

SEVERN TRENT FINANCE HOLDINGS  
LIMITED

Reg. No. 06044159

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# Delivering the future of water

Severn Trent Plc Annual Report and Accounts 2013

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## 2013 Severn Trent group highlights

- Delivering on dividend policy – 8.2% growth vs. 2011/12.
- Total shareholder return in the current regulatory period (AMP5)<sup>1</sup> – 72%.
- Creating long term value through efficient investment – £555 million invested this year.
- Continued growth in RCV<sup>2</sup> from £7,089 million to £7,364 million (+3.9%).
- Delivered significant operational improvements and higher levels of customer service
  - Improved or stable performance on 13 out of 14 Ofwat KPIs year on year.
  - Customer satisfaction (SIM score) improving.
- Efficiency improvements at Severn Trent Water helping to offset additional infrastructure investments.
- Non-regulated business delivered revenue growth year on year<sup>3</sup>.
- Well prepared for next price review.
- Full year dividend for 2013/14 set to be 80.40 pence, up 6%, in line with current RPI+3% growth policy.

1 1 April 2010 to 31 March 2013. TSR assumes reinvestment of ordinary and special dividends.

2 Regulatory Capital Value.

3 Excluding the impact of structural changes, exchange movements and exceptional items.

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\* before tax, exceptional items and losses on financial instruments

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\* before exceptional items, losses on financial instruments and deferred tax

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### Cautionary statement

This document contains certain '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', 'will', 'could', 'may', 'should', 'expects', 'believes', 'intends', 'plans', 'potential', 'reasonably possible', 'targets', 'goal' or 'estimates'. 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 will occur in the future.

There are a number of factors that could cause actual results 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. Severn Trent does not intend to update these forward looking statements.

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 United States absent registration or an applicable exemption from the registration requirements of the US Securities Act of 1933 (as amended).

## What we do

### Our business

We provide clean water and waste water services in the UK and internationally, principally through our regulated and non-regulated businesses – Severn Trent Water and Severn Trent Services.

### Regulated – Severn Trent Water

One of the largest of the 10 regulated water and sewerage companies in England and Wales. We provide high quality services to more than 4.2 million households and businesses in the Midlands and mid-Wales.

More on pages 12–23

### Non-regulated – Severn Trent Services

One of the world's leading commercial suppliers of water and waste water treatment services and products, with customers in the UK, the Americas, Europe, Middle East and Asia.

More on pages 24–32

Find out more on our corporate website: [www.severntrent.com](http://www.severntrent.com)

Severn Trent Water website: [www.stwater.co.uk](http://www.stwater.co.uk)

Severn Trent Services website: [www.severntrentservices.com](http://www.severntrentservices.com)

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# The Severn Trent World

2012/13 has been a year of continued focus and evolution for Severn Trent. We fundamentally believe in the positive impact of increasing competition in our industry and the opportunities it will bring. The boundary between regulated and non-regulated activities in the UK is changing and we are adapting our business to take full advantage of the changes ahead, while continuing to focus on ensuring our core activities maintain quality and deliver excellent customer service and value.

## Water trading

We have seen regulatory and political support for further water trading in the UK with Severn Trent being perfectly geographically positioned to trade water with our neighbours.

## £5.6m

We spent £5.6 million across Severn Trent on the development of renewables such as large scale wind energy. We do this to reduce our reliance on grid electricity, it also reduces our carbon emissions.

## £38m

We've invested £38 million in Gloucestershire since the 2007 floods. The Mythe water treatment works has new flood defences and pipelines to provide alternative supplies to 160,000 customers. We've built 1 km of new sewers and new storm tanks to prevent networks being overwhelmed by heavy rain.

More on page 19

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## 133cm

2012 recorded the second highest annual rainfall in England since 1910. We collect water from reservoirs, rivers and underground boreholes across our region.

## Severn Trent Services

In October 2012 we formed a business with Costain to offer large multi-site water users a single supplier of water and waste water services. It aims to deliver efficiency improvements, save costs, manage legal compliance and risk and deliver water efficiency solutions

More on page 25

## £150m

Through effective procurement and capital delivery we generated £150 million of efficiency savings. We are reinvesting this to improve the performance of our network and treatment assets to provide better service to customers.

## Overview

## Regulatory reform

We have continued to play an active role in discussions about the evolving regulatory and policy framework for the water industry. Many of the ideas we have proposed in our Changing Course series of publications have now been adopted by policy makers.

More on page 33

# 89p

The average cost to our customer per day for combined services is 89 pence. Our customers benefit from the lowest average combined bills in England and Wales.

# 7,000

We have carried out research with more than 7,000 household and business customers about the future of our services.

# 11 years

Severn Trent De Nora was established in 2002 to provide seawater and brine onsite hypochlorite generation systems for marine, offshore water and waste water treatment applications.

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# 5%

We reduced leakage across our region by 5%, a reduction of 23 megalitres per day (ML/d). We also work with others and through our operation and maintenance contract with the UK Ministry of Defence we have cut the leakage at their sites to an all time low.

# £555m

capital spend

Over the last financial year we have invested £555 million into our network and above ground assets.

# 900

We operate more than 900 municipal water and waste water treatment facilities across the US and Europe.

## Chairman's statement

**'We continue to set ourselves high standards in everything we do and the continuous improvement that we see owes much to the hard work and commitment of our team at Severn Trent.'**

Andrew Duff, Chairman

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Our focus on water and waste water services has again delivered benefits for our customers and good returns for our shareholders. This year Severn Trent Water customers saw the first positive impact of some of the extra £150 million of investment in our water and waste water networks, which we announced in May 2012.

In addition, we continue to leverage our skills in water and waste water services in our non-regulated business Severn Trent Services. This year we completed the sale of our analytical services and metering operations in order to focus on growth in the emerging markets for commercial and industrial users in the UK, in the US and our global water purification products business.

### Strong performance at Severn Trent Water

In this third year of our current 2010-2015 business plan, I am pleased to report further progress in the operational performance and customer service delivered by our regulated business, Severn Trent Water.

Our customers continue to benefit from high quality drinking water as well as the lowest average bills for water and sewerage combined in England and Wales. Customer service standards improved year on year and complaint levels have fallen for the last two years.

During the early part of the year when we experienced drought in the Midlands, we carefully managed our water resources, so that we avoided the need for a hosepipe ban. Severn Trent Water is the only company targeting significant leakage reductions over this five year regulatory period and in 2012/13, we cut leakage to a 20 year low, beating our target in the process.

Drought over the early part of the year was followed by extended rainfall during the rest of the year and again, our teams performed well to help protect customers from flooding. Despite the rainfall, we achieved record levels of compliance at waste water treatment works and a reduction in pollution incidents.

## Overview Chairman's statement

The success of Severn Trent Water reflects the commitment of everyone in our business to continuous improvement and our drive towards higher standards of service, efficiency and operational performance. I'm particularly proud that the last year was our safest ever. I am personally committed to pushing our safety standards even higher so that everybody remains healthy and safe when they are at work.

**Good financial performance**

In 2012/13, our financial performance was as expected. Total group revenue increased by 3.4% to £1,832 million, whilst underlying group profit before tax decreased 3.3% to £266.3 million. This resulted in adjusted basic earnings per share of 98.9 pence, up 11.2%.

Our policy during this current five year period to March 2015 is to increase our dividend each year by 3% more than the retail price index. The board therefore proposes a final dividend of 45.51 pence, to be paid on 26 July 2013. This will give a total dividend for the year of 75.85 pence, an increase of 8.2%.

During the year we were pleased to return a further £150 million to shareholders, through the special dividend of 63 pence per share in July 2012 and we also announced the investment of an extra £150 million in our water and waste water network for the benefit of our customers. This reflects our ability to create value from the business plan approved by our regulator to the benefit of both customers and shareholders.

Customers and shareholders have benefited from our consistent delivery over recent years. Since the start of the current cycle on 1 April 2010, Severn Trent's total shareholder return including the special distribution has been 71.71%, well ahead of the 25.57% return from the FTSE 100 and the 61.4% achieved by the utilities sector as a whole.

**Supporting our local economies**

On other important matters, we're very mindful of the economic, environmental and social benefits we bring to the region in which we operate. Where we can, we aim to make a positive difference.

In Severn Trent Water, we directly employ over 5,500 people and many more through our contract partners and supply chains. With the UK economy struggling to grow, investment by water companies has a particularly significant role. Investing in infrastructure is one of the fastest ways to boost economic activity and water companies use private capital, rather than drawing on public funds which could be usefully employed elsewhere. During the year, we invested £555 million into our network, making a substantial contribution to jobs and the local economy.

## **'Customers and shareholders have benefited from our consistent delivery over recent years.'**

We also help to create the skills that we, the economy and our region need. Severn Trent Water currently has more than 80 apprentices in water, waste water and customer service roles. The calibre of young people we attracted for our apprenticeship programme has been particularly high, showing the attractions of our training and the prospect of a long term career in a vital industry.

**Building for growth in non-regulated markets**

Severn Trent Services, our main non-regulated business, has sharpened the focus of its activities on water purification products and operating services, having disposed of its analytical services and metering operations.

Its underlying performance in the year was encouraging. Despite challenging conditions in its markets, it has won contracts and seen growth in sales of water purification products in emerging markets. After a period of consolidation, the continuing businesses of Severn Trent Services are again making progress.

**Shaping the future of our industry**

The last 12 months have seen much discussion about the direction of regulation in the water industry. Severn Trent continues to play a leading role in shaping the course of regulation and intends to continue to do so. As a progressive business, we have advocated changes which will help the country make the best use of its water resources, improve outcomes for customers and provide suitable returns for investors.

We're therefore supportive of the proposed direction of travel for regulation and of the Water Bill, as it passes through Parliament. In particular, we're positive about the prospects for water trading and the opportunities it brings for greater resilience and keeping customers' costs down.

**Overview** Chairman's statement

The coming year will see the submission of our final business plans for the next regulatory period 2015-2020, following an extensive period of consultation with customers, stakeholders and regulators. I would like to recognise the role of the independent Water Forum, chaired by Dame Yvonne Buckland, in providing a healthy challenge around our plans as they have come together.

As a responsible company, our aim is to produce a good plan, based on meaningful consultation, which finds the right balance between making improvements where customers value them the most, keeping bills affordable and providing a fair return to our investors.

Faced with competing pressures to maintain investment and drive up standards, whilst keeping bills low, it is essential that our sector has continued access to future financing and at a reasonable cost. At Severn Trent, we believe that a sustainable long term approach to financing should be taken by the industry and that regulation must therefore attract and incentivise equity finance. Excessive reliance on leverage characterises much of our sector today.

**Summary**

In summary, good performance continues to underpin confidence that we can create value through the remainder of the current regulatory period.

We have delivered further improvements in operational performance and customer service at Severn Trent Water. In Severn Trent Services we returned to underlying growth. We met our financial expectations and generated good returns for our shareholders.

This year's results owe a great deal to the commitment, excellence and hard work of our people. We continue to set ourselves high standards in everything we do and I would like to thank management and staff for putting us in a strong position for future success.

Finally, I would like to use this opportunity to note my thanks to our Chief Executive, Tony Wray, who has informed the board of his intention to retire from Severn Trent in Spring 2014.

With a strong executive team in place the timing of his decision provides us with the continuity of leadership and the necessary time to search for and identify his successor over the coming months.

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Andrew Duff  
Chairman

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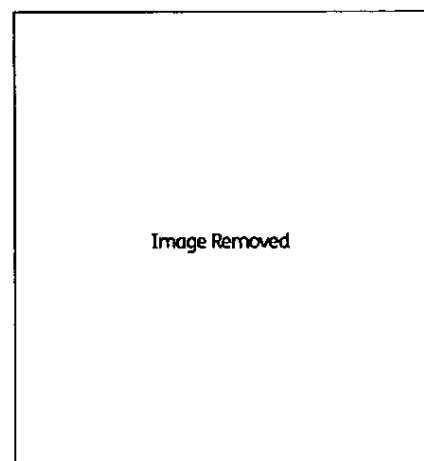


## Chief Executive's review

**'The world is changing for water companies and Severn Trent leads the way in shaping that change. We are continually improving our performance, improving our customer service and positioning the group for sustainable growth.'**

Tony Wray, Chief Executive

See our film at [www.severntrent.com/focusonwater](http://www.severntrent.com/focusonwater)



### Delivering the future of water

The UK water industry faces significant challenges. We need to deal with the real impact of climate change and the increasing frequency of water shortages and flooding. We need to access and use water and environmental resources more efficiently. We need to keep improving customer service and customer choice whilst keeping our bills affordable for our customers. We need to maintain the significant investments that are required to ensure that our networks can deliver the essential water and waste water services. And, whilst keeping bills as low as we can for our customers, we need to generate sustainable returns for our investors.

Proposals from the UK Government and Ofwat will help us respond to these challenges. The changes are evolutionary, but together they add up to the largest shift in the industry's rules since privatisation.

The Water Bill will allow more competition for non-household customers, greater 'upstream' competition – water trading in particular – and increase the scope for mergers and acquisitions, which should eventually lead to a more efficient industry structure.

Ofwat is considering important changes to the way it regulates, as it prepares for the next price review in 2014 (PR14). Notable differences from the current regime include separate controls for the wholesale part of the business – the networks and treatment plants – and the retail element, which manages customer relationships. This will increase focus on delivering the best customer service at lowest cost, and create more choice for non-household customers.

There will be greater emphasis on achieving objectives that companies set in consultation with their customers, helping them to innovate and benefit all stakeholders. Companies will be able to choose larger incentives for outperformance, at the risk of bigger penalties if they fall short. Also our customers and other stakeholders now have a much bigger role in influencing our next five year plan. Further details of our stakeholder engagement and the role of the Water Forum are provided on pages 18 and 20.

Severn Trent welcomes these changes. We've been active in the debate about the future of water and we're pleased that the changes are aligned with our own proposals. That's allowed us to prepare for these changes, through a strategy that creates opportunities to leverage our core skills.

## Our strategy

## Sustainable

## Strategy aim

Delivering value for our customers and investors.

Responsible leadership, protecting the environment, thinking long term and setting high standards in everything we do.

Sustainable financing, ensuring we have a strong and flexible balance sheet.

## Highlights 2013

- Our regulated business met its leakage target, reduced interruptions to supply and protected more homes from sewer flooding.
- We maintained the lowest average bills for water and sewage combined in England and Wales.
- Our non-regulated business delivered top line growth, focused its operations and is well positioned for the future.
- We continued to grow our dividend.
- Our Focus on Water strategy provides value for money for our customers and long term sustainable growth for our investors.
- We achieved our best ever health and safety performance.
- We continued to invest in our sector leading renewable energy operation.
- We made further progress with our catchment management programme.
- We continued to influence the regulatory debate about the future of our industry, through a series of publications.

- We remained prudently financed and maintained our strong credit rating.
- We successfully refinanced £500 million of our debt and issued our first retail bond drawing £75 million from new investors.

## Key measures

441 Ml/d

Leakage megalitres per day  
(2012: 464)

4.19

Customer written complaints per 1,000 properties (STW)  
(2012: 4.88)

- 0.2 Lost time incidents per 100,000 hrs worked (2012: 0.3).
- We generate just under a quarter of the electricity needed by our regulated business.
- We support the direction of the Water Bill, which is expected to become law later this year.

£731.2m

Cash generated from operations  
(2012: £725.9m)

58.4%

Net Debt/RCV Gearing  
(2012: 56.0%)

## Growth

## Strategy aim

Growing Severn Trent Water in the UK through investment in our networks and services.

Positioning Severn Trent to capitalise on opportunities in a changing regulatory framework.

Deploying Severn Trent Services business into new markets.

Developing new treatment technologies.

## Highlights 2013

- We continued to make good progress with our preparations for PR14.
- We invested £555 million in our infrastructure.
- We increased our regulatory capital value by £275 million.
- We created a new venture with Costain to compete for large user business customers.
- We strengthened Severn Trent De Nora by acquiring certain product lines from Chlorine Engineers Corp, giving us an opportunity for future growth in Japan.
- We invested in further developing BALPURE® and continued to grow its sales.

## Key measures

3.9%

RCV growth  
(2012: 4.0%)

- First Milk, the first business customer to switch water supplier.
- Input lessons from the first multi-site, multi-national switch into Regulatory bodies.

£113.4m

Water Purification turnover  
(2012: £98m)

£4.6m

New commercial orders

## Overview Chief Executive's review

**A strategy to deliver the future of water**

Our 'Focus on Water' strategy, with the goal of creating sustainable growth through our focus on water and waste water services in the UK and key international markets, drives everything that we do. This strategy recognises that the boundary between our regulated and non-regulated activities is moving and that in future, we will generate returns from a broader range of operations across the regulated and non-regulated areas. As one of the UK's biggest water and waste water companies, Severn Trent is well positioned to succeed.

Our focus on sustainable growth means that we balance the needs of our customers, our people, the environment and investors. Achieving this balance leads directly to good financial performance and delivers value for our customers and investors today and in the longer term.

We recognise that economic conditions are tough and that our customers have seen their incomes squeezed. While prices will inevitably rise because of the ongoing need for investment, we're determined to keep them as low as we can and deliver value for money. This means further improving our service, protecting customers from the effects of drought and floods and providing them with water that's good to drink and always available.

Protecting the environment is also key because we and our customers depend on it to provide the resources we need.

Efficient investment allows us to deliver sustainable returns for our shareholders. Our strategy is to remain focused on water and waste water services. Our people are central to our future. We work hard to make sure they have the skills and tools they need, and are motivated to continually improve our service to customers.

With significant changes in the sector approaching, we keep our strategy under constant review. This includes having open and constructive relationships with key stakeholders, such as customer representatives, our economic and environmental regulators and our investors, so we understand what they expect from us. We then formally review our strategy each year, involving both the Executive Committee and the board, so it remains relevant, balanced and sufficiently forward looking.

**'Our focus on sustainable growth means that we balance the needs of our customers, our people, the environment and investors.'**

**Business performance review**

The group delivered a good financial performance during the year, despite challenging conditions in some markets. This underpins our dividend promise, which is to grow our dividend by 3% more than the retail price index up to 2014/15.

We also maintained our financial stability, by continuing to refinance our existing debt and issuing new debt to support our investment programme. This included our first ever retail bond, which raised £75 million.

**Regulated – focused on continuous improvement**  
Our customers benefited for the fourth year running from the lowest average bills for water and sewerage combined in England and Wales. Whilst prices increased they were below the industry average. We continued to supply customers with excellent drinking water and, despite the drought at the start of the year, we once again avoided a hosepipe ban.

Our UK regulated business, Severn Trent Water, continued to improve its operational and environmental performance. These improvements, along with effective procurement and capital delivery, help us to be more efficient. In this Regulatory Period we are re-investing £150 million of our efficiency gains into our plant and networks to improve services for our customers further.

This investment contributed to our ongoing performance improvement. We cut leakage to a 20 year low and beat our target. Underlying levels of interruptions to supply also fell, with our Ofwat measure improving, although a handful of burst mains which affected numerous customers meant that we didn't meet our internal target. We further reduced pollution incidents, while compliance at our waste water treatment works reached a new record high, contributing to improving river water quality.

During the year, we delivered the outputs that Ofwat required from us. We were pleased to see that recent investment in the flood defences at the Mythe Water Treatment Works proved their worth as the plant withstood exceptionally heavy rains and flooding. We also reduced the number of homes at risk of sewer flooding and there are now fewer properties on the 'at-risk' register than ever before.

In previous years, we've identified customer service as an area where we would like to improve. Our customer experience programme is changing the way we think about how we interact with our customers, which has led to pleasing improvements in our customer service scores, as measured by Ofwat's Service Incentive Mechanism (SIM).

## Overview Chief Executive's review

This contributed to a customer satisfaction level of 4.36 out of 5 in our SIM quantitative survey, as well as falling levels of complaints. However, we know we have much further to go and we are not complacent. This includes resolving more of our customers' issues to their satisfaction on first point of contact and continuing to invest in our people, to help them form a better appreciation of our customers' needs and concerns when they have to contact us.

Our combined SIM score for 2012/13 was 78.1 against 69.9 in 2011/12. This represents a 12% year on year improvement and we're the most improved water and waste water company.

**Non-regulated – driving new markets in the UK and overseas**

We improved our operational and financial performance in our non-regulated business. Like for like revenue in Severn Trent Services grew by 5.3% and we maintained underlying profits after investing further in business development.

We strengthened our Severn Trent De Nora business by acquiring some electrochlorination technologies from Chlorine Engineers Corp for £1.3 million. This gives Severn Trent De Nora an opportunity for future growth in Japan. Our Operating Services business won several new contracts in the US, including 21 from SouthWest Water Company as they exited contract operations in the Texas Municipal Utility District. We recently agreed to acquire service contracts with 10 municipalities and three private entities in California which will provide us with a base for growth in the Western US. We reorganised our products business to create a regional structure, which will bring it closer to its customers and reduce costs by sourcing and assembling more locally. We also sharpened our focus by disposing of the metering and analytical services businesses. Disposal of our analytical services business also satisfied an undertaking made to Ofwat who have now closed the section 26 investigation into this market.

In the UK, we're driving forward retail competition with the UK's first retail switch when we signed major dairy First Milk as a customer, including sites in England, Scotland and Wales.

We also continue to leverage our sector leading position in renewable and green energy. For the second successive year, we generated around one quarter of the electricity needed by our UK regulated businesses. We lead the UK in anaerobic digestion technology and are developing plans to expand into the emerging UK opportunity from food waste digestion. During the year, we also extended our crop digestion plant in Nottinghamshire and started construction of the first of three large wind turbines.

### People and culture

The performance we've delivered this year shows the quality of our people and their desire to do an excellent job. I would like to thank them for everything they have done.

We have talented and committed people throughout the group. Together, they have a wide breadth of expertise, from hydrologists and engineers to customer service experts and technologists.

They apply these skills to our common mission, delivering high standards and the lowest possible charges for customers, with great people.

We've created a culture of continuous improvement that sustains our desire to do better. This culture is key. While we have a sophisticated set of tools which combine behavioural science and lean management to help us improve the way we work, it's the culture, values and attitude of our people that make those tools effective and drive us forward, every day.

### Looking forward

Severn Trent is well positioned as the UK industry enters the next phase of development. We have accepted Ofwat's proposed licence modifications and are aligned to the agenda for regulatory reform and the Water Bill, both of which we continue to help shape.

Our preparations for PR14 are progressing well. Customers are at the heart of our planning, through the widespread engagement we've already conducted and through our customer challenge panel, the Water Forum. Further details are provided on pages 18 and 20.

Regulatory and political support for water trading is growing and companies are likely to be incentivised to trade in the future. Severn Trent has an ongoing dialogue with neighbouring companies and we are well placed to benefit from more effective use of the country's water resources.

Looking further ahead, companies will have to ensure they're sustainably financed. The utilities sector in the UK will need to find billions of pounds for investment and it isn't certain that all of this can be done through debt. Equity is therefore required to play a part, which means companies will have to be able to earn an appropriate return to attract that funding. We published important discussion papers on this subject during the year.

In summary, Severn Trent is operating from a great base. We have the right people doing the right things and delivering the right outcomes. Our markets around the world need clean water and waste water services, and we have the right focus to prosper.

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Tony Wray  
Chief Executive

## Overview

### Today... We're getting it right first time for customers

We've introduced new ways of working so we fix 80% of bursts on customers' properties, that are eligible under our free repair scheme, after one call to us and with one visit.

We put ourselves in our customers' shoes to understand their experience. We mapped out our processes from when our customer first contacts us to resolving the job and we reviewed how we kept our customers informed. We also stood in our employees' shoes and looked at the training we provided and the systems they used.

The result is a redesigned training programme for our teams, improved collaboration between field and call centre colleagues and a better customer experience of dealing with Severn Trent.

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### Tomorrow... We continue to invest in excellent customer service

We work hard to provide our customers with a service experience that is consistently reassuring and reliable, whilst doing whatever we can to personalise the way in which we deal with each individual customer query

# Regulated

## Severn Trent Water

Severn Trent Water aims to be the best water and waste water company in the UK, by providing the highest standards and lowest possible charges, through great people.

See our film 'It's what we do' at [www.severntrent.com/whatwedo](http://www.severntrent.com/whatwedo)

### Our long term objectives...

Over the last year, we have consulted widely with our stakeholders and customers about investment priorities for the medium and longer term. Based on that consultation, we have set out ten long term objectives

1. We will provide water that is good to drink
2. We will ensure water is always there when you need it
3. We will safely take your waste water away
4. We will provide excellent customer service
5. We will have the lowest possible charges
6. We will help you if you struggle
7. We will protect our water environment
8. We will protect the wider environment
9. We will make a positive difference in the community
10. We will finance our business sustainably

We measure our performance against 16 key performance indicators (KPIs). Details of our KPIs can be found on page 139.

### Where we operate

Our region stretches across the heart of the UK. We serve more than 4.2 million households and businesses, from the Bristol Channel to the Humber, and from mid-Wales to the East Midlands.

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### ...delivered through four focus areas

We implement our strategy and plans by focusing on four key areas: our customers, people, process and finance. We aim to deliver the highest standards and lowest charges to our customers, through a highly skilled and committed workforce

#### Customers

Our household customers have the lowest average combined water and sewerage bills in England and Wales. Delivering customer satisfaction also requires us to provide water that's good to drink and always available, and to take away waste water, to reflect customers' priorities in our plans, to communicate clearly, and to keep our promises and put things right if they go wrong.

More on customers on page 17

#### People

Our people are the cornerstone of our success. We strive to recruit, develop and retain the best people, provide them with great workplaces and maintain a strong culture of safety, personal responsibility and continuous improvement.

More on people on page 20

#### Process

Our drive to work safer, better and faster is the foundation of our approach to continuous improvement. Making sure we have the right processes and systems is fundamental to achieving operational excellence.

More on process on page 21

#### Finance

The higher our standards, the more effectively and efficiently we work. This helps us to keep our costs low and generate progressive, sustainable returns which earn the trust of and reward for our investors. We look to finance the company in an efficient, sustainable way and maintain an investment grade credit rating.

More on finance on page 23

### Key facts

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Drinking water supplied per day

1.8bn litres

Image removed

Waste water collected per day

1.4bn litres

Image removed

Employees

5,631

as at 31 March 2013

### Turnover

£1,511.0m  
(2012: £1,457.5m)

### Profit\*

£500.9m  
(2012: £500.0m)

\* Before interest, tax and exceptional items.

## Regulated Severn Trent Water

### Today... We've developed innovative and sustainable solutions

We've invested in new innovative technology resulting in increased operational efficiencies and significantly reducing our carbon impacts.

At our Ashbourne Sewage Treatment Works we've installed the UK's first full scale HYBACS plant. The HYBACS units can be added onto activated sludge plants to cope with increased loads into our works. The HYBACS offers operational cost savings of around 80% and operational carbon savings of around 60%.

With Midlands based firm Lontra, we have developed a version of the Blade Compressor™ specifically optimised for waste water aeration. The world's first full scale trial of the technology has been in operation at our Worcester Sewage Treatment Works for the last six months. We spend around £9 million a year on power for aeration in our activated sludge plants and the design of the Blade Compressor™ can reduce this electricity consumption by around 20%.

Alongside Lontra we recently won 'Most Innovative New Technology of the Year' at the Water Industry Achievement Awards for this groundbreaking development.

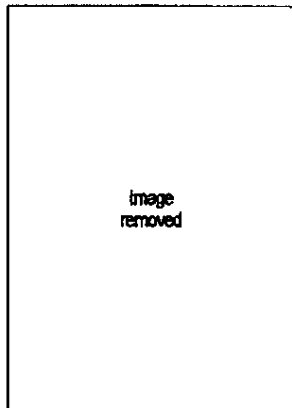


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### Tomorrow... Our research is leading to new efficiencies

As we replace our old metal pipes with plastic ones, detecting leaks becomes harder

We have worked with Loughborough University to develop a prototype leak detection system that will reduce the time it takes to detect a leak on plastic pipes. Now under commercial development with Echologics it could significantly improve efficiency, resulting in a positive impact for customers and the environment.

## Regulated Severn Trent Water

# Our business model

Water is essential to life and to the communities in which we live and work. Severn Trent Water is intrinsically linked to the life cycle of water. The customer is at the heart of our continuous drive to improve our operations and services across collection, delivery and cleaning of water.

Severn Trent Water is a regulated business. We work within five year planning cycles, with customer prices set by our economic regulator, Ofwat, to allow us to fund our investment programme and cover an efficient level of operating costs. We are also subject to regulation by two quality regulators – the Drinking Water Inspectorate and the Environment Agency (details of these regulators are provided below).

Our prices and asset base are adjusted by RPI inflation each year. In certain circumstances we can ask for prices to be reviewed within the five year period due to costs associated with 'notified items' or 'relevant changes of circumstance'. Customer bad debt and the adoption of private drains and sewers are included in these categories for the current five year period.

The company earns a return on its asset base. We can generate additional returns if we outperform Ofwat's assumptions by becoming more efficient in the delivery of our capital programme, managing our operational costs more effectively, and by financing our business at a lower cost.

Our operating performance is assessed and benchmarked against the sector by Ofwat. At the next price review there is scope to earn additional income, or incur penalties, based on our performance.

### Regulatory framework

#### Consumer Council for Water

Consumer Council for Water is an independent body designed to protect the rights of consumers. [www.ccwater.org.uk](http://www.ccwater.org.uk)

#### Drinking Water Inspectorate (DWI)

The Drinking Water Inspectorate makes sure companies supply water that is safe to drink and complies with all national and European standards. [www.dwi.defra.gov.uk](http://www.dwi.defra.gov.uk)

#### Environment Agency (EA)

The Environment Agency is a public body set up to protect and improve the environment. [www.environment-agency.gov.uk](http://www.environment-agency.gov.uk)

#### Health and Safety Executive

The Health and Safety Executive is the enforcing authority on health and safety law. [www.hse.gov.uk](http://www.hse.gov.uk)

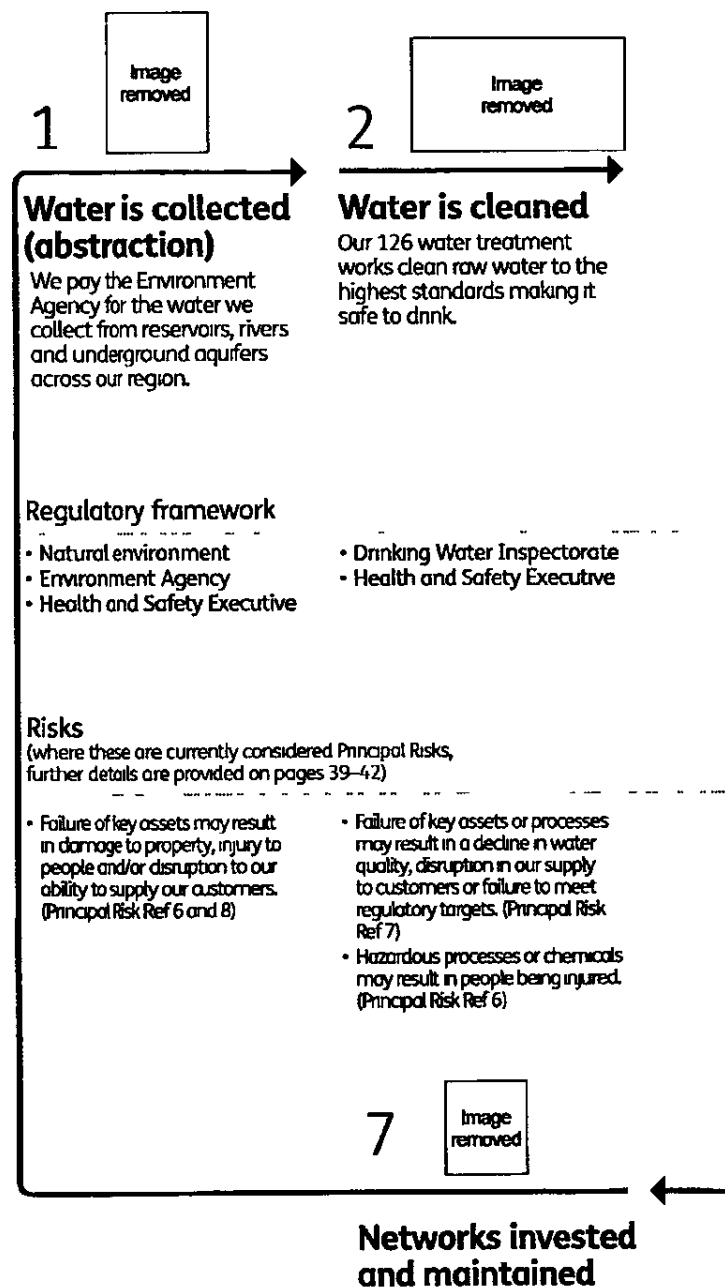
#### Natural environment

Natural Resources Wales and Natural England.  
[www.naturalresourceswales.gov.uk](http://www.naturalresourceswales.gov.uk)  
[www.natureland.org.uk](http://www.natureland.org.uk)

#### Ofwat

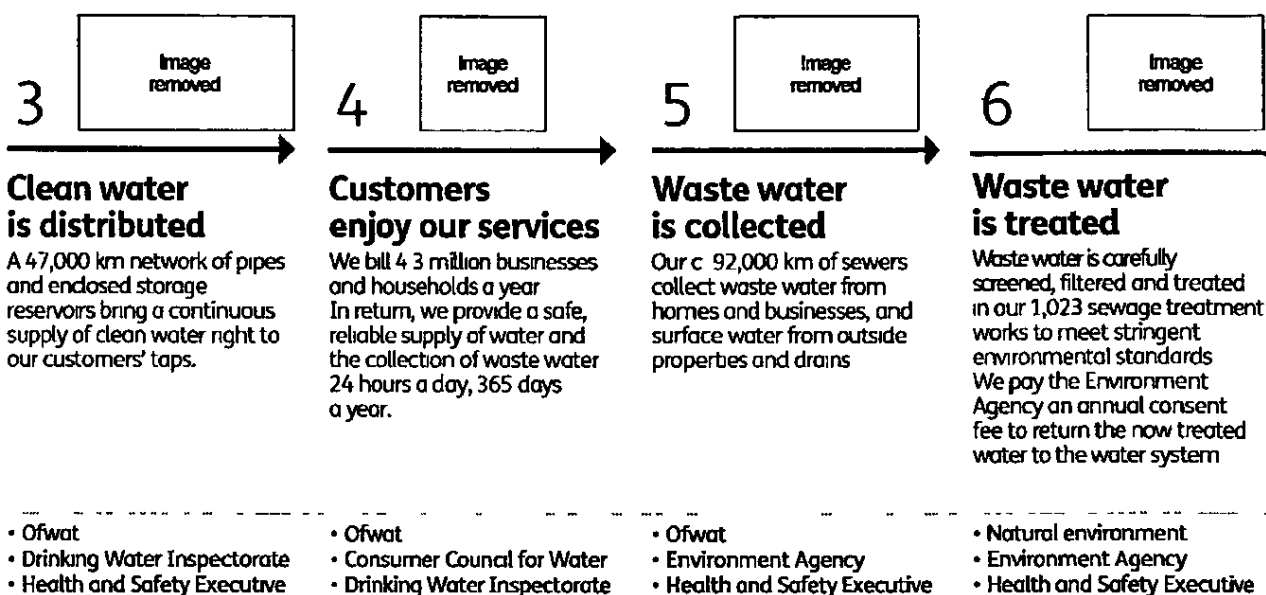
The economic regulator for the water and sewerage industry. It makes sure that water companies use customers' money efficiently and effectively and sets our price limits. [www.ofwat.gov.uk](http://www.ofwat.gov.uk)

## The role of Severn Trent Water





## Regulated Severn Trent Water



- The performance of our distribution network may fall below the standards expected by DWI or Ofwat, resulting in poor service to our customers and increased leakage from our network. (Principal Risk Ref 7)
- Failure of one of our key assets could result in disruption to supply to customers. (Principal Risk Ref 8)

- We may be unable to sufficiently improve our performance in relation to customer service in order to deliver what our customers tell us they want. (Principal Risk Ref 1)
- We may be unable to respond effectively to the opening up of the business retail market to competition. (Principal Risk Ref 2)

- Failure to deal with customer waste effectively may lead to sewer flooding. (Principal Risk Ref 7)

- We may suffer operational failure in our waste water operations which results in damage to the local environment. (Principal Risk Ref 7)

We are an investment led industry, and our capital programme this year was £555 million, or £129 per connected property reflecting increased investment year on year in our water and sewerage networks, including finding and fixing more leaks and reducing the number of supply interruptions, improvements to our water and sewage treatment plants and upgrades to our sewer network to reduce incidents of sewer flooding. We fund this investment programme from the profits we generate, but also by borrowing money from the capital markets.

Capital investment is added on to our asset base, called the RCV. Our asset base also rises in line with inflation each year. The returns that we generate for shareholders on that asset base are set by our economic regulator, Ofwat, over five year planning cycles. We can increase these returns by outperformance.

## Risks

We operate within a complex legal and regulatory environment as a water and sewerage service provider in England and Wales. As a result we face a number of risks including those associated with possible non-compliance with our legal and regulatory framework, failure to obtain support from Ofwat for our business plan for 2015–2020 and failure to meet

the terms of our regulatory contract as set out in our agreed business plan for 2010–2015. We also face risks associated with possible future changes in legislation which may result in our business plans becoming unsustainable. (Principal Risk Ref 3, 4 and 5 on pages 39–42)

## Overview

### Industry and market

The water industry in England and Wales invests more than £3.0 billion each year and employs over 27,000 people. There are currently 10 water and sewerage companies in England and Wales, as well as a number of smaller water only companies.

The privatisation of the industry in 1989 has led to improvements in customer service, better drinking water and higher environmental standards. However, our sector still faces significant long term challenges. These include further improvements to operational and environmental performance, enhancing security of supply, dealing with extremes of dry and wet weather, managing the country's water resources more efficiently and in the long term, sustainably financing the industry's infrastructure investment. Our proposals for changes in our industry are informing the debate about meeting these challenges.

### How we're regulated

Severn Trent Water is a regulated business. We work within five year planning cycles, with the prices we charge our customers set at the beginning of each cycle by our economic regulator, Ofwat. These five year cycles are known as Asset Management Plan (AMP) periods. We have just reached the end of the third year of AMP5.

As well as being regulated by Ofwat, our performance is monitored by:

- the Drinking Water Inspectorate, which makes sure we comply with drinking water quality regulations; and
- the Environment Agency, which controls water abstraction, river pollution and flooding

We also work with the UK Government (including the Department for Environment, Food and Rural Affairs and the Welsh Assembly Government) and other agencies such as the Consumer Council for Water, Natural England and Natural Resources Wales, to make sure we meet the highest customer service and environmental standards, whilst offering our customers the lowest prices.

### Key strengths

Severn Trent Water has a number of key strengths and we work hard to maintain them. In particular:

- our average bills for water and sewerage combined are the lowest in England and Wales;
- we continually work to improve our performance and deliver cost and operational efficiencies against KPIs, which are aligned to our long term strategy;
- we are committed to long term sustainability, keeping in balance the needs of our customers, the environment and our investors;
- our high standards and efficiencies keep our costs low, which in turn helps keep charges low for customers and generates progressive, sustainable returns for our shareholders, and
- we have a clear strategy and business plan and a strong management team

## Progress against our long term objectives

| Long term objective                                      | Progress in the year  |
|--|---|
| 1. We will provide water that is good to drink           | <ul style="list-style-type: none"> <li>• Our drinking water quality remained high and we maintained our compliance with the Drinking Water Inspectorate's standards.</li> <li>• We invested in improvements to our water treatment plants and developed Drinking Water Safety Plans.</li> </ul>   |
| 2. We will ensure water is always there when you need it | <ul style="list-style-type: none"> <li>• We continued to manage our water resources effectively and once again avoided any hosepipe bans.</li> <li>• We reduced leakage to its lowest ever level and cut the underlying number of interruptions to supply</li> </ul>  |
| 3. We will safely take your waste water away             | <ul style="list-style-type: none"> <li>• We increased waste water treatments works compliance and reduced properties on the 'at-risk' of sewer flooding register to its lowest level.</li> <li>• We made substantial investment to improve sewer systems.</li> </ul>  |
| 4. We will provide excellent customer service            | <ul style="list-style-type: none"> <li>• We introduced a range of initiatives to improve customer service, resulting in increased customer satisfaction scores.</li> <li>• We achieved the best improvement in customer experience across our peer group as measured by Ofwat.</li> </ul>   |
| 5. We will have the lowest possible charges              | <ul style="list-style-type: none"> <li>• Our average combined water and sewerage bills remained the lowest in England and Wales.</li> <li>• Our bills will remain the lowest in 2013/14</li> </ul>  |
| 6. We will help you if you struggle                      | <ul style="list-style-type: none"> <li>• We helped 44,821 customers who struggled to pay bills via a range of flexible tariffs and schemes.</li> <li>• We donated £3.0 million to the Severn Trent Trust Fund.</li> </ul>   |
| 7. We will protect our water environment                 | <ul style="list-style-type: none"> <li>• We reduced pollution incidents year on year</li> <li>• We continued to take an industry leading role in shaping the regulatory regime and new legislation.</li> </ul>  |
| 8. We will protect the wider environment                 | <ul style="list-style-type: none"> <li>• Around one quarter of the electricity needed by our UK regulated business was provided by our renewable energy operations.</li> <li>• We reduced our net greenhouse gas emissions during the year and are on target to beat our business plan target by 2015.</li> </ul>   |
| 9. We will make a positive difference in the community   | <ul style="list-style-type: none"> <li>• We invested heavily into our network and treatment plants, making a substantial contribution to jobs and the local community</li> <li>• We talked to schools, other organisations and social housing about water efficiency, contributing to one of the lowest per capita consumptions in the country</li> </ul> |
| 10. We will finance our business sustainably             | <ul style="list-style-type: none"> <li>• We continued to ensure we were properly financed, with a strong balance sheet and investment grade credit rating.</li> <li>• We continued to help shape the debate on future industry financing and published our paper, 'Changing course through sustainable financing'</li> </ul>                              |

## Regulated Severn Trent Water



Customer written  
complaints per  
1,000 properties

2013

**4.19**

(2012 - 4.88)



Point of contact  
resolution

2013

**90.0%**

(2012 - 89.4%)



Average water  
and sewage bill

2012/13

**£326**

(2011/12 - £311)



Average customer  
cost per day

2012/13

**89p**

(2011/12 - 85p)

## How we measure success

Severn Trent has published its own set of KPIs since 2007. In 2011/12 Ofwat adopted a set of KPIs that it required all water companies to publish. Severn Trent has adapted its own KPIs to meet this new requirement. These KPIs provide Ofwat with an overall picture of performance against the company's commitments made as part of the AMP5 price review. Our KPIs are set out on page 139.

