer written complaints by 17%.
- Achieved better outcomes for customers on a number of measures including external and internal sewer flooding, and achieved ODI outperformance payments of £80.2 million.
- Maintained the lowest bills in England and Wales, and assisted more than 50,000 vulnerable customers with their bills.
- Developer Services team recognised by Ofwat as 1st for Water and 2nd for Waste in its SLA compliance comparison tables.

Areas of focus for 2018/19

- Build greater capability in incident management focusing on continuous improvement.
- Develop the use of the 'Wonderful on tap' brand to increase the focus of all colleagues on enhancing the quality of our products and customer service, and make our customers aware of what we do for them and our connection with their daily lives.
- Deliver on the things that matter most to our customers as measured in Customer ODIs.
- Provide a service that is affordable for all and support our financially vulnerable customers by assisting 50,000 customers with their bills.



Improving our performance for developers

Every year, we connect around 20,000 new properties and install and adopt around 100 km of new water and waste water pipes. And whether we're working with an individual doing a self-build, a national housebuilder constructing a new 200-home estate or office block, or a farmer wanting a new water supply for a distant drinking trough for his cattle, we aim to make this process as simple and cost-effective as possible.

By reorganising our Developer Services business around our three main customer segments – small and first time developers, large developers and self-lay providers – we evolved our approach over the last year to meet the needs of our customers more precisely.

The result? The best customer service within our sector – finishing 1st for water and a close 2nd for waste water as measured by the Ofwat customer service KPI. We also saw a 29% reduction in customer complaints compared to the previous year.

"We continue to maintain the lowest bills in England and Wales, and assisted more than 50,000 vulnerable customers with their bills."

How we are doing against our strategic objectives continued

Drive operational excellence and continuous innovation



What do we mean by this?

We'll build a smarter water and waste water network, develop our business intelligence and simplify our cross business processes.

What we said we would do in 2017/18

- On track delivery of our plans to be Upper Quartile for Retail, Water and Waste.
- On track delivery of Upper Quartile financing performance by the end of 2019.
- Continue to provide environmental leadership as evidenced by EA 4* status.
- Develop the profitability of our US and UK Business Services operations.
- Deliver budgeted benefits from implementing 10 innovation projects and 10 digital projects, and developing a sustainable pipeline and process for innovation.
- Drive innovative developer solutions to deliver a step-change in the new connections service to customers.
- Reduce the number of water quality complaints.



Seeking out best practice, wherever in the world it lives

Our teams are constantly coming up with brilliant ideas on how we can do things better, faster or cheaper for our customers – and the Bike on a Boat project gives them all the support they need to become even more innovative.

Named after a clever idea developed by an America's Cup yacht racing team, Bike on a Boat is all about learning from each other as well as from best practice around the world. Towards the end of 2017, we took Bike on a Boat on tour, holding 64 roadshows at 10 different venues over six weeks and generating over 6,200 ideas from our people.

In October 2017, we launched a £100,000 Bike on Boat fund to enable any of our people to apply to travel anywhere in the world in order to learn more about how other companies are reducing water usage and leakage.

We have received over 30 applications and approved 13 trips as far afield as Australia and Singapore.

Our progress 2017/18

- Achieved Upper Quartile performance in key waste measures including external sewer flooding.
- Delivered sector leading environmental performance, which we expect to lead to EA 4* status.
- UK Business Services profit increased, and US business sold.
- Expanded our search globally for innovative solutions to deliver the highest standards and greatest efficiency for our customers.
- Achieved 1st and 2nd place in Ofwat's water and waste rankings respectively for new connections SLA compliance.
- Delivered our best water quality performance in five years, reducing water quality complaints by 12%.
- Deployed innovative solutions, such as the addition of bio-augmentation to prevent the build-up of fatbergs, to deliver higher standards and greater efficiency.

Areas of focus for 2018/19

- Deliver our plans to be Upper Quartile for Retail, Water and Waste.
- Continue to provide environmental leadership.
- Regain self-assured status for our English business.
- Make further progress on the quality of our water as measured by the DWI's Compliance Risk Index.

Customer water quality complaints

↓ 12%



Trialling the use of augmented reality technology at one of our operational sites.

How we are doing against our strategic objectives continued

Invest responsibly for sustainable growth

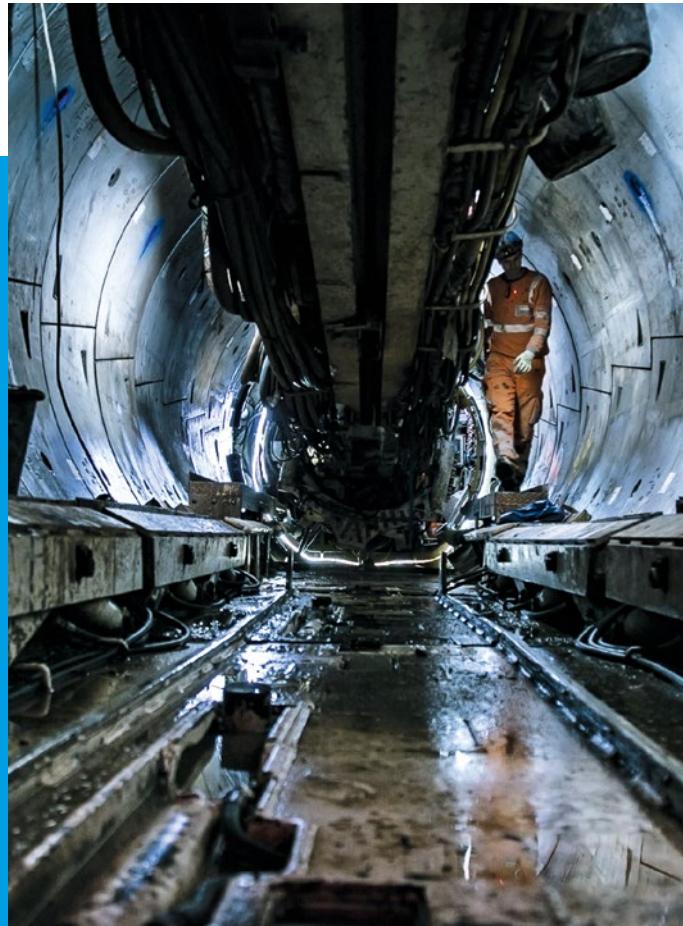


What do we mean by this?

We'll develop an effective strategy which optimises our regulated asset base, whilst creating new growth opportunities for the future.

What we said we would do in 2017/18

- On track to delivering on our PR14 commitments and make appropriate targeted investments for the future.
- Integrate and deliver the benefits of the Dee Valley acquisition, combining the strengths of the two companies to create a strong Welsh entity focused on delivering local priorities.
- Complete the transfer of our non-household customers to our joint venture business Water Plus.
- Generate the equivalent of 38% of our energy needs from renewable sources.
- Achieve material improvements in some of our key Enterprise Risk Management risks.



Bringing new resilience to local infrastructure

The market town of Newark in Nottinghamshire has survived everything from the black death to the civil war. But an expanding population coupled with an ageing, inadequate sewer network was challenging the town's resilience. The infrastructure was at breaking point, with 400 properties regularly at risk of sewer flooding – after fire, the worst thing that can happen to a property.

We're currently investing £60 million in a three year project to replace more than 20 km of pipes, including a 2.8 metre diameter tunnel running 15 metres below Newark's streets. Despite short term disruption, the end results will be welcomed by all. The town will have a sewer and water pipe network fit for its future population. And for the 400 households at the heart of the project, a drop of rain will no longer raise the fear of sewage flooding their homes and gardens.

Our progress 2017/18

- Embraced Totex, identifying a further £100 million of efficiencies which will be re-invested in the business to further improve customer service and ensure we're in the best possible position for AMP7.
- Substantially completed the integration of Dee Valley Water into the Severn Trent Group, allowing the two companies to learn and share best practice with each other for the benefit of their customers.
- Well advanced in realigning the boundaries of Severn Trent Water and Dee Valley Water along English and Welsh national borders.
- Generated the equivalent of 38% of our energy needs from renewable sources, and made good progress on the construction of new renewable energy plants.
- Delivered key milestones in major capital schemes, including the Birmingham Resilience Programme and the Newark waste and water improvement project. Major capital schemes are on track to meet any associated ODI commitments.

Areas of focus for 2018/19

- Deliver fully on our PR14 (AMP6) investment commitments, being confident that we are able to deliver against our current plans and make appropriate investments for the future.
- Achieve material improvements in some of our key ERM risks.
- Drive a focus on efficiency across all business areas including central functions to support frontline investment.
- Continue to embed innovation across the Company, making it part of every team's way of working.

The end of an era

Customers in North Wales are now enjoying higher quality water, thanks to the completion of a complex scheme to close an old treatment works and instead supply water from a more resilient and efficient facility.

Constructed in the 1920s, the works at Legacy on the outskirts of Wrexham was licensed to abstract water from nearby former lead mines. This water was then treated through a series of pressure filters and chlorination plants before being held in a 350,000 gallon tank. However, despite regular upgrades, the facility was nearing the end of its useful life and some customers were experiencing occasional discolouration problems.

In March 2018, following several years of hard work by the team at Dee Valley, a project to transfer the raw water to Llynn Onn was completed – including a new distribution water pipe – and the Legacy treatment works was finally closed.



How we are doing against our strategic objectives continued

Change the market for the better



What do we mean by this?

We'll embrace market opening in the UK and explore opportunities for growth in new water markets.

What we said we would do in 2017/18

- Have a clear PR19 outline plan in place that evidences our leading status.
- Produce compelling cases for investment that customers want to see, at PR19, that enables strong RCV growth over AMPs 7 and 8.
- Design and implement the Bioresources change programme and business model.
- Be seen as the water sector's thought leader.
- Create a strong Welsh entity focused on delivering local priorities.



Tanker arriving at our sludge treatment centre at Worksop, north Nottinghamshire.

Preparing for competition in new markets

During the year we commenced preparations for the separation of our Bioresources activity from our Regulated Water and Waste Water business into Business Services to ready ourselves for competition. We have created regional treatment hubs; streamlined logistics; optimised treatment strategy and rationalised sites. We are already active in the market having completed our first trial trade with Yorkshire Water in April 2018.

Our progress 2017/18

- Our PR19 plans are coming together well, co-creating them with our largest ever customer engagement programme, and we are in a good position to submit in September 2018.
- Restructured our waste business to create a stand-alone Bioresources team, identifying opportunities for operating efficiencies and trading with our companies.
- Worked with the Social Market Foundation to assess the likely costs associated with renationalising the water and sewerage industry in England.
- Worked with United Utilities to engage with Thames Water on the construction of a super interconnector to transfer and trade water between the Severn and Thames catchment areas.
- Integration of Dee Valley Water is well advanced, and plans to realign the boundary of the Company wholly within Wales will take effect in July 2018.

Areas of focus for 2018/19

- Produce compelling cases for investment at PR19 that enable strong RCV growth over AMPs 7 & 8.
- Deliver phase two of the energy and renewables strategy to achieve 50% self-generation.
- Build a sector leading approach to Bioresources.
- Finalise the creation of Hafren Dyfrdwy and deliver a great first year.



Integration of Dee Valley Water is well advanced, and plans to realign the boundary of the Company wholly within Wales will take effect in July 2018.

How we are doing against our strategic objectives continued

Create an awesome place to work



What do we mean by this?

We'll create a culture of empowerment and accountability with a focus on skills, talent and career development.



What we said we would do in 2017/18

- Deliver a step change in our safety performance.
- Improve the wellbeing of our colleagues.
- Deliver a further uplift in our employee engagement scores.
- Progress our talent agenda.
- Continue to strive for the most diverse and inclusive business with increasing numbers of Black, Asian and Minority Ethnic ('BAME') talent in our business.
- Further improve employee engagement by resolving the top 10 issues identified by our employees.

Opportunity and support for all

We're striving to make Severn Trent an awesome place to work – where anybody who wants to reach their potential can thrive.

Graduates already recognise the opportunities we offer – and apprentices are continuing to follow suit, with another increase in their numbers over the last year. We're also succeeding in attracting a more diverse workforce – BAME employees on our graduate programmes were up 12.74% during the year. Now we're redoubling our efforts to encourage people from less socially mobile populations to join us, removing artificial barriers to entry and working with more schools in disadvantaged areas. For example, for the year ahead we've ring fenced 25 work experience opportunities at five schools across five social mobility 'cold spots' in our region.

Once they're part of our team, we provide all our people with a range of training programmes. We've committed to invest in technical skills and will create a new Severn Trent Training Academy, focused on delivering tailored programmes for staff across our region, with the aim of making our workforce the most technically skilled in the industry.

We recognise the importance of supporting people in all aspects of their lives. During the year, we continued our major programme to improve our employees' understanding of mental health issues, as well as encouraging greater awareness of cancer and menopause. In April 2018, we also signed up to the TUC's Dying to Work charter which aims to protect employees with a terminal diagnosis.

Our progress 2017/18

- Achieved a 23% reduction in lost time injuries, resulting in an LTI rate of 0.17, through an enhanced focus on safety culture, standards compliance and training.
- Continued our focus on mental and musculoskeletal health to drive an improvement in employee wellbeing and reduce absences.
- Achieved a six percentage points improvement in our employee engagement survey, demonstrating improvement in all areas, and achieving an upper quartile position relative to our peers.
- Continued investment both in our graduate and apprentice schemes, as well as innovative investment in the ongoing training and development of our broader employee population.
- Focused efforts on further improving social mobility within our region, through targeted recruitment from social mobility cold spots.
- Delivered solutions for two of the top 10 issues identified by our employees, and made progress to resolve the remaining issues.

Areas of focus for 2018/19

- Deliver a further step change in our safety performance and support the wellbeing of our colleagues.
- Continue to build on our strong volunteering performance and drive the CR agenda.
- Continue our focus on improving overall Quest engagement scores.
- Deliver the foundations of the new Academy, to make a positive contribution to technical development.



Supporting clean, safe water and sanitation

As a founding member and long term supporters of WaterAid, we've raised over £450,000 for the charity over the last two years. We believe that our continued support can help WaterAid realise our shared ambition for clean water, decent toilets and hygiene for everyone everywhere by 2030.

ODIs and KPIs

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

Progress against our Outcome Delivery Incentives²

1. Embed customers at the heart of all we do

Internal sewer flooding



Rate of Reward/Penalty (per incident)

£42,820¹

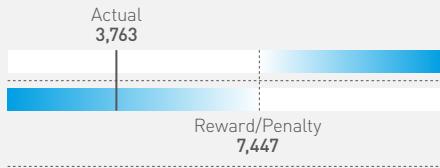
Why we measure it

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

Progress in the year

We are reporting a performance of 662 internal incidents, ahead of our committed performance level of 960 incidents.

External sewer flooding



Rate of Reward/Penalty (per incident)

£19,779¹

Why we measure it

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

Progress in the year

We are reporting a performance of 3,763 external incidents, ahead of our committed performance level of 7,447 incidents.

Minutes without supply



Rate of Reward/Penalty (per minute)

£1.10m¹

Why we measure it

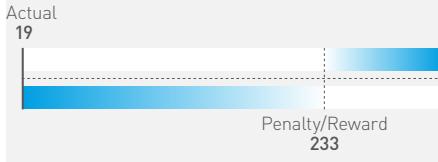
Our customers value water being there when they need it. This performance commitment ensures we are driving down the impact of any interruptions to supply across our network to minimise the impact on customers.

Progress in the year

We interrupted customers' supplies for an average of 34.29 minutes in 2017/18, well behind our performance commitment of 10.8 minutes.

2. Drive operational excellence and continuous innovation

Improvements to river water quality



Rate of Penalty/Reward (per unit)

£150,000¹

Why we measure it

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

Progress in the year

There were 19 individual points completed in 2017/18, bringing our cumulative total to 34 points, and we are on track for our end of AMP target.

Number of category 3 pollution incidents



Rate of Reward/Penalty (per incident)

£53,900¹

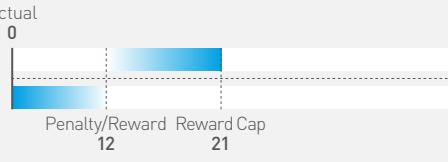
Why we measure it

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

Progress in the year

We are reporting 327 category 3 incidents against a committed performance level of 374; this is 47 ahead of target and our reward dead-band.

Successful catchment management schemes



Rate of Penalty/Reward (per scheme)

£1.03m¹

Why we measure it

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

Progress in the year

Over the last year, we have undertaken a review of our schemes and processes and optimised our approach based on previous years' experience. We are on track to deliver more than our performance commitment of 12 catchments in 2018/19.

3. Invest responsibly for sustainable growth

See our Regulated Water and Waste Water performance review on pages 34 to 41.

4. Create an awesome place to work

Lost time incidents per 100,000 hrs worked

Severn Trent Water Limited

0.17 2016/17: 0.22

Severn Trent Business Services

0.15 2016/17: 0.04

SIM – Customer experience

Not yet defined by Ofwat

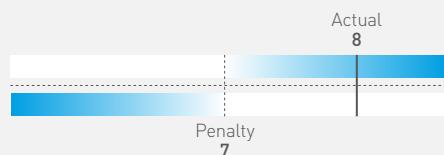
83.2 SIM score

Why we measure it

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

Progress in the year

We have seen a slight decline in our quantitative areas of our business and maintained our qualitative scores which has meant that we have reported a SIM score of 83.2 for 2017/18, behind our original upper quartile target.

Asset Stewardship – coliform failures

Rate of Penalty

£463,000¹

Why we measure it

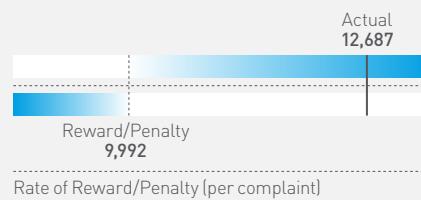
The presence of coliforms in our drinking water is unacceptable as it is an indicator of poor quality so we continually monitor our works to ensure they are not being detected.

Progress in the year

During 2017, we detected coliforms at eight water treatment works sites, which is worse than our committed performance level of seven or fewer works with coliform detections.

Severn Trent engagement score improvement³

6 percentage points

Complaints about water quality**Why we measure it**

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

Progress in the year

In 2017, the number of drinking water quality complaints decreased from 14,461, to 12,687, but we did not achieve our committed performance level of 9,992.

Leakage

Rate of Reward/Penalty (per megalitre per day)

£123,000¹

Why we measure it

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

Progress in the year

Our outturn position for 2017/18 was a total of 443 Ml/day, which was behind our committed performance level of 434 Ml/day.

Progress against our financial KPIs⁴**Group turnover**

£1,694.1m

2016/17: £1,638.0m

Group underlying PBIT

£541.0m

2016/17: £520.1m

Underlying earnings per share

121.0p

2016/17: 115.7p

Notes

- 1 In 2012/13 prices after tax.
- 2 These are also key measurements used to assess our Corporate Responsibility performance.
- 3 Engagement index used for the Group since 2015/16 to support benchmarking and gain better insight about us as an employer.
- 4 Alternative Performance Measures are defined in Note 46 to the Group Financial Statements on pages 192 to 194.

Key

Actual

| Severn Trent Actual Performance 2017/18

Performance review

Regulated Water and Waste Water

Our Regulated Water and Waste Water business performed well during the year, as we continued to deliver our five strategic priorities.

Here, we provide greater detail on the achievements and challenges we encountered while delivering our five strategic priorities over the last 12 months – and also identify some of the areas where there's still more to do.

Litres of drinking water supplied each day

1.6bn

Kilometres of sewerage pipes in our network

94,027

Households and businesses served

4.3m



We aim to educate and inspire an entire generation, not just about water conservation and environmental protection, but also by emphasising the importance of hydration to their health and wellbeing.



Embedding customers at the heart of all we do

Serving our 4.3 million customers and doing our best for their local communities sits right at the very centre of everything we do.

During the year, we carried out the most intensive customer engagement activity in our history. This included a range of in-depth, deliberative sessions with customers to get right to the heart of their needs, and close collaboration to explore how those needs – and our service – could evolve in the future.

The customer engagement confirmed that the priorities for our customers are consistent and simple – including less sewer flooding and lower bills. Simple to understand, of course, but not so simple to achieve. So it's extremely pleasing to report that this was the third consecutive year where we outperformed on the measures that our customers care most about.

Less sewer flooding

An improved record on sewer flooding sits right at the top of our list of achievements. There's been a 35% reduction in the number of customers affected by external sewer flooding, largely due to our continued focus on prevention.

With many blockages caused by wipes and other non-degradable items, we've continued to use a wide range of initiatives to educate our customers about what they can and can't put down toilets and drains. Among households, wipes are the main culprits and during the year we interacted with 200,536 customers to help them to improve their understanding of how sewers work and to be careful around how much water is consumed. We're paying particular attention to the customers of the future, and engaged with 156,102 schoolchildren during the year. We aim to educate and inspire an entire generation, not just about water conservation and environmental protection, but also by emphasising the importance of hydration to their health and wellbeing.

In the non-household sector, we followed up last year's pioneering agreement with McDonald's by engaging with more fast food restaurants. In Gloucestershire, for example, we worked with companies including YO! Sushi, J D Wetherspoon and The Mayflower to help prevent fatbergs by educating staff about what they shouldn't be pouring down sinks and drains, and advising them on what grease containment and treatment is needed.



We're the first water company to provide a 24/7 service for non-emergencies, so customers can contact us to discuss anything they want in the middle of the night, if that's what fits in with their lives.

Lower bills

For the 8th consecutive year, Severn Trent Water's customers paid the lowest bills in England and Wales, with our average combined bill for the year being £341. We're proud of this record – but we're even more proud of our continuing efforts to do more every year to help vulnerable customers who are struggling to make ends meet. In its third year, our Big Difference scheme helped 36,000 customers access discounts of between 10% and 90%, which is a critical part, along with other tailored schemes, to ensure we deliver on our commitment to help at least 50,000 customers with bills every year. Experience tells us that financial difficulties can often indicate issues in other areas of a customer's life, so we've expanded our care and assistance team to give us the capacity to engage with agencies such as housing associations, the NHS, Citizens Advice and charities including MIND, Samaritans and local food banks, as well as other utility companies. By working together, sharing appropriate information and adopting a holistic approach to vulnerable people, we believe we'll be able to do even more to play a key role at the heart of local communities.

More ways to contact us

It's important to our customers that they can get in touch with us how they want, when they want. We now maintain nine different customer communication channels, including webchat which saw an increase in traffic during the year. We're the first water company to provide a 24/7 service for non-emergencies, so customers can contact us to discuss anything they want in the middle of the night, if that's what fits in with their lives. The value of round-the-clock availability can be seen in the fact that on most nights, more people contact us with questions about payment of their bills and other issues than about emergencies.

Although our customer Service Incentive Mechanism ('SIM') score – which Ofwat uses to measure how well and how quickly we put things right when our service fails to meet customers' expectations – is disappointing, we are working hard to improve the consistency of our customer experience. There's still more to do, and we're going to focus extra effort in areas such as the time we take to respond when customers inform us of a leak. But it's encouraging to see that our drive to embed customers at the centre of all we do is paying off where it matters most – in the hearts and minds of customers themselves. Customer written complaints for the year are down 17%.

We continued to perform well on the Institute of Customer Service's UK index, which measures customer satisfaction across the utilities sector, achieving upper quartile position for customer satisfaction, equivalent to fourth position in the Utilities sector. We look forward to the introduction of Ofwat's new C-MeX measure; currently in development, we believe that this measure will provide a truer reflection of our relative performance.

Performance review continued

Regulated Water and Waste Water



Driving operational excellence and continued innovation

We're fully supportive of the incentive environment that Ofwat has created. The clear linkage between performance and reward has encouraged us to think differently about how we work and to develop a sharper focus than ever on improving customer service. The result has been a good performance which has generated significant ODI outperformance payments of £80.2 million. We've decided to defer these earnings and access them in the years to come, when they'll help us to smooth future customer bills.

Nowhere is our performance better demonstrated than on our waste measures, including sewer flooding. As reported above, we achieved a significant reduction in the number of customers affected by such incidents over the last year. In fact we've outperformed our internal sewer flooding regulatory target by 31% and our external target by 49%. How have we achieved this? By continuous investment supported by leading edge technology. At a macro level, we're using sophisticated data and analytics to predict the areas at greatest risk and then addressing these with targeted capital investment. At a more micro level, we're carrying out root cause analysis of incidents when they do occur and putting measures in place to prevent reoccurrence – whether caused by geographic factors or customer behaviours.

Regaining 4* status

Pollution is an area where the investments made since privatisation are really paying off – and we're delighted to report that our environmental performance should enable us to regain coveted 4* status from the Environment Agency.

Our number of serious pollution incidents (categories 1 and 2) decreased to two from seven the previous year while category 3 performance again improved, with 327 incidents against a regulatory target of 374. At the same time, we worked hard to improve the quality of the water entering our rivers and reservoirs. Metaldehyde is an effective pesticide against slugs, snails, and other gastropods – but once it runs off fields and enters the watercourse, it's extremely expensive to remove. We continued to use financial incentives to encourage farmers to pursue different and less environmentally damaging alternatives, with considerable success.



We've outperformed our internal sewer flooding regulatory target by 31% and our external target by 49%.

The Drinking Water Inspectorate ('DWI') plays a key role in our regulatory environment, and we continued to fulfil our commitment to carry out diagnostics at our 16 largest sites. Our performance is measured by a metric known as mean zonal compliance, and during 2017/18 we improved our performance compared with the prior year at 99.96% (2016/17: 99.94%).

Scope for improvement

Unfortunately, our performance on supply interruptions was less pleasing, with a two-fold year-on-year deterioration. Due to a number of significant bursts some of our customers were left without water. The major burst at Tewkesbury in December, which affected many thousands of people, was challenging both to locate and isolate. Although we worked tirelessly to reconnect our customers and provided 100,000 litres of bottled drinking water, we recognise that our performance was unacceptable.

Then, in March 2018 the very rapid thaw following 'The Beast from the East' led to a substantial increase over a seven day period in the number of burst pipe notifications we would typically receive during that period, followed by complications caused by airlocks, further snowfall and then further bursts. We were incredibly disappointed that homes and communities were left without water as a result of the unprecedented weather. We know how difficult everyday life was for our customers until we could restore supplies – and we decided immediately to pay £30 compensation, roughly equivalent to our average monthly combined bill for water and waste, to any who were without water for more than 12 continuous hours, or experienced intermittent supply for more than 15 hours. We also worked with business customers and their retailers who were affected. With around 70% of issues occurring on private property, we know we need to do more to advise customers better on how to prepare for winter.

The quality of our drinking water is constantly monitored and strictly regulated. Our strategy for the year was to focus more efforts on our surface water treatment works – and while this generated good results it was accompanied by a slight dip in performance at our ground water sites. For example, the number of sites where coliforms were detected rose from five to eight. While coliforms are harmless bacteria, their presence can be an indication that water quality is not as high as it should be. Overall, we received 12,687 complaints about water quality during the year, down by 12%. This was our best performance for six years, and sustained the prior year's improvements. We're committed to further improvement and acknowledge that the number of complaints in 2017/18 is still significantly above our regulatory target of 9,992. We're targeting improvements in many ways, including adopting the water flushing programme initiatives in place at Dee Valley Water which helped the team there achieve 100% compliance during the year. One of the Dee Valley Water teams is currently leading the Severn Trent water quality improvement programme – a good example of how we're sharing best practice and learning from each other's experiences.

Investing in innovation

We continue to seek out innovative ideas that can transform our performance, no matter where they originate. For example, our commitment to remove phosphorus from our sewage treatment works has seen our innovation team evaluate technologies from across the world. Following intensive £2 million trials at our Packington site over the last two years, we're now commencing the roll-out of five different and highly advanced technologies. These include a magnetite ballasted coagulation process pioneered in the US. At one site this technology has replaced our original solution, which was costed at £21.1 million. The new solution reduced the cost to £12.5 million and will lead to a total expenditure (Totex) saving of £8.7 million – a return on investment of 218% on one scheme alone.

We're also seeking to improve our performance on leaks through innovative projects, such as the introduction of detector robots into the pipe network. This innovative solution uses small touch sensors to spot the nature and exact location of leaks rather than the current visual and acoustic techniques. Based on technology first used in North America, we were the first test case in Europe and only the third test case globally with very encouraging early results.



We're also seeking to improve our performance on leaks through innovative projects, such as the introduction of detector robots into the pipe network.

Performance review continued

Regulated Water and Waste Water continued



Investing responsibly for sustainable growth

At Severn Trent, we've been responsible for £21 billion of the £130 billion invested by our industry since privatisation – and our capital programme continued at pace through 2017/18, as we invested £855 million across our estate. Last year, we committed to investing a further £120 million in AMP6 in order to make sure we're in the best possible shape for AMP7, and we've increased our forecast Totex efficiencies by £100 million. These now stand at £870 million. This additional £100 million of Totex efficiencies, which is in addition to the £120 million previously announced, will also be reinvested in our business, for the benefit of customers.

Delivering our capital programme

Looking at our major capital projects, we started work on a £60 million project to protect 400 homes and businesses at Newark in Nottinghamshire from sewer flooding, and provide the town with a more reliable water supply. On track for completion in 2019, the project will see us install 4 km of new sewers and 10 km of new water mains, and also build a 3 km, 2.8 metre diameter, tunnel 15 metres below Newark.

The £300 million Birmingham Resilience Project is the largest capital project undertaken in the industry during AMP6. Due to be completed in 2020, this will create a second major source of water for Birmingham. Progress during the year included preparatory works for the Lickhill to Frankley pipeline comprising the laying of 17 km of pipework and major tunnelling operations.

Meanwhile, the £40 million investment to replace an ageing reservoir with two new ones at Ambergate was completed a year early in February 2018. This project will lower the risk to drinking water quality while improving our storage capacity resilience at the same time.

Our capital programme is delivering rewards in many areas of the business. We've retained our Upper Quartile position in waste and are moving in that direction on water. In terms of ODIs, we've significantly outperformed our targets and our ODI outperformance payments have exceeded £80 million.

Building a sustainable business

It's important to balance capacity-building projects with the need to create a sustainable business that's able to deliver customer benefits in the long term – not just next year but over the coming decade and beyond.

For example, we carried out 15,367 home water efficiency checks during the year. These help customers save money by using water more efficiently – and that means less pressure on water resources in the future. We're now using demographic data such as socioeconomic profiling, to target customers who we believe stand to gain most from a visit by our team. In total, our education programmes helped over 171,469 customers use water more wisely in 2017/18.

We're fortunate that the Severn Trent estate is home to a diverse array of species of plants and animals. During the year, we improved biodiversity at Sites of Special Scientific Interest ('SSSIs') covering 9.86 hectares, representing good progress against our 2020 target of 75 hectares – and we also improved almost 120 km of rivers as part of the Water Framework Directive. We continue to focus on exploring innovative ways to generate renewable energy from waste, and last year self-generated the equivalent of 38% of our energy needs. Please see the Business Services performance review on page 42 for more details.

On a more negative note, our emissions performance was disappointing as we failed to achieve our Water carbon ODI due to higher than expected energy use. In response, we've introduced new energy management initiatives for the coming year. We've also agreed to help the National Grid balance energy supply and demand by turning some of our operational sites off at certain times.

We know that our own efforts to become more sustainable become even more effective when we're joined by others – and in May 2017, we were delighted to see our supply chain partners stepping up to support our ambitions. At an event in Coventry, senior delegates from our top suppliers engaged with our management team to explore opportunities to work together for mutual benefit. The outcome included a series of pledges from these influential suppliers to work on improving sustainability in areas relevant to their business. For example, embedding carbon and water reductions in their processes and pledging to work closely with us on mitigating the risks of modern slavery.

Closer to home, we are working with PwC and Hope for Justice to provide our people with bespoke training on modern slavery. This programme raised awareness of the issue and how to identify it, particularly among our suppliers – and it's encouraged our people to become advocates of our zero tolerance approach to modern slavery.



Changing the market for the better

Severn Trent Water and Dee Valley Water are very active players in the water industry across England and Wales. We're keen to play our part to the full – promoting the industry and the positive influence it has had on life in the UK since privatisation, and encouraging greater awareness among regulators and others of the issues we face.

During the year, we supported the Social Market Foundation in publishing a report into the likely implications of renationalising the water industry on public sector debt levels. With some commentators estimating the cost of such a development to be in excess of £90 billion, our view is that the public should be fully aware of the facts around all aspects of renationalisation. We also collaborated with Thames Water and United Utilities to publish a thought leadership document on how water companies could create and manage a systems operator for water trading in order to drive greater efficiency.



Encouraging new ideas

We have a track record of embracing markets where we believe we can create value for our customers. For example, our Water Plus joint venture with United Utilities is enabling us to take advantage of the opportunities presented by the opening of the non-household retail market in April 2017.

We continued to engage with our industry peers on a wide range of issues throughout 2017/18, in order to identify and evaluate new and better ways of working. Our draft Water Resources Management Plan outlines a range of potential trading options to help meet future demand pressures and to secure supplies for the long term. We've already worked with Thames Water and United Utilities to investigate the benefits that a super interconnector could bring to our respective regions, by enabling us to move and trade water. Additional future options include bio-resources trading – and we've taken part in trials to make sure we're ready for the opportunity when it arises.

We also worked closely with the Water Forum, which not only gave us valuable customer insights but also helped guide the new and deeper approach we're taking to supporting vulnerable members of our local communities.

Acquired in 2017, Dee Valley Water has now been substantially integrated into the Group, and we've been busy sharing ideas between the businesses. The acquisition gave us the opportunity to realign both Dee Valley Water and Severn Trent Water around national boundaries. Once the realignment is complete in July 2018, Dee Valley Water will be answerable to the government in Wales, while Severn Trent Water will be answerable to the government in England.

We recognise the importance of leading by example, and aim to help our industry regain public trust and legitimacy by demonstrating the highest standards of governance. Our Board leads from the front and is responsible for the oversight of all aspects of the business, including culture. During the year, the Directors continued to evaluate a broad set of cultural indicators, such as exit interviews and external stakeholders' perceptions, in order to ensure that our values remain central to everything we do.

Performance review continued

Regulated Water and Waste Water continued



Creating an awesome place to work

Our people are key to the success of our business – and we want to make sure we motivate, reward and support them accordingly. It was very encouraging to see our efforts reflected by a six percentage points improvement in our annual employee engagement survey in 2017. The increased score builds on the positive momentum of recent years as our culture matures, and was achieved across the board – people in every part of the business support what we're doing.

We're creating an awesome place to work by focusing on a broad set of projects and initiatives. Recruitment and career paths clearly play an important role – graduates continue to be attracted to the challenges and opportunities we offer, and our apprentice intake increased yet again. In fact during 2017/18 we were delighted to see four experienced employees start on our first ever Masters level apprentice programme.



Celebrating diversity

The last 12 months saw the establishment of our first LGBT+ inclusion group. The mission of this team was to create a proud and inclusive culture for our LGBT+ community, supporting our colleagues and ongoing commitment to being recognised as a diverse and inclusive business.

Helping people progress

We invest in skills and development at all levels of the business, doing all we can to provide people with progressive, successful careers. A number of our current senior managers started in junior positions. We aim to provide great opportunities for all, regardless of gender, race or background. We continually strive to be a diverse, inclusive business that reflects the demographics of our region, and achieved a 13% increase in the numbers of Black, Asian and Minority Ethnic ('BAME') employees on our graduate programmes during the year. The population in the East and West Midlands is among the least socially mobile groups in the UK – but as a major employer we can help change that and enable people to realise their potential. To this end, we've removed barriers to entry such as the requirement to have a degree for some of our programmes and we have changed our selection process to focus on potential rather than experience.

Our gender diversity performance improved during the year and we now have a mean gender pay gap of just 2.4%. However, we're working hard to reduce it still further. We benefit from high female representation at executive level and were pleased to be placed second among FTSE 100 companies for representation of women on boards and in senior leadership roles by the 2017 Hampton-Alexander Review. The last year also saw the creation of our first LGBT+ inclusion group. The mission of this team was to create a proud and inclusive culture for our LGBT+ community, supporting our colleagues' ongoing commitment to being recognised as a diverse and inclusive business.

We encourage all our people, across all roles and age ranges, to be creative and put forward their ideas for innovations that can improve customer service. We repeated the all-employee staff roadshow, following its success in 2015. The 'Bike on a Boat' tour, inspired by the innovative approach of the New Zealand America's Cup-winning team of 2017, captured and shared a wide range of brilliant ideas. Since its launch we have funded 13 ideas, including sending employees to evaluate initiatives in Singapore, Australia, Denmark and USA that could be adopted in our business.

We also restructured the business during the year. This brought a renewed emphasis on our core work in water and waste water, it's also improved our customer focus and, crucially, brought a new level of clarity to our employees on roles and responsibilities. We all know what's expected of us, and we all know that the business will do its best to support us by giving us the tools we need – whether that's a robot leakage detector, an innovative agreement with a farmer or a day of intensive management training.

Pay and conditions are high on everybody's list of priorities, and we've made good progress here too. We provide jobs that are well paid and with excellent pensions. Our bonus scheme also embraces everybody, ensuring that the rewards of a good year's work are shared among us all. The annual employee engagement survey identified pay transparency and relativity as two of the top 10 issues where our people thought we could improve. We're now addressing this by clarifying pay rates and being more thorough in the way we explain career opportunities.

Promoting health, safety and wellbeing

We pay particular attention to the health, safety and wellbeing of our teams, and in 2017/18 continued our major initiative around mental health. Our aim is to remove the stigma around mental health, for example by creating a workplace where people can talk about problems with depression or stress. To date, we've trained over 400 mental health first aiders to spot the signs of a possible issue, while a number of senior managers have brought mental health more into the open by talking frankly about their own experiences. During the year, we held an initiative on the menopause and other areas that people can be uncomfortable discussing, including cancer, and we signed up to Dying to Work, which supports employees with a terminal diagnosis.

We're committed to the highest standards of behaviour at all times, not only in our own business but also among our suppliers, who are required to sign up to our Code of Conduct, anti-corruption and bribery policy and our sustainable supply chain charter to illustrate that they share our values and are committed to helping us achieve our goals. We audit suppliers as part of our tendering process for large contracts, and they must demonstrate full compliance with our standards at all times.



Over 40% of employees volunteered during the year, a huge increase on the 11% that took part in 2016/17.

During the year, we worked with Hope for Justice to develop a training package, including upskilling our contract managers on how to spot the signs of slavery and human trafficking and the steps they should take if any concerns are raised. We have clear policies and training in place – and these are supported by an independent and confidential whistleblowing service which we actively promote via communications such as messages on payslips. Every report of possible corruption or bribery, from any source, is investigated and reported to both the Corporate Responsibility and Audit Committees of the Board.

We want our people to feel part of a progressive company that plays its part to the full – and the record level of employee volunteering is another positive sign of this. Over 40% of employees volunteered during the year, a huge increase on the 11% that took part in 2016/17. Most volunteering was through our new Community Champions programme, working alongside key partners such as The Wildlife Trust to improve 50 km of riverside environments in our regions. Our volunteers also helped our corporate charities, Comic Relief, Sport Relief and Children in Need, as well as continuing our long term support for WaterAid. In addition to raising nearly £300,000 during the year, our people also drew on specific industry skills to give practical help to WaterAid, for example by supporting the charity's campaign to improve water quality in Cambodia.

Business Services

We have transformed Business Services during the year: divesting our overseas operating services businesses and increasing our focus in the UK; expanding our energy production capacity and establishing our Bioresources business; and setting up our Property division.

Focusing on the domestic UK market

Following the sale of our Italian business in the previous year, in June 2017 we sold the Operating Services' US business to Public Pensions Capital for \$62 million. This enabled us to sharpen our focus on our core UK and Ireland domestic market, in line with our strategy.

Our UK contracts business again provided a solid foundation for the year's performance. The 25 year operating and maintenance contract with the Ministry of Defence ('MOD') has now reached the halfway point. We're delighted to continue to receive positive feedback from our customers regarding the service we're delivering and we've continued to see strong returns from project work across the MOD estate.

We continue to grow and value our close working relationships with customers. For example, this was demonstrated to good effect on our Coal Authority contract. Our team is now co-located in the customer's Mansfield office, from where we manage the contract to prevent flooding and pollution issues at disused mines.

Seizing new opportunities

We've completed the integration of our non-household retail operation into Water Plus. This joint venture with United Utilities is focused on the opportunities created by the opening of the non-household retail market to competition in April 2017. Water Plus is working well, maintaining its share of a growing market by winning several major contracts. The emphasis for the year ahead will be on driving improvements in the market and improving our service to meet customer needs, as we strive to be recognised as a leader in this new market.

In a move that will help us extract maximum value from our estate, we created a new property division during the year. The Property Development business unit aims to develop land previously used for operations through the planning process for onward sale to developers to enable new homes and commercial premises to be built, creating new homes, communities and jobs. Our experienced, dedicated team has significant property expertise and will assess the potential in our surplus land. Together with Severn Trent Water's Estates Management Team, our aim is to deliver £100 million profit over the next decade.





Construction of our third food waste plant is also progressing well. Sited in Derby, this new plant is the first in the UK to incorporate advanced thermopressure hydrolysis, which will enable us to generate more energy and take in waste from the broader waste market.

Generating our own energy

Our sewage sludge anaerobic digesters, food waste and crop digestion plants, two wind turbines and solar PVs generated the equivalent of 38% of our energy during the year – and we remain on track to achieve our target of increasing that percentage to 50% by 2020.

In pursuit of that goal, we took steps to expand our renewable activities by announcing a new Bioresources business unit. Set to begin operations in April 2018, the new unit will manage all bio-resource activities within our regulated business, in preparation for the opening up of the bio-resource market in 2020.

Our crop digestion plant near Nottingham will play an important role in achieving our 50% target. The plant produces gas by digesting maize that's been grown on contaminated land around our treatment works. Construction of a new biogas facility to expand capacity by 50% completed in December 2017 and delivers biomethane directly into the National Grid.

Food waste plants – which take waste food from restaurants, supermarkets and other facilities – are another way in which we're turning waste into renewable energy. Our second food waste plant at Stourbridge opened for business in June 2017. It will produce enough green gas to power around 3,000 homes and help the Government meet its objective to decarbonise the environment. Construction of our third food waste plant is also progressing well. Sited in Derby, this new plant is the first in the UK to incorporate advanced thermo-pressure hydrolysis, which will enable us to generate more energy and take in waste from the broader waste market.

Managing our critical resources and relationships

Every day, we rely on six key resources and relationships to support the long-term sustainability of our business.

On these pages we explain these resources and relationships in detail, and showcase a number of practical examples of how we managed them over the last year.

This year we have integrated our CR metrics among our commentary on managing our critical resources and relationships.

Positive engagement with land managers

85%

2017: 44%

Water Framework Directive classification improvement points

19

2017: 15

Hectares improved from unfavourable or deteriorating condition using Natural England's database of SSSIs

9.86

2017: 29.74

Expected EA rating

4*

2017: 3*

Number of Environment Agency Category 1 & 2 incidents (calendar year metric)

2

2017: 7

Reduction in Group carbon emissions

4.4%

(scope 1 and 2) – our direct emissions and those from the energy we use
2017: 8.3%

Our natural resources

Maintaining our reservoirs, rivers and underground aquifers

We're fortunate to be responsible for some of the UK's most impressive natural resources. From the chain of man-made lakes created by damming the Elan and Claerwen rivers in Wales, which provide clean water to Birmingham, to stunning stretches of rivers such as the Severn, the Dee and the Trent, these wonderful resources provide the raw materials for our services.

Despite the relatively dry winter, our reservoirs were full at the end of the financial year, and we're in a strong position to ensure a reliable supply to customers during the year ahead.

Working with landowners...

Prevention is better than cure, so we work hard to make sure that the water entering our watercourses is as clean as possible. Supported by the skills of a dedicated team of agricultural advisers, the Severn Trent Environmental Protection Scheme ('STEPS') aims to improve watercourses and the wider environment.

STEPS provides grants of up to £5,000 for infrastructure improvement and land management changes in our target areas. This is part of our plan to invest £21 million by 2020 to help farmers improve water quality – an investment that will pay off several times over by protecting the environment and reducing treatment costs.

For example, we continued to recompense farmers prepared to switch from metaldehyde to less invasive alternatives for the control of slugs. Once in the watercourse via field run-off, metaldehyde is extremely expensive to remove – and the scheme has again delivered excellent value while helping us achieve our catchment management target.

We improved biodiversity on 9.86 hectares of Sites of Special Scientific Interest ('SSSIs') during the year, and have a target of improving 75 hectares of SSSIs by 2020.

...and ensuring long term supply

As the financial year closed, we published our draft Water Resources Management Plans ('WRMP'). Our long term view on supply availability, the WRMP articulates the need to make significant investments in water supply and demand management schemes, particularly in light of the Government's requirements for the industry to reduce levels of water abstraction. For example, Severn Trent Water has targeted a 15% reduction in leakage over the next five years, and we plan to increase the use of water meters, in addition to stepping up our home water efficiency checks. We carried out 15,367 checks during the year – helping customers save money and protect future supplies by using water more efficiently.



Helping farmers step up to the challenge

Prevention can be more cost-effective than treatment, particularly when it comes to pesticides which can enter our rivers from surrounding fields. Through STEPS we offer farmers grants of up to £5,000 per year to undertake works which will help reduce pollution.



Retaining the Carbon Trust Standard

We were proud to once again be reaccredited with the Carbon Trust Standard during the year. This achievement verifies that we have sound carbon management processes in place and are reducing absolute carbon emissions year-on-year. In fact, we've reduced our GHG emissions by 17% since 2014.

Managing our critical resources and relationships continued

Cleaning our rivers

Under the EU Water Framework Directive ('WFD'), we're charged with achieving 'good status' for all watercourses. We continued to support the aims of the WFD during 2017/18 and again made significant progress towards achieving our ambitious target of improving the health of 1,800 km of river by 2020. We completed 10 WFD sewage treatment projects during the year which improved almost 120 km of river – an increase of around 650% over the previous year – and we're now approximately 15% of the way to reaching our objective. River health is assessed by the Environment Agency and measured against a set of criteria including oxygen levels and the presence of fish and invertebrates.

Managing our environmental impact

During 2017/18, we outperformed our internal sewer flooding regulatory target by 31% and our external target by 49% – and these have been key factors that should help us regain a 4* rating from the Environment Agency.

We also achieved all of our regulatory targets relating to pollution incidents, reducing serious category 1 and 2 pollutions to two events during 2017/18, down from seven in the prior year.

We failed to reach our water ODI carbon emissions target for 2017/18, primarily due to greater energy consumption as we need to meet increases in demand for water production. Efficiency measures now in place are expected to drive the required reduction in the coming 12 months. Meanwhile, we continue to increase the amount of renewable energy we generate. During the year, we produced the equivalent of 38% of Severn Trent Water Limited's energy needs and are on track to increase this to 50% by 2020.



Using technology to prevent pollution

Combined sewer overflows ('CSOs') are susceptible to pollution if they block or stop working properly. So over the last year we've invested in monitors at over 70% of our CSOs. We're also installing over 1,000 monitors in manholes where there's a high risk of internal flooding or pollution.



40% of employees volunteer to clear 50 km of rivers

Our volunteering scheme continues to go from strength to strength. During the year, over 40% of our people worked with partners such as local Wildlife Trusts to help clean up the environment alongside 40 km of rivers in England and a further 10 km in Wales.

Our physical assets

Ensuring a resilient and well-maintained network

Our physical assets include over 49,000 km of water mains, 27 dams, 139 water treatment works and a vast range of equipment, sites, offices and other structures across an estate that covers more than 53,000 acres. While a significant number of these assets are over 100 years old and of historic importance, many are among the most technologically advanced examples of their type in the water industry – not only in the UK but worldwide.

We're committed to ensuring that our assets are in optimum condition at all times, able to deliver the high quality services that our customers depend on. At dams and reservoirs, for example, we carry out regular checks to identify any remedial actions that need to be undertaken – and every year, the Board receives a full report on the condition of each dam and reservoir in our portfolio.

Security is an increasingly important issue for all key UK infrastructure. Mindful of our role and responsibilities, we co-operate closely with the Government on potential terrorist targets and provide physical security at all major sites. At the same time, our cyber security team constantly monitors our IT assets, identifying and addressing any vulnerabilities in order to protect our data and that of our customers.

Improving our portfolio to improve efficiency...

Since privatisation, the water industry has invested some £130 billion in assets to improve services for customers, with our own capital programme involving an investment of around £3 billion over the five years to March 2020.

The major projects currently underway include the £300 million Birmingham Resilience Project – the largest ongoing capital project in the industry – and a £60 million scheme to improve sewers and water mains at Newark in Nottinghamshire. We also have a continuous investment programme to improve the effectiveness of our sewage treatment works, including a £12.5 million project to remove phosphorus.

...and reduce interruptions and leakage

While our capital programme is delivering rewards in many areas of the business, we recognise that our customers experienced too many supply interruptions during the year. Some of these caused major hardships, notably at Tewkesbury in December 2017, when we took too long to locate, isolate and rectify a burst main, and in March 2018 when the countrywide freeze and subsequent thaw contributed to some customers being left without water or with only intermittent water supplies for extended periods of time.

We're working hard to improve our performance, including investing in robot leakage detector technology which we believe would have been invaluable at bursts such as the one at Tewkesbury.

The time we take to respond when customers tell us about a leak is another area where we need to improve. However, this is not as clear cut as it appears. Our performance commitment target is to respond within 24 hours, but, this may not be the most operationally effective way to provide a good service to customers or manage our network efficiently. We're currently evaluating our response capabilities in order to assure ourselves and our customers that our current approach is appropriate.

Managing our critical resources and relationships continued

Our people

Creating a place where people enjoy coming to work – where they're safe, well rewarded and treated with respect

The Group employs around 6,000 people at locations primarily across the East and West Midlands as well as in North and mid-Wales. We know that we're only as good as our people. So we strive to create a workplace that's welcoming, safe and well-rewarded – and where they're treated with respect. This year's employee survey showed a six percentage points increase in engagement, clearly demonstrating that we're on the right path to making the Group an awesome place to work.

Health, safety and wellbeing

The health and safety of our people is a core aspect of how we work, and we ensure that they're provided with the training and resources to follow our safety rules. Our Lost Time Injury ('LTI') frequency rate for the year was 0.17 per 100,000 hours worked, a significant decrease of 23% over the previous year. Our rigorous approach to safety has led to this improvement over the last three years, from 0.21 in 2015. However, there's no room for complacency and we'll continue to promote safe working practices through initiatives including training and regular communications.

We also made good progress in ensuring our people's wellbeing during the year. We continued our mental health programme and now have over 400 trained mental health first aiders across the Group. This is part of our drive to promote greater awareness of some of the more challenging issues that people can face in their everyday lives – for the year ahead we're continuing to focus on the menopause and cancer.

Pay and career paths

We aim to provide people with careers, not just jobs. Pay scales are relatively high for our Midlands heartlands, and we work hard to make sure that our people can see how and where they can progress up through our organisation – regardless of their starting point.

Attracting high quality people is a challenge for all employers, so we're pleased to see the high numbers of graduates that apply to Severn Trent. Our apprentice programme expanded yet again during the year and for the first time included a Masters level option.

Over the next 12 months we're going to respond to issues raised in the employee survey, including greater clarification on pay rates and extra focus on how we explain career opportunities.

Diversity and inclusion

We're already a diverse, inclusive business – but we know there are opportunities to do even more to reflect the demographics of our region.

The year saw a 13% increase in the numbers of Black, Asian and Minority Ethnic ('BAME') employees on our graduate programmes, and we've introduced new ways of working designed to drive a further increase in future years. These include removing barriers to entry such as the requirement to have a degree for some of our programmes and improving the way we target recruitment activities at schools.

Gender diversity is another area where we're performing well. Our mean gender pay gap for the year was 2.4% – and we're committed to reducing it still further. Our executive team has particularly high female representation, which is why we were placed second among FTSE 100 companies by the 2017 Hampton-Alexander Review.



Signing up to help those with a terminal illness

We were proud to sign up to the TUC's Dying to Work charter during the year, which aims to protect employees with a terminal illness. We believe that nobody should have to worry about keeping their job if they have a terminal diagnosis.

Raising awareness of mental health

Since 2015, 19% of our employees have taken part in mental health awareness training. We're going to continue to focus on this issue during the year ahead – while also expanding our efforts to embrace other aspects of wellbeing such as physical health, nutrition, exercise and sleep.

Our suppliers and partners

Building strong relationships that provide mutual benefit

We rely on a pool of suppliers that use their expertise and resources to maintain and improve our infrastructure. Through the One Supply Chain programme, we agree long term contracts that give suppliers greater certainty of workflow and revenue, while the benefit to Severn Trent lies in the opportunity to negotiate more competitive prices. The long term nature of the contracts also enables both parties to build stronger relationships, work more closely together and explore more efficient ways of working.

In addition to achieving operational excellence and meeting our efficiency targets, our contracts also stipulate that suppliers must adhere to our own high safety standards and sign up to our policy on bribery and corruption and our sustainable supply chain charter. We ensure compliance with these requirements through a comprehensive audit during the tendering process, and through regular communications and meetings. For example, a number of our suppliers have signed up to corporate responsibility targets agreed with us, and we review progress against these monthly. Through our supplier events, we have set out our plans and expectations, and have invited delegates to contribute their own ideas on how we could work better together. We also took the opportunity to underline the role that safety and ethics play in creating enduring supplier relationships.

Partnering with others

We're keen to work with partner organisations from both inside and outside our industry, combining their specialist knowledge with our own in order to address some of the challenges and opportunities we face.

For example, during the year we extended our drive to support vulnerable customers – and have now formed deeper relationships with bodies including MIND, Samaritans, Citizens Advice, local food banks, the NHS and other utility firms. By sharing our knowledge, we aim to build a holistic view of people who are potentially vulnerable and to put measures in place to help them at an earlier stage.

We've continued to collaborate with our peers in the industry. We engaged with Thames Water to evaluate a project to build a super interconnector that would enable water trading, and with the Social Market Foundation to publish a report into the possible financial implications of renationalisation. In partnership with Thames Water and United Utilities, we also published our joint ideas on how the creation of a systems operator could support greater efficiency.



Inspecting the condition of our waste water assets at Packington treatment works.

Suppliers signed up to sustainable supply chain charter

211

Introduced in May 2017

Suppliers paid on time

96%

2017: 97%

Managing our critical resources and relationships continued

Our customers and communities

Improving the customer experience

We're responsible for meeting the needs of 4.3 million household and business customers, across an area stretching from the Bristol Channel to the Humber, and from North and mid-Wales to the East Midlands. We provide these customers with around 1.6 billion litres of high quality drinking water every day and treat around 2.77 billion litres of waste water, which we clean and return to the system.

Everything we do is to the benefit of our customers and their communities – and during the year we carried out our most extensive research project ever, to make sure that we're addressing the issues that matter most to them.

Making a difference

Communication is the key to managing expectations, and we work hard to keep customers and communities informed and to minimise disruption when we carry out planned work on our network. Through our education programme, we help people save water and prevent blockages in our sewers and drains, supporting the long term integrity of the network and protecting water supplies for future generations.

The scale of our operations and the nature of our assets means we have a great opportunity to be a positive influence on the environment in local communities. We're continuing to implement initiatives – and working with local businesses, including farmers – to improve important habitats such as rivers, for the ultimate enjoyment of all. Our 17 visitor sites host a total of 4 million visits a year, and provide access to water for a range of leisure facilities, as well as customer education facilities.

Many of our people continued to play their part in the lives of their local communities during 2017/18. In fact more of our people than ever before took the chance to join in some form of volunteering or fundraising activity.

Customers who rate our service value for money in an independent quarterly survey

59%

2017: 58%

Customers we help each year through social tariffs and assistance schemes

51,716

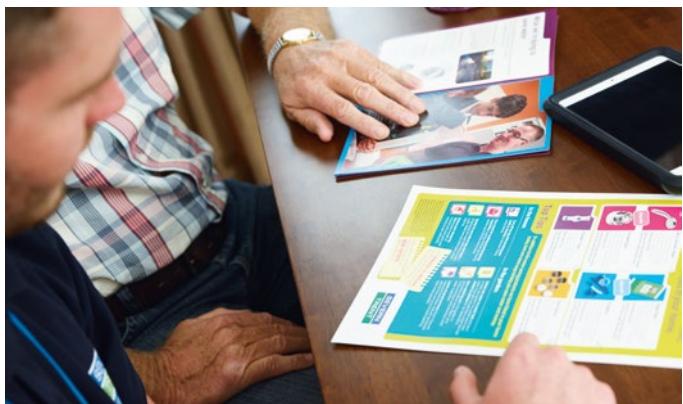
2017: 50,903

Regulators

Working with the authorities to shape our industry

We maintain positive and constructive relationships with Ofwat and other regulatory bodies. Complying with their requirements at all times isn't just the right thing to do – it's essential to our licence to operate and our ability to meet our commitments to our customers and other stakeholders.

We engage with regulators on a regular basis in order to share our knowledge and promote developments which could lead to improved services for customers across the industry.



Our 17 visitor sites host a total of 4 million visits a year, and provide access to water for a range of leisure facilities, as well as customer education facilities.

Chief Financial Officer's review

We have delivered a good financial performance in 2017/18, absorbing the upward pressures from sector-wide changes in business rates and energy pass-through costs. In our Regulated Water and Waste Water business, a full year's contribution from Dee Valley Water and higher revenues more than offset the impact of these pressures on our operating costs. In Business Services we have delivered good growth both in revenues and PBIT.

Underlying basic earnings per share increased by 4.6% to 121.0 pence per share in the current year. Reported basic EPS from continuing operations was 102.2 pence.

Our Return on Regulated Equity ('RoRE') at 11.5% is 1.5 percentage points higher than the previous year, driven by a strong performance across all three levers – Totex, customer ODIs and financing. Last year our RoRE was amongst the best in the sector and we expect to be in a similar position when this year's results for all companies are published in July.

In line with the revised dividend policy announced last year of growth of RPI plus at least 4% per annum, the proposed dividend for the year has increased by 6.2%.

On financing, we have a strong funding position, with all our projected investment and other cash flow needs covered by cash or committed facilities through to March 2020. This year saw the first rate increase from the Bank of England in more than 10 years. We actively monitor and manage our interest rate exposure and took steps to hold our proportion of debt at floating rates at 26% through the year end. We are also preparing for the introduction of CPIH indexation in AMP7, entering into CPI/RPI swaps with a notional value of £100 million in the second half of the year, which increased the total amount of these swaps to £150 million at 31 March 2018. And we have entered into a further swap for £100 million since the year end.

We are committed to paying the right amount of tax at the right time. In addition to the corporation tax, which is included in our tax charge in the income statement, we also pay business rates, employers' national insurance and environmental taxes such as the Climate Change Levy and the Carbon

Reduction Commitment. In 2017/18 we incurred £146.5 million in these taxes, charges and levies (2016/17: £147.2 million). Our corporation tax charge for the year was just above the statutory rate of 19% with our cash tax payments reduced by the benefit of allowances on our capital programme, contributions to our pension schemes and by the timing of instalment payments to HMRC under the current rules.

A brief overview of our financial performance for the year is as follows:

- Group turnover from continuing operations was £1,694.1 million (2016/17: £1,638.0 million), an increase of 3.4% as Regulated Water and Waste Water revenue increased by 3.0%, mainly due to the RPI-linked tariff increases and a full year of Dee Valley Water, and Business Services' external turnover grew by 9.2%.
- We increased underlying PBIT by 4.0% to £541.0 million (2016/17: £520.1 million). The first full year of Dee Valley Water contributed an additional £5.7 million and, excluding Dee Valley Water, underlying PBIT in our Severn Trent Regulated Water and Waste Water business grew by £14.5 million. Business Services underlying PBIT grew by £3.8 million, offset by a reduction in corporate and other PBIT of £3.7 million.
- We recorded net exceptional costs of £12.6 million (2016/17: credit of £16.6 million). Costs to prepare our Bioresources business for the introduction of the competitive market in 2020 were £20.9 million, partially offset by a credit from the Pension Exchange Arrangement reported at the half year. Reported Group PBIT was down as a result by 1.5% to £528.4 million (2016/17: £536.7 million).
- Net finance costs were £219.5 million (2016/17: £205.1 million). Our effective interest rate of 4.5% was up only marginally from 2016/17 (4.4%) despite the impact of higher RPI on our index-linked debt.
- Our full effective tax rate was 20.5% and our underlying effective tax rate was 12.7%, down from 16.6% in 2016/17 largely due to higher capital allowances from the larger capital programme in the year.

Regulated Water and Waste Water

Turnover for our Regulated Water and Waste Water business was £1,574.6 million (2016/17: £1,528.8 million) and underlying PBIT was £514.9 million (2016/17: £494.7 million).

	2018		2017		Better/(worse)			
	Excluding Dee Valley £m	Dee Valley £m	Total £m	Excluding Dee Valley £m	Dee Valley £m	Total £m	Excluding Dee Valley £m	%
Turnover	1,546.7	27.9	1,574.6	1,526.6	2.2	1,528.8	20.1	1.3
Net labour costs	(136.4)	(5.4)	(141.8)	(139.8)	(1.0)	(140.8)	3.4	2.4
Net hired and contracted costs	(145.8)	(1.9)	(147.7)	(144.6)	–	(144.6)	(1.2)	(0.8)
Power	(93.6)	(2.3)	(95.9)	(86.7)	(0.1)	(86.8)	(6.9)	(8.0)
Bad debts	(25.1)	(0.6)	(25.7)	(20.4)	(0.2)	(20.6)	(4.7)	(23.0)
Other costs	(188.1)	(4.8)	(192.9)	(187.7)	(0.6)	(188.3)	(0.4)	(0.2)
	(589.0)	(15.0)	(604.0)	(579.2)	(1.9)	(581.1)	(9.8)	(1.7)
Infrastructure renewals expenditure	(134.4)	(0.8)	(135.2)	(136.2)	–	(136.2)	1.8	1.3
Depreciation	(314.3)	(6.2)	(320.5)	(316.7)	(0.1)	(316.8)	2.4	0.8
Underlying PBIT	509.0	5.9	514.9	494.5	0.2	494.7	14.5	(2.9)

Chief Financial Officer's review

continued

Dee Valley Water was acquired on 15 February 2017 so this is its first full year in the Group. It contributed £27.9 million to turnover and £5.9 million to underlying PBIT in the year. The following commentary on the Regulated Water and Waste Water business excludes Dee Valley Water and is therefore on a like-for-like basis.