For the 2015-2020 period we have defined 10 long term objectives to meet customer and stakeholder needs. In April 2013 we published a consultation on our proposals for bills and services for the period (Your water. Your choices).

This included consultation on a proposed new set of measures by which our customers, stakeholders, and regulators can see how much progress we are making towards achieving these objectives. Following the consultation, we will be finalising the measures and including them in our business plan which we will submit to Ofwat in December 2013.

Further details of our performance are provided in our Annual Regulatory Performance Report, which is available at [www.stwater.co.uk](http://www.stwater.co.uk)

## Performance

At Severn Trent Water we focus on four key areas – customers, people, process and finance (as we explain on page 12). Having the right people with the right skills and using the right processes, enables us to offer high quality, low cost services to our customers. This in turn drives our financial results.

The following pages describe what we achieved in each of these areas during the year.

## Customers

For the fourth year running, our average combined water and sewerage bills were the lowest in England and Wales, at £326. Our bills will remain the lowest in 2013/14.

We aim to supply water that's good to drink and always available. Despite the drought at the start of this year, we managed our water resources carefully and once again avoided any hosepipe bans or other limits on our customers' water use. The subsequent heavy rain helped restore our reservoirs and aquifers and our water resources are now in good shape.

Our water quality remained high and we maintained our compliance with the Drinking Water

Inspectorate's standards at 99.98%. We delivered water at the right pressure and further improved our overall performance on supply interruptions. However our company KPI (performance on interruptions) was not as good as last year owing to a single burst trunk main which affected numerous customers. We remain focused on cutting supply interruptions, with further investment planning to improve our performance.

We continue to invest to ensure we provide the best water quality and resilience. To achieve this we have numerous projects, including renewing nearly 300 km of water mains, improving resilience in South Gloucestershire, and refurbishing 5 km of the Derwent Valley aqueduct. We're also renewing sections of high risk trunk mains, to minimise the risk of interruptions to supply. Other significant projects include new treatment plants in Shropshire, Warwickshire, Nottinghamshire and Derbyshire, to address catchment quality issues.

We made further progress with our catchment management programme during the year. This involves encouraging farmers and other large land users to reduce their impact on water resources. The drought and wet weather made it a difficult year for farmers, but their interest in catchment management remains high. During the year, we completed around 150 water quality investigations arising from Drinking Water Safety Plans, and hit our target for catchment management investigations under the EA's National Environment Programme, receiving a positive response from the EA.

One issue associated with wet weather is an increasing problem with metaldehyde, a pesticide used to control slugs and snails. We took additional action from late summer, but could not prevent a number of higher pesticide results in the autumn. We continue to take a leading role nationally in seeking an industry solution to metaldehyde.

The intense rain in 2012 led to an increase in the number of internal sewer flooding repeat incidents. Last year was the second wettest year on record and parts of our region suffered severe flooding. Some of our customers experienced flooding during the year and we did everything we could to help the local authorities and the EA respond, for example by providing large pumps to protect roads and properties adjacent to rivers.

We are investing significant amounts in our waste water services to improve the service to our customers. Further details of the investment can be found on pages 22 and 23.

## Customer experience

We work hard to provide our customers with a service experience that is consistently reassuring and reliable, whilst doing whatever we can to personalise the way in which we deal with each individual customer query.

We aspire to be an organisation that is designed around its customers, not just its network. We

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## **'We're pleased to have demonstrated the best improvement in SIM performance across our peer group.'**

know that customer expectations continue to be influenced by the vast number of brands, products and technologies that they interact with. It's therefore essential for us to look at our processes, policies and general ways of working through a customer lens and not an operational lens. We started this cultural journey two years ago when we launched our Customer Experience Programme. By engaging every Severn Trent colleague in the practical pursuit of the best possible experience for our customers, we've succeeded in achieving a very real improvement across our key indicators of customer satisfaction.

We're proud of what we've achieved – but we won't stop until our customers consider us to be one of the very best customer service providers in the industry. We are able to benchmark our performance against that of our peer group via Ofwat's independent SIM. Ofwat's SIM measures our customers' experience of dealing with us. The SIM score has two elements, quantitative, based on the number of customers that have to contact us, and qualitative, which assesses our service quality when they do.

We have consistently received good quantitative scores, but in the past, our quality of service has fallen short. In the last 12 months, we have focused on improving the areas our customers say are important to them, namely:

- resolving their issues or queries at first point of contact;
- being available to them when they want us; and
- keeping them informed every step of the way.

To do this, we created a cross company group to look at how we could drive improvement in our processes, response times and simplify the language we use to communicate with our customers. This helped us improve both elements of our SIM score in 2012/13.

We're pleased to have demonstrated the best improvement in SIM performance across our peer group, but we're not yet where we want to be from a benchmark perspective. And so the journey towards the best possible customer experience continues with a relentless focus on putting our customers at the heart of how we operate.

Our 'voice of the customer' tool gives us direct feedback from customers at the end of a call or when we've finished doing something for them.

We get around 12,000 responses a month. This valuable feedback helps us improve our

processes and how we deal with customers when they feel they need us most.

We have maintained first point of contact resolution at around 90%. Our Customer Advisors are consistently receiving satisfaction scores in the 90s and, as a result, our complaints volume continues to decline at a very healthy rate. We also further reduced written complaints, which were down 14%.

One of the important points of contact with customers is when they receive a bill from us. We've continued to improve our bill design to make them easier to understand, and to pass on useful information, such as the different ways customers can get in touch with us. We will also be introducing e-billing for customers who prefer it.

### **Managing debt**

Some customers choose not to pay and some customers genuinely struggle to pay. In line with our commitment to fair and affordable bills for all, we operate robust processes to influence the behaviours of those who choose not to pay, which in turn controls our healthy debt levels.

For our customers who truly struggle to pay, we offer a range of flexible tariffs and schemes. These can involve matching the customer's payments, capping bills for people with low incomes who have to use large amounts of water for medical or family reasons, or allowing customers to make payments directly from their benefits. In 2012/13, we helped a total of 44,821 customers this way. The Severn Trent Trust Fund offers an alternative avenue of support and has helped many customers over the years to fund their water bills. During the year we donated £3.0 million to the Severn Trent Trust Fund to enable the charity to support our customers who have difficulty in paying their water bills. However, a customer who struggles with their water bill is likely to struggle with other household bills. We wish to provide these customers with more meaningful support and have therefore entered into a partnership with the Citizens Advice Bureau which has the skills to help customers address their financial issues at a deeper level. We hope in this way to help our most financially vulnerable customers to manage and avoid household debts more effectively in the future.

### **Engaging with our customers**

One of the significant differences between the process for PR14 and the previous price review is the increased role for customers and other stakeholders in helping us to formulate and challenge our plan.

The Water Forum is our customer challenge group for PR14. It includes representatives from customers, our environmental regulators and local authorities, and has an independent chair, Dame Yve Buckland, who is also national chair of the Consumer Council for Water.

## Regulated Severn Trent Water

### Today... We're improving our flood defences in Gloucestershire

Since 2007, we've invested over £38.0 million across Gloucestershire to ensure we are better able to cope with extreme weather

To ensure our sewers in Gloucester can cope with heavy rainfall we have laid over 1 km of new sewers. We've protected our sewage pumping station at Longlevens with underground storage tanks and storm water pumping and at our Mythe Water Treatment Works we've installed flood protection barriers. To ensure we always have a back-up supply we've built pipelines from our other water treatment works.

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### Tomorrow... We're continuing to invest across our region

Replacing our largest covered reservoir at Ambergate, Derbyshire and replacing over 7 km of sewers in Newark, Nottinghamshire are just two of our major investment schemes over the next five years. We will invest over £58.0 million on these two projects to ensure we continue to provide quality water and prevent sewer flooding.

The role of the Water Forum is to ensure that customer and other stakeholders' views are understood and represented by Severn Trent Water when we submit our plans to Ofwat in December 2013.

Ofwat will assess our plan against four criteria: outcomes, costs, risk and reward, and affordability and financeability. Our plan will then be categorised as 'enhanced', 'standard' or 'resubmission'. This will determine the level of scrutiny and challenge of our plan and the financial incentives available. The Water Forum reports on the quality of our customer engagement, and how well our business plan reflects customer views and priorities. It will form a key input to Ofwat's assessment against the outcomes criteria.

We also have a broader engagement programme and have run workshops on topics including managing climate change, water and waste water issues, and customer service. A wide range of stakeholders attended these sessions. We also carried out a major customer survey, to understand their willingness to pay for improvements we could deliver as part of our plan.

In April 2013, we issued another consultation paper, 'Your water. Your choices', which set out our thinking on what might happen to customer bills, investment and investor returns over the next five years. This will give us further clarity on our stakeholders' views.

## People

We aim to have people with the right skills and approach to work, personal development and customer focus. To drive the behaviours we think are important, we have a Code of Conduct (Doing the right thing – The Severn Trent way) that applies across the group and explains our approach to issues ranging from health and safety, to ethics and honesty, and to delivering excellent customer service.

Our Code of Conduct explains who we are, what we stand for and how we work; it also tells our customers and business partners that they can rely on us. Further details are provided in the Governance report on page 50.

### A safe and healthy workforce

Protecting the health and safety of our customers, people and contractors is our number one priority. We were delighted to reduce lost time incidents once again, making 2012/13 our safest year yet.

Our MindSafety™ training programme contributed to this improvement. It teaches our people about different states of awareness, so they understand how they should work and can take responsibility for their own safety. We have coaches around the business to reinforce the MindSafety™ approach and will be running refresher programmes. Other initiatives to enhance safety during the year included improving our risk assessments and making sure that our people understand their roles and responsibilities.

## **'We were delighted to reduce lost time incidents once again, making 2012/13 our safest year yet.'**

One area that has concerned us is an increase in road traffic accidents. Whilst our staff didn't cause these accidents, we are looking at ways to reduce the risk by minimising the miles they travel and providing training on safe and effective driving and preventative actions.

As well as raising safety standards, we aim to be more proactive with our people's health and well-being. In 2012/13, we appointed a new occupational health provider. We're legally required to monitor the health of some employees, for example if they're exposed to noise or vibration, or work in confined spaces. Our new occupational health provider has a mobile unit, which visits sites to monitor our people. This saves time and provides a friendlier environment than an off-site facility.

We're also working with a new provider to help employees with musculoskeletal problems. Our partner looks at job design and how we can make changes to help people back to work. We are increasingly looking to take action before problems arise.

### Engaging our people

Our annual employee survey once again showed that our people are positive about working for us. Our overall Engagement Index rose to 79%, ahead of our target of 75% and the industry benchmark of 74%. The survey response rate also increased, a sign that our people know that it's important to us that they give their feedback and that we listen.

The most improved area was in people believing we are committed to customer service. Our score for commitment to customers rose from 71% to 83%.

A number of factors were behind the improved survey results. Developing our managers has made them more willing to engage with their teams and we have also put effort into making sure managers understand our business goals and can communicate them to their teams. Our continuous improvement programme also contributed, by giving our people the tools and techniques to solve problems they face at work.

Previous employee surveys showed that our people wanted to see more of our executive team and to find out how they were leading the business. This year, we ran a rolling programme where Executive Committee members went out to meet people across the business. More than 1,000 of our people attended these meetings, enabling them to ask any question they wanted. The feedback has been positive and our executives have also learned where we need to communicate better.

## Regulated Severn Trent Water

## Developing our people

Every year, we invest significant amounts in people development (£3.9 million in 2012/13). This year, we piloted a 'Leading for Performance' development programme in our waste water business. The aim is to have leaders who can inspire and engage our people and lead them through change – an area where we know we can do better. The programme helps our leaders to understand themselves and to learn how to coach others as well as build high performing teams. After positive results, we're now rolling out the programme across all of our operational leadership.

We have many other leadership programmes, which together form our 'Line Manager Journey'. They make sure that as people move into management, they have the skills to lead effectively. For example, to drive our performance culture, we want all our employees to have a performance discussion with their manager. We run programmes for managers at all levels, so they understand the process and can have those sometimes difficult conversations.

We'll soon be launching an initiative for nearly 1,400 people in Customer Relations, called the Great People Programme. Managers will learn about creating a customer orientated culture and coaching people in customer service skills. Frontline advisors will become better at giving customers a positive and memorable experience when they get in touch with us.

As part of our talent review process, we piloted new development centres this year. These took people identified as promotable and assessed their strengths and development needs. Each person came out with an in depth development plan.

In a changing world, we need leaders with a breadth of experience who can rise to different challenges. We therefore reintroduced our graduate programme, taking on nine high calibre people. In 2013/14, we plan to increase this to 20 and we're also considering introducing a technical graduate scheme, with progression to chartered engineering.

Finding people with the right skills is a challenge across the industry, so we further expanded our apprenticeship scheme. We now have 82 apprentices at different stages of development, including 22 we recruited in September 2012 for technical training, including two for a new environmental conservation apprenticeship. Almost all our apprentices move on to permanent jobs with us.

Through a pilot programme called 'Employee Ownership of Skills', the UK Government has asked employers to set out how we might use public funds alongside our own investment to improve the skills we currently have in the industry, identify the skills we'll need in the future and where we should invest.

We're also continuing to support projects in the Midlands to encourage young people to study science, technology, engineering and maths (STEM) subjects in order to be able to take up engineering and technical careers in the future.

## Attracting a diverse workforce

Our goal is to attract a diverse range of talent, with a balance of gender and ethnicity that reflects the market we operate in. At the moment, our workforce is slightly more diverse than the sector average, with more female employees and people from black, Asian and ethnic minority groups.

We have a diversity working group, with members from across the business. Its current focus is on gender diversity in leadership roles. We are also starting to get more insight into ethnic diversity.

It's important that we attract the broadest range of candidates when we recruit, so we track our attraction rates across different genders and ethnic backgrounds. We have also refreshed our careers website, to make it appeal to a wider range of people.

Helping our people to manage their finances  
In April 2013, we auto enrolled more than 1,000 people into our pension scheme. We believe that pensions are important and we're committed to providing a competitive scheme.

As many of our people told us that they didn't understand pensions, we set up a financial education programme which is now part of our ongoing training. So far, 1,200 employees have attended a session to learn about pensions, debt, mortgages, savings and other financial matters.

## Process

To deliver great service to our customers, we look to continuously improve our processes and technology.

Our approach to continuous improvement is called 'Safer Better Faster'. It helps our people to find ways to do things better, so we can improve our service. We continue to invest, including building and training our team of expert practitioners, who work with colleagues to help them use 'Safer Better Faster' techniques on a daily basis.

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## Regulated Severn Trent Water

During the year, we explored our previous investment in SAP and desktop technologies, and used our 'Safer Better Faster' approach to improve our business processes. For example, we introduced better processes in solving bursts on private properties, fixing stop tap problems and giving our customers a better service. We implemented software to allow work crews to access maps and asset data on their laptops, so they can pinpoint leaks and blockages more efficiently. We're also increasing the use of remote monitoring to improve performance across our networks. This helps us to detect leaks and prevent supply interruptions, allowing us to respond to problems before customers are affected.

One of our biggest challenges was improving how we engage with our customers at our call centres. During the year we made a strategic investment in telephony systems, to improve our customers' experience when they call us. The new system links to our other back office systems, giving our people better information to resolve customer issues during the call.

By investing in our people and technology, we've reduced to almost zero the number of customers who receive an engaged tone. More customers can speak to someone quickly, so fewer are hanging up because we've kept them waiting.

Using text messages, our new website and other technologies has helped us keep our customers informed about what we're doing. Live update maps on our website tell customers what's going on in their area and we're also making more use of Twitter. We want customers to contact us in the way that's best for them, and around one quarter of all contacts are now through our website, where customers can pay bills and update their details.

We increased the resilience of our technology, by investing in new data centres. We also made significant investment in business modelling software, which will allow us to model different planning scenarios for the next five years reflecting the input we have received from our PR14 customer focus group.

We are improving the efficiency of our procurement. We're working with our supply chain to get better value for money, including using our SAP system to give us more visibility of what we buy and where. During the year, we and our One Supply Chain framework partners continued to deliver greater efficiencies in our capital programme. Our strategic relationships with our One Supply Chain partners help us to become more innovative as we work together, for example by consolidating buying throughout the supply chain.

We want to work with responsible suppliers, so we've developed guidelines and standards that we expect suppliers to meet to ensure they are aligned to our philosophy of doing the right thing and our underlying policies. These cover key areas of corporate responsibility, such as our suppliers' approach to health and safety, anti bribery and anti corruption, and environmental performance. For more details on 'Doing the right thing – The Severn Trent way' see page 50.

A number of new technologies went live in our waste water operations this year. In order to drive efficiency we are exploring technology innovation at places such as Ashbourne where we have installed the UK's first full scale HYBACS plant. HYBACS is a treatment technology that allows us to process higher volumes, while using less energy. In Birmingham we have installed the UK's first Annamox plant to treat high concentrations of ammonia. Anaerobic ammonium oxidation intensifies the sewage treatment process, so we can use fewer and smaller assets. In Nottingham we are installing one of the UK's first struvite recovery plants to reclaim phosphate so that we can sell it on. We have also been working with a partner which provides air compressors that can reduce electricity consumption by around 20%. These play an important part in sewage treatment. More broadly, we work extensively with other organisations to develop new processes and have more than 30 academic or industrial research partners.

### Environment

Delivering our environmental obligations has a real impact on our customers and the communities in which they live and work.

### Managing waste water

We achieved good improvements in our environmental performance in waste water. The number of reported pollution incidents fell from 458 in the previous year to 376, a reduction of 18%. While we are one of the industry leaders at preventing the most serious pollution incidents, we can still improve in other less serious categories. We are investing in training, working on faster response times and using technology to try to predict where pollutions might occur.

Severn Trent has around 1,000 sewage treatment works. Of these, only 0.85% failed to reach their compliance limits (2012 2.54%), our best ever performance. This was down to our improvement group, which has analysed the root causes of failure and enabled us to systematically eliminate those problems, as well as the ongoing benefits of our investment programme and more remote monitoring of our sewage treatment process.

Image removed



## Regulated Severn Trent Water

This year has seen us reach halfway on our £200 million major projects programme of work. Upgrades are under way to our key sewage treatment works serving Nottingham, Leicester, Worksop, Stoke, Coventry, Burton-upon-Trent and Telford. Elsewhere this year we have invested almost £204 million to maintain service to our customers and undertaken key environmental improvements to our rivers. Looking forward, we're investing significantly in improving river water quality and have carried out a pilot study with the EA on how to achieve zero pollutions and breaches of consent.

Sewer systems are primarily designed to handle waste water and on occasions can be overwhelmed during heavy rain events.

Sewer flooding is one of the worst service failures that can happen to a customer. During the year we have made improvements to protect 158 properties from internal flooding and 70 external areas including substantial investment to improve sewer systems in Leamington Spa and Gloucester. The number of homes on the risk of sewer flooding register is now at its lowest ever level. We expect to be ahead of our target at the end of this regulatory period.

We have a proactive programme to clean and repair our sewer network which helps to prevent blockages, pollutions, flooding and collapses of our sewerage system.

This was our first full year of managing the 37,000 km of private drains and sewers that transferred to us on 1 October 2011. While this increased the number of blockages we had to deal with, overall we saw a lower level of reactive work than we expected. We are carrying out more inspections and condition/CCTV surveys of these assets, so we can learn more about them and have better informed plans for the future.

### Deploying water resources wisely

Severn Trent is the only company to target a significant reduction in leakage during AMP5. We made further good progress, cutting leakage to its lowest ever level at 441 ML/d. This compares with 464 ML/d last year and our internal target of 465 ML/d. Our performance benefited from our ongoing investment programme and the relatively mild weather.

Managing water resources effectively also means helping our customers to reduce the amount they use. We have a sizeable outreach programme with schools and other organisations, to teach people about using less water. We also distribute water efficient devices and have industry leading initiatives with social housing. All of these contribute to one of the lowest per capita consumptions in the country. The overall water saving this year as a result of these measures is 3.26 ML/d, which has contributed to the continued reduction in our per capita consumption. Last year our customers used an average of 121 litres per person per day.

## 'We remain at the forefront of the industry's debate about its future.'

### Protecting biodiversity

Severn Trent has a role in protecting and enhancing biodiversity at our sites or sites affected by our activities. We manage 12 public access sites where we work alongside volunteers and in partnership with organisations to ensure the long term biodiversity value of the sites, whilst engaging with our customers. Across our region we also own or partly manage 37 sites of special scientific interest, where we work with our regulators, tenants and others to safeguard them.

### Finance

We aim to finance the company in an efficient and sustainable way, which helps to keep customer bills low by keeping our financing costs low. Our funding comes from payment of customer bills, issuing debt on the capital markets and by shareholders retaining equity in the business. We have an investment grade credit rating, with a stable outlook. We also look to the long term sustainability of our financing and during the year we published some further thoughts in 'Changing course through sustainable financing', part of our continuing Changing course series of thought papers on the future of our industry.

More information about our financial performance and our debt issuance during the year can be found in the Financial review on pages 35 to 38.

### Outlook

We remain focused on achieving sustainable growth, by concentrating on our customers, people, process and finance. We aim to deliver the benefits of our investment programmes and to continuously improve the way we work, to raise standards and drive efficiency. Giving our customers an even better service is an important part of this.

Our operating environment will change as the UK Government passes the Water Bill and Ofwat completes its preparations for PR14. We remain at the forefront of the industry's debate about its future and will continue to help shape the legislation and regulation as it progresses.

# Non-regulated

## Severn Trent Services

Severn Trent Services is one of the world's leading suppliers of water and waste water treatment solutions. We are known for innovation, reliability, quality services and leadership in our chosen markets

### Key strategic intentions...

Severn Trent Services has six key strategic intentions, which define our strategy and set out how we intend to achieve our objectives

1. Engaged employees with the right skills to deliver
2. Continuously improve health, safety, employee well-being and environmental performance
3. Determine and deliver what customers value
4. Develop new markets and products through geographic expansion, end user focus, technology innovation and strategic partnerships
5. Continue to build strong and respected brands
6. Continuously improve and optimise our products, processes and organisational capabilities to enhance customer value and improve returns to our investors

### Where we operate

Severn Trent Services is our main non-regulated business. It has two business streams – Water Purification and Operating Services. Water Purification is organised around three regions – the Americas; Asia Pacific and China; Europe, the Middle East and Africa. Operating Services works for customers in the US, UK, Ireland and Italy

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### ...delivered through our areas of focus

Severn Trent Services is one of the world's leading water and waste water businesses. To achieve our strategy we focus on

#### Water Purification (Products)

Municipal, commercial, industrial and marine applications require water treatment technologies to meet their disinfection, filtration and process needs. The Water Purification group's portfolio of water products are used around the world in support of these applications

More on Water Purification on page 29

#### Operating Services

Operating Services delivers safe drinking water and waste water treatment services. It is responsible for operating more than 900 treatment facilities across its markets.

More on Operating Services on page 30

### Key facts

Image removed

#### Orderbook

**£49.6m**  
as at 31 March 2013

Image removed

#### Employees

**2,339**  
as at 31 March 2013

#### Turnover

**£328.5m**  
(2012: £332.3m)

#### Profit\*

**£12.7m**  
(2012: £18.0m)  
\*Before interest, tax and exceptional items.

## Non-regulated

### Today... We completed the first retail switch

Severn Trent Costain provides water and waste water management services in the UK to commercial and industrial users, delivering water strategies to improve efficiencies, reduce costs, mitigate risk and manage compliance.

In October 2012, we announced First Milk as the first business customer to switch water supplier. We supply, manage and monitor over 600 million litres of water per year across six First Milk sites, and are now working with First Milk to help them achieve their objectives for water management.

"Being able to get a closer handle on our water usage is not just beneficial to our business, but to any business. We believe that this contract with Severn Trent Costain will help us in our quest to meet some of the sustainability targets, and help prepare us for some of the short and long term challenges facing our industry."

Paul Rowe, First Milk Group Projects Director

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### Tomorrow... We're well placed to take a leading role

As the UK water supply market undergoes significant change, we are taking a leading role. With water services licences for Scotland, England and Wales, we can offer multi-sited businesses the benefits and synergies of a single supplier approach.

We will continue to work in partnership with high volume business users to manage the increasing challenges presented by climate change and extreme weather such as flooding, scarcity, rising costs and increasing regulation. We will develop innovative water strategies which deliver sustainability, reduce costs and fulfil corporate social responsibility agendas to meet the increasing demands from consumers and stakeholders to preserve and protect a valuable resource.

## Non-regulated

## Our business model

## Sewern Trent Services

Our business is evolving from a traditional base of municipal water and waste water to one where we operate in a variety of municipal, industrial and commercial sectors for the delivery of both products and services

The market for water and waste water products and services is significant, with good prospects for long term sales and profit growth due to fundamental drivers: water scarcity, population growth, climate change and more stringent regulatory requirements.

Our strategy is to introduce new technologies into existing markets, adapting existing technology (for example our BALPURE® ballast water technology) to fit new market opportunities, as well as growing our Operating Services business in the US and Europe where we operate more than 900 facilities and have over £190 million revenue.

We target a return on capital in excess of the regulated water business, commonly above 10%.

## Key to our services

- ① **Filtration**  
Areas where STS offers filtration, separation and adsorption products/services for all or part of the process cycle
- ② **Disinfection**  
Areas where STS offers disinfection and related instrumentation products/services for all or part of the process cycle
- ③ **Operating Services**  
Areas of the process cycle where STS offers contract operations

Other non-regulated businesses  
Renewable energy in the UK

As a group, we face an increasing need for energy due to ever tightening standards. We have three main reasons for developing our own energy, to:

- reduce our reliance on electricity from the national grid,
- reduce our carbon emissions; and
- limit our impact on the environment.

## Areas of focus

**Sewage gas combined heat and power (CHP)** – We have 55 engines on 35 sites producing 40 MW of power

**Trade waste** – We have four Sewage Treatment Works providing permanent trade waste storage and dosing facilities creating methane gas.

**Energy from crops** – Our 'energy crop' anaerobic digestion plant next to the Stoke Bardolph Sewage Treatment Works in Nottinghamshire.

**Hydro** – We have six hydro turbines installed at four sites producing around 1.7 MW

**Large wind turbines** – We aim to generate 22 GWh of electricity from four large wind turbines in 2015

## Where we invest and where we make our returns

We are investing across the above five areas of focus with £8.75 million invested in 2012/13. We make direct returns on our renewable energy activities, and benefit from cost saving across the group.

Providing Operating Services  
and Water Purification Products to:

1

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Municipal Water  
Treatment

Sewern Trent Services provides filtration, disinfection and process solution technologies for various municipal water treatment applications.

In addition, we provide contract operations and maintenance for municipal water treatment facilities in the US, UK, Ireland and Italy

## Disinfection ② ②

## Product:

Advance™, AQUAWARD®, Capital Controls®, Chlor-a-Voc®, Chloromatic™, ClarTec®, MicroDynamics®, UltraDynamics®

## Filtration ② ②

## Product:

Bayoxide® E33, Omni-SORB™, SORB 07™/09™/33®, TETRA® DeepBed™, TETRAplex®, LIAT™, TETRA DeNite®, Higgins Loop™, TETRA FlumeFlow®, TETRA® LP Blocks™

## Services:

Waste Water Facility Operations & Maintenance (O&M), Water System Treatment & Distribution, Asset & Capital Management, Design & Build, Integrated Water Services Management, Leakage Detection & Reduction, Legionella Control, Network Repair, Maintenance & Renewal, Project Finance Arrangements, Water Quality Sampling, Assessment & Rectification, Water Regulations Compliance

## Risks

(Where these are currently considered Principal Risks, further details are provided on pages 39–42)

- We may be unable to collect and store sufficient water to meet customer demand.
- Hazardous processes may result in our people being injured. (Principal Risk Ref 6)
- Regulatory or political change may lead to decreased demand for our services.

## Non-regulated

2

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## Municipal Waste Water Treatment

Severn Trent Services provides filtration, disinfection and process solution technologies for various municipal waste water treatment applications.

In addition, we provide contract operations and maintenance for municipal waste water treatment facilities in the US, UK, Ireland and Italy

### Primary Treatment ☉

### Secondary/Biological Treatment ☉ ☉

Product:  
TETRA® SAF, Amphidrome, TETRA® ColOX

### Tertiary/Advanced Treatment ☉ ☉

Product:  
TETRA® DeepBed™, TETRA® Denite®, TETRA® NSAF, TETRA® Shortcut-NRT™, TETRA® SNAP-T®

### Final Treatment UV/Chlor Disinfection ☉ ☉

Product:  
Capital Controls®, ClarTec®, MicroDynamics®, MicroChem®

### Services:

Waste Water Facility Operations & Maintenance (O&M), Waste Water System Treatment & Collection, Asset & Capital Management, Design & Build, Industrial Pre-treatment, Network Repair, Maintenance & Renewal, Project Finance Arrangements, Sludge Treatment & Disposal

### Risks

- Failure of products or treatment processes may result in environmental damage and regulatory non-compliance (Principal Risk Ref 5)
- Regulatory or political change may lead to decreased demand for our services
- Hazardous processes may result in our people being injured. (Principal Risk Ref 6)

3

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## Industrial

Severn Trent Services offers a range of disinfection, filtration and process solutions for a suite of industrial water and waste water applications. In addition, we provide design, build and contract operations for water and waste water treatment facilities for a variety of industrial segments in the US, UK, Ireland and Italy, and supply retail water to businesses throughout the UK.

### Process Water ☉ ☉

Product:  
Capital Controls®, ClarTec®, EST™, MicroDynamics®, TETRA® DeepBed™, TETRA® Higgins Loop™, UAT™, UltraDynamics®, MicroChem®

### Cooling Water ☉ ☉ ☉

Product:  
Capital Controls®, ClarTec®, EST™, MicroDynamics®, SANILEC®, SEACLOR®, TETRA® DeepBed™, TETRA® Higgins Loop™, UAT™, UltraDynamics®, MicroChem®

### Services:

Severn Trent Services provides a full range of expertise from the individual aspects of water/waste water utility management to the provision of integrated water/waste water services for a variety of clients, including:

- Utilities
- Public Sector
- Estates and Facilities Management
- UK MoD
- Developers
- Domestic Customers
- Business Retail Customers

### Risks

- Failure of products or treatment processes may result in injury to people, environmental damage and regulatory non-compliance. (Principal Risk Ref 5 and 6)
- Disruption in the global supply chain may impact our ability to meet customer needs.
- We may be unable to take advantage of the opening of the UK market to competition (Principal Risk Ref 2)

4

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## Marine

Severn Trent Services offers a range of disinfection, filtration and process solutions for marine and offshore water and waste water applications.

### Electrochlorination ☉

Product:  
SANILEC®, SEACLOR®

### Desalination ☉ ☉

Product:  
SANILEC®, SEACLOR®, UAT™, UltraDynamics®

### Marine Sewerage ☉ ☉

Product:  
MARINER OMNIPURE® Series M55, OMNIPURE™ & OMNIPURE™ Series 55, SANILEC®, SEACLOR®, UAT™, UltraDynamics®

### Ballast Water Treatment ☉ ☉

Product:  
BALPURE®

### Risks

- The Intellectual Property in our key products may be used by competitors.
- Regulatory change may lead to decreased demand for our products.
- New products may be introduced to the market leading to increased competition for our products and services.

### Our websites

[www.severntrentservices.com](http://www.severntrentservices.com)  
[www.severntrentdenora.com](http://www.severntrentdenora.com)  
[www.severntrentcoastan.com](http://www.severntrentcoastan.com)

## Non-regulated

### Overview

#### Industry and market

The market for water and waste water products and services is large with substantial long term prospects for growth in the areas we serve. That is because the drivers of the water and waste water business: water scarcity; population growth; climate change; and more stringent regulatory requirements remain strong.

#### Our business

Severn Trent Services provides water and waste water treatment products and operating services to utilities, municipalities and commercial customers in selected markets around the world. We focus on the growth markets and geographies where our products and services meet the significant needs of our customers.

We have two principal business streams, Water Purification (Products) and Operating Services, which are described under our areas of focus on page 24.

Operating Services includes Severn Trent Costain, which provides complete business water and waste water management, from source to disposal, for high volume commercial and industrial water users in England, Wales and Scotland.

We also have a sector leading renewable energy operation, which provides electricity to our UK regulated business, Severn Trent Water, with excess power supplied to the national grid.

#### Key strengths

Our non-regulated operations have the following key strengths.

- our business has a clear strategy for growth, which focuses on the growing global demand for clean water and safe, efficient waste water treatment;
- we provide operating services to an increasing number of utilities, municipalities and commercial customers in targeted countries, and
- we are a leader in the design, production and sale of water purification products in growth markets such as disinfection, filtration, adsorption and marine/offshore waste water treatments.

#### How we measure success

Severn Trent Services establishes an annual suite of performance targets (KPIs) which are used to measure and guide the business throughout the year. KPIs are measured and reported monthly to all employees and are aligned with the delivery of our long term strategic plan which is set out in our Key Strategic Intentions (KSIs) below.

### Progress against our key strategic intentions

| Key strategic intention   | Progress in the year  |
|---|---|
| 1. Engaged employees with the right skills to deliver   | <ul style="list-style-type: none"> <li>• Our quarterly surveys show employee engagement ahead of target and benchmarks for similar businesses.</li> </ul>   |
| 2. Continuously improve health, safety, employee well-being and environmental performance   | <ul style="list-style-type: none"> <li>• We delivered strong health and safety performance, with a further reduction in lost time incidents.</li> <li>• We won awards that recognised our commitment to protecting the environment.</li> </ul>  |
| 3. Determine and deliver what customers value   | <ul style="list-style-type: none"> <li>• We undertook a 'fit for purpose' review of all our products and services across Severn Trent Services and disposed of our analytical and metering services operations so we could focus on our key activities.</li> <li>• We implemented a new comprehensive voice of customer process across all parts of Severn Trent Services.</li> <li>• We developed new communication tools with existing customers which have contributed to improved contract retention rates.</li> </ul>  |
| 4. Develop new markets and products through geographic expansion, end user focus, technology innovation and strategic partnerships                          | <ul style="list-style-type: none"> <li>• We strengthened our Severn Trent De Nora business by acquiring electrochlorination technologies and establishing an opportunity for future growth in Japan.</li> <li>• We formed a new subsidiary, Severn Trent Costain, to compete for commercial and business customers in the UK.</li> <li>• We recently agreed to acquire service contracts with 10 municipalities and three private entities in California providing us with a stronger base for growth in the Western US.</li> </ul>   |
| 5. Continue to build strong and respected brands  | <ul style="list-style-type: none"> <li>• We continued to invest in developing BALPURE® and a number of other water purification products.</li> <li>• Severn Trent Services has a series of electrochlorination products for ballast water, waste water and drinking water applications, out of which our established ClorTec® line has a strong reputation as the leading global technology with a proven track record of over 3,000 global installations since 1995.</li> <li>• Severn Trent De Nora has established an excellent reputation and brand name across the globe and specifically in the Middle East by occupying a strong leadership position in this region.</li> <li>• We launched new foreign language websites in Spanish, Italian and Chinese within <a href="http://www.severntrentservices.com">www.severntrentservices.com</a> to provide native language product and service information for key international markets.</li> </ul> |
| 6. Continuously improve and optimise our products, processes and organisational capabilities to enhance customer value and improve returns to our investors | <ul style="list-style-type: none"> <li>• Water Purification reorganised on a regional basis, to get closer to its customers.</li> <li>• We introduced the Severn Trent group's 'Safer Better Faster' approach to continuous improvement.</li> </ul>   |

## Non-regulated

## Performance

Severn Trent Services delivered an encouraging performance, despite continuing challenging conditions in some of its markets. In 2012/13, revenue was £328.5 million, while profit before interest tax and exceptional items (PBIT) was £12.7 million.

During the year, we conducted a thorough review of Severn Trent Services' products and service portfolio, including a 'fit for purpose' analysis of the structure of each business and our shared services. In addition, we took action to strengthen our focus on the core water and waste water markets through the divestiture of our analytical services and metering services operations in the UK. The disposal of analytical services also satisfied an undertaking made to Ofwat who have now closed the Section 26 investigation into this market. Excluding the impact of acquisitions, exchange movements and these disposals, revenue grew by 5.3% but underlying PBIT decreased by 3.5%, after increased investment in business development, which was £1.6 million higher at £3.6 million. Reported revenue fell by 1.1%, while reported PBIT fell by 29.4%, mainly due to the loss of earnings on disposal from the metering and analytical services business.

## Water Purification (Products)

Water Purification grew in emerging markets such as Asia Pacific and the Middle East & North Africa, while performance in North America and Europe was impacted due to difficult economic conditions and limited customer investment in water and waste water projects.

Disinfection and filtration product demand increased due to stringent effluent standards in China and demand for electrochlorination products in offshore applications was high in Latin America (Brazil) and Asia Pacific (Malaysia) due to increased oil and gas exploration.

To support and expand on this demand, a small acquisition was made in the Japanese market – Chlonne Engineers' CECHLO seawater and brine electrochlorination systems.

In the marine market, the International Maritime Organisation (IMO) has yet to ratify ballast water treatment standards. However, our BALPURE® ballast water treatment line still delivered growth and we have a pipeline of new projects. We continue to invest in BALPURE®, so it has a broader reach across the marketplace. This includes modifying the product to make it more cost competitive for smaller ships, and taking costs out of the original design to improve its competitiveness across the product range.

To take advantage of growth in emerging markets, we reorganised the Water Purification business on a regional basis. This new operating model is divided into the Americas; Europe, Middle East and Africa; Asia Pacific and China; and Severn Trent De Nora, which has global management with operations in the US, China, Italy, Japan and Singapore.

Reorganising the business in these regions will allow us to offer customers a full suite of products and services, while operating with similar capabilities to those we already have in North America and Europe. It is also expected to reduce our costs by leveraging global procurement.

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**'Severn Trent Services delivered an encouraging performance, despite continuing challenging conditions in some of its markets.'**

## Non-regulated

### Operating Services

Despite a flat market, revenue grew in the US. Increased efficiencies made our existing contracts in the UK and Ireland more profitable. In Italy performance was again affected by economic conditions and continued political uncertainty.

In the US, fewer existing contracts came up for renewal across the market. We therefore focused on increasing the proportion of our own contracts that we retained on renewal. Overall, we secured 31 new projects and renewed 46 contracts, improving our renewal rate for contracts of more than \$100,000 a year to 85%.

In Italy our performance was negatively impacted by the political and economic environment. We saw a lower level of activity and we restructured the business to reduce our ongoing cost base.

Our 25 year, £1.0 billion operation and maintenance contract with the UK Ministry of Defence (MoD) cut leakage to an all time low, exceeding the MoD's targets. Environmental performance remains strong. Our Severn Trent Response business in Ireland operated well in a difficult economic environment, while the Severn Trent Retail Utility Services business was generally flat due to the stagnant UK housing market.

#### Severn Trent – serving the emerging UK business market

Severn Trent and Costain formed a business in June 2012 to offer large multi-site water users a single water and waste water supplier. Severn Trent Costain operates across England, Wales and Scotland, focusing on high volume commercial and industrial users for whom water is a critical process element. It helps customers to improve efficiency, save costs, manage legal compliance and risk, and solve their water efficiency challenges. It builds on the success of our existing business with Costain, which began in 2005 and delivers operations and maintenance for a portion of the UK MoD's water and waste water assets.

In October 2012, Severn Trent Costain signed First Milk, a major UK dairy, as a customer. First Milk is the first business customer to switch since the UK Government amended the regulations to allow more businesses to choose their water supplier. Severn Trent Costain now supplies, manages and monitors First Milk's water across six major sites in England, Wales and Scotland, involving more than 600 million litres of water a year.

### Continuous improvement

#### Environment

We must manage and measure our impact on the global water environment. During the year, the Delaware (US) Department of Natural Resources and Environmental Control recognised our commitment to the environment, when it gave its Clean Water Partnership Award to the Lewes, Delaware waste water treatment plant, for achieving 100% compliance over the last five years.

The facilities we operate in Lititz, Pennsylvania (US) received the US Environmental Protection Agency's (EPA) 2012 Source Water Protection Award.

This recognises organisations and communities that take extraordinary steps to protect drinking water sources in the EPA's mid-Atlantic region. Lititz was recognised for protecting groundwater sources from contamination through its joint wellhead protection programme with the neighbouring Warwick Township Municipal Authority. No other communities in Pennsylvania have received this award since 2009.

#### People, health and safety

Protecting health and safety is one of our core values. We advocate safety in all we do, both professionally and personally. Our performance in the year was solid, continuing the improving trend in recent years.

This continuous improvement was evident in our Operating Services business in Italy, where our employees worked 27 months without a lost time incident (LTI) (ended in February 2013). In the US, our Clinton, Oklahoma Operating Services project received the Water Environment Federation's 2012 Burke Safety Award for having the best safety record of all waste water treatment facilities in the state. Other successes in US Operating Services included Bristol, Tennessee celebrating 13 years without an LTI, and the Gulf region municipal utility district maintenance department working for three years without an LTI, while performing some of the most hazardous work across Severn Trent Services. For the fourth consecutive year, Operating Services in the UK and Ireland received an award from the Royal Society for the Prevention of Accidents for its exceptional track record in health and safety.

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## Non-regulated

To develop our people we have introduced a learning and development programme that has identified top talent throughout the organisation. We're working to develop and empower all employees to think creatively and to drive change across Severn Trent Services.

We carry out engagement surveys with around 25% of our employees each quarter. The most recent survey showed engagement at 81%, ahead of our 72% target. This reflects a more positive attitude to the business as we've stepped up our communications to employees and begin to see the benefits of reorganising and refocusing the business.

Nearly 1,000 of our people took part in the Global Corporate Challenge this year. This is a 16 week programme in which teams of people record their physical activity each day. Our employees walked a combined 1.1 billion steps, the equivalent of 18 times round the world. More than 26,000 teams took part globally and we had two teams in the top 100 and seven in the top 1,000. We also came first in the global gas, electric and water supply category. Our participants reported benefits including weight loss, increased energy and productivity, better stress management and improved overall health.

### Process

We look to continually improve the way we work and have started to roll out the Severn Trent group's 'Safer Better Faster' approach to continuous improvement. Water Purification was the first to implement 'Safer Better Faster' and we are now rolling it out across the business.

We're also investing in our systems. This includes implementing a new enterprise resource planning system across much of the business. This is a significant upgrade to our previous system and will help us, in conjunction with the 'Safer Better Faster' programme, to improve customer service and our operations. Over the next 18 to 24 months, we'll be moving ahead with a number of other IT improvements, including a human resources system to consolidate all our global HR activities, a global customer relationship management system and new cloud based office management systems.

We also enhanced our governance during the year. As the business grows internationally, we wanted assurance that we have controls fully in place to protect our investments and ensure we're operating ethically. This work included due diligence across our supplier base and our channel partners.

### Product technology

We recognise the importance of maintaining a pipeline of new products and enhancements to existing products. We do this internally and through relationships with technology partners, with whom we can jointly develop products for new and existing markets. We have several new products at different stages, including the ongoing development of BALPURE®, as discussed earlier.

## Outlook

To compete in the global market, Severn Trent Services must be lean and effective, and provide quality products and services that deliver value. The regionalisation of our Water Purification structure, new product development and enhancements to existing products undertaken in the last 12 months are critical elements of our long term strategy.

Emerging markets continue to provide opportunities for Water Purification, offsetting continuing challenges in traditional markets.

Existing political and economic factors continue to hamper immediate prospects in our US and Italy Operating Services businesses. However, opportunities to acquire existing projects are surfacing in the US as competitors exit the market and seek alternative strategies. The potential for future growth in Italy is present given proposed investment of €65.0 billion in the water sector over the next 30 years, though timing is uncertain. In both countries we will continue to reduce costs and increase efficiencies of existing projects.

## Renewables and green energy

For the second successive year, our renewable energy operation generated almost one quarter of the electricity used by our regulated business, Severn Trent Water. Maintaining this performance was particularly challenging because of the unusually high rainfall, which increases the requirement for pumping and leads to higher energy consumption.

We extended our crop digestion plant in Nottinghamshire and began constructing our first three large wind turbine installations.

These investments will provide another big step towards our target of generating 30% of Severn Trent Water's electricity from renewables in 2015.

The remaining output growth will come from further investment in sewage digestion efficiency, new hydro generation at several raw water reservoirs, and injecting part of the gas produced from sewage digestion at our largest generating station into the UK gas network. Bio-methane injection is an emerging technology in the UK but commonplace in Northern Europe. It involves removing contaminants from the gas, increasing the methane concentration, adding an odourant and pressuring to inject the gas into the nearby transmission network. Our plant, which will go live in 2014, will be one of only a handful in the UK and is likely to be the largest.

We lead the UK in the anaerobic digestion of sewage and produce most of our renewable energy this way. We're now developing plans to expand into the emerging UK opportunity for food waste digestion. We'll be able to offer a competitive service and see the potential for this to extend our renewables production beyond 30% as we approach 2020.

**Non-regulated****Today...****We generate renewable electricity and heat from sewage**

Our largest waste water treatment works at Minworth receives the sewage from over two million customers in and around Birmingham. The treatment processes ensure that the cleaned effluent can be returned to the river. The remaining organic matter is first used to generate renewable energy using the anaerobic digestion process and then recycled to agriculture where it acts as a valuable bio-fertiliser.

Anaerobic digestion uses bacteria similar to those in the human stomach to convert the sewage into a methane rich biogas. The gas is then used as a fuel for engines which drive generators to produce electricity. Heat is recovered from the engine exhaust and cooling systems to maintain the digesters' temperature at 38°C. This part of the process is known as combined heat and power (CHP). Renewable energy has been produced in this way at Minworth for over 50 years but output has significantly increased during the last few years following major investment in the processes. The generating station satisfies all of the electricity needs of the site and also exports a significant amount into the national grid.

See our film at [www.severntrent.com/renewables](http://www.severntrent.com/renewables)

Image removed

**Tomorrow...****We will be injecting renewable gas into the national grid**

We are planning to invest a further £12.7 million on renewable energy at the site over the year to replace life expired CHP units and to introduce a new process that will increase efficiency by injecting around a third of the gas into the national gas grid.

The process of bio-methane injection is detailed on page 31. Our plant which goes live in 2014 will be one of a handful in the UK and it is likely to be the largest. This plant will make more efficient use of the energy within the gas and as such qualifies for the financial support of the Renewable Heat Incentive that the UK Government has recently introduced.

## Looking forward

Since we published the first of our Changing course documents back in 2010, Severn Trent has played a leading role in shaping the future of the UK water industry. We've continued this engagement in the last 12 months, with a series of new publications. We issued a paper on designing balanced incentives that drive the right behaviour by water companies. KPMG wrote a report for us on financing water infrastructure beyond 2015. Alongside National Grid, we produced a paper on encouraging equity financing in the water and energy sectors.

We're pleased that our efforts have been productive. The changes from the UK Government, in the form of the Water Bill, and from Ofwat in its recently published consultation on the framework for PR14, are aligned with our own proposals. Together, these promise the most significant changes to water industry regulation since privatisation in 1989.

### The challenges for the industry

Water industry regulation needs to change because the sector has to deal with significant challenges in the coming years.

Affordability is a key theme for the next five years. Households are facing declining real incomes and welfare reform, intensifying the need to keep water bills as low as possible. Pressure is also coming from business customers, who want to better manage their costs and have greater choice of water supplier.

We need to respond to climate change and water scarcity. Recent experience shows that the UK's weather patterns are changing, with droughts followed by floods. Water companies need to effectively manage customer demand, make better use of existing water resources on a national rather than regional basis, and increase the network's resilience. This would also create more capacity to move water, making water trading between regions easier.

The water industry must also be more sustainable. This means rebalancing abstraction and taking less water from areas where it's already affecting the environment. It also requires the industry to reduce its bias towards capital expenditure and promote operational solutions, such as improving catchment management rather than building new treatment works.

## 'Water industry regulation needs to change because the sector has to deal with significant challenges in the coming years.'

### The Water Bill

The UK Government is responding to these challenges through the Water Bill, which ministers hope to enact in 2013/14. This builds on its 2011 Water White Paper, which set out a vision for 'a resilient, affordable and sustainable water supply network'.

The Bill covers four main areas. First, it increases the scope for non-household retail competition. This is already possible to a limited extent but the Bill will make it easier for business customers to switch supplier. This creates an opportunity for us and we have set up Severn Trent Costain in response. However, while retail competition is positive because it encourages efficiency and promotes choice, it won't transform the sector's economics.

Secondly, the Bill also allows more upstream competition and in particular water trading. This will enable better use of national water resources, a significant improvement on the current situation where companies have to look within their region for solutions to water shortages. This will lead to better resilience and lower costs for customers. However, the right economic model needs to be developed to enable water trading to happen.

Thirdly, it is designed to enhance the physical resilience of the industry by, for example, encouraging farmers and other land owners to store water and to clarify the duties of Ofwat to promote resilience.

Finally, the Bill will reform the mergers and acquisitions regime. While major mergers will still be unlikely, the changes create the potential for a more efficient industry structure, reducing costs which can be shared with customers.

Overall, the Water Bill includes measures which are broadly in line with those we set out in Changing course, and we'll continue to support it as it passes through Parliament.

### The PR14 framework

In January 2013, Ofwat published a consultation on its framework and approach for PR14. The proposed framework has four key elements.

First, it introduces separate price controls for the retail and wholesale parts of the business. This gives companies a greater incentive to provide the best customer service at lowest cost, and will create more choice for non-household customers. The RCV will stay with wholesale, which currently generates around 90% of Severn Trent Water's revenue. This means that the vast majority of our revenues will still be based on the RCV and will be adjusted for the movement in the RPI each year.

Ofwat is aiming to be less prescriptive about what companies deliver during the next regulatory cycle, so it's asking them to set the high level outcomes they will aim to achieve. These outcomes will be focused on benefits for customers and will give companies more leeway to innovate in the way they deliver their plans.

Companies will also face fewer but greater incentives, which will focus regulation where it's needed most. Companies can choose larger incentives for outperformance but would also face more significant penalties for underperformance. The new regime will also, in theory, address the industry's bias towards capital expenditure, as the model will move more to a total expenditure (or totex) basis. Companies will be able to choose whether to recover this expenditure on a 'pay as you go' basis, which will be beneficial for cash flow, or by adding it to their RCV and earning a return, which will be better for their long term returns.

Finally, the framework has a much greater emphasis on customer and stakeholder engagement. Customer challenge groups (such as our Water Forum, which is discussed on pages 18 and 20) will influence companies as they develop their plans, which should lead to plans that are better informed. Companies will still own their plans but they must show that they have listened to their challenge group and explain their approach where their view differs. The customer challenge group will also report on the quality of the company's engagement and whether it supports its business plan. This will in part determine the depth of Ofwat's review of the plan. Ofwat's proposals are still at the consultation stage

**'Companies will also face fewer but greater incentives, which will focus regulation where it's needed most.'**

and there are important details that need to be finalised. For example, it's important to get the level of details right when setting outcomes. Outcomes that are too detailed will lose the benefits of risk based regulation. Conversely, if there's not enough detail it will be hard to define meaningful measures of success. We also need to know more about key elements such as the basis for the average retail cost calculations and how the totex baseline expenditure will be set. Overall, though, the draft PR14 framework contains no surprises for us and we're supportive of its aims.

Severn Trent Water's April 2013 consultation, 'Your water. Your choices' sets out outline proposals for what the company could achieve during 2015-2020, with customer bills forecast to rise by no more than inflation during the period. There are a number of important areas where there is scope for choice, however customers' and stakeholders' views will directly influence the final business plan to be submitted to Ofwat in December 2013.

### Sustainable financing

In the longer term, the water industry will need more capital. It has invested £100 billion since privatisation but the challenges outlined earlier will require further significant investment. We believe that investors will continue to fund this if they remain confident in the industry.

In our view, it's unlikely that debt can provide all this funding. High gearing transfers risks to customers and the failure of one company will affect all the others, by damaging their chances of raising further debt. The 2008/09 financial crisis also showed that companies cannot guarantee access to debt finance when they need it. Our conclusion is that there's a need for long term equity in a balanced financing structure, which means that equity holders will have to be appropriately rewarded for providing those funds.

In the short term, we also need to look at the way the weighted average cost of capital (WACC) is calculated for PR14. In current market conditions, the capital asset pricing model, which is used to calculate the WACC, could produce an unsustainable answer. Other models should be used to cross check and justify the cost of equity and debt. We also believe that it's possible to differentiate the cost of capital based on company risk. We have made all these points in a series of publications over the year and are engaged with stakeholders to discuss the future implications.

### Summary

In summary, we support the general direction of the Water Bill and the PR14 framework. While the changes they propose are evolutionary rather than revolutionary, they are still significant and will help the industry to address its challenges. We're pleased to have played an important part in shaping these proposals and will continue to do so as they progress.

## Financial review

### Group financial performance

The group has delivered a good financial performance. At the regulated business, Severn Trent Water, revenues were negatively impacted by lower consumption, with bad weather in the early part of the year also driving higher operational activities and thus costs, to meet the operating performance standards our customers and regulators expect. We delivered a good performance on those costs that we directly control. For those costs where we have less influence – power, quasi taxes and bad debts – we saw increases in the first two, while we maintained performance on bad debts at 2.2% of rising revenues (UK GAAP). To complete the picture at Severn Trent Water we maintained our long term plans for investment in year three of this five year regulatory plan and invested £19.0 million more than the previous year in infrastructure which is expensed under IFRS accounting rules.

In our non-regulated business, Severn Trent Services, we refocused its business activities and continued to invest in business development where we see future growth potential. If we exclude these factors the business achieved modest revenue and profit growth in these markets which is encouraging for the future.

The group continued to look to its long term financing, successfully issuing its first bond into the nascent UK retail bond market and issuing a new 13 year bond into the sterling wholesale market raising £500 million at 3.625%, the lowest cost Severn Trent has issued in its recent history.

PBIT is profit before interest and tax; underlying PBIT is PBIT excluding exceptional items as set out in note 8.

Group turnover was £1,831.6 million (£1,770.6 million), an increase of 3.4% over last year.

Underlying group PBIT decreased by 1.2% to £498.0 million (£504.2 million). The primary factors affecting underlying PBIT are described in the commentary on Severn Trent Water and Severn Trent Services below.

There were net exceptional items before tax of £5.8 million (£50.9 million). Group PBIT increased 4.8% to £492.2 million (£469.8 million).

### Regulated – Severn Trent Water

Turnover in Severn Trent Water increased by 3.7% in 2012/13, to £1,511.0 million. Prices increased by inflation from 1 April 2012 which gave rise to an increase in turnover of £76.2 million. The wet summer weather reduced consumption from metered customers and overall lower metered consumption year on year reduced turnover by £19.3 million. New growth, net of the impact of meter optants, increased turnover by £1.1 million which was offset by other decreases amounting to £4.5 million. Underlying PBIT was stable year on year at £500.9 million. Direct operating costs increased by £18.4 million (see below), there was an increase in infrastructure renewals expenditure of £18.8 million and depreciation, profit on disposal of fixed assets and release of deferred income, increased by £14.4 million.

In the following analysis costs related to private drains and sewers of £10.4 million (£4.7 million incurred in the prior year) have been excluded to give a consistent view of operating costs year on year. In total, controllable costs were up £1.2 million, or 0.3%. Employment costs increased by 12.1% to £225.0 million partly due to delivery of service improvements and the growth in our capital programme which led to labour and related overheads capitalised £9.9 million higher than in 2012 at

£86.8 million. Hired and contracted costs decreased by £13.6 million to £139.1 million. Overall net labour costs, including hired and contracted, were 0.3% higher year on year. Raw materials and consumables at £43.4 million were 7.3% lower than the same period in the prior year. Other operating costs increased by £3.8 million to £46.7 million.

In total, non-controllable costs were up £12.5 million or 6.6%. Bad debts were 5.0% higher at £31.8 million, representing 2.2% of turnover (UK GAAP), stable year on year. An increase of £6.1 million in net power costs to £57.9 million arose due to increased consumption as a result of the wet weather and higher strike prices on our energy swaps. Quasi taxes, which comprise rates, service charges and the Carbon Reduction Commitment, increased by £4.9 million to £112.5 million, mainly due to an increase in rates.

During the financial year, Severn Trent Water invested £555.4 million (UK GAAP after deducting grants and contributions) (2012: £474.2 million) in fixed assets and maintaining and improving its infrastructure network. Included in this total was net infrastructure renewals expenditure of £147.7 million (2012: £128.9 million), charged to the income statement under IFRS.

### Non-regulated – Severn Trent Services

|   | 2013<br>£m | 2012<br>£m | Increase/<br>(decrease)<br>% |
|---|------------|------------|------------------------------|
| <b>Turnover</b>                         |            |            |                              |
| Services as reported                    | 328.5      | 332.3      | (1.1%)                       |
| Structural changes                      | (21.1)     | (40.7)     |                              |
| Impact of exchange<br>rate fluctuations | –          | 0.3        |                              |
| Like for like                           | 307.4      | 291.9      | 5.3%                         |

|   | 2013<br>£m | 2012<br>£m | Increase/<br>(decrease)<br>% |
|---|------------|------------|------------------------------|
| <b>Underlying PBIT</b>                  |            |            |                              |
| Services as reported                    | 12.7       | 18.0       | (29.4%)                      |
| Structural changes                      | 1.2        | (3.5)      |                              |
| Impact of exchange<br>rate fluctuations | –          | (0.1)      |                              |
| Like for like                           | 13.9       | 14.4       | (3.5%)                       |

In Severn Trent Services, the sale of our Analytical Services and Metering Services businesses further focused this segment on the water and waste water markets we serve. There was like for like growth in sales year on year in both our core Operating Services and Water Purification businesses. However both businesses were impacted by exceptional costs totalling £14.6 million, the detail of which is in the exceptional items section below.

Reported turnover was £328.5 million in 2012/13, a decrease of 1.1% vs. the prior year, and reported underlying PBIT decreased by 29.4% to £12.7 million.

## Business review Financial review

After adjusting for changes in the group and the impact of exchange rate fluctuations turnover on a like for like constant currency basis was up 5.3% and underlying PBIT measured on the same basis was down 3.5%.

### Operating Services

Turnover for the year on a like for like basis was £194.1 million, an increase of 0.2% compared with the prior year.

### Water Purification

Turnover for the year on a like for like basis was £113.4 million, an increase of 15.7% compared with the prior year.

### Corporate and other

Corporate overheads amounted to £14.1 million (2012: £15.6 million). Our other businesses generated an underlying loss of £3.2 million (2012: profit of £0.1 million). This included an underlying loss on our captive insurance activity of £1.8 million and an underlying loss of £0.9 million in our renewables business arising mainly from feasibility and other similar costs written off. There were exchange gains in Corporate of £0.3 million (2012: £0.1 million).

### Exceptional items

There were net exceptional items before tax in the year to 31 March 2013 of £5.8 million (2012: £50.9 million) including exceptional operating costs of £4.3 million (2012: £34.4 million) which are described in further detail below and a net exceptional loss on disposal of businesses of £1.5 million.

Exceptional operating costs included:

- in Severn Trent Water, a profit of £13.3 million arising from the disposal of a number of properties, and
- in Severn Trent Services exceptional costs of £14.6 million comprising:
  - impairment charges totalling £9.1 million; including writing off the remaining goodwill invested in Spain (£4.6 million) as economic conditions in this country show no signs of improvement and the balance (£4.5 million) impairing all historical investment in the development of a purification product which is showing poor performance in testing,
  - provisions totalling £5.5 million; including provisions for a commercial legal dispute and for senior personnel restructuring charges at Operating Services in Italy; and
- in Corporate there were exceptional costs of £3.0 million related to professional fees for a transaction that did not proceed.

### Net finance costs

The group's net finance costs before exceptional items were £231.9 million, compared with £229.0 million in the prior year. There were exceptional finance costs in the prior year of £16.5 million arising from the early redemption of debt. Total finance costs were £231.9 million (2012: £245.5 million).

The effective interest rate, including index linked debt, for the year was 5.9% (2012: 6.4%). The cash interest rate was 4.9% (2012: 5.0%). RPI was lower year on year resulting in a reduction in the non-cash interest charge. This was offset by an increased cash interest charge on a higher level of net debt.

### Losses on financial instruments

The group uses financial derivatives solely to hedge risks associated with its normal business activities including

- exchange rate exposure on borrowings denominated in foreign currencies;
- interest rate exposures on floating rate borrowings, and
- exposures to increases in electricity prices.

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

Where the derivatives are held to their full term, these mismatches are expected to net out. Furthermore, the changes in value that are recorded during the lives of the derivatives, unless crystallised, do not represent cash flows. Therefore the group presents adjusted earnings figures that exclude these non-cash items. An analysis of the amounts charged to the income statement in the period is presented in note 12 to the financial statements.

### Profit before tax

Underlying group profit before tax decreased by 3.3% to £266.3 million (2012: £275.3 million). Group profit before tax was £215.2 million (2012: £156.7 million).

### Taxation

The current year tax charge before exceptional items was £57.1 million (2012: charge of £69.2 million). A prior year current tax credit of £29.2 million (2012: credit of £8.7 million) has arisen due to adjustments to prior year tax computations. These primarily related to an industry agreement over the treatment of infrastructure income. The deferred tax credit before exceptional tax was £4.7 million (2012: credit of £9.1 million).

The group's UK subsidiary companies have adopted the new accounting standard FRS 101 in the current year. This has changed the statutory accounts that form the basis for those companies' corporation tax computations. The most significant impact of this change is that certain amounts that had been taxed in previous years will now be recognised as profits and taxed in future periods. Therefore, to prevent such items being taxed twice, the tax already paid on such items is repayable. The impact of this change was an exceptional credit of £40.5 million to current tax and an exceptional charge of £38.8 million to deferred tax.

There was an exceptional credit of £36.7 million (2012: £69.1 million) arising from the reduction in corporation tax rate from 24% to 23% with effect from 1 April 2013.

The total tax credit for the year was £15.2 million (2012: credit of £17.7 million).

The underlying effective rate of current tax, excluding prior year credits and exceptional tax credits, calculated on profit before tax, exceptional items before tax and gains/(losses) on financial instruments was 25.4% (2012: 25.7%).

We expect the effective rate of current tax, as defined above, for 2013/14 to be in the range of 23% to 25%.

**Business review Financial review****Profit for the period and earnings per share**

Profit for the period was £230.4 million (2012: £174.4 million).

Adjusted basic earnings per share (before exceptional items, gains/(losses) on financial instruments and deferred tax) were 98.9 pence (2012: 88.9 pence) (see note 15). Basic earnings per share were 95.7 pence (2012: 72.5 pence).

**Cash flow**

|                                    | 2013<br>£m | 2012<br>£m |
|------------------------------------|------------|------------|
| Cash generated from operations     | 731.2      | 725.9      |
| Net capital expenditure            | (401.8)    | (351.2)    |
| Net interest paid                  | (233.4)    | (210.4)    |
| Tax (paid)/received                | (72.5)     | (72.0)     |
| Other cash flows                   | (0.5)      | (1.0)      |
| Free cash flow                     | 23.0       | 91.3       |
| Acquisitions and disposals         | 11.1       | —          |
| Dividends                          | (322.0)    | (159.0)    |
| Net issue of shares                | 5.3        | 2.4        |
| Change in net debt from cash flows | (282.6)    | (65.3)     |
| Non-cash movements                 | (46.9)     | (33.7)     |
| Change in net debt                 | (329.5)    | (99.0)     |
| Net debt 1 April                   | (3,967.8)  | (3,868.8)  |
| Net debt at 31 March               | (4,297.3)  | (3,967.8)  |
| <b>Net debt comprises:</b>         |            |            |
| Cash and cash equivalents          | 403.6      | 295.1      |
| Bank overdrafts                    | (0.4)      | (0.4)      |
| Cross currency swaps hedging debt  | 100.7      | 135.9      |
| Bank loans                         | (758.7)    | (852.5)    |
| Other loans                        | (3,840.9)  | (3,326.9)  |
| Finance leases                     | (201.6)    | (219.0)    |
|                                    | (4,297.3)  | (3,967.8)  |

Cash generated from operations was £731.2 million (2012: £725.9 million). Capital expenditure net of grants and proceeds of sales of fixed assets was £401.8 million (2012: £351.2 million). Net interest paid increased to £233.4 million (2012: £210.4 million).

Net debt at 31 March 2013 was £4,297.3 million (2012: £3,967.8 million). Balance sheet gearing (net debt/net debt plus equity) at the year end was 83.6% (2012: 80.2%). Net debt, expressed as a percentage of Regulatory Capital Value at 31 March 2013 of £7,364 million was 58.4% (2012: 56.0%).

The group's net interest charge, excluding gains/(losses) on financial instruments and net finance costs from pensions, was covered 3.4 times (2012: 3.4 times) by profit before interest, tax, depreciation and exceptional items, and 2.1 times (2012: 2.2 times) by underlying PBIT.

The fair value of the group's net debt at 31 March 2013 is estimated to be £5,071.1 million (2012: £4,579.3 million) compared to the book value of £4,297.3 million (2012: £3,967.8 million). Discounted future cash flows are used to determine fair values for debt. Discount rates are derived from yield curves based on quoted interest rates and are adjusted for the group's credit risk.

**Treasury management and liquidity**

The group's principal treasury management objectives 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 maintain an investment grade credit rating, and
- to maintain a flexible and sustainable balance sheet structure

The group continues to carefully monitor liquidity. At 31 March 2013 the group had £403.6 million in cash and cash equivalents and committed undrawn facilities amounting to £500 million. The group is funded for its investment and cash flow needs up to January 2015.

In July 2012 the group issued a £75 million sterling denominated RPI linked bond in the retail bond market. A coupon of 1.3% is payable on the notes which are due to mature in July 2022.

In January 2013 the group issued £500 million 3.625% Guaranteed Notes under its Euro Medium Term Note programme. The notes have a 13 year term.

Cash is invested in deposits with highly rated banks and liquidity funds and the list of counterparties is regularly reviewed and reported to the board.

**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.

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 the 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's current policy for the management of interest rate risk requires that not less than 45% of the group's borrowings should be at fixed interest rates, or hedged through the use of interest rate swaps or forward rate agreements. At 31 March 2013, interest rates for 76.8% of the group's net debt of £4,297.3 million were fixed.

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. We have investments in various assets denominated in foreign currencies, principally the US dollar and the euro. Our current policy is to hedge an element of the currency translation risk associated with certain foreign currency denominated assets.

The group issues notes in foreign currency under its Euro Medium Term Notes (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.

The group holds interest rate swaps with a net notional principal of £364.9 million and cross currency swaps with a net notional principal of £610.2 million which economically act to hedge the interest rate risk on floating rate debt or the exchange rate risk on certain foreign currency borrowings. However, the swaps do not meet the hedge accounting rules of IAS 39 and therefore the changes in fair value are taken to gains/(losses) on financial instruments in the income statement. During the year there was a charge of £26.0 million in relation to these instruments. Some of these swaps, which were entered into in 2000-2005, include options for the counterparty to terminate the contracts at specified points in their lives. During the year the group terminated three of these contracts at a cash outlay of £44.3 million. These swaps had a notional principal amount of £100.0 million. As a result of the termination the corresponding amount of our net debt will now be subject to current market interest rates, which are presently lower than the amounts that were payable under the swaps.

The fair value at 31 March 2013 of remaining swaps with termination options was a liability of £110.0 million and their aggregate notional principal amount was £275.0 million. The next termination options for the remaining swaps occur between November 2014 and May 2016 and the group will actively manage its exposure to these contracts over that period.

The group has entered into a series of forward starting interest rate swaps with a notional principal amount of £450.0 million that hedge the interest rate risk on the anticipated borrowing requirements of Severn Trent Water for AMP5. These swaps are treated as cash flow hedges and the changes in fair value are taken to other comprehensive income.

The group manages its electricity costs through a combination of forward price contracts and financial derivatives. All of our power requirements for the first four years of AMP5 and some of the remaining year have been hedged in this way, at prices below those allowed in the Final Determination.

The group's long term credit ratings are:

| Long term ratings   | Severn Trent Plc | Severn Trent Water |
|---------------------|------------------|--------------------|
| Moody's             | Baa1             | A3                 |
| Standard and Poor's | BBB-             | BBB+               |

### Pensions

The group operates two defined benefit pension schemes, of which the Severn Trent Pension Scheme (STPS) is by far the largest. Formal triennial actuarial valuations and funding agreements for the STPS were renewed as at 31 March 2010. The next triennial valuation as at 31 March 2013 is currently underway. Deficit reduction contributions include a payment of £10.0 million per annum in cash and a further £8.2 million per annum through an asset backed funding arrangement.

The final salary sections of the pension schemes were closed to new entrants in 2006 and the age profile of scheme participants is expected to rise and hence service costs are also expected to rise until the schemes are closed to future accrual.

The defined benefit pension schemes will close to future accrual on 31 March 2015. A new defined contribution pension scheme has been established and members of the defined benefit pension schemes will then become members of the new defined contribution pension scheme. The existing defined contribution pension scheme will also be replaced by the new pension arrangements with effect from 1 April 2015. From 1 April 2012 new employees have been automatically enrolled into this scheme and those employees who were not members of a Severn Trent scheme were automatically enrolled into this scheme from 1 April 2013.

The key actuarial assumptions for the defined benefit schemes have been updated for these accounts. On an IAS 19 basis, the estimated net position of the schemes was a deficit of £383.7 million at 31 March 2013. This compares to a deficit of £345.8 million at 31 March 2012. The movements in the net deficit are summarised in note 27. The funding level has remained constant at 81.8%.

The major assumptions used in the valuation of the defined benefit pension schemes were as follows:

|                                      | 2013<br>% | 2012<br>% |
|--------------------------------------|-----------|-----------|
| Price inflation                      | 3.2       | 3.1       |
| Salary increases                     | 3.0       | 3.6       |
| Pension increases in payment         | 3.2       | 3.1       |
| Pension increases in deferment       | 3.2       | 3.1       |
| Discount rate                        | 4.4       | 4.9       |
| Long term rate of return on equities | 6.6       | 6.8       |

|   |      |      |
|---|------|------|
| Remaining life expectancy for members currently aged 65 (years) |      |      |
| - men   | 21.5 | 21.2 |
| - women   | 24.6 | 25.1 |

|   |      |      |
|---|------|------|
| Remaining life expectancy at age 65 for members currently aged 45 (years) |      |      |
| - men   | 22.7 | 21.8 |
| - women   | 26.2 | 25.9 |

The following table summarises the estimated impact on scheme liabilities resulting from changes to key actuarial assumptions whilst holding all other assumptions constant.

| Assumption      | Change in assumption                  | Impact on scheme liabilities       |
|-----------------|---------------------------------------|------------------------------------|
| Discount rate   | Increase/decrease by 0.1%             | Decrease/increase by £38.0 million |
| Price inflation | Increase/decrease by 0.1%             | Increase/decrease by £35.0 million |
| Mortality       | Increase in life expectancy by 1 year | Increase by £55.0 million          |

### 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.



## Risk management

### Our approach to risk

Across the group our approach to risk balances the need to effectively manage inherent risks and also the opportunity to improve our performance through selected risks.

Within the largest part of our group, Severn Trent Water, 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 business is such that there are some significant inherent risks as illustrated in the section headed 'Principal risks'. We aim to have a strong control framework in place to enable us to understand our risks and manage them effectively.

Although the Severn Trent Services businesses are not generally regulated, we provide products and services for clients who operate in regulated environments and, as a result, we take a similar approach to risk.

Across the group the management of risks takes place within the overall governance framework which includes clear accountabilities and delegated authority limits.

### Our Enterprise Risk Management process

We continue to use our established Enterprise Risk Management (ERM) process across the group to assess and manage our most significant risks. We analyse both the possible causes of a risk and what the impact would be if the risk occurred. Using this process, we are able to consider the controls needed to minimise the likelihood of risks occurring and those which can help to maximise our resilience to risks. Our assessment of risks includes explicit consideration of the possible impact of the risk on the reputation of the group as a whole. The understanding which we are able to gain from our ERM process allows us to put in place effective mitigation strategies.

Key risks are reported to the Audit Committee and to the board every six months in the form of risk maps.

In addition, individual risks or specific risk topics are also discussed by the board during the year. We also have regular risk 'deep dives' at our executive team meetings. These take the form of updates from individual business teams within Severn Trent Water on their progress with improving controls and providing effective mitigation for their most significant risks.

We have also continued with our work to make sure that the annual business planning process within Severn Trent Water is closely aligned to the ERM process so that we can be confident that our business plans adequately address key risk areas.

### Principal risks

There are a number of significant risks which are inherent to companies operating water and sewage treatment works, distribution networks and related activities. These are shown on our business models on pages 14 to 15 and 26 to 27 and include:

- we, or our clients, operate in heavily regulated environments and are subject to many varied, complex and changing obligations. As result, we face risks associated with non-compliance;
- Severn Trent Water has an extensive network of assets and the failure of key individual or collections of these assets could result in a significant impact on our core business activities;
- we face risks to the health, safety and well-being of our people, customers and contractors as a result of the nature of our operations;
- our business operations depend on the effective performance of key supply chain partners;
- we share a concern with many other businesses over our ability to fund long term pension promises; and
- we share concerns with other businesses over access to funding and over the security of funds placed with counterparties, particularly in the current unsettled economic climate.

Where appropriate, these are discussed in the table of principal risks overleaf.

### Risk management in practice

Our assets right across our region work 24 hours a day seven days a week to provide water to our customers or to take away and treat our customers' waste water. With so many assets working so many hours, occasionally things break down and we need to know about this as soon as possible so that services to our customers are not affected.

We have systems in place to monitor the performance of assets and processes so that we can be alerted as soon as possible to potential problems. A few examples include devices to monitor water levels in our sewerage networks, chlorine levels in our water distribution network and levels of water stored in our reservoirs.

The monitoring of our processes is critical to us and the ERM process has helped us to highlight the risks associated with the failure of this monitoring system and has allowed us to put controls in place. For example, we have reviewed our stock of critical spares to ensure continuous monitoring can be achieved, established an auditable process to track changes to the monitoring software combined with a planned back-up of the programme; and have set up Framework Agreements (contracts) with our business partners to support us with maintaining the system.

Effective risk control within these systems helps to reduce interruptions to customer supplies, and minimise the risk of sewer flooding and pollution events.

## Business review Risk management

| Ref                                     | What is the risk?   | Which part of Severn Trent is affected? | What does it mean for us?  | What are we doing to manage the risk?  |
|---|---|---|--|--|
| <b>Customer Perception</b>              |   |   |  |  |
| 1                                       | We may be unable to improve and maintain our levels of customer service sufficiently to deliver what our customers tell us they want.   | Severn Trent Water                      | <p>Failure to deliver the service customers expect will lead to customer dissatisfaction and as a result we may not gain customers' support for our business plan for the next price review period (AMP6) between 2015-2020</p> <p>If we are unable to provide the level of service we want to our customers we may also suffer financial penalties under Ofwat's SIM</p>  | <p>We have co-ordinated programmes of work underway across all parts of Severn Trent Water to improve our processes and our technology to enable us to deliver outstanding customer service</p> <p>We are pleased that we are the most improved water and sewerage company in the UK in terms of customer satisfaction as measured by Ofwat's SIM measures. Whilst our performance in the league tables has significantly improved, it is still not as good as we would like</p> <p>We will continue with our organisation wide improvement programmes which include looking for ways to make our processes as customer-friendly as possible</p>   |
| 2                                       | We may be unable to respond effectively to the opening up of the business retail market to competition.   | Group wide                              | We may lose income as a result of business retail customers moving to competitors or we may fail to successfully grow our business by offering a more attractive service which results in customers moving to us.  | <p>We have worked to improve our levels of service for all customers and we continue to focus on offering the lowest charges.</p> <p>Within Severn Trent Water, we are developing a strategy for improving our offering to large business customers and we are implementing the necessary organisational and system changes needed to better serve these customers.</p>  |
| <b>Legal and Regulatory Environment</b> |   |   |  |  |
| 3                                       | We may be unable to effectively anticipate and/or influence future developments in the UK water industry resulting in our business plans becoming unsustainable.                                    | Severn Trent Water                      | The major part of our business, 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.   | <p>Our joint publication with National Grid, 'Changing course through sustainable financing' which was published during the year set out our proposals for securing the long term future of the UK water industry</p> <p>We will continue to engage with our peers, Ofwat and other regulators, UK Government departments and other stakeholders to influence the direction of regulatory policy where possible.</p>   |
| 4                                       | Ofwat may not support our business plan submission for the next price review period (AMP6) for 2015-2020, or we may fail to meet some of the targets agreed with Ofwat in our current business plan | Severn Trent Water                      | <p>We submit a business plan to Ofwat every five years. When we submit our plans, there is a risk that they will not achieve the required Ofwat assessment level. This may result in more changes being required to the plan.</p> <p>There is a risk that we will be unable to deliver all of our agreed objectives in our current plan. Failure to achieve the targets could result in Ofwat being less willing to support our business plan submission for the next price review period and could result in additional funding requirements in the current period.</p> | <p>In developing our five year plan for the next price review period, we have worked closely with our customers and with our independent customer challenge group, the Water Forum, to ensure our plans reflect customers' priorities.</p> <p>We operate an established and robust internal business planning process. We review and update our business plan on an annual basis. Progress against the targets agreed in our annual business plans is monitored each quarter. This enables us to make adjustments to planned activities if we identify any concerns about our ability to achieve our annual plans or the five year plan agreed with Ofwat.</p> <p>We will continue to monitor achievement of our current plan and to engage with the Water Forum to validate our proposals for the next price review period.</p> |

## Business review Risk management

| Ref                                  | What is the risk?   | Which part of Severn Trent is affected? | What does it mean for us?   | What are we doing to manage the risk?   |
|--------------------------------------|---|---|---|---|
| 5                                    | The regulatory landscape is complex and subject to ongoing change. There is a risk that processes may fail or that our processes may not effectively keep pace with changes in legislation leading to the risk of non-compliance. | Group wide                              | Our policies and processes must reflect the current legal and regulatory environment and all relevant employees must be kept aware of new requirements. Due to the spread of our operations, and changes in activity and organisational structure this is not always straightforward. The group as a whole may face censure for non-compliance in an individual group company or a specific region in which we operate.   | <p>We have a group wide code of conduct 'Doing the right thing – The Severn Trent way' together with policies, standards, procedures and relevant training for employees to mitigate this risk.</p> <p>During the year, we have continued with our extensive programme to raise awareness of updated policies. This has included e-learning for relevant employees in relation to Competition Law and Anti-Bribery and Corruption legislation.</p> <p>We will continue our programme of training and raising awareness. We are also carrying out a review of the mechanisms by which we gain assurance that policies are fully complied with across the group to ensure these mechanisms remain fit for purpose.</p>  |
| <b>Operations, assets and people</b> |   |   |   |   |
| 6                                    | Our assets or processes may fail resulting in injury to an employee, contractor or member of the public.  | Group wide                              | The nature of our work requires our employees and contractors to undertake activities or to use equipment which have potential to cause serious harm. Whilst we take every precaution to prevent injury, asset failure or failure to follow agreed processes may result in someone being hurt. Specific examples include injury to our employees using chemicals in our processes. Additionally, failure of one of our key assets such as a reservoir could result in injury to customers or members of the public. | <p>We have clearly identified roles, responsibilities, standards and processes for controlling health, safety and well-being risks. Our strategy, which seeks to ensure that no one gets hurt or made unwell by what we do, includes improvement activity on the management system, behavioural safety culture and occupational health with a focus on preventing incidents. At a local level, safety improvement teams identify and address hazards. We monitor safety performance and have delivered year on year reductions in incidents and increases in prevention activity.</p> <p>Our assets are subject to regular and rigorous monitoring including independent inspection of our reservoirs to ensure that they remain safe and that maintenance work is undertaken where needed.</p> <p>We will continue with our programme of safety education and improvements and with our rigorous monitoring and maintenance regimes for critical assets.</p> |
| 7                                    | We may fail to meet all of our regulatory targets including targets from Ofwat in relation to ongoing operational performance of our assets resulting in regulatory penalties.  | Severn Trent Water                      | <p>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.</p> <p>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.</p>  | <p>We continue to monitor and invest in our assets and to improve our processes in order to maintain our services to our customers. We have continued our major programmes of work to review all aspects of our operations, including the necessary improvements to maintain continuous supplies, ensure water quality, reduce sewer collapses and sewer flooding and improve environmental performance.</p> <p>Our business plan submission for the price review period from 2015-2020 will include the necessary funding for upgrades and improvements to our assets to allow us to continue to provide good quality water and to effectively treat waste water for our customers.</p>  |

## Business review Risk management

| Ref                    | What is the risk?   | Which part of Severn Trent is affected? | What does it mean for us?   | What are we doing to manage the risk?  |
|------------------------|---|---|---|--|
| 8                      | Failure of certain key assets may result in an inability to provide a continuous supply of quality water to large populations within our area, or in damage to third party property | Severn Trent Water                      | Some of our assets are critical to the provision of water to large populations for which there are limited alternative means of supply. These assets are regularly inspected and maintained and our assessment of the overall condition is good. If a failure were to occur the consequence would result in temporary inability to continue to serve our customers. | <p>We have asset management plans in place which drive investment in maintenance and improvement of our assets in order to maintain our service to customers.</p> <p>We also have security measures to protect our assets and contingency plans to maintain supplies in the event of failure</p> <p>We will continue to develop and implement asset management plans to ensure the long term sustainability of our services.</p>   |
| <b>Financial Risks</b> |   |   |   |  |
| 9                      | The current economic climate may increase the difficulties associated with obtaining funding for the group (at similar rates to those assumed in our business plan)                 | Group wide                              | As a result of current market conditions and economic conditions across the eurozone, there may be increased difficulty for all businesses to obtain funds. We may therefore be unable to meet all of our funding requirements at commercially attractive rates.  | <p>We ensure we maintain access to funds through cash held on short term deposit and through our committed borrowing facilities. We constantly monitor the possible impacts of economic conditions on the funding requirements for the group. We have diversified sources of funding and have a timetable for replacement of committed lending facilities which allows us more than one opportunity to go to market in order to mitigate against short term problems in the marketplace</p> <p>We will continue to monitor our financial position and future requirements and to maintain access to a diversified source of funds. We will also continue our strategy of early refinancing where this is beneficial to the group</p> |
| 10                     | Changing demographics and fluctuations in the investment market may affect our ability to fund pension promises sustainably   | Group wide                              | We already provide significant funding. We may be called upon to provide more money to reduce deficits in our pension schemes.  | <p>We regularly revalue our schemes and monitor our investment performance.</p> <p>We have introduced new pension arrangements which we believe will be fairer for all our employees as well as reducing the build up of deficit in future years, thus allowing us to continue to fund pensions sustainably into the future</p> <p>We will continue to monitor the performance of our pension investments and to work closely with our third party advisors to ensure that the schemes are managed effectively</p>   |
| 11                     | Counterparties with whom we have invested money may fail, putting our investment at risk.   | Group wide                              | From time to time we may have considerable sums available which we have not yet invested in agreed capital programmes, and we need to manage this in the most advantageous way for our customers and shareholders. However, with any investment there is a risk of default which could result in financial loss.  | <p>We have strict policies which restrict the counterparties we can invest with and limit the amount which can be invested with individual counterparties. We continuously monitor the credit status of all our counterparties to ensure we only deposit with those who have good credit status. Compliance with our policies is monitored continuously to mitigate this risk.</p> <p>We will continue to monitor the external market environment and maintain our policies to mitigate this risk.</p>   |

## Governance

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## Board of directors

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### Dr Tony Ballance

BSc (Hons) MA (Econ) PhD (48)

*Director, Strategy and Regulation*

*Appointed to the board on 2 October 2007*

Tony's extensive experience in utility policy and regulation leaves him ideally placed to lead the company's strategic and regulatory work. Prior to joining Severn Trent he held the posts of Chief Economist for Ofwat, economic consultant, director of London Economics and was a director of Stone and Webster Consultants.