Turnover increased by 1.3%, as higher tariffs, including the impact of the annual RPI increase on prices, increased revenue by £33.8 million. Customer ODI rewards earned in 2015/16 increased turnover by £25.8 million but this was offset by a reduction from the Wholesale Revenue Forecasting Incentive Mechanism of £24.5 million arising from revenue billed in excess of the wholesale price control also in 2015/16. Our successful drive to help more vulnerable customers reduced revenue by £4.6 million due to greater take-up of social tariffs. Other movements of £10.4 million (net) including the impact of customers opting for metered status, offset by consumption increases further reduced turnover. In the current year our billed revenue was around £3 million below the wholesale price control and this will be added to revenue to be billed in 2019/20.

Net labour costs were £3.4 million (2.4%) lower. Gross employee costs increased by 5.3%, due to the annual pay award and our strategy to bring more work in-house. The increase in activity on capital projects resulted in an increase in the level of own labour capitalised, up £16.0 million on the previous year.

Net hired and contracted costs were up £1.2 million (0.8%).

Power costs were £6.9 million higher year-on-year driven as forecasted by higher pass through costs, greater consumption from a higher volume of water produced and the costs of responding to incidents. The Group manages its power costs through a combination of demand management, self-generation and forward price contracts.

Our bad debt charge increased by £4.7 million this year, and represented 2.2% of household revenue (up from 1.8% last year). In the year we improved cash collections on our current debt, but saw a decline in the amounts collected on older debt – both in accounts collected by us and by other water companies on our behalf. The prudent provisioning we apply to this older debt increased both our charge and the level of bad debt as a percentage of household revenue for the year.

Other costs increased by £0.4 million in total after higher profits on disposal of fixed assets (up £5.8 million) offset by higher business rates of around £3 million and other cost increases.

Infrastructure renewals expenditure was £1.8 million lower in the year, at the lower end of our guidance range; we expect to see growth in the programme next year.

Depreciation of £314.3 million was £2.4 million lower than the prior year. Our underlying depreciation rate increased in line with our asset base, but the change was lower year-on-year due to impairments recorded in 2016/17.

Return on Regulated Equity ('RoRE')

RoRE is a key performance indicator for the regulated business and reflects our combined performance on Totex, customer ODIs and financing against the base return allowed in the Final Determination.

Severn Trent Water's RoRE for the year ended 31 March 2018 and for the three years ended on that date is set out in the following table:

	2017/18 %	AMP6 to date %
Base return	5.6	5.6
Totex outperformance	0.8	1.3
ODI outperformance	2.3	1.5
Financing outperformance	2.8	0.9
RoRE¹	11.5	9.3

¹ Calculated in accordance with Ofwat guidance set out in RAG 4.07.

We have delivered strong returns across the board – with outstanding Customer ODI performance, improved operational and investment efficiency driving Totex savings, and continuing outperformance on financing.

Business Services

	2018 £m	2017 (restated) £m	Increase £m	%
Turnover				
Operating Services	78.3	74.4	3.9	5.2
Renewable Energy	60.4	54.0	6.4	11.9
	138.7	128.4	10.3	8.0

Underlying PBIT

Operating Services	15.9	12.8	3.1	24.2
Renewable Energy	20.1	19.4	0.7	3.6
	36.0	32.2	3.8	11.8

Our Business Services division delivered good growth in revenues (up 8.0%) and underlying PBIT (up 11.8%).

In our Operating Services business, turnover and underlying PBIT increased by £3.9 million and £3.1 million respectively, due in part to higher income from our new contract with plumbing and drainage insurers.

In the Renewable Energy business, turnover increased by 11.9% largely driven by increased generating capacity in the non-regulated business from our new food waste plant at Roundhill. Underlying PBIT increased by 3.6%, with our operating margin impacted by start-up costs in the new plant.

The results above exclude the US Operating Services business, which was sold on 30 June 2017; the Italian Operating Services business (sold on 23 February 2017); and the non-household Retail business (transferred to the Water Plus joint venture during the prior year). All of these businesses have been classified as discontinued operations in the current and previous periods and the results for the previous period have been restated to reflect this.

Corporate and Other

Corporate overheads were £8.9 million (2016/17: £6.9 million) and our other businesses generated a net loss of £0.8 million (2016/17: profit of £0.9 million).

Exceptional items before tax

We recorded a net exceptional charge of £12.6 million (2016/17: credit of £16.6 million).

We have made an early start in preparing our Bioresources business for AMP7. We have developed our business model and identified the actions that we need to take to compete effectively in the new market, determining the lowest cost structure from our existing network of sites, optimising our tanker fleet operations and identifying opportunities for trading in the new market. We have implemented a programme to reorganise the business to deliver our business model, reducing from 20 sites to 12, and as a result incurred exceptional costs of £20.9 million as follows:

- Set up and restructuring costs £2.1 million;
- Write-off of assets that will not be used in the new business £16.8 million; and
- Provision for costs to decommission these assets of £2.0 million.

An exceptional gain of £8.3 million arose (2016/17: gain of £16.6 million) from the net benefit, after implementation costs, of a Pension Increase Exchange arrangement, under which members of the defined benefit schemes will be offered the opportunity at retirement to exchange future non-statutory inflationary increases in a portion of their pensions earned prior to 1997 for a higher pension payment now. In the prior year the exceptional gain arose from a similar exercise for existing pensioners.

Net finance costs

Our net finance costs for the year were £219.5 million, up £14.4 million on the prior year. Our effective cash cost of interest (excluding the RPI uplift on index-linked debt and pensions-related charges) was 3.4%, 40 basis points lower than 2016/17. Higher RPI inflation on our index-linked debt (up £23.9 million) and pensions-related charges meant our overall effective interest rate increased marginally year-on-year to 4.5% (2016/17: 4.4%), but still compares favourably to our position at the start of AMP6 (5.4%).

Capitalised finance costs were higher than the prior year due to the increased level of capital activity in the year.

Our earnings before interest, tax, depreciation and amortisation ('EBITDA') interest cover was 4.3 times (2016/17: 4.3 times) and PBIT interest cover was 2.7 times (2016/17: 2.7 times). See note 46 for further details.

Gains/losses on financial instruments

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

- Exchange rate exposure on foreign currency borrowings;
- Interest rate exposure on floating rate borrowings; and
- Exposure to increases in electricity prices.

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

During the period a counterparty requested to terminate four interest rate swaps with a notional principal of £150 million. The fair value of the swaps at termination was a £42.6 million liability and the termination payment was £40.0 million. The gain on termination has been included in finance income.

We hold interest rate swaps with a net notional principal of £251.3 million, fixed to floating, and cross currency swaps with a sterling principal of £98.3 million, which economically act to hedge exchange rate risk on certain foreign currency borrowings. However, the swaps do not meet the hedge accounting rules of IAS 39 and so the changes in fair value are taken to gains/(losses) on financial instruments in the income statement. During the year there was a loss of £12.6 million (2016/17: gain of £11.1 million) in relation to these instruments.

Note 12 to the financial statements gives an analysis of the amounts charged to the income statement in relation to financial instruments.

As part of our power cost management strategy, we have fixed around 95% of our estimated wholesale energy usage for 2018/19.

Taxation

We are committed to paying the right amount of tax at the right time. As well as corporation tax on profits, which is included in the tax charge in our accounts, we incur a range of taxes, charges and levies imposed by government agencies:

	2018 £m	2017 £m
Tax borne:		
Corporation tax	26.7	32.4
Business rates and property taxes	82.4	78.8
Employer's National Insurance	23.2	21.6
Climate Change Levy	4.0	3.2
Carbon Reduction Commitment	5.9	6.3
Other taxes	4.3	4.3
	146.5	146.6

Chief Financial Officer's review

continued

The corporation tax charge for the year recorded in the income statement was £61.9 million (2016/17: £6.5 million) and we made net corporation tax payments of £6.5 million in the year (2016/17: £21.8 million). The difference between the tax charged and the tax paid is summarised below:

	2018 £m	2017 £m
Tax on profit on ordinary activities	61.9	6.5
Tax effect of timing differences	(29.0)	(26.4)
Current tax credits recorded in Other Comprehensive Income or Equity	(10.1)	(14.9)
Overprovisions in previous years	3.9	27.4
Impact of rate change	–	39.8
Corporation tax payable for the year	26.7	32.4
Payable by instalments next year	(12.2)	(18.0)
Instalments paid in the year	14.5	14.4
Repayments received	(8.0)	(20.6)
Payments relating to prior years	–	28.0
Net tax paid in the year	6.5	21.8

Tax payments were reduced by £29.0 million (2016/17: £26.4 million) as a result of capital allowances and other timing differences where tax relief is given ahead of the cost being recognised in the income statement.

The total tax incurred was further reduced by £10.1 million (2016/17: £14.9 million) representing tax credits that we receive on charges that are shown in the statement of comprehensive income or equity – the tax for these items is also shown in the statement of comprehensive income or equity so is not included in the income statement charge.

The tax charge includes a credit of £3.9 million (2016/17: £27.4 million) for amounts overprovided in prior years. In 2016/17 there was also a credit of £39.8 million from the impact of adjusting our deferred tax liability to reflect the tax rate reductions announced by the Government to take effect in 2020. These accounting adjustments do not impact the amount payable to HMRC.

Together these amounts represent the corporation tax payable for 2018 of £26.7 million (2016/17: £32.4 million).

Corporation tax liabilities are currently settled in four instalments, two in the year of assessment and two in the following year. In the current year we have paid instalments on this year's tax amounting to £14.5 million (2016/17: £14.4 million) and received repayments of tax overpaid in previous years of £8.0 million (2016/17: £20.6 million), net of the instalments due from 2016/17, resulting in a net tax payment of £6.5 million (2016/17: net payment of £21.8 million including payments of £28.0 million relating to prior years).

Instalments of £12.2 million (2016/17: £18.0 million) are due to be paid to HMRC next year in respect of the current year's liability.

Note 13 in the financial statements sets out the tax charges and credits in the period, which are described in more detail below.

The current tax charge for the year was £32.9 million (2016/17: £19.9 million). In the previous year there was an exceptional credit of £16.4 million from adjustments following agreement with HMRC of prior years' tax matters.

The deferred tax charge before exceptional tax was £29.0 million (2016/17: £22.4 million). In the previous year there was an exceptional deferred tax credit of £35.8 million comprising an exceptional charge of £4.0 million following agreement with HMRC of prior years' tax matters and an exceptional credit of £39.8 million arising from a reduction in the corporation tax rate, enacted in that year, to 17% with effect from 1 April 2020.

Our full effective tax rate this year was 20.5% (2016/17: 2.0% after the exceptional tax credits described above). We expect this rate to be close to the corporation tax rate in the UK of 19% (2016/17: 20%) because substantially all of our business is in the UK and the profits of these businesses are chargeable to UK corporation tax.

UK tax rules specify the period over which tax relief can be obtained for capital expenditure. Typically this is a shorter period than that over which the assets are depreciated in the accounts and this tends to reduce the corporation tax charge in the year and the Group underlying effective current tax rate. We make provision for tax that will be paid in future periods when the tax relief on the capital expenditure has been received and we receive no allowance for the depreciation charge arising from that expenditure. This is the most significant component of our deferred tax position.

Our underlying effective current tax rate was 12.7% (2016/17: 16.6%).

Profit for the year and earnings per share

Profit for the year from continuing operations decreased by 25.2% to £240.5 million (2016/17: £321.5 million).

The profit for the year from discontinued operations was £13.2 million (2016/17: £21.1 million).

Total profit for the year including discontinued operations was £253.7 million (2016/17: £342.6 million).

Basic earnings per share from continuing operations decreased by 25.3% to 102.2 pence (2016/17: 136.8 pence). Underlying basic earnings per share was 121.0 pence (2016/17: 115.7 pence). For further details see note 15.

Cash flow

	2018 £m	2017 £m
Cash generated from operations	773.3	851.0
Net capital expenditure	(591.0)	(501.3)
Net interest paid	(182.1)	(177.0)
Purchase of subsidiaries net of cash acquired	(0.2)	(77.7)
Proceeds on disposal of subsidiaries net of cash disposed and disposal costs	25.1	(19.2)
Proceeds on maturity of forward contracts	–	4.3
Swap termination payment	(40.0)	–
Tax paid	(6.5)	(21.8)
Free cash flow	(21.4)	58.3
Dividends	(197.0)	(190.4)
Issue of shares	5.6	6.1
Change in net debt from cash flows	(212.8)	(126.0)
Non-cash movements	(61.4)	(133.0)
Change in net debt	(274.2)	(259.0)
Opening net debt	(5,082.4)	(4,823.4)
Closing net debt	(5,356.6)	(5,082.4)

	2018 £m	2017 £m
Net cash and cash equivalents	38.5	44.6
Bank loans	(1,217.4)	(1,073.3)
Other loans	(4,223.9)	(4,090.0)
Finance leases	(113.9)	(115.7)
Cross currency swaps	24.5	43.4
Loans due from joint ventures	135.6	108.6
Net debt	(5,356.6)	(5,082.4)

At 31 March 2018 we held £38.5 million (2017: £44.6 million) in net cash and cash equivalents. Average debt maturity was around 14 years (2017: 15 years). Including committed facilities, our cash flow requirements are funded until March 2020.

Net debt at 31 March 2018 was £5,356.6 million (2017: £5,082.4 million) and balance sheet gearing (net debt/net debt plus equity) was 84.4% (2017: 84.6%). Group net debt, expressed as a percentage of estimated Regulatory Capital Value at 31 March 2018 was 60.6% (2017: 61.6%).

The estimated fair value of debt at 31 March 2018 was £1,184.3 million higher than book value (2017: £1,444.0 million higher). The decrease in the difference to book value is largely due to the increase in the discount rates applied, driven by higher prevailing market interest rates.

Treasury management and liquidity

Our principal treasury management objectives are:

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

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

Our policy for the management of interest rates is that at least 40% of our borrowings in AMP6 should be at fixed interest rates, or hedged through the use of interest rate swaps or forward rate agreements. At 31 March 2018, interest rates for 48% (2017: 51%) of our net debt of £5,356.6 million were fixed.

Our long term credit ratings are:

Long term ratings	Severn Trent Plc	Seven Trent Water	Outlook
Moody's	Baa1	A3	Negative
Standard & Poor's	BBB	BBB+	Stable

Treasury policy and operations

Our treasury affairs are managed centrally and in accordance with our Treasury Procedures Manual and Policy Statement. The treasury operation's role is to manage liquidity, funding, investment and our financial risk, including risk from volatility in interest and (to a lesser extent) currency rates and counterparty credit risk. The Board determines matters of treasury policy and its approval is required for certain treasury transactions. The Board has established a Treasury Management Committee to monitor treasury activities and to facilitate timely responses to changes in market conditions when necessary.

Our strategy is to access a broad range of sources of finance to obtain both the quantum required and lowest cost compatible with the need for continued availability. Our principal operating subsidiary, Severn Trent Water, is a long term business characterised by multi-year investment programmes.

Our strategic funding objectives reflect this and the liquidity position and availability of committed funding are essential to meeting our objectives and obligations. We therefore aim for a balance of long term funding or commitment of funds across a range of funding sources at the best possible economic cost. The Group also seeks to maintain an investment grade credit rating and a flexible and sustainable balance sheet structure.

Chief Financial Officer's review

continued

We use financial derivatives solely to manage risks associated with our normal business activities. We do not hold or issue derivative financial instruments for financial trading.

Except for debt raised in foreign currency, which is fully hedged, our business does not involve significant exposure to foreign exchange transactions.

The Group issues notes in foreign currency under its EMTN programme and uses cross currency swaps to convert the proceeds to sterling. The effect of these swaps is that interest and principal payments on the borrowings are denominated in sterling and hence the currency risk is eliminated. The foreign currency notes and the cross currency swaps are recorded in the balance sheet at their fair values and the changes in fair values are taken to gains/(losses) on financial instruments in the income statement. Since the terms of the swaps closely match those of the underlying notes, such changes tend to be broadly equal and opposite.

Pensions

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

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

- Deficit reduction contributions of £25 million paid in the year ended 31 March 2017 and payments of £10 million for each of the subsequent financial years ending 31 March 2019.
- Inflation-linked payments of £15 million per annum through an asset-backed funding arrangement, potentially continuing to 31 March 2031, although these contributions will cease earlier should a subsequent valuation of the STPS show that these contributions are no longer needed.
- Payments under another asset-backed funding arrangement of £8.2 million per annum to 31 March 2032.
- In addition to these payments, the Company will directly pay the annual PPF levy incurred by the STPS (£1.1 million in 2017/18).

The Schemes have entered into additional hedging arrangements to reduce the impact of fluctuations in interest rates and inflation on the Schemes' liabilities without adversely impacting the expected return from the Schemes' assets.

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

On an IAS 19 basis, the net position (before deferred tax) of all of the Group's defined benefit pension schemes was a deficit of £519.8 million (2017: £574.6 million). To calculate the pension deficit for accounting purposes, we are required to use corporate bond yields as the basis for the discount rate of our long-term liabilities, irrespective of the nature of the Scheme's assets or their expected returns.

The movements in the net deficit during the period were:

	Fair value of plan assets £m	Defined benefit obligations £m	Net deficit £m
At start of the period	2,352.8	(2,927.4)	(574.6)
Amounts credited/(charged) to income statement	60.2	(69.7)	(9.5)
Actuarial (losses)/gains taken to reserves	(1.3)	30.4	29.1
Net contributions received and benefits paid	(71.9)	107.1	35.2
At end of the period	2,339.8	(2,859.6)	(519.8)

On an IAS 19 basis, the funding level has improved to 82% (2017: 80%).

Exchange rates

The trading results of overseas subsidiaries are translated to sterling at the average rate of exchange ruling during the period and their net assets are translated at the closing rate on the balance sheet date. The impact of changing exchange rates on the subsidiaries' trading results was immaterial.

Dividends

In line with our policy for the remainder of AMP6 announced last year to increase the dividend by at least RPI+4% each year, the Board has proposed a final ordinary dividend of 51.92 pence per share for 2017/18 (2016/17: 48.90 pence per share). This gives a total ordinary dividend for the year of 86.55 pence (2016/17: 81.50 pence). The final ordinary dividend is payable on 20 July 2018 to shareholders on the register at 15 June 2018.

Accounting policies and presentation of the financial statements

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

Risk management

Our approach to risk:

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

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

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

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

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

Within Severn Trent Water Limited, our approach reflects our status as a regulated utility providing essential services and operating as part of the Critical National Infrastructure for the UK. The nature of our Severn Trent Water Limited business is such that there are some significant inherent risks, as illustrated on pages 60 to 65. We aim to have a strong control framework in place to enable us to understand and manage these risks in accordance with our risk tolerance and appetite.

In our non-regulated businesses we take a more commercial approach to risk. However, we recognise that we provide products and services for clients who operate in regulated environments. As a result, for risks that could impact on our clients' regulated services, we take a similar approach to risk as in our own regulated business. The risks inherent in our non-regulated business are illustrated on pages 60 to 65.

Our Enterprise Risk Management process

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

This information is combined to form a consolidated view of risk across the Group and allows the risks to be prioritised. Our significant risks, in terms of likelihood and impact, form our Group risk profile which is reported to the Executive Committee for review and challenge ahead of final review and approval by the Audit Committee and Board half-yearly. The report provides an assessment of the effectiveness of controls over each of those risks and an action plan to improve controls where this has been deemed necessary.

To further enhance our ERM information, we now report 'risk flightpaths'. These graphically demonstrate the level of risk the Group faces and the timeline for the key risk mitigation steps to manage the risk to the target position. The flightpaths help to facilitate a more thorough review of the target risk positions, considering risk appetite and whether improvement actions to achieve these are on target with the correct prioritisation in place.

In addition, individual risks or specific risk topics are also discussed by the Board during the year.

On a monthly basis, the status of open risk mitigation actions across the Group risk profile is reported into the Executive Committee by the central ERM team. The level of ERM maturity in each business unit is assessed half-yearly and reported to the Executive Committee. Improvement plans are agreed to ensure ERM is fully embedded and effective. An overview of accountability for our ERM process is illustrated in the diagram opposite.

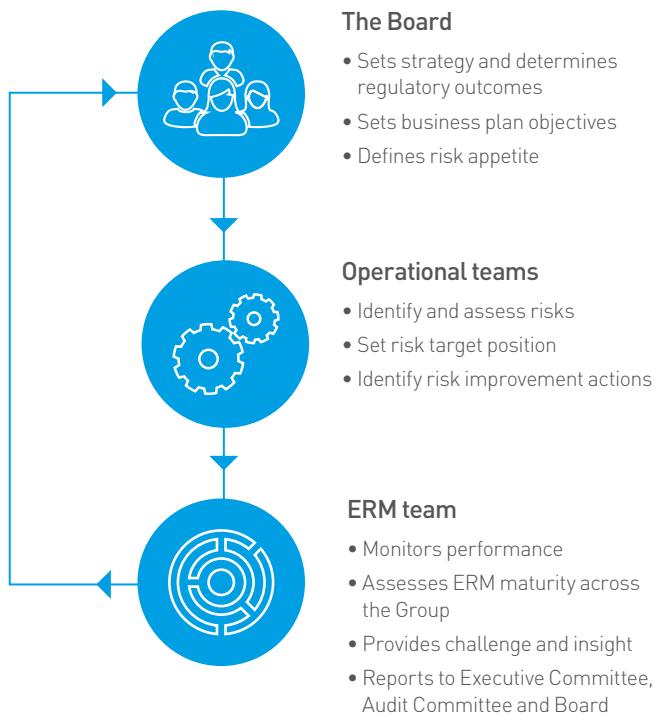
Risk appetite

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

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

Risk management continued

The ERM process



Financial risks

Like all businesses, we need to plan future funding in line with business need. This is part of our normal business planning process (see Principal Risk 2).

The Board receives regular updates relating to funding, solvency and liquidity matters through the Treasury Committee so we can respond quickly to any changes in our ability to secure financing (see Principal Risk 10). The pension fund Trustees and Company regularly monitor our pension deficit, with advice from investment managers and actuarial advisers. An annual pension fund review paper is produced for the Board to apprise them of fund performance and proposed initiatives to manage down pension liabilities and further balance pensions risk (see Principal Risk 9).

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

Sustainability risks

Sustainability risks are treated in the same way as all our other Company risks, captured at a local level by responsible teams and managed centrally through our established ERM process. By the nature of what we do, several of our principal risks have a Sustainability focus, and we monitor our social and environmental impacts in line with our broader performance.

Long-Term Viability Statement

Assessment of current position and long term prospects

The Directors' assessment of the Group's current financial position is set out in the Financial review on pages 51 to 56.

The Group's principal operating subsidiary is Severn Trent Water Limited, which is a regulated long term business characterised by multi-year investment programmes and stable revenues. The water industry in England and Wales is currently subject to economic regulation rather than market competition and Ofwat, the economic regulator, has a statutory obligation to secure that water companies are able to finance their appointed activities. Ofwat meets this obligation by setting price controls for five year Asset Management Periods ('AMPs'). This mechanism reduces the potential for variability in revenues from the regulated business. The current AMP runs until March 2020. Ofwat has published its Final Methodology for assessing companies' business plans and setting price controls for the AMP period 2020 – 2025 and Severn Trent Water Limited has made significant progress in developing its business plan, which is due to be submitted to Ofwat in September 2018.

The Group has significant investment programmes that are largely funded through access to debt markets. The Group's strategic funding objectives reflect the long term nature of the Severn Trent Water Limited business and the Group seeks to obtain a balance of long term funding at the best possible economic cost. The Group's Treasury Policy requires that it maintains sufficient liquidity to cover cash flow requirements for a rolling period of 18 months in order to mitigate the risk of restricted access to capital markets. The Group's debt maturity profile is actively managed by the Group Treasury department to spread the timing of refinancing requirements and to enable such requirements to be met under most market conditions. The weighted average maturity of debt at the balance sheet date was 14 years.

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

The plan assesses the Group's prospects and considers the potential impacts of the principal risks and uncertainties. Stress tests are performed to assess the potential impacts of combinations of those risks and uncertainties. The plan also considers the mitigating actions that might be taken to reduce the impact of such risks and uncertainties and the likely effectiveness of the mitigating actions.

Period of assessment

The Directors considered a number of factors in determining the period to be covered by the assessment. The long term nature of the Group's principal business together with relatively stable revenues and a model of economic regulation that places a duty on the regulator to secure that water companies can finance the proper carrying out of their functions support a longer period of assessment.

However, the changing nature of regulation of the water industry increases the uncertainty that is inherent in the Group's financial projections.

The Group has an established planning and forecasting process and the Directors consider that the assessment of the Group's prospects is more reliable if it is based on an established process. The Group's latest medium term plan extends to the end of the next AMP period in 2025 and the Board of Severn Trent Water Limited will make an assessment of viability covering that period in its business plan submission to Ofwat in September 2018.

A longer period of assessment introduces greater uncertainty as the variability of potential outcomes increases as the period considered extends.

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

Assessment of viability

In assessing the future prospects the Group has considered the potential effect of risks that could have a significant financial impact under severe but plausible scenarios. The risks considered were identified from the Group's ERM process, which is described on pages 57 to 58, and from the key assumptions in the financial model. The scenarios tested are described below.

The Directors have identified actions, including reducing discretionary outflows of funds and working with providers of finance, that would be available to the Group to mitigate the impact of adverse outcomes.

The Group has significant funding requirements to refinance existing debt that falls due for repayment during the period under review and to fund the Group's capital programme. Under all scenarios considered the Group would remain solvent and have access to sufficient funds in normal market conditions. The Group's Treasury Policy requires that it retains sufficient liquidity to meet its forecast obligations, including debt repayments for the next 18 months. In making its assessment the Board has made the following key assumption:

- Any period in which the Group is unable to access capital markets to raise finance during the period under review will be shorter than 18 months.

On this basis, the stress tests indicated that none of these scenarios, including the combined scenario, resulted in an impact to the Group's expected liquidity, solvency or credit metrics that could not be addressed by mitigating action and hence were not considered to be threats to the Group's viability.

Governance and assurance

The Board reviews and approves the medium term plan on which this viability statement is based. The Board also considers the period over which the assessment of prospects and viability statement should be made. The Audit Committee supports the Board in performing this review. Details of the Audit Committee's activity in relation to the Viability Statement are set out in the Audit Committee report on pages 83 to 89.

This statement is subject to review by Deloitte, our External Auditor. Their audit report is set out on pages 136 to 140.

Assessment of viability

The Directors have assessed the viability of the Company over a seven year period to March 2025, taking into account the Company's current position and principal risks.

Based on that assessment, the Directors have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the period to 31 March 2025.

Going Concern Statement

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

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

Scenario tested

1. An increase in the funding deficit of the Group's defined benefit pension schemes

The planned funding for the Group's defined benefit pension arrangements is based on assumptions on future inflation, asset returns and members' longevity. Underperformance against these assumptions might result in additional cash contributions being required during the period under consideration. Contributions are reviewed and agreed with the scheme trustees on a triennial basis with the next valuation of the main scheme due as at 31 March 2019.

2. A severe climate event, operational failure or other exceptional event with a very significant financial impact

The Group's Enterprise Risk Management process has identified a number of risks including cyber security, failure of key assets and severe weather events that might have a significant impact on the Group's operational and financial performance.

3. A reduction in inflation and increase in interest rates for the duration of the period under consideration

Severn Trent Water Limited's revenues are linked to inflation. Low or negative inflation tends to adversely impact profits and cash flows if increases in costs exceed revenue.

4. Underperformance against performance commitments

Severn Trent Water Limited operates under a regulatory model which encourages companies to deliver what customers want using performance related rewards and penalties. Failure to deliver performance at the committed level can lead to significant penalties.

5. Higher costs than planned that are not funded

Significant overspending could result in a deterioration in financial metrics and performance, which might adversely impact the Group's solvency.

6. A combination of scenarios 2, 3 and 4

It is unlikely that scenarios 1 and 3 would occur simultaneously since lower inflation and higher interest rates would tend to reduce the pension deficit. Therefore scenario 3, which has a great individual impact has been included.

Related principal risk

Risk 9: Increased funding for pension schemes

Risk 4: Cyber security
Risk 6: Failure of key assets

Risk 7: Health and safety and environmental impact
Risk 8: Impact of extreme weather/climate change

N/A – key assumption in financial model

Risk 1: Failure to deliver what our customers want

Risk 2: changes in the regulatory environment for the UK water industry

See above

Principal risks

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

- Customer perception;
- Legal and regulatory environment;

- Operations, assets and people; and
- Financial risks.

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

Customer perception

1 What is the risk?

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

Which part of Severn Trent is affected?

Regulated Water and Waste Water businesses

Link to how we're achieving our strategy (page 22)

Embedding customers at the heart of all we do

Link to our values

We put our customers first

We are passionate about what we do

We act with integrity

ODIs

ODIs 24-27

What does it mean for us?

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

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

What are we doing to manage the risk?

The three upper quartile ('UQ') programmes in Retail, Water and Waste are key to SIM improvement. Whilst Retail has a number of transformation actions in flight there are further actions to be delivered which will improve customer experience, for example website transformation. Customers tell us they are delighted when we are able to complete billing issues for them at Point of Contact so the retail programme is looking at how to improve our Point of Contact resolution to improve the overall experience.

The Waste UQ programme is focusing on both the work of our supply partner Amey in our day-to-day customer offering and also how Severn Trent supports them in complex cases. The Waste UQ programme has identified some key areas to drive and improve performance in order to improve our SIM score.

The Water UQ programme is at an early stage. The rapid action team pilot that is currently ongoing in our Derbyshire area is showing fantastic customer benefit. The programme is currently developing a rollout plan to all other areas. The E2E customer communications workstream is looking at the expectation that we set when a customer contacts us through their channel of choice and how we keep the customer informed along the journey. An element of this workstream is a review of our Track my Job customer communication tool that we use to keep customers informed.

Movement in net risk exposure



Key:

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

Legal and regulatory environment

2 What is the risk?

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

Which part of Severn Trent is affected?

Regulated Water and Waste Water businesses

Link to how we're achieving our strategy (pages 26 to 29)

Changing the market for the better
Investing responsibly for sustainable growth

ODIs

N/A

What does it mean for us?

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

What are we doing to manage the risk?

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

We have contributed to embedding the role of Market Operator Services Ltd (the body which oversees the non-household retail market) and contributed towards the success of competition in the non-household market.

We continue to participate in discussions with Ofwat on the development of the future regulatory environment and since publication of Ofwat's final methodology in relation to Water 2020 we are developing our business plan. We are actively participating in discussions on the opening of the competitive market for bioresources.

Engagement with our peers, other regulators, UK Government departments and other stakeholders, including the Welsh Government, helps us to influence the direction of regulatory policy where possible and put forward our own case for change in a constructive way.

We continue to engage constructively with stakeholders following Labour's 2017 manifesto commitment to re-nationalise the water sector. We are encouraged that both the benefits to customers of the current model and the cost to taxpayers of re-nationalisation are now being better understood.

Movement in net risk exposure



3 What is the risk?

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

Which part of Severn Trent is affected?

Group-wide

Link to how we're achieving our strategy (pages 24 to 29)

Driving operational excellence and continuous innovation
Changing the market for the better
Investing responsibly for sustainable growth

Link to our values

We act with integrity
We protect our environment

ODIs

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

What does it mean for us?

Our policies and processes must reflect the current legal and regulatory environment and all relevant employees must be kept aware of new requirements. The Group as a whole may face censure for non-compliance in an individual group company or a specific region in which we operate.

What are we doing to manage the risk?

Our Governance Framework, transparency, engagement with customers and stakeholders, policies and internal controls ensure our ongoing compliance with all applicable laws and regulations.

For the operation of separate Wholesale and Retail business we have a control framework of protocols, policies, systems, guidance and training to ensure ongoing compliance with the relevant legislation including Competition Law.

Following the integration of Dee Valley into the Severn Trent Group we have refreshed our policy framework and are updating our systems, protocols and policies in readiness for the boundary realignment of our regulated businesses.

Ensuring readiness for the General Data Protection Regulation ('GDPR') coming into effect on 25 May 2018 has also been a key area of focus for us.

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

Movement in net risk exposure



Principal risks continued

Operations, assets and people

4 What is the risk?

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

Which part of Severn Trent is affected?

Group-wide

Link to how we're achieving our strategy (pages 22 to 25)

Embedding customers at the heart of all we do

Driving operational excellence and continuous innovation

Link to our values

We put our customers first

ODIs

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

What does it mean for us?

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

What are we doing to manage the risk?

We continue to follow guidance from the National Cyber Security Centre ('NCSC') to improve our defences against cyber attacks and have focused this year on more layered-security controls to protect sensitive data in readiness for the introduction in May 2018 of the GDPR.

We have also completed risk assessments of cyber threats to our water supply systems for the introduction in May 2018 of the Network and Information Systems Directive ('NISD').

We have participated in a number of Government led and internal cyber incident exercises to test our response capability to cyber attacks.

Although not directly impacted by significant recent cyber incidents (e.g. WannaCry and NotPetya), we did review our security controls and response plans to ensure we are prepared for future attacks of this type.

Movement in net risk exposure



5 What is the risk?

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

Which part of Severn Trent is affected?

Regulated Water and Waste Water businesses

Link to how we're achieving our strategy (pages 22 to 27)

Embedding customers at the heart of all we do

Driving operational excellence and continuous innovation

Investing responsibly for sustainable growth

Link to our values

We put our customers first

We are passionate about what we do

We protect our environment

ODIs

ODIs 1-45

What does it mean for us?

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

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

What are we doing to manage the risk?

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

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

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

The three UQ programmes in Retail, Water and Waste are key to us delivering our targets for the remainder of this business plan.

Movement in net risk exposure



Key:

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

6**What is the risk?**

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

Which part of Severn Trent is affected?

Group-wide

Link to how we're achieving our strategy (pages 22 to 31)

Embedding customers at the heart of all we do
Driving operational excellence and continuous innovation
Investing responsibly for sustainable growth

Link to our values

We put our customers first
We are passionate about what we do

ODIs

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

What does it mean for us?

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

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

Other examples are our IT, telephony systems and remote monitoring systems which are also key to our operations.

What are we doing to manage the risk?

We included substantial investment in our AMP6 plan to reduce the likelihood of failure of strategic assets that supply Birmingham and to provide the city with a second source of water. We are ahead of delivery on the improvements to our strategic assets and on track with the provision of a second source.

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

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

We will continue to make significant investment into our network and processes but we accept there is always a risk of unexpected failures. For example, we experienced a number of trunk main bursts in 2017 which led to supply interruptions to our customers and in March 2018 the very rapid thaw following 'The Beast from the East' resulted in a substantial increase in pipe bursts. Our incident response helped to mitigate the impact of these failures. During the bursts we worked with local resilience forums and other agencies and had great community engagement to return suppliers back to normal as quickly as possible. We are taking the learnings from the incidents to expand our network condition monitoring programme to detect vulnerabilities before failures occur and to ensure that our incident response procedures are as good as they can be.

Movement in net risk exposure**7****What is the risk?**

Due to the nature of our operations we could endanger the health and safety of our people, contractors and members of the public as well as negatively impact our local and wider environment.

Which part of Severn Trent is affected?

Group-wide

Link to how we're achieving our strategy (pages 24 to 27, and pages 30 to 31)

Driving operational excellence and continuous innovation
Investing responsibly for sustainable growth
Creating an awesome place to work

Link to our values

We protect our environment
We act with integrity

ODIs

ODIs 30-41, 42-43

What does it mean for us?

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

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

What are we doing to manage the risk?

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

We have a well-established Health, Safety & Wellbeing framework to ensure all operations and processes are conducted in compliance with Health and Safety legislation and in the interests of the safety of our people and contractors. Our Goal Zero initiative clearly establishes our target that no one should be injured or made unwell as a result of what we do. We've continued to reduce total injuries to staff and contractors through the application of the Goal Zero plan and we work collaboratively with our supply chain and other key stakeholders to continue to seek improvements.

There are a number of ODI commitments we have made to protect our local environment, including river water quality, pollution incidents, biodiversity improvements and environmental compliance. In AMP6 we will be delivering our largest ever environment programme, spending over £300 million to deliver improvements to rivers throughout our region, a programme which is supported by our customers who want to see us do more to improve river water quality. This year we expect to regain our 4* Environmental Performance Assessment status from the Environment Agency.

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

Movement in net risk exposure

Principal risks continued

8

What is the risk?

We are unable to deal with the impact of extreme and unpredictable weather events on our assets and infrastructure and/or are unable to successfully plan for future water resource supply and demand due to climate change.

Which part of Severn Trent is affected?

Group-wide

Link to how we're achieving our strategy (pages 24 to 27)

Driving operational excellence and continuous innovation

Investing responsibly for sustainable growth

Link to our values

We protect our environment

ODIs

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

What does it mean for us?

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

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

What are we doing to manage the risk?

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

In February 2018, we published our draft water resources management plan for the next 25 years. The plan includes a detailed assessment of climate change impact for our region and our demand management and proposed new sources are designed to offset any supply risk resulting from climate change.

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

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

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

Movement in net risk exposure



Key:

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

Financial risks

9 What is the risk?

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

Which part of Severn Trent is affected?

Group-wide

Link to how we're achieving our strategy (pages 26 and 27)

Investing responsibly for sustainable growth

What does it mean for us?

We already provide significant funding but could be called upon to provide more money to reduce pension deficits in our defined benefits schemes.

What are we doing to manage the risk?

Following the Brexit vote, our main defined benefit pension scheme has seen a significant growth in the accounting value of liabilities due to the fall in long term interest rates. Volatile financial conditions are likely to remain for the foreseeable future. The growth in the accounting deficit has adversely impacted the headroom on some of our credit ratios, such as gearing, which are relevant for debt covenant and credit ratings purposes. It also has a reputational impact that could have a bearing on investment and distribution decisions.

We have completed the process of immunising our bank financial covenants from adverse movements in the accounting deficit, gaining approval from relevant banks and the European Investment Bank ('EIB'). We have worked with the ratings agencies to focus on the impact of our repair payments on credit ratings, rather than movements in the accounting value of the deficit. Importantly, we have agreed cash repair payments with the Trustee until the next Triennial Valuation at 31 March 2019. We have also completed, with Trustee agreement, additional inflation and interest rate hedging and introduced downside protection to the fund's equity holdings. The Pension Regulator has confirmed that the March 2016 actuarial valuation will not be subject to further review. However, the Regulator has stated that it believes that the current repair period, to 2032, is very long and in the event of a further deterioration in deficit does not see an extension of the recovery plan end date an appropriate solution.

Movement in net risk exposure



10 What is the risk?

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

Which part of Severn Trent is affected?

Group-wide

Link to how we're achieving our strategy (pages 26 and 27)

Investing responsibly for sustainable growth

What does it mean for us?

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

What are we doing to manage the risk?

Whilst Brexit may impact our access to funding from the EIB, an attractive source of finance, we have other sources of funding we can call upon. In November 2015, we raised £471 million through a US Private Placement debt issue and in November 2016 to December 2017, we raised £900 million through three sterling bond issues. Despite some initial volatility following the Brexit vote, global debt capital markets continue to deliver substantial levels of liquidity.

See our Long-Term Viability Statement on pages 58 and 59.

Movement in net risk exposure



The Strategic report, as set out from page 1 through to page 65, has been approved by the Board.

By order of the Board

Bronagh Kennedy

Group General Counsel and Company Secretary

22 May 2018

Governance report

Chairman's introduction to governance

Leadership & Effectiveness

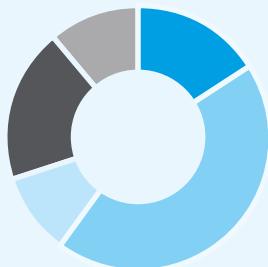


Andrew Duff
Chairman

The Board provides strong leadership and support to the business. All Directors have a passion for the business and there is a sense of “creating a legacy for those who come after us”.

Manchester Square Partners
Board Effectiveness Report

Board Focus 2017/18



● Finance & Risk (Specific Finance Items and CFOs report)	16%
● Strategy (Items for discussion/approval)	44%
● Governance (Governance items, Company Secretary's report, and Committee reports)	10%
● Performance Review (Standing items – excluding CFOs report)	19%
● Other (Procedural Business)	11%
TOTAL (Mins)	100%

Dear Shareholder

I am pleased to introduce our Governance report for 2018 on behalf of your Board in accordance with the April 2016 UK Corporate Governance Code (the ‘Code’). This report reflects the themes of the Code and provides details on the activities and governance processes of the Board and its Committees (and refers you to other areas of the Annual Report and Accounts where further relevant information can be found).

The Board has had a diverse agenda during the year: from addressing the challenges of the upcoming Ofwat Price Review (‘PR19’) without losing focus on other key strategic and operational priorities; to ensuring that Dee Valley Water is operating effectively as a standalone, licensed business within the Group. PR19 is a key strategic item for the business that has required a robust governance process to ensure the right level of debate and oversight without allowing this topic to dominate the strategic landscape. In summary, the Board’s principal areas of focus have been:

- PR19;
- Customer service;
- Water quality;
- Environmental performance;
- Financing our businesses;
- Dee Valley integration; and
- Profitable growth of the non-regulated business.

Customers continue to be at the forefront of our attention, as our strategic focus on such topics as delivering Upper Quartile Sector Performance and Customer Experience demonstrate. Customer Delivery, Water Quality and Environmental Performance have been the subject of regular ‘performance review’ items on the agenda. Financing has been addressed through the continuing important work of the Treasury Committee, through the Chief Financial Officer’s regular reports to the Board and via specific finance related items on the agenda. The cost of debt methodology for PR19 has been a key consideration due to its wider impact for the business as a whole. (See Board activities on pages 76 and 77.)

Alignment on strategy and clarity on individual roles have allowed clear strategic focus for the Board during the year, and produced robust challenge where appropriate. There is a positive dynamic in the Boardroom but we are by no means complacent and recognise that there are still many challenges to tackle. We continue to foster a culture of ownership, stewardship and always **doing the right thing**, sharing the wider company values: we put our customers first; we are passionate about what we do; we act with integrity; we protect our environment; and we are inspired to create an awesome company.

The Board has continued to keep the Group's **risk management and internal control systems** under close scrutiny during the year and believes the quality of risk management and reporting, and in particular the risk identification, mitigation plans, business ownership and tracking, are excellent and continue to evolve and improve. In respect of the Company's **stakeholders**, there has been oversight of, and a very active, engagement with shareholders, regulators, customers, pension trustees, communities and employees alike. There have been regular communications with shareholders and open lines of communication with our regulators: Ofwat, CCW and the DWI. In particular, the Corporate Responsibility Committee has overseen a broad range of well received community initiatives (detailed in its report on page 92). All the Board members have multiple formal and informal opportunities to engage with customers and employees and are constantly impressed at the quality of Severn Trent's people, wherever they work in the Group and whatever their role. Engagement scores from the annual employee engagement questionnaire are excellent and this is mirrored in the Board's communication with employees at and below management level.

We continue to strive for comprehensive **talent development and succession planning** at all levels of the business. Whilst much has been done in this respect and plans are in place, with well regard to graduate and apprenticeships programmes and strong external hiring and internal promotions, we are keen to make further progress in identifying, developing and progressing top talent through the organisation and making further improvements in respect of management and leadership development. The focus on improving diversity remains strong and, whilst we have made good progress on gender diversity in line with the Hampton-Alexander Review, we are looking to make further progress in terms of wider diversity.

Looking forward, Severn Trent has a strong unified Board with the broad range of professional backgrounds, skills and perspectives needed to take the Company into the next regulatory period.

Finally, on a personal note, whilst I hope you find this report provides insight into governance within Severn Trent, I always welcome feedback if you feel there is more we could do to enlighten shareholders. We encourage participation at our AGM and look forward to meeting with many of our shareholders in July.

Andrew Duff
Chairman

UK Corporate Governance Code Compliance Statement

The version of the Corporate Governance Code applicable to the current reporting period is the April 2016 UK Corporate Governance Code (the 'Code'). The Code is available on the Financial Reporting Council's ('FRC') website (www.frc.org.uk).

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

In December 2017, the FRC published proposals for a revised code, which we expect to apply to our financial year ending 31 March 2019, to reflect the changing business environment and help in achieving the highest levels of governance. As the revised code is not yet finalised, we are reporting against the 2016 Code in this report but are looking closely at the new proposals and assessing what more we can do to align with best practice principles to further engender trust in our business.

In terms of the principles of the 2016 Code, you can find out more information on the following pages:

Leadership	68 to 74
Details of the Board are available (including their skill set and experience) and an overview of the governance structure, distinguishing between leadership by the Board and by Executive Management. The differing roles of the Chairman, Executive Directors and Non-Executive Directors is also set out.	
Effectiveness	80 to 82
An overview of the process for appointment, induction, and evaluation of the Directors is provided here and further detail is set out in pages 80 to 82 covering the work of the Nominations Committee.	
Accountability	83 to 89
The report of the Audit Committee details the corporate reporting, risk management and internal control measures that are overseen by the Board.	
Remuneration	96 to 128
The Directors' Remuneration Report provides full details on remuneration.	
Relations with shareholders	94 to 95
Details of the Group's engagement with shareholders is set out in this section.	

Governance of subsidiaries

The membership of the Board of the listed Company, Severn Trent Plc, is the same as that of Severn Trent Water Limited. This structure was implemented in 2007 to make sure that the highest standards of corporate governance are applied at the regulated subsidiary level and to foster greater visibility and supervision by the Severn Trent Plc Board.

Severn Trent Water Limited complies with the Code and our regulator's Principles of Leadership and Governance to ensure the highest standards of governance.

Taking into account the Code and Ofwat's Principles of Leadership and Governance, we have undergone a programme of change during the year in Dee Valley Water Limited, and have appointed a majority of new independent non-executive directors to its Board. Dee Valley Water Limited also complies with the Code to ensure the highest standards of governance.

A more detailed explanation of the Governance Framework and Company structures which apply to each of our regulated subsidiaries can be found in their respective Annual Reports, available on their websites.

Board of Directors

Leadership & Effectiveness



1. Andrew Duff BSc FEI (59)

Appointed: Non-Executive Director on 10 May 2010, Chairman on 20 July 2010

Membership: n Chair c r

Skills, competence and experience:

Andrew's extensive experience of international and regulated business, strategic management and customer service in high profile, dynamic environments has equipped him well for the role of Chairman of the Group. Andrew spent 16 years at BP in marketing, strategy and oil trading. He joined National Power in 1998 and the Board of Innogy plc upon its demerger from National Power in 2000. He played a leading role in its restructuring and transformation through the opening of competition in energy markets culminating in its subsequent sale to RWE in 2003. He became CEO of the successor Company and a member of the RWE Group Executive Committee until his retirement in 2010. He was a Non-Executive Director of Wolseley plc from July 2004 until November 2013.

Andrew was appointed Non-Executive Deputy Chairman of Elementis plc on 1 April 2014 and became Non-Executive Chairman of Elementis plc on 24 April 2014. He is the senior trustee of Macmillan Cancer Support and a trustee of the Earth Trust.

Other roles:

- Member of the CBI President's Committee
- Trustee of Macmillan Cancer Support and Earth Trust
- Fellow of the Energy Institute

2. Olivia Garfield BA (Hons) (42)

Appointed: Chief Executive on 11 April 2014

c e

Skills, competence and experience:

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

Other roles:

- Member of The 30% Club
- Director of Water UK
- Member of Take Over Panel
- Director of Water Plus Limited – joint venture with United Utilities

3. James Bowling BA (Hons) Econ, ACA (49)

Appointed: Chief Financial Officer on 1 April 2015

Membership: e t d

Skills, competence and experience:

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

4. John Coghlan BCom, ACA (60)

Appointed: Independent Non-Executive Director on 23 May 2014

Membership: a Chair t Chair n

Skills, competence and experience:

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

Other roles:

- Chairman of Freight Transport Association Ireland Limited

Committee membership key

a	Audit Committee
c	Corporate Responsibility Committee
e	Executive Committee
n	Nominations Committee

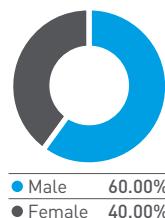
r	Remuneration Committee
t	Treasury Committee
d	Disclosure Committee

Tenure and gender diversity

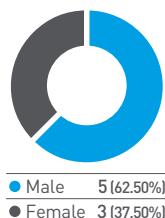
The graphics below show the tenure of the Non-Executive Directors over the short, medium and long term, together with the gender diversity across the Executive team, the full Board, and amongst Non-Executive Directors. See page 81 for gender diversity across the rest of the Severn Trent Group.

Gender diversity as at 31 March 2018

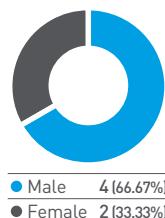
Executive



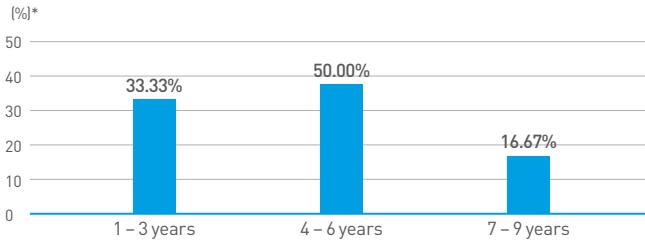
Main Board



Non-Executive



Tenure of Non-Executive Directors



5. Dame Angela Strank DBE, FRS, FREng, CEng, FIChemE, DSc, PhD (65)

Appointed: Independent Non-Executive Director on 24 January 2014

Membership: Chair n r

Skills, competence and experience:

Angela brings a wealth of strategic, technical and commercial experience to the Board. Angela is Head of Downstream Technology and Group Chief Scientist at BP plc. She is a member of the Downstream Executive Leadership Team. Angela is responsible for enabling delivery of the Downstream strategic agenda through the development of differentiated technology advantage across the refining, fuels, lubricants and petrochemicals businesses. Since joining BP in 1982, she has held many senior leadership roles around the world in business development, commercial and technology, including in 2012, Vice President and Head of the Chief Executive's Office. In 2010, Angela was the winner of the UK First Woman's Award in Science and Technology in recognition of pioneering UK women in business and industry. Her track record and experience in strategy, operations, technology and transformational change are a complementary addition to the Board's skill set. In June 2017, Angela was recognised in the Queen's Birthday Honours List with the title Dame Commander of the Most Excellent Order of the British Empire (DBE) for services to the Oil and Gas Industry and encouraging women into STEM careers.

Other roles:

- Board Governor of The University of Manchester
- BP Group plc – Chief Scientist
- Member of the Royal Society's Science, Industry & Translation Committee

6. The Hon. Philip Remnant CBE FCA MA (63)

Appointed: Independent Non-Executive Director on 31 March 2014

Membership: Chair a n t

Skills, competence and experience:

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

Other roles:

- Governor of Goodenough College
- Director and Trustee of St Paul's Cathedral Foundation

7. Dominique Reiniche MBA (62)

Appointed: Independent Non-Executive Director on 20 July 2016

Membership: c n

Skills, competence and experience:

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

8. Kevin Beeston FCMA (55)

Appointed: Senior Independent Non-Executive Director on 1 June 2016

Membership: a n r

Skills, competence and experience:

Kevin has a wealth of commercial, financial and high level management experience. Kevin is Chairman of Taylor Wimpey plc and Elysium Healthcare and also a Non-Executive Director of The Football Association Premier League Limited and Marston Corporate Limited. Previously, Kevin spent 25 years at Serco plc, where he held the roles of Finance Director, Chief Executive and finally Chairman until 2010. Kevin was previously Chairman of Domestic & General Limited and Partnerships in Care Limited, Equiniti Group plc and a Non-Executive Director of IMI plc.

Director serving for part of the year

Emma Fitzgerald MA, DPhil Oxon, MBA (51)

Managing Director, Wholesale Operations
Directorship ceased on 31 December 2017

Emma stepped down from the Board on 31 December 2017, having been a Director since 1 April 2016. She remained on the Executive Committee until 16 April 2018 and is due to leave Severn Trent in July 2018.

Executive Committee

Leadership & Effectiveness



1. Olivia Garfield BA (Hons) (42)

Appointed: Chief Executive on 11 April 2014

Please see full biography on page 68

2. James Bowling BA (Hons) Econ, ACA (49)

Appointed: Chief Financial Officer on 1 April 2015

Please see full biography on page 68

3. Dr. Tony Ballance BSc (Hons), MA (Econ), PhD (53)

Appointed: Director, Strategy and Regulation on 25 July 2005

Member of the Executive and Disclosure Committee

Career and responsibilities:

Tony's extensive experience in utility policy, regulation and stakeholder engagement leaves him ideally placed to lead the Company's strategic, regulatory and external affairs work. Prior to joining Severn Trent, he held the posts of Chief Economist for Ofwat, Director of London Economics and Director of Stone and Webster Consultants.

Other roles:

- Senior Independent Director of the National Forest Company
- Member of Water UK Council
- Chairman of the Corporate Advisory Panel of the Regulatory Policy Institute

4. Sarah Bentley BSc (Hons), Management Science with Computing (46)

Appointed: Chief Customer Officer in December 2014

Member of the Executive Committee

Career and responsibilities:

Responsible for Customer Retail and Network operations, Group Technology and Transformation. She previously worked for Accenture as Managing Director of their £3 billion global digital business focused on digital marketing, mobility and analytics for customers, employees and the enterprise. Prior to Accenture, Sarah was CEO of Datapoint, an Alchemy backed company delivering CRM services, and Senior Vice President of eLoyalty, a global CRM and marketing consultancy. She was SVP of the European Business, led the sales and operations activity in North America and ran eLoyalty Ventures L.L.C. working in Silicon Valley, Austin and New York.

Other roles:

- Twizzletwig Limited – Director and Secretary

5. Martin Kane BSc, CEng, CEnv, MICE, MIWEM, FIW (65)

Appointed: Martin joined Severn Trent Water in 1975 and was appointed Chief Engineer in July 2014

Member of the Executive Committee

Career and responsibilities:

He has held various senior roles giving him an extensive and unique understanding of the design, construction and operation of water and waste water treatment plants, water distribution networks and sewerage systems. Martin was Director of Customer Relations, Severn Trent Plc, from May 2006 until January 2012, and Chief Executive Officer of Severn Trent Services until July 2014.

Other roles:

- Member of the Boards of Utilities and Service Industries Training Limited
- Trustee of International Society for Trenchless Technology
- Chairman, Panton McLeod Ltd
- Chairman of the Coventry and Warwickshire Growth Hub



6. Bronagh Kennedy BA (Hons) (54)

Appointed: Group General Counsel and Company Secretary in June 2011
Member of the Executive and Disclosure Committee

Career and responsibilities:

Bronagh is a solicitor and was previously Group Company Secretary and General Counsel and HR Director at Mitchells & Butlers, where she worked for 15 years. Prior to that, she was a Senior Associate at Allen & Overy. She is a member of the GC100 Group and an Independent Non-Executive Director and Chairman of the HR and Remuneration Committee of British Canoeing.

7. Helen Miles CIMA (47)

Appointed: Group Commercial Director in November 2014
Member of the Executive Committee

Career and responsibilities:

Helen joined Severn Trent in November 2014 as the Chief Commercial Officer and brings with her a breadth of commercial experience having worked within regulated businesses and sectors across Telecoms, Leisure and Banking. As a member of the UK Board, Helen was instrumental in delivering HomeServe's future growth strategy and ensuring a sustainable, customer-focused business. As an experienced finance professional, Helen was previously Chief Financial Officer for Openreach, part of BT Group plc, and has extensive experience of delivering major business transformation across the Group. Prior to BT Group, Helen worked in a variety of sectors and organisations such as Bass Taverns, Barclays Bank, Compass Group and HSBC.

8. Andy Smith BTech (Hons) (57)

Appointed: Managing Director, Business Services in 2014
Member of the Executive Committee

Career and responsibilities:

Andy was appointed to the role of MD, Business Services on its creation in 2014 having previously been responsible for the drinking water business within Severn Trent Water. Andy brings to the role a broad range of executive and operational expertise gained from diverse sectors. Currently, Andy is also a Non-Executive Director of Diploma plc. He has worked in the UK and overseas with global businesses such as BP, Mars and Pepsi in both engineering, HR and operational management roles. Previously, he has served as a member of the Board at Severn Trent Plc and at Boots Group plc.

9. Neil Morrison Bsc (Hons), Chartered FCIPD (44)

Appointed: Director of Human Resources in August 2017
Member of the Executive Committee

Career and responsibilities:

Neil joined Severn Trent in August 2017 as a Director of Human Resources. Neil started a career in HR management in 1996 and for the subsequent 12 years he worked in a variety of HR roles within FTSE 100 companies, including Rentokil Initial and GUS (which latterly became Home Retail Group). Before joining Severn Trent, Neil worked at Penguin Random House taking responsibility for strategic people issues across their publishing and distribution offices in the UK, APAC, India and South Africa. He was one of the main leads in helping to steer and finalise the global merger between Random House and Penguin. Neil also sits on the board of the Chartered Institute of Personnel and Development (CIPD).

10. Dr. James Jesic BEng (Hons), PhD, MICheM E, CEng (39)

Appointed: Managing Director of Production on 1 December 2017
Member of the Executive Committee

Career and responsibilities:

James is a chartered chemical engineer who joined Severn Trent on its graduate programme in 2003 and was appointed as Managing Director of Production in 2017. During his time with the business, James has had full accountability for the management of the operational multi-billion pound asset base, being responsible for producing and supplying drinking water and collecting and treating waste water for millions of customers across the Midlands. As part of that role, he has delivered industry-leading customer service performance, as well as driving sector-leading environmental results. He has a PhD in Chemical Engineering from the University of Birmingham and has attended Harvard Business School.

Executives serving for part of the year

Evelyn Dickey BSc (Hons) (55)

Director of Human Resources

Evelyn stepped down from the Executive Committee on 31 August 2017 after 11 years of service.

Emma Fitzgerald MA, DPhil Oxon, MBA (51)

See page 69

Governance Framework

Leadership & Effectiveness

Board of Directors

Responsible and accountable for the long term success of the Severn Trent Group; ensuring Severn Trent delivers the Group's strategic objectives whilst operating to the highest standards of corporate governance in meeting its obligations to all stakeholders.

Board Committees

Nominations Committee

Keeps the structure, size, composition and succession needs of the Board under review and assists the Board on conflicts of interest and independence issues.

 Read more on pages 80 to 82

Audit Committee

Assists the Board in discharging its responsibilities for the integrity of the Company's financial statements, the assessment of the effectiveness of the systems of Internal Control, Risk Management and scrutinises the work of the Internal and External Auditors. It also reviews the adequacy of the Company's whistleblowing arrangements.

 Read more on pages 83 to 89

Corporate Responsibility Committee

Provides guidance and direction to the Company's Corporate Responsibility and Sustainability programme based on Severn Trent's values and reviews the Group's non-financial risks and opportunities.

 Read more on pages 91 to 93

Remuneration Committee

Determines the Company's policy on the remuneration of Executive Directors, other members of the Executive Committee and the Chairman of the Board.

 Read more on pages 96 to 128

Treasury Committee*

Provides oversight of treasury activities in implementing the policies, funding and treasury risk management plan including: the measurement and management of risks in respect of interest rates; funding; counterparty credit; liquidity and treasury operations; funding proposals; relationship with rating agencies; debt investor relations; bank relationship management; and treasury internal controls.

 Read more on page 90

Severn Trent Executive Committee ('STEC')

Oversees the development and execution of Group strategy, with accountability for achieving financial and operational performance.

CEO – Liv Garfield

Delegated responsibility for the development and implementation of strategy and overall commercial objectives, and responsible for the day-to-day management of the business and the communication of Board agreed objectives to employees.

Executive Sub-Committee

Disclosure Committee

Executive Sub-Committee overseeing Severn Trent's compliance with its disclosure obligations, considering the materiality, accuracy, reliability and timeliness of information disclosed and assessment of assurance received.

Governance Framework Foundations

- Matters Reserved to the Board
- Terms of Reference for Board Committees
- Charter of Expectations
- Doing the Right Thing – the Severn Trent Way
- Group Authorisation Arrangements
- Conflicts of Interest review

- Board strategy days
- Training
- Board Effectiveness Review
- Policies and procedures
- Diversity/independence

Corporate Governance Code

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

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

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

In compliance with the Code, the Board also delegates certain roles and responsibilities to its various Committees, which assist by focusing in detail on their particular areas, reporting to the Board on decisions and actions they've taken, and making any necessary recommendations in line with their Terms of Reference.

Charter of Expectations

The Severn Trent Charter of Expectations sets out clearly the defined roles of the Chairman, Chief Executive, Chief Financial Officer, Senior Independent Director and Non-Executive Directors, the operation of the Board and Board Committees, and also reflects the Board's responsibility for setting the tone of the Group's culture, values and behaviour. In accordance with the Code, it sets out a clear division of responsibilities between the roles of Chairman and CEO.

The Charter of Expectations is reviewed annually, with the last review undertaken in March 2018. It's also used to assist in the ongoing assessment of the effectiveness of the Board and its Committees and that of individual Directors (see page 79 for further details). It is available on our website (www.severntrent.com).

Matters Reserved to the Plc Board

The Schedule of Matters Reserved to the Board sets out the processes in place regarding the Board's tasks and activities and the matters specifically reserved for the Board's decision making. A copy is available on our website (www.severntrent.com).

The Board has reserved the following matters, amongst others, for its own consideration:

- the Group's strategic and operating plans;
- financial reporting and controls;
- major acquisitions and disposals;
- key Group policies; and
- Group Authorisation Arrangements ('GAA').

Terms of Reference

The Terms of Reference for each Board Committee are reviewed annually, updated to take account of best practice, and to reflect the requirements of the UK Corporate Governance Code (as revised from time to time).

The sub-committee structure is detailed in the Governance Framework on page 72 and key responsibilities are set out on page 74.

Conflicts

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

Group Authorisation Arrangements

The GAA is the framework through which the Severn Trent Plc Board authorises the right people, at the right level, to take important decisions to effectively control and manage legal, financial and administrative decisions throughout the Group. These arrangements are reviewed annually, with the last review undertaken in April 2018.

The flow of authority is from the Severn Trent Plc Board to the Chief Executive and the Severn Trent Executive Committee. In respect of certain decisions, the delegated authority is subject to an obligation to work with specialist business service areas (such as Tax, Treasury, Group Finance, Group Commercial and General Counsel), which provides additional expertise and a group-wide perspective.

'Doing the Right Thing – the Severn Trent Way'

In addition to the Charter of Expectations and Terms of Reference for the Board, and the company-wide GAA, Severn Trent also sets out the cultural tone expected of its workforce through clearly defined values and standards of behaviour that are expected from everyone who works for the Severn Trent Group. Its Code of Conduct 'Doing the Right Thing – the Severn Trent Way' has been rolled out across the Group in the form of all-employee training programme, is integral to the induction process and is continuously re-enforced by management to make sure that all of our people embody Severn Trent's values:

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

Our Code of Conduct is key to helping us achieve our vision of being the most trusted water company by 2020.