#### External appointments

Member of Water UK Council

#### Committee membership

Executive Committee

Image removed

### Dr Bernard Bulkin

BS PhD FRSC FRSA FIE (71)

*Independent non-executive director*

*Appointed to the board on 1 January 2006*

Bernard's successful and wide ranging career in academia and business has provided him with in depth experience in scientific, technology and engineering industries. He held the prominent position of Chief Scientist of BP Plc. His involvement in both innovation and policy on climate change and renewable energy, and his significant skills and experience in delivering performance improvement on safety and environmental operational issues, make his contribution to the board invaluable.

#### External appointments

Non-executive director of Ze-gen Corporation (US)

Non-executive Chairman of Pursuit Dynamics plc

Chair of the Office of Renewable Energy Deployment at the UK Department of Energy and Climate Change

#### Committee membership

Audit Committee

Corporate Responsibility Committee (Chairman)

Nominations Committee

Remuneration Committee

Image removed

### Richard Davey

BA (64)

*Senior independent non-executive director*

*Appointed to the board on 1 January 2006*

Richard spent the majority of his executive career in investment banking at NM Rothschild and Sons, in roles including Head of Investment Banking. Richard brings invaluable specialist financial expertise to the board, the Audit Committee and as chair of the Remuneration Committee, having run Rothschild's Financial Services Group and worked with a number of high street banks and insurers. Previously he held non-executive roles at Yorkshire Building Society, where he was Vice Chairman, Freeserve Plc and Scottish Widows Fund and Life Assurance Society

#### External appointments

Non-executive Chairman, member of the Audit and Nomination Committees of Amfin Plc

#### Committee membership

Audit Committee

Nominations Committee

Remuneration Committee (Chairman)

Image removed

### Martin Lamb

BSc MBA (53)

*Independent non-executive director*

*Appointed to the board on 29 February 2008*

Martin has extensive experience of managing and developing large engineering businesses in all parts of the world. Martin has worked for IMI for over 25 years where he has held a number of senior management roles. His strong commercial acumen, experience of managing complex projects, and familiarity with current market pressures as a serving Chief Executive leave him well placed to add value to the Severn Trent business. Previously Martin was a non-executive director of Spectris plc.

#### External appointments

Chief Executive and member of the Nominations Committee of IMI plc

Member of the Advisory Board of AEA

Investors (UK) Limited

#### Committee membership

Nominations Committee

Remuneration Committee

Image removed

### Michael McKeon

MA CA (56)

*Finance Director*

*Appointed to the board on 13 December 2005*

Michael brings significant financial and commercial expertise to the board and has over seven years' experience of the Severn Trent group. Prior to joining Severn Trent he was Finance Director of Novor Plc and before that, held various senior roles with Rolls-Royce Plc, including Finance Director of Aerospace Group. He has extensive international business experience having worked overseas for CamouidMetabox, Elf Atochem and Price Waterhouse. Michael is a Chartered Accountant and a Member of the Institute of Chartered Accountants of Scotland

#### External appointments

Non-executive director and Chairman of the

Audit Committee of The Merchants Trust Plc

#### Committee membership

Executive Committee

Image removed

### Baroness Noakes

DBE LLB FCA (63)

*Independent non-executive director*

*Appointed to the board on 29 February 2008*

Sheila brings valuable expertise to the board as an experienced director and Audit Committee Chairman of UK listed companies and with extensive and varied professional, political and public sector experience. A qualified chartered accountant, she previously headed KPMG's European and International Government practices and has been President of the Institute of Chartered Accountants in England and Wales. Sheila was appointed to the House of Lords in 2000 and has served on the Conservative front bench in various roles including as shadow treasury minister between 2003 and May 2010. Previously she held non-executive roles on the Court of the Bank of England, Hanson Plc, ICI Plc, John Laing and STree

#### External appointments

Non-executive director, member of the Group Audit, Group Nominations and Board Risk Committees of The Royal Bank of Scotland Group Plc

Deputy Chairman, senior independent director and Chairman of the Nominations Committee of Carpetright Plc

Trustee of the Thomson Reuters Founders Share Company

#### Committee membership

Audit Committee (Chairman)

Nominations Committee

## Governance Board of directors

Image removed

**Andrew Duff**

BSc FEI (54)

*Non-executive Chairman**Appointed to the board on 10 May 2010 and Chairman on 20 July 2010*

Andrew's extensive experience of international and regulated business, strategic management and customer service in high profile, dynamic environments have 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 its daughter company Innogy plc upon its demerger from National Power in 2000. He led the restructuring and subsequent sale of Innogy to RWE in 2003. He became CEO of the successor company, npower, and a member of the RWE Group Executive Committee. He was non-executive Chairman of RWE npower until his retirement in December 2010.

**External appointments**

Senior independent director, Chairman of the Remuneration Committee, member of the Audit Committee and Nominations Committee of Wolsley Plc. Member of the CBI President's Committee. Trustee of Macmillan Cancer Support and Earth Trust. Fellow of the Energy Institute.

**Committee membership**

Corporate Responsibility Committee  
Nominations Committee (Chairman)  
Remuneration Committee

Image removed

**Gordon Fryett**

(59)

*Independent non-executive director**Appointed to the board on 1 July 2009*

Gordon's extensive experience working in and with international businesses, managing significant capital expenditure and in depth retail expertise at both executive and operational level in a customer facing, highly competitive environment, enables him to bring substantial experience and expertise to the board. He is currently Group Property Director at Tesco Plc, having previously held a number of senior roles within the Tesco Group, including Operations Director, International Support Director and CEO Republic of Ireland.

**External appointments**

Alumnus of INSEAD

**Committee membership**

Corporate Responsibility Committee  
Nominations Committee

Image removed

**Martin Kane**

BSc CEng CEnv MICE MIWEM FIW (60)

*Chief Executive Officer, Severn Trent Services**Appointed to the board on 2 October 2007*

Martin joined Severn Trent Water in 1975 and 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 Water, from May 2006 until January 2012, when he was appointed Chief Executive Officer of Severn Trent Services.

**External appointments**

Member of the boards of Utilities and Service Industries Training Limited and National Association of Water Companies (US).  
Trustee of International Society for Trenchless Technology.

**Committee membership**

Executive Committee

Image removed

**Andy Smith**

BTech (Hons) (52)

*Director of Water Services**Appointed to the board on 2 October 2007*

Andy brings a broad range of executive and operational expertise gained from diverse sectors to the board. Andy has significant experience having worked in the UK and overseas with global businesses such as BP, Mars and Pepsi, in engineering and operational management roles. Previously he was Group HR Director and a member of the board at Boots Group Plc.

**Committee membership**

Executive Committee

Image removed

**Tony Wray**

BSc (Hons) (51)

*Chief Executive**Appointed to the board on 7 March 2005**Tony became Chief Executive on 2 October 2007.*

His extensive experience in a wide range of operational and strategic leadership roles in the energy, telecoms, water and waste industries enables him to bring a multi-disciplined approach to his contribution to the board. Tony brings to his position an in depth operational knowledge of Severn Trent and strategic vision for the group. Previously he was director of Networks at Eircom, the Republic of Ireland's telephone operation and has held director roles within Transco and National Grid Transco.

**External appointments**

Non-executive director, Chairman of the Board Risk and Compliance Committee and member of the Audit Committee of Granger plc.  
Member of Business Advisory Board for 'Living with Environmental Change'.  
Member of Water UK Board.

**Committee membership**

Corporate Responsibility Committee  
Executive Committee (Chairman)  
Nominations Committee

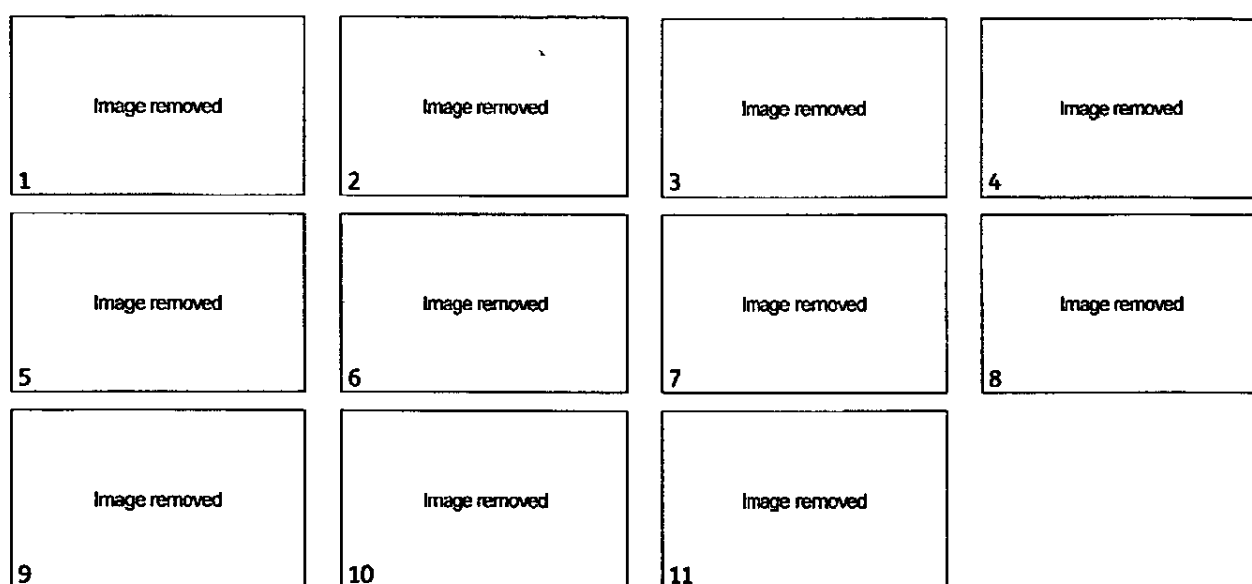
## Executive Committee

The Chief Executive is supported in his role by the executive management team and together they comprise the Executive Committee. During the year, the Executive Committee comprised the executive directors and senior executive managers responsible for key operational and central functions. Photographs of the members of the committee, together with their biographies are set out below

The Executive Committee oversees the development and execution of the Severn Trent strategy. It also has accountability for achieving business results. The terms of reference of the Executive Committee are available on the company's website ([www.severntrent.com](http://www.severntrent.com)) or from the Company Secretary

During the year, the Executive Committee met to consider strategy, business management, policy and planning, and operational performance

Members of the Executive Committee are delegated responsibility to sit on steering groups that oversee the delivery of our strategy and business management. During the year, steering groups were set up to oversee areas such as the integrated delivery of our year end results and Ofwat Annual Regulatory Returns.



**1. Dr Tony Ballance**  
BSc (Hons) MA (Econ) PhD (48)  
*Director, Strategy and Regulation*  
Please see full biography on page 44

**2. Simon Cocks**  
BA (Hons) (47)  
*Waste Water Services Director*  
Joined Severn Trent in July 2009. Simon is an electrical engineer by training. He previously worked for London Electricity in various operational and management roles and, more recently, for National Grid where he was Head of UK Operations Performance and Planning, then Commercial Director for the gas and electricity business in the UK and Europe and held the position of Chief Procurement Officer before joining Severn Trent. Simon is a board member of UK Water Industry Research.

**3. Evelyn Dickey**  
BSc (Hons) (50)  
*Director of Human Resources*  
Joined Severn Trent in November 2006. Evelyn has extensive HR experience leading design and delivery of major change programmes, business restructuring, employee relations, resourcing, executive remuneration, organisational capability and performance management initiatives. Before joining Severn Trent Evelyn worked in HR consultancy and as HR Director (HR Operations) for Boots the Chemists.

**4. Myron Hrycyk**  
MBA (56)  
*Chief Information Officer*  
Joined Severn Trent in April 2008. Myron has held senior IT posts for major organisations across a range of business sectors, Financial Services, Publishing, Automotive and Logistics/Supply Chain. He has delivered strategic IT and business transformation programmes, restructured corporate IT units and deployed high performance IT practices. Myron also has executive responsibility for Supply Chain & Procurement.

**5. Angela Hunter-Dobson**  
MA (Hons) (41)  
*Customer Relations Director*  
Joined Severn Trent in May 2012. Angela commenced her career with IBM during its transformation from manufacturing to services business. She has since held senior operational leadership positions for Barclays, Hiscax and Vodafone, delivering customer services across B2B, B2C, domestic, international, indirect and regulated markets. In addition to leading award winning customer operations, she has consulted widely in the area of customer service in multiple sectors.

**6. Martin Kane**  
BSc CEng CEIV MICE MIWEM FIW (60)  
*Chief Executive Officer, Severn Trent Services*  
Please see full biography on page 45

**7. Bronagh Kennedy**  
(BA) (Hons) (49)  
*General Counsel and Company Secretary*  
Joined Severn Trent in June 2011. Bronagh is a solicitor and was previously Group Company Secretary and General Counsel at Mitchells & Butlers, where she worked for 15 years. Prior to that, she was a Senior Associate at Allen & Overy

**8. Michael McKean**  
MA CA (56)  
*Finance Director*  
Please see full biography on page 44

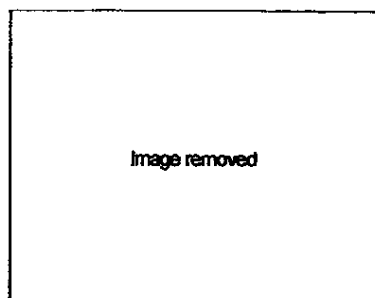
**9. Alec Richmond**  
BSc (Econ) FCA FIIA (55)  
*Director of Internal Audit*  
Joined Severn Trent in June 2007. Prior to that, he worked for Cadbury Schweppes Plc, leading the company's global internal audit service from 2000-2005. Before joining Severn Trent, he worked for RSM Robson Rhodes as a director and a member of the management board responsible for Risk Assurance Services. Alec is a fellow of the Institute of Chartered Accountants in England and Wales and the Institute of Internal Auditors.

**10. Andy Smith**  
BTech (Hons) (52)  
*Director of Water Services*  
Please see full biography on page 45

**11. Tony Wray**  
BSc (Hons) (51)  
*Chief Executive*  
Please see full biography on page 45



## Chairman's letter



Andrew Duff  
Chairman

### Governance in Severn Trent

#### The way we are structured

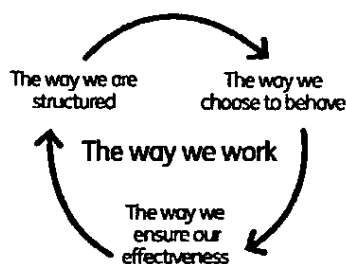
- Our organisation is structured to allow for effective and efficient decision making with clear accountabilities.

#### The way we choose to behave

- Our Code of Conduct: 'Doing the right thing - The Severn Trent way' sets out our approach to responsible business behaviours.
- The Code of Conduct is supported by 15 group policies and our behaviours model. Further details of these can be found on our website ([www.severntrent.com](http://www.severntrent.com))

#### The way we ensure our effectiveness

- We always look to ensure our people have the right skills in order to drive performance improvement.
- Management assurance is provided by a combination of effective management processes and risk and compliance activities.
- Independent assurance is provided primarily by Internal Audit, by our external auditors and other external bodies.



### Dear Shareholder

At Severn Trent, we are committed to delivering value to our stakeholders and building a sustainable business, which is underpinned by good governance. As a board we are accountable to shareholders for ensuring that effective governance processes are in place and complied with.

The board's role is to

- understand and meet its obligations to the company's stakeholders;
- govern the group within a framework of prudent and effective controls which enable risk to be assessed and managed,
- approve the group's strategic objectives; and
- ensure that sufficient resources are available to enable it to meet those objectives.

Good governance provides a framework that allows the right decisions to be taken by the right people at the right time

During the year I led the review of our board's effectiveness and looked at how we have made progress with the areas identified as requiring further improvement at the last review. We have overseen the continued embedding of our Code of Conduct across our businesses and reviewed our supporting policies

The following sections of this report set out how good governance supports our activities at Severn Trent and describe how the board applies the principles of the UK Corporate Governance Code - in the way we are structured, the way we choose to behave and the way we ensure our effectiveness.

I believe that assessing our governance arrangements in terms of these headings enables us to establish the right long term behaviours, which will help us to deliver the group's strategic objectives in a sustainable manner.

I firmly believe that we will continue to deliver value and achieve sustainable growth for our company through the successful mix of good governance, a clear strategy with a supporting business plan and a strong management team to execute it.

Andrew Duff  
Chairman

### Compliance with the UK Corporate Governance Code

The UK Corporate Governance Code 2010 (the 'Governance Code') was revised by the publication of the UK Corporate Governance Code 2012 in September 2012. The new code applies to financial years beginning on or after 1 October 2012, although we intend to comply early with the new code where appropriate and reasonably practicable. Our formal obligation for 2013 is to report how we have applied the principles of the current Governance Code.

The Governance Code is available on the Financial Reporting Council's website ([www.frc.org.uk](http://www.frc.org.uk)). For the whole of the financial year ended 31 March 2013, Severn Trent was compliant with the Governance Code, with the exception that the adequacy of arrangements in relation to the company's whistleblowing procedures falls within the remit of the Corporate Responsibility (CR) Committee, rather than the Audit Committee. The CR Committee's remit is to deal with any allegations from employees relating to any breaches under Severn Trent's Code of Conduct. The Audit Committee reviews reports of matters arising in respect of financial or internal control matters from the company's whistleblowing procedures and the company's procedures for preventing and detecting fraud and bribery, and receives reports on non-compliance. The board considers that these arrangements are appropriate.

## Governance report

### Group Authorisation Arrangements

The Group Authorisation Arrangements (GAA) are the framework through which the Severn Trent Plc board authorises the right people, at the right level, to take important decisions as we manage legal, financial and administrative issues throughout the group. The GAA are designed to facilitate good control, efficient decision making and demonstrable compliance.

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 issues, the delegated authority is subject to an obligation to work with specialist business services areas (such as Tax, Treasury, Group Finance and Company Secretariat) that provide additional expertise and a group wide perspective.

### Governance of subsidiaries

The membership of the board of the listed company, Severn Trent Plc, is the same as that of its regulated subsidiary, Severn Trent Water Limited. This structure was implemented in 2007 when it was decided to integrate the management of the companies to gain greater transparency and insight of Severn Trent Water by the Plc board.

Following his appointment as CEO of Severn Trent Services in January 2012, Martin Kane became a non-executive director of Severn Trent Water Limited.

The two companies operate as distinct legal entities. The boards comply with the Severn Trent Plc Board Governance document and the Severn Trent Water Limited Matters Reserved to the board. They are assisted through the management of separate agendas, meetings and minutes by Company Secretariat and advised in their meetings by the Company Secretary where appropriate.

Subsidiary company boards are required to be managed scrupulously with respect to legal, fiscal and administrative matters. In particular, the relationships between Severn Trent Water Limited and our other businesses such as Severn Trent Services are monitored and controlled to ensure that we comply with our obligations on arm's length transactions between them.

## The way we are structured

### Board membership

During the year under review the board has comprised your non-executive Chairman, five executive directors and five independent non-executive directors. Photographs of the members of the board, together with their biographies and a description of the complementary skills and wealth of experience that they bring to bear, can be found on pages 44 and 45.

We believe this unitary board brings an appropriate balance of innovation, experience, independence and challenge to ensure effective decision making.

In accordance with the Governance Code, all the directors will retire at this year's AGM and submit themselves for reappointment by the shareholders.

Details of our policy on diversity in the boardroom are provided in the Nominations Committee report on pages 52 and 53.

### Role of the Chairman

The role of Andrew Duff, your Chairman, is to lead a unitary board, facilitating the contribution of its members at its meetings, and to be responsible for ensuring that the principles and processes of the board are maintained in line with the board governance framework, which can be found on our website ([www.severntrent.com](http://www.severntrent.com)).

Agendas for board meetings are agreed by the Chairman in consultation with the Chief Executive and Company Secretary, although any director may request that an item be added to the agenda. The Chairman has authority to act and speak for the board between its meetings, including engaging with the Chief Executive. He reports to the board and committee chairmen as appropriate on decisions and actions taken between meetings of the board. He also meets with the non-executive directors without the executive directors present, to consider the performance of the executive directors and to provide feedback.

### Senior independent non-executive director

Richard Davey is your senior independent non-executive director. He chairs the Remuneration Committee and is a member of the Audit and Nominations Committees. The board has agreed that Richard will act as Chairman of the board in the event that the Chairman is unable to do so for any reason.

### Non-executive directors

Your non-executive directors are appointed to the board to contribute their individual external expertise and experience in areas of importance to the group. Their competences include corporate finance, general finance, corporate strategy, customer care, property, environmental and technology matters, general management and supply chain management. They also provide independent challenge and rigour in the board's deliberations and are encouraged to make independent assessments of the group's competences. The non-executive directors, led by the senior independent non-executive director, meet without the Chairman at least once a year for them to appraise the Chairman's performance. The non-executive directors and the Chairman also meet without the executive directors present at least once a year.

Your board has reviewed the status of the non-executive directors and considers them all to be independent in character and judgement as defined by the Governance Code.

**Chief Executive**  
Responsibility has been delegated to the Chief Executive, Tony Wray, to achieve the company's strategy. He is empowered to take all decisions and actions that further the company's strategy and which in his judgement are reasonable, having regard to the Chief Executive limits set out in the company's GAA. The non-executive directors, led by the Chairman, appraise his performance annually.

**Executive directors**  
The executive directors support the Chief Executive in driving the implementation of strategy forward in Severn Trent. They are committed to doing this in a responsible way which takes account of our commitment to long term sustainable and responsible stewardship of the business, the environment, our customers and the communities in which we live and work.

## Governance

### Reporting obligations

As a public listed company, the company is required to comply with a range of reporting obligations set out by law and regulation. The company is committed to the promotion of investor confidence by taking steps within its power to ensure that trade in its securities takes place in an efficient and informed market.

The company recognises the importance of effective communication as a key part of building shareholder value and that, to prosper and achieve growth, it must earn the trust of security holders, employees, customers, suppliers and communities, by being open in its communications and consistently delivering on its commitments.

The company announces its results on a half yearly basis and complies with the requirement to make interim management statements.

The Chief Executive has established a Disclosure Committee, chaired by the Finance Director, with specific responsibilities for the delivery of the interim and year end reporting processes. The Disclosure Committee oversees the delivery of an integrated plan incorporating all elements of the year end reporting process, namely the group's preliminary results announcement and report and accounts, the company's AGM, the statutory and regulatory accounts of Severn Trent Water Limited, the Annual Regulatory Compliance Statement and the Annual Regulatory Performance Report.

Graph removed

### Role of the Company Secretary

All directors have access to the advice and services of the Company Secretary, Bronagh Kennedy, and the Company Secretariat team. Bronagh is responsible for ensuring that the board operates in accordance with the governance framework it has adopted and that there are effective information flows to the board and its committees and between senior management and the non-executive directors.

The appointment and resignation of the Company Secretary is a matter for consideration by the board as a whole

### Terms and conditions of appointment

We have made the terms and conditions of appointment of the directors available for inspection by any person at the company's registered office during normal business hours. They will also be available at the AGM. The letters of appointment of the directors can also be seen on our website ([www.severntrent.com](http://www.severntrent.com))

### Board processes

We have processes in place regarding:

- the board's tasks and activities;
- the matters specifically reserved for the board's decision making, the authority delegated to the Chief Executive, the accountability of the Chief Executive for that authority, and guidance on managing the relationship between the board and the Chief Executive; and
- the boundaries on Chief Executive action (Chief Executive limits)

The board has reserved the following for its own consideration:

- the appointment of the Chief Executive, directors, the Company Secretary and the Director of Internal Audit;
- the strategy and budgets of the company;
- the GAA which set out the group's delegated approval limits;
- decisions regarding the company and its subsidiaries required to be made by the company's GAA, constitutional documents, statute or external regulation, and
- the approval or adoption of documents (including the publication of reports and statements to shareholders), required to be made by the board by the company's GAA, constitutional documents, statute or external regulation.

### Board meetings

We have regular scheduled meetings of the board and of its permanent committees throughout the year and any additional meetings and ad hoc committee meetings are convened when required.

Papers, including minutes of board committees held since the previous board meeting and performance reports, are circulated in advance of each meeting

There is an agreed procedure in place which allows directors to take independent professional advice in the course of their duties and all directors have access to the advice and services of the Company Secretary. If a director has a concern over any unresolved matter they may require the Company Secretary to minute that concern.

In addition to formal board meetings, the board attended a full day strategy session this year, where the board and executive management team together considered the value proposition for Severn Trent and the potential areas of future value creation across the business. During the financial year, six ad hoc committee meetings of the board were convened to consider such matters as Severn Trent Plc's preliminary and interim results and interim management statements.

### Board attendance in 2012/13

|                   |     |                 |     |
|-------------------|-----|-----------------|-----|
| Andrew Duff       | 7/7 | Martin Lamb     | 7/7 |
| Tony Ballance     | 7/7 | Michael McKeon  | 7/7 |
| Dr Bernard Bulkin | 7/7 | Baroness Noakes | 7/7 |
| Richard Davey     | 7/7 | Andy Smith      | 7/7 |
| Gordon Fryett     | 7/7 | Tony Wray       | 7/7 |
| Martin Kane       | 7/7 |                 |     |

#### 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

Presentations are made to shareholders and analysts following the release of the interim and year end results. The Chief Executive and Finance Director regularly meet shareholders during the year. The Chairman and the senior independent non-executive director have also met shareholders separately from executive directors and are available to meet shareholders if required. The board receives written feedback following meetings with institutional shareholders and monitors shareholder activity on a quarterly basis at its meetings.

During the year we have undertaken an investor audit which sets out to ascertain both bondholders' and shareholders' views of us as a company, our strategy, performance, and effectiveness of our communications. It also aims to determine our standing relative to our peers and to the equity and debt markets as a whole. The results will be available early in the 2013/14 financial year.

#### Board committees

We have established committees of the board to deal with specific issues or approvals, as and when necessary

The four permanent committees of the board assist in the execution of its responsibilities and the board has delegated some of its responsibilities to those board committees. The committees assist the board by fulfilling their roles and responsibilities, focusing on their specific activities, reporting to the board on decisions and actions taken, and making any necessary recommendations.

The terms of reference of the Audit, Remuneration and Nominations Committees comply with the provisions of the Governance Code, except as reported on page 47, and are available for inspection, together with the terms of reference of the Corporate Responsibility Committee, on our website ([www.severntrent.com](http://www.severntrent.com)) or may be obtained on request from the Company Secretary.

The effectiveness of each of the committees has been reviewed during the year as part of the internal board review and the committees have also considered their terms of reference during the year.

Reports from the Chairmen of these committees are set out on pages 52 to 70 of this report.

## The way we choose to behave

#### Code of Conduct: 'Doing the right thing – The Severn Trent way'

Every day Severn Trent 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 customers, doing what is right ethically – and indeed what is right legally

However, sometimes it is not so clear. 'Doing the right thing – The Severn Trent way' details the principles we work by. This is our Code of Conduct and explains who we are, what we stand for and how we work, it also tells our customers and business partners that they can rely on us. These principles apply to everyone in Severn Trent's businesses, no matter where in the world they are based. They provide a common and consistent framework for responsible business practices and set out the standards we need to follow in our day to day activities.

During the year we have continued to roll out the Code of Conduct across the group to make sure that everyone in the business understands what it is all about and upholds our ethical standards. All employees are provided with a copy in their local language as part of their induction. Training sessions are also available and all teams have been encouraged to discuss it.

#### Policies

The Code of Conduct is supported by 15 group policies and our behaviours model. Further details of these can be found on our website ([www.severntrent.com](http://www.severntrent.com)).

During the year we have completed the annual review of the policies to ensure they are fit for purpose. In particular the Whistleblowing Policy has been refreshed and new guidance on the process has been issued to assist those who may need to deal with whistleblowing concerns. New posters advertising the whistleblowing procedures have also been distributed throughout the business.

#### Conflicts of interests

The board has a full process in place to authorise situational conflicts in accordance with the provisions of the Companies Act 2006

At every board meeting there is a standing agenda item at the beginning of the meeting to consider and discuss whether any potential conflicts exist. If it does then the relevant director does not participate in the discussion on that item.

An annual review of conflicts is carried out and is incorporated into the year end process of verifying directors' interests. Half yearly reports are also made to the board of all directors' conflicts and directors are reminded from time to time of their obligations.

#### Interests

No director had a material interest at any time during the year in any contract of significance with the company or any of its subsidiary undertakings.

## Governance

### 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. In March 2012 shareholders were re-consulted as to their preferred method of receiving company communications. Following the consultation, 54,856 shareholders (82%) receive confirmation that the annual report is available to view online, whilst 11,829 shareholders (18%) continue to receive a hard copy

Our website ([www.severntrent.com](http://www.severntrent.com)) contains an archive of annual reports together with other information relevant to investors. This includes comprehensive share price information, financial results, company news and financial calendars.

The company offers a Dividend Reinvestment Plan (DRIP). Details of the DRIP are available on our website and the website of Equiniti, our registrar

### Shareholder networking programme

The aim of the programme is to offer retail shareholders the opportunity to learn more about the company, through site visits and talking to staff.

As part of our Shareholder Networking Programme, participants in October 2012 had a choice to visit either a waste water or clean water site. These were hosted by Simon Cocks, Waste Water Services Director and Andy Smith, Director of Water Services. Nineteen participants were taken to our Minworth Sewage Treatment Works (Birmingham) for a tour and presentation on renewable energy. Twenty-one participants were taken to Campion Hills Water Treatment Works (Royal Leamington Spa) for a tour then on to Severn Trent Water (Finham) for a demonstration of making a connection to a live water main and a display of materials used in the distribution network. This was followed by both groups visiting our operating centre in Coventry.

Positive feedback was given on the organisation and content with strong support for the company continuing the programme, both from shareholders and employees who enjoyed the interest shown in their work.

### Shareholder engagement

#### Annual General Meeting

The AGM of the company will be held at the International Convention Centre, Broad Street, Birmingham B1 2EA at 11am on Wednesday 17 July 2013.

Presentations are made on the group's activities, performance during the year and an operationally focused presentation prior to the formal business of the meeting. The Chairmen of the Audit, Corporate Responsibility, Remuneration and Nominations Committees, together with all other directors, attend the AGM.

The AGM gives shareholders an opportunity to feedback to the company on performance, management and the way we work in a very direct fashion, through the way they vote. Shareholders may also meet informally with directors and senior management before and after the meeting and ask formal questions during the meeting.

The board encourages shareholders to attend the company's AGM and to exercise their right to vote. The notice of meeting and related papers are sent to shareholders at least 20 working days before the meeting. Separate resolutions are proposed on each substantially separate issue. The poll results from the 2013 AGM will be made available on our website after the meeting.

## The way we ensure our effectiveness

### Induction

On joining the board, a director's induction needs are evaluated and then they are provided with a comprehensive and personalised induction pack which includes information on the group structure, the regulatory framework of the operating businesses within the group, strategic plans, financial reports and business plans and information on our governance framework.

Meetings are arranged with members of the executive management team and with external advisers who provide support to the relevant board committees on which the directors may serve. Visits to operational and office sites across the group and management presentations are also arranged for directors joining the board and subsequently throughout the year.

### Continuing professional development

The directors received updates throughout the year on matters such as changes to best practice governance guidelines. The directors also have access to professional development provided by external bodies and our advisers.

Continuing professional development requirements were considered as part of the board effectiveness review referred to below. No additional requirements were identified.

### Performance and effectiveness reviews

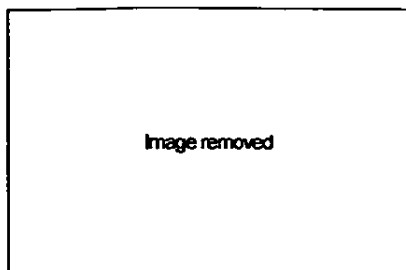
An independent external review of the effectiveness of the board is conducted every three years. The last external review was carried out in November 2011. In November 2012, the board commenced an internal review of its effectiveness and the effectiveness of its key committees. The review was led by the Chairman, assisted by the Company Secretary and was in the form of a series of confidential interviews between each director, the Company Secretary and the Chairman.

The board's strengths include a high quality of debate, relevant and complementary collective skills and talents and an effective use of time. The Audit, Corporate Responsibility and Remuneration Committees were strong, effective and continued to improve during the year.

The review also considered progress made in the areas identified as requiring further development in the independent external review, carried out in the previous financial year. It concluded that good progress had been made with respect to the prioritisation of strategic matters on board agendas.

To become even more effective, the most recent board review identified the need to continue to allocate time for consideration of strategic matters, improve comparative peer performance analysis and, with regard to leadership and succession planning, continue to focus on development of management below the Executive Committee level.

## Nominations Committee



**Andrew Duff**  
Chairman of the Nominations Committee

The main purpose of the Committee is to assist the board by keeping the composition of the board under review and conducting a rigorous and transparent process when making or renewing appointments of directors to the board. It also advises the board on issues of directors' conflicts of interest and independence. The full terms of reference for the Committee can be found on our website ([www.severntrent.com](http://www.severntrent.com)) and are also available from the Company Secretary.

This report provides details of the role of the Nominations Committee and the work it has undertaken during the year.

The Committee keeps under review the balance of skills on the board and the knowledge, experience, length of service and performance of the directors. It also reviews their external interests with a view to identifying any actual, perceived or potential conflicts of interests, including the time available to commit to their duties to the company. The results of these reviews are important when the board considers succession planning and the election and reappointment of directors. Members of the Committee take no part in any discussions concerning their own circumstances.

The members of the Committee in 2012/13 were the non-executive directors of the board and the Chief Executive, Tony Wray.

During the year the Committee considered the composition of the board, the board's diversity policy, the board's effectiveness review and the succession plan for the Chief Executive. It also reviewed the strength and depth of talent and succession planning below Executive Committee level.

In accordance with the requirements of the Governance Code, all members of the board will seek re-election at the AGM in July 2013. In March 2013 the Committee formally reviewed the performance, contribution and commitment of each of the directors retiring at this year's AGM and seeking reappointment, and supported and recommended their reappointment to the board. The Committee has confirmed that each director continues to perform well both on an individual and collective basis, making a valuable contribution to the board's deliberations and demonstrating commitment to the long term interests of the company.

### Nominations Committee attendance in 2012/13

|                   |     |                 |     |
|-------------------|-----|-----------------|-----|
| Dr Bernard Bulkin | 2/2 | Martin Lamb     | 2/2 |
| Richard Davey     | 2/2 | Baroness Nookes | 2/2 |
| Andrew Duff       | 2/2 | Tony Wray       | 2/2 |
| Gordon Fryett     | 2/2 |                 |     |

Each Committee meeting complied with the terms of reference in that a minimum of five members were in attendance, with the majority being independent, non-executive directors.

## Governance Nominations Committee

### Succession planning

When considering new appointments to the board, the Committee oversees the preparation of a role specification that is provided to an independent recruitment organisation retained to conduct a global search. In addition to the specific skills, knowledge and experience deemed necessary, the specification contains criteria such as:

- a proven track record of creating shareholder value;
- unquestioned integrity and a diversity of psychological mindset;
- a commitment to the highest standards of governance;
- having the required time available to devote to the job;
- strategic mindset, an awareness of market leadership, outstanding monitoring skills,
- a preparedness to question, challenge and openly assess, and
- an independent point of view

### Diversity

Further to the publication of the Davies Report, 'Women on Boards', in February 2011, boards of FTSE 350 companies have been encouraged to promote greater female representation on corporate boards. Guidance from the Financial Reporting Council has also highlighted the importance of greater diversity of psychological profile around the board table.

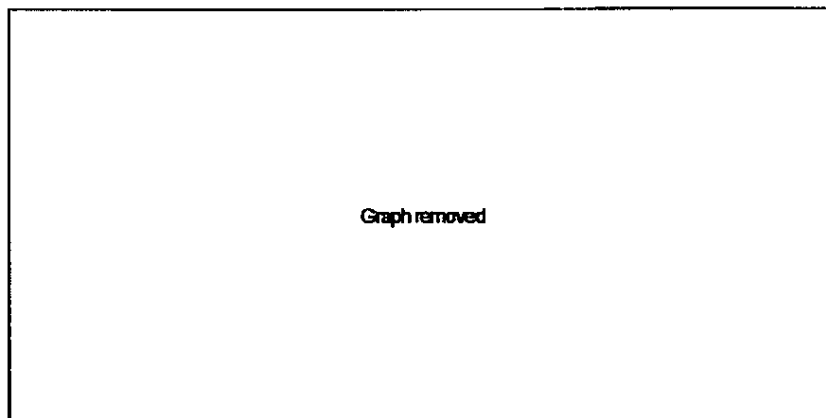
Severn Trent believes that a diverse and inclusive culture is a key factor in being a successful business. Severn Trent Plc shares the aspiration of the Davies Report to promote greater female representation on listed company boards

As and when board appointment opportunities arise, we will make full use of the procedures recommended by the Davies Report and by the Governance Code to support this aspiration. All board appointments will be based on merit and must be in the interests of all stakeholders.