We know that the right culture must be set from the top. Our annual employee engagement survey, QUEST, is therefore designed to provide us with actionable data in a clear and comprehensive form, giving us a better understanding on what's going well and what can be improved across the whole of our business. QUEST is carried out by an independent research company to ensure the results are anonymous and results are reported to the Board.

Policies, Standards and Procedures

In addition to our Code of Conduct, Severn Trent has an additional 12 policies which apply to everyone who works for the Severn Trent Group. These policies have been designed to help employees and contractors understand their role within the Company and their responsibility to the Severn Trent Group. They also, in turn, outline the Group's responsibility to the individual. These policies are the strategic link between the Severn Trent vision and how we manage our day-to-day business, and are underpinned by specific company standards and procedures.

Key Board responsibilities

Leadership & Effectiveness

Board composition, roles and attendance

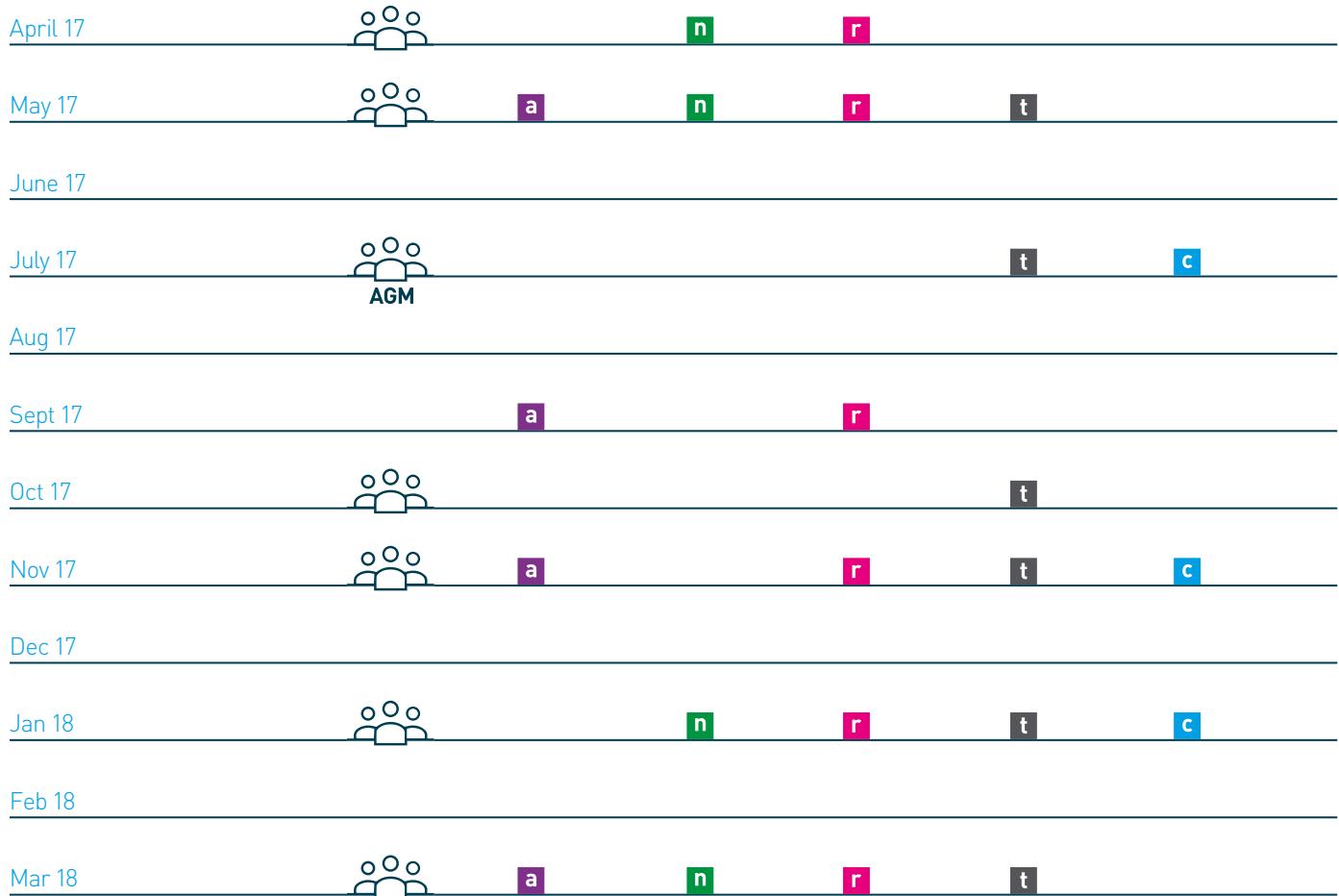
Where Directors have not been able to attend meetings, they have still received related papers in advance of the scheduled meeting and any input they have provided has been considered.

The Board held seven scheduled meetings during the year, and the key roles of individuals and their attendance is set out overleaf. For additional information on the activities of the Board, see pages 76 and 77.

There were 11 additional ad hoc meetings of the Board or Committee of the Board convened throughout the year.

Director		Responsibility
Chairman	Andrew Duff	<ul style="list-style-type: none"> Leads our unified Board and is responsible for its effectiveness. Sets agendas and ensure timely dissemination of information to the Board, in consultation with CEO, CFO and Company Secretary. Responsible for scrutinising the performance of the Executive Committee. Facilitates contribution from our Directors. Ensures effective communication with our shareholders and other stakeholders.
CEO	Liv Garfield	<ul style="list-style-type: none"> Develops and implements the Group's strategy, as approved by the Board. Responsible for the overall commercial objectives of the Group. Promotes and conducts Group affairs with the highest standards of integrity, probity and corporate governance. Sets the cultural tone of the organisation.
CFO	James Bowling	<ul style="list-style-type: none"> Manages the Group's financial affairs. Supports the CEO in the implementation and achievement of the Group's strategic objectives.
SID	Kevin Beeston	<ul style="list-style-type: none"> Supports the Chairman in delivery of his objectives. Alternative contact for shareholders should they have a concern that is unresolved by the Chairman, CEO or CFO. Leads the appraisal of the Chairman's performance with the Non-Executive Directors. Key role in succession planning for the Board, together with the Board Committees, Chairman, and NEDs.
NED	John Coghlan Dominique Reiniche Dame Angela Strank Philip Remnant	<ul style="list-style-type: none"> Constructively challenge our Executive Directors in all areas. Monitor the delivery of strategy by the Executive Committee within the risk and control framework set by the Board. Satisfy themselves that internal controls are robust and that the External Audit is undertaken properly. Responsible for agreeing appropriate levels of remuneration for Executive Directors. Key role in succession planning for the Board, together with the Board Committees, Chairman, and SID.
Executive Director	Emma FitzGerald (until 31.12.17)	<ul style="list-style-type: none"> Responsible for the Group's wholesale business until 31 December 2017. Supported the CEO in the implementation and achievement of the Group's strategic objectives until 31 December 2017.

Board attendance



Director	Board Meeting Attendance ⁽ⁱ⁾	Audit Committee ⁽ⁱⁱ⁾	Nominations Committee ⁽ⁱⁱ⁾	Remuneration Committee ⁽ⁱⁱ⁾	Treasury Committee ⁽ⁱⁱ⁾	CR Committee ⁽ⁱⁱ⁾
Andrew Duff	7/7	–	4/4	6/6	–	2/3
Liv Garfield	7/7	–	–	–	–	3/3
James Bowling	7/7	–	–	–	6/6	–
Kevin Beeston ⁽ⁱⁱⁱ⁾	6/7	4/4	4/4	6/6	–	–
John Coghlan ⁽ⁱⁱⁱ⁾	6/7	4/4	3/4	–	6/6	–
Dominique Reiniche	7/7	–	4/4	–	–	3/3
Dame Angela Strank	7/7	–	4/4	6/6	–	3/3
Philip Remnant	7/7	3/4	4/4	6/6	6/6	–
Emma FitzGerald (until 31.12.17)	5/5	–	–	–	–	–

(i) Includes the scheduled Board meetings. Some additional meetings have been required to cover specific matters throughout the year.

(ii) Kevin Beeston was unable to attend a Board meeting due to illness during the year.

(iii) John Coghlan was unable to attend a Board and Committee meeting due to a bereavement.

Committee membership key

	Audit Committee		Remuneration Committee
	Corporate Responsibility Committee		Treasury Committee
	Nominations Committee		Board

Key Board responsibilities continued

Leadership & Effectiveness

Board activities

The table below sets out the main matters considered by the Board in 2017/18 at its scheduled Board meetings and the updates covered as part of its Lunch and Learn and operational site visit sessions. The Board's agenda is ordinarily structured as follows:

- procedural matters (including Board Committee reports);
- performance review (including health and safety, operational, customer and financial matters);
- strategic items; and
- items for approval/noting (including the Company Secretary's Update on governance, legal and regulatory issues).

This structure has been agreed to ensure that Matters Reserved to the Board are addressed appropriately and that the Board's time is spent effectively. Strategic items are regularly presented to the Board by senior managers within the business, giving the Directors the opportunity to meet with key members of management who report into the Executive team. This also assists the succession planning process.

Board strategy days

In addition to formal meetings at which strategic matters are regularly reviewed, in June 2017 the Board held a dedicated strategy meeting along with the Executive Committee to consider areas of future value creation across the Group and spent time considering asset strategy and potential future disruptors, regulatory strategy and growth strategies across our portfolio of businesses. For 2018, success of the PR19 plans are key, therefore a good portion of the Board's strategy meeting is scheduled to focus on this. Over the medium to long term it's anticipated that opportunities and risks to the business will come from emerging technologies such as artificial intelligence and robotics so this will be on the agenda, together with mergers and acquisitions and a discussion about our future people strategy.

The format of each day involves a few topics being discussed in-depth; with external speakers to challenge thinking and an interactive approach to each of the conversations.

Summary Board Activities 2017/18

Overview

All Board meetings are a full day's agenda consisting of Procedural matters; Performance Reviews; Strategy; Items for approval/noting. Further details are provided below:

Board Focus – Topics & Actions

Procedural matters

Agreeing minutes of last meeting, reviewing progress against specific actions. Updates from the Chairman of each Board Committee has been strategically moved to this early part of the agenda to reflect the importance of the Committees' activities. See Committee reports on pages 80 to 93 for further details.

Performance Reviews

Reviews are received from the CEO and CFO at every meeting and from Directorates at regular intervals. There has been a strong focus on Production, Customer Delivery and Capital Delivery & Commercial during the year. The financial reviews have included consideration of the Annual Report and Accounts and the pension scheme funding, in addition to budget and dividend approval. From 2018, separate operational reviews for the Regulated Business and those for Business Services have been introduced to better reflect how the Group's divisions operate.

Strategy

Whilst the following is not an exhaustive list of all the matters the Board have considered during the financial year, it does indicate the key areas of activity and hopefully provide insight into the strategic workings of the Board:

Upper Quartile: As part of its focus on achieving and maintaining Upper Quartile retail, water and waste performance as measured by Ofwat, the Board have reviewed a route map of key milestones on outputs so it can monitor progress towards achieving this aspiration.

M&A Strategy: The Board have continued to keep merger and acquisition opportunities under review and gave more detailed consideration to this matter at its Strategy Day.

Bioresources Trading: The Board have been considering the opportunities created by the development of this market. Technology and potential investment opportunities have been discussed and considered in more depth at its Strategy Day.

Insourcing Opportunities: To address service issues, the Board have considered proposals for insourcing, exploring alternative models and seeking practical worked examples from management for specified issues and considering the resources required in each case.

Water Resources Management Plan: The Board have challenged the prescribed methodology and drilled down in terms of the assumptions, variances and scenarios in addition to simply testing alternative methodologies, applying the expertise of those Board members who have the skills set for such matters.

Dee Valley Water Limited Board Composition: Further to consultation with Ofwat, the Board, in consultation with the Nominations Committee, have considered the future make-up of the Dee Valley Water Limited Board, appointed the Chairman of this Board and appointed three new Independent Non-Executive Directors.

Customer Service: As well as receiving updates on performance at every meeting the Board met with CCW for both England and Wales to listen to its perspective on Customers' views on Severn Trent's performance.

OSUK&I Update: Following the transfer of customers to Water Plus and the sale of its Italian and US businesses, the Board has reviewed the operational effectiveness of its Business Services operations in the UK and Ireland and the future structure of this division of the business moving forward, commending management on markedly improved customer satisfaction and better performance. It is keeping opportunities for growth and the risk profile of each business unit under review.

PR19: This price review is a particularly challenging area this year (further details on pages 16 to 17) and the Board has therefore spent a commensurate amount of time on it to enable progressive scrutiny.

Enterprise Risk Management ('ERM') Update: The Board receives six monthly updates on ERM risks. Following its feedback to management, the Board now receives 'Cost to Target' and 'Flightpath' analysis on Board level risks, the former providing confirmation that risk reduction actions have been reflected in the budgeting process, business plans and long range plans, and the latter mapping out the risk reduction over time. The combined effect of these enhancements now provides the Board with greater insight to enable reprioritisation of such risks enabling more efficient risk reduction. The Board is also rolling out true cost of control approach across all ERM risks.

Health, Safety and Wellbeing Strategy: The Board received an update and noted pleasing progress with the achievement of certain important milestones during the year (see page 41 for further information) but acknowledges there are still further issues to improve upon and the cultural challenge continues.

Property Strategy: The Board considered the new clear strategy and approved the communication of property profits to the market and the inclusion of property profits in future business targets to reflect the value arising from that strategy in the Company's share price.

Review of Water Plus Performance: The Board receives six monthly updates on Water Plus. Whilst the business has been competing well in the market, the Board keeps the performance of Water Plus under close scrutiny.

HomeServe Update: The Board has reviewed the HomeServe affinity partnership.

Re-nationalisation Debate: The Board has been closely following topical debate around the proposal by the Labour Party in its May 2017 election manifesto to re-nationalise utilities including the water sector.

Water Quality: The Board met with the DWI and invited it to give feedback on the Company's water quality performance, both in terms of current performance and challenges for the next AMP.

Business Security and Resilience Review: The Board have kept abreast of progress during the year through its established incident management steering group which continually reviews and learns from incidents, both planned events and real incidents. It receives reports which include a guide path showing progress against specified targets.

Cyber Security: Given the Cyber Security landscape continues to evolve with an increasing level of activity and a number of high profile incidents for other companies and government departments, the Board has received an update on the Company's Cyber Security Roadmap during the year. It noted the scrutiny by the National Cyber Security Centre, its risk based approach and investment priorities, and increased in-house support and positive reviews by Defra and PwC.

GDPR: The Board recognises that the implementation of GDPR is challenging but through a considered update during the year was reassured about what has to be done by management in order to prepare for it. It has scheduled future updates to review progress.

Innovation Investment Review: The Board reviewed the work of the innovation team and the progress that has been made to accelerate the pace of application in deploying value-generating technology.

Items for approval/noting

This is a standing item on the agenda to meet the requirements of the business in terms of approving matters such as leases and land disposals, the alignment of water licences (particularly in light of re-defining the English/Welsh boundaries following the acquisition of Dee Valley Water Limited), and setting tariff charges. This item always includes the Company Secretary's Update to address regular reviews of governance matters (by way of example see annual reviews shown below), keep abreast of regulatory changes and obtain Board approvals for specific matters reserved to the Board.

Annual Governance Reviews:

- Directors' conflicts of interest;
- Gifts and Hospitality Register;
- Anti-Slavery and Human Trafficking Statement;
- Board Diversity Policy;
- Sharesave Invitation;
- Board Evaluation Process;
- Board Committee Terms of Reference;
- Charter of Expectations;
- Matters Reserved to the Board;
- Group Authorisation Arrangements; and
- Feedback from Institutional Shareholders.

Lunch and Learn Sessions

The Board's time has been maximised by utilising the time spent over lunch to conduct deep dives into topics such as:

- Investor Technology Day;
- Building an ethical culture;
- HS2, update on route, programmes and costs;
- Nationalisation Defence Debate;
- Water Forum; and
- Responding to customers: Inspiring the next generation of water users.

Effectiveness

Leadership & Effectiveness

Term of office

The Board recognises the Code's recommendation that Directors serve a fixed term of appointment and considers plans for orderly succession to the Board to maintain an appropriate balance of skills and experience within the Company. As such, the Company maintains a clear framework of Non-Executive Director tenure and the skill set that each Director provides. Individual Directors' biographies can be found on pages 68 and 69. In accordance with the Code, all the Directors will retire at this year's AGM and submit themselves for reappointment by shareholders. An overview of tenure for the Board is shown in the table on page 69. Each of the Non-Executive Directors seeking reappointment at the AGM is considered by the Board to be independent in character and judgement.

Diversity

The Board and Nominations Committee are committed to diversity. Female representation on the Board exceeds 30% in respect of the main Board and is 40% on the Executive Committee (see table on page 69). There is also a continual focus on promoting wider diversity. We believe that our Company should reflect our communities and customers, and embrace a diverse range of perspectives, experiences and expertise to support our long term viability and commercial success.

We are committed to developing our talent pipeline, to ensure we have appropriate representation from minority ethnic candidates, as well as other relevant diverse groups. You can find additional details on our progress and ambitions on page 81 of the Nominations Committee report and details of diversity across the Severn Trent Group on page 81.

Training and continuing professional development

As well as Board agenda items, training sessions in relation to specific topics of interest that were presented to Directors during the year are set out on page 77.

The aim of the training sessions is to continually refresh and expand the Board's knowledge and skills to enable them to fulfil their roles effectively on the Board and its Committees and contribute to discussions on technical and regulatory matters. The sessions also serve as an opportunity for the Board to discuss strategy and risks with management below Executive Committee level and gain further insight into our businesses and management capability.

Directors' resources

An online resource library and Continuing Professional Development ('CPD') repository is available for use by the Directors, which is constantly reviewed and updated. The library includes a Corporate Governance Manual, a Results Centre and Investor Relations section, Strategy Day materials and details of Board training sessions. It also contains a further reading section which covers updates and guidance on changes to legislation and corporate governance best practice. The Directors also have access to professional development provided by external bodies and our advisers. CPD requirements were considered, through individual performance review meetings between the Chairman and each Director, as part of the externally facilitated Board effectiveness review in 2017/18.

Induction programme

Whilst there have been no new appointments to the Board of Severn Trent Plc during the year, there is an induction programme in place which can be tailored as applicable and includes the following elements/details:

- Ofwat pre-appointment process;
- Company structure including regulatory overview and performance;
- Company strategy;
- Key stakeholder relations including customers, suppliers, regulators and service providers;
- Key operations and processes including operational areas and key sites;
- Financial performance including analyst and investor opinion;
- Our people – including health, safety and wellbeing, talent and succession, trade unions and an overview of our Remuneration Policy;
- Group risk profile and our approach to risk;
- Governance Framework;
- Board calendar, effectiveness reviews and action plans; and
- Insight into key areas of focus for any specific appointment.

We will continue to enhance the Board's induction process, particularly bearing in mind feedback from new appointees.

The new Independent Non-Executive Directors of Dee Valley Water Limited received an appropriate induction facilitated by the Company Secretary covering the above topics, as well as a tour of key operational sites to understand our water treatment and distribution processes, and the customer journey, in a live environment, as follows:

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

Independence of NEDs

The independence of our Non-Executive Directors is formally reviewed annually by the Nominations Committee, and as part of the Board evaluation exercise. The Nominations Committee and Board consider that there are no business or other circumstances that are likely to affect the independence of any Non-Executive Director and that all Non-Executive Directors continue to demonstrate independence. The Board recognises the Code's recommendation that Directors serve a fixed term of appointment and considers plans for orderly succession to the Board to maintain an appropriate balance of skills and experience within the Company. Individual Director biographies can be found on pages 68 and 69. In accordance with the Code, all the Directors will retire at this year's AGM and submit themselves for reappointment by shareholders. Each of the Non-Executive Directors seeking reappointment are considered to be independent in judgement and character.

Board Evaluation

Leadership & Effectiveness

The effectiveness of the Board and of the Board's committees is reviewed annually and progress is reviewed every six months. An independent externally facilitated review of the effectiveness of the Board is conducted every three years. An externally facilitated evaluation was therefore undertaken this year, the last having taken place in 2014/15. Manchester Square Partners ('MSP'), who undertook the previous review, were chosen to facilitate the exercise to provide continuity and measure progress against their prior review. MSP has no other connection with the Company.

While the Board was functioning well at the time of the last external review a number of areas were highlighted for attention:

- Strategy: While there was alignment at a high level on the strategic priorities there was more to be done on agreeing the strategic opportunities to be pursued and the plans to achieve these.
- Pace of change: There was a need to ensure the pace of change could be delivered in a sustainable way, with the Board considering major change earlier in the process, so as to be able to review over several meetings and provide appropriate support and challenge.
- Mentoring: Talent management and succession planning were identified as needing further focus once the new Executive team was in place.
- Board Agenda: Change suggested to provide more time to discuss a range of strategic opportunities and other key initiatives, whilst not losing focus on performance and finance.

MSP concluded that significant progress had been made since 2014/15 and there had been a noticeable step change in the focus, alignment, contribution and effectiveness of the Board with well planned and structured board agendas.

Review dimensions

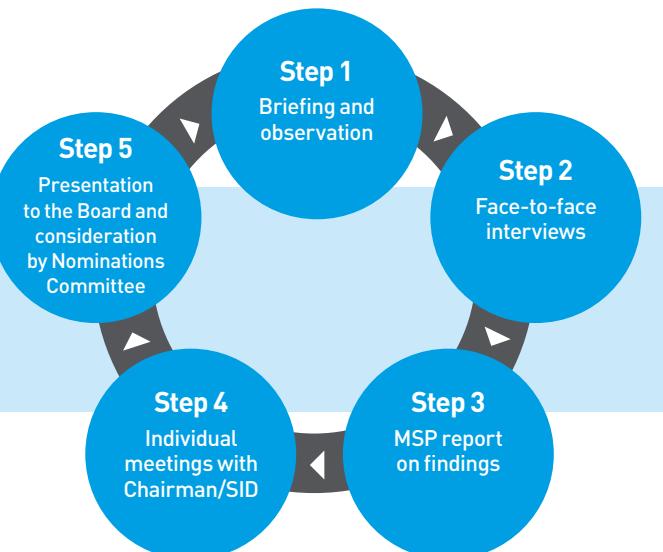
Strategy, challenges and risks, and values and culture, Role of the Board, Board dynamics and engagement, Structure of the Board, its composition and succession planning, Governance, execution and leadership.

The process for the 2017/18 review is set out below:

- Step 1** MSP briefed by Chairman and Company Secretary and attended the January Board Meeting in order to observe the Board first hand. They were also provided with access to prior years' Board and Committee papers and minutes and details of the previous internal reviews and progress updates to provide relevant background material.
- Step 2** MSP conducted face-to-face interviews with each Director and the General Counsel and Company Secretary.
- Step 3** MSP produced a report setting out their findings which they discussed with the Chairman and Senior Independent Director. Details of their observations and suggested focus areas are shown below, together with the related actions arising from the evaluation process.
- Step 4** The Chairman met with each of the Directors and the General Counsel and Company Secretary to discuss the performance of the Board and their individual contributions. The Senior Independent Director met with the Non-Executive Directors to discuss the performance of the Chairman and the Non-Executive Directors met to discuss the performance of the Chief Executive Officer.
- Step 5** MSP's report discussed by the Nominations Committee in its consideration of the re-election of Directors and reported to the full Board at its meeting in April 2018, together with a recommendation by MSP.
- Step 6** Six-monthly reviews of progress against recommendations in the report.

MSP reported favourably against all dimensions to the 2017/18 review with noticeable alignment on strategy and areas of potential challenges and risk. Overall, the Board functioned extremely well and in line with first class corporate governance. There were only two areas requiring further development, as follows:

- Continuing to maintain focus on strategic, operational and reputational priorities other than PR19; and
- A more structured plan for succession planning and talent development discussions at Nominations Committee and the Board.



Nominations Committee report

Leadership & Effectiveness



"A significant part of the Committee's work this year has been in developing our talent pipeline with a focus on the need for diversity."

Andrew Duff

Chairman of the Nominations Committee

Attendance table

Member of the Nominations Committee	Meetings attended	Max possible
Andrew Duff [Chairman]	4	4
John Coghlan ⁽ⁱ⁾	3	4
Dominique Reiniche	4	4
Kevin Beeston	4	4
Philip Remnant	4	4
Dame Angela Strank	4	4

(i) John Coghlan was unable to attend a Committee meeting due to a bereavement.

The members of the Committee in 2017/18 were the Non-Executive Directors of the Board. Only members of the Committee have the right to attend Committee meetings. Other individuals such as the Chief Executive, members of senior management, the Director of Human Resources and external advisers may be invited to attend meetings as and when appropriate.

Introduction

As Chairman of the Nominations Committee, I am pleased to introduce the report of the Nominations Committee which details the role of the Committee. The pages that follow provide additional details on the role of the Committee and the work it has undertaken during the year.

Throughout the year, increased focus continued to be given to the Group's succession and contingency planning and diversity needs. Discussion centred on the importance of developing, and maintaining, a diverse range of perspectives, skills, experiences and expertise, essential to ensuring our long-term viability and commercial success. More information on our diversity initiatives can be found in the Strategic report on page 40.

Other significant parts of the Committee's work this year have been the evaluation of the Board, its Committees and Directors and developing our talent pipeline for Directors and high performing individuals below Board level with a focus on the need for diversity. The Committee also considered and approved the appointment of three Independent Non-Executive Directors to the Board of Dee Valley Water Limited.

Andrew Duff

Chairman of the Nominations Committee

Nominations Committee responsibilities

The responsibilities of the Nominations Committee include:

- reviewing the structure, size and composition (including the skills, knowledge, experience, availability and diversity) of the Board;
- reviewing the leadership needs of the Company, both Executive and Non-Executive, at regular intervals;
- reviewing the adequacy of Board and Executive succession planning in the long and short term;
- ensuring an effectiveness review of the Board, its Committees and Directors are conducted annually;
- recommending to the Board the appointment or reappointment by shareholders of Directors at the AGM, in accordance with the Code; and
- carrying out an annual review of the Company policy on Board level diversity.

The Nominations Committee Terms of Reference, which were updated in May 2018, can be found at www.severntrent.com

Nominations Committee activities

Diversity and succession planning

As highlighted earlier in the report, the Board and Nominations Committee continue to drive the agenda of diversity across the Group and are proud of the progress made, especially in respect of female representation on the Board and Executive Committee (now at 37.5% and 40% respectively). A breakdown by gender of the number of persons who were Directors of the Company, senior managers and other employees as at 31 March 2018 is set out below.

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

The Board Diversity Policy (the 'Policy'), which is approved annually by the Board, was updated and approved by the Board in October 2017. The objective of the Policy is to develop a pipeline of diverse high calibre candidates for Board level roles. The Nominations Committee reviews the Board's effectiveness and composition each year and, in particular, considers the balance of skills, experience and independence of the Board, in accordance with the Policy. It considers the benefits of all aspects of diversity but without compromise as to the calibre of Directors, when identifying candidates for appointment.

The selection of candidates to join the Board will continue to be made based on merit and the individual's ability to contribute to the effectiveness of the Board, which in turn will be dependent on the pool of candidates available. To support this, we continue only to engage with executive search firms who have signed

up to the voluntary Code of Conduct on gender and BAME diversity and best practice. Diversity was a key consideration for the Committee when nominating candidates to the Board of Dee Valley Water Limited during the year. Throughout the year, focus also continued to be given to succession and contingency planning, including diversity needs. Succession Planning is reviewed annually by the Committee with discussion centred on the importance of developing and maintaining a diverse range of perspectives, skills, experiences and expertise, essential to ensuring our long-term viability and commercial success. With great graduate and apprenticeships programmes, as well as external hires and internal promotions, we are keen to make further progress in identifying, developing and progressing top talent through the organisation, ensuring succession remains in line with the Groups' strategic needs.

Talent development

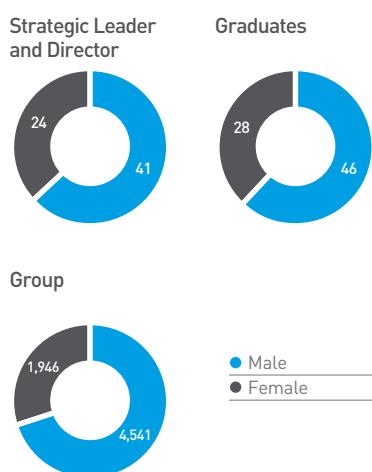
We continue to recognise the importance of developing our people and as such talent management remains a key topic of discussion. The Group's five year talent plan focuses on building both technical and leadership capability, and creating talent pipelines for the future.

We currently have a total of 73 graduates in training – 38 places were offered in 2016 and 35 in 2017. We have four entry programmes for graduates – Business Leadership, Finance, IS and Engineering. Our placements programme for undergraduates offers a range of summer and 12 month placements across Engineering, Finance and the Visitor Experience teams, with 21 opportunities filled in 2017.

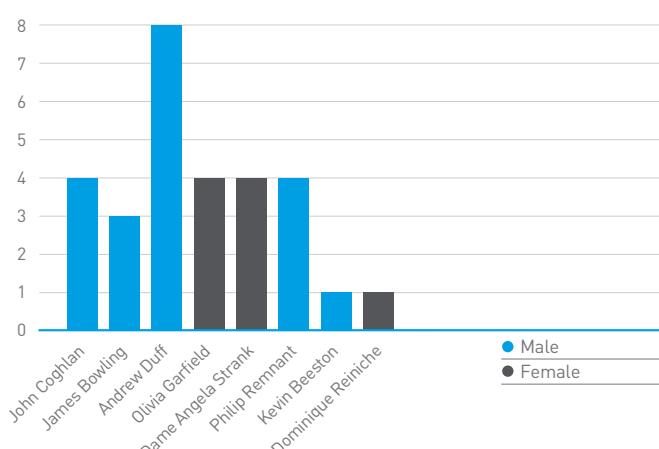
We currently have 161 apprentices in training. In 2017, we launched four new Apprenticeship programmes within Finance, Group Commercial, Project Management and Senior Network Technician populations. This means we now have nine active Apprenticeship programmes, and we expect this to increase to 12 in 2018, which includes a degree level legal Apprenticeship and a Higher Apprenticeship in HR.

We have been a key partner in the development and implementation of the new water industry apprenticeships standards through the Government's Trailblazer initiative.

Gender diversity at 31 March 2018



Severn Trent Board diversity figures Tenure [Years]



*Emma Fitzgerald stepped down from the Board on 31 December 2017.

Nominations Committee report continued

Leadership & Effectiveness

As one of the 13 firms making up the employer group we have ensured that Severn Trent has been at the forefront of the development of this new avenue for apprenticeships. There are now two Trailblazer programmes being successfully delivered across the industry for Water Process Technicians ('WPT') and Utilities Engineering Technician ('UET') and we currently offer both of these Apprenticeship routes in partnership with our learning provider, the EEF Technology College.

Our innovative delivery model for Trailblazer has allowed us to design a programme that ensures high quality apprenticeship training delivered in just 24 months – significantly faster than any previous schemes, as elsewhere in the industry this course would take at least 36 – 48 months for apprentices to complete, and we are proud to have had the first four water industry Trailblazer apprentices in the UK to complete the new standard and qualify through the new assessment model.

Evaluation of the Board

The effectiveness of the Board is reviewed annually and an independent externally facilitated review of the effectiveness of the Board is conducted every three years and conducted according to the guidance set out in the Code. The Board therefore conducted an externally facilitated board effectiveness evaluation this year, the last having taken place in 2015.

This year, the Board evaluation was externally facilitated by Manchester Square Partners with support from the Chairman and Company Secretary. The next externally facilitated review is scheduled for 2021. More information on the Board evaluation can be found on page 79 of the Governance report.

The subsequent report prepared by Manchester Square Partners was discussed by the Nominations Committee in

its consideration of the re-election of Directors and it was also the subject of a presentation to the Board.

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

Director	Number of Listed Company Appointments as Chairman [including Severn Trent Plc]	Number of Listed Company Appointments as Non-Executive Director [including Severn Trent Plc]
Kevin Beeston	1	1
James Bowling	0	0
John Coghlan	0	1
Andrew Duff	2	0
Emma FitzGerald (Stepped Down 31 December 2017)	-	-
Liv Garfield	0	0
Dominique Reiniche	0	2
Philip Remnant	1	2
Dame Angela Strank	0	1

As a result of this review, the Committee did not identify any instances of overboarding and confirms that all individual Directors have sufficient time to commit to their appointment as a Director of Severn Trent Plc.

The full list of external appointments held by our Non-Executive Directors can be found on pages 68 and 69.

Progress against 2016/17 Action Plan

The areas identified for further focus and attention in the April 2017 Board Effectiveness Report to the Board were:

Area for further focus identified in 2016/17 internal review	Progress against areas for further focus identified in 2017/18 internal review
Seeking opportunities to improve the ethnic diversity of the Board	Whilst there are currently no vacancies on the ST Plc and STW Boards, the recruitment of Dee Valley NEDs gave an opportunity to seek to improve the diversity of the Group's NED population.
Succession planning for the Executive team	Neil Morrison has only recently taken up the role of HR Director but talent development and succession planning will be an area of focus for him going forward. The new role of Production Manager on STEC also creates less of a big 'step up' in terms of senior operational succession.
Additional/more depth of content on regulatory topics in director induction material	The regulatory section of the induction material and the induction programme will have additional face to face meetings with the regulatory team, 3 and 6 months in, following appointment. John Coghlan has also kindly agreed to help provide support to any new Director in this regard.
Improved communication of Committee proceedings to the Board	Committee meeting reports now take place at the beginning of every Board meeting giving a greater opportunity for non-members to ask questions or seek clarification.
A distinct separation of strategy days from Board meeting as an opportunity to step back and discuss, debate and interrogate	The recent strategy day was entirely different in format, offsite and with external speakers, and received very positive feedback from NEDs.

Further information is available within the Board Evaluation section on page 79.

Audit Committee report

Accountability



"The Committee continues to focus on ensuring the adequate mitigation of risks faced by the Group."

John Coghlan

Chairman of the Audit Committee

Attendance table

Member of the Audit Committee	Meetings attended	Max possible
John Coghlan (Chairman)	4	4
Philip Remnant	3	4
Kevin Beeston	4	4

In addition to the attendance set out above, Andrew Duff, the CEO, the CFO, the Head of Internal Audit, the Group Financial Controller and the External Auditor normally attend, by invitation, all meetings of the Committee. Other members of senior management are also invited to attend as appropriate.

The Committee regularly holds private discussions with the Head of Internal Audit and the External Auditor separately, without Executive management present. The Chairman regularly holds separate one-to-one meetings with the CFO, the Head of Internal Audit and the External Auditor to better understand any issues or areas for concern.

During 2017/18, the Committee held five additional quorate meetings convened at short notice.

Introduction

As Chairman of the Audit Committee, I am pleased to introduce the report of our role and the work we have undertaken during the year. The pages that follow provide additional detail on the activities and discussions of the Committee and provides an overview of the significant issues the Committee assessed and steps taken to address any issues identified.

The Committee has continued to play a key role in supporting the Board in discharging its oversight responsibilities for the integrity of the Company's financial statements and matters relating to the Group's system of internal controls and risk management. As such, there is a continued focus on ensuring the adequate mitigation of risks faced by the Group. This report provides additional detail of how we carried out our risk assessment activities and you can read more about how we identify and manage risks on pages 57 and 58 of our Strategic report.

Other significant parts of the Committee's work this year have included: oversight of the relationship with our External Auditor; including the assessment of its ongoing objectivity and independence; overseeing the assurance of regulatory returns made by Severn Trent Water Limited and Dee Valley Water Limited to Ofwat; oversight of the wholesale charges; new connections charging; PR19 assurance framework; customer ODI forecast; company monitoring framework and Water Resource Management Plan for both Severn Trent Water Limited and Dee Valley Water Limited.

John Coghlan

Chairman of the Audit Committee

Audit Committee responsibilities

The responsibilities of the Audit Committee include:

- oversight of financial statements and accounting policies;
- review of risk management and internal controls;
- oversight of Internal and External Audit;
- review of the adequacy of the Group's procedures for whistleblowing, reporting fraud and other inappropriate behaviour, including reviewing reports of all allegations at their meetings;
- review of the Financial Reporting Council ('FRC') reporting requirements on Going Concern and Long-Term Viability Statements; and
- regulatory reporting obligations of our subsidiaries Severn Trent Water Limited and Dee Valley Water Limited.

The Audit Committee Terms of Reference, which were updated in March 2018, can be found at www.severntrent.com

Audit Committee report continued

Accountability

Audit Committee activities

A summary of the matters considered at each meeting is set out below:

Meeting	Matters considered
May 2017	<ul style="list-style-type: none"> • Financial results 2016/17 • Severn Trent Plc Annual Report and Accounts 2016/17, including fair, balanced and understandable review • Severn Trent Water Limited Annual Report and Accounts 2016/17 • Regulatory: Annual Performance Report and Annual Regulatory Compliance Statement for Severn Trent Water Limited and Dee Valley Water Limited • Regulatory: Annual Performance Report assurance, including ODIs for Severn Trent Water Limited • Internal control and risk management effectiveness • External Audit: Deloitte year end final report • Whistleblowing update
September 2017	<ul style="list-style-type: none"> • Internal Audit: half-year report • Gifts and Hospitality Update • External Audit: 2017/18 plan and terms of engagement • External Audit: Review of non-audit fees • Draft Wholesale charges • Enterprise Risk Management update • Water Resource Management Plan for Severn Trent Water Limited and Dee Valley Water Limited • Assurance Map re-design • Whistleblowing update • PR19 Assurance Framework
November 2017	<ul style="list-style-type: none"> • Interim results • External Audit: Deloitte half-year report • Management Representation letters • Regulatory: Company Monitoring Framework • Report from the Disclosure Committee • Severn Trent Water Limited Customer ODI Forecast • Water Resource Management Plan • Material litigation and compliance update • Whistleblowing update
December 2017	<ul style="list-style-type: none"> • Dee Valley Water Limited – Water Resources Management Plan • Water Resources RCV Allocation for PR19 • New Connections Charging
January 2018	<ul style="list-style-type: none"> • New Connections Charging
March 2018	<ul style="list-style-type: none"> • Finance: Year end considerations and Long-Term Viability Statement update • Regulatory: Year end considerations, Annual Performance Report and Annual Compliance Statement • Regulatory: WICS Compliance Statement • External Audit: Effectiveness review • External Audit: Non-audit fees policy and review of non-audit fees • Committee Terms of Reference • Internal Audit Q4 Update • Internal Audit Plan 2018/19 • Enterprise Risk Management update – Draft Principal Risks 2018 for the Annual Report • Report from the Disclosure Committee • Material litigation and legal compliance update • Whistleblowing update • Bribery and fraud prevention and detection • Assurance Map update • Accounting policies update • Subsidiary Audit Exemptions

In addition to the matters considered above, the Committee reviewed the proposed presentations to analysts in conjunction with the draft results announcements for both the interim and full year results, applying particular attention to the tone of the announcements and presentations to maintain consistency with the financial statements. In reviewing the financial statements, the Committee receives input from the Disclosure Committee, a sub-committee of the Executive Committee which is chaired by the CFO.

In May 2018, the Audit Committee also reviewed the outcome of the process to confirm that the Annual Report and Accounts are 'fair, balanced and understandable'. The Disclosure Committee undertook a detailed review of the Annual Report and Accounts prior to making a recommendation to the Board that it could make the fair, balanced and understandable statements contained in the Directors' Responsibilities Statement on page 135.

Significant financial statement reporting issues

The Committee looked carefully at those aspects of the financial statements which required significant accounting judgements or where there was estimation uncertainty. These areas are explained in note 4 of the financial statements on page 152.

The Committee receives detailed reports from both the CFO and the External Auditor on these areas and on any other matters which they believe should be drawn to the attention of the Committee. The Committee also reviews the draft of the External Auditor's report on the financial statements, with particular reference to those matters reported as carrying risks of material misstatement. The Committee discusses the range of possible treatments both with management and with the External Auditor and satisfies itself that the judgements made by management are robust and should be supported. The significant issues that the Committee considered in 2017/18 were:

Issue	How the issue was addressed by the Committee
Going concern basis for the financial statements and long-term viability statement.	The Committee reviewed and challenged the evidence and assumptions underpinning the use of the going concern assumption in preparing the accounts and in making the statements in the Strategic report on going concern and long-term viability.
Determination of the provision for impairment of trade receivables in Severn Trent Water Limited.	The Committee challenged the changes made to the methodology for calculating the provision during the year and critically appraised management's explanations for these changes.
At 31 March 2018, the provision in Severn Trent Water Limited's financial statements was £124.5 million and the charge for the year was £25.0 million.	The Committee considered the work performed by the Auditor and the conclusions they reached regarding the adequacy of the provision.
Severn Trent Water Limited has a statutory obligation to continue to supply water and waste water services to customers even when their bills are unpaid. This increases the risk of bad debts. In addition it has a large and diverse customer base which requires impairments against trade receivables to be assessed on a systematic basis.	The Committee determined that no adjustment to the amounts recorded was required.
Revenue recognition in relation to the estimation of metered revenue from the new non-household retail market in Severn Trent Water Limited.	The Committee does not consider that there is a significant risk of a material adjustment in respect of this estimate in the next financial year because the estimated amount is not material. Nevertheless, the Committee considered this to be a significant issue because the systems and processes are new and the amounts recognised are subject to management judgement.
In the year ended 31 March 2018, Severn Trent Water Limited recognised £371.4 million in revenue from sales to retailers in the new non-household retail market.	The Committee reviewed the process for calculating the metered revenue estimate from non-household retailers and considered the reasonableness of the estimates in the light of emerging trends and the experience of other market participants. The Committee scrutinised management's evidence supporting its judgements and examined the data from the underlying evidence. The Committee discussed the Auditor's work and their conclusions.
On 1 April 2017, the non-household retail market in England opened to competition. This enabled all non-household customers to choose their water and waste water supplier although wholesale services remained with the incumbent companies. Market Operator Services Limited ('MOSL') was established to operate the market and to provide data to wholesalers and retailers to allow settlement between market participants to take place. MOSL provides data for monthly settlement periods based on actual meter readings and estimations extrapolated from the last known meter read. This is an iterative process with subsequent settlement runs including more actual readings for the same period. Empirical observations have shown that metered consumption is consistently higher than the previous estimates.	The Committee determined that the approach taken by management was reasonable and that no adjustment was required to the amounts recognised in the financial statements.
The proposed classification of costs between operating expenditure and capital expenditure in Severn Trent Water Limited.	The Committee considered the application of the Group's accounting policies in relation to capital expenditure during the year.
Severn Trent Water Limited has a significant capital programme that includes projects made up of a combination of expenditure and activities, some of which are recognised as property, plant and equipment and some of which are recognised as operating costs. For most of the expenditure this distinction is clear but there is an element where subjective judgements are required to determine the appropriate accounting treatment.	The Committee enquired of management whether the policies had been applied consistently from year to year and sought explanation for the increase in amounts capitalised. The Committee considered the results of the Auditor's work and discussed the conclusions with the Auditor.
	The Committee determined that no adjustment to the amounts recorded was required.

Audit Committee report continued

Accountability

Issue	How the issue was addressed by the Committee
Determination of the amount of the Group's retirement benefit obligations.	The Committee scrutinised the assumptions underlying the valuation of the obligations, noting and probing assumptions that were not in line with their expectations. The Committee considered whether the assumptions taken as a whole were appropriate, taking account the work of the Auditor and the benchmark information provided by them.
At 31 March 2018, net retirement benefit obligations amounting to £519.8 million were recognised.	The Committee considered that the assumptions were reasonable and that no adjustment was required to the draft financial statements.
The net obligation recognised on the balance sheet is the difference between the fair value of the schemes' assets at the balance sheet date and the present value of the benefits expected to be paid to members of the schemes. This requires assumptions to be made regarding expected age of retirement and longevity of members, future inflation rates and increases to benefits. It is also necessary to determine an appropriate discount rate to calculate the present value of the estimated gross obligations. Management takes advice from external qualified actuaries who perform the calculation of the present value of the benefits based on the assumptions set by management.	

For all of the matters described above the Committee concluded that the treatment adopted in the Group financial statements was appropriate.

Internal control over financial reporting

The Group has established procedures for exercising control and managing risk in relation to financial reporting and preparation of consolidated financial statements including:

- the formulation and communication of Group accounting policies which are regularly updated for developments in IFRS and other reporting requirements;
- specification of a set of financial controls that all of the Group's operating businesses are required to implement as a minimum;
- a range of system, transactional and management oversight controls embedded into our financial processes;
- deployment of a group-wide consolidation system with controls to restrict access and maintain integrity of data;
- recruitment training and development of appropriately qualified and experienced financial reporting personnel;
- oversight by the Disclosure Committee of the Group's compliance with its disclosure obligations; and
- monthly reviews by the Board of financial reports from the Group's operating businesses.

Effectiveness of the Audit Committee

The Committee's performance was considered and reviewed as part of the annual review of the Board and its Committees, details of which can be found on page 79.

The Board is satisfied that the Committee members bring a wide range and depth of financial and commercial experience across various industries and that all members have competence relevant to regulated and/or utilities businesses as well as significant recent and relevant financial experience.

Internal and External Audit

Internal Audit and internal controls

Internal Audit is an independent assurance function available to the Board, Audit Committee and all levels of management. The Internal Audit function is supported by a co-sourcing partner, PricewaterhouseCoopers. The arrangement is reviewed annually and the Committee believes this structure adds value, through greater access to specific areas of expertise, increased ability to scale up operations, and the ability to challenge management independently. Co-source specialists will continue to bring expertise to support the team and delivery of the audit plan where relevant. During the year, and following a meeting with the Chairman of the Audit Committee, a new Head of Internal Audit was appointed. This appointment complemented planned changes to the Internal Audit team to help deliver third line assurance for PR19 and other regulatory activities, without compromising the delivery of the 2018/19 audit plan.

The role of Internal Audit is to provide assurance that the Group's risk management and internal control systems are well designed and operate effectively and that any corrective action is taken in a timely manner. Each year, Internal Audit develops an annual risk-based audit plan for approval by the Audit Committee and Performance Dashboards to enable onward monitoring of the plan's execution. The Audit Committee challenges the Audit plan, specifically whether the key risk areas identified as part of the Enterprise Risk Management process are being audited with appropriate frequency and depth, and also by bringing an external view of risks the Company may be exposed to.

The Performance Dashboards summarise the performance of the Internal Audit function over the year against key measures and are reviewed by the Committee twice a year. Following the completion of each planned audit, the Internal Audit function seeks feedback from management which is reported through the Performance Dashboards and assessed in turn by the Audit Committee twice a year. The effectiveness of the controls over financial reporting is also monitored by the Audit Committee, which receives regular reports of the testing conducted by the External Auditor.

The Audit Committee is confident that, where any failings or weaknesses are identified in the course of its review of internal control systems, management puts in place robust actions to address these on a timely basis. An internal control system can provide only reasonable and not absolute assurance against material misstatement or loss, as it is designed to manage rather than eliminate the risk of failure to achieve business objectives. To ensure continued efficiency, an external review of the effectiveness of the Internal Audit function will be carried out in October 2018.

External Auditor

Annually, the Committee reviews the External Auditor's audit plan and reviews and assesses information provided by them confirming their independence and objectivity within the context of applicable regulatory requirements and professional standards. Deloitte contributes a further independent perspective on certain aspects of the Company's financial control systems arising from its work, and reports both to the Board and the Audit Committee.

Following a formal tender process in 2015/16, Deloitte LLP were reappointed as Auditor at the 2016 AGM. The senior statutory Auditor, Kari Hale, has overseen the audit of the Severn Trent Group since 2015/16. The Company intends to put the External Audit out to tender at least as often as is required by applicable law, rules, regulations and best practice in line with the Competition and Markets Authority and EU requirements for mandatory tendering and rotation of the audit firm. Under current regulations the External Audit must be put out to tender by 2025 and Deloitte will not be able to participate. The Company has complied with the provisions of the CMA Audit Order during the financial year.

The Committee considers the effectiveness of the External Auditor every year and, further to Deloitte's reappointment, a full effectiveness review was conducted during this year. The review involved assessment of the Auditor by the Committee and key Executives and evaluation of whether the Auditor meets minimum standards of qualification, independence, expertise, effectiveness and communication.

Based on our consideration of the responses to the effectiveness review the Committee remains satisfied with the efficiency and effectiveness of the audit.

Non-audit fees

The Company has approved a formal policy on the provision of non-audit services aimed at safeguarding and supporting the independence and objectivity of the External Auditor. The policy sets out the approach to be taken by the Group when using the services of the External Auditor, including requiring that certain services provided by the External Auditor are pre-approved by the Committee or its Chairman and separately sets out those non-audit services which are prohibited, since the independence of the External Auditor could be threatened.

The process for approving all non-audit work provided by our Auditor is overseen by the Committee in order to safeguard the objectivity and independence of the Auditor. Prior to approval, consideration is given to whether it is in the interests of the Company that the services are purchased from Deloitte rather than another supplier. Where Deloitte have been chosen, this is as a result of their detailed knowledge of our business and understanding of our industry as well as demonstrating that they have the necessary expertise and capability to undertake the work cost-effectively.

The policy was revised in early 2016, ahead of new EU regulations coming into force in June 2016, to provide that non-audit fees and independence of our Auditor would continue to be subject to ongoing review in light of those rules. The current policy, which was reviewed by the Committee during the year, continues to comply with the EU regulations and requires approval by the Committee or its Chairman if a non-audit service provided by the Auditor is expected to cost more than £100,000. The policy also prohibits aggregate fees from non-audit services in excess of 70% of the audit fee for the year.

Non-audit services where the External Auditor may be used include: audit-related services required by statute or regulation, services related to fraud, Corporate Responsibility report reviews and regulatory support.

Audit Committee report continued

Accountability

During the year, Deloitte received £558,000 in fees for work relating to the audit services they provide to the Group. Non-audit related work undertaken by Deloitte amounted to fees of £201,000 this year, which amounts to 36% of the total audit fees paid to them. Fees paid to Deloitte are set out in note 7 of the financial statements on page 157, but details of significant non-audit work undertaken are set out below:

Nature of service	Reason for Deloitte's appointment	Fees (£'000)
Audit related assurance services		
Interim review	This work is akin to an audit and is expected to be performed by the External Auditor. The same safeguards that apply to the External Audit also apply to this work.	£54
Assurance of regulatory returns	Audit of sections 1 and 2 of Dee Valley Water Limited's and Severn Trent Water Limited's Annual Performance Reports is closely related to the External Auditor's statutory audit work and the two assignments are performed in parallel.	£65
Reporting under Group financing documents	These documents require reports from the Auditor.	£49
Subtotal		£168
Other assurance services		
Assurance in connection with regulatory reports to Ofwat	Agreed-upon procedures relating to section 4 of Dee Valley Water Limited's and Severn Trent Water Limited's Annual Performance Reports and Severn Trent Water Limited's wholesale scheme of charges.	£15
Other assurance		£18
Subtotal		£33
Total 2017/18 non-audit fees		£201

In approving these non-audit fees, the Committee considered the overall ratio of non-audit fees to audit fees and, given the scope of work, considered that Deloitte was best placed to perform these services.

Regulated subsidiaries

The regulated activities carried out by Severn Trent Water Limited and Dee Valley Water Limited also require annual reporting submissions to Ofwat which are reviewed by the Committee. They include an annual submission on their regulatory performance and obligations known as the Annual Performance Report, together with a Compliance Statement and a statement to underpin the customer charges made by each subsidiary.

In November 2017, the Committee reviewed the statement of risks, strengths and weaknesses and draft assurance plans for Severn Trent Water Limited and Dee Valley Water Limited, which is a requirement of Ofwat's Company Monitoring Framework. These documents set out the process, timeline and assurance framework in place for information published for customers and other stakeholders, including the Annual Performance Report.

For each of Severn Trent Water Limited and Dee Valley Water Limited, Deloitte provides an audit opinion on the regulatory financial reporting and price control segmentation sections of the respective Annual Performance Reports, and assurance of certain aspects of additional regulatory information that is included. The respective Annual Performance Reports also provide an overall picture of performance, covering many aspects which are not financial including performance against commitments and ODIs for each of Severn Trent Water Limited and Dee Valley Water Limited. Both Severn Trent Water Limited and Dee Valley Water Limited appoint independent engineering consultants, Jacobs and Black & Veatch respectively, to report and provide assurance on those aspects. The Committee receives reports from Jacobs and Deloitte on their work for Severn Trent Water Limited, and Black & Veatch and Deloitte for Dee Valley Water Limited, as part of its review of the respective Annual Performance Reports.

Risk management

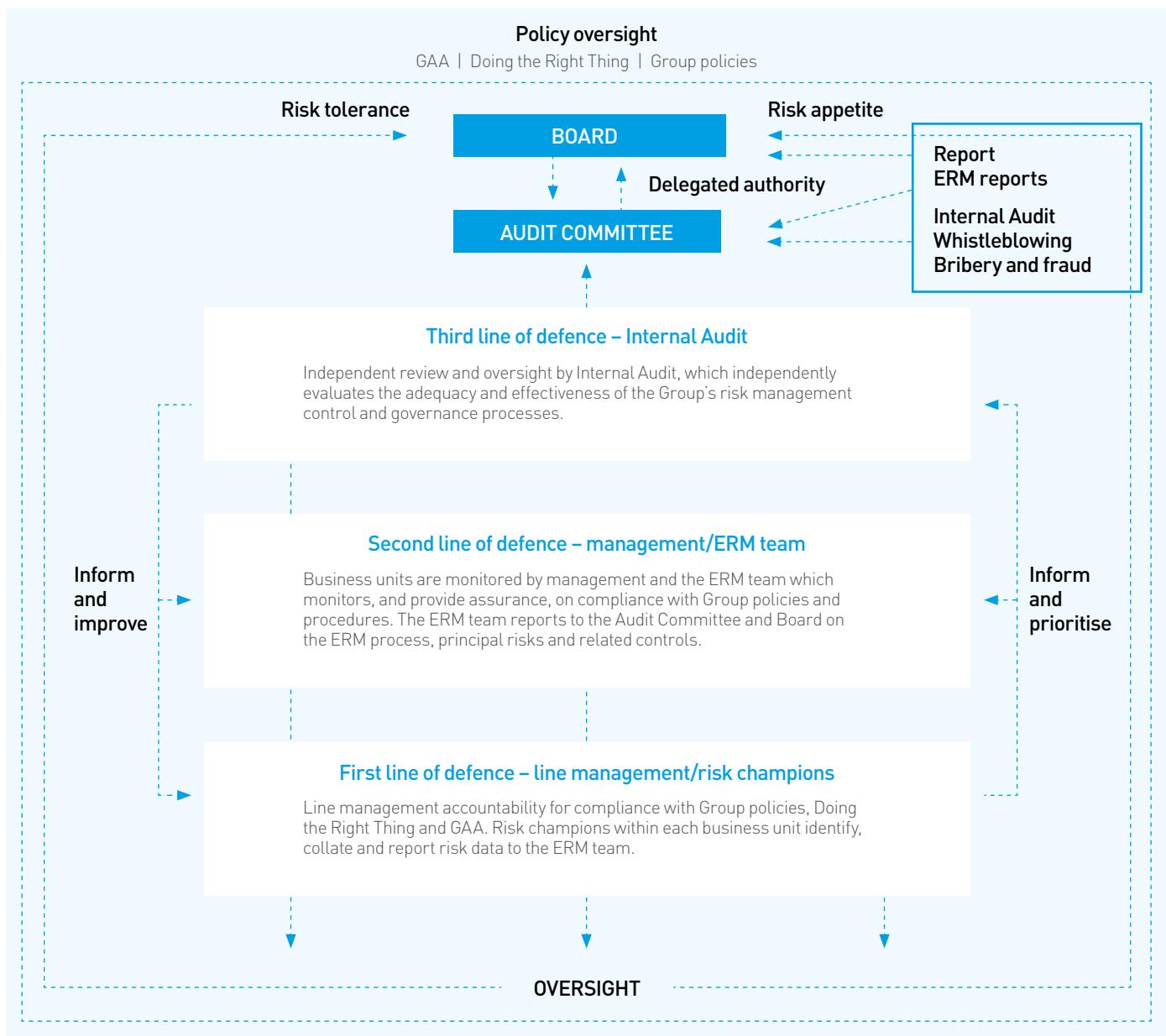
The Audit Committee reviews the processes for, and outputs from, the Group's Enterprise Risk Management ('ERM') process, through which our principal risks and related controls are identified. The Committee also reviews the effectiveness of the risk management system on behalf of the Board and keeps under review ways in which to enhance the control and assurance arrangements. The Committee receives half-yearly reports from the Head of Risk detailing the significant risks and uncertainties faced by the Group, an assessment of the effectiveness of controls over each of those risks and an action plan to improve controls where this has been assessed as necessary.

To further enhance the clarity of reporting and insight that can be gained from this ERM information 'risk flightpaths' are now reported to the Audit Committee. The flightpaths graphically demonstrate the level of risk the Group faces and the timeline for the key risk mitigation steps to manage the risk to the target position. This builds upon the established reporting dashboard for the Group's significant risks. The flightpaths and the reporting dashboard help to facilitate a more thorough review of the target risk positions considering risk appetite and whether improvement actions to achieve these are on target with the correct prioritisation in place.

The Board confirms that procedures providing an ongoing process for identifying, evaluating and managing the principal risks and uncertainties faced by the Group have been in place for the year to 31 March 2018 and up to the date of this report, which is in accordance with the Code and Guidance on Risk Management, Internal Control and Related Financial and Business Reporting September 2014 (the 'Guidance'). A risk identification and horizon scanning update was provided to the Board in March 2018. During its review of risk management during the year, the Board explicitly considered the target position for significant risks and whether target risk positions are appropriate and confirmed that suitable timescales had been agreed for reaching them.

Risk management governance process

The Group's risk management governance process is based on the three lines of defence model and is scrutinised by the Audit Committee, through delegated authority from the Severn Trent Plc Board.



Treasury Committee report

Accountability



“The Committee has focused on the ensuring that the Group has sufficient ongoing liquidity to meet the committed funding requirements of its regulated and non-regulated businesses, provided through a sustainable, resilient financial structure”.

John Coghlan

Chairman of the Treasury Committee

Attendance table

Member of the Treasury Committee	Meetings attended	Max possible
John Coghlan	6	6
Philip Remnant	6	6
James Bowling	6	6

The members of the Committee in 2017/18 are shown above. The Group Treasurer is also a member of the Committee, but not a member of the Board of Directors.

The Treasury Committee Terms of Reference were updated in March 2018 and can be found at www.severntrent.com

Only members of the Committee have the right to attend Committee meetings. In addition to the attendance set out above, Andrew Duff, Kevin Beeston, the Group Commercial Director and the Group Financial Controller normally attend, by invitation, all meetings of the Committee. Other individuals may be invited to attend meetings as and when appropriate.

To ensure that the Company’s treasury practices are in line with best practice, the Committee has access to advice from advisers. Evercore are independent advisers to the Committee, with no other connection to the Company, and provide regular market updates to the Committee. The Committee is satisfied that the advice it receives is objective and independent.

During 2017/18, the Committee held one additional quorate meeting convened at short notice.

Introduction

As Chairman of the Treasury Committee, I am pleased to introduce this report which details the role of the Committee and the important work it has undertaken during the year.

The Committee has continued to play a key role in supporting the Board in monitoring performance against the Group’s approved treasury policy and annual treasury plan, reviewing in detail the Group’s funding requirements and providing oversight of the Group’s key financing risks and opportunities.

John Coghlan

Chairman of the Treasury Committee

Treasury Committee Responsibilities

The responsibilities of the Treasury Committee include:

- oversight of treasury activities in implementing approved treasury policies;
- oversight of interest rate and inflation risk management strategies. In particular, the monitoring of the impact of changes in forecast interest rates and inflation on Group earnings;
- oversight of the Group’s funding strategy;
- monitoring the Group’s exposure to financial institution credit risk;
- monitoring the Group’s exposure to foreign currency risk;
- monitoring the Group’s exposure to financial liquidity risk;
- receiving updates on general financial market movements; and
- oversight of treasury internal controls.

Key areas of Focus in 2017/18

The Committee provides Board oversight of the Group’s key financing risks and opportunities.

Some key areas of discussion for the Committee during 2017/18 included:

- the impact of prevailing economic conditions on the accurate forecasting of long-term interest rates and associated interest rate and inflation risk management policy;
- the impact of Brexit on existing and future sources of funding for the Group’s businesses;
- the introduction of CPI-linked debt into the Group’s debt mix;
- analysis of Ofwat’s proposed PR19 cost of debt methodology, including an early view of the impacts of a number of scenarios on the Company’s credit metrics going forward; and
- the review of the Group’s European Medium Term Note Programme and approval for bonds to be issued pursuant to that Programme during the year.

Corporate Responsibility Committee report

Stakeholder Engagement



“Acting in a socially and environmentally responsible manner is embedded in our Group strategy, and this year, we are reporting our performance against our CR Framework as part of our annual Group performance reporting”.

Dame Angela Strank

Chairman of the Corporate Responsibility Committee

Attendance table

Member of the Corporate Responsibility Committee	Meetings attended	Max possible
Dame Angela Strank (Chairman)	3	3
Andrew Duff	2	3
Dominique Reiniche	3	3
Liv Garfield	3	3

In addition to the attendance set out above, the Company Secretary normally attends, by invitation, all meetings of the Committee. Other members of senior management, including the Head of Internal Audit, and subject matter experts are also invited to attend as appropriate.

Introduction

As Chairman of the Corporate Responsibility ('CR') Committee, I am pleased to introduce this report which details the role of the Committee and the important work it has undertaken during the year. The Committee has continued to play a key role in supporting the Board, monitoring performance against our Corporate Responsibility Framework, reviewing in detail our CR commitments including several ODIs and providing an oversight of the Group's key non-financial risks and opportunities.

Dame Angela Strank

Chairman of the Corporate Responsibility Committee

Corporate Responsibility Committee responsibilities

The responsibilities of the Corporate Responsibility Committee include:

- development of the Corporate Responsibility Framework and metrics;
- regularly receiving and reviewing reports on progress against our Corporate Responsibility Framework;
- consideration of our Code of Conduct and associated Group policies for recommendation to the Board. Particular focus includes the provision of a healthy and safe working environment for employees and contractors, human rights (including Modern Slavery) and employee diversity and inclusion;
- review of our environmental performance standards and commitments; and
- the promotion of socially responsible values and standards that relate to the social and economic community in which the Company operates.

The Corporate Responsibility Committee Terms of Reference, which were updated in April 2018, can be found at www.severntrent.com.