As at 31 March 2013 and at the date of this report, we had one female member on our board of 11 (representing 9%) and three female members out of 11 on the Executive Committee (representing 27%). The total workforce gender split is 30% female and 70% male.

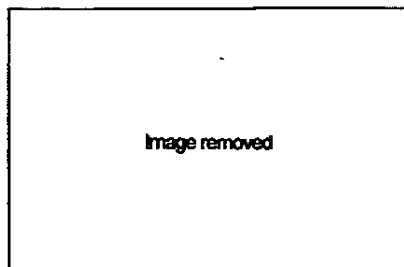
As we reported last year, we have conducted gender diversity research with women employees in Severn Trent Water to understand what is important to them in developing careers at Severn Trent. The research was designed so that the insights provided would help us to improve policies and practices in developing women in our organisation.

We plan to use the same methodology to explore ethnic diversity in the future, so we can gain more insights into this aspect of our workforce composition and the findings will be examined by our Diversity Working Group.



**Andrew Duff**  
Chairman of the Nominations Committee

## Audit Committee



Baroness Nookes DBE  
Chairman of the Audit Committee

The Committee assists the board in discharging its responsibilities for the integrity of the company's financial statements, the assessment of the effectiveness of the systems of internal controls and monitoring the effectiveness and objectivity of the internal and external auditors. The role and the responsibilities of the Committee are set out in written terms of reference. These can be found on our website ([www.severntrent.com](http://www.severntrent.com)) and are also available from the Company Secretary

This report provides details of the role of the Audit Committee and the work it has undertaken during the year.

The members of the Committee are Baroness Nookes DBE (Chairman), Dr Bernard Bulkin and Richard Davey whose experience and background are set out on page 44. The board is satisfied that Baroness Nookes and Richard Davey have recent and relevant financial experience and that all members of the Committee remain independent.

The members of the Committee receive updates in financial reporting and the group's regulatory framework in various forms throughout the year. The Chairman, Chief Executive, Finance Director, Director of Internal Audit, Group Financial Controller and the external auditors 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 both the internal and external auditors.

In performing its duties, the Committee has access to the services of the Director of Internal Audit, the Company Secretary and, if required, external professional advisers.

The Committee reports to the subsequent meeting of the board on the Committee's work. It met five times in 2012/13 and its work focused on four key areas:

- financial statements and accounting policies;
- risk management and internal controls;
- oversight of internal and external audit; and
- the regulatory reporting obligations of our subsidiary Severn Trent Water Limited

The Committee's performance was included in the review of the board referred to on page 51. No matters requiring action by the Committee arose from that review

### Financial statements and accounting policies

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 pages 88 and 89. The Committee paid particular attention to:

- whether further impairments of the goodwill and intangible assets related to businesses in Severn Trent Services were properly estimated;
- whether the assumptions used to calculate the amount of the deficit in the group's defined benefit pension schemes were reasonable and in line with those used by similar companies;
- the way in which derivative instruments were accounted for and in particular the impact of termination options which resulted in the termination of three interest rate swaps during the year; and
- the amount of provisions held for tax liabilities which were still the subject of discussion with the tax authorities.

The Committee also examined the disclosure of items which are described as exceptional in the consolidated income statement.

The Committee reviewed the evidence and assumptions underpinning the use of the going concern assumption in preparing the accounts and in making the statement made in the Directors' report that the company is a going concern.

In reviewing the financial statements, the Committee receives input from the Disclosure Committee, which is chaired by the Finance Director. The work of the Disclosure Committee is described further on page 49.

Deloitte LLP (Deloitte) reported to the Committee on their review of the half year interim results and on their audit of the year end financial statements.

### Internal controls

The Committee receives regular reports from Internal Audit in respect of their work on internal controls and reviews management letters received from the external auditors.

The Committee reviewed the processes for and outputs from our Enterprise Risk Management process, through which the principal risks and related controls are identified. The Committee discussed the approach to documenting risk appetite and providing guidance to risk owners on the board's tolerance for different types of risk. In addition, it monitored the ongoing development of our compliance and assurance processes in respect of the key risks.



## Governance Audit Committee

### Policy on the provision of non-audit services

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 auditors.

The policy sets out the approach to be taken by the group when using the services of the external auditors, including requiring that certain services provided by the external auditors are pre-approved by the Committee or its Chairman.

It defines the non-audit services that may be provided by the external auditors and separately sets out those non-audit services which are prohibited, since the independence of the external auditors could be threatened.

Non-audit services where the external auditors may be used include: audit related services required by statute or regulation, tax compliance and tax planning advice, due diligence on acquisitions and disposals, services related to fraud, corporate responsibility report reviews and regulatory support.

The approval of the Committee or its Chairman is always required if a non-audit service provided by the auditors is expected to cost more than £100,000 or if non-audit fees for the year would exceed the amount of the audit fee.

Furthermore, the procurement of non-audit services will need to comply with the Utility Contracts Regulations and all services requirements over the current EC threshold will have to be subject to tender.

The Committee reviews the procedures, systems and controls designed to prevent and detect fraud and bribery and receives a regular log of incidents of fraud or bribery which includes the actions taken to investigate and respond to the incidents. There were no material incidents during the year.

The Committee also reviewed the group's approach to IT continuity. Given the increasing dependency of the business on technology, this is an area of crucial importance and further reviews will be carried out in the next year.

Further details of our internal control framework can be found in the Directors' report on page 71.

### Internal Audit

The Director of Internal Audit and his team report on a day to day basis to management on the effectiveness of the group's systems of internal controls and the adequacy of these systems to manage business risk and to safeguard the group's assets and resources. This work is summarised and reported to the Committee on a regular basis and is a key element of the assurance that the Committee receives on the risks and controls in the group.

The effectiveness of the Internal Audit function, its plans, level of resources and budget are reviewed at least annually by the Committee. The Director of Internal Audit is free to raise any issues with the Committee or its Chairman at any time during the year.

### External auditors

Deloitte were appointed auditors of the company in 2005, pursuant to a competitive tender process. Deloitte audit all significant subsidiaries of the group. Annually, the Committee reviews the external auditors' 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. The Committee also reviews the auditors' effectiveness, which involves assessment of the auditors by the Committee and key executives, and confirmation that the auditors meet minimum standards of qualification, independence, expertise, effectiveness and communication. These assessments are carried out prior to the Committee recommending to the board that the external auditors be proposed for reappointment at the AGM.

The company does not currently have a policy of tendering the external audit at specific intervals but would initiate a tender process if there were any concerns about the quality of the audit or the independence and objectivity of the auditors. In addition the company will comply with the tendering requirements of the UK Corporate Governance Code 2012 which will require an audit tender no later than 2020. There are no contractual obligations that act to restrict the Committee's choice of external auditors.

Details of the amounts paid to Deloitte for audit and non-audit services are provided in note 7 to the accounts on page 93.

### Severn Trent Water Limited

The regulated activities carried out by Severn Trent Water Limited require two main reporting requirements to Ofwat which are reviewed by the Committee: an annual submission on Severn Trent Water Limited's regulatory obligations, known as the Annual Regulatory Performance Report together with the Annual Regulatory Compliance Statement; and a statement that underpins the customer charges made by Severn Trent Water Limited, known as the Principal Statement.

In March 2013 the Committee reviewed the assurance framework in place for the Annual Regulatory Compliance Statement process. In November 2012 the Committee reviewed the assurance framework for the Principal Statement and the PR14 process.

Deloitte make reports to Ofwat in respect of Severn Trent Water Limited's regulatory accounts. The Annual Regulatory Performance Report, which provides an overall picture of company performance, covers many aspects which are not financial and Severn Trent Water Limited appoints engineering consultants, Atkins, to report on those aspects. The Committee receives reports from Deloitte and Atkins on their work as part of its review of the Annual Regulatory Returns.

### Audit Committee attendance in 2012/13

|                   |     |               |     |
|-------------------|-----|---------------|-----|
| Baroness Noakes   | 5/5 | Richard Davey | 5/5 |
| Dr Bernard Bulkin | 4/5 |               |     |

## Corporate Responsibility Committee



**Dr Bernard Bulkin**  
Chairman of the Corporate  
Responsibility Committee

The Committee provides guidance and direction to the group's Corporate Responsibility (CR) programme, reviews the group's key non-financial risks and opportunities and monitors progress.

The terms of reference for the Committee can be found on our website ([www.severntrent.com](http://www.severntrent.com)) and are also available from the Company Secretary

The Committee reviews annually the adequacy of the group's formal whistleblowing policy and procedures which deal with allegations from employees relating to breaches of the Code of Conduct and reviews at each of its meetings the whistleblowing incident log.

This report provides details of the role of the Corporate Responsibility (CR) Committee and the work it has undertaken during the year

The members of the Committee are Dr Bernard Bulkin (Chairman), Andrew Duff, Gordon Fryett and Tony Wray

The purpose of the Committee is to provide board oversight of the management of all non-financial risks to the group. This year we aligned the structure for our CR framework to 'Doing the right thing - The Severn Trent way', our Code of Conduct. This comprises nine key principles that we work to and provides a common framework for both our businesses - regulated and non-regulated.

- 1 Keeping everyone healthy and safe
- 2 Supporting employees' rights and diversity
- 3 Maintaining ethical and honest behaviour
- 4 Staying free from bribery and corruption
- 5 Keeping our communications open and responsible
- 6 Delivering excellent customer service
- 7 Working within the community
- 8 Protecting our environment
- 9 Standing up for what's right

Within the nine principles of our CR framework, we have identified focus areas that are critical to our management of risk and reputation. These areas were determined through stakeholder dialogue, risk assessment and benchmarking within the water industry and the FTSE 100 and are reviewed annually.

The nine principles of our Code of Conduct provide the basis for the forward agenda of the Committee. During the year the Committee has received papers on key business programmes and strategies linked to the terms of reference of the Committee. These included water efficiency, supply chain management, environmental management systems, brand and reputation, occupational health, employee volunteering, vulnerable customers, employee satisfaction and diversity. In addition, the Committee responds to emerging issues and received updates on disability access and pollution performance.

The Committee also received reports from Internal Audit with respect to their work on non-financial risk linked to the terms of reference of the Committee and regular updates on health, safety and environmental performance and whistleblowing.

Within Severn Trent Water we have an effective performance management system in place through our core business KPIs. These are overseen by the Executive Committee and the board. Many of the business KPIs relate directly to our CR focus areas and therefore contribute significantly to our CR performance. We report internally on our performance through both the Executive Committee and the Committee. Externally, we report through a number of channels including our Annual Regulatory Returns to Ofwat, our websites and our annual report and accounts.

### Corporate Responsibility Committee attendance in 2012/13

|                   |     |               |     |
|-------------------|-----|---------------|-----|
| Dr Bernard Bulkin | 3/3 | Gordon Fryett | 3/3 |
| Andrew Duff       | 3/3 | Tony Wray     | 3/3 |

## Remuneration Committee



Richard Davey  
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 members of the Committee during the year were Dr Bernard Bulkin, Richard Davey (Committee Chairman) and Martin Lamb all of whom are independent non-executive directors. Andrew Duff, the company Chairman, who was independent on his appointment to the board, is also a member. Accordingly, the composition of the Committee is in accordance with the Governance Code.

### Dear Shareholder

This report sets out the remuneration policy for the directors of Severn Trent Plc and discloses the amounts paid to them in the year ended 31 March 2013.

The UK Government has tabled proposals to reform the way directors' remuneration is voted upon and reported. The new legislative requirements will not come into effect until October 2013. Although not mandatory for this report, the Committee has sought to comply with the new requirements where practicable and where minimal duplication with current reporting standards occurs. Therefore, this report has been split into two sections, a Policy report which sets out the remuneration policy of the executive and non-executive directors and an Implementation report which discloses how the current remuneration policy has been implemented in the year ended 31 March 2013. We will be seeking your support for both parts of the report by way of a single advisory vote at the forthcoming AGM on 17 July 2013.

The remuneration policy for senior executives is set with close regard to the company's four key focus areas and risk management.

| Key focus  | Remuneration policy  |
|--|--|
| Customer<br>– delivering quality services at prices customers can afford | <ul style="list-style-type: none"> <li>Customer focused KPIs form a substantial part of the annual bonus scorecard</li> <li>Our general policy is to position fixed pay around the market median to ensure that remuneration remains affordable.</li> <li>Return on Regulatory Capital Value (RoRCV) targets within the Long Term Incentive Plan (LTIP) and financial based KPIs within the annual bonus are set with close regard to Ofwat's Final Determination, ensuring that we closely manage our performance within the regulatory limits.</li> </ul>                                    |
| Employee<br>– investing in the right people with the right skills        | <ul style="list-style-type: none"> <li>In setting directors' pay the Committee is sensitive to pay and conditions in the workforce generally.</li> <li>Selected KPIs for the annual bonus include health safety and well-being and employee engagement.</li> <li>HMRC approved share plans (all-employee Share Incentive Plan (SIP) and Sharesave) are operated annually for Severn Trent Water (STW) UK based executives and employees. Severn Trent Services (STS) employees are eligible to participate in the Sharesave only given the SIP relates to STW performance.</li> </ul>          |
| Environment<br>– reducing pollution and our carbon footprint             | <ul style="list-style-type: none"> <li>Environmental KPIs are included within the annual bonus for all employees, including directors.</li> <li>The Committee can override the formulaic bonus outcome if there is a significant environmental issue.</li> </ul>   |
| Financial<br>– making our business attractive to investors               | <ul style="list-style-type: none"> <li>A variety of financial KPIs are used within the annual bonus scorecard to help ensure our financial performance is optimised.</li> <li>Outturn under the LTIP is determined by the achievement of RoRCV against the Ofwat Final Determination. Payment will not be made if performance is below the RoRCV target set by Ofwat.</li> <li>Relative total shareholder return (TSR) is used to measure performance in the Share Matching Plan to reward executives for Severn Trent outperforming a peer group of companies in the stock market.</li> </ul> |

**Governance Remuneration Committee****Link between pay and Severn Trent performance in 2012/13**

Annual bonus payments to executive directors were between 95% and 115% of base salary, reflecting a strong year of operational performance of the business. Payments under the LTIP vested at 57.5% of the maximum award available, reflecting a 43.3% increase in share price over the three years to 31 March 2013 and TSR performance above median when compared to the FTSE 51-150 (our TSR benchmark group for the 2010 LTIP award).

**Key policy developments for 2013/14**

There are no material changes to the remuneration policy or Committee processes proposed for 2013/14.

The Committee continues to monitor policy to ensure that it is fit for purpose and aligned with shareholders' interests, corporate governance and all employee remuneration policies. Therefore, in 2013, the Committee intends to examine whether the current long term incentives can be simplified, assess whether sufficient weighting is given to long term performance and to review directors' service contracts. The Committee will consult with major shareholders over the course of the next financial year regarding any changes. Any amendments to the revised remuneration policy will be effective from 1 April 2014 and will be voted upon under the new BIS regulations at the 2014 AGM.

Richard Davey  
Chairman of the Remuneration Committee



## Governance Remuneration Committee

### Policy report

This part of the Directors' remuneration report sets out the remuneration policy for the company with effect from 1 April 2013

#### Setting the remuneration policy

Each year, the Committee reviews the remuneration policy for executive directors and other senior executive managers, taking into account both the external market and the company's strategic objectives over the short and the medium term. Furthermore, there is a clear link between all-employee remuneration policies and those operated at a senior executive level.

The Committee addresses the need to balance risk and reward. The Committee continues to monitor the variable pay arrangements for the executive directors and other members of the Executive Committee to take account of the risk profile of the company ensuring sustainability and how this is reflected in variable remuneration. The Committee believes that the schemes are appropriately managed and that the choice of performance measures and targets does not encourage undue risk taking by the executives. The schemes incorporate a range of internal and external performance metrics, measuring both operational and financial performance providing a rounded assessment of overall company performance.

#### Linkage to all employee pay

The Committee addresses the need to ensure that changes in senior executive remuneration are kept in line with workforce pay. Whilst it has not set a specific policy on the relationship between executive directors' pay and that of the rest of the workforce, it aims to ensure that executive salary movement is appropriately aligned to the rest of the workforce and specifically considers this carefully as part of its decision making process. Furthermore, bonus schemes operate on a consistent basis throughout Severn Trent (using the same balanced scorecard) and all UK employees may participate in the Sharesave and Share Incentive Plan.

#### Shareholder views

The Committee engages proactively with the company's major shareholders, and takes seriously their views. When any material changes are made to the remuneration policy, the Committee Chairman will inform, and where appropriate, meet major shareholders in advance.

#### Remuneration policy for the executive directors

The remuneration policy for executive directors comprises the following elements:

- base salary;
- annual bonus scheme;
- long term incentive schemes; and
- pension and benefits.

The following table sets out a summary of each element of the executive directors' remuneration packages.

| Component  | Tony Wray<br>Chief Executive  | Michael McKean<br>Finance Director       | Tony Ballance<br>Director, Strategy<br>and Regulation                     | Martin Kane<br>CEO – Severn<br>Trent Services | Andy Smith<br>Director of<br>Water Services  |
|--|---|--|---|---|--|
| Base salary from<br>1 July 2013  | £575,000  | £466,800                                 | £211,300  | £256,900                                      | £274,600   |
| On target annual<br>bonus (% of salary)                                  | 60%   | 60%                                      | 60%   | 60%   | 60%  |
| Maximum annual<br>bonus (% of salary)                                    | 120%  | 120%                                     | 120%  | 120%  | 120%   |
| % of bonus earned<br>deferred into shares                                | 50%   | 50%                                      | 50%   | 50%   | 50%  |
| Annual LTIP award<br>(% of salary)                                       | 70%   | 50%                                      | 50%   | 50%   | 50%  |
| SMP award –<br>maximum ratio of<br>matching shares to<br>deferred shares | 0.5:1   | 0.5:1                                    | 0.5:1   | 0.5:1   | 0.5:1  |
| Pension<br>arrangement   | Cash supplement of<br>40% of base salary  | Cash supplement of<br>40% of base salary | Defined contribution<br>scheme,<br>contributions of<br>30% of base salary | Cash supplement of<br>30% of base salary      | Final salary defined<br>benefit scheme<br>with cash<br>supplement of 40%<br>of base salary above<br>the salary cap |
| Benefits   | A car allowance of £15,000 per annum, family level private medical insurance, life assurance worth 6 x<br>base salary and an incapacity benefits scheme |  |   |   |  |

## Governance Remuneration Committee

### Base salary

Base salaries for individual directors are reviewed annually by the Committee and 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 the market median for similar roles in publicly quoted companies of a comparable size and practice in other water companies) and internal relativities.

The Committee gives due consideration to the current economic climate, current market practice and affordability regarding executive salary reviews and the broader employee salary review policy at the company.

The Committee has reviewed salaries for 2013/2014 and has determined that the base salaries for all executive directors will be increased by 2.5% from 1 July 2013. This level of increase is in line with the average increase across the rest of the company.

### Annual Bonus Scheme

Executive directors are eligible for annual bonuses to encourage improved performance, with targets established by the Committee to align directors' interests with shareholders' interests. The maximum annual bonus opportunity for all executive directors is 120% of salary. For the achievement of target performance (which requires satisfaction of challenging goals), 60% of salary could be earned. All annual bonus payments are non-pensionable.

Executive directors' bonuses are determined by performance against a balanced scorecard of measures with their individual contribution assessed through personal objectives.

Half of any bonus paid is deferred into shares and held for three years following payment. If the executive is summarily dismissed without notice under his/her employment contract then the deferred bonuses are forfeited. In all other cases of cessation of employment the deferred bonuses are not lost and the shares are automatically released on the dealing day after the cessation of employment.

Severn Trent continues to operate a clawback provision.

Details of the bonus outturn for 2012/13 are shown in the Implementation report on pages 64 and 65.

### Long term incentives

The executive directors are eligible to participate in two long term incentive schemes: a) LTIP; and b) a Share Matching Plan (SMP).

#### a) LTIP

The LTIP was approved by shareholders at the 2005 AGM. Under the LTIP, annual conditional awards of performance shares may be made to executive directors and senior staff, up to an annual maximum of 125% of base salary. The policy level of LTIP awards is 70% of base salary for the Chief Executive and 50% of base salary for other directors.

RoRCV will remain as the performance metric for the 2013 LTIP. This measure is consistent with the measure used by Ofwat in setting customer prices as part of the Final Determination (the process whereby Ofwat sets the level of prices we can charge customers) and reflects the efficiency of earnings rather than simply being an absolute measure of profit and is verified and published as part of the Annual Regulatory Performance Report. The Committee believes that the use of RoRCV provides a strong alignment between the long term financial and operational performance of the group and the reward delivered to management.

Further information with regards to the performance of the 2009 and 2010 LTIP can be found in the Implementation report on page 67, together with the vesting schedule.

#### b) SMP

Under the SMP, executive directors can receive up to one matching share for each share deferred under the annual bonus plan. The current policy is that they receive 0.5 matching share for each share deferred. Awards will normally vest as soon as the Committee determines that the performance conditions have been met provided that the participant remains in employment at the end of the three year period.

Awards under the SMP are subject to a relative TSR measure over three distinct performance periods. However, awards will not normally vest to participants until the third anniversary of grant. The performance condition requires the company's TSR is measured relative to those companies ranked 51-150 in the FTSE Index by market capitalisation (excluding investment trusts). This is considered to be the most suitable comparator group since the number of comparable regulated companies against which to compare the company's performance remains too small to enable a meaningful analysis. The FTSE 51-150 comparator group allows for the company performance to be measured against a broader market without any one sector overly impacting the group. In addition for awards to vest, the Committee must be satisfied that the TSR is reflective of the company's underlying performance.

At the time of release participants will receive the value of the dividends paid on vested shares over the performance period. The TSR vesting schedule and detail of shares vested during the period reported are shown in the Implementation report. The plan was introduced in 2010 with the first awards due to vest this year.

## Governance Remuneration Committee

### Pension

Severn Trent executive directors receive retirement benefits from a variety of legacy pension arrangements including defined benefit, defined contribution (DC), payments made direct to personal plans and cash in lieu. However, whilst for legacy reasons the executive directors participate in a variety of different arrangements, the policy for employer contributions for new executive directors is 25% of salary. If the value of the pension contribution is above the HMRC Annual Allowance or Lifetime Allowance executive directors will receive cash in lieu.

Details of the specific pension arrangements implemented in the year for each executive director are detailed in the Implementation report.

### Reward scenarios

The charts below show how the composition of each of the executive directors' remuneration packages varies at different levels of performance achievement. Target performance assumes a 60% of salary bonus, a 0.25 to 1 match on the related SMP award and 50% vesting under the LTIP award for a single year. Maximum performance assumes full payment of bonus and full vesting of the SMP and LTIP awards. No assumptions have been made as to share price growth over the vesting period.

Graph Removed

## Governance Remuneration Committee

### Executive service contracts

The Remuneration Committee reviews the contractual terms for executive directors to ensure that these reflect best practice and for new joiners a new model contract was introduced during 2012. This provides for termination provisions that comprise a maximum of 12 months' salary and fixed benefits only.

The remuneration related elements of the current contracts for executive directors are shown in the table below:

| Provision           | Policy  |                                     |                           |                                     |           |             |              |                |                 |                  |               |             |              |             |                |                  |            |             |                |
|---------------------|---|-------------------------------------|---------------------------|-------------------------------------|-----------|-------------|--------------|----------------|-----------------|------------------|---------------|-------------|--------------|-------------|----------------|------------------|------------|-------------|----------------|
| Notice period       | 12 months from either party   |                                     |                           |                                     |           |             |              |                |                 |                  |               |             |              |             |                |                  |            |             |                |
| Termination payment | <p>Theoretical maximum payment in the case of redundancy or termination in breach of the agreement by the company of 175% of base salary. In determining actual payouts, the Committee has a duty to take into account the following.</p> <ul style="list-style-type: none"><li>- a reduction of up to 10% can be made at the Committee's sole discretion (i.e. lowering the payout to 157.5% of salary), and</li><li>- an explicit clause in the contract stating that the company shall not be required to reward poor performance</li></ul> <p>The value of any payment will not include the release of awards which have been made under any share plans. The plans contain separate provisions regarding the treatment of leavers in line with best practice guidelines.</p> |                                     |                           |                                     |           |             |              |                |                 |                  |               |             |              |             |                |                  |            |             |                |
| Mitigation          | Any termination payment will not be made automatically but will be subject to both phasing and mitigation (including offset against any earnings from new employment) unless, in the circumstances, the Committee considers it appropriate to achieve a clean break through payment of a lump sum, in which case it will require some discount for early payment.   |                                     |                           |                                     |           |             |              |                |                 |                  |               |             |              |             |                |                  |            |             |                |
| Change of control   | There are no specific contractual payments or benefits which would be triggered in the event of a change in control of the company  |                                     |                           |                                     |           |             |              |                |                 |                  |               |             |              |             |                |                  |            |             |                |
| Contract dates      | <table><tr><th>Executive directors</th><th>Date of current agreement</th><th>Date of appointment to Severn Trent</th></tr><tr><td>Tony Wray</td><td>20 May 2008</td><td>7 March 2005</td></tr><tr><td>Michael McKeon</td><td>6 December 2005</td><td>13 December 2005</td></tr><tr><td>Tony Ballance</td><td>2 June 2008</td><td>23 July 2005</td></tr><tr><td>Martin Kane</td><td>1 January 2012</td><td>10 November 1975</td></tr><tr><td>Andy Smith</td><td>2 June 2008</td><td>1 January 2005</td></tr></table>   | Executive directors                 | Date of current agreement | Date of appointment to Severn Trent | Tony Wray | 20 May 2008 | 7 March 2005 | Michael McKeon | 6 December 2005 | 13 December 2005 | Tony Ballance | 2 June 2008 | 23 July 2005 | Martin Kane | 1 January 2012 | 10 November 1975 | Andy Smith | 2 June 2008 | 1 January 2005 |
| Executive directors | Date of current agreement   | Date of appointment to Severn Trent |                           |                                     |           |             |              |                |                 |                  |               |             |              |             |                |                  |            |             |                |
| Tony Wray           | 20 May 2008   | 7 March 2005                        |                           |                                     |           |             |              |                |                 |                  |               |             |              |             |                |                  |            |             |                |
| Michael McKeon      | 6 December 2005   | 13 December 2005                    |                           |                                     |           |             |              |                |                 |                  |               |             |              |             |                |                  |            |             |                |
| Tony Ballance       | 2 June 2008   | 23 July 2005                        |                           |                                     |           |             |              |                |                 |                  |               |             |              |             |                |                  |            |             |                |
| Martin Kane         | 1 January 2012  | 10 November 1975                    |                           |                                     |           |             |              |                |                 |                  |               |             |              |             |                |                  |            |             |                |
| Andy Smith          | 2 June 2008   | 1 January 2005                      |                           |                                     |           |             |              |                |                 |                  |               |             |              |             |                |                  |            |             |                |

### Personal shareholdings

The company operates shareholding guidelines under which executive directors are expected to build and maintain a shareholding in the company. The Chief Executive is expected to build and maintain a holding of shares to the value of 1.5 x base salary and other executive directors 1 x base salary. Executive directors are expected to retain all of the net of tax number of shares they receive through the LTIP, SMP and other share-based plans until the shareholding guidelines have been met. Details of the current shareholdings of the directors are set out on page 66.

### External directorships

Executive directors are permitted to take on external non-executive directorships, though normally only one other FTSE 100 appointment. In order to avoid any conflicts of interest, all such appointments are subject to the approval of the Nominations Committee. Executive directors are normally only permitted to retain the fees arising from one such appointment. External non-executive appointments help to bring a further external perspective to the group and help in the development of key individuals' experience.

Michael McKeon was appointed as a non-executive director of The Merchants Trust Plc on 1 May 2008 and in respect of the appointment for the year ended 31 March 2013 he was paid fees of £23,458.

Tony Wray was appointed as a non-executive director of Grainger plc on 24 October 2011 and in respect of the appointment for the year ended 31 March 2013 has been paid fees of £41,250.

Both Michael McKeon and Tony Wray retained their respective fees in accordance with the above policy.

No other executive directors currently hold any external fee earning non-executive directorships.



## Governance Remuneration Committee

### Chairman and non-executive directors

The remuneration policy for non-executive directors, other than the Chairman, is determined by the board, within the limits set out in the articles of association. A single fee including such memberships is paid, with additional fees paid for the senior independent director and chairmanship of the board committees. The Chairman's fee is reviewed annually by the Committee (without the Chairman present). He receives a single fee of £250,000 to cover all his board duties.

The current fee levels for the non-executive directors are set out in the table below and remain at 2012 fee levels.

|   | Fees    |
|---|---------|
| Base fee paid to all non-executive directors  | £50,000 |
| Supplementary fees                            |         |
| – Senior independent director                 | £10,000 |
| – Audit Committee Chairman                    | £15,000 |
| – Remuneration Committee Chairman             | £15,000 |
| – Corporate Responsibility Committee Chairman | £13,000 |

Non-executive directors normally serve terms of three years. They do not have service contracts. Instead they 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.

|                        | Initial appointment | Current appointment | Current expiry date |
|------------------------|---------------------|---------------------|---------------------|
| Dr Bernard Bulkin      | 1 January 2006      | 1 January 2012      | 31 December 2014    |
| Richard Davey          | 1 January 2006      | 1 January 2012      | 31 December 2014    |
| Andrew Duff (Chairman) | 10 May 2010         | 10 May 2013         | 9 May 2016          |
| Gordon Fryett          | 1 July 2009         | 1 July 2012         | 30 June 2015        |
| Martin Lamb            | 29 February 2008    | 1 March 2011        | 28 February 2014    |
| Baroness Noakes        | 29 February 2008    | 1 March 2011        | 28 February 2014    |

All of the directors are subject to reappointment at the 2013 AGM.

### Implementation report

#### Membership of the Remuneration Committee

The members of the Committee are listed in the table below. All are independent non-executive directors, as defined under the Governance Code, with the exception of the company Chairman who was independent on his appointment.

During the year ended 31 March 2013, the Committee met five times to discuss key remuneration issues arising, the review and operation of the company's remuneration policy and market updates by its advisers.

#### Committee attendance in 2012/13

|               |     |                   |     |
|---------------|-----|-------------------|-----|
| Richard Davey | 5/5 | Dr Bernard Bulkin | 5/5 |
| Andrew Duff   | 5/5 | Martin Lamb       | 4/5 |

With the exception of the company Chairman, the Committee members have no personal financial interest, other than as shareholders, in the matters to be decided.

#### External advisers

To ensure that the company's remuneration practices are market competitive, the Committee has access to detailed external advice from experienced specialist consultants.

New Bridge Street (a trading name of Aon Hewitt Limited) is the independent adviser to the Committee. Neither Aon Hewitt Limited nor any other part of Aon plc (Aon Hewitt's parent company) provided other services to the company during the year. During 2012/2013, the Committee carried out a review of its advisers, and reappointed New Bridge Street.

The Chief Executive (Tony Wray), the Director of Human Resources (Evelyn Dickey) and the General Manager of Reward and Pensions (Richard Galletly) and New Bridge Street 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, Bronagh Kennedy, is secretary to the Committee.

The total fees paid to New Bridge Street in respect of its services to the Committee during the year were £130,799 (excluding VAT). The fees charged for major projects are normally negotiated in advance of any major project being undertaken. However, an element of the fees relate to sundry ongoing advice, in line with New Bridge Street's role to provide ongoing support throughout the Committee over the entire remuneration year and are predominantly charged on a 'time spent' basis. New Bridge Street is a signatory to the Remuneration Consultants' Code of Conduct.

## Governance Remuneration Committee

The text and tables that follow comprise the auditable part of the Directors' remuneration report, being the information required by the UKLA Listing Rules 9.8.6 and 9.8.8.

### Directors' emoluments

|                   | Basic salary and fees (£'000) | Benefits in kind <sup>(i)</sup> (£'000) | Annual bonus cash <sup>(ii)</sup> (£'000) | Annual bonus deferred <sup>(ii)</sup> (£'000) | Other <sup>(iii)</sup> (£'000) | Total 2012/2013 before DC pension contributions (£'000) | DC pension contributions (£'000) | Total including DC pension contributions (£'000) | Total 2011/2012 including DC pension contributions (£'000) |
|-------------------|-------------------------------|---|---|---|--------------------------------|---|----------------------------------|--|--|
| Dr Bernard Bulkin | 63.0                          | -                                       | -   | -   | -                              | 63.0  | -                                | 63.0   | 59.4   |
| Richard Davey     | 75.0                          | -                                       | -   | -   | 0.3                            | 75.3  | -                                | 75.3   | 71.4   |
| Andrew Duff       | 250.0                         | -                                       | -   | -   | -                              | 250.0   | -                                | 250.0  | 250.0  |
| Gordon Fryett     | 50.0                          | -                                       | -   | -   | -                              | 50.0  | -                                | 50.0   | 46.4   |
| Martin Lamb       | 50.0                          | -                                       | -   | -   | -                              | 50.0  | -                                | 50.0   | 46.4   |
| Baroness Noakes   | 65.0                          | -                                       | -   | -   | 0.3                            | 65.3  | -                                | 65.3   | 58.6   |
| Tony Ballance     | 198.5                         | 1.5                                     | 97.9                                      | 97.9  | 15.0                           | 410.8   | 72.8                             | 483.6  | 395.3  |
| Martin Kane       | 250.8                         | 49.4                                    | 144.0                                     | 144.0   | 166.8                          | 755.0   | -                                | 755.0  | 501.4  |
| Michael McKeon    | 452.2                         | 1.5                                     | 223.1                                     | 223.1   | 196.4                          | 1,096.3   | -                                | 1,096.3  | 879.8  |
| Andy Smith        | 256.8                         | 1.5                                     | 126.9                                     | 126.9   | 66.7                           | 578.8   | -                                | 578.8  | 466.5  |
| Tony Wray         | 552.4                         | 1.5                                     | 273.2                                     | 273.2   | 238.3                          | 1,338.6   | -                                | 1,338.6  | 1,034.9  |
| Total             | 2,263.7                       | 55.4                                    | 865.1                                     | 865.1   | 683.8                          | 4,733.1   | 72.8                             | 4,805.9  | 3,810.1  |

#### Footnote:

- (i) The figure shown for Martin Kane is largely representative of his US cost of living expenses, (accommodation £22,799, UK and US private medical insurance £10,605, vehicle costs £5,858, air fares £2,662, tax advice £7,390 and flexible benefits £71.00)
- (ii) The directors receive 50% of their annual bonus award in cash and 50% in shares. The amounts shown in the table have been made in respect of 2012/13 performance. Outstanding unreleased annual bonus scheme awards are shown as non-beneficial interests in the table of directors' share interests and in the deferred bonus award table.
- (iii) Other emoluments include expenses chargeable to income tax, car allowances, travel allowances, telephone allowances, and amounts paid in lieu of pension contributions. Included in other emoluments are:
- Richard Davey expenses £333.50
  - Baroness Noakes expenses £264.50.
  - Tony Ballance car allowance £15,000.
  - Martin Kane pension supplement £75,180, car allowance £15,000, US disturbance allowance and utility costs £32,309, and compensation for UK tax suffered on US benefits £44,270
  - Michael McKeon pension supplement £181,270, car allowance £15,000 and a telephone allowance £112.68.
  - Andy Smith pension supplement £51,670 and car allowance £15,000
  - Tony Wray pension supplement £223,300 and £15,000 car allowance.

### Details of variable pay earned in the year

#### Annual bonus plan outcome – 2012/13

In the 2012/13 financial year, the Chief Executive and Finance Director had: (i) 80% of their bonus outcome based on the performance of Severn Trent Water, (ii) 10% based on the performance of Severn Trent Services and (iii) 10% based on personal contribution. The remaining executive directors with the exception of the Chief Executive Officer, Severn Trent Services, had 90% of their bonus outcome attributed to the performance of Severn Trent Water and 10% based on personal performance.

The Chief Executive Officer, Severn Trent Services had 70% of his bonus linked to the performance of Severn Trent Services, 10% linked to the performance of Severn Trent Water and 20% against personal contribution.

#### i) Severn Trent Water

The bonus outcome in respect of Severn Trent Water performance was operated by reference to a balanced scorecard of measures, based on 10 of the company's 16 KPIs (shown on page 139). The Committee believes that the use of the selected 10 Severn Trent Water KPIs continues to be both an effective and challenging annual bonus metric and meets the needs of the business. The bonus entitlement was determined by reference to the aggregate number of points awarded across all the KPIs. The targets taken together are considered by the board to have an impact on the longer term financial performance of the company and a number of them are reported to Ofwat.

## Governance Remuneration Committee

A definition of each KPI is listed below:

| Key area    | Objective                                    | Key Performance Indicators |   |
|-------------|--|----------------------------|---|
| Employee    | Provide a safe working environment           | KPI 1                      | Lost time incidents per 100,000 hrs worked                              |
|             | Develop a confident and productive workforce | KPI 2                      | Employee motivation   |
| Customer    | Quality interaction with the customer        | KPI 4                      | Service Incentive Mechanism – Qualitative                               |
|             |  | KPI 5                      | Service Incentive Mechanism – Quantitative                              |
|             |  | KPI 7                      | Serviceability – Waste  |
|             |  | KPI 8                      | Serviceability – Water  |
| Financial   | Asset base enhancement                       | KPI 9                      | Capital Expenditure (net) versus Final Determination – % outperformance |
|             | Management of cost base                      | KPI 11                     | Operating Expenditure versus Final Determination – % outperformance     |
| Environment | Minimise environmental impact                | KPI 12                     | Pollution incidents (cat 1, 2 and 3)                                    |
|             |  | KPI 16                     | Leakage MI/d – Post MLE   |

Each KPI has 100 target points, 130 stretch points and are uncapped. For executive directors to be awarded the maximum bonus available they are required to achieve 1,300 aggregate points. During the year 7 of the 10 KPIs exceeded the stretch level of performance. After examining the overall performance and indicative bonus outcome the Committee determined that each of the 7 KPIs should be capped at the level of stretch performance. As a consequence the bonus awarded for the Severn Trent Water portion of the annual bonus was 77.7% of its bonus element maximum, representing a strong performance in the year and continues the positive progressive trend in the outcome of the KPIs. The chart below shows the points awarded by the Committee for bonus purposes under each of the 10 KPIs in relation to the 2012/13 annual bonus scheme and the effect of capping of each KPI at stretch performance.

Graph Removed

Capital expenditure (Capex) is measured annually and over the five year AMP period. The directors are incentivised to outperform the annual Capex target, however, this year the annual target was not outperformed and therefore zero points were achieved. Severn Trent Water remains on track to meet its five year Capex target at the end of the AMP.

### ii) Severn Trent Services

A proportion of the bonus opportunity for the Chief Executive (10%), Finance Director (10%) and Chief Executive of Severn Trent Services (70%) was measured against the performance of Severn Trent Services. Performance was measured against the profit before interest and tax (PBIT) (before exceptional items) and the return on invested capital (ROIC) of Severn Trent Services. A number of the personal objectives set for the directors named above also relate to the performance of Severn Trent Services. Following a strong year of performance, the PBIT and ROIC targets were met in full and the bonus award for this element of the plan will pay out at the maximum.

### iii) Personal contribution

All directors had 10% of their bonus opportunity measured against personal objectives, with the exception of the Chief Executive of Severn Trent Services who had 20%. Performance against personal objectives in the year was strong with directors receiving between 90% and 96% of the maximum bonus opportunity available under this element of the annual bonus plan.

The Committee has reviewed the operation of the annual bonus plan over the year and concluded that it should operate on a similar basis for 2013/2014.

## Governance Remuneration Committee

## Directors' pension provisions

Tony Wray and Michael McKeon receive a salary supplement of 40% of base salary in lieu of future pension provision and Martin Kane receives 30% of salary

Tony Ballance is a member of the Severn Trent Pension Scheme (Pension Choices section) which is one of the company's defined contribution schemes. He currently contributes 3% of salary and the company contributes 30%, plus a further 2.5% in respect of death in service and ill health benefits. The normal retirement age for the scheme is 65 although retirement prior to 65 is possible with the consent of the company

Andy Smith participates in the Severn Trent Pension Scheme which will close in 2015. The scheme is a funded HMRC registered final salary occupational pension scheme which provides:

- a normal retirement age of 60 years;
- an overall pension at normal retirement age of two thirds of final pensionable salary, which for executive directors is defined as base salary only, subject to the completion of 20 years' pensionable service and member contributions of 6%;
- life cover of 4 x pensionable earnings;
- a pension payable in the event of retirement on grounds of ill health, and
- a dependant's pension on death of two thirds of the member's pension.

Andy Smith participates up to the level of the scheme specific earnings cap which in 2012/13 was £137,400. He is provided with a cash supplement in lieu of pension entitlement above this scheme cap at 40% of his salary. Early retirement is available after the age of 55 with the consent of the company, subject to actuarial reduction, other than in the case of incapacity.

## Details of directors' interests in defined benefit pension schemes

| Name        | Service completed in years (including transferred in service credits) | Accrued pension at 31 March 2013 (£pa) | Increase in accrued pension during the year (£pa) | Increase in accrued pension during the year (net of inflation) (£pa) | Transfer value of accrued pension at 31 March 2013 (£'000) | Transfer value of accrued pension at 31 March 2012 (£'000) | Increase in transfer value over the year net of directors' contributions (£'000) | Transfer value of accrued benefits net of directors' contributions (£'000) |
|-------------|---|--|---|--|--|--|--|--|
| Andy Smith  | 8   | 37,769                                 | 6,452   | 5,450  | 680.8  | 493.3  | 179.3  | 108.1  |
| Tony Wray   | 6   | 29,818                                 | 347   | (596)  | 511.5  | 424.3  | 87.2   | 6.0  |
| Martin Kane | 35  | 149,113                                | 14,340  | 10,027   | 2,748.9  | 2,166.1  | 582.8  | 264.4  |

## Notes:

Accrued pension figures and transfer value calculations provided by Towers Watson.

The transfer value base has been updated since the last year end. Transfer values quoted above reflect the transfer value base that was in force at the time of the accrued pension calculation. The impact of the change in methodology was to increase the transfer value at 31 March 2013 value as follows: Andy Smith £23,400, Tony Wray £17,100, Martin Kane £89,300.

Mr Wray ceased to contribute to the scheme from 31 December 2011. At this date he became a deferred pensioner of the scheme and stopped accruing pensionable service. Towers Watson have calculated his accrued pension and Final Pensionable Salary as at 31 December 2011. In addition, Towers Watson have calculated his transfer value as at 31 March 2013 allowing for deferred revaluation to this date.

Inflation figure used in respect of year is February 2013 (3.2%) as the latest available figure prior to the year end. This approach is consistent with the prior year.

## Directors' share interests

The directors of the company at 31 March 2013 and their beneficial interests in the shares of the company were as follows:

## i) Beneficial holdings and outstanding deferred shares

|   | At 1 April 2012 number of ordinary 97 1/4p shares each |                             | At 31 March 2013 number of ordinary 97 1/4p shares each |                             | At 22 May 2013 number of ordinary 97 1/4p shares each |                             |
|---|--|-----------------------------|---|-----------------------------|---|-----------------------------|
|   | Beneficial   | Non-beneficial <sup>1</sup> | Beneficial  | Non-beneficial <sup>1</sup> | Beneficial  | Non-beneficial <sup>1</sup> |
| <b>Chairman and other non-executive directors</b> |  |                             |   |                             |   |                             |
| Dr Bernard Bullen                                 | 554  | —                           | 554   | —                           | 554   | —                           |
| Richard Davey                                     | 588  | —                           | 588   | —                           | 588   | —                           |
| Andrew Duff (chairman)                            | 3,500  | —                           | 3,500   | —                           | 3,500   | —                           |
| Martin Lamb                                       | 3,012  | —                           | 3,012   | —                           | 3,012   | —                           |
| Baroness Noakes                                   | 4,018  | —                           | 4,018   | —                           | 4,018   | —                           |
| Gordon Fryett                                     | 1,064  | —                           | 1,149   | —                           | 1,149   | —                           |
| <b>Executive directors</b>                        |  |                             |   |                             |   |                             |
| Tony Ballance                                     | 4,218  | 13,544                      | 9,172   | 11,317                      | 9,172   | 11,317                      |
| Martin Kane <sup>2</sup>                          | 11,162   | 15,678                      | 16,225  | 13,759                      | 16,674  | 13,759                      |
| Michael McKeon                                    | 8,168  | 32,574                      | 20,302  | 25,601                      | 20,302  | 25,601                      |
| Andy Smith  | 9,514  | 19,333                      | 16,051  | 15,364                      | 16,051  | 15,364                      |
| Tony Wray <sup>3</sup>                            | 13,429   | 35,453                      | 26,419  | 29,733                      | 27,542  | 29,733                      |

1 Non-beneficial holdings are yet to be released conditionally held under the Annual Bonus Scheme, to which directors became unconditionally entitled on the third anniversary of grant.

2 Martin Kane acquired 449 shares on 1 May 2013, with a market price of 1,823p per share, following the exercise of his 2010 three year Sharesave scheme option.

3 Tony Wray acquired 1,123 shares on 1 May 2013, with a market price of 1,823p per share, following the exercise of his 2010 three year Sharesave scheme option.

## Governance Remuneration Committee

### ii) Long Term Incentive Plan

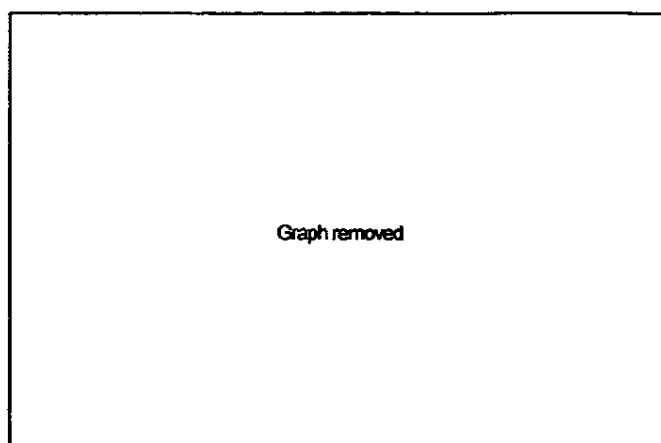
The executive directors have further interests in the company's ordinary shares of 97<sup>17</sup>/<sub>19</sub>p each by virtue of having received contingent awards of shares under the LTIP. The LTIP operates on a three year rolling basis. Awards do not vest until they have been held in trust for three years and specific performance criteria have been satisfied. The Severn Trent Employee Share Ownership Trust is operated in conjunction with the LTIP. Executive directors have a technical interest in 395,749 shares held by the Severn Trent Employee Share Ownership Trust. The individual interests, for the executive directors, which represent the maximum aggregate number of shares to which each individual could become entitled, are as follows.

|                | Awards granted | Maximum award | Awards vested | Awards lapsed | Maximum outstanding awards as at 31 March 2013 |
|----------------|----------------|---------------|---------------|---------------|--|
| Tony Ballance  | 7 July 2009    | 7,405         | 2,103         | 5,302         | -  |
|                | 21 June 2010   | 6,803         | -             | -             | 6,803  |
|                | 22 June 2011   | 6,525         | -             | -             | 6,525  |
|                | 19 June 2012   | 5,741         | -             | -             | 5,741  |
| Martin Kane    | 7 July 2009    | 8,154         | 2,315         | 5,839         | -  |
|                | 21 June 2010   | 8,504         | -             | -             | 8,504  |
|                | 22 June 2011   | 7,121         | -             | -             | 7,121  |
|                | 19 June 2012   | 7,119         | -             | -             | 7,119  |
| Michael McKeon | 7 July 2009    | 18,733        | 5,320         | 13,413        | -  |
|                | 21 June 2010   | 17,211        | -             | -             | 17,211   |
|                | 22 June 2011   | 14,411        | -             | -             | 14,411   |
|                | 19 June 2012   | 12,684        | -             | -             | 12,684   |
| Andy Smith     | 7 July 2009    | 11,019        | 3,129         | 7,890         | -  |
|                | 21 June 2010   | 10,124        | -             | -             | 10,124   |
|                | 22 June 2011   | 8,477         | -             | -             | 8,477  |
|                | 19 June 2012   | 7,460         | -             | -             | 7,460  |
| Tony Wray      | 7 July 2009    | 27,769        | 7,886         | 19,883        | -  |
|                | 21 June 2010   | 25,512        | -             | -             | 25,512   |
|                | 22 June 2011   | 23,271        | -             | -             | 23,271   |
|                | 19 June 2012   | 21,875        | -             | -             | 21,875   |

Market price on the date of the 2012 award was £17.49 (19 June 2012).

The LTIP awards made in 2009 and 2010 were subject to TSR performance, measured relative to those companies ranked 51-150 in the FTSE by market capitalisation (excluding investment trusts). At median performance, 25% of awards vest and 100% vest for performance at or above the upper quartile. In addition, for awards to vest, the Committee must be satisfied that the company's TSR is reflective of the company's underlying performance. The 2009 award ended its TSR performance period on 31 March 2012 and vested at 28.4%. The market price on the date of vesting (1 June 2012) of the 2009 award was £17.60. The 2010 award ended its TSR performance period on 31 March 2013 and will vest at 57.5%.

The performance conditions for the LTIP awards made in 2011 and 2012 are based on Return on Regulatory Capital Value (RoRCV). A sliding scale of targets is used, linked to outperformance of the Ofwat Final Determination shown graphically below:



## Governance Remuneration Committee

This vesting schedule is set so as to ensure that executives are appropriately rewarded for performance in excess of the Final Determination, with no payouts for performance below this. However, it is also important that executives are not over incentivised to achieve excessive levels of RoRCV, which could in theory incentivise inappropriate behaviours such as operational performance which does not deliver customer value or inadequate investment in our capital base. The Committee believes the above scale encourages delivery of strong performance against the Final Determination, but without compromising the company's wider values.

Performance is measured over three financial years. If the vesting result is 0% or greater than 50% then the Committee reserves the discretionary power to change this result. If it is greater than 50% it may reduce the vesting to a number not less than 50% as it considers appropriate, and if it is 0% it may increase it to any figure not greater than 50%. The use of this discretion is expected to be exceptional, but may be invoked by the Committee in order to take into account of any of the following factors (not an exhaustive list)

- actual RPI compared to the Ofwat assumed RPI figure – even though the RoRCV is adjusted each year for RPI a significant swing in inflation during the year can result in substantial under or over performance on the RoRCV target. RPI in itself is not a factor that management can influence;
- changes to the financing of the company as approved by the board during the performance period – for example a significant change to the level of gearing of the balance sheet would result in partially meeting this performance condition, and
- policy changes that occur during the performance period – there is much discussion on the future shape of the water industry in the UK and if enacted we would wish to ensure that any changes have a neutral impact on existing awards.

Participants are entitled to additional shares in lieu of dividends paid on vested shares over the performance period.

### iii) Annual Bonus Scheme

The shares in respect to 2012/2013 performance year are due to be granted in June 2013. The table below shows outstanding unreleased share awards from previous years.

|                | Date of grant | Annual bonus deferred into shares | Number of shares | Deferred share award release date |
|----------------|---------------|-----------------------------------|------------------|-----------------------------------|
| Tony Ballance  | 7 July 2009   | £62,294                           | 5,669            | 9 July 2012                       |
|                | 28 June 2010  | £51,448                           | 4,139            | 27 June 2013                      |
|                | 30 June 2011  | £51,823                           | 3,736            | 29 June 2014                      |
|                | 28 June 2012  | £55,634                           | 3,442            | 27 June 2015                      |
| Martin Kane    | 7 July 2009   | £68,598                           | 6,243            | 9 July 2012                       |
|                | 28 June 2010  | £64,310                           | 5,173            | 27 June 2013                      |
|                | 30 June 2011  | £59,119                           | 4,262            | 29 June 2014                      |
|                | 28 June 2012  | £69,887                           | 4,324            | 27 June 2015                      |
| Michael McKeon | 7 July 2009   | £157,590                          | 14,343           | 9 July 2012                       |
|                | 28 June 2010  | £128,724                          | 10,355           | 27 June 2013                      |
|                | 30 June 2011  | £109,242                          | 7,876            | 29 June 2014                      |
|                | 28 June 2012  | £119,108                          | 7,370            | 27 June 2015                      |
| Andy Smith     | 7 July 2009   | £92,700                           | 8,437            | 9 July 2012                       |
|                | 28 June 2010  | £75,810                           | 6,098            | 27 June 2013                      |
|                | 30 June 2011  | £66,555                           | 4,798            | 29 June 2014                      |
|                | 28 June 2012  | £72,210                           | 4,468            | 27 June 2015                      |
| Tony Wray      | 7 July 2009   | £166,680                          | 15,187           | 9 July 2012                       |
|                | 28 June 2010  | £138,996                          | 11,182           | 27 June 2013                      |
|                | 30 June 2011  | £126,000                          | 9,084            | 29 June 2014                      |
|                | 28 June 2012  | £152,988                          | 9,467            | 27 June 2015                      |

#### Note:

The 2009 awards were released on 9 July 2012 at £16.84 per share

The market price on the date of grant of the 2012 award was £16.45 (28 June 2012).

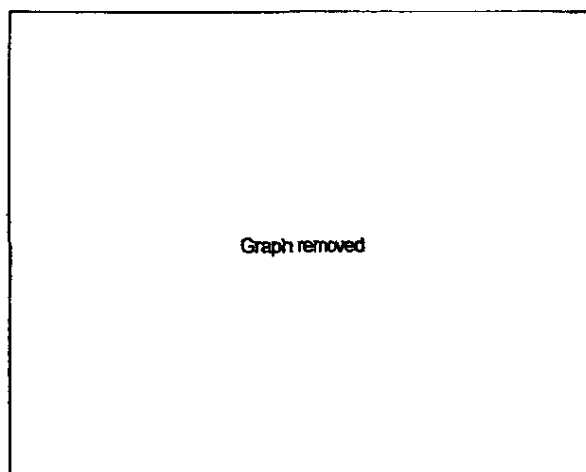
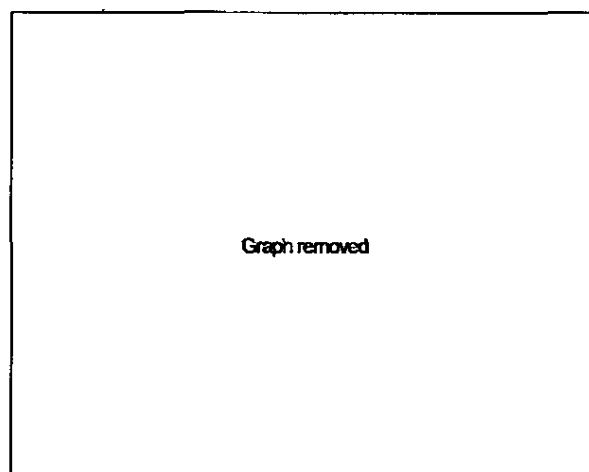
**Governance** Remuneration Committee**iv) Share Matching Plan**

Under the Share Matching Plan executives can receive, subject to performance, matching shares for each share deferred under the annual bonus plan. The current policy is for one matching share to be awarded for every two deferred shares. The table below shows outstanding unreleased matching shares.

|                | Date of award | Maximum award | Awards vesting | Awards lapsing | Maximum outstanding awards as at 31 March 2013 |
|----------------|---------------|---------------|----------------|----------------|--|
| Tony Ballance  | 21 May 2010   | 2,069         | -              | -              | 2,069  |
|                | 20 May 2011   | 1,868         | -              | -              | 1,868  |
|                | 25 May 2012   | 1,721         | -              | -              | 1,721  |
| Martin Kane    | 21 May 2010   | 2,586         | -              | -              | 2,586  |
|                | 20 May 2011   | 2,131         | -              | -              | 2,131  |
|                | 25 May 2012   | 2,162         | -              | -              | 2,162  |
| Michael McKeon | 21 May 2010   | 5,177         | -              | -              | 5,177  |
|                | 20 May 2011   | 3,938         | -              | -              | 3,938  |
|                | 25 May 2012   | 3,685         | -              | -              | 3,685  |
| Andy Smith     | 21 May 2010   | 3,049         | -              | -              | 3,049  |
|                | 20 May 2011   | 2,399         | -              | -              | 2,399  |
|                | 25 May 2012   | 2,234         | -              | -              | 2,234  |
| Tony Wray      | 21 May 2010   | 5,591         | -              | -              | 5,591  |
|                | 20 May 2011   | 4,542         | -              | -              | 4,542  |
|                | 25 May 2012   | 4,733         | -              | -              | 4,733  |

The performance condition for the 2010 SMP awards is the same as that applying to the LTIP awards granted in 2010, albeit with the performance period being three years from the date of grant.

Shown graphically, the vesting schedule and performance and vesting periods apply to the 2010, 2011 and 2012 SMP awards is:



In addition, for any awards to vest, the Committee must be satisfied that the vesting level is justified when taking into account the underlying financial performance of the company over the full three year performance period and that there has been no compromise to the commercial practices or optional standards of the group over this period.

The TSR performance up to 31 March 2013 for the outstanding 2010, 2011 and 2012 SMP awards indicates that 67.1%, 73.8% and 0% of the maximum award will vest for each award respectively, reflecting generally strong performance compared to the other companies in the TSR comparator group.

## Governance Remuneration Committee

## v) Sharesave options over ordinary shares

|                            | At the start of the year (No of shares) | Exercised during the year (No. of shares) | Cancelled during the year (No. of shares) | Granted during the year (No. of shares) | At the end of the year (No. of shares) | Year of grant of option | Exercise price (p) | Date from which exercisable | Expiry date |
|----------------------------|---|---|---|---|--|-------------------------|--------------------|-----------------------------|-------------|
| Sharesave <sup>1</sup>     |   |   |   |   |  |                         |                    |                             |             |
| Tony Ballance <sup>2</sup> | 556                                     | (556)                                     | -   | -                                       | -                                      | 2009                    | 862                | May 2012                    | Oct 2012    |
|                            | 561                                     | -   | -   | -                                       | 561                                    | 2010                    | 808                | May 2013                    | Oct 2013    |
|                            | -                                       | -   | -   | 725                                     | 725                                    | 2013                    | 1,241              | May 2016                    | Oct 2016    |
| Martin Kane <sup>3</sup>   | 222                                     | (222)                                     | -   | -                                       | -                                      | 2009                    | 862                | May 2012                    | Oct 2012    |
|                            | 449                                     | -   | -   | -                                       | 449                                    | 2010                    | 808                | May 2013                    | Oct 2013    |
|                            | 316                                     | -   | -   | -                                       | 316                                    | 2011                    | 1,137              | May 2014                    | Oct 2014    |
|                            | -                                       | -   | -   | 152                                     | 152                                    | 2012                    | 1,177              | May 2015                    | Oct 2015    |
|                            | -                                       | -   | -   | 290                                     | 290                                    | 2013                    | 1,241              | May 2016                    | Oct 2016    |
| Michael McKeon             | 1,943                                   | -   | -   | -                                       | 1,943                                  | 2009                    | 862                | May 2014                    | Oct 2014    |
| Andy Smith                 | 1,123                                   | -   | -   | -                                       | 1,123                                  | 2010                    | 808                | May 2013                    | Oct 2013    |
|                            | -                                       | -   | -   | 725                                     | 725                                    | 2013                    | 1,241              | May 2016                    | Oct 2016    |
| Tony Wray                  | 1,123                                   | -   | -   | -                                       | 1,123                                  | 2010                    | 808                | May 2013                    | Oct 2013    |
|                            | -                                       | -   | -   | 725                                     | 725                                    | 2013                    | 1,241              | May 2016                    | Oct 2016    |

1 The executive directors, in common with all eligible UK employees of the group, are entitled to participate in the company's HMRC approved Sharesave Scheme.

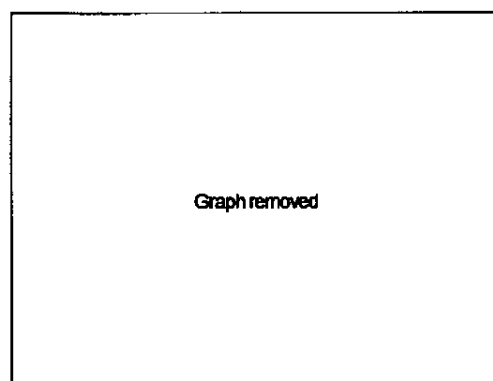
2 Tony Ballance acquired 556 shares on 8 November 2012, with a market price of 1,517p per share, following the exercise of his 2009 three year Sharesave scheme options, generating a £3,641 gain.

3 Martin Kane acquired 222 shares on 1 May 2012, with a market price of 1,683p per share, following the exercise of his 2009 three year Sharesave scheme options, generating a £1,822 gain.

The terms and conditions applicable to these options are those provided in that scheme. The options have no performance conditions as such conditions are not permitted by legislation. No executive share options in respect of executive directors were granted or lapsed during the year. At the close of business on 31 March 2013 the mid-market price of the company's shares was £17.12 and the range during the year was £14.97 to £18.36.

## Five year total shareholder return chart

This graph illustrates the value, by 31 March 2013, of £100 invested in Severn Trent Plc on 31 March 2008 compared with the value of £100 invested in the FTSE 100 Index. The intermediate points show the value at intervening financial year ends.



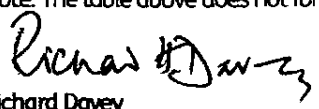
## Statement of shareholding voting at AGM

At last year's AGM, the resolution approving the Directors' remuneration report received the following votes from shareholders:

|                  | Total number of votes | % of votes cast     |
|------------------|-----------------------|---------------------|
| For              | 135,101,023           | 96.96%              |
| Against          | 4,231,635             | 3.04%               |
| Total votes cast | 139,332,658           | 58.47% <sup>1</sup> |
| Abstentions      | 2,383,537             | N/A                 |

1 As a percentage of share capital.

Note: The table above does not form part of the auditable section of the Directors' remuneration report.

  
 Richard Davey  
 Chairman of the Remuneration Committee



## Directors' report

The directors present their report, together with the audited financial statements of the group, for the year ended 31 March 2013

### Principal activity

The principal activity of the group is to treat and provide water and remove waste water in the UK and internationally.

Details of the principal joint ventures, associated and subsidiary undertakings of the group at 31 March 2013 are shown in notes 19, 20 and 42 to the financial statements on pages 101 and 127.

### Business review

The Chairman's statement, the Chief Executive's review, the report and performance reviews for the group's main businesses and the Financial review on pages 35 to 38 provide detailed information relating to the group, its business models and strategy, the operation of its businesses and the results and financial position for the year ended 31 March 2013.

Details of the principal risks and uncertainties facing the group are set out in the risk management section on pages 39 to 42.

All of the above are incorporated by reference in (and are deemed to form part of) this report.

### Directors and their interests

Biographies of the directors currently serving on the board are set out on pages 44 and 45

All of the directors will be offering themselves for reappointment at the Annual General Meeting (AGM), as set out in the Governance report on pages 48 to 51.

Details of directors' service agreements are set out in the Directors' remuneration report on page 62. The interests of the directors in the shares of the company are shown on pages 66 to 70 of that report.

### 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. In accordance with the company's articles of association, and to the extent permitted by law, in November 2011 the company indemnified 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. Severn Trent does not have in place any indemnities for the benefit of the auditors.

### Employees

The average number of employees within the group is shown in note 9 to the financial statements on page 94

Severn Trent believes that a diverse and inclusive culture is a key factor in being a successful business. Apart from ensuring an individual has the ability to do the job we do not discriminate in any way and make every effort to ensure that those with disabilities are able to be employed by us. We endeavour to retain employees in the workforce if they become disabled, we make all reasonable adjustments to their role and, if necessary, look for redeployment opportunities to support them in seeking an alternative role within Severn Trent.

We ensure that training, career development and promotion opportunities are available for all our employees irrespective of their gender, race, age or disability

The group actively encourages employee involvement and consultation and places emphasis on keeping its employees informed of its activity and financial performance by way of briefings and publication to staff of all relevant information and corporate announcements. To help develop employees' interest in the company's performance, Severn Trent offers two employee share plans. The Severn Trent Sharesave Scheme, an HM Revenue and Customs approved SAYE plan, is offered to UK employees on an annual basis. The Severn Trent Share Incentive Plan, approved by HM Revenue and Customs, makes an annual award of shares to Severn Trent Plc and Severn Trent Water Limited employees, based on performance against the KPIs.

### Research and development

Expenditure on research and development is set out in notes 7 and 17 to the Financial statements on pages 93 and 99 respectively.

### Treasury management

The disclosures required under the EU Fair Value Directive in relation to the use of financial instruments by the company are set out in note 32 to the Financial statements on pages 109 to 118. Further details on our treasury policy and management are set out in the Financial review on page 37

### Post balance sheet events

Details of post balance sheet events are set out in note 40 to the group financial statements on page 126.

### Dividends

An interim dividend of 30.34 pence per ordinary share was paid on 11 January 2013. The directors recommend a final dividend of 45.51 pence per ordinary share to be paid on 26 July 2013 to shareholders on the register on 21 June 2013. This would bring the total dividend for 2012/13 to 75.85 pence per ordinary share (2012: 70.10 pence). The payment of the final dividend is subject to shareholder approval at the AGM.

On 27 July 2012 a special dividend of 63.0 pence per ordinary share was paid to shareholders.

### Capital structure

Details of the company's issued share capital and of the movements during the year are shown in note 29 to the financial statements on page 109. 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 of association 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 33 to the financial statements on pages 119 to 122. 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.

## Governance Directors' report

With regard to the appointment and replacement of directors, the company is governed by its articles of association, the Governance 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, the articles and the Governance report on pages 48 to 51.

Under its articles of association, the directors have authority to allot ordinary shares, subject to the aggregate nominal amount limit set at the 2012 AGM.

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 is 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 that occurs because of a takeover bid.

### Substantial shareholdings

As at 31 March 2013 the company had been notified in accordance with chapter 5 of the Disclosure and Transparency Rules of the following major shareholdings

| Name of holder                   | No. of ordinary shares of 97 <sup>17</sup> / <sub>16</sub> p each | Percentage of voting rights and issued share capital |
|----------------------------------|---|--|
| Blackrock Inc                    | 23,457,458  | 9.87%  |
| Newton Investment Management Ltd | 12,087,473  | 5.09%  |
| Legal & General Group Plc        | 9,627,643   | 4.04%  |

Percentages rounded to two decimal places.

As at 29 May 2013, the company had been notified of the following holdings of voting rights in the ordinary share capital of the company: Blackrock Inc 23,457,458 (9.87%); Newton Investment Management Ltd 12,087,473 (5.09%) and Legal & General Group Plc 9,627,643 (4.04%).

### Authority to purchase shares

The company was given authority at its AGM in 2012 to make market purchases of ordinary shares up to a maximum number of 23,819,555 shares. Similar authority will again be sought from shareholders at this year's AGM. No market purchases were made by the company during the year ended 31 March 2013.

### Supplier payment policy

Individual operating companies within the group are responsible for establishing appropriate policies with regard to the payment of their suppliers. 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. Details of supplier payment policies can be obtained on request to the company. Trade creditors for the group at the year end are estimated as representing 17.9 days' purchases (2012: 21.2 days' purchases).

### Contributions for political and charitable purposes

Donations to charitable organisations during the year amounted to £97,707 (2012: £107,325). 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. 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 2012 AGM, shareholders gave the company authorities 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 £50,000 for the company and its subsidiaries. Pursuant to those authorities, during the year ended 31 March 2013 the group incurred costs of £nil (2012: £nil). Those authorities will expire at the 2013 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 of £50,000 per annum. 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.

## Governance Directors' report

## Analysis of shareholdings at 31 March 2013

| Category                      | Number of shareholders | % of shareholders | Number of shares   | % of shares   |
|-------------------------------|------------------------|-------------------|--------------------|---------------|
| Individual and joint accounts | 60,846                 | 91.3              | 25,034,928         | 10.5          |
| Other*                        | 5,790                  | 8.7               | 213,330,806        | 89.5          |
| <b>Total</b>                  | <b>66,636</b>          | <b>100.00</b>     | <b>238,365,734</b> | <b>100.00</b> |

\* Includes insurance companies, nominee companies, banks, pension funds, other corporate bodies, limited and public limited companies.

| Size of holding | Number of shareholders | % of shareholders | Number of shares   | % of shares   |
|-----------------|------------------------|-------------------|--------------------|---------------|
| 1-499           | 47,987                 | 72.01             | 9,380,610          | 3.93          |
| 500-999         | 11,980                 | 17.98             | 8,346,739          | 3.50          |
| 1,000-4,999     | 5,684                  | 8.53              | 9,771,710          | 4.10          |
| 5,000-9,999     | 317                    | 0.48              | 2,146,409          | 0.90          |
| 10,000-49,999   | 320                    | 0.48              | 7,647,097          | 3.21          |
| 50,000-99,999   | 95                     | 0.14              | 6,791,417          | 2.85          |
| 100,000+        | 253                    | 0.38              | 194,281,752        | 81.51         |
| <b>Total</b>    | <b>66,636</b>          | <b>100.00</b>     | <b>238,365,734</b> | <b>100.00</b> |

## Internal controls

The board is responsible for the group's system of internal control and for reviewing its effectiveness. The board reviews the effectiveness of the system of internal control, including financial, operational, compliance and risk management, at least annually in accordance with the requirements of the Governance Code. The internal control system can provide only reasonable and not absolute assurance against material misstatement or loss, as it is designed to manage rather than eliminate the risk of failure to achieve business objectives.

The Audit Committee reviews the group's risk management process and the effectiveness of the system of internal control on behalf of the board and keeps under review ways in which to enhance the control and assurance arrangements.

The Audit Committee receives reports every six months from the Chief Executive 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. During the course of its review of the system of internal control in 2012/13, the Audit Committee has not identified nor been advised of any failings or weaknesses which it has determined to be significant.

The Internal Audit department provides objective assurance and advice on risk management and control. The external auditors also report on significant financial control issues to the Audit Committee.

An independent reporter (Atkins) provides objective assurance in relation to the Severn Trent Water Limited Annual Regulatory Compliance Statement and Annual Regulatory Performance Report.

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 2013 and up to the date of approval of the annual report, which is in accordance with the revised guidance on internal control published in October 2005 (the Turnbull Guidance).

The group's procedures for exercising control and managing risk in relation to financial reporting and preparation of consolidated accounts include

- 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;
- 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.

## 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 auditors are 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 auditors are 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 auditors

The Audit Committee has recommended to the board the reappointment of Deloitte LLP and a resolution to that effect will be on the agenda at the AGM. Deloitte LLP have indicated their willingness to continue as auditors. The Audit Committee will also be responsible for determining the audit fee on behalf of the board.

**Governance Directors' report****Accounts of Severn Trent Water Limited**

Regulatory accounts for Severn Trent Water Limited are prepared and sent to Ofwat. A copy of these accounts will be available on the website of Severn Trent Water Limited ([www.stwater.co.uk](http://www.stwater.co.uk)) or on request to the Company Secretary. There is no charge for this publication.

**Going concern**

The group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Chief Executive's review on pages 7 to 10 and the business reviews of Severn Trent Water and Severn Trent Services on pages 11 to 32. The financial position of the group, its cash flows, liquidity position and borrowing facilities are described in the Financial review on pages 35 to 38. The group's objectives, policies and processes for managing its capital and its financial risk management objectives are described in the Financial review on pages 35 to 38 and in the Risk management report on pages 39 to 42. Details of the group's financial instruments, hedging activities and exposure to credit risk and liquidity risk are described in note 32 to the group financial statements.

The group's principal operating subsidiary, Severn Trent Water, is a regulated long term business characterised by multi year investment programmes. The group's strategic funding objectives reflect this. The group therefore seeks to attain a balance of long term funding or commitment of funds across a range of funding at the best possible economic cost. Average debt maturity is 16 years and the effective average interest cost during the year was 5.9%. The group is in a strong liquidity position and had £403.6 million in cash and liquid reserves and £500.0 million of undrawn committed bank facilities at 31 March 2013, which are expected to be sufficient to fund its investment and cash flow needs at least until January 2015 in the normal course of business.

Severn Trent Water operates in an industry that is currently subject to economic regulation rather than market competition. Ofwat, the economic regulator, has a statutory obligation to set price limits that it believes will enable the water companies to finance their activities. As a consequence the directors believe that the group is well placed to manage its business risks successfully despite the current uncertain economic outlook.

After making enquiries, the directors have a reasonable expectation that the company and the group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

**Annual General Meeting**

The AGM of the company will be held at the International Convention Centre, Broad Street, Birmingham B1 2EA at 11am on Wednesday 17 July 2013. 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 the company's website ([www.severntrent.com](http://www.severntrent.com)).

By order of the board



Bronagh Kennedy  
General Counsel and Company Secretary  
29 May 2013

## Directors' responsibility statement

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors are required to prepare 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 chosen to prepare the parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). 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 these financial statements, International Accounting Standard 1 requires that the 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 United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

We confirm that to the best of our 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; and
- the management report, which is incorporated into the Directors' 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.

  
Andrew Duff  
Chairman

  
Michael McKeon  
Finance Director

## Financial statements

### Group financial statements

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# Independent auditor's report to the members of Severn Trent Plc

We have audited the group financial statements of Severn Trent Plc for the year ended 31 March 2013 which comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity, the consolidated balance sheet, the consolidated cash flow statement, and the related notes 1 to 42. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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.

## Respective responsibilities of directors and auditor

As explained more fully in the Directors' responsibility statement, the directors are responsible for the preparation of the group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

## Scope of the audit of the financial statements

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

## Opinion on financial statements

In our opinion the group financial statements

- give a true and fair view of the state of the group's affairs as at 31 March 2013 and of its profit for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation

## Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' report for the financial year for which the group financial statements are prepared is consistent with the group financial statements.

## Matters on which we are required to report by exception

We have nothing to report in respect of the following.

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

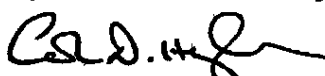
- certain disclosures of directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the directors' statement, contained within the Directors' report, in relation to going concern,
- the part of the Chairman's letter relating to the company's compliance with the nine provisions of UK Corporate Governance Code specified for our review; and
- certain elements of the report to shareholders by the Board on directors' remuneration

## Other matters

We have reported separately on the parent company financial statements of Severn Trent Plc for the year ended 31 March 2013 and on the information in the Remuneration Committee report that is described as having been audited.



Carl D Hughes (Senior Statutory auditor)  
for and on behalf of Deloitte LLP  
Chartered Accountants and Statutory Auditor  
London, UK  
29 May 2013

## Consolidated income statement

For the year ended 31 March 2013

|  | Notes | 2013<br>£m | 2012<br>£m |
|--|-------|------------|------------|
| Turnover   | 5, 6  | 1,831.6    | 1,770.6    |
| Operating costs before exceptional items                                 | 7     | (1,333.6)  | (1,266.4)  |
| Exceptional operating costs  | 8     | (4.3)      | (34.4)     |
| Total operating costs  | 7     | (1,337.9)  | (1,300.8)  |
| Exceptional loss on disposal of businesses                               | 8     | (1.5)      | -          |
| Profit before interest, tax and exceptional items                        | 5     | 498.0      | 504.2      |
| Exceptional items before interest and tax                                | 8     | (5.8)      | (34.4)     |
| Profit before interest and tax   |       | 492.2      | 469.8      |
| Finance income   | 10    | 90.8       | 107.7      |
| Finance costs excluding exceptional costs                                | 11    | (322.7)    | (336.7)    |
| Exceptional finance costs  | 11    | -          | (16.5)     |
| Net finance costs  |       | (231.9)    | (245.5)    |
| Losses on financial instruments  | 12    | (45.3)     | (67.7)     |
| Share of results of associates and joint ventures                        |       | 0.2        | 0.1        |
| Profit before tax, losses on financial instruments and exceptional items |       | 266.3      | 275.3      |
| Exceptional items before tax   | 8     | (5.8)      | (50.9)     |
| Losses on financial instruments  | 12    | (45.3)     | (67.7)     |
| Profit on ordinary activities before taxation                            |       | 215.2      | 156.7      |
| Taxation on profit on ordinary activities                                |       |            |            |
| Current tax excluding exceptional credit                                 | 13    | (27.9)     | (60.5)     |
| Deferred tax excluding exceptional charge/(credit)                       | 13    | 4.7        | 9.1        |
| Exceptional tax credit   | 13    | 38.4       | 69.1       |
| Total taxation   | 13    | 15.2       | 17.7       |
| Profit for the year  |       | 230.4      | 174.4      |
| Attributable to:   |       |            |            |
| Owners of the company  |       | 227.5      | 171.8      |
| Non-controlling interests  |       | 2.9        | 2.6        |
|  |       | 230.4      | 174.4      |
| Earnings per share (pence)   |       |            |            |
| Basic  | 15    | 95.7       | 72.5       |
| Diluted  | 15    | 95.2       | 72.1       |



## Consolidated statement of comprehensive income

For the year ended 31 March 2013

|   | 2013<br>£m | 2012<br>£m |
|---|------------|------------|
| Profit for the year   | 230.4      | 174.4      |
| Losses on cash flow hedges taken to equity                          | (39.0)     | (86.5)     |
| Deferred tax on losses on cash flow hedges taken to equity          | 9.0        | 20.8       |
| Amounts on cash flow hedges transferred to the income statement     | 14.8       | 3.7        |
| Deferred tax on transfers to income statement                       | (3.4)      | (0.9)      |
| Exchange movement on translation of overseas results and net assets | 5.4        | (1.4)      |
| Actuarial losses on defined benefit pension schemes                 | (54.2)     | (110.7)    |
| Tax on actuarial losses   | 12.5       | 26.6       |
| Deferred tax movement arising from rate change                      | (3.4)      | 1.7        |
| Other comprehensive loss for the year                               | (58.3)     | (146.7)    |
| Total comprehensive income for the year                             | 172.1      | 27.7       |
| Attributable to:  |            |            |
| Owners of the company   | 168.7      | 25.1       |
| Non-controlling interests   | 3.4        | 2.6        |
|   | 172.1      | 27.7       |

## Consolidated statement of changes in equity

For the year ended 31 March 2013


|   | Equity attributable to owners of the company |                     |                      |                         |             | Non-controlling interests | Total equity |
|---|--|---------------------|----------------------|-------------------------|-------------|---------------------------|--------------|
|   | Share capital<br>£m                          | Share premium<br>£m | Other reserves<br>£m | Retained earnings<br>£m | Total<br>£m | £m                        | £m           |
| At 1 April 2011   | 232.2  | 80.0                | 464.5                | 323.1                   | 1,099.8     | 6.3                       | 1,106.1      |
| Profit for the period   | -  | -                   | -                    | 171.8                   | 171.8       | 2.6                       | 174.4        |
| Losses on cash flow hedges  | -  | -                   | (86.5)               | -                       | (86.5)      | -                         | (86.5)       |
| Deferred tax on losses on cash flow hedges                          | -  | -                   | 20.8                 | -                       | 20.8        | -                         | 20.8         |
| Amounts on cash flow hedges transferred to the income statement     | -  | -                   | 3.7                  | -                       | 3.7         | -                         | 3.7          |
| Deferred tax on transfers to the income statement                   | -  | -                   | (0.9)                | -                       | (0.9)       | -                         | (0.9)        |
| Exchange movement on translation of overseas results and net assets | -  | -                   | (1.4)                | -                       | (1.4)       | -                         | (1.4)        |
| Actuarial losses  | -  | -                   | -                    | (110.7)                 | (110.7)     | -                         | (110.7)      |
| Tax on actuarial losses   | -  | -                   | -                    | 26.6                    | 26.6        | -                         | 26.6         |
| Deferred tax arising from rate change                               | -  | -                   | -                    | 1.7                     | 1.7         | -                         | 1.7          |
| Total comprehensive income for the period                           | -  | -                   | (64.3)               | 89.4                    | 25.1        | 2.6                       | 27.7         |
| Share based payments  |  |                     |                      |                         |             |                           |              |
| - proceeds from shares issued                                       | 0.4  | 3.8                 | -                    | -                       | 4.2         | -                         | 4.2          |
| - value of employees' services                                      | -  | -                   | -                    | 4.5                     | 4.5         | -                         | 4.5          |
| - free shares issued  | -  | -                   | -                    | (1.8)                   | (1.8)       | -                         | (1.8)        |
| Current tax on share based payments                                 | -  | -                   | -                    | 0.4                     | 0.4         | -                         | 0.4          |
| Deferred tax on share based payments                                | -  | -                   | -                    | 0.3                     | 0.3         | -                         | 0.3          |
| Dividends paid  | -  | -                   | -                    | (159.0)                 | (159.0)     | (1.0)                     | (160.0)      |
| At 31 March 2012  | 232.6  | 83.8                | 400.2                | 256.9                   | 973.5       | 7.9                       | 981.4        |
| Profit for the period   | -  | -                   | -                    | 227.5                   | 227.5       | 2.9                       | 230.4        |
| Losses on cash flow hedges  | -  | -                   | (39.0)               | -                       | (39.0)      | -                         | (39.0)       |
| Deferred tax on losses on cash flow hedges                          | -  | -                   | 9.0                  | -                       | 9.0         | -                         | 9.0          |
| Amounts on cash flow hedges transferred to the income statement     | -  | -                   | 14.8                 | -                       | 14.8        | -                         | 14.8         |
| Deferred tax on transfers to the income statement                   | -  | -                   | (3.4)                | -                       | (3.4)       | -                         | (3.4)        |
| Exchange movement on translation of overseas results and net assets | -  | -                   | 4.9                  | -                       | 4.9         | 0.5                       | 5.4          |
| Actuarial losses  | -  | -                   | -                    | (54.2)                  | (54.2)      | -                         | (54.2)       |
| Tax on actuarial losses   | -  | -                   | -                    | 12.5                    | 12.5        | -                         | 12.5         |
| Deferred tax arising from rate change                               | -  | -                   | -                    | (3.4)                   | (3.4)       | -                         | (3.4)        |
| Total comprehensive income for the period                           | -  | -                   | (13.7)               | 182.4                   | 168.7       | 3.4                       | 172.1        |
| Share based payments  |  |                     |                      |                         |             |                           |              |
| - proceeds from shares issued                                       | 0.7  | 5.9                 | -                    | -                       | 6.6         | -                         | 6.6          |
| - value of employees' services                                      | -  | -                   | -                    | 6.9                     | 6.9         | -                         | 6.9          |
| - free shares issued  | -  | -                   | -                    | (1.3)                   | (1.3)       | -                         | (1.3)        |
| Current tax on share based payments                                 | -  | -                   | -                    | 0.8                     | 0.8         | -                         | 0.8          |
| Transfer of infrastructure reserve                                  | -  | -                   | (314.2)              | 314.2                   | -           | -                         | -            |
| Dividends paid  | -  | -                   | -                    | (322.0)                 | (322.0)     | (0.5)                     | (322.5)      |
| At 31 March 2013  | 233.3  | 89.7                | 72.3                 | 437.9                   | 833.2       | 10.8                      | 844.0        |