Our Corporate Responsibility Framework

Our Corporate Responsibility Framework is ambitious, broad ranging and underpinned by stretching targets, to ensure we are delivering the commitments expected of a leading socially and environmentally responsible business. Acting in a responsible manner is integral to supporting our purpose of serving our communities and customers, building a lasting water legacy and achieving our vision to be the most trusted water company by 2020.

We hold ourselves to account against our CR Framework and agreed metrics through an effective performance management system. Our CR performance is embedded within the organisation, with ODIs embedded in the large majority of our CR metrics, demonstrating we are focusing on issues of upmost importance to our customers.

Performance against the CR Framework is reported on a quarterly basis to the Committee, and externally on an annual basis through our Annual Report and Accounts, through our website and through selected environmental, social and governance indices. Our employees' reward is directly linked to our CR performance, with customer ODIs, health and safety and our key CR metrics contributing to the bonus which our employees receive. We believe that by focusing on the issues most important to our customers, our CR Framework has the right focus, and we are proud that we have again been accredited by FTSE4Good.

Corporate Responsibility Committee report continued

Stakeholder Engagement

Key areas of focus for 2017/18

The Committee provides Board oversight of our CR strategy and our performance against our CR Framework. The Committee regularly reviews reputational risks, non-financial Internal Audit reports, whistleblowing allegations and reviews in detail key topics against our CR Framework. Some key areas of discussion and review during 2017/18 included:

- Our goal zero mind-set for serious pollutions, as a key indicator of our environmental leadership. Reviewing our performance and plan for continuous improvement.
- Our ambition to make our region the most water efficient in the UK. Reviewing progress against our commitment to empower our customers to save 25 million litres a day (Mld) and future challenges we need to consider.
- Delivering our ambition for our vulnerable customers. Reviewing performance against our commitment to support 50,000 customers who struggle to pay their bill and customer research into developing our next five year plan to ensure we lead at supporting customers in vulnerable circumstances, both in terms of accessibility and service.
- Our approach to catchment management and taking a catchment based approach. Reviewing our performance against our AMP6 catchment ambitions and demonstrating the benefits of developing a vision for catchments across the Severn Trent region in collaboration with farmers.
- Our zero tolerance approach to modern slavery and our plans to take all reasonable efforts to eradicate modern slavery within both our business and our supply chain.
- Our approach to whistleblowing. Reviewing the effectiveness of our whistleblowing procedures to ensure we provide adequate support for both the whistleblower and training for the investigating managers.

Corporate Responsibility Committee activities

A summary of some of the matters considered at each meeting is set out below:

July 2017

- Quarterly Corporate Responsibility performance report
- The identification and management of political risk
- Demonstrating environmental leadership – a Deep Dive on ‘Pollution Performance’
- Anti-Slavery and Human Trafficking Statement 2017 Update
- Whistleblowing Report

November 2017

- Quarterly Corporate Responsibility performance report
- Deep Dive: Water Efficiency
- Deep Dive: Help if you struggle
- Whistleblowing Report

January 2018

- Corporate Responsibility Update 2018
- Deep Dive: Catchment Management and the Catchment Based Approach
- Deep Dive: Supporting our Colleagues’ Mental Wellbeing
- Review of Whistleblowing policy and procedures
- Whistleblowing Report

April 2018

- Quarterly Corporate Responsibility performance report
- Deep Dive: Community Champions – employee volunteering
- Internal Audit aligned with CR Framework
- Whistleblowing Report
- Anti-Slavery and Human Trafficking Statement 2018 – Update

Ambition One

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

Ambition Two

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

Values

1
We put our customers first

2
We are passionate about what we do

3
We act with integrity

4
We protect our environment

5
We are inspired to create an awesome company

Human rights

We are committed to protecting the human rights of our employees and contractors as we have clearly set out in our Code of Conduct, 'Doing the Right Thing'. We have a responsibility to understand our potential impact on human rights and to mitigate or eliminate any potentially negative impacts. Whilst not having a specific human rights policy, we have Group policies on Human Resources, Anti Bribery and Anti-Fraud, Whistleblowing ('Speak Up') and Procurement. These policies are, in turn, supported by a broader range of policies to support key human rights.

Prevention of child labour and forced labour

We will not condone the use of child labour and forced labour under any circumstances. Our highest risk is through our supply chain. Therefore we work with our suppliers to ensure they operate to the same standards we set ourselves, and we have also been working closely with our suppliers to ensure they understand the risks involved in their own supply chains. All suppliers are required to sign up and operate in line with our Code of Conduct, which clearly states our zero tolerance, and is built into our procurement tender process as part of the pre-qualification questionnaire template. We encourage all suppliers, irrespective of turnover, to make a modern slavery and human trafficking statement that they do not tolerate modern slavery and human trafficking in their businesses.

Freedom of association and collective bargaining

We recognise the right of all employees to Freedom of Association and Collective Bargaining. We seek to promote co-operation between employees, our management team and recognised trade unions. We meet with our trade unions on a quarterly basis at the Company forum and see mutual benefit in sharing information with our colleagues and seeking their feedback and suggestions. We believe this fosters a common understanding of business needs and helps to deliver joint solutions aimed at making our business successful. We also believe that the Company forum provides a suitable opportunity for engagement with the whole workforce to ensure workforce views are taken into account.

Whistleblowing

All Severn Trent employees are encouraged to raise concerns at work in the first instance through their line manager, or senior management, however, we recognise that employees may find this difficult under certain circumstances. If this might be the case, employees are encouraged to use our confidential and independent whistleblowing helpline or email service, operated by Safecall, an independent company that specialises in handling concerns at work. The service is available internationally and Safecall provides a translation service, allowing any employee to access it, wherever they are in the world. All investigations are carried out independently of direct line management and the findings are reported directly through to the Audit and CR Committees. This year we reviewed the effectiveness of our whistleblowing procedures to ensure we offer suitable support to both the whistleblowers and also the investigating managers.

'Doing The Right Thing – The Severn Trent Way'

Every day our employees have to make choices about what they do and how they do it. Most of the time it is clear what the right thing to do is, whether it is about doing what is safe, doing the right thing for our customers, doing what is right ethically and what is right legally. But there are always going to be times when the situation isn't completely clear, and that's where our Code of Conduct 'Doing the Right Thing' comes in. It details the values we work by and explains who we are, what we stand for and how we work. It also tells our customers, investors and business partners that they can trust and rely on us. These principles apply to everyone in the Group, no matter where in the world they are based or what they do. It clearly sets out the standards we need to follow in our day-to-day activities. This remains an essential part of our employee induction and last year we introduced an e-learning module for all employees to ensure they understand their personal responsibilities.

Prevention and detection of bribery and corruption

Our Group financial crime policy prohibits bribery, corruption and fraud in all our business dealings, regardless of the country or culture within which we work. This year we have also updated our policy to take into account the new tax evasion offences. Employees identified as high risk, through a risk review for all Group employees, are required to undertake an online training module and test to ensure awareness of and compliance with anti-bribery and corruption. The Audit Committee carries out an annual review of our systems and controls to detect and prevent bribery and corruption.

Responsible business practices are an integral part of our business strategy and so this year, rather than having a separate CR Report within our Annual Report and Accounts, we have integrated our performance throughout the report to reflect the importance of its embedded nature.

Investor relations

Stakeholder Engagement

Primary investor events

May 2017	London Roadshow
May 2017	Edinburgh Roadshow
May 2017	US Roadshow
June 2017	Geneva & Zurich Roadshow
June 2017	BAML Utilities & Renewables Conference
June 2017	Exane European CEO Conference
June 2017	RBC Reverse Roadshow
July 2017	Scott Harris Roadshow
September 2017	Investor Site Visit
September 2017	Citi Reverse Roadshow
September 2017	Morgan Stanley Power and Utility Summit
September 2017	Bernstein Strategic Decisions Conference
November 2017	London Roadshow
November 2017	US/Canada Roadshow
November 2017	Edinburgh Roadshow
November 2017	Geneva Roadshow
January 2018	Citi European Utilities Conference
February 2018	London Roadshow
March 2018	US Roadshow

Institutional shareholders and analysts

The Board recognises the importance of representing and promoting the interests of its shareholders and that it is accountable to shareholders for the performance and activities of the Company. Various mechanisms have been put in place to ensure it remains in touch with key activities and developments, including:

- monthly update reports on the key shareholder engagement activities carried out by the Executive Committee and the Investor Relations team;
- a monthly report of our shareholder register, outlining the significant buyers and sellers of Severn Trent Plc shares; and
- regular summaries of sector research notes, allowing the Board to understand the key opinions being communicated to investors by sell-side analysts.

Retail shareholder engagement strategy

The Board has an active shareholder engagement strategy, the main elements of which are set out below.

The Annual Report and Accounts is the principal means of communicating with shareholders. The Group has adopted e-communications as an alternative method of sending company information. Following a consultation with shareholders in March 2017, a significant majority of shareholders, 85% elect to view and download the Annual Report online, whilst 15% continue to receive a hard copy. The next consultation will take place in 2019.

Our website contains an archive of Annual Reports together with other information relevant to investors, including comprehensive share price information, financial results, Company news and a financial calendar. The Company offers a Dividend Reinvestment Plan ('DRIP'), details of which are available on our website and the website of Equiniti, our registrar.

Additional investor engagement

Presentations are made to shareholders and city analysts following the release of the half-year and full-year results. Furthermore, the Chief Executive and Chief Financial Officer regularly meet shareholders during the year.

The Chairman and Senior Independent Director also offer to meet with our largest shareholders without the Executive Directors once every year and are available to meet with investors at any other time upon request.

In line with the Code, we recognise that the Board has overall responsibility for ensuring that a satisfactory dialogue with shareholders takes place. The Chairman, Chief Executive and the Chief Financial Officer report shareholder views on Severn Trent to the Board at least quarterly.

A clear Investor Relations strategy has been documented and agreed by the Board. This sets out the Investor Relations team's approach to identification of, and engagement with, the Company's shareholders, sell-side analysts and debt investors.

2017/18 engagement

During 2017/18, the key topics for our investors have been a combination of company specific, performance-orientated factors and broader regulatory and political factors.

At a company level, conversations with our investors have largely focused on our performance against the three key regulatory outperformance levers of customer Outcome Delivery Incentives (ODIs), Totex and financing. In particular, questions have been targeted on how the outperformance to date has been achieved, what areas have received specific attention and what scope there is for further improvement. Investors have also been interested in opportunities for further growth in our regulatory capital value ('RCV'), the performance of our non-regulated business, in particular our renewable energy activities, and the potential for further merger and acquisition activity in the sector. We are also seeing an increased level of interest in our approach to Corporate Social Responsibility.

Broader factors impacting Severn Trent and the water sector have played a more significant part in investor conversations this year. In particular, the increased regulatory news flow relating to PR19 (the price review process which will set prices for AMP7, the regulatory period for 2020-25) and the inclusion in the Labour Party's 2017 election manifesto of a policy to renationalise certain sectors, including the water sector, have dominated recent conversations.

Regarding PR19, there were two key announcements from Ofwat, in July and December 2017, in which it set out its methodology that helped shape the regulatory framework for AMP7 and gave clear guidance on how companies can outperform. The focus from investors has been on how these changes will impact Severn Trent and how well the Company is positioned to benefit from the sharpened incentive regime.

The renationalisation debate has been at the forefront of investors' minds since the general election in June 2017. In particular, they have sought to understand the likelihood of it happening, should the Labour Party win the next general election, and what the success story of the industry has been since privatisation.

Looking ahead to 2018/19

We have already established a structured programme of investor engagement for 2018/19, incorporating roadshows to many of the key locations where our shareholder base are located, including London, Edinburgh and North America. We have also confirmed attendance at a number of industry conferences.

We expect the PR19 process to be the key theme for investors throughout 2018/19, with several key milestones in the process

of being reached, including the submission of company business plans to Ofwat in September 2018 and the initial assessment of business plans by Ofwat in January 2019. The dialogue with our shareholders on the risk of renationalisation will be maintained. At a company level, the focus will likely remain on our ability to outperform the regulatory incentive mechanisms of customer ODIs, Totex and financing.

Tax Strategy

We are committed to managing our tax affairs in a responsible manner. This means paying the right amount of tax at the right time in compliance with UK tax rules and acting in accordance with the values set out in our Corporate Responsibility Framework. References to 'tax' include taxes that we incur (corporation tax, business rates, employer's NIC, VAT and various environmental taxes) as well as taxes that we administer and collect on HMRC's behalf (PAYE and employee's NIC).

Our approach to tax

Our approach to tax is overseen by the Severn Trent Plc Board and is governed by the following key principles:

- We will manage our tax affairs responsibly, in a manner consistent with our vision to be the most trusted water company by 2020;
- We will not undertake aggressive tax planning or any planning not otherwise in support of business requirements;
- We will make use of widely claimed incentives that Government has chosen to make available to encourage investment; and
- We will maintain an open, transparent and collaborative relationship with HMRC consistent with maintaining our good working relationship.

The effective management of our tax affairs is in the best interests of customers as it helps to keep our bills as low as possible.

Tax Governance

Responsibility for tax governance sits with the Chief Financial Officer, with oversight from the Board and Audit Committee and day-to-day support from a team of qualified in-house tax professionals.

In accordance with Group risk management procedures, tax risks are recorded and monitored throughout the year. If a material uncertainty is identified, external advice may be sought to ensure that our interpretation of the relevant UK tax rules is appropriate. We may also seek to resolve an uncertain tax position directly with HMRC before a tax return is filed, in accordance with HMRC's framework for co-operative compliance.

Any significant tax risk is reported to, and overseen by, the Group's Audit Committee, who also receive tax status updates as part of the interim and year end financial reporting programmes.

Relationship with HMRC

In maintaining a good working relationship with HMRC, we seek to ensure that HMRC are kept up to date with business developments, including any commercial transactions with potentially significant tax implications. Where queries arise, these are managed on the basis of full disclosure. We will make representations to, and consult with, HMRC on issues that could adversely affect investment in UK infrastructure or our customers' bills.

Non-UK operations

Substantially all of the Group's revenues and profits are generated in the UK and are subject to UK tax. Details of the Group's overseas subsidiaries at 31 March 2018 are set out below:

- Severn Trent Response Limited is a 60% owned subsidiary company operating in Ireland. It designs, builds, operates and maintains water infrastructure assets in Ireland and is subject to Irish tax.
- Lyra Insurance Guernsey Limited and Derwent Insurance Limited are wholly owned subsidiary companies incorporated in Guernsey and Gibraltar respectively. They were established to provide insurance services to the Group. Both companies are subject to the UK Controlled Foreign Company ('CFC') rules and therefore the Group incurs tax at the UK Corporation Tax rate on their profits.
- Severn Trent Holdings SA is a wholly owned subsidiary company incorporated in Belgium. It was the holding company for businesses that the Group previously owned in Belgium. Following the disposal of those businesses the holding company was retained to deal with a number of legacy legal issues. These issues have now been resolved and the Group is considering options for liquidating the company. This company is subject to Belgian tax.
- Severn Trent Africa (Pty) Ltd is a dormant company incorporated in South Africa. It has no impact on the Group's tax.

Scope

This Tax Strategy covers the period ended 31 March 2018 and applies to Severn Trent Plc and its UK subsidiary undertakings. It is published in compliance with the Finance Act 2016 requirement for large businesses to publish their tax strategy.

Directors' remuneration report

Remuneration



Philip Remnant

Chairman of the Remuneration Committee

The Committee determines, on behalf of the Board, the Company's policy on the remuneration of Executive Directors, other members of the Executive Committee and the Chairman of the Board. The Committee determines the total remuneration packages and contractual terms and conditions for these individuals. The policy framework for remunerating all senior executive managers is consistent with the approach taken for Executive Directors. The Committee also provides oversight of all-employee reward, for example the annual bonus scheme, and reviews the cascade and alignment of reward throughout the Group.

The Remuneration Committee Terms of Reference were updated in March 2018 and can be found at www.severntrent.com.

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Term	Definition
AMP	Five year Asset Management Plan
Customer ODIs	Outcome Delivery Incentives which are important to customers
FD	Final Determination of price controls set by Ofwat for every five year AMP period
LTIP	Long Term Incentive Plan
PBIT	Profit Before Interest and Taxation
RoRCV	Return on Regulatory Capital Value
RoRE	Return on Regulated Equity
SIM	Service Incentive Mechanism
Totex	Total Expenditure (Capital Expenditure + Operational Expenditure)
UQ	Upper Quartile performance compared with peers
WaSCs	Water and Sewerage Companies

Chairman's Statement

Dear Shareholder,

Our performance

As a Remuneration Committee we are focused on ensuring that the reward our Executive Directors receive reflects the performance of the Company and remains proportionate to the overall employee base and to the returns received by shareholders. We are mindful of the external focus on executive pay and the need to ensure both fairness and transparency, challenging ourselves to make sure that we only reward for delivering for our customers and communities. The Committee scrutinises performance targets to ensure that there is always an appropriate link between performance and reward.

This is why we are particularly proud to be UQ for our customer satisfaction performance commitments, achieving fourth position in the utilities sector on the Institute of Customer Service's UK Customer Service Index and, whilst our SIM performance remains below our end of AMP target, we continue to focus time and energy on driving further improvement.

Through investing responsibly for sustainable growth, we have locked in a further £100 million of Totex efficiencies, taking our gross efficiencies for AMP6 to £870 million. Taking account of our £220 million total reinvestment plans, our net total outperformance versus our FD is £240 million, of which half will be shared with our customers through lower bills in AMP7. We are proud that we continue to have the lowest combined bills in Britain and moreover we exceeded our commitment to help 50,000 of our most vulnerable customers with their bills. In addition, strong financial performance continues, delivering RoRE of 11.5% calculated in line with the Ofwat measure (10.6% on the Severn Trent RoRE measure).

Across a large number of our customer ODI measures we have performed well and we are particularly proud of our continuing performance in waste water measures. We also know that we can do more in areas such as supply interruptions and in the last year management has reorganised the business to deliver greater focus on areas which we want to improve for our customers. We have achieved a customer ODI reward of £80.2 million, up from £47.4 million on the previous year.

As a large regional business and employer we are always conscious of the positive impact our performance can play in the communities that we serve. Our environmental leadership has led us to improve 9.86 hectares as we progress towards our 2020 target. We have supported over 40% of our employees to volunteer in their local area and, when it comes to employment, we are proud to have had our work to improve social mobility recognised in the first social mobility index.

Remuneration for the year under review

Overall, the business has continued to perform strongly in 2017/18 against a set of stretching annual bonus targets, which required the delivery of improvements across all areas, whilst navigating a number of challenging headwinds. Respective bonus outturns were 72.54% of salary for each of the CEO and CFO, out of a maximum annual bonus opportunity of 120% of salary.

LTIP awards based on RoRE over the three years to 31 March 2018 will vest in full for the CEO and the CFO. This is representative of outstanding performance in customer ODIs, financing and Totex.

There is a detailed breakdown on pages 111 to 114 of the targets set and the payments under the annual bonus and LTIP.

The new Remuneration Policy

The Company's current Remuneration Policy was approved by 97.99% of shareholders at the 2015 AGM. The votes in favour for the implementation of the Policy demonstrated through the annual votes on the Directors' remuneration report were 98.26% in 2016 and 97.30% in 2017. Given this level of shareholder support and the Committee's view that the current Remuneration Policy remains largely appropriate, the new Remuneration Policy is evolutionary rather than revolutionary.

The Company is proposing to put the new Remuneration Policy to shareholders for a binding vote at the AGM on 18 July 2018. Once approved, this Policy will operate for up to three years.

Aim of the new Remuneration Policy and link to our strategy

The Company's new Remuneration Policy focuses on delivering business priorities through a framework designed to promote the long-term success of Severn Trent and remains aligned with the interests of customers, shareholders and the communities which we serve. The Committee has endeavoured to construct a policy which has a fair and competitive approach to pay and which ensures that as a company we can attract and retain the best people with the skills to run this essential service efficiently and effectively for our customers.

At the heart of our business is ensuring the service and experience we provide meets the needs of our customers. We believe that the long-term success of our business should be aligned with this goal. As such, we positively welcome Ofwat's message that customers must be at the heart of AMP7 business plans. To reflect this, at least 28% of annual bonus will continue to relate to customer ODIs and customer experience, which we know are the measures that matter most to them, and to customer experience.

Within the LTIP, we have selected RoRE as our measure for 2018 LTIP awards. RoRE measures our success over three years in a range of areas, one being the all-important customer ODIs, and we believe that RoRE continues to be the most appropriate measure in terms of our long-term success.

Shareholder consultation

During the year, we embarked on an extensive shareholder consultation exercise with our largest shareholders and representative bodies on our new Remuneration Policy. We contacted our 30 largest shareholders representing over 50% of our issued share capital, as well as Glass Lewis, The Investment Association and ISS, to consult on proposed changes to our policy. The proposed changes discussed with shareholders were:

- Changing the annual bonus opportunity from 120% to 150% of salary for both the CEO and CFO;
- Changing the LTIP opportunity from 150% to 200% of salary for the CEO and 100% to 150% of salary for the CFO;
- Recalibrating the current stretch target as target and introducing a new stretch target of UQ performance;
- Introducing a two year post-vesting holding period for new awards under the LTIP which will continue to operate post cessation of employment;
- Increasing the minimum shareholding requirement from 200% to 300% of salary for the CEO and 150% to 200% of salary for the CFO; and
- Reducing the maximum pension contribution to 15% of salary, in line with the general workforce, for new Executive Directors.

The feedback and responses received on the proposed changes were positive and supportive overall of the Committee's approach. Having listened carefully to that feedback, we decided not to progress with the increase in the bonus opportunity. This recognised a preference from a number of shareholders that any quantum increase be provided through the LTIP.

The table following this letter sets out full details of the Committee's rationale for the proposed changes to the current policy, shareholder feedback during the consultation and the final position reached.

Directors' remuneration report continued

Remuneration

Wider workforce considerations and our approach to fairness

Through being a successful business we can create good jobs in our community and value for colleagues by offering a competitive total reward package. This includes a bonus for all, flexible benefits and a market-leading defined contribution pension scheme as well as a competitive salary. We are in the unusual position in our sector that social mobility is weak in many of the areas in which we operate, so we believe we have a role to invest well to build secure employment opportunities and create fulfilling careers for our colleagues. Over half of our employees have joined from areas of lower social mobility and benefit not just financially, but from our training, development and career opportunities.

We recognise the central importance of all of our teams in delivering success which is why one of our five key strategic goals is to create an awesome place to work for them. We understand that this will mean different things to different people and seek to create a working environment which enables everyone to contribute fully and be the best they can be. Our annual employee engagement survey shows a significant increase in overall engagement of six percentage points.

The Committee and management are committed to fair pay across the organisation. We continue to see diversity and inclusion as central to everything we do and we are pleased to report a relatively low mean gender pay gap of 2.4%.

To ensure the voice of our employees is heard, we have an active Company employee forum which meets every quarter to discuss business challenges and opportunities. The forum is chaired jointly by a member of the Executive Committee and the Trade Unions. Members include representatives from HR, joint Trade Unions and employees from our other business area employee forums. The objectives of the Company employee forum are to:

- Involve employees by sharing information on the future of our business and the water industry;
- Work together on issues that affect our employees; and
- Work in partnership to deliver better solutions to improve the way we work.

During 2017/18, the CEO discussed with the Company employee forum the performance of the business, key financial information and ideas for efficiencies. We have already taken steps to utilise further this forum in line with the draft FRC UK Corporate Governance Code. The Chairman has attended his first meeting and will be attending on an annual basis to share views and seek feedback to ensure the Board is able to consider the views of employees in its decision making.

More information relating to the wider workforce can be found on page 108.

Board changes

Emma FitzGerald was appointed to the Board on 1 April 2016 and stepped down on 31 December 2017 following the successful completion of the restructuring of the wholesale operating model. Details of Emma's remuneration relating to her time on the Board, during 2017, are contained within this report.

Structure of the report

This year, we include a comprehensive explanation of our proposed Remuneration Policy which will be put to shareholders for approval at the 2018 AGM. This can be found after the Annual Report on Remuneration section starting on page 120.

I am grateful for the time and input shareholders and their representative bodies have given us throughout the engagement process. I trust that we can rely on your vote in support of our approach to remuneration and the proposed Remuneration Policy. If you would like to discuss any aspect of this report, I would be happy to hear from you. You can contact me through Bronagh Kennedy, Company Secretary and Group General Counsel.

Philip Remnant

Chairman of the Remuneration Committee

The table below sets out full details of the Committee's rationale for the proposed changes to the current Policy, shareholder feedback during the consultation and the final position reached.

Key points	Committee's rationale	Majority view of shareholders consulted	Final proposals												
Increase in quantum	<p>The Committee's rationale was as follows:</p> <ul style="list-style-type: none"> • The Executive Directors were inexperienced at the time the current Policy was introduced and incentive levels reflected this. The Committee believes that the Executive Directors are now fully embedded in the business and over the past three years they have performed successfully in their roles, demonstrating an exceptional level of commitment in executing the business strategy for the benefit of our shareholders, customers and the wider community; • The Committee wants to provide an appropriate level of incentive opportunity to deliver a competitive total remuneration package that retains and motivates a truly exceptional management team for the rest of this AMP and into the next; • The Committee is keen to ensure that there is an appropriate level of incentive opportunity in the remuneration to reflect the greater focus of Ofwat on the relative performance of WaSCs and the tougher regulatory context during AMP7; and • It should be noted that even with the proposed increase in quantum the total remuneration available to the Company's Executive Directors is around the median for the FTSE 51-150, the Committee's main external reference point. See page 106 for further details. 	<p>Shareholders were supportive of the increase in quantum for longer term performance measured through the LTIP. While in general shareholders were also supportive of a proposed increase to the annual bonus maximums, there was a concern about increasing the bonus opportunity in the current environment. In addition, in general the preference of shareholders was for any increase in quantum to be focused on the LTIP.</p>	<p>Based on this feedback, the Committee determined to make increases to the LTIP quantum only.</p> <p>The proposed policy sets out the following maximum annual LTIP grants (current policy in brackets):</p> <ul style="list-style-type: none"> • CEO 200% of salary (150%); • CFO 150% of salary (100%). <p>It should be noted that the increase in the LTIP opportunity has been accompanied by an increase in the stretch of the performance conditions (see below).</p>												
Type of LTIP performance condition	<p>The Committee proposed RoRE as the sole performance condition for the LTIP (as is the case for the current policy). The Committee's rationale was as follows:</p> <ul style="list-style-type: none"> • RoRE is a holistic measurement of performance requiring management to focus on performance across a range of areas such as Totex, customer ODI and financing which help measure long-term success within the business. Therefore, whilst it is a single measure, delivering the RoRE performance requires the Executive Directors to deliver on a number of Company KPIs; and • RoRE is the primary measure used by Ofwat to measure the performance of the Company and other WaSCs. In addition, Ofwat calculates and ranks RoRE for the WaSCs giving an independently verified and comparable value for the Company. 	<p>During the consultation a number of different performance measures were discussed with shareholders. However, on engagement with the Committee the general view of shareholders was that RoRE was the key long term metric for the Company and appropriate as the sole performance condition for the LTIP.</p>	<p>Given the strong level of shareholder support the Committee determined to proceed with its proposal to retain RoRE as the performance condition for the LTIP.</p>												
Calibration of LTIP performance condition	<p>The Committee proposed a new calibration of the RoRE targets for 2018 LTIP grants:</p> <table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th></th> <th>Threshold FD % Salary No change</th> <th>1.39 x FD % Salary No change</th> <th>UQ RoRE Compared with WaSCs % Salary New maximum</th> </tr> </thead> <tbody> <tr> <td>CEO</td> <td>37.5%</td> <td>150%</td> <td>200%</td> </tr> <tr> <td>CFO</td> <td>25%</td> <td>100%</td> <td>150%</td> </tr> </tbody> </table> <p>The Committee is setting these targets for the 2018 LTIP grant. The Committee will review the targets in 2019 as two years of the performance period will be in the new AMP7.</p> <p>Current maximum vesting (2016 and 2017 awards) occurs for 1.39x FD (7.78% return).</p> <p>The Committee wants to ensure that any additional incentive opportunity can only be earned through even more stretching performance. The rationale for the use of the UQ comparison against other WaSCs is that:</p> <ul style="list-style-type: none"> • It ensures full vesting is only achieved for UQ comparative performance. At the point of AMP change over it is difficult to set an absolute target for UQ performance; and • It aligns with the Company's aspirations to remain an UQ performer. 		Threshold FD % Salary No change	1.39 x FD % Salary No change	UQ RoRE Compared with WaSCs % Salary New maximum	CEO	37.5%	150%	200%	CFO	25%	100%	150%	<p>Shareholders supported:</p> <ul style="list-style-type: none"> • The introduction of a comparative element to RoRE; and • The increased performance stretch required to earn the additional incentive opportunity. 	<p>Given the strong level of shareholder support the Committee determined to proceed with its proposed calibration of the RoRE performance condition for the 2018 LTIP awards, accompanied by an increase in the stretch of the performance conditions.</p>
	Threshold FD % Salary No change	1.39 x FD % Salary No change	UQ RoRE Compared with WaSCs % Salary New maximum												
CEO	37.5%	150%	200%												
CFO	25%	100%	150%												

Directors' remuneration report continued

Remuneration

Key points	Committee's rationale	Majority view of shareholders consulted	Final proposals
Addition of holding period to the LTIP	The Committee's rationale was to provide further alignment with shareholders' interests and to bring the LTIP into line with best practice.	This change was universally supported by shareholders.	Introduction of a two year holding period post vesting for Executive Directors which will continue to operate post cessation of employment.
Increase in the minimum shareholding Requirement	The Committee's rationale was to provide further alignment with shareholders' interests.	This change was universally supported by shareholders.	Increase in requirement: <ul style="list-style-type: none">• CEO 300% of salary (200% current); and• CFO 200% of salary (150% current).
Reduction in maximum pension contribution	The Committee's rationale was to align pension contribution quantum for new Executive Directors with pension contribution for the wider workforce.	This change was universally supported by shareholders.	No change for current Executive Directors. New appointments will have a maximum pension contribution of 15% of salary (25% current).

At a Glance

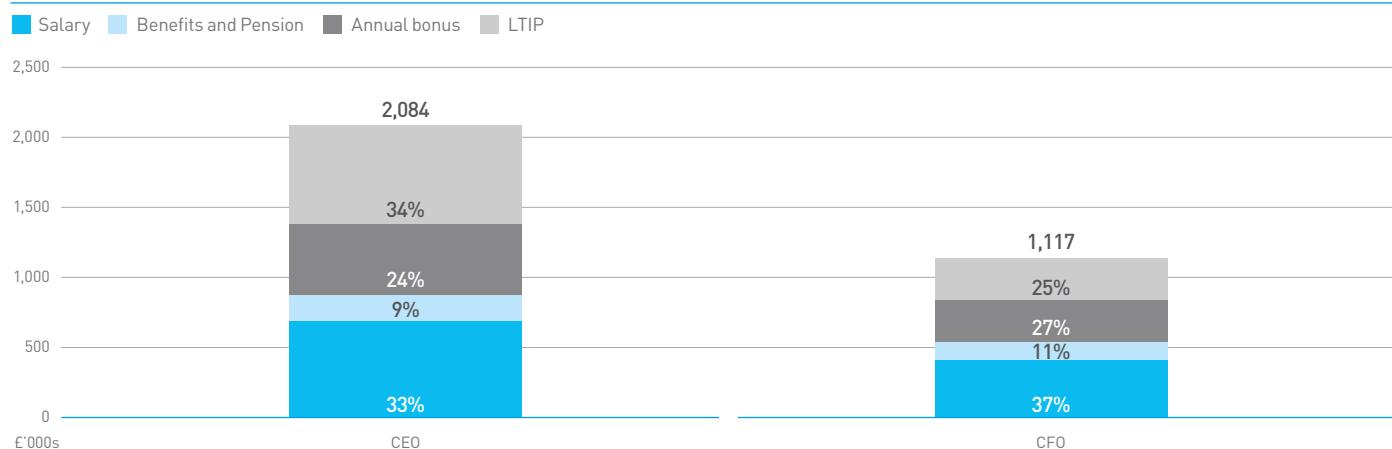
Shareholders approved Severn Trent's Remuneration Policy at the 2015 AGM (set out in full in the 2015 Annual Report). As highlighted last year, and in line with regulations, Severn Trent is now seeking shareholder approval for a new Remuneration Policy at the 2018 AGM, after which the new Remuneration Policy will come into effect and govern pay arrangements for our Executive Directors for the next three years.

The following section sets out our remuneration framework, how our previous Remuneration Policy was applied in 2017/18 and how the Committee intends to implement the proposed Remuneration Policy in 2018/19.

2017/18 Remuneration outcomes

Single figure remuneration 2017/18

This table shows how the successful delivery of our strategy has flowed through to the rewards provided to our Executive Directors. The table and chart below provide a summary total single figure of remuneration for 2017/18. We note that Emma FitzGerald (Managing Director, Wholesale Operations) stepped down from the Board in December 2017. The 'At a Glance' section contains remuneration for the CEO and CFO only. The full explanatory notes for each element of remuneration are detailed on page 110 in the Annual Report on Remuneration.



Executive Directors	Year	Salary (£'000) ⁽ⁱ⁾	Benefits (£'000)	Annual bonus (£'000)	LTIP (£'000)	Pension (£'000)	Other (£'000)	Total 2017/18 (£'000)
CEO	2017/18	687.2	17.7	501.0	706.6	171.8	-	2,084.3
CFO	2017/18	414.2	18.7	301.9	278.3	103.5	-	1,116.6

(i) Salaries are shown before the deduction of benefits purchased through the Company's salary sacrifice scheme.

Governance

Directors' remuneration report continued

Remuneration

Annual bonus scheme 2017/18

An annual bonus of 72.54% of salary for each of the CEO and CFO was awarded. Further details are set out on page 111 in the Annual Report on Remuneration.

	Threshold (0% payable)	Target (50% payable)	Maximum (100% payable)	Weighting	Outcome achieved
STW PBIT	£151.8m	£529.2m	£542.6m	47%	21%
		Actual: £527.6m			
Customer ODIs	£13m	£23m	£33m	20%	20%
			Actual: £80.2m		
Business Services PBIT	£35.6m	£36.6m	£37.6m	10%	10%
			Actual: £38.1m		
Health and safety ⁽ⁱ⁾	0.20	0.16	0.12	8%	2%
		Actual: 0.17			
Customer experience ⁽ⁱⁱ⁾	15%	20%	25%	8%	2%
		Actual: 17.20%			
Personal performance		Details on pages 112 and 113		7%	6% – CEO 6% – CFO

(i) Measured as number of lost time incidents divided by number of hours worked multiplied by 100,000.

(ii) Measured as the percentage reduction in complaints.

LTIP 2015/18

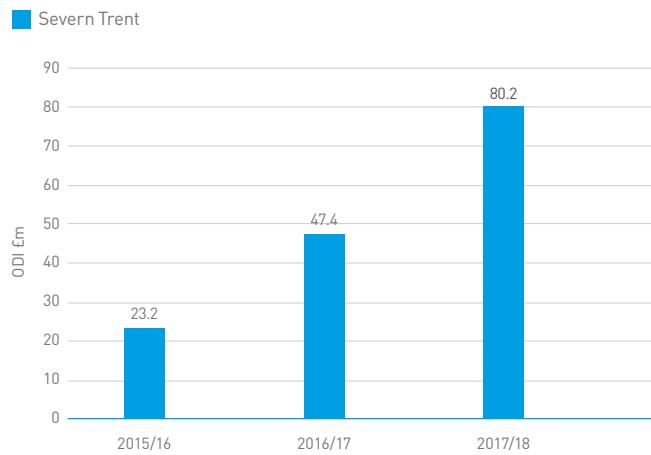
The 2015 LTIP vested at 100% of maximum. Further information is provided on page 114 in the Annual Report on Remuneration.

	Threshold (25% payable)	Maximum (100% payable)	Vesting outcome as % of award	
			CEO	CFO
RoRE – measured as multiple of Ofwat FD	FD	1.29x	100%	100%
		Actual: 1.79x		

Link between long-term performance and the remuneration outcomes

The charts below show our customer ODI and RoRE performance since the beginning of the current AMP. This strong sustained level of performance has informed the level of reward received by our Executive Directors and our employees through the company-wide bonus scheme, which is linked to the same performance measures.

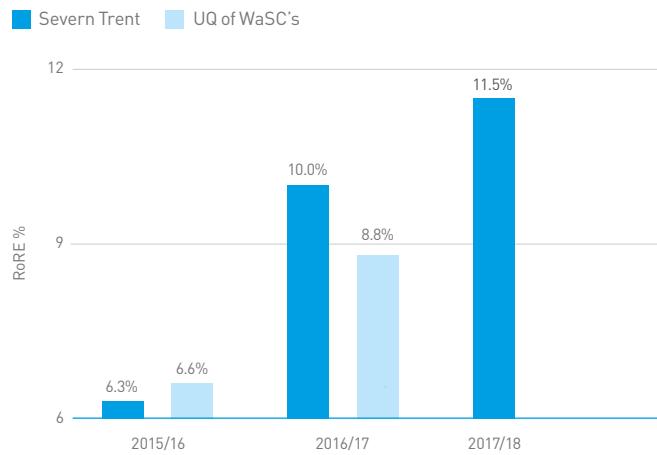
Severn Trent performance – ODI £m⁽ⁱ⁾



(i) ODIs gross of tax.

(ii) Calculated in accordance with Ofwat methodology. UQ data not yet available for the current year.

Severn Trent performance – RoRE %⁽ⁱⁱ⁾



Remuneration principles

The remuneration principles which underpin our policy support our strategic priorities, align our interests with those of customers and inform the decisions made by the Committee in relation to executive pay. Our core remuneration principles are as follows:

Simplicity	Relevance	Objectivity	Competitive
The Remuneration Policy should support transparency in terms of design and communication to internal and external stakeholders.	Reward will be relevant to our business goals and objectives, and be affordable. Remuneration outcomes should mirror the customer, shareholder, employee and wider stakeholder experience. The Remuneration Policy should clearly link individual pay outcomes to corporate results.	Performance measures and targets for incentive plans will be objectively determined. The Remuneration Policy should support potential changes in business priorities over time.	Remuneration will be aligned to support the interests of our shareholders. The Remuneration Policy should provide opportunity which is competitive against companies of a similar size and complexity with a strong emphasis on variable elements.

Directors' remuneration report continued

Remuneration

Strategic alignment of remuneration

The Committee believes it is important that for Executive Directors, and senior management, a significant proportion of the remuneration package is performance-related and that performance conditions applying to incentive arrangements support the delivery of the Company's strategy through our five strategic priorities. The following table sets out how each of these are reflected in the annual bonus and LTIP.

	Strategic priorities	Embed customers at the heart of what we do	Drive operational excellence and continuous innovation	Investing responsibly for sustainable growth	Change the market for the better	Create an awesome place to work
Annual bonus	PBIT		✓			
	Customer ODIs	✓	✓			
	Health and safety		✓			✓
	Customer experience	✓				
	Personal objectives	✓	✓	✓	✓	✓
LTIP	RoRE	✓	✓	✓		

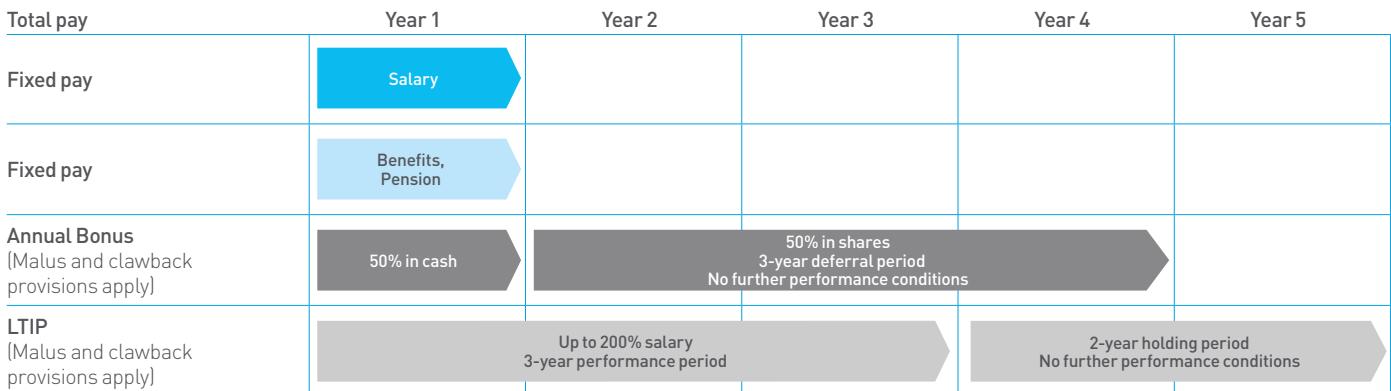
Summary of Remuneration Policy, proposed amendments and implementation in 2018/19

Shareholders approved the Remuneration Policy at the AGM in 2015 (97.99% voted in favour). As such, the Company is required to seek approval for the new policy at the 2018 AGM. The table below sets out an overview of the key areas of the policy and summarises how the Committee is proposing to implement the policy in 2018/19. Full details of the proposed policy can be found on pages 120 to 128.

The Committee believes that the fundamental architecture of the Executive Directors' remuneration package is appropriate but we have made a number of evolutionary changes to the previous Remuneration Policy to reflect the development of the Company, our Executive Directors and the latest corporate governance best practice:

- Pension contributions for any new Executive Directors will be capped at 15% of salary in line with other employees;
- The maximum LTIP award opportunity will be increased to 200% of salary for an additional stretch performance of UQ;
- A two year holding period will apply following the vesting of LTIP awards for the Executive Directors (this holding period will continue post cessation of employment); and
- The minimum shareholding requirement will be increased to 300% of salary for the CEO and 200% of salary for other Executive Directors.

The diagram below illustrates the balance of pay and time period of each element of the proposed Remuneration Policy for Executive Directors.



The Company's Remuneration Policy remains to attract, retain and motivate its leaders and to ensure they are focused on delivering business priorities within a framework designed to promote the long term success of Severn Trent, aligned with shareholder interests. The table below sets out the key components of the Executive Directors' remuneration package, including the proposed changes from the current Remuneration Policy along with rationale. Further information regarding the proposed Remuneration Policy is set out on pages 120 to 128 of this report.

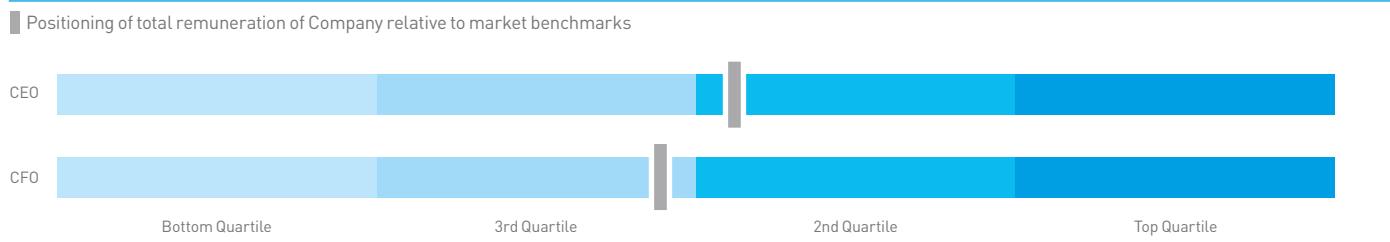
Element and link to strategy	Key features of current Policy	Policy change	How we will implement the proposed Policy in 2018/19
Salary To recruit and reward Executive Directors of a suitable calibre for the role and duties required.	<ul style="list-style-type: none"> Salaries for individual Executive Directors are reviewed annually by the Committee and normally take effect from 1 July. To the extent that increases are proposed, these will not be higher than the average increase for employees. 	No change.	<p>A salary increase of 2.5% will be applied at the salary review date. From 1 July 2018, Executive Director salaries will be:</p> <ul style="list-style-type: none"> CEO – £708,000 CFO – £426,600 <p>These rises are lower than the general employee salary increase.</p>
Benefits To provide competitive benefits in the market to enable the recruitment and retention of Executive Directors	<ul style="list-style-type: none"> The value of benefits is based on the cost to the Company and there is no pre-determined maximum limit. The range and value of the benefits offered is reviewed periodically 	No change.	Normal company benefit provision.
Pension To provide pension arrangements comparable with similar companies in the market to enable the recruitment and retention of Executive Directors.	<ul style="list-style-type: none"> A defined contribution scheme and/or cash supplement in lieu of pension. Maximum pension contribution of 25% of salary. 	<ul style="list-style-type: none"> For current Executive Directors, the maximum pension contribution will remain at 25% of salary. For future appointments the maximum pension contribution will be capped at 15% of salary. This is in line with the level provided to the wider workforce. 	<p>Executive Director pension arrangements for 2018/19 are as follows:</p> <ul style="list-style-type: none"> CEO – 25% of salary CFO – 25% of salary
Annual bonus To encourage improved financial and operational performance and align the interests of Executive Directors with shareholders through the partial deferral of payment in shares.	<ul style="list-style-type: none"> Maximum award of 120% of salary. There will be no payment made for threshold performance. 50% of total bonus deferred into shares for three years (with the value of any dividends to be rolled up and paid on vesting). 50% of maximum will be paid for target performance and 100% of maximum will be paid for stretch performance. Malus and clawback provisions apply. 	No change.	<p>The following maximum opportunities will apply in 2018/19:</p> <ul style="list-style-type: none"> CEO – 120% of salary CFO – 120% of salary <p>The weightings of performance measures in the annual bonus will be as follows:</p> <ul style="list-style-type: none"> Regulated Water and Waste Water PBIT – 47% Business Services PBIT – 10% Customer ODI – 20% Health & safety – 8% Customer experience – 8% Personal objectives – 7% <p>The Committee considers the forward-looking targets to be commercially sensitive but full disclosure of the targets and performance outcome will be set out in the year's remuneration report setting out the bonus outcomes.</p>
LTIP To encourage strong and sustained improvements in financial performance, in line with the Company's strategy and long term shareholder returns	<ul style="list-style-type: none"> Maximum award of 150% of salary. Awards are granted annually and are subject to a three year performance condition being RoRE. Malus and clawback provisions apply. 	<ul style="list-style-type: none"> Increase in maximum award opportunity to 200% of salary. The Committee will ensure that the increased opportunity is reflected in the level of challenge in the LTIP targets and has introduced a stretch target based on UQ performance. Introduction of a two year holding period post-vesting which will continue to operate post-ceasation of employment. 	<p>The following grant levels will apply in 2018/19:</p> <ul style="list-style-type: none"> CEO – 200% of salary CFO – 150% of salary <p>RoRE will remain the sole LTIP performance condition, with the addition of a stretch target. RoRE is calculated as profit after tax [plus incentives earned in the year] divided by the average equity proportion of our regulatory capital value, as prescribed by Ofwat.</p> <p>See page 99 for details of the RoRE target for the 2018 LTIP awards.</p>
Shareholding requirement To encourage strong shareholder alignment and interests of Executive Directors with the rest of the workforce.	<ul style="list-style-type: none"> The CEO is expected to build and maintain a holding of shares to the value of 200% of salary, and other Executive Directors 150% of salary. Executive Directors are expected to retain all of the net of tax number of shares they receive through the LTIP and deferred share bonus until the shareholding requirement has been met. 	<ul style="list-style-type: none"> Increase in minimum shareholding requirement to 300% of salary for the CEO and 200% of salary for other Executive Directors. Other terms of the shareholding requirement remain. 	Application of the new shareholding requirement.

Directors' remuneration report continued

Remuneration

Our policy quantum compared with peers

The following table shows the relative position of target total compensation under the proposed policy for our Executive Directors compared with the FTSE 51-150.

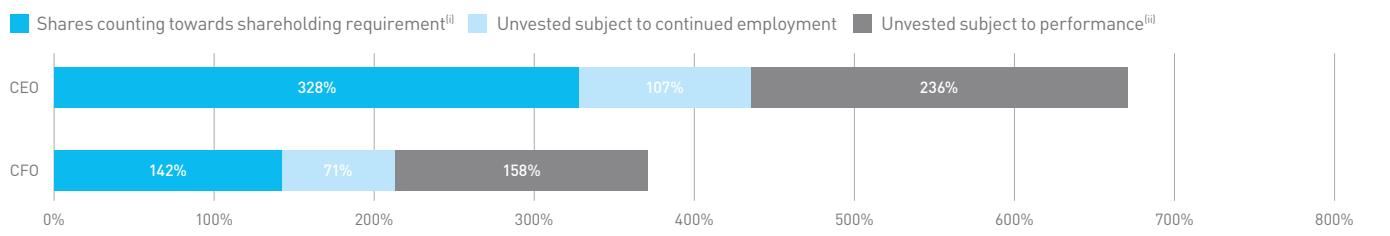


When we set the remuneration for the Executive Directors, one of the factors the Committee considers is the relevant market for Executive Directors, which we believe is the FTSE 51-150, and the size of the Company compared with these peers. The Company is around the median by market capitalisation and the proposed target total compensation has been set broadly in line with this position.

Shareholding requirement

The minimum shareholding requirement for Executive Directors is set out below. It must be built up over a five year period and then subsequently held. The table below sets out the current share interests of the Executive Directors taking into account shares which are owned outright or vested, shares which are unvested and shares which are subject to performance.

Share interests



(i) Represents beneficially owned shares as well as shares held in trust as part of the annual bonus deferred share awards (of which 50% deducted to cover statutory deductions).

(ii) Represents the 2016 and 2017 LTIP awards which are subject to performance.

Calculated using the closing share price on 31 March 2018 of £18.44.

The CEO has exceeded the shareholding requirement applicable in 2017/18 of 200% of salary and the CFO is close to exceeding the shareholding requirement applicable in 2017/18 of 150% of salary.

Overall link to remuneration and equity of the Executive Directors

As a Committee we want to incentivise Executive Directors to take a long term, sustainable view of the performance of the Company. That is why when we look at the remuneration paid in the year we also look at the total equity they hold in relation to the performance of the Company. The ability of Executive Directors to lose and gain, dependent on share price performance, can have a material impact on their total remuneration and is a central focus of our Remuneration Policy.

The following table sets out the single figure for 2017/18, the number of shares beneficially owned by the Executive Director at the beginning and end of the financial year and the impact on the value of these shares taking the opening price and closing price for the year.

	2017/18 Single Figure	Shares held at start of year	Shares held at end of year	Value of shares at start of year [£'000s] ⁽ⁱ⁾	Value of shares at end of year [£'000s] ⁽ⁱⁱ⁾	Difference [£'000s]
CEO	2,084.3	75,127	103,274	£1,789.5	£1,904.4	+£114.9
CFO	1,116.6	15,263	23,464	£363.6	£432.7	+£69.1

(i) Based on a closing share price on 31 March 2017 of £23.82.

(ii) Based on a closing share price on 31 March 2018 of £18.44.

Chairman and Non-Executive Directors' fees (audited)

From 1 April 2018, Non-Executive Director fees were increased by 3% from £53,450 to £55,100 and the Chairman's fee was increased by 2.5% from £280,500 to £287,600. These increases are in line with the general employee salary increase.

The current fee levels and those for the future financial year are set out in the table below:

	Fees 2018/19	Fees 2017/18	Increase %
Chairman's fee	£287,600	£280,500	2.5%
Fee paid to all Non-Executive Directors	£55,100	£53,450	3.0%
Supplementary fees:			
- Senior Independent Director	£10,000	£10,000	0.0%
- Audit Committee Chairman	£15,000	£15,000	0.0%
- Remuneration Committee Chairman	£15,000	£15,000	0.0%
- Corporate Responsibility Committee Chairman	£13,000	£13,000	0.0%
- Treasury Committee Chairman	£15,000	£15,000	0.0%

The Chairman and Non-Executive Directors normally serve for terms of three years. The current expiry dates of their letters of appointment are Kevin Beeston (1 June 2019), Dominique Reiniche (20 July 2019) John Coghlan (23 May 2020), Andrew Duff (9 May 2019), Philip Remnant (31 March 2020) and Dame Angela Strank (24 January 2020). However, all of the Directors are subject to annual appointment or reappointment at the AGM.

Directors' remuneration report continued

Remuneration

Employment at Severn Trent

We recognise the central importance of all of our teams in delivering success and as such we seek to create an inclusive working environment, reward our employees in a fair and equitable manner and provide fulfilling careers. We do this by providing all our employees with:

Item	Details
Market competitive pay	Our approach is to position ourselves as a market median payer, balancing competitive pay for employees with responsible use of our customers' money. Employees who are not on a training rate of pay (such as apprentices) receive at least the voluntary Living Wage. We also closely monitor the rates of pay of people who are training with us to make sure they remain fair and competitive. Our 2018 Apprentice starting rate is £14,926 and 2018 Graduate starting rate is £26,500.
Sharing in success	We want our employees to share in our success and our all-employee bonus plan is based on Company performance, ensuring all employees are aligned with the same measures and rewarded for achieving our key objectives. For this year the bonus paid out £964 to 88.5% of our frontline employees in Severn Trent Water Limited and Dee Valley Water Limited. Those who were not eligible were new starters after the beginning of January 2018. 71% of our people are active participants in our Sharesave scheme which gives employees a chance to save up to £500 per month over three or five years, with the option to buy Severn Trent Plc shares at a discounted rate at the end of the period.
Flexibility	We provide a flexible benefits scheme for all, which we believe is amongst the best in the industry. Including insurance and health cover with retail and childcare vouchers, it is designed to support a positive work-life balance. 45% of our people choose to tailor their benefits via our flexible benefits scheme, saving a combined total of £40,000 on everything from everyday essentials to holidays and luxuries through our employee discount partnerships.
An opportunity to save for the future	We know many of our colleagues want to be able to save for their future security. We offer a market leading defined contribution pension scheme and double any contributions that employees make (up to a maximum of 15% of salary), regardless of level or seniority. When colleagues get closer to retirement, we provide education and support to help plan for the next stage of their lives. We are proud that 98% of our people are members of the pension scheme and 57% pay contributions above the statutory minimum 3%.
Building a career	As a major regional employer, we recognise the importance of equipping our colleagues with the skills for now and the future. Our focus is on both leadership and technical development across the whole organisation. We support the development of colleagues at all stages of their career, from foundation apprenticeships and graduate entrants, through to higher level apprenticeships and Masters degrees. Our aim is to ensure that every employee feels competent and confident in their everyday work.
Diversity and inclusion	Our employees tell us we are doing well on diversity and inclusion, through great scores in our employee engagement survey, but we know there are opportunities to reflect better the demographics of our region. We are recognised for leading performance in the FTSE 100 for women's representation at Board and Executive Committee level and our mean gender pay gap for the year was just 2.4%. This year we have also launched our menopause awareness programme, supported by our Trades Unions. Our apprenticeship scheme has a Black, Asian and Minority Ethnic ('BAME') representation of 9.6% and this is 15.3% for our graduate scheme.
Investing in the community	Our education and work experience programmes now actively focus on the areas of lowest social mobility in our region. We already have a strong track record of creating jobs in these areas, with over half of our employees from areas outlined by the Social Mobility Commission, but we want to do more. Our employee volunteering programme gives all employees two paid days per year to participate in voluntary work in our community. This year saw participation numbers increase to 40%.

Diversity and inclusion policies

We continue to focus on long term improvement through our diversity and inclusion policies:

Developing role models	We believe that strong role models inspire more junior employees and demonstrate an inclusive culture to potential candidates. We are leading the way on senior leader gender diversity, placing us ahead of many of our industry peers.
Reflecting the communities we serve	We have increased our programme of school career events over the last two years, helping to broaden the range of students who are aware of Severn Trent and the career opportunities we offer.
Changing the way we recruit	During 2016, we moved to a strengths-based interview process for our graduate and apprentice positions. This is helping us to understand the potential of each candidate and remove bias throughout the process. We want to attract candidates who share the same passion about the water industry and understand the needs of the communities we serve.
Breaking down stereotypes	We are making progress in attracting more diverse candidates into roles that require science, technology, engineering and mathematics ('STEM') backgrounds. By taking part in engineering initiatives aimed at women, including National Women in Engineering Day, we are raising our profile among prospective applicants. The challenge to increase diversity in these areas is longer term and we will continue to face a challenge to recruit female employees if we do not receive a sufficient level of applications to these roles.

Gender Pay Gap Reporting

We reported our Gender Pay Gap in November 2017 in line with statutory requirements. The data was based on 5 April 2017 and showed a mean gap of 2.4% and a median gap of 14.6%. The relatively low mean gap is predominately due to our senior gender diversity. The higher median gap is representative of occupational segregation. We have a large number of operational roles which attract shift, on-call and stand-by allowances, and these roles are principally held by men.

By way of comparison, the average mean and median gaps for those WoCs and WaSCs that have reported data is 11.9% and 15.3% respectively.

Our full Gender Pay Gap report can be found on www.severntrent.com

Alignment of pay throughout Severn Trent

The Committee is keen that remuneration decisions are made in the context of the cascade of reward structures throughout the business, shown in the diagram below:

Element of pay	CEO	Board	Executive Committee	Senior Management	Management	Wider workforce
Salary	✓	✓	✓	✓	✓	✓
Annual bonus (all employees aligned to the same measures)	✓	✓	✓	✓	✓	✓
LTIP	✓	✓	✓	✓ ⁽ⁱ⁾	✓ ⁽ⁱ⁾	
Pension	✓	✓	✓	✓	✓	✓
Benefits	✓	✓	✓	✓	✓	✓

(i) A proportion of this population participate in the LTIP by annual invitation.

Percentage change in the remuneration of the CEO

The table below shows the movement in salary, benefits and annual bonus for the CEO between the current and previous financial year compared with that of the average employee. The Committee looks to ensure that the approach to fair pay is implemented in practice throughout the Company.

	CEO (£'000)			Average per employee (£'000)		
	2017/18	2016/17	% Change	2017/18	2016/17	% Change
- Salary ⁽ⁱⁱ⁾	690.6	677.0	2%	30.5	29.9	2% ^(iv)
- Benefits ⁽ⁱⁱⁱ⁾	17.7	18.0	-1.7%	0.4	0.4	0%
- Bonus ⁽ⁱⁱⁱ⁾	501.0	615.8	-18.6%	1.8	2.0	-11%

(i) The salary figures shown are based on full time equivalent comparisons.

(ii) The benefits figures include car allowance and family level private medical insurance for senior and middle managers.

(iii) The figures shown are reflective of any bonus earned during the respective financial year. Bonuses are paid in the following June.

(iv) The average pay increase for the wider workforce during the year was 2%.

The Committee has elected to use the average earnings per employee as this avoids the distortions that can occur to the Company's total wage bill as a result of movements in the number of employees. The comparator group used is Severn Trent employees in the UK as this is where the vast majority of employees are based.

Directors' remuneration report continued

Remuneration

Annual Report on Remuneration

The Annual Report on Remuneration and the Annual Statement will be put to an advisory shareholder vote at the Annual General Meeting on 18 July 2018. The information on pages 110 to 119 is audited.

Total single figure of remuneration (audited)

The total single figure of remuneration table below sets out the remuneration received by the Directors for 2017/18 (or for performance periods ending in 2017/18 in respect of the long term incentives) and, for the purposes of comparison, for 2016/17. Where necessary, further explanations of the values provided are included below. This table and the explanatory notes below this table have been audited.

Executive Directors	Year ending 31 March 2018						Year ending 31 March 2017							
	Salary and fees (£'000) ⁽ⁱ⁾	Benefits (£'000) ⁽ⁱⁱ⁾	Annual bonus (£'000) ⁽ⁱⁱⁱ⁾	LTIP (£'000) ^(iv)	Pension (£'000) ^(v)	Other (£'000) ^(vi)	Total (£'000)	Salary and fees (£'000) ⁽ⁱ⁾	Benefits (£'000) ⁽ⁱⁱ⁾	Annual bonus (£'000) ⁽ⁱⁱⁱ⁾	LTIP (£'000) ^(iv)	Pension (£'000) ^(v)	Other (£'000) ^(vi)	Total (£'000)
Liv Garfield	687.2	17.7	501.0	706.6	171.8	–	2,084.3	673.7	18.0	615.8	948.1	168.4	–	2,424.0
James Bowling	414.2	18.7	301.9	278.3	103.5	–	1,116.6	406.0	19.8	368.7	315.8	101.5	–	1,211.8
Emma FitzGerald ^(viii)	302.4	13.1	209.8	271.3	75.6	–	872.2	395.9	17.6	360.2	324.3	99.0	–	1,197.0
Non-Executive Directors	Salary and fees (£'000)	Benefits (£'000)	Annual bonus (£'000)	LTIP (£'000)	Pension (£'000)	Other (£'000)	Total (£'000)	Salary and fees (£'000)	Benefits (£'000)	Annual bonus (£'000)	LTIP (£'000)	Pension (£'000)	Other (£'000)	Total (£'000)
Andrew Duff (Chairman)	280.5	–	–	–	–	–	280.5	275.0	–	–	–	–	–	275.0
John Coghlan	83.5	–	–	–	–	–	83.5	67.4	–	–	–	–	–	67.4
Philip Remnant	68.5	–	–	–	–	–	68.5	67.4	–	–	–	–	–	67.4
Kevin Beeston	63.5	–	–	–	–	–	63.5	50.7	–	–	–	–	–	50.7
Dominique Reiniche	53.5						53.5	36.6						36.6
Dame Angela Strank	66.5	–	–	–	–	–	66.5	61.5	–	–	–	–	–	61.5

- (i) Salaries are shown before the deductions of benefits purchased through the Company's salary sacrifice scheme, such as pension contributions via salary sacrifice – this is consistent with the approach taken last year.
- (ii) Benefits include a car allowance of £15,000 p.a., family level private medical insurance, life assurance worth six times salary and participation in an incapacity benefits scheme.
- (iii) The annual bonus is paid 50% in cash and 50% in shares with the portion deferred into shares subject to an additional holding period of three years with no further performance conditions attached.
- (iv) This relates to the vesting of the 2015 LTIP which is based on RoRE performance over the three year period to 31 March 2018. The value of the shares has been estimated using the average share price for the period from 1 January 2018 to 31 March 2018 of £18.69.
- (v) The Executive Directors' pension provision is equal to 25% of salary. No Executive Directors accrued benefits under any defined contribution pension plans during the year or have participated in a defined benefits scheme while an Executive Director.
- (vi) This relates to the vesting of the third tranche of James Bowling's and the second tranche of Emma FitzGerald's Recruitment Award. The performance condition for these awards was the same as for the 2015 LTIP grant, which was based on RoRE performance over the three year period to 31 March 2018. The awards vested at 100% and the figures shown have been updated to reflect their actual share price on vesting (£22.37).
- (vii) This figure relates to taxable expenses relating to travel.
- (viii) Stepped down from the Board on 31 December 2017. Amounts for Emma FitzGerald are pro-rated for the period in which she was an Executive Director, with one exception of the vesting of the 2015 LTIP award.