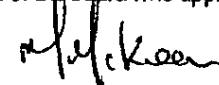
# Consolidated balance sheet

At 31 March 2013

|   | Note | 2013<br>£m       | 2012<br>£m       |
|---|------|------------------|------------------|
| <b>Non-current assets</b>                           |      |                  |                  |
| Goodwill  | 16   | 41.7             | 44.9             |
| Other intangible assets                             | 17   | 99.3             | 116.0            |
| Property, plant and equipment                       | 18   | 6,760.0          | 6,577.8          |
| Interests in joint ventures                         | 19   | 0.3              | 0.2              |
| Interests in associates                             | 20   | 4.7              | 4.6              |
| Derivative financial instruments                    | 32   | 130.1            | 132.6            |
| Available for sale financial assets                 | 32   | 0.1              | 0.1              |
|   |      | 7,036.2          | 6,876.2          |
| <b>Current assets</b>                               |      |                  |                  |
| Inventory   | 21   | 32.1             | 34.4             |
| Trade and other receivables                         | 22   | 506.0            | 479.4            |
| Current tax receivable                              |      | 40.5             | -                |
| Derivative financial instruments                    | 32   | 1.0              | 30.0             |
| Cash and cash equivalents                           | 23   | 403.6            | 295.1            |
|   |      | 983.2            | 838.9            |
| <b>Total assets</b>                                 |      | <b>8,019.4</b>   | <b>7,715.1</b>   |
| <b>Current liabilities</b>                          |      |                  |                  |
| Borrowings  | 32   | (170.3)          | (89.3)           |
| Derivative financial instruments                    | 32   | (0.6)            | (0.5)            |
| Trade and other payables                            | 25   | (399.0)          | (397.6)          |
| Current income tax liabilities                      |      | -                | (46.5)           |
| Provisions for liabilities and charges              | 28   | (11.1)           | (17.0)           |
|   |      | (581.0)          | (550.9)          |
| <b>Non-current liabilities</b>                      |      |                  |                  |
| Borrowings  | 32   | (4,631.3)        | (4,309.5)        |
| Derivative financial instruments                    | 32   | (309.6)          | (288.0)          |
| Trade and other payables                            | 25   | (453.4)          | (411.0)          |
| Deferred tax  | 26   | (785.8)          | (801.5)          |
| Retirement benefit obligations                      | 27   | (383.7)          | (345.8)          |
| Provisions for liabilities and charges              | 28   | (30.6)           | (27.0)           |
|   |      | (6,594.4)        | (6,182.8)        |
| <b>Total liabilities</b>                            |      | <b>(7,175.4)</b> | <b>(6,733.7)</b> |
| <b>Net assets</b>                                   |      | <b>844.0</b>     | <b>981.4</b>     |
| <b>Equity</b>                                       |      |                  |                  |
| Called up share capital                             | 29   | 233.3            | 232.6            |
| Share premium account                               | 30   | 89.7             | 83.8             |
| Other reserves                                      | 31   | 72.3             | 400.2            |
| Retained earnings                                   |      | 437.9            | 256.9            |
| <b>Equity attributable to owners of the company</b> |      | <b>833.2</b>     | <b>973.5</b>     |
| <b>Non-controlling interests</b>                    |      | <b>10.8</b>      | <b>7.9</b>       |
| <b>Total equity</b>                                 |      | <b>844.0</b>     | <b>981.4</b>     |

Signed on behalf of the board who approved the accounts on 29 May 2013

  
 Andrew Duff  
 Chairman

  
 Michael McKeon  
 Finance Director

Company Number: 2366619

## Consolidated cash flow statement

For the year ended 31 March 2013

|   | Note | 2013<br>£m | 2012<br>£m |
|---|------|------------|------------|
| Cash generated from operations  | 36   | 731.2      | 725.9      |
| Tax paid  |      | (72.5)     | (72.0)     |
| Net cash generated from operating activities                                |      | 658.7      | 653.9      |
| Investing activities  |      |            |            |
| Interest received   |      | 3.7        | 6.7        |
| Net cash inflow from sale of businesses                                     | 35   | 12.4       | -          |
| Acquisition of subsidiaries   | 34   | (1.3)      | -          |
| Proceeds on disposal of property, plant and equipment and intangible assets |      | 16.1       | 9.1        |
| Purchases of intangible assets  |      | (16.0)     | (12.0)     |
| Purchases of property, plant and equipment                                  |      | (429.2)    | (371.1)    |
| Contributions and grants received   |      | 27.3       | 22.8       |
| Net cash used in investing activities                                       |      | (387.0)    | (344.5)    |
| Financing activities  |      |            |            |
| Interest paid   |      | (186.8)    | (203.5)    |
| Closed out swaps  |      | (44.3)     | -          |
| Interest element of finance lease payments                                  |      | (6.0)      | (13.6)     |
| Dividends paid to shareholders of the parent                                |      | (322.0)    | (159.0)    |
| Dividends paid to non-controlling interests                                 |      | (0.5)      | (1.0)      |
| Repayments of borrowings  |      | (259.9)    | (157.4)    |
| Repayments of obligations under finance leases                              |      | (17.4)     | (47.6)     |
| New loans raised  |      | 668.3      | 250.0      |
| Issues of shares  |      | 6.6        | 4.2        |
| Purchase of own shares  |      | (1.3)      | (1.8)      |
| Net cash used in financing activities                                       |      | (163.3)    | (329.7)    |
| Increase/(decrease) in cash and cash equivalents                            |      | 108.4      | (20.3)     |
| Net cash and cash equivalents at beginning of period                        |      | 294.7      | 315.2      |
| Effect of foreign exchange rates  |      | 0.1        | (0.2)      |
| Net cash and cash equivalents at end of period                              |      | 403.2      | 294.7      |
| Net cash and cash equivalents comprise:                                     |      |            |            |
| Total cash and cash equivalents   |      | 403.6      | 295.1      |
| Bank overdrafts   |      | (0.4)      | (0.4)      |
| Net cash and cash equivalents at end of period                              |      | 403.2      | 294.7      |

The increase in cash and cash equivalents is reconciled to the movement in net debt in note 36.

# Notes to the group financial statements

For the year ended 31 March 2013

## 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 have been prepared in accordance with International Financial Reporting Standards (IFRS), International Accounting Standards (IAS) and IFRIC interpretations issued and effective and endorsed by the European Union as at 31 March 2013

The financial statements have been prepared on the going concern basis (see Directors' report on page 74) under the historical cost convention as modified by the revaluation of certain financial assets and liabilities (including derivative instruments) at fair value.

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses for the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results may ultimately differ from those estimates

### b) Basis of consolidation

The financial statements include the results of Severn Trent Plc and its subsidiaries, joint ventures and associated undertakings. The results of subsidiaries, joint ventures and associated undertakings are included from the date of acquisition or incorporation and excluded from the date of disposal.

The results of subsidiaries are consolidated where the group has the power to control a subsidiary

The results of joint venture undertakings are accounted for on an equity basis where the company exercised joint control under a contractual arrangement.

The results of associates are accounted for on an equity basis where the company holding is 20% or more or the company has the power to exercise significant influence.

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

All intra-group transactions, balances, income and expenses are eliminated on consolidation

### c) Revenue recognition

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

Revenue 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

In respect of long term contracts, revenue is recognised based on the value of work carried out during the year with reference to the total sales value and the stage of completion of these contracts.

Interest income is accrued on a time basis by reference to the principal outstanding and at the effective interest rate applicable. Dividend income from investments is recognised when the group's rights to receive payment have been established. Interest and dividend income are included in finance income

### 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.

### e) Taxation

Current tax payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income and expenses that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred taxation is provided in full, using the liability method, on taxable temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements. 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 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.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the group intends to settle its current tax assets and liabilities on a net basis.

## 2 Accounting policies (continued)

### f) Goodwill

Goodwill represents the excess of the fair value of purchase consideration over the fair value of the net assets acquired. Goodwill arising on acquisition of subsidiaries is included in intangible assets, whilst goodwill arising on acquisition of associates is included in investments in associates. 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. Purchased goodwill arising on acquisitions 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 2m) 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 assets

Intangible assets acquired separately are capitalised at cost and when acquired in a business combination are capitalised at fair value at the date of acquisition. Following initial recognition, the historical cost model is applied to intangible assets.

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

|              | Years |
|--------------|-------|
| Software     | 3-10  |
| Other assets | 2-20  |

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

Intangible assets are reviewed for impairment where indicators of impairment exist.

### h) Research and development

Research expenditure is expensed when it is incurred. Development expenditure is capitalised and written off over its expected useful economic life where the following criteria are met:

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

Expenditure on property, plant and equipment relating to research and development projects is capitalised and written off over the expected useful life of those assets.

### i) Pre-contract costs

Pre-contract costs 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.

### j) 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. The costs of like for like replacement of infrastructure components are recognised in the income statement as they arise. Where it is probable that the expenditure will cause future economic benefits to flow to the group, then costs are 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.

Borrowing costs directly attributable to the acquisition, construction or production of assets, that necessarily take a substantial period of time to get ready for their intended use, are added to the cost of those assets until such time as the assets are ready for their intended use.

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

## 2 Accounting policies (continued)

### k) Leased assets

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

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

### 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 the income statement over the useful economic life of those non-current assets.

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

### m) 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.

### n) Inventory

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

### o) 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.

### p) Retirement benefits

The group operates both defined benefit and defined contribution pension schemes.

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

Defined benefit pension scheme assets are measured at fair value using bid price for assets with quoted prices. Defined benefit pension scheme liabilities are measured at the balance sheet date by an independent actuary using the projected unit method and discounted at the current rate of return on high quality corporate bonds of equivalent term and currency to the liability. Service cost, which is the increase in the present value of the liabilities of the group's defined benefit pension schemes expected to arise from employee service in the period, is included in operating costs. The expected return on the scheme's assets and the increase during the period in the present value of the scheme's liabilities, arising from the passage of time, are included in other finance income or cost.

Actuarial gains and losses arising from experience adjustments, changes in actuarial assumptions and amendments to pension plans are charged or credited to equity and recorded in the statement of comprehensive income.

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

### q) Provisions

Provisions are recognised where:

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

Insurance provisions in the group's captive insurance subsidiary 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.

## 2 Accounting policies (continued)

### r) Purchase of own shares

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.

### s) Financial instruments

#### (i) Financial assets

Financial assets are classified into the following categories:

- at fair value through profit or loss;
- held to maturity investments;
- available for sale financial assets, and
- loans and receivables.

#### *Financial assets at fair value through profit or loss*

A financial asset is classified at fair value through profit or loss if it is so designated or if it is classified as 'held for trading'. Derivative financial assets that are not designated and effective as hedging instruments are required to be classified as 'held for trading' by IAS 39. However, the group's Treasury Policy, described in the Financial review on pages 37 and 38, is that the group does not hold or issue derivative financial instruments for trading. Financial assets at fair value through profit or loss are stated at fair value, with any gains or losses arising on remeasurement recognised in gains/losses on financial instruments in the income statement. Fair value is determined using the methodology described in note 32. Interest receivable in respect of derivative financial assets is included in finance income.

#### *Held to maturity investments*

Where the group has the ability and intent to hold an investment to maturity the financial asset is classified as held to maturity. Such financial assets are measured at amortised cost using the effective interest rate method, with any gains or losses being recognised in the income statement.

#### *Available for sale financial assets*

After initial recognition at cost (being the fair value of the consideration paid), investments which are classified as available for sale are measured at fair value, with gains or losses recognised in other comprehensive income. When an available for sale investment is disposed of or impaired, the gain or loss previously recognised in other comprehensive income is taken to the income statement. Where there is no active market in the investments and the fair value cannot be measured reliably, the investments are held at cost.

#### *Loans and receivables*

Trade receivables, loans and other receivables that have fixed or determinable payments and that are not quoted in an active market are classified as loans and receivables. Such assets are measured at fair value on initial recognition and are subsequently measured at amortised cost using the effective interest rate method unless there is objective evidence that the asset is impaired, where it is written down to its recoverable amount and the irrecoverable amount is recognised as an expense.

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

#### (ii) Financial liabilities

Financial liabilities are classified as either:

- financial liabilities at fair value through profit or loss, or
- other financial liabilities.

#### *Financial liabilities at fair value through profit or loss*

A financial liability is classified at fair value through profit or loss if it is so designated or if it is classified as 'held for trading'. Derivative financial liabilities that are not designated and effective as hedging instruments are required to be classified as 'held for trading' by IAS 39. However, the group's Treasury Policy, described in the Financial review on pages 37 and 38, is that the group does not hold or issue derivative financial instruments for trading. Financial liabilities at fair value through profit or loss are stated at fair value, with any gains or losses arising on remeasurement recognised in gains/losses on financial instruments in the income statement. Fair value is determined using the methodology described in note 32. Interest payable in respect of derivative financial liabilities is included in finance costs.

#### *Other financial liabilities*

Other financial liabilities, including borrowings, are initially recognised at fair value less transaction costs. After initial recognition, other financial liabilities are subsequently measured at amortised cost using the effective interest rate method.

#### (iii) Hedge accounting

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. Such derivative instruments are recognised and measured in accordance with the accounting policies described above.

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

- the relationship between the hedging instrument and the hedged item;
- its risk management objectives and strategy for undertaking hedge transactions; and
- whether the hedging instrument is 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.

#### *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 hedging instrument is taken to gains/losses on financial instruments in the income statement where the effective portion of the hedge will offset the gain or loss on the hedged item.

When hedge accounting is discontinued, the fair value adjustment to the carrying amount of the hedged item arising from the hedged risk is amortised to the income statement from that date.



## Group financial statements Notes to the group financial statements

## 2 Accounting policies (continued)

## s) Financial instruments (continued)

## (iii) Hedge accounting (continued)

*Cash flow hedges*

The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in equity and the ineffective portion in gains/losses on financial instruments in the income statement. The gains or losses deferred in equity in this way are recycled through gains/losses on financial instruments in the income statement in the same period in which the hedged underlying transaction or firm commitment is recognised in the income statement.

When hedge accounting is discontinued any cumulative gain or loss on the hedging instrument 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.

*Hedges of net investments in foreign operations*

Where forward currency contracts and foreign currency borrowings are used to hedge net investments in foreign currency denominated operations, to the extent that they are designated and effective as net investment hedges, they are matched in equity against changes in value of the related assets. Any ineffectiveness is taken to gains/losses on financial instruments in the income statement.

## (iv) Embedded derivatives

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contract and the host contract is not carried at fair value, with gains and losses reported in gains/losses on financial instruments in the income statement.

## t) Share based payments

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

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

## u) Cash flow statement

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

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

## v) 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 and associated 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.

Exchange differences arising in respect of foreign exchange instruments taken out as hedges of overseas investments are also treated as movements in equity to the extent that the hedge is effective (see note 2 s)

All other 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.

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

## w) 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.

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 co-ordinated 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.

Non-current assets classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell. Depreciation is not charged on such assets.

### 3 New accounting policies and future requirements

The following standards have been issued by the International Accounting Standards Board and are likely to affect future financial statements.

IFRS 9 'Financial instruments' is likely to affect the measurement and disclosure of financial instruments.

The standard is required to be implemented by the group with effect from 1 April 2013, subject to EU endorsement.

IFRS 10 'Consolidated Financial Statements' was issued in May 2011 and is required to be implemented by the group from 1 April 2013. The standard includes a new definition of control to be used to determine when entities are consolidated. The standard is not expected to have a material impact on the group's financial statements.

IFRS 11 'Joint Agreements' was issued in May 2011 and is required to be implemented by the group from 1 April 2013. IFRS 11 replaces IAS 31 'Interests in Joint Ventures' and SIC-13 'Jointly-controlled Entities'. IFRS 11 uses the definition of control given in IFRS 10 to define joint control and removes the option to account for joint ventures using proportionate consolidation. This is not expected to have a material impact on the group's financial statements.

IFRS 12 'Disclosure of Interests in Other Entities' was issued in May 2011 and is required to be implemented by the group from 1 April 2013. The standard provides disclosure requirements for subsidiaries, associates, joint agreements and structured entities which were previously covered in IAS 27, IAS 28 and IAS 31. Additional disclosures will be required in the group financial statements to meet the requirements of the standard.

IFRS 13 'Fair Value Measurement' was issued in May 2011 and is required to be implemented by the group from 1 April 2013. The standard provides additional guidance on how to measure fair value but does not change when fair value is permitted or required. The standard may impact the methods of determining fair value which are currently employed by the group and will require further disclosure of these methods.

IAS 19 'Employee Benefits' (revised) includes a requirement to measure the expected return on the defined benefit pension scheme assets using the discount rate applied to the scheme liabilities. The estimated effect this will have is to reduce profit by £16.0 million and increase actuarial gains in the statement of other comprehensive income by £16.0 million in the year ended 31 March 2014. The standard is required to be implemented by the group with effect from 1 April 2013.

The directors assess that the other standards and interpretations issued but not yet effective are not likely to have a significant impact on future financial statements.

### 4 Significant 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.

The more significant judgements were:

#### a) Tax provisions

Assessing the outcome of uncertain tax positions requires judgements to be made regarding the result of negotiations with and enquires from tax authorities in a number of jurisdictions. The assessments made are based on advice from independent tax advisers and the status of ongoing discussions with the relevant tax authorities.

#### b) Provisions for other liabilities and charges

Assessing the financial outcome of uncertain commercial and legal positions requires judgements to be made regarding the relative merits of each party's case and the extent to which any claim against the group is likely to be successful. The assessments made are based on advice from the group's internal counsel and, where appropriate, independent legal advice.

The key accounting estimates were:

#### a) Goodwill impairment

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating unit (CGU) to which goodwill has been allocated. The value in use calculation requires the group to estimate the future cash flows expected to arise from the CGU and a suitable discount rate to calculate present value. Details of the assumptions used are set out in note 16 to the financial statements.

#### b) 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 j).

#### c) 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, salary and pension increases, investment returns 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 are set out in note 27 to the financial statements.

## Group financial statements Notes to the group financial statements

## 4 Significant accounting judgements and key sources of estimation uncertainty (continued)

## d) Unbilled revenue

Severn Trent Water raises bills and recognises revenue in accordance with its right to receive revenue in line with the limits established by the periodic regulatory price review processes. For water and waste water customers with water meters, the amount recognised depends on the volume supplied including an estimate of the sales value of units supplied between the date of the last meter read and the year end. Meters are read on a cyclical basis and the group recognises revenue for unbilled amounts based on estimated usage from the last billing to the end of the financial year. The estimated usage is based on historical data, judgement and assumptions.

## e) Provision for impairment of trade receivables

Provisions are made against Severn Trent Water's trade receivables based on historical experience of levels of recovery from accounts in a particular ageing category. The actual amounts collected could differ from the estimated level of recovery which could impact operating results.

## 5 Segmental analysis

The group has two reportable segments, Severn Trent Water and Severn Trent Services. The key factor determining the identification of reportable segments is the regulatory environment in which the businesses operate. Severn Trent Water is subject to economic regulation by Ofwat and operates under a licence to provide water and sewerage services within a defined geographical region in England and Wales. Severn Trent Services is not subject to economic regulation and operates in markets in the US, Europe and Asia.

The Severn Trent Executive Committee is considered to be the group's chief operating decision maker. The reports provided to the Executive Committee include segmental information prepared on the basis described above. Details of Severn Trent Water's operations are described on pages 12 to 23 of the Business review and those of Severn Trent Services on pages 24 to 32.

Transactions between reportable segments are included within segmental results, assets and liabilities in accordance with group accounting policies. These are eliminated on consolidation.

The group has a large and diverse customer base and there is no significant reliance on any single customer.

The measure of profit or loss that is reported to the Executive Committee for the segments is profit before interest, tax and exceptional items (underlying PBIT). A segmental analysis of sales and underlying PBIT is presented below.

|  | Severn Trent<br>Water<br>£m | Severn Trent<br>Services<br>£m |
|--|-----------------------------|--------------------------------|
| 2013   |                             |                                |
| External sales   | 1,509.3                     | 320.6                          |
| Inter-segment sales  | 1.7                         | 7.9                            |
| Total sales  | 1,511.0                     | 328.5                          |
| Profit before interest, tax and exceptional items                  | 500.9                       | 12.7                           |
| Exceptional items  | 13.3                        | (16.1)                         |
| Profit/(loss) before interest and tax                              | 514.2                       | (3.4)                          |
| Profit before interest, tax and exceptional items is stated after: |                             |                                |
| Amortisation of intangible assets                                  | 28.9                        | 1.5                            |
| Depreciation of property, plant and equipment                      | 261.4                       | 5.3                            |
| Loss/(profit) on disposal of fixed assets                          | 1.5                         | (1.4)                          |

## 5 Segmental analysis (continued)

|  | Severn Trent<br>Water<br>£m | Severn Trent<br>Services<br>£m |
|--|-----------------------------|--------------------------------|
| 2012   |                             |                                |
| External sales   | 1,456.1                     | 313.3                          |
| Inter-segment sales  | 1.4                         | 19.0                           |
| Total sales  | 1,457.5                     | 332.3                          |
| Profit before interest, tax and exceptional items                  | 500.0                       | 18.0                           |
| Exceptional items  | 10.3                        | (44.7)                         |
| Profit/(loss) before interest and tax                              | 510.3                       | (26.7)                         |
| Profit before interest, tax and exceptional items is stated after: |                             |                                |
| Amortisation of other intangible assets                            | 28.7                        | 1.9                            |
| Depreciation of property, plant and equipment                      | 252.1                       | 5.9                            |
| Profit on disposal of fixed assets                                 | (4.2)                       | (0.2)                          |

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 the Executive Committee on a segmental basis.

Interests in joint ventures and associates are not material and are not included in the segmental reports reviewed by the Executive Committee.

Separate segmental analyses of assets and liabilities are not reviewed by the Executive Committee. The balance sheet measure reviewed by the Executive Committee on a segmental basis is capital employed which includes the following components:

|  | Severn Trent<br>Water<br>£m | Severn Trent<br>Services<br>£m |
|--|-----------------------------|--------------------------------|
| 2013                                       |                             |                                |
| Operating assets                           | 7,218.7                     | 173.1                          |
| Goodwill                                   | 1.3                         | 41.7                           |
| Interests in joint ventures and associates | 0.1                         | 4.9                            |
| Segment assets                             | 7,220.1                     | 219.7                          |
| Segment operating liabilities              | (1,137.4)                   | (94.0)                         |
| Capital employed                           | 6,082.7                     | 125.7                          |

|  | Severn Trent<br>Water<br>£m | Severn Trent<br>Services<br>£m |
|--|-----------------------------|--------------------------------|
| 2012                                       |                             |                                |
| Operating assets                           | 7,022.9                     | 185.5                          |
| Goodwill                                   | -                           | 44.8                           |
| Interests in joint ventures and associates | 0.1                         | 4.6                            |
| Segment assets                             | 7,023.0                     | 234.9                          |
| Segment operating liabilities              | (1,064.3)                   | (95.3)                         |
| Capital employed                           | 5,958.7                     | 139.6                          |

Operating assets comprise other intangible assets, property, plant and equipment, inventory and trade and other receivables.

Operating liabilities comprise trade and other payables, retirement benefit obligations and provisions.

## Group financial statements Notes to the group financial statements

## 5 Segmental analysis (continued)

Additions to other intangible assets and property, plant and equipment were as follows:

|                               | Severn Trent Water<br>£m | Severn Trent Services<br>£m |
|-------------------------------|--------------------------|-----------------------------|
| 2013                          |                          |                             |
| Other intangible assets       | 13.6                     | 2.2                         |
| Property, plant and equipment | 451.6                    | 8.6                         |

|                               | Severn Trent Water<br>£m | Severn Trent Services<br>£m |
|-------------------------------|--------------------------|-----------------------------|
| 2012                          |                          |                             |
| Other intangible assets       | 9.8                      | 2.1                         |
| Property, plant and equipment | 405.3                    | 5.5                         |

The reportable segments' revenue is reconciled to group turnover as follows:

|                       | 2013<br>£m | 2012<br>£m |
|-----------------------|------------|------------|
| Severn Trent Water    | 1,511.0    | 1,457.5    |
| Severn Trent Services | 328.5      | 332.3      |
| Other                 | 101        | 9.8        |
| Inter-segment sales   | (18.0)     | (29.0)     |
| Group turnover        | 1,831.6    | 1,770.6    |

Segmental underlying PBIT is reconciled to the group's profit before tax and discontinued operations as follows:

|   | 2013<br>£m | 2012<br>£m |
|---|------------|------------|
| Underlying PBIT                                   |            |            |
| - Severn Trent Water                              | 500.9      | 500.0      |
| - Severn Trent Services                           | 12.7       | 18.0       |
| - Corporate and other                             | (16.8)     | (15.3)     |
| Consolidation adjustments                         | 1.2        | 1.5        |
| Group underlying PBIT                             | 498.0      | 504.2      |
| Exceptional items allocated to segments           |            |            |
| - Severn Trent Water                              | 13.3       | 10.3       |
| - Severn Trent Services                           | (16.1)     | (44.7)     |
| - Corporate and other                             | (3.0)      | -          |
| Share of results of associates and joint ventures | 0.2        | 0.1        |
| Net finance costs                                 | (231.9)    | (245.5)    |
| Losses on financial instruments                   | (45.3)     | (67.7)     |
| Profit before tax                                 | 215.2      | 156.7      |

The reportable segments' assets are reconciled to the group's total assets as follows:

|                            | 2013<br>£m | 2012<br>£m |
|----------------------------|------------|------------|
| Segment assets             |            |            |
| - Severn Trent Water       | 7,220.1    | 7,023.0    |
| - Severn Trent Services    | 219.7      | 234.9      |
| Corporate and other assets | 49.5       | 46.4       |
| Other financial assets     | 534.8      | 457.8      |
| Current tax recoverable    | 40.5       | -          |
| Consolidation adjustments  | (45.2)     | (47.0)     |
| Total assets               | 8,019.4    | 7,715.1    |

The consolidation adjustments comprise elimination of intra-group debtors and unrealised profits on fixed assets.

## Group financial statements Notes to the group financial statements

## 5 Segmental analysis (continued)

The reportable segments' liabilities are reconciled to the group's total liabilities as follows:

|                             | 2013<br>£m | 2012<br>£m |
|-----------------------------|------------|------------|
| Segment liabilities         |            |            |
| - Severn Trent Water        | (1,137.4)  | (1,064.3)  |
| - Severn Trent Services     | (94.0)     | (95.3)     |
| Corporate liabilities       | (64.7)     | (57.8)     |
| Other financial liabilities | (5,111.8)  | (4,687.3)  |
| Current tax                 | -          | (46.5)     |
| Deferred tax                | (785.8)    | (801.5)    |
| Consolidation adjustments   | 18.3       | 19.0       |
| Total liabilities           | (7,175.4)  | (6,733.7)  |

The consolidation adjustments comprise elimination of intra-group creditors.

## Geographical areas

The group's sales were derived from the following countries.

|       | 2013<br>£m | 2012<br>£m |
|-------|------------|------------|
| UK    | 1,584.7    | 1,538.0    |
| US    | 142.2      | 136.5      |
| Other | 104.7      | 96.1       |
|       | 1,831.6    | 1,770.6    |

The group's non-current assets (excluding financial instruments, deferred tax assets and retirement benefit assets) were located in the following countries.

|       | 2013<br>£m | 2012<br>£m |
|-------|------------|------------|
| UK    | 6,834.2    | 6,670.4    |
| US    | 61.1       | 59.2       |
| Other | 10.8       | 14.0       |
|       | 6,906.1    | 6,743.6    |

## 6 Revenue

|   | 2013<br>£m | 2012<br>£m |
|---|------------|------------|
| Water and sewerage services               | 1,500.9    | 1,446.3    |
| Other services                            | 180.1      | 191.4      |
| Sale of goods                             | 110.7      | 94.4       |
| Service concession arrangements (note 38) | 39.9       | 38.5       |
| Total turnover                            | 1,831.6    | 1,770.6    |
| Interest receivable (note 10)             | 2.6        | 7.0        |
|   | 1,834.2    | 1,777.6    |

## Group financial statements Notes to the group financial statements

## 7 Operating costs

|  | 2013                        |                      |          | 2012                        |                      |          |
|--|-----------------------------|----------------------|----------|-----------------------------|----------------------|----------|
|  | Before exceptional costs £m | Exceptional costs £m | Total £m | Before exceptional costs £m | Exceptional costs £m | Total £m |
| Wages and salaries   | 282.9                       | 1.2                  | 284.1    | 264.2                       | 2.6                  | 266.8    |
| Social security costs                                      | 20.2                        | -                    | 20.2     | 17.7                        | 0.1                  | 17.8     |
| Pension costs  | 29.8                        | -                    | 29.8     | 27.5                        | (23.1)               | 4.4      |
| Share based payments                                       | 6.8                         | -                    | 6.8      | 4.1                         | -                    | 4.1      |
| Total employee costs                                       | 339.7                       | 1.2                  | 340.9    | 313.5                       | (20.4)               | 293.1    |
| Power  | 65.8                        | -                    | 65.8     | 59.0                        | -                    | 59.0     |
| Carbon Reduction Commitment                                | 5.7                         | -                    | 5.7      | 5.9                         | -                    | 5.9      |
| Raw materials and consumables                              | 130.8                       | -                    | 130.8    | 135.0                       | 0.4                  | 135.4    |
| Rates  | 73.2                        | -                    | 73.2     | 69.4                        | -                    | 69.4     |
| Charge for bad and doubtful debts                          | 33.1                        | -                    | 33.1     | 30.7                        | 21.5                 | 52.2     |
| Service charges  | 31.9                        | -                    | 31.9     | 33.3                        | -                    | 33.3     |
| Depreciation of property, plant and equipment              | 264.6                       | -                    | 264.6    | 256.0                       | -                    | 256.0    |
| Amortisation and impairment of other intangible assets     | 30.5                        | 3.6                  | 34.1     | 30.8                        | -                    | 30.8     |
| Impairment of goodwill                                     | -                           | 4.6                  | 4.6      | -                           | 22.9                 | 22.9     |
| Hired and contracted services                              | 196.2                       | 3.7                  | 199.9    | 219.2                       | 4.3                  | 223.5    |
| Operating leases rentals                                   |                             |                      |          |                             |                      |          |
| - land and buildings                                       | 3.1                         | -                    | 3.1      | 3.4                         | -                    | 3.4      |
| - other  | 1.9                         | -                    | 1.9      | 1.5                         | -                    | 1.5      |
| Hire of plant and machinery                                | 4.4                         | -                    | 4.4      | 5.6                         | -                    | 5.6      |
| Research and development expenditure                       | 5.4                         | -                    | 5.4      | 4.5                         | -                    | 4.5      |
| Loss/(profit) on disposal of property, plant and equipment | 2.9                         | (13.3)               | (10.4)   | (4.4)                       | -                    | (4.4)    |
| Foreign exchange (gains)/losses                            | (0.3)                       | -                    | (0.3)    | 0.1                         | -                    | 0.1      |
| Infrastructure maintenance expenditure                     | 147.7                       | -                    | 147.7    | 128.9                       | -                    | 128.9    |
| Other operating costs                                      | 93.2                        | 4.5                  | 97.7     | 59.2                        | 5.7                  | 64.9     |
|  | 1,429.8                     | 4.3                  | 1,434.1  | 1,351.6                     | 34.4                 | 1,386.0  |
| Release from deferred income                               | (9.3)                       | -                    | (9.3)    | (8.7)                       | -                    | (8.7)    |
| Own work capitalised                                       | (86.9)                      | -                    | (86.9)   | (76.5)                      | -                    | (76.5)   |
|  | 1,333.6                     | 4.3                  | 1,337.9  | 1,266.4                     | 34.4                 | 1,300.8  |

Further details of exceptional costs are given in note 8.

During the year the following fees were charged by the auditors:

|   | 2013<br>£m | 2012<br>£m |
|---|------------|------------|
| Fees payable to the company's auditors for  |            |            |
| - the audit of the company's annual accounts  | 0.1        | 0.1        |
| - the audit of the company's subsidiaries   | 0.5        | 0.5        |
| Total audit fees  | 0.6        | 0.6        |
| Fees payable to the company's auditors and their associates for other services to the group |            |            |
| - audit related assurance services  | 0.2        | 0.2        |
| - services relating to corporate finance  | 0.1        | -          |
| Total non-audit fees  | 0.3        | 0.2        |

Details of directors' remuneration are set out in the Directors' remuneration report on pages 57 to 70

## Group financial statements Notes to the group financial statements

## 8 Exceptional items before tax

|  | 2013<br>£m | 2012<br>£m |
|--|------------|------------|
| Exceptional operating costs                                    |            |            |
| Sewer Trent Water  |            |            |
| Profit on disposal of fixed assets                             | (13.3)     | -          |
| Restructuring costs  | -          | 11.5       |
| Curtailment gains on defined benefit pension schemes           | -          | (21.8)     |
|  | (13.3)     | (10.3)     |
| Sewer Trent Services   |            |            |
| Impairment of development costs and related assets             | 4.5        | -          |
| Impairment of goodwill   | 4.6        | 22.9       |
| Provisions for commercial disputes and restructuring           | 5.5        | 1.6        |
| Provisions for bad debts                                       | -          | 21.5       |
| Curtailment gains on defined benefit pension schemes           | -          | (1.3)      |
|  | 14.6       | 44.7       |
| Corporate and other  |            |            |
| Professional fees on proposed transaction that did not proceed | 3.0        | -          |
|  | 3.0        | -          |
| Total exceptional operating costs                              | 4.3        | 34.4       |
| Exceptional loss on disposal of businesses                     | 1.5        | -          |
| Exceptional finance costs                                      |            |            |
| Costs incurred on early redemption of debt                     | -          | 16.5       |
| Exceptional items before tax                                   | 5.8        | 50.9       |

Exceptional tax is disclosed in note 13.

## 9 Employee numbers

Average number of employees (including executive directors) during the year

|                      | 2013<br>Number | 2012<br>Number |
|----------------------|----------------|----------------|
| By type of business  |                |                |
| Sewer Trent Water    | 5,458          | 5,162          |
| Sewer Trent Services | 2,749          | 2,878          |
| Corporate and other  | 14             | 11             |
|                      | 8,221          | 8,051          |

## 10 Finance income

|  | 2013<br>£m | 2012<br>£m |
|--|------------|------------|
| Interest revenue earned on:                              |            |            |
| Bank deposits  | 2.6        | 4.1        |
| Other financial income                                   | -          | 2.9        |
| Total interest revenue                                   | 2.6        | 7.0        |
| Expected return on defined benefit pension scheme assets | 88.2       | 100.7      |
|  | 90.8       | 107.7      |



## Group financial statements Notes to the group financial statements

## 11 Finance costs

|   | 2013        | Before<br>exceptional<br>costs<br>£m | Exceptional<br>costs<br>£m | 2012        |
|---|-------------|--------------------------------------|----------------------------|-------------|
|   | Total<br>£m |                                      |                            | Total<br>£m |
| Interest on bank loans and overdrafts               | 27.7        | 28.9                                 | –                          | 28.9        |
| Interest on other loans                             | 191.6       | 198.9                                | –                          | 198.9       |
| Interest on finance leases                          | 8.5         | 9.7                                  | –                          | 9.7         |
| Total borrowing costs                               | 227.8       | 237.5                                | –                          | 237.5       |
| Other financial expenses                            | 2.7         | 1.5                                  | 16.5                       | 18.0        |
| Interest cost on defined benefit scheme obligations | 92.2        | 97.7                                 | –                          | 97.7        |
|   | 322.7       | 336.7                                | 16.5                       | 353.2       |

Borrowing costs of £10.4 million (2012: £10.5 million) incurred funding eligible capital projects have been capitalised at an interest rate of 5.12% (2012: 5.93%).

## 12 Losses on financial instruments

|   | 2013<br>£m | 2012<br>£m |
|---|------------|------------|
| Loss on cross currency swaps used as hedging instruments in fair value hedges | (7.3)      | (5.1)      |
| Gain arising on adjustment for foreign currency debt in fair value hedges     | 3.4        | 1.9        |
| Exchange (loss)/gain on other loans   | (1.1)      | 41.5       |
| Loss on cash flow hedges transferred from equity                              | (14.8)     | (3.7)      |
| Loss arising on swaps where hedge accounting is not applied                   | (25.5)     | (102.3)    |
|   | (45.3)     | (67.7)     |

The group's hedge accounting arrangements are described in note 32 f).

## 13 Taxation

## a) Analysis of tax credit in the year

|  | Before<br>exceptional<br>tax<br>£m | Exceptional<br>tax<br>£m | 2013<br>Total<br>£m | 2012<br>Total<br>£m |
|--|------------------------------------|--------------------------|---------------------|---------------------|
| Current tax  |                                    |                          |                     |                     |
| Current year at 24% (2012: 26%)                                  | 57.1                               | (40.5)                   | 16.6                | 69.2                |
| Prior years at 28% (2012: 28%)                                   | (29.2)                             | –                        | (29.2)              | (8.7)               |
| Total current tax  | 27.9                               | (40.5)                   | (12.6)              | 60.5                |
| Deferred tax   |                                    |                          |                     |                     |
| Origination and reversal of temporary differences – current year | (0.3)                              | 38.8                     | 38.5                | (14.0)              |
| Origination and reversal of temporary differences – prior year   | (4.4)                              | –                        | (4.4)               | 4.9                 |
| Exceptional credit arising from rate change                      | –                                  | (36.7)                   | (36.7)              | (69.1)              |
| Total deferred tax   | (4.7)                              | 2.1                      | (2.6)               | (78.2)              |
|  | 23.2                               | (38.4)                   | (15.2)              | (17.7)              |

The group's UK subsidiary companies have adopted the new accounting standard FRS 101 in the current year. This has changed the statutory accounts that form the basis for those companies' corporation tax computations. The most significant impact of this change is that certain amounts that had been taxed in previous years will now be recognised as profits and taxed in future periods. Therefore, to prevent such items being taxed twice, the tax already paid on such items is repayable. The impact of this change was an exceptional credit of £40.5 million to current tax and an exceptional charge of £38.8 million to deferred tax.

Current tax credits have arisen due to adjustments to prior year tax computations. In 2013 these primarily related to an industry agreement over the treatment of infrastructure income.

The exceptional deferred tax credit arises from the reduction in the rate at which the temporary differences are expected to reverse from 24% to 23%. On 20 March 2013 the Government announced that the main rate of corporation tax in the UK would reduce to 23% with effect from 1 April 2013 with subsequent reductions per annum to reach 20% by 1 April 2015.