Salary for 2017/18 (audited)

Salaries for individual Executive Directors are reviewed annually by the Committee and normally take effect from 1 July. The Committee considered the Executive Directors' pay review in July 2017 in light of pay review budgets across the Group. As a result, the Committee determined that the salaries for the Executive Directors would increase by 2% in 2017/18, in line with the average increase that applied to the general UK workforce. For 2018/19, a 2.5% increase to salaries for Executive Directors has been agreed, lower than the average increase that will apply to the general UK workforce.

	Salary 01/07/2017	Salary 01/07/2018	Percentage increase
CEO	£690,600	£708,000	2.5%
CFO	£416,200	£426,600	2.5%

Benefits for 2017/18 (audited)

The value of benefits is based on the cost to the Company and there is no pre-determined maximum limit. The range and value of the benefits offered is reviewed periodically. In line with our Remuneration Policy outlined on page 121, we show below the benefits received by the individual Executive Directors in the year, and their typical annual value where possible.

	Typical annual value 2017/18	Typical annual value 2016/17	Percentage increase
Car allowance	£15,000	£15,000	0%
Private medical insurance	£1,500	£1,500	0%
Life assurance	Up to 6 x salary	Up to 6 x salary	0%
Personal accident cover	As per the group-wide policy	As per the group-wide policy	0%
Biennial health screening	£620 per health screen	£620 per health screen	0%
Incapacity benefits	Worth 50% of salary for a period of five years (subject to qualifying criteria)	Worth 50% of salary for a period of five years (subject to qualifying criteria)	0%

Annual bonus outturn for 2017/18 (audited)

Annual bonus performance is measured over a single financial year against a range of financial and non-financial targets and against personal objectives. The maximum bonus opportunity was 120% of salary. An annual bonus was awarded of 72.54% of salary for each of the CEO and CFO, and 68.94% of salary for the Managing Director, Wholesale Operations. The table below shows a summary of the metrics and targets which were used to determine the annual bonus awards:

	Threshold (0% payable)	Target (50% payable)	Maximum (100% payable)	Weighting	Outcome achieved
STW PBIT	£515.8m	£529.2m	£542.6m	47%	21%
	Actual: £527.6m				
Customer ODIs	£13m	£23m	£33m	20%	20%
	Actual: £80.2m			30% – MD, WO	30%
Business Services PBIT	£35.6m	£36.6m	£37.6m	10%	10%
	Actual: £38.1m				
Health and safety ⁽ⁱ⁾	0.20	0.16	0.12	8%	2%
	Actual: 0.17				
Customer experience ⁽ⁱⁱ⁾	15%	20%	25%	8%	2%
	Actual: 17.20%				
Personal performance	Details on pages 112 and 113			7%	6% – CEO 6% – CFO 3% – MD, WO
	Actual: 17.20%				

(i) Measured as number of lost time incidents divided by number of hours worked multiplied by 100,000.

(ii) Measured as the percentage reduction in complaints.

Directors' remuneration report continued

Remuneration

Despite a period with some significant operational challenges and a difficult year on bad debt, we have continued to make good progress in managing our underlying cost base to absorb these and other cost pressures to end the year delivering PBIT of £527.6 million in STW (before property profits). Our customer ODI rewards of £80.2 million were underpinned by significant improvements in internal and external sewer flooding, and sustained performance on Category 3 pollutions with a gross performance on waste of £109 million. However, this was offset by the impact of operational incidents on water measures such as supply interruptions, which resulted in a net penalty of £29 million. This year the Committee agreed to include an additional measure to drive improvement in customer experience, targeting a 20% reduction in written complaints.

In the last few months we have seen a significant improvement in performance driven by a significant improvement in billings related complaints, with these learnings being rolled out across our other teams. The result of these improvements is represented by a 17.2% reduction for the year. We set ourselves bold targets to improve the safety of our employees this year and, although we still incurred 18 LTIs, this represents a 23% year on year improvement, resulting in our best ever year and the lowest LTI rate in the sector in England. Business Services has had a particularly strong year, benefiting from a new contract with plumbing and drainage insurers that contributed significantly to both revenue and PBIT.

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

As noted on page 111, the achievement of the personal objectives for each of the Executive Directors was as follows: 6%, 6% and 3% for the CEO, CFO and Managing Director, Wholesale Operations, respectively.

The table below sets out performance outcomes for each Executive Director in relation to their specific personal objectives.

CEO

Objective	Activity	Key achievements in 2017/18	Performance outcome
Embed customers at the heart of all we do	<ul style="list-style-type: none"> Deliver a step change in customer experience Support financially vulnerable customers Be recognised as a UQ Wholesaler Provide an industry leading New Connections experience 	<ul style="list-style-type: none"> Conducted detailed customer research study. Focused efforts on resolving issues more rapidly. Customer complaints down 6% 38,000 customers have received financial help with their bills through relaunched Big Difference scheme. 50,000 vulnerable customers supported overall Achieved 1st and 2nd place in Ofwat's water and waste rankings respectively for new connections UQ for UK Customer Service Index for 2017/18 	Partly met
Drive operational excellence and continuous innovation	<ul style="list-style-type: none"> Be UQ in water and waste Develop the profitability and growth of the Business Services operations Deliver a sustainable pipeline and process for innovation 	<ul style="list-style-type: none"> UK Business Services profit increased and US business sold Held a staff roadshow to capture and share ideas around innovation and improvement Exceptional waste customer ODI performance 	Fully met
Invest responsibly for sustainable growth	<ul style="list-style-type: none"> On track delivery of AMP6 plans to deliver growth and reduce risk Integrate and deliver benefits from the acquisition of Dee Valley Set up Severn Trent and Water Plus for success in new business retail market 	<ul style="list-style-type: none"> Delivery of additional £100million Totex savings Completed integration of Dee Valley into the business Advanced in realigning boundaries along national borders Water Plus maintaining its share of a growing market 	Partly met
Change the market for the better	<ul style="list-style-type: none"> Clear PR19 plan in place that evidences our leading status Produce compelling case for investment at PR19 Design and implement the Bioresources change programme and business model Be seen as the water sector's thought leaders 	<ul style="list-style-type: none"> Strong position to submit by September 2018 Created a standalone Bioresources team identifying opportunities for operating efficiencies Collaborated with Thames Water and United Utilities to publish thought leadership document 	Fully met
Create an awesome place to work	<ul style="list-style-type: none"> Improve safety programme Deliver 5% uplift in employee engagement scores Strive to continue to improve diversity and inclusion 	<ul style="list-style-type: none"> Lost Time Injury frequency rate decreased by 23% Employee engagement increased by 6% Increase in the number of 'BAME' employees on graduate programme Launched key inclusion initiatives such as 'Dying to work' charter and menopause education 	Fully met

CFO

Objective	Activity	Key achievements in 2017/18	Performance outcome
Embed customers at the heart of all we do	• Improve insurance approach to third party damage	• Completed the review and implemented identified improvements	Fully met
Drive operational excellence and continuous innovation	• Support the business to identify and achieve cost efficiencies • Continue the evolution of finance, internal audit and enterprise risk functions • Reduce the downside risk to pension scheme liability • Finance plan in place for key remaining maturities	• Identified £100 million of efficiencies to be reinvested into the business • ERM Champions and coordinators operate throughout the business • Significantly reduced pension risk through implemented hedging strategy and financing actions	Fully met
Invest responsibly for sustainable growth	• Build and deploy new risk based interest management policy • Support the Energy and Renewables growth strategy • Deliver target M&A strategy	• Generated 38% of energy needs from renewable sources	Partly met
Change the market for the better	• Support regulatory finance in PR19 and Bioresources plan	• Created a standalone Bioresources team identifying opportunities for operating efficiencies	Fully met
Create an awesome place to work	• Deliver change in visible Health and Safety leadership, with a focus on mental wellbeing • Deliver better engagement and diversity in finance	• LTI rate improvement • Improvement of 5% in Finance Employee Engagement performance	Fully met

MD, WO

Objective	Activity	Key achievements in 2017/18	Performance outcome
Embed customers at the heart of all we do	• Improvement in customer experience and delivery of customer strategy • Be recognised as a UQ Wholesaler	• Exceptional waste customer ODI performance	Partly met
Drive operational excellence and continuous innovation	• Be UQ in water and waste • Provide environmental leadership • Deliver 10 innovation projects	• Gained provisional EA 4* status • Strong progress made on innovation	Partly met
Invest responsibly for sustainable growth	• On track delivery of the AMP6 plan to deliver growth and reduce risk • Integrate and deliver benefits from the acquisition of Dee Valley	• Delivery of Totex savings • Delivery of Water Resources Management Plan • Completed integration of Dee Valley into the business	Partly met
Change the market for the better	• Clear PR19 plan in place that evidences our leading status and investment case • Design and implement the Bioresources change programme and business model • Be seen as the water sector's thought leaders	• Strong position to submit by September 2018 • Created a standalone Bioresources team identifying opportunities for operating efficiencies	Partly met
Create an awesome place to work	• Deliver change in visible Health and Safety leadership, with a focus on mental wellbeing • Deliver 5% uplift in employee engagement scores • Progress our talent agenda, including BAME talent agenda • Contribute to resolve the top 10 company irritants	• LTI rate improvement of 23% and strong supply chain performance sustained • Wholesale employee engagement increased by 8% • External recognition of graduate and apprentice programme and increase of 13% in number of 'BAME' employees on graduate programme	Partly met

Directors' remuneration report continued

Remuneration

LTIP awards vesting in relation to performance in 2017/18 (audited)

The table below shows the outcome of LTIP awards which had performance periods ended 31 March 2018. The LTIP based on RoRE over the three years to 31 March 2018 will vest in full. This is representative of outstanding performance in customer ODIs, financing and Totex.

	Threshold FD (25% payable)		Maximum (100% payable)	CEO outcome (vesting as % of award)	CFO outcome (vesting as % of award)	MD, WO outcome (vesting as % of award)
RoRE – measured against multiple of Ofwat FD ⁽ⁱⁱ⁾	1x		1.29x	100%	100%	100%

Executive	Award type	Grant date	Number of shares granted	End of performance period	% award vesting	Number of shares vesting	Value of resultant award £000s ⁽ⁱⁱⁱ⁾	Vesting date
CEO	2015 LTIP	15/07/15	37,808	31/03/18	100%	37,808	£706.6	15/07/18
CFO	2015 LTIP	15/07/15	14,890	31/03/18	100%	14,890	£278.3	15/07/18
MD, Wholesale Operations	2015 LTIP	15/07/15	14,518	31/03/18	100%	14,518	£271.3	15/07/18

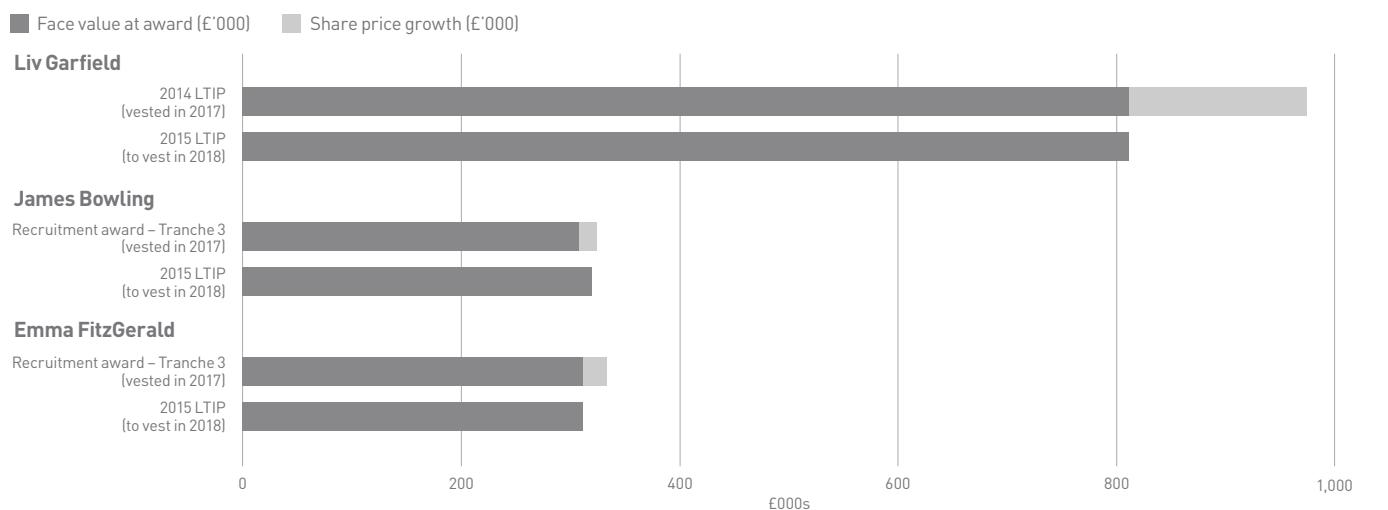
(i) The RoRE calculation used for LTIPs differs slightly from that used in the annual performance report, which uses the Ofwat definition. The LTIP measure seeks to align better our LTIP targets to actual cash flows and against a clearly defined target. In this measure, financing outperformance is based on actual gearing rather than the notional capital structure and compares our cost of debt against the allowance in the Ofwat Financial Model. It includes profits/losses associated with land sales, miscellaneous activities and the impact of the wholesale revenue forecasting incentive mechanism.

(ii) Based on the average share price over the final three months of the performance period (£18.69) as the awards will not be released until after the end of the close period.

LTIP vesting

The chart below sets out a breakdown of the LTIP awards for the Executive Directors in 2017 and 2018 and shows the face value of the awards and share price growth, if applicable.

Value of LTIP awards



Outstanding scheme interests, including share awards granted during the year (audited)

The table below sets out details of the Executive Directors' outstanding share awards as at 31 March 2018.

Executive	Award type	Maximum number of shares ⁽ⁱ⁾	Percentage vesting at threshold performance	Exercise price (pence)	End of performance period	Vesting/exercise date ⁽ⁱⁱ⁾	Awards granted during the year		
							Basis of award	Face value £000	Notes
Liv Garfield	2015 LTIP	37,808	25%	–	31/03/18	15/07/18	–	–	[a]
	2015 ABS	9,668	–	–	31/03/15	29/06/18	–	–	[d]
	2015 SAYE	1,136	–	1,584	–	May–18	–	–	[e]
	2016 LTIP	46,115	25%	–	31/03/19	21/06/19	–	–	[b]
	2016 ABS	16,260	–	–	31/03/16	28/06/19	–	–	[d]
	2017 LTIP	42,383	25%	–	31/03/20	20/06/20	150% of salary	£1,015.5	[c]
	2017 ABS	12,850	–	–	31/03/17	28/06/20	Deferred bonus	£307.9	[d]
	2018 SAYE	1,089	–	1,652	–	May–21	–	–	[e]
	Total	167,309							
James Bowling	2015 LTIP	14,890	25%	–	31/03/18	15/07/18	–	–	[a]
	2016 LTIP	18,529	25%	–	31/03/19	21/06/19	–	–	[b]
	2016 ABS	9,634	–	–	31/03/16	28/06/19	–	–	[d]
	2016 SAYE	1,044	–	1,724	–	May–19	–	–	[e]
	2017 LTIP	17,028	25%	–	31/03/20	20/06/20	100% of salary	£408.0	[c]
	2017 ABS	7,693	–	–	31/03/17	28/06/20	Deferred bonus	£184.3	[d]
	Total	68,818							
Emma FitzGerald⁽ⁱⁱⁱ⁾	2015 LTIP	14,518	25%	–	31/03/18	15/07/18	–	–	[a]
	2016 LTIP	14,453	25%	–	31/03/19	21/06/19	–	–	[b]
	2016 ABS	7,112	–	–	31/03/16	28/06/19	–	–	[d]
	2017 LTIP	13,282	25%	–	31/03/20	20/06/20	80% of salary	£318.2	[c]
	2017 ABS	7,516	–	–	31/03/17	28/06/20	Deferred bonus	£180.1	[d]
	Total	56,881							

(i) Additional dividend equivalent shares may be released where provided in the rules.

(ii) Awards that are due to vest in a close period will be released as soon as practicable after the end of the close period.

(iii) See page 117 for details on Emma FitzGerald's 2016 and 2017 Annual Bonus Scheme and LTIP awards on cessation of employment.

a) 2015 LTIP award

The 2015 awards are subject to a RoRE performance condition measured over three financial years. Average RoRE performance is compared with the baseline RoRE figure set by Ofwat in our FD. 25% of the award will vest if average RoRE matches the baseline figure of 5.65%, increasing on a straight-line basis to full vesting for outperforming the baseline by 1.29 times (equivalent to 7.29%).

The 2015 LTIP awards were granted on 15 July 2015. The share price used to calculate the number of shares granted was £21.49 (being the average price over the preceding three days).

b) 2016 LTIP award

The 2016 awards are subject to a RoRE performance condition measured over three financial years. Average RoRE performance is compared with the baseline RoRE figure set by Ofwat in our FD. 25% of the award will vest if average RoRE matches the baseline figure of 5.65%, increasing on a straight-line basis to full vesting for outperforming the baseline by 1.39 times (equivalent to 7.86%).

The 2016 LTIP awards were granted on 21 June 2016. The share price used to calculate the number of shares granted was £21.59 (being the average price over the preceding three days).

c) 2017 LTIP award (awards granted during the year)

The 2017 awards are subject to a RoRE performance condition measured over three financial years. Average RoRE performance is compared with the baseline RoRE figure set by Ofwat in our FD. 25% of the award will vest if average RoRE matches the baseline figure of 5.65%, increasing on a straight-line basis to full vesting for outperforming the baseline by 1.39 times (equivalent to 7.86%).

The 2017 LTIP awards were granted on 20 June 2017. The share price used to calculate the number of shares granted was £23.96 (being the average price over the preceding three days).

d) Deferred shares under the annual bonus scheme (awards granted during the year)

Each year, 50% of an Executive Director's annual bonus is deferred in shares for three years. The awards are granted in the form of deferred shares. The 2017 award relates to the deferral of the annual bonus for 2016/17. The awards were granted on 28 June 2017. The share price used to calculate the number of shares granted was £23.96 (being the average price over the preceding three days). The deferred shares relating to the annual bonus for 2017/18 will be granted in June 2018.

Directors' remuneration report continued

Remuneration

e) Save As You Earn (SAYE)

The Executive Directors, in common with all eligible UK employees, are entitled to participate in the Company's HMRC tax-advantaged SAYE Scheme.

External directorships

Emma FitzGerald was appointed as a Non-Executive Director of DCC Plc in December 2016 and, in respect of her appointment for the year ended 31 March 2018, she was paid fees of £49,601 (converted from EUR using the exchange rate of 1 EUR = £0.88), which she retained (this covers the period to December 2017).

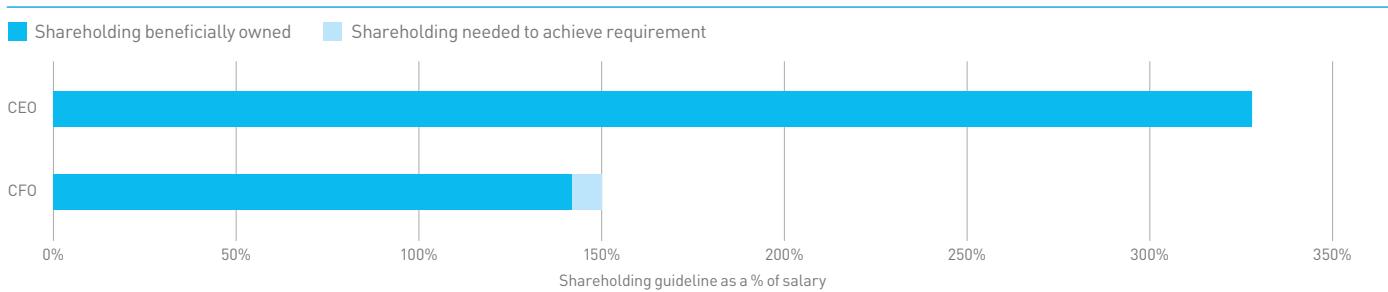
Liv Garfield was appointed a member of the Takeover Panel in November 2017. In respect of her appointment for the year ended 31 March 2018 she was paid fees at £5,000 which she retained.

Directors' shareholdings and summary of outstanding share interests (audited)

The Company operates shareholding requirements under which Executive Directors are expected to build and maintain a shareholding in the Company of 200% of salary for the CEO and 150% of salary for the CFO. Details of the current shareholdings of the Directors and whether Executive Directors have met the shareholding requirements are set out below.

The Committee believes that it is an essential part of the Company's Remuneration Policy that Executive Directors become material shareholders. The retention and build-up of equity is important in a long term business such as Severn Trent as it encourages decisions to be made on a long term sustainable basis for the benefit of customers and shareholders.

The CEO has exceeded the shareholding requirement applicable in 2017/18 of 200% of salary and the CFO is close to exceeding the shareholding requirement applicable in 2017/18 of 150% of salary.



Director	Beneficially owned	Interests in shares as at 31 March 2018				% Shareholding guideline achieved ⁽ⁱ⁾	
		Outstanding scheme interests					
		LTIP and Recruitment Awards	Deferred shares under the annual bonus	SAYE options	Total		
Kevin Beeston	2,244	–	–	–	2,244	–	
Dominique Reiniche	400	–	–	–	400	–	
John Coghlan	2,670	–	–	–	2,670	–	
Andrew Duff	8,184	–	–	–	8,184	–	
Philip Remnant	1,969	–	–	–	1,969	–	
Dame Angela Strank	459	–	–	–	459	–	
Liv Garfield	103,274	126,306	38,778	2,225	270,583	163%	
James Bowling	23,464	50,447	17,327	1,044	92,282	95%	
Emma FitzGerald ⁽ⁱⁱ⁾	25,941	42,253	14,628	–	82,822	120%	

(i) The share price used to calculate the percentage of the shareholding guideline achieved was £18.44 (as at 31 March 2018). The guideline figures include unvested ABS shares (50% deducted to cover statutory deductions).

(ii) As at 31 December 2017.

Shares counting towards achievement of the guideline include beneficially owned shares (including shares held by connected persons) and the net of tax value of deferred shares under the annual bonus since they are not subject to performance conditions. The Executive Directors are expected to retain all shares received through the vesting of any incentive schemes (after the settlement of any tax liability) until the shareholding requirements are met.

There has been no change in the Directors' interests in the ordinary share capital of the Company between those set out above and 22 May 2018.

Payments for loss of office and to past Directors (audited)

Emma FitzGerald

Background

In advance of PR19 the Company has reshaped the wholesale business to create three teams: Customer Delivery, Capital Delivery and Commercial, and Production.

The reorganisation has resulted in changes to the role of the Managing Director, Wholesale Operations, held by Emma FitzGerald. As a consequence, following the transition of her responsibilities, Emma stepped down from the Board on 31 December 2017 and will leave the Company on 31 July 2018. During the period between her stepping down as Managing Director, Wholesale Operations and leaving the Company, she is focusing on developing the Company's management and integration of disruptive innovation.

Emma was appointed to the Board on 1 April 2016. During this time, she led the wholesale business and played a key role in helping the Company achieve its success during the first half of the AMP.

On the basis that Emma's role as Managing Director, Wholesale Operations will no longer exist in its current form, the Committee has determined under the loss of office policy under the approved Remuneration Policy to treat her as a good leaver.

Remuneration

As Emma remains an employee of the Company, she will be paid her salary, benefits and pension for the period to 31 July 2018, on a monthly basis. For clarity, no pay in lieu of notice will be paid after she ceases employment with the Company.

Emma was employed for the full financial year and, therefore, will receive an annual bonus of 68.94% of salary in relation to 2017/18, based on performance against the relevant targets (set out on page 113). The Committee has determined to pay the bonus in cash because under the Remuneration Policy and the rules of the deferred annual bonus plan deferred share awards would vest on cessation of employment and, given the short period between the determination of the bonus for the year and her departure, it is administratively simpler. No bonus will be paid to Emma for 2018/19 and Emma will not receive an LTIP award for 2018/19.

All unvested and unexercised awards will be treated in accordance with the applicable plan rules and our loss of office policy.

Unvested shares held under the deferred annual bonus plan will be released on cessation of employment, and remain subject to malus and clawback provisions. The table below sets out details of Emma's unvested deferred annual bonus plan shares.

Award	Date of grant	Vesting date	Number of shares
2016 ABS	28 June 2016	31 July 2018	7,112
2017 ABS	28 June 2017	31 July 2018	7,516

Emma's unvested LTIP awards will vest in line with the ordinary vesting dates, subject to the satisfaction of the relevant performance conditions. Emma's awards will be pro-rated up to the end of her employment on 31 July 2018. These awards will continue to be subject to malus and clawback provisions. The table below sets out details of Emma's unvested LTIP awards.

Award	Date of grant	Vesting date	Maximum number of shares capable of vesting ⁽ⁱ⁾
2016 LTIP	21 June 2016	21 June 2019	11,243
2017 LTIP	21 June 2017	20 June 2020	5,895

(i) Time pro-rating applied in accordance with the LTIP rules from the start of the relevant performance period up to the date of cessation of employment (31 July 2018).

Directors' remuneration report continued

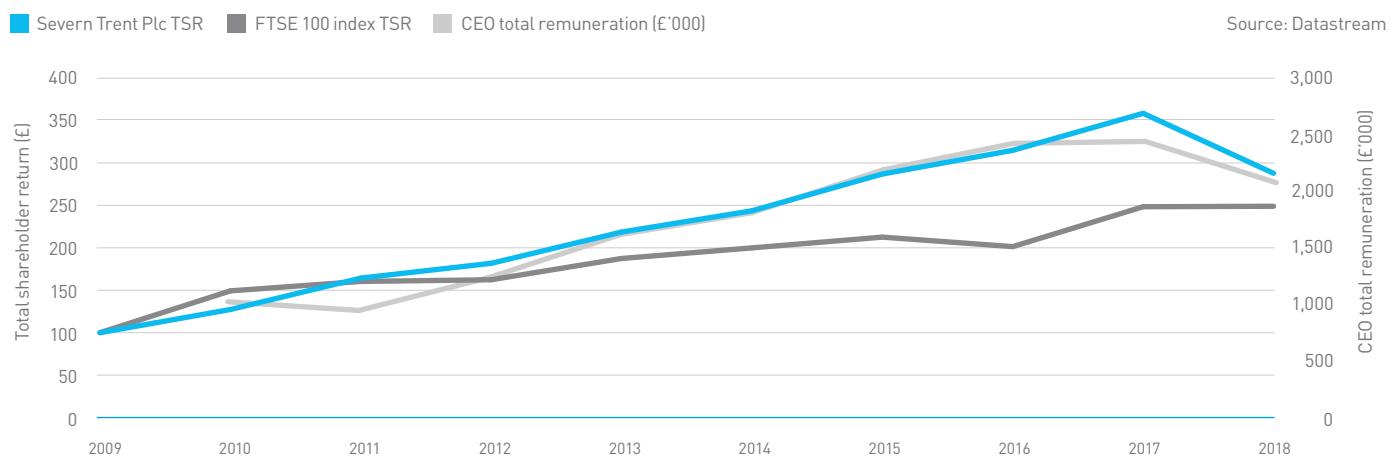
Remuneration

Total shareholder return chart and total remuneration of the CEO

This graph shows the value at 31 March 2018 of £100 invested in Severn Trent Plc on 1 April 2009 compared with the value of £100 invested in the FTSE 100 index. The FTSE 100 was chosen as the comparator index because the Company is a constituent of that index. The intermediate points show the value at the intervening financial year ends.

The figure of remuneration for the CEO over the last nine financial years is shown in the table below. The annual bonus payout and LTIP vesting level as a percentage of the maximum opportunity is also shown.

Total shareholder return and total remuneration



Remuneration of the CEO

CEO	Year ending 31 March								
	2010	2011	2012	2013	2014	2015	2016	2017	2018
CEO	Tony Wray	Tony Wray	Tony Wray	Tony Wray	Tony Wray	Liv Garfield	Liv Garfield	Liv Garfield	Liv Garfield
Total remuneration (£'000)	1,027.0	949.8	1,244.1	1,635.3	1,818.4	2,197.6	2,493.6	2,450.7	2,084.3
Annual bonus (% of maximum)	51.5%	43.2%	48.1%	82.4%	78.7%	52.0%	88.2%	75.8%	72.54%
LTIP vesting (% of maximum)	60.3%	0.0%	28.4%	57.5%	100.0%	100.0%	100.0%	100.0%	100.0%
SMP vesting (% of maximum)	N/A	N/A	N/A	78.0%	64.3%	N/A	N/A	N/A	N/A

Relative importance of the spend on pay

The table below shows the expenditure of the Company on staff costs against dividends paid to shareholders for both the current and prior financial periods, and the percentage change between the two periods.

	2018	2017	% Change
Staff costs (£m) ⁽ⁱ⁾	288.1	267.1	7.9%
Dividends (£m)	197.0	190.4	3.5%

(i) Staff costs from continuing operations.

Statement of implementation of the Policy in 2018/19

See pages 120 to 126.

Membership of the Remuneration Committee and its advisers

The Committee determines, on behalf of the Board, the Company's policy on the remuneration of Executive Directors, other members of the Executive Committee and the Chairman of the Board. The Committee determines the total remuneration packages and contractual terms and conditions for these individuals. The Policy framework for remunerating all senior executive managers is consistent with the approach taken for Executive Directors. The Committee also provides oversight of all-employee reward, for example the annual bonus scheme, and reviews cascade and alignment of reward throughout the organisation.

The Remuneration Committee Terms of Reference were updated in March 2018 and can be found at www.severntrent.com

The members of the Committee are listed in the table below. All are independent Non-Executive Directors, as defined under the Code, with the exception of the Company Chairman who was independent on his appointment. During the year ended 31 March 2018, the Committee met seven times to discuss key remuneration issues arising, the review and operation of the Company's Remuneration Policy and market updates by its advisers.

Remuneration Committee member	Attendance in 2017/18
Philip Remnant (Chairman)	7/7
Andrew Duff	7/7
Kevin Beeston	7/7
Dame Angela Strank	7/7

The Committee members have no personal financial interest, other than as shareholders, in the matters to be decided. The CEO, Director of Human Resources and by invitation the Head of Economic Regulation and Reward & Pensions Manager also attended the Committee meetings to provide advice and respond to specific questions. Such attendances specifically excluded any matter concerning their own remuneration. The Company Secretary acts as secretary to the Committee.

To ensure that the Company's remuneration practices are in line with best practice, the Committee has access to advice from advisers. PricewaterhouseCoopers ('PwC') are independent advisers to the Committee. Fees for advice provided to the Committee during the year were £170,500 excluding VAT to PwC (2016/17: £68,000 paid to PwC and £24,676 paid to NBS). Separate teams within PwC also provided unrelated tax consulting, pensions, and other assurance and advisory services during the year. PwC is one of the founding members of the Remuneration Consultants Group Code of Conduct and adheres to this Code in its dealings with the Committee. The Committee reviews the appointment of its advisers annually and is satisfied that the advice it receives is objective and independent.

Statement of shareholder voting at the 2017 AGM

At last year's AGM, the Directors' remuneration report received the following votes from shareholders:

Resolution	Votes for	Votes against	Votes withheld
Approve Directors' remuneration report	142,422,030 (97.30%)	3,948,356 (2.70%)	1,351,934

The Committee has taken into account the strong support from shareholders for the current Remuneration Policy and its implementation in proposing the new Remuneration Policy; which is an evolution of the current policy.

Directors' remuneration report continued

Remuneration

Remuneration Policy

Development of Policy report

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

Linkage to all-employee pay

The Committee reviews changes in remuneration arrangements in the workforce generally as we recognise that all our people play an important role in the success of the Company. Severn Trent is committed to creating an inclusive working environment and to rewarding our employees throughout the organisation in a fair manner. In making decisions on executive pay, the Committee considers wider workforce remuneration and conditions to ensure that they are aligned on an ongoing basis. We believe that employees throughout the Company should be able to share in the success of the Company. The annual bonus scheme is cascaded throughout the organisation and all employees may participate in the HMRC tax-advantaged Save As You Earn ('SAYE') scheme.

As part of our commitment to fairness, we have a section in this report (see page 108) which sets out more information on our wider workforce pay conditions, our Gender Pay statistics and our diversity initiatives. Whilst we recognise there is always an opportunity to improve in relation to these issues, we believe that transparency is an important first step.

Shareholder views

The Committee engages proactively with the Company's major shareholders and is committed to maintaining an open dialogue. The Committee reviews any feedback received from shareholders as a result of the AGM process. Committee members are available to answer questions at the AGM and throughout the rest of the year. The Committee takes into consideration the latest views of investor bodies and their representatives, including the Investment Association, the Pension and Lifetime Savings Association and proxy advice agencies such as Institutional Shareholder Services.

Salary

Purpose and link to strategy: To recruit and reward Executive Directors of a suitable calibre for the role and duties required.

Operation (including performance metrics)	Maximum opportunity	Substantive changes from Policy agreed at 2015 AGM and rationale
<ul style="list-style-type: none"> Salaries for individual Executive Directors are reviewed annually by the Committee and normally take effect from 1 July. Salaries are set with reference to individual performance, experience and contribution, together with developments in the relevant employment market (having regard to similar roles in publicly quoted companies of a comparable size), Company performance, affordability, the wider economic environment and internal relativities. In addition, when the Committee determines a benchmarking exercise is appropriate it will also consider salaries within the ranges paid by the companies in the comparator groups used for remuneration benchmarking. The Committee intends to review the comparators periodically and may add or remove companies from the Group as it considers appropriate. Any changes to the comparator groups will be set out in the section headed Implementation of Remuneration Policy, in the following financial year. 	<ul style="list-style-type: none"> Details of the current salary levels for the Executive Directors are set out in the Annual Report on Remuneration on page 110. Any increase to Executive Directors' salaries will generally be no higher than the average increase for the UK workforce. However, a higher increase may be proposed in the event of a role change or promotion, or in other exceptional circumstances. The Company, where appropriate, may set salary levels below the market reference salary at the time of appointment, with the intention of bringing the salary levels in line with the market as the individual gains the relevant experience. In such cases, subsequent increases in salary may be higher than the general rises for employees until the target positioning is achieved. 	No changes.

Benefits

Purpose and link to strategy: To provide competitive benefits in the market to enable the recruitment and retention of Executive Directors.

Operation (including performance metrics)	Maximum opportunity	Substantive changes from Policy agreed at 2015 AGM and rationale
<ul style="list-style-type: none"> A car allowance, family level private medical insurance, life assurance, personal accident insurance, health screening, an incapacity benefits scheme and other incidental benefits and expenses. The Committee recognises the need to maintain suitable flexibility in the benefits provided to ensure it is able to support the objective of attracting and retaining personnel in order to deliver the Group strategy. Therefore, additional benefits such as relocation, disturbance and expatriate allowances and tax equalisation may be paid as appropriate. Directors will be reimbursed for any reasonable business expenses incurred in the course of their duties, including the tax payable thereon. 	<ul style="list-style-type: none"> The value of benefits is based on the cost to the Company and there is no pre-determined maximum limit. The range and value of the benefits offered is reviewed periodically. 	No changes.

Pension

Purpose and link to strategy: To provide pension arrangements comparable with similar companies in the market to enable the recruitment and retention of Executive Directors.

Operation (including performance metrics)	Maximum opportunity	Substantive changes from Policy agreed at 2015 AGM and rationale
<ul style="list-style-type: none"> The Company maintains a defined contribution scheme and/or cash supplement in lieu of pension. 	<ul style="list-style-type: none"> For current Executive Directors, the company contribution to a pension scheme and/or cash allowance will be up to a maximum of 25% of salary. For any new recruit, the contribution will be up to a maximum of 15% of salary. 	<ul style="list-style-type: none"> No change for current Executive Directors. New appointments will have a maximum pension contribution of 15% of salary (25% of salary currently). This change aligns pension contribution quantum for new Executive Directors with pension contribution for the wider workforce.

Directors' remuneration report continued

Remuneration

Annual bonus

Purpose and link to strategy: To encourage improved financial and operational performance and align the interests of Executive Directors with shareholders through the partial deferral of payment in shares.

Operation (including performance metrics)	Maximum opportunity	Substantive changes from Policy agreed at 2015 AGM and rationale
<ul style="list-style-type: none"> Bonuses are based on financial, operational, customer and personal performance over a performance period of one financial year. No more than 20% of the bonus will relate to personal contribution for any Executive Director. 50% of the bonus is paid in cash and 50% in shares which vest after three years (with the value of any dividends to be rolled up and paid on vesting). There are no further performance targets on the deferred amount. The performance measures and targets for the annual bonus are selected annually to align with the business strategy and the key drivers of performance set under the regulatory framework. The annual weighting of the bonus between the various metrics and personal contribution may vary depending on the key priorities of the business for the year ahead. Robust and demanding targets are set taking into account the operating environment and priorities, market expectations and the business plan for the year ahead. The Committee is of the opinion that given the commercial sensitivity arising in relation to the detailed financial targets used for the bonus, disclosing precise targets for the Plan in advance would not be in shareholder interests. Therefore, performance targets and performance achieved will be published at the end of the performance period so shareholders can fully assess the basis for any pay-outs under the Plan. Malus and clawback mechanisms also apply to allow the recoupment within three years of the payment of the cash bonus or the grant of deferred shares in the event of financial misstatement, error in the calculation or gross misconduct. Any exercise of discretion by the Committee will be communicated to shareholders in full in the following year's Directors' Remuneration Report. Cessation of employment and change of control provisions apply as set out in the notes to the Policy table. 	<ul style="list-style-type: none"> The maximum annual bonus payment will equal 120% of salary for maximum performance. For threshold performance, 0% of maximum opportunity will be paid. On target performance: 50% of maximum opportunity will be paid. The Committee will operate all incentive plans according to the rules of each respective plan and the discretions contained therein. The discretions cover aspects such as the timing of grant and vesting of awards, determining the size of the award (subject to the policy limits), the treatment of leavers, retrospective adjustment of awards (e.g. for a rights issue, a corporate restructuring or for special dividends) and, in exceptional circumstances, the discretion to adjust previously set targets for an incentive award if events happen which cause the Committee to determine that it would be appropriate to do so. In exercising such discretions, the Committee will take into account generally accepted market practice, best practice guidelines, the provisions of the Listing Rules and the Company's approved Remuneration Policy. In exceptional circumstances the Committee retains the discretion to: <ul style="list-style-type: none"> Change the performance measures and targets and the weighting attached to the performance measures and targets part way through a performance year if there is a significant and material event which causes the Committee to believe the original measures, weightings and targets are no longer appropriate; and Make downward or upward adjustments to the amount of bonus earned resulting from the application of the performance measures, if the Committee believe that the bonus outcomes are not a fair and accurate reflection of business performance. 	No changes.

LTIP

Purpose and link to strategy: To encourage strong and sustained improvements in financial performance, in line with the Company's strategy and long term shareholder returns.

Operation (including performance metrics)	Maximum opportunity	Substantive changes from Policy agreed at 2015 AGM and rationale
<ul style="list-style-type: none"> Awards are granted annually and will be subject to one or more performance conditions which will be assessed over three years. A two year holding period will apply following the three year vesting period for LTIP Awards granted to the Executive Directors. Currently, LTIP awards require the Company's RoRE to outperform the target set out in Ofwat's Final Determination. A sliding scale of targets is set. Different targets and/or performance measures may be set for future LTIP awards to reflect the business strategy and regulatory framework operating at that time. Using RoRE to assess long term performance reflects the focus of Ofwat in AMP6 and is consistent with our aim to deliver efficient returns to shareholders. RoRE measures the returns (after tax and interest) that companies have earned by reference to the notional regulated equity, where regulated equity is calculated from the RCV and notional net debt. The Committee believes that the use of RoRE provides a strong alignment between the long term financial and operational performance of the Group and the reward delivered to management. No material change will be made to the type of performance conditions without prior shareholder consultation. The value of dividends paid on the shares comprising the award will be rolled up and paid on vesting. The award may be structured as a conditional share award [awards may also be settled in cash in certain circumstances]. Malus and clawback mechanisms apply to allow the recoupment of incentive awards within three years of vesting in the event of financial misstatement, an error in calculating the level of vesting or gross negligence, fraud or gross misconduct. Cessation of employment and change of control provisions apply as set out in the notes to the Policy table. 	<ul style="list-style-type: none"> Maximum limit is 200% of salary. Up to 25% of an award may vest for threshold performance. The Committee will review the targets before each grant to ensure they remain appropriate. The Committee may change the balance of the measure, or use different measures for subsequent awards, as appropriate. The Committee will operate all incentive plans according to the rules of each respective plan and the discretions contained therein. The discretions cover aspects such as the timing of grant and vesting of awards, determining the size of the award (subject to the policy limits), the treatment of leavers, retrospective adjustment of awards (e.g. for a rights issue, a corporate restructuring or for special dividends) and, in exceptional circumstances, the discretion to adjust previously set targets for an incentive award if events happen which cause the Committee to determine that it would be appropriate to do so. In exercising such discretions, the Committee will take into account generally accepted market practice, best practice guidelines, the provisions of the Listing Rules and the Company's approved Remuneration Policy. In exceptional circumstances the Committee retains the discretion to: <ul style="list-style-type: none"> a) Change the performance measures and targets and the weighting attached to the performance measures and targets part way through a performance year if there is a significant and material event which causes the Committee to believe the original measures, weightings and targets are no longer appropriate; and b) Make downward or upward adjustments to the amount earned resulting from the application of the performance measures, if the Committee believes that the LTIP outcomes are not a fair and accurate reflection of business performance. <p>In addition, for any awards to vest, the Committee must be satisfied that there has been no compromise to the commercial practices or operational standards of the Group. If the Committee is not so satisfied, then the vesting percentage may be scaled back as appropriate (including to 0%).</p>	<p>Increase in maximum LTIP opportunity:</p> <ul style="list-style-type: none"> CEO – 200% of salary (currently 150%) CFO – 150% of salary (currently 100%) <p>The Committee will ensure that the increased opportunity is reflected in the level of challenge in the LTIP targets and has introduced a stretch target based on UQ performance.</p> <p>The Committee's rationale for increasing the maximum LTIP opportunity is as follows:</p> <ul style="list-style-type: none"> The Executive Directors were inexperienced at the time the current Policy was introduced and incentive levels reflected this. The Committee believes that the Executive Directors are now fully embedded in the business and over the past three years they have performed successfully in their roles, demonstrating an exceptional level of commitment in executing the business strategy for the benefit of our shareholders, customers and the wider community. The Committee wants to provide an appropriate level of incentive opportunity to deliver a competitive total remuneration package that retains and motivates a truly exceptional management team for the rest of this AMP and into the next. The Committee is keen to ensure that there is an appropriate level of incentive opportunity in the remuneration to reflect the greater focus of Ofwat on the relative performance of water companies and the tougher regulatory context during AMP7. Introduction of a two year holding period which will continue to operate post cessation of employment to enhance long term alignment between shareholders, customers and executive's interests.

All-employee share plans

Purpose and link to strategy: To encourage widespread employee share ownership to enable employees to share in the success of the business, and to align their interests with those of shareholders.

Operation (including performance metrics)	Maximum opportunity	Substantive changes from Policy agreed at 2015 AGM and rationale
<ul style="list-style-type: none"> The Executive Directors are able to participate in HMRC tax advantaged all-employee share plans on the same terms as other eligible employees. 	<ul style="list-style-type: none"> The maximum limits under the plans are as set by HMRC. 	<p>No changes.</p>

Governance

Directors' remuneration report continued

Remuneration

Shareholding requirements

Purpose and link to strategy: To encourage strong shareholder alignment.

Operation (including performance metrics)	Maximum opportunity	Substantive changes from Policy agreed at 2015 AGM and rationale
<ul style="list-style-type: none">The Company operates shareholding requirements under which Executive Directors are expected to build and maintain a shareholding in the Company.The CEO is expected to build and maintain a holding of shares to the value of 300% of salary, and other Executive Directors 200% of salary.Executive Directors are expected to retain all of the net of tax number of shares they receive through the LTIP and deferred share bonus until the shareholding requirements have been met.The Committee retains the discretion to increase the shareholdings requirements as appropriate.	n/a	<p>Increase in minimum shareholding requirement:</p> <ul style="list-style-type: none">CEO – 300% of salary (currently 200%)CFO – 200% of salary (currently 150%) <p>The Committee considers that higher shareholder requirements will ensure greater long term alignment between the shareholders and Executive Directors in the light of the higher quantum of LTIP awards.</p>

External directorships

Executive Directors are permitted to take on external non-executive directorships, though normally only one other appointment, to bring a further external perspective to the Group and help in the development of key individuals' experience. In order to avoid any conflicts of interest, all appointments are subject to the approval of the Nominations Committee. Executive Directors are permitted to retain the fees arising from appointments.

Approach to recruitment and promotion

The Company's approach is for the remuneration of any new Director to be assessed in line with the principles applied to the Executive Directors. The Committee is mindful that it wishes to avoid paying more than it considers necessary to secure a preferred candidate with the appropriate calibre and experience needed for the role. In setting the remuneration for new recruits, the Committee will have regard to guidelines and shareholder sentiment regarding one-off or enhanced short term or long term incentive payments as well as giving consideration to the appropriateness of any performance measures associated with an award.

Item	Policy
Salary, Benefits and Pension	<ul style="list-style-type: none">These will be set in line with the Policy for existing Executive Directors.
Annual Bonus	<ul style="list-style-type: none">Maximum annual participation will be set in line with the Company's Policy for existing Executive Directors and will not exceed 120% of salary.
LTIP	<ul style="list-style-type: none">Maximum annual participation will be set in line with the Company's Policy for existing Executive Directors and will not exceed 200% of salary.
Maximum Variable Remuneration	<ul style="list-style-type: none">The maximum variable remuneration which may be granted is 320% of salary.
'Buyout' of incentives forfeited on cessation of employment	<ul style="list-style-type: none">Where the Committee determines that the individual circumstances of recruitment justifies the provision of a buyout, the equivalent value of any incentives that will be forfeited on cessation of an Executive Director's previous employment will be calculated taking into account the following: the proportion of the performance period completed on the date of the Executive Director's cessation of employment; the performance conditions attached to the vesting of these incentives and the likelihood of them being satisfied; and any other terms and condition having a material effect on their value ('lapsed value').The Committee may then grant up to the same value as the lapsed value, where possible, under the Company's incentive plans. To the extent that it was not possible or practical to provide the buyout within the terms of the Company's existing incentive plans, a bespoke arrangement would be used.
Relocation Policies	<ul style="list-style-type: none">In instances where the new Executive Director is required to relocate or spend significant time away from his/her normal residence, the Company may provide one-off compensation to reflect the cost of relocation for the Executive Director. The level of the relocation package will be assessed on a case-by-case basis but will take into consideration any cost of living differences/ housing allowance, disturbance allowances and schooling.
Internal promotions	<ul style="list-style-type: none">In the case of an internal appointment, any variable pay element awarded in respect of the prior role would be allowed to payout according to the terms on which it was originally granted. These would be disclosed to shareholders in the remuneration report for the relevant financial year.

The Company's Policy when setting fees for the appointment of new Non-Executive Directors is to apply the policy which applies to current Non-Executive Directors, which is set out on page 127.

Service contracts for Executive Directors

Name	Date of service contract	Nature of contract	Notice period	Termination payments
Liv Garfield	10.04.14	Rolling	12 months	Payments for loss of office comprise a maximum of 12 months' salary and benefits only
James Bowling	01.04.15			

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

Policy on Payments for Loss of Office

The remuneration related elements of the current contracts for Executive Directors are shown in the table below, together with details of the treatment on cessation of employment. No changes from the 2015 Policy are proposed.

Element	Treatment on Cessation of Employment	
General	The Committee will honour Executive Directors' contractual entitlements. Service contracts do not contain liquidated damages clauses. If a contract is to be terminated, the Committee will determine such mitigation as it considers fair and reasonable in each case. There are no contractual arrangements that would guarantee a pension with limited or no abatement on severance or early retirement. There is no agreement between the Company and its Directors or employees, providing for compensation for loss of office or employment that occurs because of a takeover bid. The Committee reserves the right to make additional payments where such payments are made in good faith in discharge of an existing legal obligation (or by way of damages for breach of such an obligation); or by way of settlement or compromise of any claim arising in connection with the termination of an Executive Director's office or employment.	
Salary, Benefits and Pension	These will be paid over the notice period. The Company has discretion to make a lump sum payment in lieu.	
Annual Bonus	Good Leaver Reason ⁽ⁱ⁾	Other Reason
Cash Awards	Performance conditions will be measured at the bonus measurement date. Bonus will normally be pro-rated for the period worked during the financial year.	No bonus will be payable for year of cessation.
	Discretion	
	The Committee has the following elements of discretion:	
	<ul style="list-style-type: none"> • To determine that an Executive Director is a good leaver. It is the Committee's intention to use this discretion only in circumstances where there is an appropriate business case which will be explained in full to shareholders; • To determine whether to pro-rate the bonus to time. The Remuneration Committee's normal policy is to pro-rate for time. It is the Committee's intention only to use discretion not to pro-rate in circumstances where there is an appropriate business case, based on the circumstances of the Executive Director's departure. Use of discretion will be explained in full to shareholders; and • The bonus would be paid at the same time as for the other Executive Directors and, if the Executive has left employment by that date, it may be paid solely in cash. 	
Annual Bonus	Good Leaver Reason ⁽ⁱ⁾	Other Reason
Deferred Share Awards	All subsisting deferred share awards will vest on the dealing day after such termination.	All subsisting deferred share awards will vest on the dealing day after such termination with the exception of summary dismissal of the participant, when any deferred share award held by the individual shall lapse immediately on such termination.
	Discretion	
	The Committee has the following elements of discretion:	
	<ul style="list-style-type: none"> • To determine that an Executive Director is a good leaver. It is the Committee's intention to use this discretion only in circumstances where there is an appropriate business case which will be explained in full to shareholders; • To vest deferred shares at the end of the original deferral period or at the date of cessation. The Committee will make this determination depending on the type of good leaver reason resulting in the cessation; and • To determine whether to pro-rate the maximum number of shares to the time from the date of grant to the date of cessation. The Committee's normal policy is not to pro-rate awards for time. The Committee will determine whether or not to pro-rate where there is an appropriate business case, based on the circumstances of the Executive Director's departure. Use of discretion will be explained in full to shareholders. 	

(i) Good leavers are defined under the Annual Bonus Scheme Rules and the LTIP Rules as an "individual whose employment is terminated by the Company as a result of injury, ill-health or disability, redundancy or retirement (in each case, as determined by the Committee) or whose employment terminates automatically by reason of their death". As stated above, the Committee also retains an overall discretion to determine that an individual is a good leaver.

Governance

Directors' remuneration report continued

Remuneration

Element	Treatment on Cessation of Employment	
LTIP	Good Leaver Reason ⁽ⁱ⁾ Pro-rated to time and performance in respect of each subsisting LTIP award.	Other Reason Lapse of any unvested LTIP awards.
	Discretion The Committee has the following elements of discretion: <ul style="list-style-type: none">• To determine that an Executive Director is a good leaver. It is the Committee's intention to use this discretion only in circumstances where there is an appropriate business case which will be explained in full to shareholders;• To determine to pay cash in lieu of shares;• To measure performance over the original performance period or at the date of cessation. The Committee will make this determination depending on the type of good leaver reason resulting in the cessation;• To determine whether to vest shares at the end of the original performance period or at the date of cessation. The Committee will make this determination depending on the type of good leaver reason resulting in the cessation; and• To determine whether to pro-rate the maximum number of shares to the time from the start of the performance period to the date of cessation. The Committee's normal policy is to pro-rate awards for time. In circumstances where there is an appropriate business case based on the circumstances of the Executive Director's departure, the Committee may use discretion and not pro-rate. Use of discretion will be explained in full to shareholders.	
Holding periods	Where cessation of employment occurs during any holding period the LTIP award will continue as normal. However, the Committee retains discretion to allow the award to vest when cessation of employment occurs in certain circumstances, such as: <ul style="list-style-type: none">• Where the reason for departure is death, disability or ill-health;• Where there are extenuating factors which impact at the time of departure (such as unforeseen changes to personal circumstances); or• Any other reason, permitted by Committee in its absolute discretion in any particular case, except where termination is for dishonesty, fraud, misconduct or other circumstances justifying summary dismissal (in which cases it is very likely any outstanding LTIP awards would lapse on cessation regardless).	
Other	There are no other historical contractual provisions other than those set out above.	

(i) Good leavers are defined under the Annual Bonus Scheme Rules and the LTIP Rules as an "individual whose employment is terminated by the Company as a result of injury, ill-health or disability, redundancy or retirement (in each case, as determined by the Committee) or whose employment terminates automatically by reason of their death". As stated above, the Committee also retains an overall discretion to determine that an individual is a good leaver.

Outplacement services and reimbursement of legal costs may be provided where appropriate. Any statutory entitlements or sums to settle or compromise claims in connection with a termination would be paid as necessary. Outstanding savings/awards under the SAYE and the legacy Share Incentive Plan would be transferred in accordance with the terms of the plans as approved by HMRC.

Change of control

The change of control policy for the new Remuneration Policy is set out below. No changes to 2015 Policy are proposed.

Element	Purpose and link to strategy	Operation
Annual Bonus Cash Awards the Year of the Change of Control	Pro-rated to time and performance to the date of the change of control (formula included in rules).	The Committee has discretion regarding whether to pro-rate the bonus to time. The Committee's normal policy is that it will pro-rate the bonus for time. In circumstances where there is an appropriate business case, the Committee may use discretion and not pro-rate. Use of discretion will be explained to shareholders.
Annual Bonus Deferred Share Awards	Subsisting deferred share awards will vest on a change of control.	The Committee has discretion regarding whether to pro-rate the awards to time. The Committee's normal policy is that it will not pro-rate awards for time. The Committee will make this determination depending on the circumstances of the change of control.
LTIP	The number of shares subject to subsisting LTIP awards will vest on a change of control, pro-rated to time and performance. The holding period will not apply on change of control.	The Committee has discretion regarding whether to pro-rate the LTIP awards to time. The Committee's normal policy is that it will pro-rate the LTIP awards for time. In circumstances where there is an appropriate business case, the Committee may use discretion and not pro-rate. Use of discretion will be explained in full to shareholders. Shares subject to a holding period will vest on change of control.

Chairman and Non-Executive Directors

The Remuneration Policy for Non-Executive Directors, other than the Chairman, is determined by the Chairman and Executive Directors. The fee for the Chairman is determined by the Remuneration Committee (without the Chairman present). No changes to the 2015 Policy are proposed.

Element	Purpose and link to strategy	Operation	Maximum Opportunity
Fee	To recruit and retain Non-Executive Directors of a suitable calibre for the role and duties required.	Board fee with additional fees paid for the Senior Independent Director and chairmanship of the Board Committees. The Chairman receives a total fee in respect of his Board duties. Fees are paid monthly. Directors will be reimbursed for any reasonable business expenses incurred in the course of their duties, including the tax payable thereon. The fees for the Non-Executive Directors and Chairman are set taking into account the time commitment of the role and market rates in comparable companies. The fees are normally reviewed annually (but not necessarily increased) effective from 1 April. The Company retains the flexibility to pay fees for the membership of committees. In exceptional circumstances, fees may also be paid for additional time spent on the Company's business outside normal duties. Non-Executive Directors do not participate in any variable remuneration or receive any other benefits.	Details of the current fee levels for the Directors are set out in the Annual Report on Remuneration on page 110. The fee levels are set subject to the maximum limits set out in the Articles of Association.

Non-Executive Directors normally serve terms of three years. They do not have service contracts. Instead, Non-Executive Directors are engaged by letters of appointment which are terminable by either party with no notice period and no compensation in the event of such termination, other than accrued fees and expenses. All Directors are subject to annual appointment or reappointment at the AGM.

Directors' remuneration report continued

Remuneration

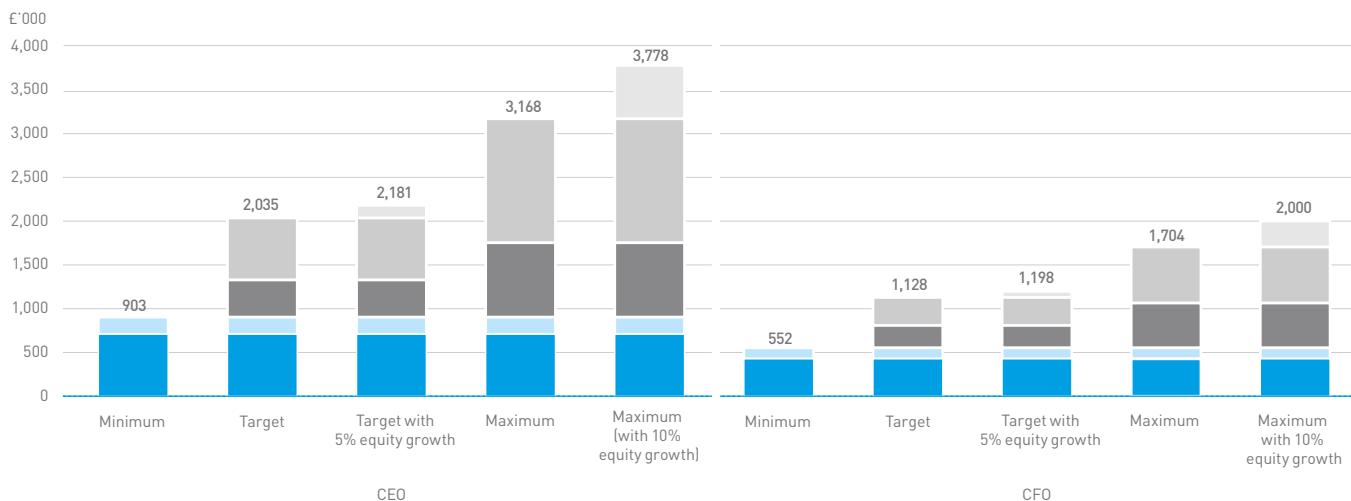
Application of the Remuneration Policy

The charts below provide an illustration of what could be received by each of the Executive Directors under the new Remuneration Policy for 2018/19. These charts are illustrative as the actual value will depend on business performance in the year 2018/19 (for the annual bonus) and in the three year period to 2020/2021 (for the LTIP), as well as share price performance to the date of the vesting of the share element of the Annual Bonus Plan and LTIP awards in 2021.

The on-target and maximum scenarios include an additional bar which shows the impact of share price growth over the relevant performance period to show how the package value is aligned to shareholders. We have used share price growth of 5% p.a. for on target performance and 10% p.a. for maximum performance. It is a key part of our Remuneration Policy to align interests of the Executive Directors and shareholders through the provision of a substantial element of remuneration in shares. Increases in the value of remuneration through an increase in share price are evidence of the direct link between the interests of the two.

Remuneration scenarios

■ Salary ■ Benefits and pension ■ Annual bonus ■ Long term share awards ■ Additional equity growth value (bonus and LTIP)



Note: Minimum pay is fixed pay only (i.e. salary + benefits + pension). On-target pay includes fixed pay, 50% of the maximum bonus (equal to 60% of salary for both the CEO and the CFO) and 50% vesting of the LTIP awards (with grant levels of 200% of salary for the CEO and 150% of salary for the CFO). Maximum pay includes fixed pay and assumes 100% vesting of both the annual bonus and the LTIP awards. All amounts have been rounded to the nearest £1,000. Salary levels (which are the base on which other elements of the package are calculated) are based on those applying at 1 July 2018. The value of taxable benefits is the cost of providing those benefits in the year ended 31 March 2018. The Executive Directors are also permitted to participate in HMRC tax advantaged all-employee share plans, on the same terms as other eligible employees, but they have been excluded from the above graph for simplicity.

Philip Remnant

Chairman of the Remuneration Committee

22 May 2018

Directors' report

The Directors present their report and the audited Group financial statements, for the year ended 31 March 2018. The performance review of the Company can be found within the Strategic report from the inside cover to page 65. This provides detailed information relating to the Group, its business model and strategy, the operation of its businesses, future developments and the results and financial position for the year ended 31 March 2018. The Governance Report set out on pages 66 to 128 is incorporated by reference into this report and, accordingly, should be read as part of this report.

Details of the Group's policy on addressing the principal risks and uncertainties facing the Group are set out in the risk management section on pages 57 to 65.

Principal activity

The principal activity of the Group is to treat and provide water and remove waste water in the UK and Ireland.

Details of the principal joint ventures, associated and subsidiary undertakings of the Group as at 31 March 2018 are shown in note 19 and 47 to the financial statements on pages 168 and 195 respectively.

Areas of operation

During the course of 2017/18, the Group had activities and operations in the UK and Ireland. On 3 July 2017, the Group announced the sale of its operations in the United States.

Directors and their interests

Biographies of the Directors currently serving on the Board are set out on pages 68 and 69.

All of the Directors, with the exception of Emma FitzGerald, will be offering themselves for appointment or reappointment at the Annual General Meeting ('AGM'), as set out in the Governance Report on page 78.

Details of Directors' service contracts are set out in the Directors' remuneration report on page 125. The interests of the Directors in the shares of the Company are shown on page 116 of that report. The Board has a documented process in place in respect of conflicts.

Insurance and indemnities

The Company maintains Directors' and Officers' liability insurance in respect of legal action that might be brought against its Directors and Officers. As permitted by the Company's Articles of Association (the 'Articles'), and to the extent permitted by law, the Company indemnifies each of its Directors and other Officers of the Group against certain liabilities that may be incurred as a result of their positions with the Group. The indemnity was in force throughout the tenure of each Director during the last financial year, and is currently in force. Severn Trent Plc does not have in place any indemnities for the benefit of the External Auditor.

Employees

The average number of employees within the Group is shown in note 9 to the financial statements on page 157.

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

We are an equal opportunities employer and welcome applications from all individuals, including those with a disability. We are fully committed to supporting applications made by disabled persons, and make reasonable adjustments to their environment where possible (having regard to their particular aptitudes and abilities). We are also responsive to the needs of our employees. As such, should any employee become disabled during their time with us, we will actively re-train that employee and make reasonable adjustments to their environment where possible, in order to keep them in employment with us.

All our training, promotion and career development processes are in place for all our employees to access, regardless of their gender, race, age or disability. The provision of occupational health programmes is of crucial importance to Severn Trent with the aim of keeping our employees fit, healthy and well, including an employee assistance programme.

Employee engagement

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

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

Details of the financial and economic factors affecting the performance of the Company are shared with all employees at the appropriate time using the methods listed above.

We provide opportunities for employees to give their feedback to the Company in a number of ways, from team or shift meetings and annual employee satisfaction surveys.

Directors' report continued

Other disclosures

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

Over 70% of Severn Trent's UK employees participate in the Sharesave scheme, with the average participant contributing £142 each month.

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

Research and development

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

Expenditure on research and development is set out in note 7 to the financial statements on page 156.

Internal controls

Further details of our internal control framework can be found in the Audit Committee report on page 86.

Treasury management

The disclosures required under the European Union ('EU') Fair Value Directive in relation to the use of financial instruments by the Company are set out in note 34 to the financial statements on pages 176 to 177. Further details on our Treasury Policy and management are set out in the Chief Financial Officer's review on page 55.

Post balance sheet events

Details of post balance sheet events are set out in note 44 to the Group financial statements on page 191.

Dividends

An interim dividend of 34.63 pence per Ordinary Share was paid on 5 January 2018. The Directors recommend a final dividend of 51.92 pence per Ordinary Share to be paid on 20 July 2018 to shareholders on the register on 15 June 2018. This would bring the total dividend for 2017/18 to 86.55 pence per Ordinary Share (2016/17: 81.50 pence). The payment of the final dividend is subject to shareholder approval at the AGM.

Dividend Policy

We have enhanced our Dividend Policy for the period 2015-2020, with effect from 2017/18, and will now increase the dividend by growth of at least RPI +4% each year. This replaced the previous Dividend Policy of annual growth of the dividend at no less than RPI until March 2020.

The Dividend Policy reflects our strong operational delivery and financial performance, while ensuring that our bills are affordable for all our customers. When determining the policy the Board considered various scenarios and sensitivities, and reviewed the impact of adverse changes in inflation and interest rates on key metrics. The Board believes that the Dividend Policy is commensurate with a sustainable investment grade credit rating.

Capital structure

Details of the Company's issued share capital and of the movements during the year are shown in note 10 to the Company financial statements on page 202. The Company has one class of Ordinary Shares which carries no right to fixed income. Each share carries the right to one vote at General Meetings of the Company. The issued nominal value of the Ordinary Shares is 100% of the total issued nominal value of all share capital.

There are no specific restrictions on the size of a holding nor on the transfer of shares, which are both governed by the general provisions of the Articles and prevailing legislation. The Directors are not aware of any agreements between holders of the Company's shares that may result in restrictions on the transfer of securities or on voting rights.

Details of employee share schemes are set out in note 37 to the financial statements on pages 184 to 186. For shares held by the Severn Trent Employee Share Ownership Trust, the Trustee abstains from voting.

No person has any special rights of control over the Company's share capital and all issued shares are fully paid.

With regard to the appointment and replacement of Directors, the Company is governed by its Articles, the Code, the Companies Act 2006 and related legislation. The Articles may be amended by Special Resolution of the shareholders. The powers of Directors are described in the Severn Trent Plc Board Governance document which can be found on our website, the Articles and the Governance report on page 73.

Under the Articles, the Directors have authority to allot Ordinary Shares, subject to the aggregate nominal amount limit set at the 2017 AGM.

Change of control

There are a number of agreements that take effect after, or terminate upon, a change of control of the Company, such as commercial contracts, bank loan agreements, property lease arrangements and employee share plans. None of these are considered to be significant in terms of their likely impact on the business of the Group as a whole. There are no agreements between the Company and its Directors or employees that provide for compensation for loss of office or employment because of a takeover bid.

Substantial shareholdings

As at 31 March 2018, the Company had been notified in accordance with Chapter 5 of the Disclosure Guidance and Transparency Rules of the following major shareholdings:

Name of holder	No. of Ordinary Shares of 97½ p each	Percentage of voting rights and issued share capital
BlackRock, Inc	18,425,671	7.8%
Reef Real Estate	10,248,946	4.34%
Aberdeen Standard Investments	9,308,469	3.94%
Legal & General Investment Management	8,226,287	3.48%
Maple-Brown Abbott	7,835,714	3.32%
Lazard Asset Management	7,335,575	3.10%

As at 22 May 2018, the Company had been notified of the following holdings of voting rights in the Ordinary Share capital of the Company: BlackRock, Inc 18,297,775 shares (7.74%); Reef Real Estate 9,988,240 shares (4.23%); Aberdeen Standard Investments 8,964,476 shares (3.79%); Legal & General Investment Management 8,533,601 shares (3.61%); Maple-Brown Abbott 8,054,760 shares (3.41%); Lazard Asset Management 10,424,261 shares (4.41%).

The percentage of voting rights detailed above was calculated at the time of the relevant disclosures were made in accordance with Rule 5 of the Disclosure Guidance and Transparency Rules.

Authority to purchase shares

The Company was given authority at its AGM in 2017 to make market purchases of Ordinary Shares up to a maximum number of 23,603,888 Ordinary Shares. During the year, no Ordinary Shares have been repurchased.

Authority will again be sought from shareholders at this year's AGM to purchase up to a maximum of 23,677,393 Ordinary Shares.

The Directors believe that it is desirable to have the general authority to buy back the Company's Ordinary Shares in order to provide maximum flexibility in the management of the Group's capital resources. However, the authority would only be used if the Board was satisfied at the time that to do so would be in the best interests of shareholders.

Contributions for political and charitable purposes

Donations to charitable organisations during the year amounted to £81,947 (2017: £312,588). Donations are given to charities whose projects align closely with our aim to promote the responsible use of water resources and waste water services which provide the opportunity for longer term partnerships. In addition, we provide donations to employee nominated charities through a matched funding scheme and health and safety reward schemes. We are also committed to supporting WaterAid, the UK's only major charity dedicated to improving access to safe water, hygiene and sanitation in the world's poorest countries.

Severn Trent's policy is not to make any donations for political purposes in the UK, or to donate to EU political parties or incur EU political expenditure. Accordingly, neither Severn Trent Plc nor its subsidiaries made any political donations or incurred political expenditure in the financial year under review.

Under the provisions of the Political Parties Elections and Referendums Act 2000 (the relevant provisions of which are now contained in Part 14 of the Companies Act 2006), shareholder authority is required for political donations to be made or political expenditure to be incurred by the Company or any of its subsidiaries in the EU and disclosure of any such payment must be made in the Annual Report and Accounts. The legislation gives a wide definition of what constitutes political donations and political expenditure including sponsorship, subscriptions, payment of expenses, paid leave for employees fulfilling public duties and support for bodies representing the business community in policy review or reform. The Company has therefore obtained limited authority from shareholders as a precautionary measure to allow the Company to continue supporting the community and such organisations without inadvertently breaching the legislation.

At the 2017 AGM, shareholders gave the Company authority to make political donations or to incur political expenditure in the EU (which would not ordinarily be regarded as political donations) up to an aggregate annual limit of £150,000 for the Company and its subsidiaries. Pursuant to those authorities, during the year ended 31 March 2018 the Group incurred costs of £nil (2017: £nil). Those authorities will expire at the 2018 AGM and, in line with market practice to renew the authorities on an annual basis, the Board has decided to put forward a resolution to this year's AGM to renew the authorities to make donations to political organisations and to incur political expenditure up to a maximum aggregate of £150,000 p.a. As permitted under the Companies Act 2006, this resolution also covers any political donations made or political expenditure incurred by any subsidiaries of the Company.

Directors' report continued

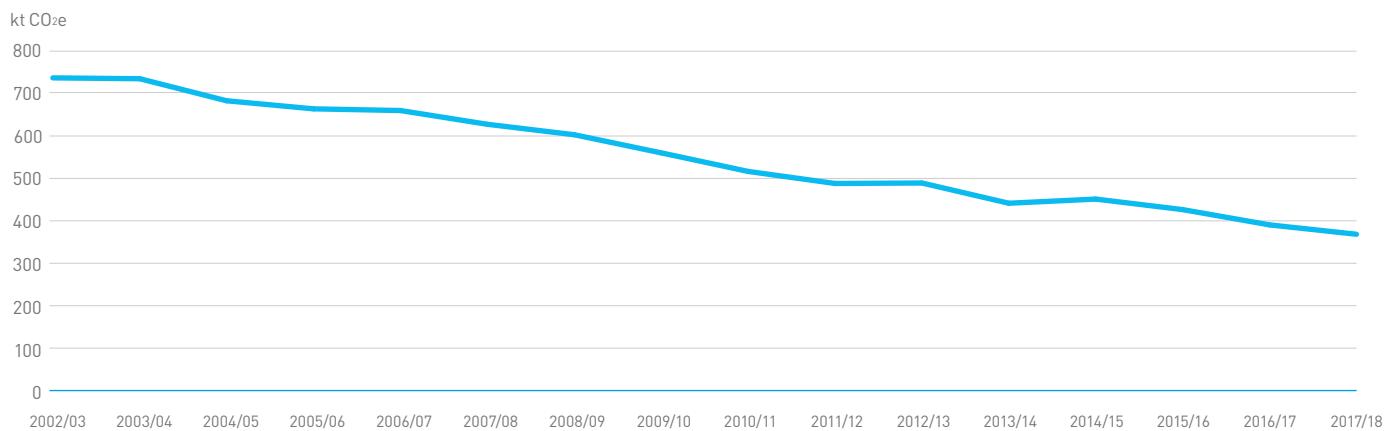
Other disclosures

We reduce our carbon footprint

The UK is playing a leading part in reducing carbon emissions. We want to play our part in reducing our impact by reducing our carbon emissions. As the majority of our carbon emissions are driven by our use of energy, managing carbon means managing costs. We therefore aim to reduce carbon emissions and increase our generation of renewable energy.

We are achieving both of these aims, and this year we have seen another reduction in overall carbon emissions. We've seen a consistent reduction since 2002 when we began publicly reporting on our greenhouse gas emissions. We have held the Carbon Trust Standard since 2009 in recognition of this achievement and we've been recertified to 2019.

Severn Trent Carbon Footprint



The Carbon Trust Standard recognises our consistent emissions reductions and effective carbon management processes and we scored in the top quartile of companies. We continue to report to the Carbon Disclosure Project ('CDP') each year which means our climate change information is publicly accessible. CDP request information about climate change from companies on behalf of investors and score each company on the quality and completeness of their responses.

During this year, we again increased renewable energy generation and across Severn Trent we now generate an equivalent of 38% of Severn Trent Water Limited's electricity needs. We continue to lead the UK water industry, with an aim of building on this position by generating the equivalent of 50% of our electricity needs by 2020.

We plan to continue to reduce our operational emissions by reducing our energy use and increase our renewable energy generation, mainly within Business Services. Pursuing these measures will continue to reduce our key sources of emissions, reduce our reliance on the electricity grid and bring financial benefits for our customers and investors.

Report on greenhouse gas emissions

This is the fifth year Severn Trent has been required to report greenhouse gas ('GHG') emissions in the Directors' report.

Severn Trent is committed to reducing its GHG emissions. For Severn Trent Water Limited, which accounts for 99% of our total Group emissions, we have been publicly reporting on our emissions since 2002. In that time we have reduced our emissions by being more energy efficient and generating more renewable energy.

Our GHG emissions are reported in tonnes of carbon dioxide equivalent ('tCO₂e'), for the period 1 April 2017 to 31 March 2018.

Our total net emissions have fallen again this year, due to our increased generation of renewable energy, a reduction in the emissions-intensity of UK grid electricity and reduced fuel and process emissions. The sale of our US business has reduced our emissions outside the UK.

The GHG data we report is reported internally during the year to the Corporate Responsibility Committee and to the Board. We have subjected our GHG data and processes to external assurance by Jacobs.

Severn Trent Plc Direct Operational Greenhouse Gas Emissions (tCO₂e)	2013/14	2014/15	2015/16	2016/17	2017/18
Emissions from combustion of fuel and operation of facilities (Scope 1)	132,535	132,406	134,584	138,131	134,307
Emissions from electricity purchased for own use (Scope 2)	330,679	357,756	337,028	294,426	279,393
Total Annual Gross Operational Emissions	463,214	490,163	471,612	432,557	413,700
Emissions benefit of the renewable energy we export (including biomethane exported for which we hold green gas certificates)	21,672	38,878	45,085	42,069	45,333
Total Annual Net Operational Emissions	441,542	451,285	426,527	390,488	368,367

Annual GHG intensity ratio (tCO₂/unit)	2013/14	2014/15	2015/16	2016/17	2017/18
Operational GHG emissions of Severn Trent per £m turnover	248.6	255.2	234.7	214.0	217.4

Our approach to reporting is based on the GHG Protocol Corporate Accounting and Reporting Standard and we have included only emissions from the assets which we own and operate and which we can directly influence and reduce, known as the financial control boundary. In accordance with the reporting regulations, we have not reported on emissions we can influence, but which we are not responsible for, referred to as indirect emissions. We have used the 'location based' methodology rather than the more recently-introduced 'market-based' method to account for use of grid electricity in order to ensure consistency with previous years.

For the appointed UK Water businesses Severn Trent Water Limited and Dee Valley Water Limited, we have calculated our emissions using the 'Carbon accounting in the UK Water Industry: methodology for estimating operational emissions, Version 12' [released April 2018]. This is a peer-reviewed calculation tool developed and used by all the major water companies in the UK. It is updated each year to include the latest available emissions factors. For Severn Trent Services, we have used the latest Defra emissions factors which include the relevant conversion factors for overseas electricity.

SEVERN TRENT WATER ONLY –					
Operational Greenhouse Gas Emissions (tCO₂e)	2013/14	2014/15	2015/16	2016/17	2017/18
Scope 1 Emissions (Combustion of fuel and operation of facilities)	123,940	122,282	126,009	128,584	130,662
Scope 2 Emissions (Electricity purchased for own use)	333,721	357,701	340,484	298,872	264,290
Total Annual Gross Operational Emissions	457,661	479,983	466,493	427,456	394,951
Emissions benefit of the renewable energy we export (including biogas for which we hold green gas certificates)	18,638	24,247	24,887	22,790	27,476
Total Annual Net Operational Emissions	439,023	455,735	441,606	404,666	367,475

Supplier payment policy

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

Relevant audit information

The Directors confirm that:

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

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

External Auditor

Having carried out a review of their effectiveness during the year, details of which can be found in the Audit Committee report on page 87, the Audit Committee has recommended to the Board the reappointment of Deloitte LLP. The reappointment and a resolution to that effect will be on the agenda at the AGM. Deloitte LLP indicated their willingness to continue as Auditor. The Audit Committee will also be responsible for determining the audit fee on behalf of the Board.

Directors' report continued

Other disclosures

Disclosures required under Listing Rule 9.8.4R

The information required to be disclosed by Listing Rule 9.8.4R can be located in the following pages of this Annual Report and Accounts:

Section	Information to be included	Location
(1)	A statement of the amount of interest capitalised	Page 158
(4)	Details of long term incentive schemes	Page 123
(8)	Section 7 in relation to subsidiary undertakings	Pages 195 to 196
(2), (5), (6), (7), (9)–(14)		Not applicable

Greenhouse gas emissions

The disclosures required by law relating to the Group's greenhouse gas emissions are included in the Directors' report on pages 132 and 133.

Accounts of Severn Trent Water Limited and Dee Valley Water Limited

Separate Annual Performance Reports for each of Severn Trent Water Limited and Dee Valley Water Limited are prepared and provided to Ofwat. Copies will be available on our website or on request to the Company Secretary. There is no charge for these publications.

Annual General Meeting

The AGM of the Company will be held at the Ricoh Arena, Phoenix Way, Coventry, CV6 6GE at 11am on Wednesday 18 July 2018. The notice convening the meeting, together with details of the business to be considered and explanatory notes for each resolution, is distributed separately to shareholders. It is also available on our website.

By order of the Board

Bronagh Kennedy

Group General Counsel and Company Secretary

22 May 2018

Directors' Responsibilities Statement

Other disclosures

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors are required to prepare the Group financial statements in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the European Union and Article 4 of the IAS Regulation and have elected to prepare the Company financial statements in accordance with United Kingdom Generally Accepted Practice (United Kingdom Accounting Standards and applicable law) including FRS101 'Reduced Disclosure Framework'. Under company law the Directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

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

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

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

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

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

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

Responsibility Statement

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

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

This Responsibility Statement was approved by the Board of Directors on 22 May 2018 and is signed on its behalf by:

Andrew Duff

Chairman

22 May 2018

James Bowling

Chief Financial Officer

Group financial statements

Independent auditor's report to the members of Severn Trent Plc

Report on the audit of the financial statements

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2018 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including Financial Reporting Standard 101 "Reduced Disclosure Framework"; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements of Severn Trent Plc (the 'parent company') and its subsidiaries (the 'group') which comprise:

- the consolidated income statement;
- the consolidated and parent company statements of comprehensive income;
- the consolidated and parent company statements of changes in equity;
- the consolidated and parent company balance sheets;
- the consolidated cash flow statement; and
- the related notes to the consolidated financial statements 1 to 47 and the related notes to the parent company financial statements 1 to 18.

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

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the group and the parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the parent company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Summary of our audit approach

Key audit matters	<p>The key audit matters that we identified in the current year were:</p> <ul style="list-style-type: none">• Accuracy of wholesale revenue for non-household customers in the new water market;• Valuation of the provision for trade receivables in Severn Trent Water Limited;• Valuation of the group's retirement benefit obligations; and• Classification and valuation of capital expenditure in Severn Trent Water Limited. <p>Within this report, any new key audit matters are identified with  and any key audit matters which are the same as the prior year are identified with .</p>
Materiality	The materiality that we used for the group financial statements was £18 million [2017: £18 million] which was determined on the basis of profit before tax, gains/losses on financial instruments and exceptional items.
Scoping	Our audit scoping has resulted in over 90% of the group's net operating assets and profit before tax being subject to audit testing.
Significant changes in our approach	The group disposed of its Operating Services (US) business on 30 June 2017 and therefore it has not been subject to a component audit for the year ended 31 March 2018. There have been no other significant changes to our scoping approach.

Conclusions relating to going concern, principal risks and viability statement

Going concern

We have reviewed the directors' statement in note 2a to the financial statements and page 59 of the Strategic report about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the group's and company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.

We are required to state whether we have anything material to add or draw attention to in relation to that statement required by Listing Rule 9.8.6R(3) and report if the statement is materially inconsistent with our knowledge obtained in the audit.

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

Principal risks and viability statement

Based solely on reading the directors' statements and considering whether they were consistent with the knowledge we obtained in the course of the audit, including the knowledge obtained in the evaluation of the directors' assessment of the group's and the company's ability to continue as a going concern, we are required to state whether we have anything material to add or draw attention to in relation to:

- the disclosures on pages 60 to 65 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation on page 60 that they have carried out a robust assessment of the principal risks facing the group, including those that would threaten its business model, future performance, solvency or liquidity; or
- the directors' explanation on pages 58 and 59 as to how they have assessed the prospects of the group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We are also required to report whether the directors' statement relating to the prospects of the group required by Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.

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

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

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

The following key audit matters from the prior year have not been included in the current year:

- revenue recognition in relation to the estimation of unbilled metered revenue in Severn Trent Water Limited on the basis that the difference between the amount accrued and subsequently billed has consistently represented approximately 1% of the accrued income over a number of consecutive years; and
- the valuation of current and deferred tax balances following the settlement of open enquiries with HMRC in the prior year.

Accuracy of wholesale revenue for non-household customers in the new water market



Key audit matter description	<p>On 1 April 2017 the new water retail market opened in England, allowing eligible non-household customers the opportunity to choose their water retailer for the first time. Market Operator Services Limited ("MOSL") was established to facilitate the switching of customers, and also to provide a service to settle accounts between water wholesalers and retailers. Severn Trent Water is a wholesaler. Management have recorded manual adjustments to revenue compared to the information provided by MOSL's Core Market Operating System ("CMOS"). Non-household revenue for the year ended 31 March 2018 is £371.4 million as disclosed on page 85.</p> <p>The key audit matter has been focussed on whether manual adjustments made to revenue are accurate. Due to the high level of judgement involved, we have determined that there was a potential for fraud through possible manipulation of this balance.</p> <p>The Audit Committee also considered this as a significant issue as discussed in the Audit Committee Report on page 85.</p>
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How the scope of our audit responded to the key audit matter	<p>We have challenged the assumptions applied and the integrity of management's calculation of the adjustments by performing the following:</p> <ul style="list-style-type: none"> evaluated the design and implementation of key controls over the adjustments to revenue; understood and audited reconciling items between volume and revenue recorded by Severn Trent Water Limited and the information provided by CMOS, specifically recalculating the extrapolation based on settlement reports received; inquired as to whether any Market Operator disputes or Market Arrangement Code disputes are open at the year end date which could indicate that revenue has been incorrectly recorded; reviewed and challenged the information used to build up the model by considering the accuracy and completeness of the source data used for calculating the adjustments; tested the completeness of adjustments by reference to operational data; and benchmarked the direction of the adjustment across the industry and made direct enquiries of management of the Group's joint venture, WaterPlus, of adjustments being recorded by them.
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Key observations	We are satisfied that management's manual adjustments to revenue are appropriate.
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Valuation of the provision for trade receivables in Severn Trent Water Limited	
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Key audit matter description	<p>A proportion of Severn Trent Water Limited's customers do not or cannot pay their bills which results in the need for provisions to be made for non-payment of the customer balance. Management makes estimates regarding future cash collection when calculating the bad debt provision.</p> <p>The value of the provision for trade receivables in Severn Trent Water at 31 March 2018 is £124.5 million of the total provision of £129.0 million (31 March 2017 £125.4 million of the total provision of £130.5 million) in note 21.</p> <p>Provisions are made against Severn Trent Water Limited's trade receivables based on historical experience of levels of recovery from accounts in particular ageing categories. The key audit matter has been focused on the determination of the ageing of trade receivables balances as this determines the level of provisioning to be recorded and the historical cash collection rates applied to the aged debt. Due to the high level of judgement involved, we have determined that there was a potential for fraud through possible manipulation of this balance.</p> <p>The Audit Committee also considered this as a significant issue as discussed in the Audit Committee Report on page 85.</p>
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Independent auditor's report to the members of Severn Trent Plc continued

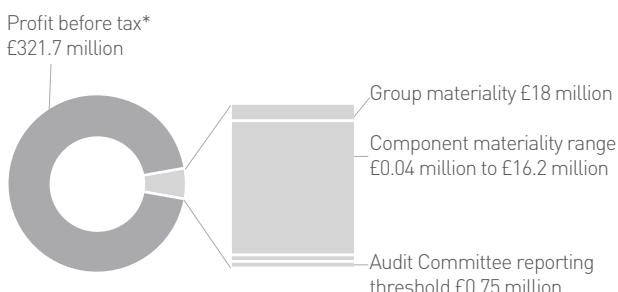
How the scope of our audit responded to the key audit matter	<p>We challenged and tested the information used to determine the bad debt provision by considering cash collection performance against historical trends and the level of bad debt charges over time. Specifically, we analysed the actual experience of slow paying customers in the period using data analytics to consider the collection of debtors that were previously in each aged category. We have also:</p> <ul style="list-style-type: none"> evaluated the design and implementation of key management review controls over the bad debt model and management's bad debt paper; reconciled the debtor ageing for each debt category used in the bad debt provision model using source data from Severn Trent's customer billing system; audited the information used in calculating the bad debt provision to assess whether it was updated for current cash collection performance; assessed and audited the rationale for changes to the basis of estimation where changes were made to the bad debt calculation in the current year to reflect historical cash collection patterns for debts with certain characteristics; compared and assessed the payment profile and level of bad debt provision with those established in previous periods; considered whether the provision appropriately covered any exposure inherent in the accrued income element of the debtor balance; deployed our spreadsheet analyser tool to identify anomalies in the bad debt model for further consideration; and considered whether any of the changes to the estimation in the year represented changes in accounting policy or material error, which required reassessment of the historical position.
Key observations	We are satisfied that the assumptions applied in assessing the impairment of trade receivables and the calculation of the ageing of trade receivable are appropriate and no additional provision was identified from the audit work performed.
Valuation of the group's retirement benefit obligations	↗
Key audit matter description	<p>This is an area involving significant estimation because the process is complex and requires management after taking advice from their actuarial advisers to make a number of assumptions concerning the discount rate, inflation and pension increases, and the longevity of current pensioners in order to determine the value of the scheme's liabilities. The key audit matter is focused on the valuation of the pension scheme liabilities and the appropriateness of the actuarial assumptions that are used to calculate it, specifically with reference to the discount rate.</p> <p>The group's retirement benefit obligation at 31 March 2018 is £519.8 million [31 March 2017 £574.6 million] as per note 28 Retired Benefit Schemes.</p> <p>The Audit Committee also considered this as a significant issue as discussed in the Audit Committee Report on page 86. Management has included this as a key source of estimation uncertainty in note 4 to the financial statements.</p>
How the scope of our audit responded to the key audit matter	<p>We have challenged the assumptions applied by performing the following procedures:</p> <ul style="list-style-type: none"> evaluated the design and implementation of key controls and with support from the pension specialists within our audit team, we challenged the assumptions used in the calculation of the pension scheme deficit as detailed in note 28, specifically challenging the discount rate with reference to comparable market and other third party data; and assessed whether there had been any changes in the methodology to determine the assumptions since the prior year.
Key observations	We are satisfied that management's assumptions in the valuation of the retirement benefit obligation, including discount rates, are appropriate and within a reasonable range.
Classification and valuation of capital expenditure in Severn Trent Water Limited	↗
Key audit matter description	<p>Severn Trent Water Limited has a substantial capital programme which has been agreed with the regulator ("Ofwat") and therefore incurs significant expenditure in relation to the development and maintenance of both infrastructure and non-infrastructure assets.</p> <p>Property, plant and equipment ('PPE') additions in Severn Trent Water Limited were £663.2 million of the total additions of £691.2 million disclosed in note 18 (£541.5 million of £583.9 million at 31 March 2017).</p> <p>Expenditure in relation to increasing the capacity or enhancing the network is treated as capital expenditure. Capital projects may contain a combination of enhancement and maintenance activity which are not distinct and therefore there is a key audit matter that PPE is valued incorrectly as a result of items of operating expenditure being misclassified. Due to the level of judgement involved, we have determined that there was a potential for fraud through possible manipulation of this balance.</p> <p>The Audit Committee also considered this a significant issue as discussed in the Audit Committee Report on page 85. Management has included this as a critical judgement in note 4 to the financial statements.</p>
How the scope of our audit responded to the key audit matter	<p>We performed the following procedures to respond to the key audit matter:</p> <ul style="list-style-type: none"> we assessed the group's capitalisation policy to determine compliance with relevant accounting standards; we evaluated the design and implementation and tested the operating effectiveness of controls over the application of the policy to expenditure incurred on projects within the group's capital programme during the year; for a sample of capital projects, we assessed the application of the capitalisation policy to the costs incurred by understanding the initial business case for the project and ensuring that it had been approved by the relevant capital programme board; and we agreed a sample of costs to third party invoices and assessed whether the split between capital and operating expenditure was aligned to the original approved business plan.
Key observations	We are satisfied that the valuation and classification of assets capitalised in the year is appropriate.

Our application of materiality

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

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

	Group financial statements	Parent company financial statements
Materiality	£18 million (2017: £18 million)	£16.2 million (2017: £16.2 million)
Basis for determining materiality	Approximately 5.6% (2017: approximately 5.7%) of profit before tax, gains/losses on financial instruments and exceptional items.	3.0% of net assets (2017: 3.0%) capped to 90% of group materiality.
Rationale for the benchmark applied	As in 2017, profit before tax, gains/losses on financial instruments and exceptional items has been used in order to focus on the group's underlying trading performance consistent with the group's internal and external reporting.	The parent company does not trade or exist for profit generating purposes so materiality has been determined using net assets.



- Profit before tax*
- Group materiality

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

An overview of the scope of our audit

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

Regulated Water and Waste Water is primarily comprised of Severn Trent Water Limited and Dee Valley Water Limited which were subject to a full scope audit using a materiality of £15m and £0.4m respectively. We have audited a further 10 components using individual statutory materialities which range from £44,000 to £9,000,000. Operating Services US was disposed on 30 June 2017 contributing £42.1 million of revenue and profit before interest and tax of £1.4 million and was subject to analytical review.

This represents over 90% (2017: over 90%) of the group's net operating assets and profit before tax, gains/losses on financial instruments and exceptional items.

We also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to full scope audit procedures.

Our scoping is consistent with the prior year except that Water Plus Limited, Derwent Insurance Limited and Lyra Insurance Guernsey Limited have not been audited by separate component teams in 2018. They are subject to audit procedures performed by the Group audit team.

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

In this context, matters that we are specifically required to report to you as uncorrected material misstatements of the other information include where we conclude that:

- Fair, balanced and understandable – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the group's position and performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- Audit committee reporting – the section describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee; or
- Directors' statement of compliance with the UK Corporate Governance Code – the parts of the directors' statement required under the Listing Rules relating to the company's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R[2] do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

We have nothing to report in respect of these matters.

Group financial statements

Independent auditor's report to the members of Severn Trent Plc continued

Responsibilities of directors

As explained more fully in the Directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group's and the parent company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

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

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Companies Act 2006

In our opinion the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

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

- the information given in the Strategic report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic report and the Directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the group and of the parent company and their environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

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

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

We have nothing to report in respect of these matters.

Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made or the part of the Directors' remuneration report to be audited is not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

Other matters

Auditor tenure

We were appointed by the Company at its annual general meeting on 26 July 2005 to audit the financial statements of the Company for the year ending 31 March 2006 and subsequent financial periods. Following a competitive tender process, we were reappointed as auditor of the Company for the year ending 31 March 2016 and subsequent financial periods.

Our total uninterrupted period of engagement is 13 years, covering periods from our initial appointment through to the year ending 31 March 2018.

Consistency of the audit report with the additional report to the audit committee

Our audit opinion is consistent with the additional report to the Audit Committee we are required to provide in accordance with ISAs (UK).

Kari Hale, ACA (Senior statutory auditor)

For and on behalf of Deloitte LLP

Statutory Auditor

London, United Kingdom

22 May 2018

Consolidated income statement

For the year ended 31 March 2018

	Notes	2018 £m	2017 (restated) £m
Turnover	5, 6	1,694.1	1,638.0
Operating costs before exceptional items	7	(1,153.1)	(1,117.9)
Exceptional items	8	(12.6)	16.6
Total operating costs		(1,165.7)	(1,101.3)
Profit before interest, tax and exceptional items	5	541.0	520.1
Exceptional items	8	(12.6)	16.6
Profit before interest and tax		528.4	536.7
Finance income	10	67.7	72.2
Finance costs	11	(287.2)	(277.3)
Net finance costs		(219.5)	(205.1)
Net losses on financial instruments	12	(6.7)	(1.8)
Share of net profit/(loss) of joint ventures accounted for using the equity method	19	0.2	(1.8)
Profit on ordinary activities before taxation		302.4	328.0
Current tax	13	(32.9)	(36.3)
Deferred tax	13	(29.0)	(22.4)
Exceptional tax	13	–	52.2
Taxation on profit on ordinary activities	13	(61.9)	(6.5)
Profit for the year from continuing operations		240.5	321.5
Profit for the year from discontinued operations	39	13.2	21.1
Profit for the year		253.7	342.6
Attributable to:			
Owners of the company		253.7	342.8
Non-controlling interests		–	(0.2)
		253.7	342.6

Earnings per share

		2018 pence	2017 (restated) pence
From continuing operations			
Basic	15	102.2	136.8
Diluted	15	101.9	136.2
From continuing and discontinued operations			
Basic	15	107.8	145.9
Diluted	15	107.5	145.3

Consolidated statement of comprehensive income

For the year ended 31 March 2018

	2018 £m	2017 £m
Profit for the year	253.7	342.6
Other comprehensive income/(loss)		
Items that will not be reclassified to the income statement:		
Net actuarial gain/(loss)	29.1	(311.2)
Tax on net actuarial gain/loss	(7.6)	56.3
Deferred tax arising on change of rate	-	(3.1)
	21.5	(258.0)
Items that may be reclassified to the income statement:		
Gains/(losses) on cash flow hedges	5.8	(8.0)
Deferred tax on gains/losses on cash flow hedges	(1.0)	1.3
Amounts on cash flow hedges transferred to the income statement	8.2	2.9
Deferred tax on transfer to the income statement	(1.4)	(0.4)
Exchange movement on translation of overseas results and net assets	(1.6)	5.2
Cumulative exchange gains taken to the income statement	(29.8)	(2.8)
	(19.8)	(1.8)
Other comprehensive income/(loss) for the year	1.7	(259.8)
Total comprehensive income for the year	255.4	82.8
Attributable to:		
Owners of the company	255.4	83.1
Non-controlling interests	-	(0.3)
	255.4	82.8

Consolidated statement of changes in equity

For the year ended 31 March 2018

	Equity attributable to owners of the company						Total equity £m
	Share capital £m	Share premium £m	Other reserves £m	Retained earnings £m	Total £m	Non-controlling interests £m	
At 1 April 2016	234.3	106.8	116.5	559.8	1,017.4	1.1	1,018.5
Profit for the year	–	–	–	342.8	342.8	(0.2)	342.6
Losses on cash flow hedges	–	–	(8.0)	–	(8.0)	–	(8.0)
Deferred tax on losses on cash flow hedges	–	–	1.3	–	1.3	–	1.3
Amounts on cash flow hedges transferred to the income statement	–	–	2.9	–	2.9	–	2.9
Deferred tax on transfer to the income statement	–	–	(0.4)	–	(0.4)	–	(0.4)
Exchange movement on translation of overseas results and net assets	–	–	5.3	–	5.3	(0.1)	5.2
Cumulative exchange gains transferred to income statement	–	–	(2.8)	–	(2.8)	–	(2.8)
Net actuarial losses	–	–	–	(311.2)	(311.2)	–	(311.2)
Tax on net actuarial losses	–	–	–	56.3	56.3	–	56.3
Deferred tax arising from rate change	–	–	–	(3.1)	(3.1)	–	(3.1)
Transfer net of deferred tax	–	–	7.0	(7.0)	–	–	–
Total comprehensive income/(loss) for the year	–	–	5.3	77.8	83.1	(0.3)	82.8
Share options and LTIPs							
– proceeds from shares issued	0.4	5.7	–	–	6.1	–	6.1
– value of employees' services	–	–	–	6.2	6.2	–	6.2
Current tax on share based payments	–	–	–	0.8	0.8	–	0.8
Deferred tax on share based payments	–	–	–	0.1	0.1	–	0.1
Disposal of non-controlling interest	–	–	–	–	–	(0.8)	(0.8)
Dividends paid	–	–	–	(190.4)	(190.4)	–	(190.4)
At 31 March 2017	234.7	112.5	121.8	454.3	923.3	–	923.3
Profit for the year	–	–	–	253.7	253.7	–	253.7
Gains on cash flow hedges	–	–	5.8	–	5.8	–	5.8
Deferred tax on gains on cash flow hedges	–	–	(1.0)	–	(1.0)	–	(1.0)
Amounts on cash flow hedges transferred to the income statement	–	–	8.2	–	8.2	–	8.2
Deferred tax on transfer to the income statement	–	–	(1.4)	–	(1.4)	–	(1.4)
Exchange movement on translation of overseas results and net assets	–	–	(1.6)	–	(1.6)	–	(1.6)
Cumulative exchange gains transferred to income statement	–	–	(29.8)	–	(29.8)	–	(29.8)
Net actuarial gains	–	–	–	29.1	29.1	–	29.1
Tax on net actuarial gains	–	–	–	(7.6)	(7.6)	–	(7.6)
Transfer between reserves	–	–	(9.0)	9.0	–	–	–
Total comprehensive (loss)/income for the year	–	–	(28.8)	284.2	255.4	–	255.4
Share options and LTIPs							
– proceeds from shares issued	0.4	5.2	–	–	5.6	–	5.6
– value of employees' services	–	–	–	6.9	6.9	–	6.9
Current tax on share based payments	–	–	–	0.8	0.8	–	0.8
Deferred tax on share based payments	–	–	–	(1.3)	(1.3)	–	(1.3)
Dividends paid	–	–	–	(197.0)	(197.0)	–	(197.0)
At 31 March 2018	235.1	117.7	93.0	547.9	993.7	–	993.7

Consolidated balance sheet

At 31 March 2018

	Notes	2018 £m	2017 £m
Non-current assets			
Goodwill	16	62.2	81.0
Other intangible assets	17	88.4	80.9
Property, plant and equipment	18	8,471.9	8,116.4
Interests in joint ventures	19	37.6	37.4
Derivative financial instruments	20	36.0	67.0
Trade and other receivables	21	181.3	58.1
Retirement benefit surplus	28	18.2	9.8
		8,895.6	8,450.6
Current assets			
Inventory		18.5	16.2
Trade and other receivables	21	456.4	517.8
Current tax receivable		—	7.3
Derivative financial instruments	20	0.2	—
Cash and cash equivalents	22	51.1	44.6
		526.2	585.9
Current liabilities			
Borrowings	23	(308.7)	(559.4)
Derivative financial instruments	25	—	(0.6)
Trade and other payables	26	(462.6)	(451.9)
Current tax payable		(8.6)	—
Provisions for liabilities	29	(40.6)	(17.5)
		(820.5)	(1,029.4)
Net current liabilities		(294.3)	(443.5)
Non-current liabilities			
Borrowings	23	(5,259.1)	(4,719.6)
Derivative financial instruments	25	(116.0)	(184.1)
Trade and other payables	26	(1,009.4)	(955.7)
Deferred tax	27	(674.4)	(623.7)
Retirement benefit obligations	28	(538.0)	(584.4)
Provisions for liabilities	29	(10.7)	(16.3)
		(7,607.6)	(7,083.8)
Net assets		993.7	923.3
Equity			
Called up share capital	30	235.1	234.7
Share premium	31	117.7	112.5
Other reserves	32	93.0	121.8
Retained earnings		547.9	454.3
Total equity		993.7	923.3

Signed on behalf of the Board who approved the accounts on 22 May 2018.

Andrew Duff
Chairman

James Bowling
Chief Financial Officer

Company Number: 02366619

Consolidated cash flow statement

For the year ended 31 March 2018

	Notes	2018 £m	2017 £m
Cash generated from operations	40	773.3	851.0
Tax received	40	8.0	20.6
Tax paid	40	(14.5)	(42.4)
Net cash generated from operating activities		766.8	829.2
Cash flows from investing activities			
Purchase of subsidiaries net of cash acquired		(0.2)	(77.7)
Investments in associates and joint ventures		–	(13.5)
Purchases of property, plant and equipment		(608.5)	(519.2)
Purchases of intangible assets and goodwill		(27.3)	(29.1)
Contributions and grants received		36.8	39.5
Proceeds on disposal of subsidiaries and other businesses net of cash disposed		25.1	5.1
Proceeds on disposal of business to joint venture net of cash disposed		–	(10.8)
Proceeds on disposal of property, plant and equipment		8.0	7.5
Net loans advanced to joint ventures		(26.6)	(109.0)
Proceeds on maturity of forward contract		–	4.3
Interest received		6.4	1.4
Net cash from investing activities		(586.3)	(701.5)
Cash flow from financing activities			
Interest paid		(183.4)	(172.6)
Interest element of finance lease payments		(5.1)	(5.8)
Dividends paid to shareholders of the parent		(197.0)	(190.4)
Repayments of borrowings		(552.6)	(276.2)
Repayments of obligations under finance leases		(1.8)	(1.5)
New loans raised		789.2	498.0
Issues of shares		5.6	6.1
Swap termination payment		(40.0)	–
Net cash flow from financing activities		(185.1)	(142.4)
Net movement in cash and cash equivalents		(4.6)	(14.7)
Net cash and cash equivalents at the beginning of the year		44.6	55.2
Effect of foreign exchange rates		(1.5)	4.1
Net cash and cash equivalents at end of year		38.5	44.6
Cash and cash equivalents		34.7	25.8
Bank overdrafts		(12.6)	–
Short term deposits		16.4	18.8
Net cash and cash equivalents at end of year		38.5	44.6

Notes to the group financial statements

For the year ended 31 March 2018

1 General information

The Severn Trent group has a number of operations. These are described in the segmental analysis in note 5.

Severn Trent Plc is a company incorporated and domiciled in the United Kingdom. The address of its registered office is shown on the back of the cover of the Annual Report and Accounts.

Severn Trent Plc is listed on the London Stock Exchange.

2 Accounting policies

a) Basis of preparation

The financial statements for the group and the parent company have been prepared on the going concern basis (see strategic report on page 59) under the historical cost convention as modified by the revaluation of certain financial assets and liabilities at fair value.

(i) Consolidated financial statements

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRS'), International Accounting Standards ('IAS') and IFRIC interpretations issued and effective and ratified by the European Union as at 31 March 2018.

(ii) Parent company financial statements

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

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

As permitted by FRS 101, the parent company has taken advantage of the disclosure exemptions available under that standard in relation to statement of cash flows, share based payment, financial instruments, capital management, presentation of comparative information in respect of certain assets, standards not yet effective, impairment of assets and related party transactions. Where required, equivalent disclosures are given in the consolidated financial statements.

As permitted by section 408 of the Companies Act 2006, no profit or loss account or cash flow statement is presented for the parent company. The profit for the year is disclosed in the statement of comprehensive income, the statement of changes in equity and the balance sheet.

Severn Trent Plc is a partner in Severn Trent Limited Partnership ('the partnership'), which is registered in Scotland. As the partnership is included in the consolidated accounts, the parent company has taken advantage of the exemption conferred by Regulation 7 of The Partnership (Accounts) Regulations 2008 from the requirements of Regulations 4 to 6.

The key accounting policies for the group and the parent company are set out below and have been applied consistently. Differences in the accounting policies applied in the consolidated and the parent company financial statements are described below.

(iii) Prior year restatement

Prior year figures in the consolidated income statement, related notes and alternative performance measures in note 46 have been restated to present separately amounts relating to operations classified as discontinued in the current year. For details, see note 39.

b) Basis of consolidation

The consolidated financial statements include the results of Severn Trent Plc and its subsidiaries and joint ventures. Results are included from the date of acquisition or incorporation and excluded from the date of disposal.

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

Joint venture undertakings are accounted for on an equity basis where the group exercised joint control under a contractual arrangement.

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

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

c) Revenue recognition

Revenue includes turnover and interest income.

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

Turnover is not recognised until the service has been provided to the customer or the goods to which the sale relates have either been despatched to the customer or, where they are held on the customer's behalf, title has passed to the customer.

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

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

d) Exceptional items

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

2 Accounting policies continued

e) Taxation

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

Deferred taxation is provided in full on taxable temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements.

Deferred taxation is measured on a non-discounted basis using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred tax liability is settled.

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

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

f) Goodwill

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

Goodwill arising on all acquisitions prior to 1 April 1998 was written off to reserves under UK GAAP and remains eliminated against reserves. Following the disposal of the US Operating Services business on 30 June 2017, all acquisitions prior to 1 April 1998 that were included in goodwill have now been sold. Purchased goodwill arising on acquisitions of subsidiaries after 31 March 1998 is treated as an intangible fixed asset.

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

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

g) Other intangible non-current assets

Intangible assets acquired separately are capitalised at cost. Following initial recognition, finite life intangible assets are amortised on a straight-line basis over their estimated useful economic lives as follows:

	Years
Software	3 – 10
Other assets	2 – 20

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

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

Intangible assets with indefinite useful lives are carried at cost less accumulated impairment losses. Such assets are reviewed for impairment at least annually and where indications of impairment exist in accordance with the policy set out in note 2 k) below.

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

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

Research expenditure is expensed when it is incurred.

h) Pre-contract costs

Costs incurred in bidding and preparing for contracts are expensed as incurred except where it is probable that the contract will be awarded, in which case they are recognised as a prepayment which is written off to the income statement over the life of the contract.

The group assesses that it is probable that a contract will be awarded when preferred bidder or equivalent status has been achieved and there are no significant impediments to the award of the contract.

i) Property, plant and equipment

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

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

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

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

Notes to the group financial statements continued

For the year ended 31 March 2018

2 Accounting policies continued

i) Property, plant and equipment continued

Property, plant and equipment is depreciated, using the straight-line method, to its estimated residual value over its estimated useful life, with the exception of freehold land which is not depreciated. Assets in the course of construction are not depreciated until commissioned.

The estimated useful lives are:

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

j) Leased assets

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

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

k) Impairment of non-current assets

If the recoverable amount of goodwill, an item of property, plant and equipment, or any other non-current asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Where the asset does not generate cash flows that are independent from other assets, the group estimates the recoverable amount of the cash-generating unit to which the asset belongs. Recoverable amount is the higher of fair value less costs to sell or estimated value in use at the date the impairment review is undertaken. Fair value less costs to sell represents the amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing third parties, less costs of disposal. Value in use represents the present value of future cash flows expected to be derived from a cash-generating unit, discounted using a pre-tax discount rate that reflects current market assessments of the cost of capital of the cash-generating unit or asset.

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

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

Impairments are recognised in the income statement.

l) Grants and contributions

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

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

m) Parent company investments

The parent company recognises investments in subsidiary undertakings at historical cost.

After initial recognition at cost (being the fair value of the consideration paid), investments which are classified as held for trading or available for sale are measured at fair value, with changes in fair value recognised in the income statement or equity respectively. When an available for sale investment is disposed of or impaired, the gain or loss previously recognised in reserves is taken to the income statement.

n) Loans receivable

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

o) Trade receivables

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

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

p) Service concession agreements

Where the group has an unconditional right to receive cash from a government body in exchange for constructing or upgrading a public sector asset, the amounts receivable are recognised as a financial asset in prepayments and accrued income.

Costs of constructing or upgrading the public sector asset are recognised on a straight-line basis, before adjusting for expected inflation, over the life of the contract.

2 Accounting policies continued

q) Retirement benefits

(i) Defined benefit schemes

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

Defined benefit pension scheme assets are measured at fair value using bid price for assets with quoted prices. For scheme assets with no quoted price, the fair value is derived by using quotations from independent third parties or by using applicable valuation techniques at the end of each reporting period. Defined benefit pension scheme liabilities are measured at the balance sheet date by an independent actuary using the projected unit method and discounted at the current rate of return on high quality corporate bonds of equivalent term and currency to the liability.

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

Changes in the retirement benefit obligation that arise from:

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

are classified as remeasurements, charged or credited to other comprehensive income and recorded in the statement of comprehensive income in the period in which they arise.

There is no contractual agreement, or stated policy, for charging the net defined benefit cost to participating group companies. Therefore, the parent recognises a charge in the income statement which is equal to the contributions payable in the year. The net defined benefit cost for these schemes is recognised by the sponsoring employers, Severn Trent Water Limited and Dee Valley Group Limited.

(ii) Defined contribution schemes

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

r) Provisions

Provisions are recognised where:

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

Insurance provisions are recognised for claims notified and for claims incurred but which have not yet been notified, based on advice from the group's independent insurance advisers.

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

s) Purchase of own shares

Where market purchases of Severn Trent ordinary shares are made through an obligating contract, a liability for the present value of the redemption amount is recognised and charged to

retained earnings. Payments for the purchase of shares are charged to the liability when made.

Shares held by the Severn Trent Employee Share Ownership Trust which have not vested unconditionally by the balance sheet date are deducted from shareholders' funds until such time as they vest.

t) Borrowings

The accounting policy for borrowings that are the hedged item in a fair value hedge is set out in note 2 u).

All other borrowings are initially recognised at fair value less issue costs. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest rate method whereby interest and issue costs are charged to the income statement and added to the carrying value of borrowings at a constant rate in proportion to the capital amount outstanding. Index-linked debt is adjusted for changes in the relevant inflation index and changes in value are charged to finance costs.

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

u) Derivative financial instruments

Derivative financial instruments are stated at fair value, including accrued interest. Fair value is determined using the methodology described in note 34 a). The accounting policy for changes in fair value depends on whether the derivative is designated as a hedging instrument. The various accounting policies are described below.

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

Derivatives not designated as hedging instruments

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

Derivatives designated as hedging instruments

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

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

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

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

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

Notes to the group financial statements continued

For the year ended 31 March 2018

2 Accounting policies continued

u) Derivative financial instruments continued

Fair value hedges

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

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

Cash flow hedges

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

If hedge accounting is discontinued, any cumulative gain or loss on the hedging instrument previously recognised in equity is held in equity until the forecast transaction occurs, or transferred to gains/losses on financial instruments in the income statement if the forecast transaction is no longer expected to occur.

From this point the derivative is accounted for in the same way as derivatives not designated as hedging instruments.

If the hedging instrument is terminated, the gains and losses previously recognised in equity are held in equity until either the forecast transaction occurs or the forecast transaction is no longer expected to occur.

Embedded derivatives

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

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

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

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

v) Share based payments

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

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

Share based compensation plans are satisfied in shares of the parent company. Where the fair value of the awards is not recharged to participating group companies, the parent company records the fair value of the awards as an increase in its investment in the subsidiary. The investment is adjusted to reflect shares that do not vest as a result of failing to meet a non-market based condition.

w) Cash flow statement

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

Net cash and cash equivalents include overdrafts repayable on demand.

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

x) Net debt

Net debt comprises borrowings including remeasurements for changes in fair value of amounts in fair value hedging relationships, cross currency swaps that are used to fix the sterling liability of foreign currency borrowings (whether hedge accounted or not), net cash and cash equivalents, and loans to joint ventures.

y) Foreign currency

The results of overseas subsidiary and associated undertakings are translated into sterling, the presentational currency of the group, using average rates of exchange ruling during the year.

The net investments in overseas subsidiary undertakings are translated into sterling at the rates of exchange ruling at the year end. Exchange differences arising are treated as movements in equity. On disposal of a foreign currency denominated subsidiary, the deferred cumulative amount recognised in equity since 1 April 2004 relating to that entity is recognised in the income statement under the transitional rule of IFRS 1 'First-time Adoption of International Financial Reporting Standards'.

Foreign currency denominated assets and liabilities of the company and its subsidiary undertakings are translated into the relevant functional currency at the rates of exchange ruling at the year end. Any exchange differences so arising are dealt with through the income statement.

2 Accounting policies continued

y) Foreign currency continued

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

z) Discontinued operations and assets held for sale

Where an asset or group of assets (a disposal group) is available for immediate sale and the sale is highly probable and expected to occur within one year then the disposal group is classified as held for sale. The disposal group is measured at the lower of the carrying amount and fair value less costs to sell. Depreciation is not charged on such assets.

Where a group of assets which comprises operations that can be clearly distinguished operationally and for financial reporting purposes, from the rest of the group (a component), has been disposed of or classified as held for sale, and it:

- represents a separate major line of business or geographical area of operations; or
- is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations; or
- is a subsidiary acquired exclusively with a view to resale, then the component is classified as a discontinued operation.

3 New accounting policies and future requirements

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

At the balance sheet date, the following Standards and Interpretations were in issue but not yet effective:

IFRS 9 'Financial Instruments' affects the measurement and disclosure of financial instruments with effect from 1 April 2018. The group does not anticipate that the classification of its financial assets and liabilities will change significantly as a result of the adoption of IFRS 9. The group does not propose to retrospectively apply the hedge accounting criteria of IFRS 9 to hedging relationships established under IAS 39 accounting. Existing hedges that qualify for hedge accounting under IAS 39 are expected to continue to qualify for hedge accounting under IFRS 9. For new hedges established following adoption of IFRS 9, the group will determine on a case-by-case basis whether to apply the hedge accounting provisions of IFRS 9.

Provisions against trade receivables are calculated under the current accounting policy using historical collection information and losses expected as a result of future events are not recognised. Under IFRS 9 the group will recognise a provision for the lifetime expected credit losses for trade receivables. However, the group does not expect the bad debt charge or provision to be materially different as a result.

IFRS 15 'Revenue from contracts with customers' affects the measurement and recognition of revenue with effect from 1 April 2018. The group has performed an impact analysis for each of its business segments and the expected impact on the results and financial position are set out below.

Regulated Water and Waste Water

There will be no change to the timing of recognition of revenue from charges for water or waste water services. This is by far the most significant source of the group's revenue, making up 93% of group turnover in 2017/18.

IFRS 15 requires that revenue is recognised if it is probable that it will be received. The group is under a statutory obligation to maintain water services to domestic properties within the areas defined in its water supply licences. As a result, the group might provide water and/or sewerage services to customers who are unlikely to pay for these services. Under IFRS 15, such revenue is not recognised. However, there is no readily identifiable group of customers where it is not likely, at the point of billing, that the revenue will be collected.

The group also receives income under the Water Industry Act 1991 as a result of providing new connections to its existing network. The group's current treatment for this income is to treat it as a contribution to the related expenditure, recognise it as deferred income on the balance sheet and credit it to the income statement at the same time as the depreciation of the cost. No change to this treatment is anticipated as a result of the adoption of IFRS 15.

Business Services

The Operating Services business operates under a series of bespoke contracts with specific performance obligations. The group has applied the methodology set out in IFRS 15 to each of these contracts in order to identify differences from the current accounting policy. The most significant differences arose in relation to the group's contract to provide water and waste water services to the Ministry of Defence ('MOD'). The group acts as the service provider under the MOD Project Aquatrine Package C – a 25 year contract spanning 1,295 sites across England covering the eastern sea border and from Lancashire in the North West to West Sussex on the South coast.

Under the contract, the group maintains and upgrades the MoD infrastructure assets and provides operating services for water and waste water. Both the operating services and maintenance and upgrade services are charged under a volumetric tariff, along with standing charges, which are adjusted with inflation as agreed in the contract.

The current accounting policy for this contract is to recognise revenue billed under the volumetric tariff at the point of billing. The expected costs for the upgrade services are recognised on a straight-line basis, before adjusting for expected inflation, over the life of the contract. The resulting asset is recognised as a financial asset in accordance with IFRIC 12.

Under IFRS 15, the expected revenue over the life of the contract will be allocated to the performance obligations under the following headings:

- operating and maintaining the MOD infrastructure assets;
- upgrading the MOD infrastructure assets;
- administrating the services received from statutory water and sewerage undertakers; and
- administrating billing services of the MOD's commercial and Non Base Dependent ('NBD') customers.

Notes to the group financial statements continued

For the year ended 31 March 2018

3 New accounting policies and future requirements continued

Business Services continued

Costs of upgrade services recognised as a financial asset at 31 March 2017 amounting to approximately £30 million will be written off to reserves on transition to IFRS 15 and revenue that had not been recognised under the existing accounting policy amounting to approximately £35 million will be credited to reserves. If IFRS 15 had been applied in 2017/18 revenue would have been approximately £1 million higher and operating costs would have been approximately £3 million higher.

IFRS 16 'Leases' sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ('lessee') and the supplier ('lessor') and will be effective for the group from 1 April 2019. The impact on the results or net assets of the group or company of the changes to the standard has not yet been quantified in detail but this is not expected to be significant because the group does not hold a significant value of operating leases.

There are no other standards and interpretations in issue but not yet adopted that the directors anticipate will have a material effect on the reported income or net assets of the group.

4 Critical accounting judgements and key sources of estimation uncertainty

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

During the year, management reassessed the significant estimates and critical judgements and resolved that the following were no longer considered to be critical judgements or significant estimates:

i) Tax provisions

Following the exceptional current tax credit in the prior year arising from agreement with HMRC of tax matters from several prior years, and the group's disposal of almost all of its overseas operating subsidiaries, management no longer considers there to be significant risk of a material adjustment to tax provisions in the next year.

ii) Goodwill arising on acquisition of Dee Valley Water

As set out in note 38, the fair values attributed to the assets and liabilities acquired on the acquisition of Dee Valley Water have been finalised in the year, and therefore there will not be a material adjustment to this balance in the next year.

iii) Unbilled revenue

The estimated consumption for customers with water meters is regularly compared to actual consumption data. The difference between estimated and actual consumption historically has not been material. Hence unbilled revenue is no longer considered to be a key source of estimation uncertainty.

iv) Provision for impairment of trade receivables

Provisions are made against Severn Trent Water's trade receivables based on historical experience of levels of recovery from accounts in a particular ageing category. As the provision and the charge in the income statement have not fluctuated significantly over the past few years, it is unlikely that there would be a change in assumptions that would lead to a material change in the carrying amount of trade receivables. Management has therefore concluded that provision for impairment of trade receivables is no longer considered to be a key source of estimation uncertainty.

v) Provisions for other liabilities and charges

In previous years, this area was disclosed as a significant judgement. Management has taken note of the FRC's thematic review of reporting judgements and estimates, which sets out that this is an estimate rather than a judgement. Management has assessed the risk of material change to this balance in the next year and concluded that it is not significant.

a) Critical accounting judgements

i) Classification of costs between operating expenditure and capital expenditure

Severn Trent Water's business involves significant construction and engineering projects. Assessing the classification of costs incurred on such projects between capital expenditure and operating expenditure requires judgements to be made. The judgements are made based on objective criteria that the group has developed to facilitate the consistent application of its accounting policies.

b) Sources of estimation uncertainty

i) Depreciation and carrying amounts of property, plant and equipment

Calculating the depreciation charge and hence the carrying value for property, plant and equipment requires estimates to be made of the useful lives of the assets. The estimates are based on engineering data and the group's experience of similar assets. Details are set out in note 2 i). A five year change in the average remaining useful lives of property, plant and equipment would result in a £35 million change in the depreciation charge.

ii) Retirement benefit obligations

Determining the amount of the group's retirement benefit obligations and the net costs of providing such benefits requires assumptions to be made concerning long term interest rates, inflation and longevity of current and future pensioners. Changes in these assumptions could significantly impact the amount of the obligations or the cost of providing such benefits. The group makes assumptions concerning these matters with the assistance of advice from independent qualified actuaries. Details of the assumptions made and associated sensitivities are set out in note 28 to the financial statements.

5 Segmental analysis

The group is organised into two main business segments:

Regulated Water and Waste Water includes the wholesale water and waste water activities of Severn Trent Water Limited, its retail services to domestic customers, and Dee Valley Water Limited.

Business Services includes the group's Operating Services businesses in the UK & Ireland and the group's regulated and non-regulated Renewable Energy business.

On 15 February 2017, the group completed the acquisition of Dee Valley Water Group Limited. This business has been included in the Regulated Water and Waste Water segment with effect from that date. Further details of the acquisition are set out in note 38.

The disposals of the group's Operating Services businesses in Italy and the USA were completed on 23 February 2017 and 30 June 2017 respectively. These businesses have been classified as discontinued operations. The prior year segmental results have been restated to present the Italian and US Operating Services businesses as discontinued operations as set out in the stock market announcement dated 19 July 2017.

The disposal of the group's non-household retail business to the newly created Water Plus joint venture with United Utilities was also classified as a discontinued operation in the prior year. This transaction was completed on 1 June 2016.

The Severn Trent Executive Committee ('STEC') is considered to be the group's chief operating decision maker. The reports provided to STEC include segmental information prepared on the basis described above. Details of Regulated Water and Waste Water's operations are described on pages 34 to 41 of the Strategic Review and those of Business Services on pages 42 and 43.

Results from interests in joint ventures are not included in the segmental reports reviewed by STEC.

The measure of profit or loss that is reported to STEC for the segments is underlying PBIT. A segmental analysis of sales and underlying PBIT is presented below.

Transactions between reportable segments are included within segmental results, assets and liabilities in accordance with group accounting policies. These are eliminated on consolidation.

a) Segmental results

	2018		2017 (restated)	
	Regulated Water and Waste Water £m	Business Services £m	Regulated Water and Waste Water £m	Business Services £m
External turnover	1,574.1	119.9	1,527.6	109.8
Inter-segment turnover	0.5	18.8	1.2	18.6
Total turnover	1,574.6	138.7	1,528.8	128.4
Profit before interest, tax and exceptional items	514.9	36.0	494.7	32.2
Exceptional items (see note 8)	(11.1)	(1.8)	26.4	0.6
Profit before interest and tax	503.8	34.2	521.1	32.8

Profit before interest, tax and exceptional items is stated after:

Depreciation of property, plant and equipment	300.7	7.7	299.4	6.7
Amortisation of intangible assets	19.8	0.7	17.4	0.3
(Profit)/loss on disposal of fixed assets	(5.0)	-	0.8	-

Notes to the group financial statements continued

For the year ended 31 March 2018

5 Segmental analysis continued**a) Segmental results** continued

The reportable segments' turnover is reconciled to group turnover as follows:

	2018 £m	2017 (restated) £m
Regulated Water and Waste Water	1,574.6	1,528.8
Business Services	138.7	128.4
Corporate and other	9.0	6.2
Consolidation adjustments	(28.2)	(25.4)
	1,694.1	1,638.0

Included in revenues of Regulated Water and Waste Water of £1,574.6 million (2017: £1,528.8 million) is £354.9 million (2017: £317.5 million) which arose from sales to Water Plus Select Limited. No other single customer contributed 10% or more to the group's revenue for either 2018 or 2017.

Segmental underlying PBIT is reconciled to the group's profit before tax as follows:

	2018 £m	2017 (restated) £m
Regulated Water and Waste Water	514.9	494.7
Business Services	36.0	32.2
Corporate and other	(9.7)	(6.0)
Consolidation adjustments	(0.2)	(0.8)
Profit before interest, tax and exceptional items	541.0	520.1
Exceptional items:		
Regulated Water and Waste Water	(11.1)	26.4
Business Services	(1.8)	0.6
Corporate and other	0.3	(10.4)
Net finance costs	(219.5)	(205.1)
Net losses on financial instruments	(6.7)	(1.8)
Share of profit/(loss) of joint ventures	0.2	(1.8)
Profit on ordinary activities before taxation	302.4	328.0

The group's treasury and tax affairs are managed centrally by the Group Treasury and Tax departments. Finance costs are managed on a group basis and hence interest income and costs are not reported at the segmental level. Tax is not reported to STEC on a segmental basis.

b) Segmental capital employed

Separate segmental analyses of assets and liabilities are not reviewed by STEC. The balance sheet measure reviewed by STEC on a segmental basis is capital employed, as shown below:

	2018 Regulated Water and Waste Water £m	2018 Business Services £m	2017 Regulated Water and Waste Water £m	2017 Business Services £m
Operating assets	8,900.8	196.6	8,477.1	213.1
Goodwill	63.5	–	67.3	14.9
Interests in joint ventures	–	37.6	–	37.4
Segment assets	8,964.3	234.2	8,544.4	265.4
Segment operating liabilities	(1,957.6)	(41.9)	(1,970.9)	(55.9)
Capital employed	7,006.7	192.3	6,573.5	209.5

Operating assets comprise other intangible assets, property, plant and equipment, retirement benefit surpluses, inventory and trade and other receivables.

Operating liabilities comprise trade and other payables, retirement benefit obligations and provisions.

5 Segmental analysis continued

b) Segmental capital employed continued

The Business Services capital employed at 31 March 2017 includes £31.3 million in respect of Operating Services US, which was sold on 30 June 2017.

The reportable segments' assets are reconciled to the group's total assets as follows:

	2018 £m	2017 £m
Segment assets		
Regulated Water and Waste Water	8,964.3	8,544.4
Business Services	234.2	265.4
Corporate and other	60.5	40.6
Other financial assets	87.3	111.6
Loan receivable from joint venture	135.6	108.6
Current tax receivable	-	7.3
Consolidation adjustments	(60.1)	(41.4)
Total assets	9,421.8	9,036.5

The consolidation adjustments comprise elimination of intra-group debtors and unrealised profits on fixed assets.

The reportable segments' liabilities are reconciled to the group's total liabilities as follows:

	2018 £m	2017 £m
Segment liabilities		
Regulated Water and Waste Water	(1,957.6)	(1,970.9)
Business Services	(41.9)	(55.9)
Corporate and other	(74.6)	(67.5)
Other financial liabilities	(5,683.4)	(5,463.7)
Current tax	(8.6)	-
Deferred tax	(674.3)	(623.7)
Consolidation adjustments	12.3	68.5
Total liabilities	(8,428.1)	(8,113.2)

The consolidation adjustments comprise elimination of intra-group creditors.

The following table shows the additions to other intangible assets and plant and equipment:

	2018	2017
	Regulated Water and Waste Water £m	Regulated Water and Waste Water £m
	Business Services £m	Business Services £m
Other intangible assets	25.6	26.1
Property, plant and equipment	680.4	541.5
		4.2
		5.9
		41.8

c) Geographical areas

The group's sales from continuing operations were derived from the following countries:

	2018 £m	2017 (restated) £m
UK	1,689.8	1,632.1
Other	4.3	5.9
	1,694.1	1,638.0

The group's non-current assets (excluding financial instruments, deferred tax assets and post-employment benefit assets) were located in the following countries:

	2018 £m	2017 £m
UK	8,841.4	8,345.6
US	-	28.2
	8,841.4	8,373.8

Notes to the group financial statements continued

For the year ended 31 March 2018

6 Revenue

	2018 £m	2017 (restated) £m
Water and waste water services	1,574.1	1,527.6
Other services	28.8	30.5
Service concession arrangements	49.8	44.5
Energy sales and related incentive payments	41.4	35.4
Turnover	1,694.1	1,638.0
Interest receivable	5.7	0.4
	1,699.8	1,638.4

7 Net operating costs

	2018			2017 (restated)		
	Before exceptional costs £m	Exceptional costs £m	Total £m	Before exceptional costs £m	Exceptional costs £m	Total £m
Wages and salaries	237.2	0.6	237.8	218.5	–	218.5
Social security costs	23.2	–	23.2	21.6	–	21.6
Pension costs	20.8	(8.3)	12.5	20.9	(16.6)	4.3
Share based payments	6.9	–	6.9	6.1	–	6.1
Total employee costs	288.1	(7.7)	280.4	267.1	(16.6)	250.5
Power	79.2	–	79.2	70.4	–	70.4
Carbon Reduction Commitment	5.9	–	5.9	6.3	–	6.3
Raw materials and consumables	55.1	–	55.1	51.1	–	51.1
Rates	82.4	–	82.4	78.5	–	78.5
Charge for bad and doubtful debts	25.8	–	25.8	21.1	–	21.1
Services charges	34.3	–	34.3	33.1	–	33.1
Depreciation of tangible fixed assets	308.2	16.8	325.0	305.9	–	305.9
Amortisation of intangible fixed assets	20.5	–	20.5	17.8	–	17.8
Hired and contracted services	227.7	3.5	231.2	224.9	–	224.9
Operating lease rentals						
– land and buildings	0.6	–	0.6	0.8	–	0.8
– other	1.1	–	1.1	0.4	–	0.4
Hire of plant and machinery	5.5	–	5.5	3.9	–	3.9
Research and development expenditure	2.1	–	2.1	2.2	–	2.2
Profit on disposal of tangible fixed assets	(7.3)	–	(7.3)	(5.0)	–	(5.0)
Profit on disposal of subsidiary undertaking	–	–	–	(0.6)	–	(0.6)
Exchange losses/(gains)	1.1	–	1.1	(3.1)	–	(3.1)
Infrastructure maintenance expenditure	135.2	–	135.2	136.2	–	136.2
Ofwat licence fees	3.6	–	3.6	3.6	–	3.6
Other operating costs	44.5	–	44.5	40.3	–	40.3
Other operating income	(3.0)	–	(3.0)	(4.1)	–	(4.1)
	1,310.6	12.6	1,323.2	1,250.8	(16.6)	1,234.2
Release from deferred credits	(14.3)	–	(14.3)	(13.9)	–	(13.9)
Own work capitalised	(143.2)	–	(143.2)	(119.0)	–	(119.0)
	1,153.1	12.6	1,165.7	1,117.9	(16.6)	1,101.3

Further details of exceptional costs are given in note 8.

7 Net operating costs continued

During the year the following fees were charged by the auditors:

	2018 £m	2017 £m
Fees payable to the company's auditors for:		
- the audit of the company's annual accounts	0.2	0.2
- the audit of the company's subsidiary accounts	0.4	0.5
Total audit fees	0.6	0.7
Fees payable to the company's auditors and their associates for other services to the group:		
- audit related assurance services	0.1	0.1
- other services relating to taxation	-	0.1
- other assurance services	0.1	0.3
Total non-audit fees	0.2	0.5

Details of directors' remuneration are set out in the Directors' remuneration report on pages 96 to 128.

Other assurance services include certain agreed upon procedures performed by Deloitte in connection with Severn Trent Water's regulatory reporting requirements to Ofwat.

Details of the group policy on the use of the auditor for non-audit services and how auditor independence and objectivity are safeguarded are set out in the Audit Committee report on pages 87 and 88. No services were provided pursuant to contingent fee arrangements.

8 Exceptional items before tax

	2018 £m	2017 (restated) £m
Regulated Water and Waste Water		
Profit on disposal of fixed assets	-	11.0
Gain arising on pension exchange arrangement	7.7	15.4
Restructuring costs	(18.8)	-
	(11.1)	26.4
Business Services		
Gain arising on pension exchange arrangement	0.3	0.6
Restructuring costs	(2.1)	-
	(1.8)	0.6
Corporate and other		
Elimination of intra-group profit on disposal of fixed assets	-	(11.0)
Gain arising on pension exchange arrangement	0.3	0.6
	0.3	(10.4)
	(12.6)	16.6

Exceptional tax is disclosed in note 13.

9 Employee numbers

Average number of employees (including executive directors) during the year:

	2018			2017		
	Continuing operations number	Discontinued operations number	Total number	Continuing operations (restated) number	Discontinued operations (restated) number	Total (restated) number
By type of business						
Regulated Water and Waste Water	5,660	-	5,660	5,273	2	5,275
Business Services	596	368	964	585	1,564	2,149
Corporate and other	9	-	9	11	-	11
	6,265	368	6,633	5,869	1,566	7,435

Notes to the group financial statements continued

For the year ended 31 March 2018

10 Finance income

	2018 £m	2017 (restated) £m
Interest income earned on bank deposits	0.5	0.2
Other financial income	5.2	0.2
Total interest receivable	5.7	0.4
Interest income on defined benefit scheme assets	62.0	71.8
	67.7	72.2

11 Finance costs

	2018 £m	2017 £m
Interest expense charged on:		
Bank loans and overdrafts	19.2	22.7
Other loans	183.4	167.4
Finance leases	4.4	4.2
Total borrowing costs	207.0	194.3
Other financial expenses	2.7	0.3
Interest cost on defined benefit scheme liabilities	77.5	82.7
	287.2	277.3

Borrowing costs of £26.2 million (2017: £18.6 million) incurred funding eligible capital projects have been capitalised at an interest rate of 3.89% (2017: 3.94%). Tax relief of £5.0 million (2017: £3.7 million) was claimed on these costs which was credited to the income statement, offset by a related deferred tax charge of £4.5 million (2017: £3.2 million).

12 Net losses on financial instruments

	2018 £m	2017 £m
(Loss)/gain on swaps used as hedging instruments in fair value hedges	(1.1)	17.6
Loss arising on debt in fair value hedges	–	(16.9)
Exchange gain/(loss) on other loans	12.7	(11.1)
Loss on cash flow hedges transferred from equity	(8.2)	(2.9)
Hedge ineffectiveness on cash flow hedges	1.4	(0.1)
(Loss)/gain arising on swaps where hedge accounting is not applied	(12.6)	11.1
Amortisation of fair value adjustment on debt	1.1	0.5
	(6.7)	(1.8)

The group's hedge accounting arrangements are described in note 36.

13 Taxation

a) Analysis of tax charge in the year

	2018			2017 (restated)
	£m	Before exceptional tax £m	Exceptional tax £m	Total £m
Current tax at 19% (2017: 20%)				
Current year	36.8	47.3	–	47.3
Prior years	(3.9)	(11.0)	(16.4)	(27.4)
Total current tax	32.9	36.3	(16.4)	19.9
Deferred tax				
Origination and reversal of temporary differences:				
Current year	21.4	16.4	–	16.4
Prior years	7.6	6.0	4.0	10.0
Exceptional credit from rate change	–	–	(39.8)	(39.8)
Total deferred tax	29.0	22.4	(35.8)	(13.4)
	61.9	58.7	(52.2)	6.5

The total tax charge for the year was £61.9 million (2017: £6.5 million).

The current tax charge before exceptional tax was £32.9 million (2017: £36.3 million). In 2017, the exceptional current tax credit of £16.4 million arose primarily from adjustments following agreement with HMRC of tax matters from several prior years.

The deferred tax charge before exceptional tax was £29.0 million (2017: £22.4 million). In 2017, there was an exceptional deferred tax credit of £35.8 million arising from agreeing a number of prior year tax items with HMRC and a reduction in the corporation tax rate, enacted in that year, to 17% with effect from 2020.

b) Factors affecting the tax charge in the year

The tax expense for the year is higher (2017: lower) than the standard rate of corporation tax in the UK of 19% (2017: 20%). The differences are explained below:

	2018	2017 (restated)
	£m	£m
Profit before taxation		
Tax at standard rate of corporation tax in the UK 19% (2017: 20%)	57.5	65.6
Tax effect of depreciation on non-qualifying assets	1.8	3.2
Other permanent differences	1.4	(1.4)
Current year impact of rate change	(2.5)	(3.7)
Adjustments in respect of prior years	3.7	(17.4)
Exceptional deferred tax credit arising from rate change	–	(39.8)
Total tax charge	61.9	6.5

	2018	2017 (restated)
	£m	£m
Profit before taxation		
Tax at standard rate of corporation tax in the UK 19% (2017: 20%)	57.5	65.6
Tax effect of depreciation on non-qualifying assets	1.8	3.2
Other permanent differences	1.4	(1.4)
Tax effect of accelerated capital allowances	(19.7)	(13.2)
Other timing differences	(4.2)	(6.9)
Adjustments in respect of prior years	(3.9)	(27.4)
Total current tax charge	32.9	19.9

Notes to the group financial statements continued

For the year ended 31 March 2018

13 Taxation continued

c) Tax charged/(credited) directly to other comprehensive income or equity

In addition to the amount charged to the income statement, the following amounts of tax have been charged/(credited) to other comprehensive income or equity:

	2018 £m	2017 £m
Current tax		
Tax on share based payments	(0.8)	(0.8)
Tax on pension contributions in excess of income statement charge	(9.3)	(14.1)
Total current tax credited to other comprehensive income or equity	(10.1)	(14.9)
Deferred tax		
Tax on actuarial gain/loss	16.9	(42.2)
Tax on cash flow hedges	1.0	(1.3)
Tax on share based payments	1.3	(0.1)
Tax on transfers to the income statement	1.4	0.4
Effect of change in tax rate	—	3.1
Total deferred tax charged/(credited) to other comprehensive income or equity	20.6	(40.1)

14 Dividends

Amounts recognised as distributions to owners of the company in the period:

	2018 pence per share	2018 £m	2017 pence per share	2017 £m
Final dividend for the year ended 31 March 2017 (2016)	48.90	115.2	48.40	114.0
Interim dividend for the year ended 31 March 2018 (2017)	34.63	81.8	32.60	76.4
Total dividends paid	83.53	197.0	81.00	190.4
Proposed final dividend for the year ended 31 March 2018	51.92	122.7		

The proposed final dividend is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements.

15 Earnings per share

a) Basic and diluted earnings per share

Basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year, excluding treasury shares and those held in the Severn Trent Employee Share Ownership Trust, which are treated as cancelled.

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares.

Basic and diluted earnings per share from continuing and discontinued operations are calculated on the basis of profit from continuing and discontinued operations attributable to the equity holders of the company.

The calculation of basic and diluted earnings per share is based on the following data:

(i) Earnings for the purpose of basic and diluted earnings per share from continuing operations

	2018 £m	2017 (restated) £m
Profit for the period attributable to owners of the company	253.7	342.8
Adjusted for profit from discontinued operations attributable to owners of the company [see note 39]	(13.2)	(21.3)
Profit for the period from continuing operations attributable to owners of the company	240.5	321.5

(ii) Number of shares

	2018 m	2017 m
Weighted average number of ordinary shares for the purpose of basic earnings per share	235.3	235.0
Effect of dilutive potential ordinary shares:		
- share options and LTIPs	0.8	1.0
Weighted average number of ordinary shares for the purpose of diluted earnings per share	236.1	236.0

15 Earnings per share continued

b) Underlying earnings per share

	2018 pence	2017 (restated) pence
Underlying basic earnings per share	121.0	115.7
Underlying diluted earnings per share	120.6	115.2

Underlying earnings per share figures are presented for continuing operations. These exclude the effects of deferred tax, exceptional tax, losses on financial instruments, current tax related to losses on financial instruments, exceptional items and current tax related to exceptional items. The directors consider that the adjusted figures provide a useful additional indicator of performance. The denominators used in the calculations of adjusted basic and diluted earnings per share are the same as those used in the unadjusted figures set out above.

The adjustments to earnings that are made in calculating underlying earnings per share are as follows:

	2018 £m	2017 (restated) £m
Earnings for the purpose of basic and diluted earnings per share from continuing operations	240.5	321.5
Adjustments for:		
- exceptional items before tax	12.6	[16.6]
- current tax related to exceptional items	(0.7)	[0.1]
- net losses on financial instruments	6.7	1.8
- current tax on net losses on financial instruments	(3.3)	[4.9]
- exceptional current tax	-	[16.4]
- deferred tax	29.0	[13.4]
Earnings for the purpose of underlying basic and diluted earnings per share	284.8	271.9

16 Goodwill

	2018 £m	2017 £m
Cost		
At 1 April	81.0	18.2
Acquisition of subsidiary	-	66.0
Disposal of subsidiaries	(14.4)	(5.4)
Exchange adjustments	(0.6)	2.2
Additional consideration in respect of acquisition	0.2	-
Adjustment to provisional fair values on acquisition (note 38)	(4.0)	-
At 31 March	62.2	81.0

Goodwill is allocated to the group's cash-generating units (CGUs) identified according to country of operation and business segment.

A summary of the goodwill allocation by CGU is presented below.

	2018 £m	2017 £m
Dee Valley Water	62.2	66.0
Operating Services US	-	15.0
	62.2	81.0

Dee Valley Water also has an intangible asset with indefinite useful life amounting to £4.3 million (2017: nil).

The group has reviewed the carrying value of goodwill for impairment in accordance with the policy stated in note 2 k). The carrying value of the Dee Valley Water CGU was determined on the basis of value in use in the current and prior years. The Operating Services US CGU was sold on 30 June 2017.

The value in use calculation for the Dee Valley Water CGU is based on the most recent financial projections available for the business, which cover the remainder of the current AMP period to 2020 and the following AMP period, which runs to 31 March 2025. As a regulated water company, Dee Valley Water's revenues and costs are significantly influenced by the regulatory settlement for each AMP period so management considers it appropriate for the detailed projections to be coterminous with the AMP period.

Notes to the group financial statements continued

For the year ended 31 March 2018

16 Goodwill continued

The net cash flows for the current AMP period are based on existing operations and Dee Valley Water's business plan, adjusted for the synergies arising from the acquisition by Severn Trent, to the extent that they will be realised in Dee Valley Water. The net cash flows in the following AMP period have been reduced to reflect the lower weighted average cost of capital proposed by Ofwat in its PR19 methodology.

The key assumptions underlying these projections are:

Key assumption	%
Discount rate	6.3
RPI inflation	3.0
CPI inflation	2.0
Growth rate in the period beyond the detailed projections	2.5

The discount rate was an estimate for the weighted average cost of capital at the year end date based on the market rate for the cost of debt and the cost of equity included in the Dee Valley Water Final Determination for AMP6 adjusted to take account of risks already reflected in the cash flows for AMP7 and beyond. This post-tax rate was converted to the equivalent pre-tax rate discount rate above. Inflation has been included in the detailed projections at 3% and 2% for RPI and CPI respectively based on the Bank of England's target rate for CPI.

Cash flows beyond the end of the seven year period are extrapolated using an assumption of zero real growth and an estimate of 2.5% for long-term inflation (combination of CPI and RPI).

The value in use for the CGU exceeded its carrying value by £15.6 million. The value in use is most sensitive to the assumption relating to the growth rate outside the five year period. If the growth rate assumption were reduced to 2.2% this would cause the CGU's carrying amount to exceed its recoverable amount under the revised assumption.

17 Other intangible assets

	Computer software	Capitalised development costs and patents	Instrument of appointment	Total
	Internally generated £m	Purchased £m	£m	£m
Cost				
At 1 April 2016	188.9	104.5	13.5	306.9
Additions	14.7	14.5	1.1	30.3
Disposals	(1.1)	(1.2)	(0.7)	(3.0)
Disposals of subsidiaries	–	(5.0)	–	(5.0)
Exchange adjustments	0.2	1.0	–	1.2
At 1 April 2017	202.7	113.8	13.9	330.4
Additions	9.8	18.2	0.4	28.4
Disposals	(0.7)	–	(1.5)	(2.2)
Adjustment to provisional fair values (note 38)	–	–	–	4.3
Disposals of subsidiaries	–	(7.2)	–	(7.2)
Exchange adjustments	(0.1)	(0.1)	–	(0.2)
At 31 March 2018	211.7	124.7	12.8	353.5
Amortisation				
At 1 April 2016	(159.1)	(63.0)	(12.6)	(234.7)
Amortisation for the year	(7.7)	(10.8)	(0.8)	(19.3)
Disposals	0.7	0.3	0.7	1.7
Disposals of subsidiaries	–	3.6	–	3.6
Exchange adjustments	(0.1)	(0.7)	–	(0.8)
At 1 April 2017	(166.2)	(70.6)	(12.7)	(249.5)
Amortisation for the year	(8.0)	(12.6)	(0.1)	(20.7)
Disposals	0.6	–	–	0.6
Disposals of subsidiaries	–	4.3	–	4.3
Exchange adjustments	–	0.2	–	0.2
At 31 March 2018	(173.6)	(78.7)	(12.8)	(265.1)
Net book value				
At 31 March 2018	38.1	46.0	–	88.4
At 31 March 2017	36.5	43.2	1.2	80.9

18 Property, plant and equipment

	Land and buildings £m	Infrastructure assets £m	Fixed plant and equipment £m	Moveable plant £m	Assets under construction £m	Total £m
Cost						
At 1 April 2016	3,168.0	4,939.9	3,788.1	67.0	545.2	12,508.2
Additions	15.5	73.7	12.4	1.7	480.6	583.9
Transfers on commissioning	134.4	39.9	214.7	6.3	(395.3)	–
Disposals	(5.7)	[0.7]	(24.7)	(3.8)	–	(34.9)
Acquisition of subsidiary undertaking	0.8	61.4	64.3	–	–	126.5
Disposal of subsidiary undertaking	–	–	(4.7)	–	–	(4.7)
Exchange adjustments	–	–	2.2	2.7	–	4.9
At 1 April 2017	3,313.0	5,114.2	4,052.3	73.9	630.5	13,183.9
Additions	9.1	60.5	16.4	0.9	604.3	691.2
Transfers on commissioning	69.4	52.2	136.5	4.4	(262.5)	–
Disposals	(2.0)	[0.3]	(12.4)	(2.9)	(0.8)	(18.4)
Adjustment to provisional fair values [note 38]	–	0.8	–	–	–	0.8
Disposal of subsidiary undertaking	–	–	(15.2)	(19.2)	–	(34.4)
Reclassifications	(3.0)	6.5	(10.7)	(0.3)	7.5	–
Exchange adjustments	–	–	(0.9)	(1.2)	–	(2.1)
At 31 March 2018	3,386.5	5,233.9	4,166.0	55.6	979.0	13,821.0
Depreciation						
At 1 April 2016	(1,119.5)	(1,256.5)	(2,368.0)	(45.6)	–	(4,789.6)
Charge for the year	(81.2)	(42.6)	(178.1)	(6.9)	–	(308.8)
Disposals	3.7	0.2	23.4	3.5	–	30.8
Disposal of subsidiary undertaking	–	–	3.5	–	–	3.5
Exchange adjustments	–	–	(1.4)	(2.0)	–	(3.4)
At 1 April 2017	(1,197.0)	(1,298.9)	(2,520.6)	(51.0)	–	(5,067.5)
Charge for the year	(84.5)	(31.5)	(188.0)	(4.8)	–	(308.8)
Disposals	1.7	–	12.9	2.7	–	17.3
Disposal of subsidiary undertaking	–	–	10.2	14.8	–	25.0
Reclassifications	4.1	(1.5)	(3.0)	0.4	–	–
Exceptional depreciation	(10.1)	–	(6.7)	–	–	(16.8)
Exchange adjustments	–	–	0.7	1.0	–	1.7
At 31 March 2018	(1,285.8)	(1,331.9)	(2,694.5)	(36.9)	–	(5,349.1)
Net book value						
At 31 March 2018	2,100.7	3,902.0	1,471.5	18.7	979.0	8,471.9
At 31 March 2017	2,116.0	3,815.3	1,531.7	22.9	630.5	8,116.4

The carrying amount of property, plant and equipment includes the following amounts in respect of assets held under finance leases:

	Infrastructure assets £m	Fixed plant and equipment £m	Total £m
Net book value			
At 31 March 2018	115.8	6.4	122.2
At 31 March 2017	118.8	10.2	129.0

The depreciation charge for 2018 includes £16.8 million (2017: £5.0 million) in respect of the write off of redundant plant and equipment.

Notes to the group financial statements continued

For the year ended 31 March 2018

19 Interests in joint ventures

Particulars of the group's principal joint venture undertaking at 31 March 2018 were:

Name	Type	Country of incorporation	Class of share capital held	Proportion of ownership interest
Water Plus Limited	Joint venture	Great Britain	Ordinary B	50%

The results and net assets of the principal joint venture are shown below:

	Interests in joint venture	
	2018 £m	2017 £m
Group's share of carrying value	37.6	37.4
Group's share of profit and comprehensive income	0.2	(1.8)

All results are from continuing operations in both the current and preceding year.

As at 31 March 2018 and 2017 the joint venture did not have any significant contingent liabilities to which the group was exposed and the group did not have any significant contingent liabilities in relation to its interests in the joint venture. The group had no capital commitments in relation to its interests in the joint venture at 31 March 2018 or 2017.

The company has given guarantees in favour of Water Plus Limited in respect of the joint venture's liabilities to wholesalers in the Open Water market and its loan from Severn Trent Water Limited. The guarantee in respect of liabilities to wholesalers is capped at £42.5 million (2017: £42.5 million) and the guarantees for the Severn Trent Water loan is for the amount due.

The registered office of Water Plus is Two Smithfield, Leonard Coates Way, Stoke-on-Trent, ST1 4FD.

20 Categories of financial assets

	Notes	2018 £m	2017 £m
Fair value through profit and loss			
Cross currency swaps – not hedge accounted		5.8	23.6
Interest rate swaps – not hedge accounted		11.4	23.6
		17.2	47.2
Derivatives designated as hedging instruments			
Cross currency swaps – fair value hedges		18.7	19.8
Energy hedges – cash flow hedges		0.3	–
		19.0	19.8
Total derivative financial assets		36.2	67.0
Loans and receivables (including cash and cash equivalents)			
Trade receivables	21	191.0	214.2
Loan receivable from joint venture	21	135.6	108.6
Short term deposits	22	16.4	18.8
Cash at bank and in hand	22	34.7	25.8
Total loans and receivables		377.7	367.4
Total financial assets		413.9	434.4
Disclosed in the balance sheet as:			
Non-current assets			
Derivative financial assets		36.0	67.0
Loan receivable from joint venture		135.6	9.0
		171.6	76.0
Current assets			
Derivative financial assets		0.2	–
Trade and other receivables		191.0	214.2
Loan receivable from joint venture		–	99.6
Cash and cash equivalents		51.1	44.6
		242.3	358.4
413.9		434.4	

21 Trade and other receivables

	2018 £m	2017 £m
Current assets		
Trade receivables	320.0	344.7
Bad debt provision	(129.0)	(130.5)
Net trade receivables	191.0	214.2
Other amounts receivable	38.7	38.5
Prepayments	15.5	5.7
Accrued income	211.2	159.8
Loan receivable from joint venture	—	99.6
	456.4	517.8
Non-current assets		
Other amounts receivable	1.5	—
Prepayments	13.1	21.4
Amounts receivable from service concession arrangements	31.1	27.7
Loan receivable from joint venture	135.6	9.0
	181.3	58.1
	637.7	575.9

The carrying values of trade and other receivables are reasonable approximations of their fair values.

Doubtful debts provision

Movements on the doubtful debts provision were as follows:

	2018 £m	2017 £m
At 1 April	130.5	126.9
Charge for bad and doubtful debts (continuing and discontinued operations)	27.3	21.9
Acquisition of Dee Valley Water	—	2.8
Disposal of subsidiary undertaking	(1.2)	—
Amounts written off during the year	(27.6)	(21.1)
At 31 March	129.0	130.5

The aged analysis of receivables that are specifically provided for is as follows:

	2018 £m	2017 £m
Up to 90 days	0.5	1.0
91 – 365 days	1.2	6.3
1 – 2 years	5.2	2.8
2 – 3 years	2.5	3.9
More than 3 years	5.6	6.9
	15.0	20.9

A collective provision is recorded against assets which are past due but for which no specific provision has been made. This is calculated based on historical experience of levels of recovery.

Group financial statements

Notes to the group financial statements continued

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21 Trade and other receivables continued

The aged analysis of receivables that were overdue at the reporting date but not individually provided for is as follows:

	2018 £m	2017 £m
Up to 90 days	43.6	56.6
91 – 365 days	80.0	85.8
1 – 2 years	57.5	57.2
2 – 3 years	40.7	35.1
More than 3 years	77.4	68.0
	299.2	302.7

The amounts above are reconciled to gross and net debtors in the table below:

	2018		2017
	Gross £m	Provision £m	Net £m
Not due	5.8	–	5.8
Overdue not specifically provided	299.2	(114.0)	185.2
Overdue and specifically provided	15.0	(15.0)	–
	320.0	(129.0)	191.0
	21.1	(109.6)	193.1
	20.9	(20.9)	–
	344.7	(130.5)	214.2

Credit risk

Trade receivables

Credit control policies and procedures are determined at the individual business unit level. By far the most significant business unit of the group is Severn Trent Water Limited, which represents 93% of group turnover and 91% of net trade receivables. Severn Trent Water has a statutory obligation to provide water and waste water services to customers within its region. Therefore there is no concentration of credit risk with respect to its trade receivables from these services and the credit quality of its customer base reflects the wealth and prosperity of all of the domestic households within its region.

Water Plus

In the current and prior year, the group's joint venture, Water Plus, was the largest retailer for non-domestic customers in the Severn Trent region. The trade receivables and amounts shown as loans receivable from joint ventures are disclosed within the related parties note 45.

22 Cash and cash equivalents

	2018 £m	2017 £m
Cash at bank and in hand	34.7	25.8
Short term deposits	16.4	18.8
	51.1	44.6

Short term bank deposits are held as security deposits for insurance obligations, which are not available for use by the group. In addition, £9.8 million [2017: £10.0 million] of cash at bank and in hand is restricted for use on the Ministry of Defence contract and is not available for use by the group.

23 Borrowings

	2018 £m	2017 £m
Current liabilities		
Bank overdraft	12.6	-
Bank loans	287.9	151.2
Other loans	5.3	406.1
Finance leases	2.9	2.1
	308.7	559.4
Non-current liabilities		
Bank loans	929.5	922.1
Other loans	4,218.6	3,683.9
Finance leases	111.0	113.6
	5,259.1	4,719.6
	5,567.8	5,279.0

24 Finance leases

Obligations under finance leases are as follows:

	2018 £m	2017 £m
Within 1 year	6.5	6.1
1 – 2 years	7.0	6.5
2 – 5 years	24.3	22.6
After more than 5 years	113.1	121.9
Gross obligations under finance leases	150.9	157.1
Less future finance charges	(37.0)	(41.4)
Present value of lease obligations	113.9	115.7

Net obligations under finance leases fall due as follows:

	2018 £m	2017 £m
Within 1 year	2.9	2.1
1 – 2 years	3.2	2.6
2 – 5 years	13.7	11.5
After more than 5 years	94.1	99.5
Included in non-current liabilities	111.0	113.6
	113.9	115.7

The remaining terms of finance leases ranged from 1 to 14 years at 31 March 2018. Interest terms are set at the inception of the leases. The leases bear fixed interest at a weighted average rate of 5.34% (2017: 5.34%). The lease obligations are secured against the related assets.

There were no contingent rents, escalation clauses or material renewal or purchase options. The terms of the finance leases do not impose restriction on dividend payments, additional debt or further leasing.

Notes to the group financial statements continued

For the year ended 31 March 2018

25 Categories of financial liabilities

	Notes	2018 £m	2017 £m
Fair value through profit and loss			
Interest rate swaps – not hedge accounted		98.8	163.2
Inflation swaps – not hedge accounted		2.8	–
		101.6	163.2
Derivatives designated as hedging instruments			
Interest rate swaps – cash flow hedges		13.6	20.7
Energy hedges – cash flow hedges		0.8	0.8
		14.4	21.5
Total derivative financial liabilities		116.0	184.7
Other financial liabilities			
Borrowings	23	5,567.8	5,279.0
Trade payables	26	18.9	24.0
Total other financial liabilities		5,586.7	5,303.0
Total financial liabilities		5,702.7	5,487.7
Disclosed in the balance sheet as:			
Non-current liabilities			
Derivative financial liabilities		116.0	184.1
Borrowings		5,259.1	4,719.6
		5,375.1	4,903.7
Current liabilities			
Derivative financial liabilities		–	0.6
Borrowings		308.7	559.4
Trade payables		18.9	24.0
		327.6	584.0
		5,702.7	5,487.7

26 Trade and other payables

	2018 £m	2017 £m
Current liabilities		
Trade payables	18.9	24.0
Social security and other taxes	6.9	5.8
Other payables	21.6	13.5
Deferred income	14.9	12.2
Accruals	400.3	396.4
	462.6	451.9
Non-current liabilities		
Accruals	0.4	2.1
Deferred income	1,009.0	953.6
	1,009.4	955.7
	1,472.0	1,407.6

27 Deferred tax

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

	Accelerated tax depreciation £m	Retirement benefit obligations £m	Fair value of financial instruments £m	Other £m	Total £m
At 1 April 2016	766.2	(55.8)	(51.6)	5.9	664.7
Reclassification	–	15.5	–	(15.5)	–
Charge/(credit) to income	23.3	–	3.2	(0.1)	26.4
(Credit)/charge to income arising from rate change	(42.5)	–	2.2	0.5	(39.8)
Acquired through business combination	11.9	1.7	–	(1.1)	12.5
Credit to equity	–	(42.2)	(0.9)	(0.1)	(43.2)
Charge to equity arising from rate change	–	2.1	1.0	–	3.1
At 1 April 2017	758.9	(78.7)	(46.1)	(10.4)	623.7
Charge/(credit) to income	24.5	(0.3)	1.6	3.2	29.0
Charge for adjustments to provisional fair values	0.1	–	–	1.0	1.1
Charge to equity	–	16.9	2.4	1.3	20.6
At 31 March 2018	783.5	(62.1)	(42.1)	(4.9)	674.4

Deferred tax assets and liabilities have been offset. The offset amounts, which are to be recovered/settled after more than 12 months, are as follows:

	2018 £m	2017 £m
Deferred tax asset	(109.1)	(135.2)
Deferred tax liability	783.5	758.9
	674.4	623.7

28 Retirement benefit schemes

a) Defined benefit pension schemes

(i) Background

The group operates a number of defined benefit pension schemes in the UK. The Severn Trent Pension Scheme and the Severn Trent Mirror Image Pension Scheme closed to future accrual on 31 March 2015, while the Dee Valley Water Limited Section of the Water Companies Pension Scheme, which is a sectionalised scheme, currently remains open to accrual. The defined benefit pension schemes cover increases in accrued benefits arising from inflation and pension increases. Their assets are held in separate funds administered by trustees. The trustees are required to act in the best interests of the schemes' beneficiaries. A formal actuarial valuation of each scheme is carried out on behalf of the trustees at triennial intervals by an independent professionally qualified actuary. Under the defined benefit pension schemes, members are entitled to retirement benefits calculated by reference to their pensionable service and pensionable salary history, with inflationary pension increases applying in line with the scheme rules.

The UK defined benefit pension schemes and the dates of their last completed formal actuarial valuations as at the accounting date are as follows:

	Date of last formal actuarial valuation
Severn Trent Pension Scheme [STPS]*	31 March 2016
Severn Trent Mirror Image Pension Scheme [STMIPS]	31 March 2016
Water Companies Pension Scheme – Dee Valley Water Limited Section [DVWS]	31 March 2017

* The STPS is by far the largest of the group's UK defined benefit schemes, comprising over 90% of the group's overall defined benefit obligations.

Notes to the group financial statements continued

For the year ended 31 March 2018

28 Retirement benefit schemes continued**a) Defined benefit pension schemes** continued**(ii) Amount included in the balance sheet arising from the group's obligations under the defined benefit pension schemes**

	2018 £m	2017 £m
Fair value of assets	2,339.8	2,352.8
Present value of the defined benefit obligations	(2,859.6)	(2,927.4)
	(519.8)	(574.6)

Presented on the balance sheet as:

Retirement benefit obligation – funded schemes in surplus	18.2	9.8
Retirement benefit obligation – funded schemes in deficit	(529.3)	(573.9)
Retirement benefit obligation – unfunded schemes	(8.7)	(10.5)
Retirement benefit obligation – total	(538.0)	(584.4)
Net retirement benefit obligation	(519.8)	(574.6)

	2018 £m	2017 £m
STPS, STMIPS, and DVWS		
Fair value of scheme assets		
Equities	360.4	914.3
Diversified growth funds	5.3	5.3
Gilts	–	412.6
Corporate bonds	825.7	670.8
Liability driven investment funds (LDI)	783.1	42.6
Property	180.7	174.9
Emerging markets multi-assets funds	3.9	3.3
High-yield bonds	3.4	3.3
Hedge funds	0.6	1.2
Cash	176.7	124.5
	2,339.8	2,352.8

The majority of the assets have quoted prices in active markets, but there are a small proportion of the equity and LDI investments which are unquoted.

Movements in the fair value of the scheme assets were as follows:

	2018 £m	2017 £m
Fair value at 1 April	2,352.8	2,039.8
Interest income on scheme assets	62.0	71.8
Contributions from the sponsoring companies	35.2	33.2
Contributions from scheme members	0.1	–
Return on plan assets (excluding amounts included in finance income)	(1.3)	227.6
Scheme administration costs	(1.8)	(3.3)
Benefits paid	(107.2)	(87.2)
Acquisition of Dee Valley Water	–	70.9
Fair value at 31 March	2,339.8	2,352.8

28 Retirement benefit schemes continued

a) Defined benefit pension schemes continued

(ii) Amount included in the balance sheet arising from the group's obligations under the defined benefit pension schemes continued

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

	2018 £m	2017 £m
Present value at 1 April	(2,927.4)	(2,349.3)
Service cost	(0.5)	–
Exceptional past service credit	8.3	17.3
Interest cost	(77.5)	(82.7)
Contributions from scheme members	(0.1)	–
Actuarial gains arising from changes in demographic assumptions	21.6	16.6
Actuarial gains/(losses) arising from changes in financial assumptions	6.9	(470.6)
Actuarial gains/(losses) arising from experience adjustments	1.9	(84.8)
Benefits paid	107.2	87.2
Acquisition of Dee Valley Water	–	(61.1)
Present value at 31 March	(2,859.6)	(2,927.4)

The group has an obligation to pay pensions to a number of former employees, whose benefits would otherwise have been restricted by the Finance Act 1989 earnings cap. Provision for such benefits amounting to £8.7 million (2017: £10.5 million) is included as an unfunded scheme within the retirement benefit obligation.

The group has assessed that it has an unconditional right to a refund of any surplus assets in each of the Schemes following settlement of all obligations to scheme members and therefore the surplus in DVWS has been recognised in full.

(iii) Amounts recognised in the income statement in respect of these defined benefit pension schemes

	2018 £m	2017 £m
Amounts credited to operating costs		
Current service cost	(0.5)	–
Exceptional past service credit	8.3	17.3
Scheme administration costs	(1.8)	(3.3)
	6.0	14.0
Amounts charged to finance costs		
Interest cost	(77.5)	(82.7)
Amounts credited to finance income		
Interest income on scheme assets	62.0	71.8
Total amount (charged)/credited to the income statement	(9.5)	3.1

The actual return on scheme assets was a gain of £60.7 million (2017: gain of £299.4 million).

Actuarial gains and losses have been reported in the statement of comprehensive income.

(iv) Actuarial risk factors

The Schemes typically expose the group to actuarial risks such as investment risk, inflation risk and longevity risk.

Investment risk

The group's contributions to the Schemes are based on actuarial calculations which make assumptions about the returns expected from the Schemes' investments. If the investments underperform these assumptions in the long term then the group may need to make additional contributions to the Schemes in order to fund the payment of accrued benefits.

Each plan's investment strategy seeks to balance the level of investment return sought with the aim of reducing volatility and risk. In undertaking this approach, reference is made to both the maturity of liabilities and the funding level of that plan. A number of further strategies are employed to manage underlying risks, including liability matching asset strategies, diversification of asset portfolios and interest rate hedging.

Currently the plan has a balanced approach to investment in equity securities, debt instruments and real estates. Due to the long term nature of the plan liabilities, the Trustees consider it appropriate to invest a portion of the plan assets in equity securities and in real estate to leverage the return generated by the fund.

Notes to the group financial statements continued

For the year ended 31 March 2018

28 Retirement benefit schemes continued

a) Defined benefit pension schemes continued

(iv) Actuarial risk factors continued

Inflation risk

The benefits payable to members of the Schemes are linked to inflation measured by the RPI or CPI, subject to caps. The group's contributions to the Schemes are based on assumptions about the future level of inflation. If inflation is higher than the levels assumed in the actuarial calculations then the group may need to make additional contributions to the Schemes in order to fund the payment of accrued benefits.

The Schemes use Liability Driven Investment ('LDI') within the asset portfolios to hedge against the value of liabilities changing as a result of movements in long-term interest rate and inflation expectations. This structure allows the Schemes to both hedge against these risks and retain capital investment in assets that are expected to generate higher returns.

Longevity risk

The group's contributions to the Schemes are based on assumptions about the life expectancy of Scheme members after retirement. If Scheme members live longer than assumed in the actuarial calculations then the group may need to make additional contributions to the Schemes in order to fund the payment of accrued benefits.

(v) Actuarial assumptions

The major financial assumptions used in the accounting valuation of the obligations for the STPS, which represents by far the largest defined benefit obligation for the group, were as follows:

	2018 %	2017 %
Price inflation – RPI	3.1	3.1
Price inflation – CPI	2.1	2.1
Discount rate	2.7	2.7
Pension increases in payment	3.1	3.1
Pension increases in deferment	3.1	3.1

The assumption for price inflation is derived from the difference between the yields on longer term fixed rate gilts and on index-linked gilts.

In setting our discount rate, we construct a yield curve. Short-dated yields are taken from market rates for AA corporate bonds. Long-dated yields for the curve are based on the average yield available on all long-dated AA corporate bonds. We project the expected cash flows of the schemes and adopt a single equivalent cash flow weighted discount rate based on this constructed yield curve.

The mortality assumptions are based on those used in the latest triennial funding valuations. The mortality assumptions adopted at the year end for accounting purposes and the life expectancies at age 65 implied by the assumptions are as follows for the STPS:

	2018		2017	
	Men	Women	Men	Women
Mortality table used	S2NMA	S2NFA	S2NMA	S2NFA
Mortality table compared with standard table	95%	99%	95%	99%
Mortality projections	CMI 2017	CMI 2017	CMI 2016	CMI 2016
Future improvement per annum	1.0%	1.0%	1.0%	1.0%
Remaining life expectancy for members currently aged 65 [years]	22.4	24.1	22.5	24.1
Remaining life expectancy at age 65 for members currently aged 45 [years]	23.4	25.3	23.6	25.3

The calculation of the scheme obligations is sensitive to the actuarial assumptions and in particular to the assumptions relating to discount rate, price inflation (capped, where relevant) and mortality. The following table summarises the estimated impact on the group's obligations from changes to key actuarial assumptions whilst holding all other assumptions constant.

28 Retirement benefit schemes continued

a) Defined benefit pension schemes continued

(v) Actuarial assumptions continued

Assumption	Change in assumption	Impact on disclosed obligations
Discount rate ¹	Increase/decrease by 0.1% p.a.	Decrease/increase by £48 million
Price inflation ²	Increase/decrease by 0.1% p.a.	Increase/decrease by £43 million
Mortality ³	Increase in life expectancy by 1 year	Increase by £107 million

1 A change in discount rate is likely to occur as a result of changes in bond yield and as such would be expected to be offset to a significant degree by a change in the value of the bond assets held by the plans.

2 The projected impact resulting from a change in RPI reflects the underlying effect on pensions in payment, pensions in deferment and resultant increases in salary assumptions.

3 The change in assumption is based on triennial valuations and reflect the fact that life expectancy rates are expected to increase.

In reality, interrelationships exist between the assumptions, particularly between the discount rate and price inflation. The above analysis does not take into account the effect of these interrelationships. Also, in practice any movement in obligations arising from assumption changes are likely to be accompanied by movements in asset values – and so the impact on the accounting deficit may be lower than the impact on the obligations shown above.

In presenting the above sensitivity analysis, the present value of the defined benefit obligation has been calculated using the projected unit credit method at the end of the reporting period, which is the same as that applied in calculating the defined benefit obligation liability recognised in the balance sheet.

(vi) Effect on future cash flows

Contribution rates are set in consultation with the trustees for each scheme and each participating employer.

The average duration of the benefit obligation at the end of the year is 17 years for STPS and STMIPS (2017: 20 years) and 16 years for DVWS (2017: 17 years).

The most recent completed formal triennial actuarial valuations and funding agreements were carried out as at 31 March 2016 for the STPS and STMIPS schemes and 31 March 2017 for DVWS. As a result of the STPS and STMIPS actuarial valuations, deficit reduction contributions of £25 million were paid in the year ended 31 March 2017 and £10 million for each of the subsequent financial years ending 31 March 2019 were agreed. Payments of £8 million per annum through an asset-backed funding arrangement will continue to 31 March 2032. Further inflation-linked payments of £15 million per annum are being made through an additional asset-backed funding arrangement, with payments having started in the financial year ended 31 March 2018 and continuing to 31 March 2031.

These contributions will cease earlier should a subsequent valuation of the STPS show that these contributions are no longer needed.

b) Defined contribution pension schemes

The group also operates the Severn Trent Group Personal Pension, a defined contribution scheme, for certain of its UK employees.

Dee Valley Water operates two defined contribution pension schemes, neither of which were material in either the current or prior year.

The total cost charged to operating costs of £20.3 million (2017 restated: £20.9 million) represents contributions payable to these schemes by the group at rates specified in the rules of the scheme. As at 31 March 2018, no contributions (2017: £2.2 million) in respect of the current reporting period were owed to the schemes.

Group financial statements

Notes to the group financial statements continued

For the year ended 31 March 2018

29 Provisions

	Restructuring £m	Insurance £m	Other £m	Total £m
At 1 April 2017	–	21.6	12.2	33.8
Charged to income statement	0.8	6.4	14.6	21.8
Utilisation of provision	–	(4.7)	(0.7)	(5.4)
Unwinding of discount	–	–	1.1	1.1
At 31 March 2018	0.8	23.3	27.2	51.3
Included in:				
Current liabilities			40.6	17.5
Non-current liabilities			10.7	16.3
			51.3	33.8

The restructuring provision reflects costs to be incurred in respect of committed restructuring programmes. The associated outflows are estimated to arise over a period of up to two years from the balance sheet date.

Insurance includes provisions in respect of Derwent Insurance Limited and Lyra Insurance Guernsey Limited, captive insurance companies, which are wholly-owned subsidiaries of the group, and insurance deductions in Severn Trent Water Limited. The associated outflows are estimated to arise over a period of up to five years from the balance sheet date.

Other provisions include provisions for dilapidations, commercial disputes, either from continuing or discontinued operations, and potential environmental claims. The associated outflows are estimated to arise over a period up to 10 years from the balance sheet date.

30 Share capital

	2018 £m	2017 £m
Total issued and fully paid share capital		
240,222,617 ordinary shares of 97 ¹⁷ / ₁₉ p (2017: 239,793,915)	235.1	234.7

At 31 March 2018, treasury shares of 3,948,599 were held (2017: 4,080,964).

Changes in share capital were as follows:

	Number	£m
Ordinary shares of 97¹⁷/₁₉p		
At 1 April 2016	239,344,614	234.3
Shares issued under the Employee Sharesave Scheme	449,301	0.4
At 1 April 2017	239,793,915	234.7
Shares issued under the Employee Sharesave Scheme	428,702	0.4
At 31 March 2018	240,222,617	235.1

31 Share premium

	2018 £m	2017 £m
At 1 April	112.5	106.8
Share premium arising on issue of shares for Employee Sharesave Scheme	5.2	5.7
At 31 March	117.7	112.5

32 Other reserves

	Capital redemption reserve £m	Translation reserve £m	Hedging reserve £m	Total £m
At 1 April 2016	157.1	37.9	(78.5)	116.5
Total comprehensive income for the year	–	2.5	2.8	5.3
At 1 April 2017	157.1	40.4	(75.7)	121.8
Total comprehensive (loss)/income for the year	–	(31.4)	11.6	(19.8)
Transfer to retained earnings	–	(9.0)	–	(9.0)
At 31 March 2018	157.1	–	(64.1)	93.0

The capital redemption reserve arose on the redemption of B shares.

The translation reserve arises from exchange differences on translation of the results and financial position of foreign subsidiaries.

The hedging reserve arises from gains or losses on interest rate swaps taken directly to equity under the hedge accounting provisions of IAS 39 and the transition rules of IFRS 1.

33 Capital management

The group's principal objectives in managing capital are:

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

The group seeks to achieve a balance of long-term funding or commitment of funds across a range of funding sources at the best possible economic cost. The group monitors future funding requirements and credit market conditions to ensure continued availability of funds.

The group has continued to maintain exposure to low floating interest rates, which comprises 26% of our gross debt portfolio at the balance sheet date, with a further 26% of index-linked debt and 48% of fixed rate debt.

The group's dividend policy is a key tool in achieving its capital management objectives. This policy is reviewed and updated in line with Severn Trent Water's five year price control cycle and takes into account, inter alia, the planned investment programme, the appropriate gearing level achieving a balance between an efficient cost of capital and retaining an investment grade credit rating and delivering an attractive and sustainable return to shareholders. The board has decided to set the 2017/18 dividend at 86.55 pence, an increase of 6.2% compared to the total dividend for 2016/17 of 81.50 pence. Our policy is to grow the dividend annually at no less than RPI plus 4% until March 2020.

The group's capital at 31 March was:

	2018 £m	2017 £m
Net cash and cash equivalents	38.5	44.6
Bank loans	(1,217.4)	(1,073.3)
Other loans	(4,223.9)	(4,090.0)
Finance leases	(113.9)	(115.7)
Cross currency swaps	24.5	43.4
Loans due from joint ventures	135.6	108.6
Net debt	(5,356.6)	(5,082.4)
Equity attributable to owners of the company	(993.7)	(923.3)
Total capital	(6,350.3)	(6,005.7)

Notes to the group financial statements continued

For the year ended 31 March 2018

34 Fair values of financial instruments

a) Fair value measurements

The valuation techniques that the group applies in determining the fair values of its financial instruments on a recurring basis are described below. The techniques are classified under the hierarchy defined in IFRS 13 which categorises valuation techniques into Levels 1 – 3 based on the degree to which the fair value is observable. The group's valuation techniques include Levels 2 and 3 given the wide range of financial instruments below:

	2018 £m	2017 £m	Valuation techniques and key inputs
Cross currency swaps			
Assets	24.5	43.4	Discounted cash flow Future cash flows are estimated based on forward interest rates from observable yield curves at the year end and contract interest rates discounted at a rate that reflects the credit risk of counterparties. The currency cash flows are translated at spot rate.
Interest rate swaps			
Assets	11.4	23.6	Discounted cash flow
Liabilities	(112.4)	(183.9)	Future cash flows are estimated based on forward interest rates from observable yield curves at the year end and contract interest rates discounted at a rate that reflects the credit risk of counterparties.
Energy swaps			
Assets	0.3	–	Discounted cash flow
Liabilities	(0.8)	(0.8)	Future cash flows are estimated based on forward electricity prices from observable indices at the year end and contract prices discounted at a rate that reflects the credit risk of counterparties.
Inflation swaps			
Liabilities	(2.8)	–	Discounted cash flow Future cash flows on the RPI leg of the instruments are estimated based on observable forward inflation indices. Future cash flows on the CPI leg of the instruments are estimated based on the future expected differential between RPI and CPI. Both legs are discounted using observable swap rates at the year end, at a rate that reflects the credit risk of counterparties. This is considered to be a Level 3 valuation technique.

34 Fair values of financial instruments continued

b) Comparison of fair values of financial instruments with their carrying amounts

The directors consider that the carrying amounts of cash and short term deposits, bank overdrafts, loans receivable from joint ventures, trade receivables and trade payables approximate their fair values. The carrying values and estimated fair values of other financial instruments are set out below:

	2018	2017		
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Floating rate debt				
Bank loans	917.1	918.6	776.3	782.0
Currency bonds	38.2	38.2	40.1	40.1
Floating rate notes	147.7	153.0	147.7	156.4
	1,103.0	1,109.8	964.1	978.5
Fixed rate debt				
Bank loans	185.3	185.0	186.4	186.6
Sterling bonds	2,357.0	2,700.2	2,257.2	2,746.2
Fixed rate notes	343.4	347.6	355.2	397.4
Other loans	5.3	5.3	6.7	6.7
Finance leases	113.9	122.5	115.7	130.5
	3,004.9	3,360.6	2,921.2	3,467.4
Index-linked debt				
Bank loans	115.0	124.9	110.6	126.7
Sterling bonds	1,244.1	2,057.1	1,195.8	2,063.1
Other loans	88.2	87.1	87.3	87.3
	1,447.3	2,269.1	1,393.7	2,277.1
	5,555.2	6,739.5	5,279.0	6,723.0

The above classification does not take into account the impact of unhedged interest rate swaps or cross currency swaps.

Fixed rate sterling and currency bonds are valued using market prices, which is a Level 2 valuation technique.

Index-linked bonds are rarely traded and therefore quoted prices are not considered to be a reliable indicator of fair value. Therefore, these bonds are valued using discounted cash flow models with discount rates derived from observed market prices for a sample of bonds, which is a Level 2 valuation technique.

Fair values of the other debt instruments are also calculated using discounted cash flow models, which is a Level 2 valuation technique.

35 Risks arising from financial instruments

The group's activities expose it to a variety of financial risks:

- market risk (including interest rate risk, exchange rate risk and other price risk);
- credit risk;
- liquidity risk; and
- inflation risk.

The group's overall risk management programme addresses the unpredictability of financial markets and seeks to reduce potential adverse effects on the group's financial performance or position.

Financial risks are managed by a central treasury department ('Group Treasury') under policies approved by the board of directors. The board has established a Treasury Committee to monitor treasury activities and to facilitate timely responses to changes in market conditions when necessary. Group Treasury identifies, evaluates and hedges financial risks in close cooperation with the group's operating units. The board defines written principles for overall risk management, as well as written policies covering specific areas such as exchange rate risk, interest rate risk, credit risk and the use of derivative and non-derivative financial instruments. The group's policy is that derivative financial instruments are not held for trading but may be used to mitigate the group's exposure to financial risk. The types of derivative instruments held and the related risks are described below.

Interest rate swaps are held to manage the group's exposure to changes in market interest rates. Further details are set out in section a) (i) and note 36 b) (i).

Cross currency swaps are held to mitigate the group's exposure to exchange rate movements on amounts borrowed in foreign currencies. Further details are set out in section a) (ii) and 36 a) (i).

Notes to the group financial statements continued

For the year ended 31 March 2018

35 Risks arising from financial instruments continued

Energy swaps are held to mitigate the group's exposure to changes in electricity prices. Further details are provided in note 36 b) (ii) below.

Severn Trent Water, the group's most significant business unit, operates under a regulatory environment where its prices are linked to inflation measured by RPI. In order to mitigate the risks to cash flow and earnings arising from fluctuations in RPI, the group holds debt instruments where the principal repayable and interest cost is linked to RPI.

a) Market risk

The group is exposed to fluctuations in interest rates and, to a lesser extent, exchange rates. The nature of these risks and the steps that the group has taken to manage them are described below.

(i) Interest rate risk

The group's income and its operating cash flows are substantially independent of changes in market interest rates. The group's interest rate risk arises from long-term borrowings.

Borrowings issued at variable rates expose the group to the risk of adverse cash flow impacts from increases in interest rates.

Borrowings issued at fixed rates expose the group to the risk of interest costs above the market rate when interest rates decrease.

The group's policy is to maintain 40% to 70% of its interest bearing liabilities in fixed rate instruments during AMP6. In measuring this metric, management makes adjustments to the carrying value of debt to better reflect the amount that interest is calculated on. Details of the adjustments made are set out below:

	2018 £m	2017 £m
Net debt (note 40)	5,356.6	5,082.4
Cash and cash equivalents	51.1	44.6
Loan receivable from joint venture	135.6	108.6
Cross currency swaps included in net debt at fair value	24.5	43.4
Fair value hedge accounting adjustments	(30.4)	(31.5)
Exchange on currency debt not hedge accounted	(8.5)	(21.2)
Interest-bearing financial liabilities	5,528.9	5,226.3

The group manages its cash flow interest rate risk by borrowing at fixed or index-linked rates or by using interest rate swaps. Under these swaps the group receives variable rate interest and pays fixed rate interest calculated by reference to the agreed notional principal amounts. In practice the swaps are settled by transferring the net amount. These swaps have the economic effect of converting borrowings from variable rates to fixed rates. The group has entered into a series of these interest rate swaps to hedge future interest payments beyond 2030.

The following tables show analyses of the group's interest bearing financial liabilities by type of interest. Debt which is hedged by interest rate swaps or cross currency swaps is included in the category after taking account of the impact of the swap. Debt raised in foreign currencies has been included at the notional sterling value of the payable leg of the corresponding cross currency swap since this is the amount that is exposed to changes in interest rates.

Valuation adjustments that do not impact the amount on which interest is calculated, such as fair value hedge accounting adjustments, are excluded from this analysis.

The net principal amount of unhedged swaps is shown as an adjustment to floating rate and fixed rate debt to demonstrate the impact of the swaps on the amount of liabilities bearing fixed interest.

2018	Floating rate £m	Fixed rate £m	Index- linked £m	Total £m
Overdrafts	(12.6)	–	–	(12.6)
Bank loans	(917.1)	(185.3)	(115.0)	(1,217.4)
Other loans	(167.6)	(2,685.0)	(1,332.3)	(4,184.9)
Finance leases	–	(113.9)	–	(113.9)
	(1,097.3)	(2,984.2)	(1,447.3)	(5,528.9)
Impact of swaps not matched against specific debt instruments	(349.6)	349.6	–	–
Interest bearing financial liabilities	(1,446.9)	(2,634.6)	(1,447.3)	(5,528.9)
Proportion of interest bearing financial liabilities that are fixed		48%		
Weighted average interest rate of fixed debt		4.30%		
Weighted average period for which interest is fixed (years)		8.8		

35 Risks arising from financial instruments continued

a) Market risk continued

(i) Interest rate risk continued

	Floating rate £m	Fixed rate £m	Index- linked £m	Total £m
2017				
Bank loans	(776.3)	(186.4)	(110.6)	(1,073.3)
Other loans	(167.6)	[2,586.4)	[1,283.3]	[4,037.3)
Finance leases	–	(115.7)	–	(115.7)
	[943.9)	[2,888.5)	[1,393.9)	[5,226.3)
Impact of swaps not matched against specific debt instruments	(205.3)	205.3	–	–
Interest bearing financial liabilities	(1,149.2)	[2,683.2)	[1,393.9)	[5,226.3)
Proportion of interest bearing financial liabilities that are fixed		51%		
Weighted average interest rate of fixed debt		5.16%		
Weighted average period for which interest is fixed (years)		9.2		

Interest rate swaps not hedge accounted

The group has a number of interest rate swaps which are not accounted for as cash flow or fair value hedges. This has led to a credit of £7.9 million (2017: charge of £3.3 million) in the income statement.

	Average contract fixed interest rate		Notional principal amount		Fair value	
	2018 %	2017 %	2018 £m	2017 £m	2018 £m	2017 £m
Pay fixed rate interest						
5 – 10 years	5.06	5.06	[300.0)	(450.0)	(65.6)	(125.3)
10 – 20 years	5.46	5.45	[73.7)	(68.1)	(32.6)	(37.8)
	5.16	5.11	[373.7)	(518.1)	(98.2)	(163.1)
Receive fixed rate interest						
5 – 10 years	3.36	3.34	225.0	75.0	11.4	5.8
10 – 20 years	2.75	2.92	400.0	550.0	(0.6)	17.8
	3.01	2.97	625.0	625.0	10.8	23.6
			251.3	106.9	(87.4)	(139.5)

Interest rate sensitivity analysis

The sensitivity after tax of the group's profits, cash flow and equity, including the impact on derivative financial instruments, to changes in interest rates at 31 March is as follows:

	2018		2017	
	1.0% £m	-1.0% £m	1.0% £m	-1.0% £m
Profit or loss	(47.7)	53.9	[36.1)	54.3
Cash flow	(11.5)	11.5	8.8	(8.8)
Equity	(47.7)	53.9	[36.1)	54.3

(ii) Exchange rate risk

Except for debt raised in foreign currency, which is hedged, the group's business does not involve significant exposure to foreign exchange transactions. Substantially all of the group's profits and net assets arise from Severn Trent Water, which has very limited and indirect exposure to changes in exchange rates, and therefore the sensitivity of the group's results to changes in exchange rates is not material.

Certain of the group's subsidiaries enter into transactions in currencies other than the functional currency of the operation. Exchange risks relating to such operations are not material but are managed centrally by Group Treasury through forward exchange contracts to buy or sell currency. These contracts led to a charge of £nil (2017: charge of £0.1 million) in the income statement.

In order to meet its objective of accessing a broad range of sources of finance, the group has raised debt denominated in currencies other than sterling. In order to mitigate the group's exposure to exchange rate fluctuations, cross currency swaps were entered into at the time that the debt was drawn down to swap the proceeds into sterling debt bearing interest based on LIBOR.

Notes to the group financial statements continued

For the year ended 31 March 2018

35 Risks arising from financial instruments continued

a) Market risk continued

(ii) Exchange rate risk continued

Where the terms of the receivable leg of the swap closely match the terms of the underlying debt, the swaps are expected to be effective hedges, hence the swaps have been accounted for as fair value hedges. The notional value and fair value of these swaps is shown in note 36 a).

The group also has cross currency swaps with a sterling value of £98.3 million (2017: £98.3 million) which are not accounted for as fair value hedges. Economically these swaps act to mitigate the exchange rate risk of debt within the group which is denominated in foreign currency, but they do not achieve hedge accounting under the strict criteria of IAS 39. This has led to a charge of £17.7 million (2017: credit of £13.1 million) in the income statement which is partly offset by the exchange gain of £12.7 million (2017: exchange loss of £15.4 million) on the underlying debt.

The group's gross and net currency exposures arising from currency borrowings are summarised in the tables below. These show, in the relevant currency, the amount borrowed and the notional principal of the related swap or forward contract. The net position shows the group's exposure to exchange rate risk in relation to its currency borrowings.

	Euro €m	US dollar \$m	Yen ¥bn
2018			
Borrowings by currency	(20.2)	(150.0)	(2.0)
Cross currency swaps – hedge accounted	19.9	–	2.0
Cross currency swaps – not hedge accounted	–	150.0	–
Net currency exposure	(0.3)	–	–

	Euro €m	US dollar \$m	Yen ¥bn
2017			
Borrowings by currency	(20.1)	(150.0)	(2.0)
Cross currency swaps – hedge accounted	19.9	–	2.0
Cross currency swaps – not hedge accounted	–	150.0	–
Net currency exposure	(0.2)	–	–

b) Credit risk

Operationally the group has no significant concentrations of credit risk. It has policies in place to ensure that sales of products are made to customers with an appropriate credit history, other than in Severn Trent Water Limited and Dee Valley Water Limited, whose operating licences oblige them to supply domestic customers even in cases where bills are not paid. Amounts provided against accounts receivable and movements on the provision during the year are disclosed in note 21.

Cash deposits and derivative contracts are only placed with high credit quality financial institutions, which have been approved by the board. Group Treasury monitors the credit quality of the approved financial institutions and the list of financial institutions that may be used is approved annually by the board. The group has policies that limit the amount of credit exposure to any one financial institution.

Credit risk analysis

At 31 March the aggregate credit limits of authorised counterparties and the amounts held on short term deposits were as follows:

	Credit limit		Amount deposited	
	2018 £m	2017 £m	2018 £m	2017 £m
AAA	–	5.0	–	1.2
Double A range	105.0	100.0	–	1.8
Single A range	650.0	625.0	11.1	13.8
Triple B range	10.0	10.0	5.3	2.0
	765.0	740.0	16.4	18.8

The fair values of derivative assets analysed by credit ratings of counterparties were as follows:

	Derivative assets	
	2018 £m	2017 £m
Double A range	–	0.8
Single A range	36.2	66.2
	36.2	67.0

35 Risks arising from financial instruments continued

c) Liquidity risk

(i) Committed facilities

Prudent liquidity management requires sufficient cash balances to be maintained; adequate committed facilities to be available; and the ability to close out market positions. Group Treasury manages liquidity and flexibility in funding by monitoring forecast and actual cash flows and the maturity profile of financial assets and liabilities, and by keeping committed credit lines available.

At the balance sheet date the group had committed undrawn borrowing facilities expiring as follows:

	2018 £m	2017 £m
2 – 5 years	710.0	1,000.0

(ii) Cash flows from non-derivative financial instruments

The following tables show the estimated cash flows that will arise from the group's non-derivative net financial liabilities.

The information presented is based on the earliest date on which the group can be required to pay and represents the undiscounted cash flows including principal and interest.

Interest and inflation assumptions are based on prevailing market conditions at the year end date.

2018 Undiscounted amounts payable:	Floating rate £m	Fixed rate £m	Index-linked £m	Trade payables £m	Payments on financial liabilities £m
Within 1 year	(311.4)	(136.0)	(27.8)	(18.9)	(494.1)
1 – 2 years	(10.3)	(116.1)	(29.4)	–	(155.8)
2 – 5 years	(41.3)	(982.6)	(325.7)	–	(1,349.6)
5 – 10 years	(785.3)	(1,333.6)	(199.9)	–	(2,318.8)
10 – 15 years	(52.7)	(1,056.0)	(436.2)	–	(1,544.9)
15 – 20 years	–	(60.9)	(139.0)	–	(199.9)
20 – 25 years	–	(298.8)	(167.7)	–	(466.5)
25 – 30 years	–	–	(199.2)	–	(199.2)
30 – 35 years	–	–	(649.7)	–	(649.7)
35 – 40 years	–	–	(2,273.6)	–	(2,273.6)
40 – 45 years	–	–	(1,068.1)	–	(1,068.1)
45 – 50 years	–	–	(374.2)	–	(374.2)
Total	(1,201.0)	(3,984.0)	(5,890.5)	(18.9)	(11,094.4)

Undiscounted amounts receivable:	Loans due from joint ventures £m	Trade receivables £m	Cash and short term deposits £m	Receipts from financial assets £m
Within 1 year	–	191.0	51.1	242.1
1 – 2 years	126.3	–	–	126.3
5 – 10 years	12.5	–	–	12.5
Total	138.8	191.0	51.1	380.9

Notes to the group financial statements continued

For the year ended 31 March 2018

35 Risks arising from financial instruments continued**c) Liquidity risk** continued**(ii) Cash flows from non-derivative financial instruments** continued

2017 Undiscounted amounts payable:	Floating rate £m	Fixed rate £m	Index-linked £m	Trade payables £m	Payments on financial liabilities £m
Within 1 year	(160.7)	(538.7)	(25.4)	(24.0)	(748.8)
1 – 2 years	(11.6)	(108.7)	(26.6)	–	(146.9)
2 – 5 years	(42.1)	(469.8)	(84.6)	–	(596.5)
5 – 10 years	(750.2)	(1,383.4)	(440.2)	–	(2,573.8)
10 – 15 years	(112.3)	(1,110.0)	(347.1)	–	(1,569.4)
15 – 20 years	–	(60.9)	(221.3)	–	(282.2)
20 – 25 years	–	(310.9)	(160.3)	–	(471.2)
25 – 30 years	–	–	(190.1)	–	(190.1)
30 – 35 years	–	–	(643.2)	–	(643.2)
35 – 40 years	–	–	(1,226.5)	–	(1,226.5)
40 – 45 years	–	–	(2,089.7)	–	(2,089.7)
45 – 50 years	–	–	(365.0)	–	(365.0)
Total	(1,076.9)	(3,982.4)	(5,820.0)	(24.0)	(10,903.3)

Undiscounted amounts receivable:	Loans due from joint ventures £m	Trade receivables £m	Cash and short term deposits £m	Receipts from financial assets £m
Within 1 year	99.6	214.2	44.6	358.4
5 – 10 years	12.5	–	–	12.5
Total	112.1	214.2	44.6	370.9

Index-linked debt includes loans with maturities up to 50 years. The principal is revalued at fixed intervals and is linked to movements in the RPI. Interest payments are made biannually based on the revalued principal. The principal repayment equals the revalued amount at maturity. The payments included in the table above are estimates based on the forward inflation rates published by the Bank of England at the balance sheet date.

(iii) Cash flows from derivative financial instruments

The following tables show the estimated cash flows that will arise from the group's derivative financial instruments. The tables are based on the undiscounted net cash inflows/(outflows) on the derivative financial instruments that settle on a net basis and the undiscounted gross inflows/(outflows) on those derivatives that require gross settlement. When the amount payable or receivable is not fixed, the amount disclosed has been determined by reference to the projected interest and foreign currency rates derived from the forward curves existing at the balance sheet date. Actual amounts may be significantly different from those indicated below.

2018	Derivative liabilities					Derivative assets			
	Interest rate swaps £m	Energy swaps £m	Inflation swaps £m	Interest rate swaps £m	Energy swaps £m	Cross currency swaps	Cash receipts £m	Cash payments £m	Total £m
Within 1 year	(14.9)	–	–	5.1	0.2	1.1	–	(0.2)	(8.7)
1 – 2 years	(14.3)	–	–	1.7	–	1.1	–	(0.3)	(11.8)
2 – 5 years	(47.5)	(0.8)	0.2	3.5	0.1	3.4	–	(1.1)	(42.2)
5 – 10 Years	(35.8)	–	0.8	3.9	–	23.3	–	(13.0)	(20.8)
10 – 15 Years	(13.0)	–	1.6	–	–	17.5	–	(8.8)	(2.7)
15 – 20 years	–	–	(6.7)	–	–	–	–	–	(6.7)
	(125.5)	(0.8)	(4.1)	14.2	0.3	46.4	–	(23.4)	(92.9)

35 Risks arising from financial instruments continued

c) Liquidity risk continued

(iii) Cash flows from derivative financial instruments continued

2017	Derivative liabilities			Derivative assets			Total £m	
			Interest rate swaps £m	Cross currency swaps				
	Interest rate swaps £m	Energy swaps £m		Cash receipts £m	Cash payments £m			
Within 1 year	(25.4)	(0.2)	6.9	1.1	(0.2)	(17.8)		
1 – 2 years	(24.9)	(0.5)	6.2	1.1	(0.2)	(18.3)		
2 – 5 years	(73.4)	(0.3)	13.1	3.4	(0.8)	(58.0)		
5 – 10 Years	(61.6)	–	4.3	23.9	(13.1)	(46.5)		
10 – 15 Years	(11.6)	–	(6.4)	18.1	(9.0)	(8.9)		
	(196.9)	(1.0)	24.1	47.6	(23.3)	(149.5)		

d) Inflation risk

The group's principal operating subsidiary, Severn Trent Water, operates under a regulatory environment where its prices are linked to inflation measured by RPI. Its operating profits and cash flows are therefore exposed to changes in RPI. In order to mitigate and partially offset this risk, Severn Trent Water has raised debt which pays interest at a fixed coupon based on a principal amount that is adjusted for the change in RPI during the life of the debt instrument ('index-linked debt'). The amount of index-linked debt at the balance sheet date is shown in section a) (i) Interest rate risk, and the estimated future cash flows relating to this debt are shown in section c) (ii) Cash flows from non-derivative financial instruments.

Ofgov has announced its plans to move towards an economic regulatory model linked to inflation measured on the CPIH index over a period of time. In anticipation of this the group has entered into CPI/RPI swaps with a notional value of £150 million at 31 March 2018 in order to mitigate the risk of divergence between inflation measured by CPIH and that measured by RPI.

Inflation rate sensitivity analysis

The finance cost of the group's index-linked debt instruments varies with changes in RPI rather than interest rates. The sensitivity at 31 March of the group's profit and equity to changes in RPI is set out in the following table. This analysis relates to financial instruments only and excludes any RPI impact on Severn Trent Water's revenues and Regulatory Capital Value, or accounting for defined benefit pension schemes.

	2018		2017	
	+1.0% £m	-1.0% £m	+1.0% £m	-1.0% £m
Profit or loss	(11.7)	11.7	(11.2)	11.2
Equity	(11.7)	11.7	(11.2)	11.2

36 Hedge accounting

The group uses derivative financial instruments to hedge exposures to changes in exchange rates and interest rates.

Hedge accounting is adopted for such instruments where the criteria set out in IAS 39 are met.

a) Fair value hedges

(i) Cross currency swaps

The group raises debt denominated in currencies other than sterling. Cross currency swaps are entered into at the time that the debt is drawn down to swap the proceeds into sterling debt bearing interest based on LIBOR in order to mitigate the group's exposure to exchange rate fluctuations. Where the terms of the receivable leg of the swap closely match the terms of the underlying debt, the swaps are expected to be effective hedges.

At the year end the amounts of cross currency swaps designated as fair value hedges were as follows:

	Notional principal amount		Fair value	
	2018 £m	2017 £m	2018 £m	2017 £m
Euro	11.4	11.4	10.4	10.4
Yen	8.5	8.5	8.3	9.4
	19.9	19.9	18.7	19.8

Notes to the group financial statements continued

For the year ended 31 March 2018

36 Hedge accounting continued

b) Cash flow hedges

(i) Interest rate swaps

The group has entered into interest rate swaps under which it has agreed to exchange the difference between fixed and floating interest rate amounts calculated on agreed notional principal amounts. Such contracts enable the group to mitigate the risk of changing interest rates on future cash flow exposures arising from issued variable rate debt. Where the hedge is expected to be highly effective these interest rate swaps are accounted for as cash flow hedges.

Details of interest rate swaps that have been accounted for as cash flow hedges are summarised below:

Period to maturity	Average contract fixed interest rate		Notional principal amount		Fair value	
	2018 %	2017 %	2018 £m	2017 £m	2018 £m	2017 £m
5 – 10 years	2.63	1.70	135.2	50.0	(8.6)	(1.1)
10 – 20 years	1.83	2.14	298.0	384.4	(5.0)	(19.6)
	2.08	2.09	433.2	434.4	(13.6)	(20.7)

(ii) Energy swaps

The group has entered into a series of energy swaps under which it has agreed to exchange the difference between fixed and market prices of electricity at six-monthly intervals up to March 2020.

Details of energy swaps that have been accounted for as cash flow hedges are summarised below:

Period to maturity	Average contract price		Notional contracted amount		Fair value	
	2018 £/MWh	2017 £/MWh	2018 MWh	2017 MWh	2018 £m	2017 £m
Less than 1 year	47.6	43.6	43,680	66,272	0.2	(0.2)
1 – 2 years	48.6	48.5	21,955	205,296	–	(0.5)
2 – 5 years	40.5	48.6	547,460	21,955	(0.7)	(0.1)
	41.3	47.4	613,095	293,523	(0.5)	(0.8)

37 Share based payments

The group operates a number of share based remuneration schemes for employees. During the period, the group recognised total expenses of £6.9 million (2017: £6.1 million) related to equity settled share based payment transactions.

The weighted average share price during the period was £21.25 (2017: £22.98).

At 31 March 2018, there were no options exercisable (2017: none) under any of the share based remuneration schemes.

a) Long Term Incentive Plans ('LTIPs')

Under the Long Term Incentive Plan ('LTIP'), conditional awards of shares may be made to executive directors and senior staff. Awards are subject to performance conditions and continued employment throughout the vesting period. Awards have been previously made on different bases to Severn Trent Plc and Severn Trent Water employees (the 'LTIP') and to Severn Trent Services employees (the 'Services LTIP').

Awards made under the LTIP

The 2014 LTIP awards were subject to Severn Trent Water's achievement of Return on Regulated Capital Value in excess of the level included in the Severn Trent Water AMP5 business plan over a three year vesting period. The 2015, 2016 and 2017 LTIP awards are subject to Severn Trent Water's achievement of Return on Regulated Equity in excess of the level included in the Severn Trent Water AMP6 business plan over a three year vesting period. It has been assumed that performance against the LTIP non-market conditions will be 100% (2017: 100%).

Awards made under the Services LTIP

Awards were subject to achievement of turnover and profit targets over the three year period from the financial year that the awards were granted. In 2017 it was assumed that performance against the Services LTIP would be 0%.

37 Share based payments continued

a) Long Term Incentive Plans ('LTIPs') continued

Awards outstanding

Details of changes in the number of awards outstanding during the year are set out below:

	Number of awards	
	LTIP	Services LTIP
Opening at 1 April 2016	475,878	33,864
Granted during the year	195,415	-
Vested during the year	(132,697)	-
Lapsed during the year	(21,122)	(33,864)
Outstanding at 1 April 2017	517,474	-
Granted during the year	203,035	-
Vested during the year	(139,829)	-
Lapsed during the year	(31,906)	-
Outstanding at 31 March 2018	548,774	-

Details of LTIP and Services LTIP awards outstanding at 31 March were as follows:

Date of grant	Normal date of vesting	Number of awards	
		2018	2017
July 2014	2017	-	153,724
July 2015	2018	160,028	168,335
July 2016	2019	188,131	195,415
July 2017	2020	200,615	-
		548,774	517,474

Details of the basis of the LTIP scheme are set out in the Directors' remuneration report on pages 96 to 128.

b) Employee Sharesave Scheme

Under the terms of the Sharesave Scheme, the board may grant the right to purchase ordinary shares in the company to those employees who have entered into an HMRC approved Save As You Earn contract for a period of three or five years.

Options outstanding

Details of changes in the number of options outstanding during the year are set out below:

	Number of share options	Weighted average exercise price
Outstanding at 1 April 2016	2,858,611	1,492p
Granted during the year	868,766	1,663p
Forfeited during the year	(71,133)	1,579p
Cancelled during the year	(92,095)	1,636p
Exercised during the year	(449,301)	1,226p
Lapsed during the year	(8,241)	1,396p
Outstanding at 1 April 2017	3,106,607	1,572p
Granted during the year	1,087,376	1,652p
Forfeited during the year	(46,715)	1,636p
Cancelled during the year	(134,768)	1,665p
Exercised during the year	(428,702)	1,306p
Lapsed during the year	(8,867)	1,367p
Outstanding at 31 March 2018	3,574,931	1,625p

Notes to the group financial statements continued

For the year ended 31 March 2018

37 Share based payments continued

b) Employee Sharesave Scheme continued

Options outstanding continued

Sharesave options outstanding at 31 March were as follows:

Date of grant	Normal date of exercise	Option price	Number of awards	
			2018	2017
January 2012	2017	1,177p	–	88,346
January 2013	2016 or 2018	1,241p	110,447	112,860
January 2014	2017 or 2019	1,331p	151,528	489,937
January 2015	2018 or 2020	1,584p	846,002	883,839
January 2016	2019 or 2021	1,724p	621,971	668,413
January 2017	2020 or 2022	1,663p	781,782	863,212
January 2018	2021 or 2023	1,652p	1,063,201	–
			3,574,931	3,106,607

c) Share Matching Plan ('SMP')

Under the SMP members of STEC may receive matching share awards over those shares which had been acquired under the deferred share component of the annual bonus scheme. Matching shares may be awarded at a maximum ratio of one matching share for every deferred share and are subject to a three year vesting period. No matching shares have been awarded in the current year.

Matching shares are subject to total shareholder return over three years measured relative to the companies ranked 51 – 150 by market capitalisation in the FTSE Index (excluding investment trusts).

The number of shares subject to an award will increase to reflect dividends paid through the performance period on the basis of such notional dividends being reinvested at the then prevailing share price. Awards will normally vest as soon as the Remuneration Committee determines that the performance conditions have been met provided that the participant remains in employment at the end of the performance period.

Details of changes in the number of awards outstanding during the year are set out below:

	Number of awards
Outstanding at 1 April 2016	27,613
Cancelled during the year	(24,682)
Vested during the year	(2,931)
Outstanding at 31 March 2017 and 2018	–

d) Fair value calculations

The fair values of the share awards made and share options granted during the year were calculated using the Black Scholes method. The principal assumptions and data are set out below:

	2018		2017	
	LTIP		SAYE	
	3 year scheme	5 year scheme	LTIP	3 year scheme
Share price at grant date (pence)	2,341	2,138	2,138	2,236
Option life (years)	3	3.5	5.5	3
Vesting period (years)	3	3	5	3
Expected volatility (%)	18.2	18.2	18.2	18.2
Expected dividend yield (%)	4.1	4.1	4.1	3.7
Risk free rate (%)	n/a	0.5	0.8	n/a
Fair value per share (pence)	2,328	375	351	2,224
				407
				429

Expected volatility is measured over the three years prior to the date of grant of the awards or share options.

Volatility has been calculated based on historical share price movements.

The risk free rate is derived from yields at the grant date of gilts of similar duration to the awards or share options.

The dividend yield is calculated using the expected dividend for the year divided by the share price at the date of grant.

38 Acquisitions

On 15 February 2017, Severn Trent Water Limited acquired 100% of the issued share capital of Dee Valley Group Limited comprising all subsidiaries including the regulated water company Dee Valley Water Limited. This acquisition was made through a scheme of arrangement including cash consideration of £79.0 million and the issue of loan notes with a value of £5.2 million.

The acquisition was accounted for using the acquisition method. Goodwill of £66.0 million was capitalised attributable to the anticipated future synergies and outperformance arising as a result of the acquisition. The goodwill valuation was based on management's best estimates of the fair values of the assets and liabilities acquired. Given the proximity to the year end, full detailed fair value exercises were not able to be completed before the approval of the financial statements for the year ended 31 March 2017.

The fair value exercises were completed in the current year and resulted in the revisions to the provisional fair values as set out in the following table.

	£m
Goodwill recognised at 1 April 2017 based on provisional fair values	66.0
Additional consideration in respect of acquisition	0.2
Adjustments to provisional fair values for:	
– Recognition of Dee Valley Water Limited's Instrument of Appointment	(4.3)
– Revisions to estimated fair value of property, plant and equipment	(0.8)
– Deferred tax on changes in fair value	1.1
Goodwill recognised at 31 March 2018 based on final fair values	62.2

Details of the adjustments made to the provisional fair values are set out below.

Dee Valley Water Limited holds an Instrument of Appointment as a water undertaker under the Water Act 1989 issued by the Secretary of State for Wales (the Licence). The Licence has no fixed term and requires 25 years notice of termination. Under the Licence, Dee Valley Water Limited has an exclusive right to supply water to household and non-household customers within a geographic area defined in the Licence. On 23 March 2018 Ofwat announced that it had agreed to vary the terms of the Licence with effect from 1 July 2018 to amend the geographic area to include those parts of Wales previously served by Severn Trent Water and to exclude certain parts of England previously served by Dee Valley Water.

Water undertakers are subject to a framework of economic regulation operated by the Water Services Regulation Authority (Ofwat). Under this framework, water undertakers are permitted to set wholesale tariffs that would enable an efficient company to earn a post-tax return on a notional amount known as the Regulatory Capital Value (RCV). They are also allowed to earn a net margin on their retail costs. Ofwat sets the post-tax return at a rate that it considers to be the weighted average cost of capital for companies operating in the sector based on an assumed gearing level. Therefore the Licence, together with the net operating assets, enables Dee Valley Water Limited to earn post-tax returns with a net present value equivalent to the RCV plus a net return on retail activities.

To determine the fair value of the licence we have taken the RCV at 31 March 2017 from Ofwat's Final Price Control Determination published in December 2014 adjusted to current prices at the acquisition date, added an allowance for the value of the Retail business and compared this with the fair value of the operating assets acquired. This resulted in a valuation of £4.3 million for the Licence.

The goodwill acquired represents future outperformance of the regulatory settlement and synergies arising from the combination of the group's regulated water businesses.

See note 16 for the reconciliation of goodwill recognised for the group.

39 Discontinued operations

Operating Services US and Italy

The disposal of the group's US business (Operating Services, US), which formed part of the Business Services segment, to US investors PPC Enterprises LLC and Alston Capital Partners LLC was completed on 30 June 2017. The group disposed of the Operating Services business in Italy, which formed part of the Business Services segment, on 23 February 2017 to Acea S.P.A.

The classification of these businesses as discontinued operations requires judgements as to whether they represent a separate major line of business or geographical area. The Operating Services Italy business was sold on 23 February 2017. At that point the process to dispose of the Operating Services US business was underway, as part of a single coordinated plan to exit the overseas Operating Services businesses. However, at that point the disposal of the Operating Services US business was not considered to be highly probable because the sale process was not sufficiently advanced.

On its own, Operating Services Italy was not considered to be a major line of business or geographical area and so it was not classified as a discontinued operation in the financial statements for the year ended 31 March 2017.

Following the disposal of Operating Services US on 30 June 2017, the group had completed its plan to exit the overseas Operating Services business. It reassessed the classification of these businesses and reclassified them as discontinued operations.

Prior period figures in the consolidated income statement and related notes have been restated to present separately amounts relating to discontinued operations.

Notes to the group financial statements continued

For the year ended 31 March 2018

39 Discontinued operations continued

Water Plus joint venture

On 1 March 2016 the group announced its intention, subject to approval from the Competition and Markets Authority ('CMA'), to enter into a joint venture with United Utilities PLC to compete in the non-household water and waste water retail markets in England and Scotland. On 3 May 2016 the CMA announced approval of the joint venture. On this date the group determined that completion of the proposed transaction became highly probable and the non-household retail business was classified as a disposal group and a discontinued operation with effect from this date. On 31 May 2016 the group transferred Severn Trent Water's non-household retail business to Severn Trent Select Limited and on 1 June it exchanged the entire share capital of Severn Trent Select Limited for 50% of the share capital of Water Plus Limited.

During the year, the remaining balance on the non-household retail receivable amounts that were retained when that business was transferred to Water Plus were written off. An additional £1.5 million was charged to operating costs in discontinued operations in respect of this.

The results of discontinued operations are disclosed separately in the income statement and comprise:

	2018			2017 (restated)		
	Operating Services US (3 months) £m	Non-household retail £m	Total £m	Operating Services US (12 months) £m	Operating Services Italy (10 months) £m	Non-household retail (2 months) £m
Turnover	42.1	–	42.1	160.4	20.8	66.0
Total operating costs	(40.7)	(1.5)	(42.2)	(156.0)	(20.2)	(67.3)
(Loss)/profit before interest and tax	1.4	(1.5)	(0.1)	4.4	0.6	(1.3)
Net finance income	–	–	–	0.9	0.2	–
(Loss)/profit before tax	1.4	(1.5)	(0.1)	5.3	0.8	(1.3)
Attributable tax expense	–	0.3	0.3	(0.6)	–	0.3
Gain on disposal of discontinued operations	13.0	–	13.0	–	2.0	14.6
Profit/(loss) for the year	14.4	(1.2)	13.2	4.7	2.8	13.6
Attributable to:						
Owners of the company	14.4	(1.2)	13.2	4.7	3.0	13.6
Non-controlling interests	–	–	–	–	(0.2)	–
	14.4	(1.2)	13.2	4.7	2.8	13.6
						21.1

Basic and diluted earnings per share from discontinued operations are as follows:

	2018			2017 (restated)		
	Profit attributable to owners of the company £m	Weighted average number of shares m	Per share amount pence	Profit attributable to owners of the company £m	Weighted average number of shares m	Per share amount pence
Basic earnings per share	13.2	235.3	5.6	21.3	235.0	9.1
Diluted earnings per share	13.2	236.1	5.6	21.3	236.0	9.0

39 Discontinued operations continued

The net assets of the business at the date of disposal were:

	2018	2017	
	Operating Services US £m	Operating Services Italy £m	Non-household retail £m
Goodwill	14.4	2.0	–
Other intangible assets	2.9	1.4	–
Property, plant and equipment	9.4	1.2	–
Investments	–	4.2	–
Inventories	0.6	7.5	–
Trade and other receivables	28.2	11.3	0.6
Cash and bank balances	9.9	1.5	3.5
Trade and other payables	(19.9)	(15.0)	(0.5)
Borrowings	–	(3.9)	–
Provisions for liabilities	–	(2.3)	–
	45.5	7.9	3.6
Attributable to:			
Owners of the company	45.5	7.1	3.6
Non-controlling interest	–	0.8	–
	45.5	7.9	3.6

The net gain on disposals is calculated as follows:

	Operating Services US £m	Operating Services Italy £m	Non-household retail £m
Consideration	47.8	7.9	25.5
Net assets attributable to owners of the company	(45.5)	(7.1)	(3.6)
	2.3	0.8	21.9
Tax on gain on disposal	(0.7)	–	–
Disposal costs and provisions on disposal	(18.4)	(1.6)	(7.3)
Foreign exchange gain recycled from reserves	29.8	2.8	–
Net gain on disposal	13.0	2.0	14.6

The net cash flows arising from the disposal groups were as follows:

	2018	2017 (restated)			
	Operating Services US (3 months) £m	Operating Services US (12 months) £m	Operating Services Italy (10 months) £m	Non-household retail (2 months) £m	Total £m
Net cash flows attributable to:					
- Operating activities	1.9	5.1	(0.7)	2.9	7.3
- Investing activities	(0.6)	(3.7)	0.4	–	(3.3)
- Financing activities	–	(1.1)	1.1	(3.5)	(3.5)
	1.3	0.3	0.8	(0.6)	0.5

The net cash flows arising from disposals were:

	Operating Services US £m	Operating Services Italy £m	Non-household retail £m
Consideration received in cash and cash equivalents	39.3	0.3	–
Settlement of intercompany loans	–	7.6	–
Disposal costs paid in cash and cash equivalents	(4.6)	(1.6)	(7.3)
Cash and bank balances disposed of	(9.9)	(1.5)	(3.5)
	24.8	4.8	(10.8)

Notes to the group financial statements continued

For the year ended 31 March 2018

40 Cash flow statement**a) Reconciliation of operating profit to operating cash flows**

	2018 £m	2017 (restated) £m
Profit before interest and tax from continuing operations	528.4	536.7
Profit before interest and tax from discontinued operations	13.6	20.6
Profit before interest and tax	542.0	557.3
Depreciation of property, plant and equipment	308.8	308.8
Amortisation of intangible assets	20.8	19.3
Pension service credit	(7.8)	(17.3)
Defined benefit pension scheme administration costs	1.8	3.3
Defined benefit pension scheme contributions	(35.2)	(33.2)
Share based payment charge	6.9	6.1
Profit on sale of property, plant and equipment and intangible assets	(7.3)	(5.0)
Exceptional depreciation – property, plant and equipment	16.8	–
Profit on disposal of businesses	(13.7)	(17.2)
Deferred income movement	(14.3)	(13.9)
Provisions charged to the income statement	13.8	16.5
Utilisation of provisions for liabilities	(5.4)	(10.5)
Operating cash flows before movements in working capital	827.2	814.2
Increase in inventory	(2.9)	(1.3)
(Increase)/decrease in amounts receivable	(58.4)	60.3
Increase/(decrease) in amounts payable	7.4	(22.2)
Cash generated from operations	773.3	851.0
Tax received	8.0	20.6
Tax paid	(14.5)	(42.4)
Net cash generated from operating activities	766.8	829.2

b) Non-cash transactions

No additions to property, plant and equipment during the year were financed by new finance leases (2017: nil). Assets transferred from developers at no cost were recognised at their fair value of £35.6 million (2017: £51.4 million).

c) Exceptional cash flows

The following cash flows arose from items classified as exceptional in the income statement:

	2018 £m	2017 £m
Costs of Pension Exchange Arrangement	–	(0.7)

d) Reconciliation of movement in cash and cash equivalents to movement in net debt

	Net cash and cash equivalents £m	Bank loans £m	Other loans £m	Finance leases £m	Cross currency swaps £m	Loans due from joint ventures £m	Net debt £m
At 1 April 2017	44.6	(1,073.3)	(4,090.0)	(115.7)	43.4	108.6	(5,082.4)
Cash flow	(4.6)	(138.5)	(98.1)	1.8	–	26.6	(212.8)
Fair value adjustments	–	–	2.0	–	(18.9)	–	(16.9)
RPI uplift on index-linked debt	–	(4.4)	(49.7)	–	–	–	(54.1)
Foreign exchange	(1.5)	–	12.7	–	–	–	11.2
Other non-cash movements	–	(1.2)	(0.8)	–	–	0.4	(1.6)
At 31 March 2018	38.5	(1,217.4)	(4,223.9)	(113.9)	24.5	135.6	(5,356.6)

Liabilities from financing activities comprise bank loans, other loans and finance leases.

41 Contingent liabilities

Bonds and guarantees

Group undertakings have entered into bonds and guarantees in the normal course of business. No liability (2017: £nil) is expected to arise in respect of either bonds or guarantees.

42 Service concession arrangements

The group's contract to provide water and waste water services to the Ministry of Defence ('MOD') is a service concession arrangement under the definition set out in IFRIC 12. The group acts as the service provider under the MOD Project Aquatrine Package C – a 25 year contract spanning 1,295 sites across England covering the eastern sea border and from Lancashire in the North West to West Sussex on the South coast.

Under the contract the group maintains and upgrades the MOD infrastructure assets and provides operating services for water and waste water. Both the operating services and maintenance and upgrade services are charged under a volumetric tariff, along with standard charges, which are adjusted with inflation as agreed in the contract.

Since the group has an unconditional right to receive cash in exchange for the maintenance and upgrade services, the amounts receivable are recognised as a financial asset within prepayments and accrued income. At 31 March 2018 the amounts receivable were £31.1 million (2017: £27.7 million).

There have been no significant changes to the arrangement during the year.

43 Financial and other commitments

a) Investment expenditure commitments

	2018 £m	2017 £m
Contracted for but not authorised in the financial statements	395.0	221.0

In addition to these contractual commitments, Severn Trent Water Limited has longer term expenditure plans which include investments to achieve improvements in performance mandated by the Director General of Water Services (Ofwat) and to provide for growth in demand for water and waste water services.

b) Leasing commitments

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

	2018 £m	2017 £m
Within 1 year	1.1	3.2
1 – 5 years	2.4	7.6
After more than 5 years	4.8	7.0
	8.3	17.8

Operating lease payments represent rentals by the group for certain of its office property, plant and equipment.

44 Post balance sheet events

Sale of land in Nottinghamshire

On 30 April 2018, the sale of land from Midlands Land Portfolio Limited, a subsidiary of Severn Trent Plc, to Persimmon Homes was completed. The sale values the land at £21.8 million, realising a group profit of £18.2 million in the year ending 31 March 2019.

Payments will be made in cash and phased over the life of the project with £2.3 million payable on 30 April 2018 and the remainder phased evenly over five further yearly payments of £3.9 million each ending on 30 April 2023.

Dividends

Following the year end the board of directors have proposed a final dividend of 51.92 pence per share. Further details of this are shown in note 14.

Notes to the group financial statements continued

For the year ended 31 March 2018

45 Related party transactions

Transactions between the company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not included in this note. Trading transactions between the group and its joint venture, Water Plus, are disclosed below.

	Water Plus	
	2018 £m	2017 £m
Sale of services	354.9	317.5
Net interest income	2.4	1.3
	357.3	318.8

Outstanding balances between the group and the joint venture as at 31 March were as follows:

	Water Plus	
	2018 £m	2017 £m
Trade and other receivables due from related parties	44.9	37.6
Amounts due to related parties	–	(8.8)
Loans receivable from joint ventures	135.6	108.6
	180.5	137.4

The retirement benefit schemes operated by the group are considered to be related parties. Details of transactions and balances with the retirement benefit schemes are disclosed in note 28.

Remuneration of key management personnel

Key management personnel comprise the members of STEC during the year.

The remuneration of the directors is included within the amounts disclosed below. Further information about the remuneration of individual directors is provided in the audited part of the Directors' remuneration report on pages 110 to 119.

	2018 £m	2017 £m
Short term employee benefits	6.4	7.2
Post employment benefits	–	–
Share based payments	3.5	3.1
	9.9	10.3

46 Alternative performance measures ('APMs')

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

a) Underlying PBIT

Underlying profit before interest and tax is profit before interest and tax excluding exceptional items as recorded in the income statement and restated for discontinued operations. This provides a consistent measure of operating performance excluding distortions caused by exceptional items. The calculation of this APM is shown on the face of the income statement and in note 5 for reportable segments.

b) Underlying earnings per share

Underlying earnings per share figures are presented for continuing operations. These exclude the effects of exceptional items, net gains/(losses) on financial instruments, current tax on exceptional items and on net gains/(losses) on financial instruments, exceptional current tax and deferred tax. The directors consider that the underlying figures provide a useful additional indicator of performance and remove non-performance related distortions. See note 15.

46 Alternative performance measures ('APMs') continued

c) Effective interest rate

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

$$\frac{\text{net finance costs} - \text{net finance costs from pensions} + \text{capitalised finance costs}}{\text{monthly average net debt}}$$

	2018 £m	2017 (restated) £m
Net finance costs	219.5	205.1
Net finance costs from pensions	(15.5)	(10.9)
Capitalised interest	26.2	18.6
	230.2	212.8
Average net debt	5,134.4	4,812.5
Effective interest rate	4.5%	4.4%

This APM is used as it shows the average interest rate that is attributable to the net debt of the business.

d) Effective cash cost of interest

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

$$\frac{\text{net finance costs} - \text{net finance costs from pensions} - \text{RPI interest} + \text{capitalised finance costs}}{\text{monthly average net debt}}$$

	2018 £m	2017 (restated) £m
Net finance costs	219.5	205.1
Net finance costs from pensions	(15.5)	(10.9)
RPI interest	(54.1)	(30.2)
Capitalised interest	26.2	18.6
	176.1	182.6
Average net debt	5,134.4	4,812.5
Effective cash cost of interest	3.4%	3.8%

This APM is used as it shows the average cash interest rate based on the net debt of the business.

e) PBIT interest cover

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

$$\frac{\text{Underlying PBIT}}{\text{net finance costs} - \text{net finance costs from pensions}}$$

	2018 £m	2017 (restated) £m
Underlying PBIT	541.0	520.1
Net finance costs	219.5	205.1
Net finance costs from pensions	(15.5)	(10.9)
Net finance costs excluding finance costs from pensions	204.0	194.2
	ratio	ratio
PBIT interest cover ratio	2.7	2.7

This APM is used to show how the underlying PBIT of the business covers the financing costs associated only with net debt on a consistent basis.

Notes to the group financial statements continued

For the year ended 31 March 2018

46 Alternative performance measures (APMs) continued

f) EBITDA and EBITDA interest cover

EBITDA is a commonly used proxy for cash flow, for example by ratings agencies and in debt covenants. EBITDA interest cover is the ratio of EBITDA. It is calculated as profit from continuing operations before interest, tax, exceptional items, depreciation and amortisation.

(underlying PBIT + depreciation + amortisation)
(net finance costs – net finance costs from pensions)

	2018 £m	2017 (restated) £m
Underlying PBIT	541.0	520.1
Depreciation	308.2	305.9
Amortisation	20.5	17.8
EBITDA	869.7	843.8
Net finance costs	219.5	205.1
Net finance costs from pensions	(15.5)	(10.9)
Net finance costs excluding finance costs from pensions	204.0	194.2
	ratio	ratio
EBITDA interest cover ratio	4.3	4.3

This APM is used to show how the EBITDA of the business covers the financing costs associated only with net debt on a consistent basis.

g) Underlying effective current tax rate

Current tax charge for the year on continuing operations, excluding prior year charges, exceptional current tax, and current tax on exceptional items and on financial instruments, divided by profit from continuing operations before tax, net gains/losses on financial instruments, exceptional items and share of net profit of joint ventures accounted for using the equity method.

(Current year current tax charge in the income statement – tax on exceptional items – tax on financial instruments)

(PBT – share of net profit of JVs – exceptional items – net losses on financial instruments)

	2018 £m	2017 £m	2017 (restated) £m
	Current tax thereon £m	Current tax thereon £m	Current tax thereon £m
Profit before tax	302.4	[36.8]	328.0
Adjustments:			
Share of net (profit)/loss of joint ventures	(0.2)	–	1.8
Exceptional items	12.6	(0.7)	(16.6)
Net losses on financial instruments	6.7	(3.3)	1.8
	321.5	(40.8)	315.0
Underlying effective current tax rate	12.7%		16.6%

This APM is used to remove distortions in the underlying tax charge and create a metric consistent with the calculation of underlying earnings per share in note 15. Share of net profit/loss of joint ventures is excluded from the calculation because this is included after tax and the tax on joint venture profits is therefore not included in the current tax charge.

47 Subsidiary undertakings

Details of all subsidiary undertakings as at 31 March 2018 are given below. Details of the joint venture are set out in note 19. All subsidiary undertakings have been included in the consolidation.

Owned directly by Severn Trent Plc	Country of operation and incorporation	Percentage of share capital held	Class of share capital held
Severn Trent Investment Holdings Limited	United Kingdom	100%	Ordinary

The following subsidiary undertakings all operate and are incorporated in the United Kingdom. The percentage of share capital held is 100% and the class of share capital held is ordinary.

All subsidiary undertakings	
Aqua Deva Limited	Severn Trent Leasing Limited
Biogas Generation Limited	Severn Trent MIS Trustees Limited
Charles Haswell and Partners Limited	Severn Trent Metering Services Limited
Chester Water Limited	Severn Trent Overseas Holdings Limited
City Analytical Services Limited	Severn Trent Pension Scheme Trustees Limited
Debeo Debt Recovery Limited	Severn Trent PIF Trustees Limited
Dee Valley Group Limited	Severn Trent Power Generation Limited
Dee Valley Limited	Severn Trent Property Solutions Limited
Dee Valley Services Limited	Severn Trent QUEST Limited
Dee Valley Water (Holdings) Limited	Severn Trent Reservoirs Limited
Dee Valley Water Limited	Severn Trent Retail and Utility Services Limited
East Worcester Water Limited	Severn Trent Services (Water and Sewerage) Limited
Etwall Land Limited	Severn Trent Services Defence Holdings Limited
Gunthorpe Fields Limited	Severn Trent Services Defence Limited
Midlands Land Portfolio Limited	Severn Trent Services Finance Limited
North Wales Gas Limited	Severn Trent Services Holdings Limited
Northern Gas Supplies Limited	Severn Trent Services International (Overseas Holdings) Limited
Severn Trent (W&S) Limited	Severn Trent Services International Limited
Severn Trent Corporate Holdings Limited	Severn Trent Services Operations UK Limited
Severn Trent Data Portal Limited	Severn Trent Services Purification Limited
Severn Trent Draycote Limited	Severn Trent Services UK Limited
Severn Trent Enterprises Limited	Severn Trent SSPS Trustees Limited
Severn Trent Finance Holdings Limited	Severn Trent Systems Limited
Severn Trent Finance Limited	Severn Trent Trimley Limited
Severn Trent Financing and Investments Limited	Severn Trent US Funding Management Limited
Severn Trent Funding Limited	Severn Trent Utilities Finance Plc
Severn Trent General Partnership Limited	Severn Trent Utility Services Limited
Severn Trent Green Power Limited	Severn Trent Water Limited
Severn Trent Holdings Limited	Severn Trent Wind Power Limited
Severn Trent Home Services Limited	UKTalks Limited
Severn Trent LCP Limited	Wrexham Water Limited

All subsidiary undertakings	Country of operation and incorporation	Percentage of share capital held	Class of share capital held
Derwent Insurance Limited	Gibraltar	100%	Ordinary
Energy Supplies UK Limited	United Kingdom	100%	A and B Ordinary
Lyra Insurance Guernsey Limited	Guernsey	100%	Ordinary
Procis Software Limited	United Kingdom	100%	A and B Ordinary and Ordinary
Severn Trent Africa (Pty) Ltd	South Africa	100%	Ordinary
Severn Trent Carsington Limited	United Kingdom	100%	A and B Ordinary
Severn Trent Holdings SA	Belgium	100%	Ordinary
Severn Trent Response Limited	Ireland	60%	Ordinary
ST Delta Limited	United Kingdom	100%	A and B Ordinary

Group financial statements

Notes to the group financial statements continued

For the year ended 31 March 2018

47 Subsidiary undertakings continued

Unless stated below, the registered office of the aforementioned entities is Severn Trent Centre, 2 St John's Street, Coventry, CV1 2LZ, United Kingdom.

Company	Registered office
Dee Valley Limited	Packsaddle, Wrexham Road, Rhosyllen, Wrexham, LL14 4EH
Dee Valley Water Limited	Packsaddle, Wrexham Road, Rhosyllen, Wrexham, LL14 4EH
Derwent Insurance Limited	6A Queensway, PO Box 64, Gibraltar
Lyra Insurance Guernsey Limited	St Martin's House, Le Bordage, St Peter Port, GY1 4AU, Guernsey
Severn Trent Africa (Pty) Ltd	2 Elgin Road, Sunninghill, Johannesburg, South Africa
Severn Trent General Partnership Limited	50 Lothian Road, Festival Square, Edinburgh, EH3 9WJ
Severn Trent Holdings SA	Rond Point Schuman 6 box 5, 1040 Brussels, Belgium
Severn Trent Response Limited	6th Floor, 2 Grand Canal Square, Dublin 2, Ireland

Subsidiary audit exemptions

Severn Trent Plc has issued guarantees over the liabilities of the following companies at 31 March 2018 under section 479C of Companies Act 2006 and these entities are exempt from the requirements of the Act relating to the audit of individual accounts by virtue of section 479A of the Act.

Company	Company Number
Charles Haswell and Partners Limited	2416605
Chester Water Limited	2888872
City Analytical Services Limited	2050581
Dee Valley Group Limited	4316684
Dee Valley Limited	2902525
Dee Valley Water (Holdings) Limited	4421854
East Worcester Water Limited	2757948
Gunthorpe Fields Limited	4240764
Severn Trent (W&S) Limited	3995023
Severn Trent Carsington Limited	7570384
Severn Trent Corporate Holdings Limited	4395566
Severn Trent Data Portal Limited	8181048
Severn Trent Draycote Limited	7681784
Severn Trent Finance Holdings Limited	6044159
Severn Trent Finance Limited	6294618
Severn Trent Financing and Investments Limited	6312635
Severn Trent General Partnership Limited	SC416614
Severn Trent Holdings Limited	5656363
Severn Trent Investment Holdings Limited	7560050
Severn Trent LCP Limited	7943556
Severn Trent Metering Services Limited	2569703
Severn Trent Overseas Holdings Limited	2455508
Severn Trent Power Generation Limited	2651131
Severn Trent Reservoirs Limited	3115315
Severn Trent Services Holdings Limited	4395572
Severn Trent Services International (Overseas Holdings) Limited	3125131
Severn Trent Services International Limited	2387816
Severn Trent Services Purification Limited	2409826
Severn Trent Services UK Limited	8120387
Severn Trent Systems Limited	2394552
Severn Trent Utility Services Limited	4125386

Company statement of comprehensive income

For the year ended 31 March 2018

	2018 £m	2017 £m
Profit for the year	182.4	173.0
Other comprehensive loss		
Items that will not be reclassified to the income statement:		
Net actuarial losses	(9.1)	-
Tax on net actuarial losses	1.5	-
Deferred tax arising on change of rate	-	(0.1)
Other comprehensive loss for the year	(7.6)	(0.1)
Total comprehensive income for the year	174.8	172.9

Company statement of changes in equity

For the year ended 31 March 2018

	Share capital £m	Share premium £m	Other reserves £m	Retained earnings £m	Total £m
At 1 April 2016	234.3	106.8	160.7	2,985.0	3,486.8
Profit for the year	–	–	–	173.0	173.0
Deferred tax arising from rate change	–	–	–	[0.1]	[0.1]
Total comprehensive income for the year	–	–	–	172.9	172.9
Share options and LTIPs					
– proceeds from shares issued	0.4	5.7	–	–	6.1
– value of employees' services	–	–	–	6.2	6.2
Dividends paid	–	–	–	(190.4)	(190.4)
At 31 March 2017	234.7	112.5	160.7	2,973.7	3,481.6
Profit for the year	–	–	–	182.4	182.4
Net actuarial losses	–	–	–	[9.1]	[9.1]
Tax on net actuarial losses	–	–	–	1.5	1.5
Total comprehensive income for the year	–	–	–	174.8	174.8
Share options and LTIPs					
– proceeds from shares issued	0.4	5.2	–	–	5.6
– value of employees' services	–	–	–	6.9	6.9
Dividends paid	–	–	–	(197.0)	(197.0)
At 31 March 2018	235.1	117.7	160.7	2,958.4	3,471.9

Included in retained earnings are profits of £1,221.2 million that arose from group restructuring arrangements in previous years and are therefore not distributable.

Company balance sheet

At 31 March 2018

	Notes	2018 £m	2017 £m
Non-current assets			
Intangible fixed assets	2	0.2	0.3
Tangible fixed assets	3	0.2	0.3
Investments in subsidiaries	4	3,330.0	3,325.1
Deferred tax asset	6	1.5	0.1
Trade and other receivables	5	527.6	1.0
		3,859.5	3,326.8
Current assets			
Trade and other receivables	5	44.3	493.6
Current tax receivable		15.9	21.4
		60.2	515.0
Current liabilities			
Borrowings	7	(17.2)	(5.6)
Trade and other payables	8	(137.0)	(265.2)
Provisions for liabilities and charges	9	(6.0)	(2.4)
		(160.2)	(273.2)
Net current (liabilities)/assets		(100.0)	241.8
Total assets less current liabilities		3,759.5	3,568.6
Non-current liabilities			
Borrowings	7	(85.4)	(82.3)
Trade and other payables	8	(189.0)	(3.0)
Retirement benefit obligations	14	(8.7)	-
Provisions for liabilities and charges	9	(4.5)	(1.7)
		(287.6)	(87.0)
Net assets		3,471.9	3,481.6
Capital and reserves			
Called up share capital	10	235.1	234.7
Share premium account	11	117.7	112.5
Other reserves	12	160.7	160.7
Retained earnings		2,958.4	2,973.7
Total capital and reserves		3,471.9	3,481.6

The profit for the year is £182.4 million (2017: £173.0 million).

Signed on behalf of the Board who approved the accounts on 22 May 2018.

Andrew Duff
Chairman

James Bowling
Chief Financial Officer

Company number: 02366619

Notes to the parent company financial statements

For the year ended 31 March 2018

1 Employee numbers

The average number of employees during the year was 9 (2017: 12).

2 Intangible fixed assets

	Purchased software £m
Cost	
At 31 March 2017 and 31 March 2018	1.1
Amortisation	
At 1 April 2017	(0.8)
Amortisation for the year	(0.1)
At 31 March 2018	(0.9)
Net book value	
At 31 March 2018	0.2
At 31 March 2017	0.3

3 Tangible fixed assets

	Land and buildings £m	Office fixtures and equipment £m	Total £m
Cost			
At 31 March 2017 and 31 March 2018	0.1	0.6	0.7
Depreciation			
At 1 April 2017	–	(0.4)	(0.4)
Charge for the year	–	(0.1)	(0.1)
At 31 March 2017 and 31 March 2018	–	(0.5)	(0.5)
Net book value			
At 31 March 2018	0.1	0.1	0.2
At 31 March 2017	0.1	0.2	0.3

4 Investments in subsidiaries

	£m
At 1 April 2017	3,325.1
Additions	6.9
Impairment	(2.0)
At 31 March 2018	3,330.0

Details of principal subsidiaries of the company are given in note 47 to the group financial statements.

5 Trade and other receivables

	2018 £m	2017 £m
Current assets		
Other amounts receivable	4.4	3.0
Prepayments	0.5	0.5
Amounts owed by group undertakings under loan agreements	–	467.7
Amounts owed by group undertakings	39.4	22.4
	44.3	493.6
Non-current assets		
Other amounts receivable	1.6	–
Loan receivable	26.4	–
Amounts owed by group undertakings under loan agreements	499.6	1.0
	527.6	1.0
	571.9	494.6

6 Deferred tax

	Accelerated tax depreciation £m	Retirement benefit obligations £m	Fair value of financial instruments £m	Other £m	Total £m
At 1 April 2016	0.1	–	0.1	0.5	0.7
Charge to income	–	–	–	(0.6)	(0.6)
Credit to income arising from rate change	–	–	0.1	–	0.1
Charge to equity arising from rate change	–	–	(0.1)	–	(0.1)
At 1 April 2017	0.1	–	0.1	(0.1)	0.1
Charge/(credit) to income	(0.1)	–	(0.1)	0.1	(0.1)
Credit to equity	–	1.5	–	–	1.5
At 31 March 2018	–	1.5	–	–	1.5

7 Borrowings

	2018 £m	2017 £m
Current liabilities		
Bank overdraft	17.2	5.6
Non-current liabilities		
Other loans	85.4	82.3
	102.6	87.9

Non-current borrowings comprises the company's RPI linked retail bond issued in July 2012. The bond carries a coupon of 1.3% on the principal amount which is uplifted by RPI. The bond is repayable in July 2022.

At the balance sheet date the company had £100 million (2017: £100 million) undrawn borrowing facilities.

8 Trade payables

	2018 £m	2017 £m
Current liabilities		
Trade payables	0.5	0.2
Social security and other taxes	0.5	0.1
Other payables	2.8	2.8
Accruals	4.0	1.1
Amounts due to group undertakings	129.2	261.0
	137.0	265.2
Non-current liabilities		
Amounts due to group undertakings	189.0	3.0
	326.0	268.2

Notes to the parent company financial statements continued

For the year ended 31 March 2018

9 Provisions

	Insurance £m	Other £m	Total £m
At 1 April 2017	–	4.1	4.1
Charged to income statement	–	0.9	0.9
Utilisation of provision	–	(0.1)	(0.1)
Transfer from group company	5.6	–	5.6
At 31 March 2018	5.6	4.9	10.5

	2018 £m	2017 £m
Included in:		
Current liabilities	6.0	2.4
Non-current liabilities	4.5	1.7
	10.5	4.1

Insurance includes provisions transferred from Derwent Insurance Limited, a captive insurance company, which is a wholly owned subsidiary of the group. The associated claims outflows are estimated to arise over a period of up to five years from the balance sheet date.

Other provisions include provisions for dilapidations and commercial disputes. The associated outflows are estimated to arise over a period up to five years from the balance sheet date.

10 Share capital

	2018 £m	2017 £m
Total issued and fully paid share capital		
240,222,617 ordinary shares of 97 ¹⁷ / ₁₉ p (2017: 239,793,915)	235.1	234.7

At 31 March 2018, treasury shares of 3,948,599 were held (2017: 4,080,964).

Changes in share capital were as follows:

	Number	£m
Ordinary shares of 97¹⁷/₁₉p		
At 1 April 2016	239,344,614	234.3
Shares issued under the Employee Sharesave Scheme	449,301	0.4
At 1 April 2017	239,793,915	234.7
Shares issued under the Employee Sharesave Scheme	428,702	0.4
At 31 March 2018	240,222,617	235.1

11 Share premium

	2018 £m	2017 £m
At 1 April	112.5	106.8
Share premium arising on issue of shares for Employee Sharesave Scheme	5.2	5.7
At 31 March	117.7	112.5

12 Other reserves

	Capital redemption reserve £m	Hedging reserve £m	Total £m
At 1 April 2016, 31 March 2017 and 2018	157.1	3.6	160.7

The capital redemption reserve arose on the redemption of B shares.

The hedging reserve arises from gains or losses on interest rate swaps taken directly to equity under the hedge accounting provisions of IAS 39 and the transition rules of IFRS 1.

13 Share based payments

For details of employee share schemes and options granted over the shares of the company, see note 37 of the group financial statements. Details of options exercised and awards vesting during the year and of the weighted average share price of the company during the year are also disclosed in that note.

14 Pensions

Defined benefit schemes

The group operates defined benefit pension schemes, of which some employees of the company are members. There is no contractual agreement for charging the net defined benefit cost of these schemes between the companies that participate in the schemes. As a result, the net defined benefit cost of the scheme is recognised in the financial statements of the sponsoring employer, Severn Trent Water Limited. The scheme closed to future accrual on 31 March 2015. The cost of contributions to the group schemes amount to £0.6 million (2017: nil). There were no amounts outstanding for contributions to the defined benefit schemes (2017: nil).

The company has an obligation to pay pensions to a number of former employees, whose benefits would otherwise have been restricted by the Finance Act 1989 earnings cap. This unfunded scheme is part of the Severn Trent Pension Scheme. In prior years, the unfunded pension scheme was recorded in Severn Trent Water Limited. As the obligations under the scheme are borne by Severn Trent Plc, the unfunded pension scheme obligation and corresponding deferred tax asset are now held within Severn Trent Plc.

Information about the plans as a whole is disclosed in note 28 to the group financial statements.

15 Related party transactions

The retirement benefit schemes operated by the company are considered to be related parties. Details of transactions and balances with the retirement benefit schemes are disclosed in note 14.

The company has given guarantees in favour of Water Plus Limited in respect of the joint venture's liabilities to wholesalers in the Open Water market and its loan from Severn Trent Water Limited. The guarantee in respect of liabilities to wholesalers is capped at £42.5 million (2017: £42.5 million) and the guarantee for the Severn Trent Water loan is for the amount due.

16 Contingent liabilities

a) Bonds and guarantees

The company has entered into bonds and guarantees in the normal course of business. No liabilities are expected to arise in respect of either the bonds or guarantees.

b) Bank offset arrangements

The banking arrangements of the company operate on a pooled basis with certain of its subsidiary undertakings. Under these arrangements participating companies guarantee each others' overdrawn balances to the extent of their credit balances, which can be offset against balances of participating companies. As at 31 March 2018, the company had no contingent liabilities (2017: nil).

17 Post balance sheet events

Following the year end the board of directors has proposed a final dividend of 51.92 pence per share.

18 Dividends

For details of the dividends paid in the years ended 31 March 2018 and 31 March 2017 see note 14 in the group financial statements.

Other information

Five year summary

	2018 £m	2017 (restated) ¹ £m	2016 £m	2015 £m	2014 £m
Turnover	1,694.1	1,638.0	1,753.7	1,801.3	1,756.7
Profit before interest, tax and exceptional items	541.0	520.1	503.4	540.3	523.8
Net exceptional items before tax	(12.6)	16.6	1.0	(18.7)	(15.2)
Net interest payable before (losses)/gains on financial instruments and exceptional finance costs	(219.5)	(205.1)	(209.3)	(240.0)	(247.9)
(Losses)/gains on financial instruments	(6.7)	(1.8)	7.7	(133.5)	58.0
Results of joint ventures	0.2	(1.8)	0.1	0.1	0.2
Profit on ordinary activities before taxation	302.4	328.0	302.9	148.2	318.9
Current taxation on profit on ordinary activities	(32.9)	(36.3)	(51.3)	(37.8)	(55.8)
Deferred taxation	(29.0)	(22.4)	(13.7)	5.1	(21.5)
Exceptional tax	–	52.2	78.6	–	230.2
Profit on ordinary activities after taxation	240.5	321.5	316.5	115.5	471.8
Results from discontinued operations	13.2	21.1	14.8	4.7	–
Profit for the year	253.7	342.6	331.3	120.2	471.8
Net assets employed					
Fixed assets	8,660.1	8,315.7	7,810.8	7,620.0	7,418.3
Other net liabilities excluding net debt, retirement benefit obligation, provisions and deferred tax	(960.0)	(916.8)	(798.4)	(799.0)	(631.1)
Derivative financial instruments ²	(104.3)	(161.1)	(166.3)	(177.7)	(197.1)
Net retirement benefit obligation	(519.8)	(574.6)	(309.5)	(468.9)	(348.3)
Provisions for liabilities and charges and deferred tax	(725.7)	(657.5)	(694.7)	(725.4)	(758.5)
Net assets held for sale	–	–	–	72.6	–
	6,350.3	6,005.7	5,841.9	5,521.6	5,483.3
Financed by					
Called up share capital	235.1	234.7	234.3	233.7	233.9
Reserves	758.6	688.6	783.1	521.9	789.4
Total shareholders' funds	993.7	923.3	1,017.4	755.6	1,023.3
Non-controlling interests	–	–	1.1	13.4	12.5
Net debt ³	5,356.6	5,082.4	4,823.4	4,752.6	4,447.5
	6,350.3	6,005.7	5,841.9	5,521.6	5,483.3
Statistics					
Earnings per share (continuing) – pence	102.2	136.8	133.5	48.3	198.5
Underlying basic earnings per share – pence	121.0	115.7	102.1	107.2	92.5
Dividends per share (excluding special dividend) – pence	86.6	81.5	80.7	84.9	80.4
Dividend cover (before exceptional items and deferred tax)	1.4	1.4	1.3	1.3	1.2
Gearing ⁴	84.4%	84.6%	82.6%	86.1%	81.1%
Ordinary share price at 31 March – pounds	18.44	23.82	21.73	20.59	18.23
Average number of employees					
– Regulated Water and Waste Water	5,660	5,273	5,236	5,532	5,634
– Other	605	596	2,122	1,910	1,914

1 Restated as set out in note 2 to the group financial statements.

2 Excludes instruments hedging foreign currency debt.

3 Includes instruments hedging foreign currency debt.

4 Gearing has been calculated as net debt divided by the sum of equity and net debt.

Information for shareholders

Severn Trent shareholder helpline

The Company's registrar is Equiniti. Equiniti's main responsibilities include maintaining the shareholder register and making dividend payments.

If you have any queries relating to your Severn Trent Plc shareholding you should contact Equiniti.

Registrar contact details:

Online: www.shareview.co.uk from here you will be able to securely email Equiniti with your query.

Telephone: 0371 384 2967*

Overseas enquiries: +44 121 415 7044

Text phone: 0371 384 2255*

By post: Equiniti, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6DA

Corporate website

Shareholders are encouraged to visit our website www.severntrent.com which provides:

- Company news and information;
- links to our operational businesses' websites;
- details of our governance arrangements;
- details of our strategy;
- details of the Group's business models and business plan; and
- the Company's approach to operating responsibly.

There is also a dedicated investors' section on the website which contains up to date information for shareholders including:

- comprehensive share price information;
- financial results;
- a history of dividend payment dates and amounts; and
- access to current and historical shareholder documents such as the Annual Report and Accounts.

Electronic communications

By registering to receive shareholder documentation from Severn Trent Plc electronically shareholders can benefit from being able to:

- view the Annual Report and Accounts on the day it is published;
- receive an email alert when shareholder documents are available;
- cast their AGM vote electronically; and
- manage their shareholding quickly and securely online, through Shareview.

Electronic shareholder communications also enable the Company to reduce its impact on the environment and benefit from savings associated with reduced printing and mailing costs. For further information and to register for electronic shareholder communications visit www.shareview.co.uk

Dividend payments

Bank mandates

Dividends can be paid automatically into your bank or building society account.

The benefits of doing this are that you will:

- receive cleared funds in your bank account on the payment date;
- avoid postal delays; and
- remove the risk of your cheques getting lost in the post.

To take advantage of this service or for further details contact Equiniti or visit www.shareview.co.uk

Dividend reinvestment plan ('DRIP')

The DRIP gives shareholders the option of using their dividend payments to buy more Severn Trent Plc shares instead of receiving cash. If you would like to participate in the DRIP, please request a dividend reinvestment plan mandate from Equiniti Financial Services Limited.

Telephone: 0371 384 2268*

Telephone number from outside the UK: +44 121 415 7173

Information for shareholders continued

Buying and selling shares in the UK

If you wish to buy or sell certificated Severn Trent Plc shares, you may need to use a stockbroker or high street bank which trades on the London Stock Exchange. There are also many telephone and online services available to you.

If you are selling, you will need to present your share certificate at the time of sale. Details of low cost dealing services may be obtained from www.shareview.co.uk or 0345 603 7037**.

Share price information

Shareholders can find share price information on our website and in most national newspapers. For a real time buying or selling price, you should contact a stockbroker.

Shareholder security

Fraudsters use persuasive and high pressure tactics to lure investors into scams. They may offer to sell shares that turn out to be worthless or non-existent, or to buy shares at an inflated price in return for an upfront payment. While high profits are promised, if you buy or sell shares in this way you will probably lose your money.

How to avoid share fraud:

- Keep in mind that firms authorised by the Financial Conduct Authority ('FCA') are unlikely to contact you out of the blue with an offer to buy or sell shares.
- Do not get into a conversation, note the name of the person and firm contacting you and then end the call.
- Check the Financial Services Register at www.fca.org.uk to see if the person and firm contacting you is authorised by the FCA.
- Beware of fraudsters claiming to be from an authorised firm, copying its website or giving you false contact details.
- Use the firm's contact details listed on the Register if you want to call it back.
- Call the FCA on 0800 111 6768 if the firm does not have contact details on the Register or you are told they are out of date.
- Search the list of unauthorised firms to avoid at www.fca.org.uk/scams
- Consider that if you buy or sell shares from an unauthorised firm you will not have access to the Financial Ombudsman Service or Financial Services Compensation Scheme.
- Think about getting independent financial and professional advice before you hand over any money.
- Remember, if it sounds too good to be true, it probably is.

If you are approached by fraudsters please tell the FCA using the share fraud reporting form at www.fca.org.uk/scams, where you can find out more about investment scams.

You can also call the FCA Consumer Helpline on 0800 111 6768.

If you have already paid money to share fraudsters you should contact Action Fraud on 0300 123 2040.

Unsolicited mail

The Company is legally obliged to make its share register available to the general public. Consequently some shareholders may receive unsolicited mail. If you wish to limit the amount of unsolicited mail you receive please contact:

The Mailing Preference Service ('MPS'), Freepost 29 LON20771, London W1E 0ZT

Alternatively, register online at www.mpsonline.org.uk or call the MPS Registration line on 0845 703 4599.

American Depository Receipts ('ADRs')

Severn Trent has a sponsored Level 1 American Depository Receipt ('ADR') programme, for which The Bank of New York Mellon acts as Depositary.

The Level 1 ADR programme trades on OTCQX which is the premier tier of the US over the counter ('OTC') market under the symbol STRNY (it is not listed on a US stock exchange). Each ADR represents 1 Severn Trent Ordinary Share.

If you have any enquiries regarding Severn Trent ADRs please contact The Bank of New York Mellon.

By post: BNY Mellon Shareowners Services, PO Box 30170, College Station, TX 77842-3170, US

By telephone:

If calling from within the US: (888) 269 2377 (toll-free)

If calling from outside the US: +1 201 680 6825

By email: shrelations@cpushareownerservices.com

Website: www.mybnymdr.com

* Lines are open 8.30am to 5.30pm Monday to Friday (excluding public holidays in England and Wales).

** Lines are open Monday to Friday, 8:00am to 4:30pm for dealing, and until 6:00pm for enquiries.

Financial calendar

Ex dividend date – final dividend	14 June 2018
Record date to be eligible for the final dividend	15 June 2018
AGM	18 July 2018
Interim management statement – Q1 year ending 31 March 2019	18 July 2018
Final dividend payment date	20 July 2018
Interim results announcement – year ending 31 March 2019	22 November 2018
Ex dividend date – interim dividend	29 November 2018
Record date to be eligible for the interim dividend	30 November 2018
Interim dividend payment date	4 January 2019

All dates are indicative and may be subject to change.

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