## Group financial statements Notes to the group financial statements

## 13 Taxation (continued)

## b) Factors affecting the tax credit in the year

The tax credit for the year is reconciled to tax on profit at the standard rate of corporation tax in the UK below

|   | 2013<br>£m | 2012<br>£m |
|---|------------|------------|
| Profit on ordinary activities before tax                                | 215.2      | 156.7      |
| Tax at the standard rate of corporation tax in the UK 24% (2012 26%)    | 51.6       | 40.8       |
| Tax effect of expenditure not deductible in determining taxable profits | 4.1        | 12.0       |
| Current year impact of rate change                                      | (1.2)      | 1.9        |
| Effect of different rates in overseas jurisdictions                     | 0.7        | 0.5        |
| Adjustments in respect of prior years                                   | (33.6)     | (3.8)      |
| Exceptional deferred tax credit arising from rate change                | (36.7)     | (69.1)     |
| Total tax credit  | (15.2)     | (17.7)     |

## c) Tax credited directly to equity

In addition to the amount credited to the income statement, the following amounts of tax have been credited directly to equity:

|  | 2013<br>£m | 2012<br>£m |
|--|------------|------------|
| Current tax  |            |            |
| Tax on share based payments                                      | (0.8)      | (0.4)      |
| Tax on pension contributions in excess of profit and loss charge | (1.5)      | (8.8)      |
| Total current tax credited to equity                             | (2.3)      | (9.2)      |
| Deferred tax   |            |            |
| Tax on actuarial losses  | (11.0)     | (17.8)     |
| Tax on cash flow hedges  | (5.6)      | (19.9)     |
| Tax on share based payments                                      | -          | (0.3)      |
| Effect of change in tax rate                                     | 3.4        | (1.7)      |
| Total deferred tax credited to equity                            | (13.2)     | (39.7)     |

## 14 Dividends

Amounts recognised as distributions to equity holders in the period

|  | 2013            |       | 2012            |       |
|--|-----------------|-------|-----------------|-------|
|  | Pence per share | £m    | Pence per share | £m    |
| Final dividend for the year ended 31 March 2012 (2011)   | 42.06           | 99.9  | 39.05           | 92.5  |
| Interim dividend for the year ended 31 March 2013 (2012) | 30.34           | 72.2  | 28.04           | 66.5  |
| Total ordinary dividends                                 | 72.40           | 172.1 | 67.09           | 159.0 |
| Special dividend   | 63.00           | 149.9 | -               | -     |
| Total dividends  | 135.40          | 322.0 | 67.09           | 159.0 |
| Proposed final dividend for the year ended 31 March 2013 | 45.51           |       |                 |       |

The proposed final dividend is subject to approval by shareholders at the AGM and has not been included as a liability in these financial statements.

## Group financial statements Notes to the group financial statements

## 15 Earnings per share

Basic earnings per share are calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year, excluding 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 potentially dilutive ordinary shares. These represent share options granted to employees where the exercise price is less than the average market price of the company's shares during the year.

Basic and diluted earnings per share from continuing operations are calculated on the basis of profit from continuing operations attributable to the equity holders of the company.

The calculation of basic and diluted earnings per share is based on the following data:

Earnings for the purpose of basic and diluted earnings per share from continuing operations

|  | 2013<br>£m    | 2012<br>£m    |
|--|---------------|---------------|
| Profit for the period attributable to the equity holders of the company                  | 227.5         | 171.8         |
| Number of shares   |               |               |
|  | 2013<br>m     | 2012<br>m     |
| Weighted average number of ordinary shares for the purpose of basic earnings per share   | 237.7         | 237.0         |
| Effect of dilutive potential ordinary shares   |               |               |
| - share options and LTIPs  | 1.1           | 1.2           |
| Weighted average number of ordinary shares for the purpose of diluted earnings per share | 238.8         | 238.2         |
| Adjusted earnings per share  |               |               |
|  | 2013<br>pence | 2012<br>pence |
| Adjusted basic earnings per share  | 98.9          | 88.9          |
| Adjusted diluted earnings per share  | 98.4          | 88.5          |

Adjusted earnings per share figures are presented for continuing operations. These exclude the effects of deferred tax, losses on financial instruments and exceptional items in both 2013 and 2012. 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.

## Adjustments to earnings

The adjustments to earnings that are made in calculating adjusted earnings per share are as follows:

|   | 2013<br>£m | 2012<br>£m |
|---|------------|------------|
| Earnings for the purpose of basic and diluted earnings per share from continuing operations | 227.5      | 171.8      |
| Adjustments for   |            |            |
| - exceptional items before tax  | 5.8        | 50.9       |
| - current tax related to exceptional items at 24% (2012: 26%)                               | (0.5)      | (1.5)      |
| - losses on financial instruments   | 45.3       | 67.7       |
| - deferred tax excluding exceptional charge   | (4.7)      | (9.1)      |
| - exceptional tax   | (38.4)     | (69.1)     |
| Earnings for the purpose of adjusted basic and diluted earnings per share                   | 235.0      | 210.7      |

## Group financial statements Notes to the group financial statements

## 16 Goodwill

|                       | 2013<br>£m | 2012<br>£m |
|-----------------------|------------|------------|
| <b>Cost</b>           |            |            |
| At 1 April            | 67.8       | 68.3       |
| Exchange adjustments  | 1.4        | (0.5)      |
| At 31 March           | 69.2       | 67.8       |
| <b>Impairment</b>     |            |            |
| At 1 April            | (22.9)     | -          |
| Amounts written off   | (4.6)      | (22.9)     |
| At 31 March           | (27.5)     | (22.9)     |
| <b>Net book value</b> |            |            |
| At 31 March           | 41.7       | 44.9       |

## Goodwill impairment tests

Goodwill is allocated to the group's cash-generating units (CGUs) identified according to country of operation and business segment. All of the group's goodwill is in the Severn Trent Services segment.

A summary of the goodwill allocation by CGU is presented below:

|                       | 2013<br>£m | 2012<br>£m |
|-----------------------|------------|------------|
| Water Purification US | 27.1       | 26.3       |
| Contract Operations   | 12.3       | 11.7       |
| Services Italy        | 2.3        | 2.2        |
| Services Spain        | -          | 4.7        |
|                       | 41.7       | 44.9       |

The group has reviewed the carrying value of goodwill for impairment in accordance with the policy stated in note 2 m).

The value in use calculations use cash flow projections based on financial budgets approved by management covering a five year period. The key assumption underlying these budgets is revenue growth. Management of each CGU determines assumptions based on past experience, current market trends and expectations of future developments.

Cash flows beyond the five year period are extrapolated using an estimated nominal growth rate stated below. The growth rate does not exceed the long term average growth rate for the economy in which the CGU operates. The assumptions used in relation to growth rates beyond the five year period and discount rates were:

|                       | Nominal growth rate |           | Discount rate |           |
|-----------------------|---------------------|-----------|---------------|-----------|
|                       | 2013<br>%           | 2012<br>% | 2013<br>%     | 2012<br>% |
| Water Purification US | 3.5                 | 3.5       | 6.2           | 5.8       |
| Contract Operations   | 3.5                 | 3.5       | 6.5           | 5.9       |
| Services Italy        | 2.5                 | 3.0       | 8.2           | 11.0      |
| Services Spain        | 2.5                 | 3.1       | 8.8           | 8.9       |

The weighted average growth rates used are consistent with the forecasts included in industry reports. The discount rates used are pre-tax and reflect specific risks relating to the CGU.

As a result of the impairment review, the group has fully impaired the goodwill in Services Spain by £4.6 million. This follows the further deterioration of the economic outlook in Spain.

Changes in the growth rate outside the five year period or in the discount rate applied to the cash flows may cause a CGU's carrying value to exceed its recoverable amount. However, in the opinion of the directors, the changes in growth rate or discount rate that would be required to reduce the recoverable amounts of Water Purification US and Contract Operations below their carrying value are not reasonably possible and therefore sensitivity analysis has only been provided for Services Italy.

|                | Surplus of recoverable<br>amount over carrying<br>amount<br>£m | Change required for<br>recoverable amount to<br>equal carrying amount |                                       |
|----------------|--|---|---------------------------------------|
|                |  | Growth rate<br>percentage<br>points                                   | Discount rate<br>percentage<br>points |
| Services Italy | 11.1   | (21.5)  | 9.8                                   |

## Group financial statements Notes to the group financial statements

## 17 Other intangible assets

|                           | Computer software             |                 | Other                         | Total<br>£m |
|---------------------------|-------------------------------|-----------------|-------------------------------|-------------|
|                           | Internally<br>generated<br>£m | Purchased<br>£m | Internally<br>generated<br>£m |             |
| <b>Cost</b>               |                               |                 |                               |             |
| At 1 April 2011           | 121.5                         | 170.1           | 24.8                          | 316.4       |
| Additions                 | 0.3                           | 9.7             | 2.0                           | 12.0        |
| Disposals                 | -                             | (0.4)           | -                             | (0.4)       |
| Exchange adjustments      | -                             | 0.2             | (0.2)                         | -           |
| At 1 April 2012           | 121.8                         | 179.6           | 26.6                          | 328.0       |
| Additions                 | 6.0                           | 8.5             | 1.5                           | 16.0        |
| Acquisition of businesses | -                             | -               | 1.3                           | 1.3         |
| Disposal of businesses    | -                             | -               | (1.7)                         | (1.7)       |
| Exchange adjustments      | -                             | 0.6             | 0.5                           | 1.1         |
| At 31 March 2013          | 127.8                         | 188.7           | 28.2                          | 344.7       |
| <b>Amortisation</b>       |                               |                 |                               |             |
| At 1 April 2011           | (82.8)                        | (86.2)          | (12.5)                        | (181.5)     |
| Amortisation for the year | (19.4)                        | (9.7)           | (1.7)                         | (30.8)      |
| Disposals                 | -                             | 0.2             | -                             | 0.2         |
| Exchange adjustments      | -                             | -               | 0.1                           | 0.1         |
| At 1 April 2012           | (102.2)                       | (95.7)          | (14.1)                        | (212.0)     |
| Amortisation for the year | (16.7)                        | (12.4)          | (1.4)                         | (30.5)      |
| Exceptional impairment    | -                             | -               | (3.6)                         | (3.6)       |
| Disposal of businesses    | -                             | -               | 1.2                           | 1.2         |
| Exchange adjustments      | -                             | (0.2)           | (0.3)                         | (0.5)       |
| At 31 March 2013          | (118.9)                       | (108.3)         | (18.2)                        | (245.4)     |
| <b>Net book value</b>     |                               |                 |                               |             |
| At 31 March 2013          | 8.9                           | 80.4            | 10.1                          | 99.3        |
| At 31 March 2012          | 19.6                          | 83.9            | 12.5                          | 116.0       |

Other assets primarily comprise capitalised development costs and patents.

## 18 Property, plant and equipment

|                        | Land and<br>buildings<br>£m | Infrastructure<br>assets<br>£m | Fixed<br>plant and<br>equipment<br>£m | Movable<br>plant<br>£m | Total<br>£m |
|------------------------|-----------------------------|--------------------------------|---------------------------------------|------------------------|-------------|
| <b>Cost</b>            |                             |                                |                                       |                        |             |
| At 1 April 2011        | 2,569.9                     | 4,191.7                        | 3,266.2                               | 56.7                   | 10,084.5    |
| Additions              | 106.9                       | 118.8                          | 181.5                                 | 4.5                    | 411.7       |
| Disposals              | (3.6)                       | (0.1)                          | (26.4)                                | (4.3)                  | (34.4)      |
| Exchange adjustments   | -                           | -                              | (0.8)                                 | 0.1                    | (0.7)       |
| At 1 April 2012        | 2,673.2                     | 4,310.4                        | 3,420.5                               | 57.0                   | 10,461.1    |
| Additions              | 127.2                       | 103.3                          | 220.7                                 | 8.7                    | 459.9       |
| Disposals              | (2.8)                       | (0.1)                          | (24.5)                                | (4.4)                  | (31.8)      |
| Disposal of businesses | (11.3)                      | -                              | (17.5)                                | -                      | (28.8)      |
| Exchange adjustments   | (0.1)                       | -                              | 2.1                                   | 0.7                    | 2.7         |
| At 31 March 2013       | 2,786.2                     | 4,413.6                        | 3,601.3                               | 62.0                   | 10,863.1    |
| <b>Depreciation</b>    |                             |                                |                                       |                        |             |
| At 1 April 2011        | (816.1)                     | (1,093.5)                      | (1,715.4)                             | (32.5)                 | (3,657.5)   |
| Charge for the year    | (56.0)                      | (28.2)                         | (165.1)                               | (6.7)                  | (256.0)     |
| Disposals              | 3.3                         | -                              | 22.8                                  | 3.8                    | 29.9        |
| Exchange adjustments   | -                           | -                              | 0.3                                   | -                      | 0.3         |
| At 1 April 2012        | (868.8)                     | (1,121.7)                      | (1,857.4)                             | (35.4)                 | (3,883.3)   |
| Charge for the year    | (60.9)                      | (29.6)                         | (167.5)                               | (6.6)                  | (264.6)     |
| Disposals              | 3.0                         | -                              | 19.1                                  | 4.1                    | 26.2        |
| Disposal of businesses | 7.5                         | -                              | 11.8                                  | -                      | 19.3        |
| Exchange adjustments   | 0.5                         | 0.1                            | (1.2)                                 | (0.1)                  | (0.7)       |
| At 31 March 2013       | (918.7)                     | (1,151.2)                      | (1,995.2)                             | (38.0)                 | (4,103.1)   |
| <b>Net book value</b>  |                             |                                |                                       |                        |             |
| At 31 March 2013       | 1,867.5                     | 3,262.4                        | 1,606.1                               | 24.0                   | 6,760.0     |
| At 31 March 2012       | 1,804.4                     | 3,188.7                        | 1,563.1                               | 21.6                   | 6,577.8     |

The carrying amount of property, plant and equipment includes the following amounts in respect of assets held under finance leases.

|                       | Land and<br>buildings<br>£m | Infrastructure<br>assets<br>£m | Fixed<br>plant and<br>equipment<br>£m | Movable<br>plant<br>£m | Total<br>£m |
|-----------------------|-----------------------------|--------------------------------|---------------------------------------|------------------------|-------------|
| <b>Net book value</b> |                             |                                |                                       |                        |             |
| At 31 March 2013      | -                           | 118.5                          | 54.8                                  | -                      | 173.3       |
| At 31 March 2012      | -                           | 119.2                          | 76.3                                  | -                      | 195.5       |

Property, plant and equipment includes £509.2 million (2012: £372.3 million) in respect of assets in the course of construction for which no depreciation is charged

## Group financial statements Notes to the group financial statements

## 19 Interests in joint ventures

|                     | 2013<br>£m | 2012<br>£m |
|---------------------|------------|------------|
| Group's share of    |            |            |
| Non-current assets  | 0.1        | 0.2        |
| Current assets      | 0.7        | 0.6        |
| Current liabilities | (0.5)      | (0.6)      |
|                     | 0.3        | 0.2        |
| Group's share of    |            |            |
| Turnover            | 0.4        | 0.4        |
| Operating costs     | (0.4)      | (0.4)      |
| Profit before tax   | –          | –          |
| Tax                 | –          | –          |
| Profit after tax    | –          | –          |

As at 31 March 2013 and 2012 the joint ventures had no 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 ventures. The group had no capital commitments in relation to its interests in the joint ventures at 31 March 2013 or 2012.

Particulars of the group's principal joint venture undertakings at 31 March 2013 were:

| Name                      | Country of<br>incorporation | Proportion of<br>ownership interest |
|---------------------------|-----------------------------|-------------------------------------|
| Cognica Limited           | Great Britain               | 50%                                 |
| Jackson Water Partnership | US                          | 70%                                 |

The partnership agreement for the Jackson Water Partnership requires that certain key decisions require the unanimous consent of the partners and consequently the partnership has been accounted for as a joint venture.

## 20 Interests in associates

|                      | 2013<br>£m | 2012<br>£m |
|----------------------|------------|------------|
| At 1 April           | 4.6        | 4.8        |
| Share of profits     | 0.2        | 0.1        |
| Exchange adjustments | (0.1)      | (0.3)      |
| At 31 March          | 4.7        | 4.6        |
| Group's share of     |            |            |
| Total assets         | 24.8       | 24.7       |
| Total liabilities    | (20.1)     | (20.1)     |
|                      | 4.7        | 4.6        |
| Turnover             | 4.7        | 7.7        |
| Profit after tax     | 0.2        | 0.1        |

The associate company at 31 March 2013 was Servizio Idrico Integrato S.c.p.a., a company incorporated in Italy. The proportion of ownership interest held by the group was 25%.

At 31 March 2013 and 2012 the associate company had no significant contingent liabilities to which the group was exposed. The group had no capital commitments in relation to its interests in the associate at 31 March 2013 or 2012.

The group has given certain guarantees in respect of the associate's borrowings. The guarantees are limited to €11.2 million (2012: €11.2 million). The group does not expect any liabilities that are not provided for in these financial statements to arise from these arrangements.

## 21 Inventory

|                                | 2013<br>£m | 2012<br>£m |
|--------------------------------|------------|------------|
| Inventory and work in progress | 32.1       | 34.4       |

## 22 Trade and other receivables

|   | 2013<br>£m | 2012<br>£m |
|---|------------|------------|
| Trade receivables                             | 334.7      | 306.3      |
| Less provisions for impairment of receivables | (138.0)    | (125.2)    |
| Net trade receivables                         | 196.7      | 181.1      |
| Amounts receivable from related parties       | –          | 0.2        |
| Other amounts receivable                      | 32.5       | 32.5       |
| Prepayments and accrued income                | 276.8      | 265.6      |
|   | 506.0      | 479.4      |

The carrying values of trade and other receivables are reasonable approximations of their fair values

Prepayments and accrued income include £26.8 million (2012: £27.1 million) in respect of amounts due from customers for contract work and £39.5 million (2012: £43.1 million) which is recoverable after more than one year

Credit control policies and procedures are determined at the individual business unit level. The most significant business unit of the group is Severn Trent Water Limited, which contributes 82% of group turnover and 80% of net trade receivables. Severn Trent Water has a statutory obligation to provide water and sewerage services to customers within its region. Therefore there is no concentration of credit risk with respect to its trade receivables and the credit quality of its customer base reflects the wealth and prosperity of all of the commercial businesses and domestic households within its region. None of the other business units are individually significant to the group.

Movements on the doubtful debts provision were as follows:

|   | 2013<br>£m | 2012<br>£m |
|---|------------|------------|
| At 1 April                                    | 125.2      | 98.5       |
| Amounts written off during the year           | (22.1)     | (24.4)     |
| Amounts recovered during the year             | –          | (0.3)      |
| Charge for bad and doubtful debts             | 33.1       | 30.7       |
| Exceptional charge for bad and doubtful debts | –          | 21.5       |
| Exchange adjustments                          | 1.8        | (0.8)      |
| At 31 March                                   | 138.0      | 125.2      |

Included in trade receivables are balances with a carrying amount of £176.4 million (2012: £157.8 million) which were past due at the reporting date but for which no specific provision has been made as the collective impairment recorded against such assets is considered to be sufficient allowance for the risk of non-collection of such balances.

The aged analysis of receivables that were past due at the reporting date but not individually impaired is as follows:

|                   | 2013<br>£m | 2012<br>£m |
|-------------------|------------|------------|
| Up to 90 days     | 49.4       | 46.4       |
| 91-365 days       | 77.8       | 70.1       |
| 1-2 years         | 30.9       | 26.4       |
| 2-3 years         | 11.3       | 9.5        |
| More than 3 years | 7.0        | 5.4        |
|                   | 176.4      | 157.8      |

Included in the allowance for doubtful debts are provisions amounting to £25.1 million (2012: £27.5 million) against specific trade receivables. The age of the impaired receivables was as follows:

|                   | 2013<br>£m | 2012<br>£m |
|-------------------|------------|------------|
| Up to 90 days     | 3.7        | 1.4        |
| 91-365 days       | 3.9        | 2.9        |
| 1-2 years         | 3.9        | 15.1       |
| 2-3 years         | 12.2       | 4.5        |
| More than 3 years | 3.4        | 4.1        |
|                   | 27.1       | 28.0       |



## Group financial statements Notes to the group financial statements

## 23 Cash and cash equivalents

|                          | 2013<br>£m | 2012<br>£m |
|--------------------------|------------|------------|
| Cash at bank and in hand | 47.9       | 37.4       |
| Short term deposits      | 355.7      | 257.7      |
|                          | 403.6      | 295.1      |

Of the £355.7 million (2012: £257.7 million) of short term bank deposits, £26.1 million (2012: £26.9 million) is held as security deposits for insurance obligations and is not available for use by the group.

## 24 Finance leases

Obligations under finance leases are as follows.

|  | 2013<br>£m | 2012<br>£m |
|--|------------|------------|
| Gross obligations under finance leases | 265.1      | 292.1      |
| Less future finance charges            | (63.5)     | (73.1)     |
| Present value of lease obligations     | 201.6      | 219.0      |

A maturity analysis of gross obligations under finance leases is presented in note 32. Net obligations under finance leases fall due as follows:

|                                     | 2013<br>£m | 2012<br>£m |
|-------------------------------------|------------|------------|
| Within 1 year                       | 0.5        | -          |
| 1-2 years                           | 21.2       | 17.8       |
| 3-5 years                           | 66.5       | 85.5       |
| After more than 5 years             | 113.4      | 115.7      |
| Included in non-current liabilities | 201.1      | 219.0      |
|                                     | 201.6      | 219.0      |

The remaining terms of finance leases ranged from 3 to 20 years at 31 March 2013. Interest terms are set at the inception of the leases. Leases with capital outstanding of £201.6 million (2012: £219.0 million) bear fixed interest at a weighted average rate of 5.4% (2012: 5.4%). 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.

## 25 Trade and other payables

|                                 | 2013<br>£m | 2012<br>£m |
|---------------------------------|------------|------------|
| <b>Current liabilities</b>      |            |            |
| Trade payables                  | 28.7       | 34.9       |
| Social security and other taxes | 7.0        | 7.0        |
| Other payables                  | 25.7       | 18.4       |
| Deferred income                 | 9.2        | 8.8        |
| Accruals                        | 328.4      | 328.5      |
|                                 | 399.0      | 397.6      |
| <b>Non-current liabilities</b>  |            |            |
| Trade payables                  | 2.0        | -          |
| Other payables                  | 0.4        | 0.4        |
| Deferred income                 | 437.2      | 396.6      |
| Accruals                        | 13.8       | 14.0       |
|                                 | 453.4      | 411.0      |

The directors consider that the carrying value of trade payables is not materially different from their fair values.

Accruals includes nil (2012: nil) in respect of amounts due to customers for contract work.

## Group financial statements Notes to the group financial statements

## 26 Deferred tax

An analysis of the movements in the deferred tax liabilities and assets recognised by the group is set out below:

|   | Accelerated<br>tax<br>depreciation<br>£m | Retirement<br>benefit<br>obligation<br>£m | Tax losses<br>£m | Fair value of<br>financial<br>instruments<br>£m | Other<br>£m | Total<br>£m |
|---|--|---|------------------|---|-------------|-------------|
| At 1 April 2011                           | 1,091.9                                  | (75.9)                                    | (6.4)            | (24.8)  | (65.4)      | 919.4       |
| Credit to income                          | (83.1)                                   | 13.7                                      | —                | (16.7)  | 77.0        | (9.1)       |
| Credit to income arising from rate change | (72.4)                                   | 2.8                                       | —                | 1.1   | (0.6)       | (69.1)      |
| Credit to equity                          | —  | (17.8)                                    | —                | (19.9)  | (0.3)       | (38.0)      |
| Credit to equity arising from rate change | (5.5)                                    | 3.0                                       | —                | 0.7   | 0.1         | (1.7)       |
| At 1 April 2012                           | 930.9                                    | (74.2)                                    | (6.4)            | (59.6)  | 10.8        | 801.5       |
| Charge to income                          | (0.4)                                    | (6.5)                                     | 6.4              | 0.1   | 34.6        | 34.2        |
| Credit to income arising from rate change | (39.0)                                   | 1.4                                       | —                | 1.2   | (0.3)       | (36.7)      |
| Credit to equity                          | —  | (11.0)                                    | —                | (5.6)   | —           | (16.6)      |
| Charge to equity arising from rate change | —  | 2.1                                       | —                | 1.2   | 0.1         | 3.4         |
| At 31 March 2013                          | 891.5                                    | (88.2)                                    | —                | (62.7)  | 45.2        | 785.8       |

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.

|                        | 2013<br>£m | 2012<br>£m |
|------------------------|------------|------------|
| Deferred tax asset     | (169.1)    | (198.9)    |
| Deferred tax liability | 954.9      | 1,000.4    |
|                        | 785.8      | 801.5      |

## 27 Retirement benefit schemes

## a) Defined benefit pension schemes

(i) Amount included in the balance sheet arising from the group's obligations under defined benefit pension schemes

|   | 2013<br>£m | 2012<br>£m |
|---|------------|------------|
| Fair value of scheme assets   |            |            |
| Equities  | 877.2      | 798.6      |
| Gilts   | 274.6      | 235.2      |
| Corporate bonds   | 360.9      | 339.1      |
| Property  | 147.8      | 105.7      |
| Hedge funds   | 55.8       | 52.6       |
| Cash  | 8.0        | 26.0       |
| Total fair value of assets  | 1,724.3    | 1,557.2    |
| Present value of the defined benefit obligations – funded schemes   | (2,098.7)  | (1,894.4)  |
|   | (374.4)    | (337.2)    |
| Present value of the defined benefit obligations – unfunded schemes | (9.3)      | (8.6)      |
| Liability recognised in the balance sheet                           | (383.7)    | (345.8)    |

Movements in the fair value of the scheme assets were as follows:

|  | 2013<br>£m | 2012<br>£m |
|--|------------|------------|
| Fair value at 1 April  | 1,557.2    | 1,473.4    |
| Expected return on scheme assets   | 88.2       | 100.7      |
| Contributions from the sponsoring companies                                  | 43.5       | 53.5       |
| Contributions from scheme members  | 5.1        | 5.6        |
| Actuarial gains/(losses) recognised in the statement of comprehensive income | 101.3      | (4.5)      |
| Benefits paid  | (71.0)     | (71.5)     |
| Fair value at 31 March   | 1,724.3    | 1,557.2    |

## Group financial statements Notes to the group financial statements

## 27 Retirement benefit schemes (continued)

## a) Defined benefit pension schemes (continued)

(i) Amount included in the balance sheet arising from the group's obligations under defined benefit pension schemes (continued)

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

|  | 2013<br>£m | 2012<br>£m |
|--|------------|------------|
| Present value at 1 April   | 1,903.0    | 1,765.5    |
| Service cost   | 22.8       | 22.6       |
| Past service cost  | 0.4        | -          |
| Interest cost  | 92.2       | 97.7       |
| Net curtailment gain   | -          | (23.1)     |
| Contributions from scheme members                                    | 5.1        | 5.6        |
| Actuarial losses recognised in the statement of comprehensive income | 155.5      | 106.2      |
| Benefits paid  | (71.0)     | (71.5)     |
| Present value at 31 March  | 2,108.0    | 1,903.0    |

Of which:

|                                      | 2013<br>£m | 2012<br>£m |
|--------------------------------------|------------|------------|
| Amounts relating to funded schemes   | 2,098.7    | 1,894.4    |
| Amounts relating to unfunded schemes | 9.3        | 8.6        |
| Present value at 31 March            | 2,108.0    | 1,903.0    |

(ii) Amounts recognised in the income statement in respect of these defined benefit pension schemes

|   | 2013<br>£m | 2012<br>£m |
|---|------------|------------|
| Amounts charged to operating costs                      |            |            |
| Current service cost                                    | (22.8)     | (22.6)     |
| Exceptional curtailment gain                            | -          | 23.1       |
| Past service cost                                       | (0.4)      | -          |
|   | (23.2)     | 0.5        |
| Amounts charged to finance costs                        |            |            |
| Interest cost   | (92.2)     | (97.7)     |
| Amounts credited to finance income                      |            |            |
| Expected return on scheme assets                        | 88.2       | 100.7      |
| Total amount (charged)/credited to the income statement | (27.2)     | 3.5        |

The actual return on scheme assets was a gain of £189.5 million (2012: gain of £95.9 million).

Actuarial gains and losses have been reported in the statement of comprehensive income. The cumulative amount of actuarial gains and losses recognised in the statement of comprehensive income since the adoption of IFRS is a net loss of £334.3 million (2012: net loss of £280.1 million).

## 27 Retirement benefit schemes (continued)

## a) Defined benefit pension schemes (continued)

## iii) Background

The group operates a number of defined benefit pension schemes in the UK, covering the majority of UK employees. The defined benefit pension schemes are funded to cover future salary and pension increases and their assets are held in separate funds administered by trustees. The trustees are required to act in the best interests of the schemes' beneficiaries. A formal actuarial valuation of each scheme is carried out on behalf of the trustees at triennial intervals by an independent professionally qualified actuary. Under the defined benefit pension schemes, members are entitled to retirement benefits calculated as a proportion (varying between 1/30 and 1/80 for each year of service) of their salary for the final year of employment with the group or, if higher, the average of the highest three consecutive years' salary in the last 10 years of employment.

The defined benefit pension schemes will close to future accrual on 31 March 2015. A new defined contribution pension scheme has been established and members of the defined benefit pension schemes will then become members of the new defined contribution pension scheme. The existing defined contribution pension scheme will also be replaced by the new pension arrangements with effect from 1 April 2015.

From 1 April 2012 new employees have been automatically enrolled into this scheme and those employees who were not members of a Severn Trent scheme were automatically enrolled into this scheme from 1 April 2013.

The final salary sections of the pension schemes are closed to new entrants and the age profile of scheme participants is expected to rise and hence service costs are also expected to rise until the schemes are closed to future accrual.

The schemes typically expose the company to actuarial risks such as market risk, interest rate risk and longevity risk.

The UK defined benefit pension schemes and the date of their last formal actuarial valuation are as follows.

|  | Date of last formal actuarial valuation |
|--|---|
| Severn Trent Pension scheme (STPS)*      | 31 March 2010                           |
| Severn Trent Mirror Image Pension Scheme | 31 March 2010                           |

\* The STPS is the largest of the group's UK defined benefit schemes.

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 £9.3 million (2012: £8.6 million) is included as an unfunded scheme within the retirement benefit obligation.

## (iv) Actuarial assumptions

The major assumptions used in the valuation of the STPS (also the approximate weighted average of assumptions used for the valuations of all group schemes) were as follows.

|                                | 2013<br>% | 2012<br>% |
|--------------------------------|-----------|-----------|
| Price inflation                | 3.2       | 3.1       |
| Salary increases               | 3.0       | 3.6       |
| Pension increases in payment   | 3.2       | 3.1       |
| Pension increases in deferment | 3.2       | 3.1       |
| Discount rate                  | 4.4       | 4.9       |
| Long term rate of return on    |           |           |
| Equities                       | 6.6       | 6.8       |
| Gilts                          | 3.1       | 3.3       |
| Corporate bonds                | 4.3       | 4.9       |
| Property                       | 5.5       | 5.8       |
| Hedge funds                    | 6.0       | 6.3       |
| Cash                           | 3.1       | 3.3       |

The assumption for price inflation is derived from the difference between the yields on longer term fixed rate gilts and on index-linked gilts. The discount rate is set by reference to AA rated sterling 18 year corporate bonds.

The expected rate of return on scheme assets is based on market expectations at the beginning of the period for returns over the life of the benefit obligation. For gilts and corporate bonds the expected rates of return are based on market yields. For equities, property and hedge funds, a risk premium has been added to the gilt rate.

The mortality assumptions are based on those used in the triennial valuation of the STPS as at 31 March 2010 updated by a further investigation carried out in connection with the 2013 valuation, which indicated that members' life expectancy had not been as high as the previous investigation had predicted.

## Group financial statements Notes to the group financial statements

## 27 Retirement benefit schemes (continued)

## a) Defined benefit pension schemes (continued)

## (iv) Actuarial assumptions (continued)

The mortality assumptions adopted at the year end and the life expectancies at age 65 implied by the assumptions are as follows:

|  | 2013           | 2012           |
|--|----------------|----------------|
| <b>Mortality table used</b>  |                |                |
| - men  | 'SAPS' S1NMA L | 'SAPS' S1NMA L |
| - women  | S1NFA L        | S1NFA L        |
| <b>Mortality table compared with standard table</b>                              |                |                |
| - men  | 116%           | 110%           |
| - women  | 92%            | 78%            |
| <b>Future improvement per annum</b>  | 1.0%           | 0.5%           |
| <b>Remaining life expectancy for members currently aged 65 (years)</b>           |                |                |
| - men  | 21.5           | 21.2           |
| - women  | 24.6           | 25.1           |
| <b>Remaining life expectancy at age 65 for members currently aged 45 (years)</b> |                |                |
| - men  | 22.7           | 21.8           |
| - women  | 26.2           | 25.9           |

The calculation of the scheme liabilities is sensitive to the actuarial assumptions and in particular to the assumptions relating to discount rate, price inflation and mortality. The following table summarises the estimated impact on scheme liabilities and service cost resulting from changes to key actuarial assumptions whilst holding all other assumptions constant.

| Assumption      | Change in assumption                  | Impact on scheme liabilities       |
|-----------------|---------------------------------------|------------------------------------|
| Discount rate   | Increase/decrease by 0.1%             | Decrease/increase by £38.0 million |
| Price inflation | Increase/decrease by 0.1%             | Increase/decrease by £35.0 million |
| Mortality       | Increase in life expectancy by 1 year | Increase by £55.0 million          |

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.

## (v) 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 18 years (2012: 18 years). The expected cash flows payable from the schemes are presented in the graph below.

Image Removed

It is anticipated that normal contributions to the scheme in the year ended 31 March 2014 will be unchanged. The triennial valuations for both schemes for the year ending 31 March 2013 is in progress. Pending completion of this valuation, future lump sum deficit contributions will include a payment of £10.0 million per annum in cash and a further £8.2 million per annum through an asset backed funding arrangement.

## Group financial statements Notes to the group financial statements

## 27 Retirement benefit schemes (continued)

## a) Defined benefit pension schemes (continued)

## (vi) History of actual and expected performance of pension scheme assets and liabilities

|  | 2013<br>£m | 2012<br>£m | 2011<br>£m | 2010<br>£m | 2009<br>£m |
|--|------------|------------|------------|------------|------------|
| Present value of defined benefit obligations                   | (2,108.0)  | (1,903.0)  | (1,765.5)  | (1,747.9)  | (1,308.0)  |
| Fair value of scheme assets                                    | 1,724.3    | 1,557.2    | 1,473.4    | 1,393.0    | 1,075.0    |
| Deficit in schemes   | (383.7)    | (345.8)    | (292.1)    | (354.9)    | (233.0)    |
| Difference between actual and expected return on scheme assets | 101.3      | (4.5)      | 12.2       | 270.4      | (329.8)    |
| Experience adjustments on scheme liabilities                   | (155.5)    | (106.2)    | 105.1      | 19.8       | (7.9)      |

## b) Defined contribution pension schemes

The group also operates defined contribution arrangements for certain of its UK and overseas employees. In September 2001, the Severn Trent Group Pension Scheme (an occupational defined contribution pension scheme) was established to ensure compliance with stakeholder legislation and to provide the group with an alternative pension arrangement. This was closed to new entrants on 1 April 2005 and replaced by the Severn Trent Stakeholder Pension Scheme.

The total cost charged to operating costs of £6.6 million (2012: £4.9 million) represents contributions payable to these schemes by the group at rates specified in the rules of the schemes. As at 31 March 2013, all contributions (2012: 100%) due in respect of the current reporting period had been paid over to the schemes.

## 28 Provisions

|  | Restructuring<br>£m | Insurance<br>£m | Onerous<br>contracts<br>£m | Terminated<br>operations<br>and disposals<br>£m | Other<br>£m | Total<br>£m |
|--|---------------------|-----------------|----------------------------|---|-------------|-------------|
| At 1 April 2012                        | 1.9                 | 24.9            | 5.5                        | 6.4   | 5.3         | 44.0        |
| Charged/(released) to income statement | 0.7                 | 9.0             | (0.3)                      | 0.2   | 2.0         | 11.6        |
| Utilisation of provision               | (0.4)               | (8.8)           | (2.9)                      | (2.0)   | (0.2)       | (14.3)      |
| Disposal of subsidiaries               | —                   | —               | (0.4)                      | —   | 0.1         | (0.3)       |
| Unwinding of discount                  | —                   | —               | 0.5                        | —   | 0.1         | 0.6         |
| Exchange differences                   | —                   | —               | —                          | —   | 0.1         | 0.1         |
| At 31 March 2013                       | 2.2                 | 25.1            | 2.4                        | 4.6   | 7.4         | 41.7        |

|                         | 2013<br>£m | 2012<br>£m |
|-------------------------|------------|------------|
| Included in             |            |            |
| Current liabilities     | 11.1       | 17.0       |
| Non-current liabilities | 30.6       | 27.0       |
|                         | 41.7       | 44.0       |

The restructuring provision reflects costs to be incurred in respect of committed restructuring programmes.

Derwent Insurance Limited, a captive insurance company, is a wholly owned subsidiary of the group. Provisions for claims are made as set out in note 2. The associated outflows are estimated to arise over a period of up to five years from the balance sheet date.

The onerous contract provision relates to specific contractual liabilities either assumed with businesses acquired or arising in existing group businesses, where estimated future costs are not expected to be recovered in revenues. The associated outflows are estimated to occur over a period of 10 years from the balance sheet date.

Provisions relating to terminated operations and disposals include amounts that it is probable will be paid in respect of claims arising from services performed by these businesses and the indemnities described in note 37 b).

Other provisions include provisions for dilapidations and commercial disputes. The associated outflows are estimated to arise over a period up to six years from the balance sheet date.

## Group financial statements Notes to the group financial statements

## 29 Share capital

|   | 2013<br>£m | 2012<br>£m |
|---|------------|------------|
| Total issued and fully paid share capital   |            |            |
| 238,365,734 ordinary shares of 97 <sup>11</sup> / <sub>16</sub> p (2012: 237,608,111) | 233.3      | 232.6      |

## Changes in share capital were as follows

|  | Number      | £m    |
|--|-------------|-------|
| Ordinary shares of 97 <sup>11</sup> / <sub>16</sub> p  |             |       |
| At 1 April 2011  | 237,142,534 | 232.2 |
| Shares issued under the Employee Sharesave Scheme      | 442,593     | 0.4   |
| Shares issued under the Unapproved Share Option Scheme | 22,984      | -     |
| At 1 April 2012  | 237,608,111 | 232.6 |
| Shares issued under the Employee Sharesave Scheme      | 757,623     | 0.7   |
| At 31 March 2013                                       | 238,365,734 | 233.3 |

## 30 Share premium

|   | 2013<br>£m | 2012<br>£m |
|---|------------|------------|
| At 1 April  | 83.8       | 80.0       |
| Share premium arising on issue of shares for Employee Sharesave Scheme      | 5.9        | 3.7        |
| Share premium arising on issue of shares for Unapproved Share Option Scheme | -          | 0.1        |
| At 31 March   | 89.7       | 83.8       |

## 31 Other reserves

|                                       | Capital redemption reserve<br>£m | Infrastructure reserve<br>£m | Translation exchange reserve<br>£m | Hedging reserve<br>£m | Total<br>£m |
|---------------------------------------|----------------------------------|------------------------------|------------------------------------|-----------------------|-------------|
| At 1 April 2011                       | 156.1                            | 314.2                        | 25.4                               | (31.2)                | 464.5       |
| Total comprehensive loss for the year | -                                | -                            | (1.4)                              | (62.9)                | (64.3)      |
| At 1 April 2012                       | 156.1                            | 314.2                        | 24.0                               | (94.1)                | 400.2       |
| Total comprehensive loss for the year | -                                | (314.2)                      | 4.9                                | (18.6)                | (327.9)     |
| At 31 March 2013                      | 156.1                            | -                            | 28.9                               | (112.7)               | 72.3        |

The capital redemption reserve arose on the redemption of B shares.

The infrastructure reserve arose on the group's transition to IFRS from restating Severn Trent Water Limited's infrastructure assets to fair value as deemed cost. In the current year Severn Trent Water Limited has adopted the new accounting standard IFRS 101, which uses the recognition and measurement criteria of IFRS. The infrastructure reserve has now been recognised in Severn Trent Water Limited. During the year Severn Trent Water Limited used its infrastructure reserve to issue bonus shares, which were subsequently cancelled. These transactions result in a transfer from the infrastructure reserve to retained earnings in these financial statements.

The translation reserve arises from exchange differences on translation of the results and financial position of foreign subsidiaries as well as foreign exchange differences arising from hedges of net investment.

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.

## 32 Financial instruments

## a) 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 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 does not have a specific gearing target but seeks to maintain gearing at a level consistent with its capital management objectives described above.

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.

## Group financial statements Notes to the group financial statements

## 32 Financial instruments (continued)

## a) Capital management (continued)

The group monitors future funding requirements and credit market conditions to ensure continued availability of funds.

In July 2012 the group issued a £75 million sterling denominated RPI linked bond in the retail bond market. A coupon of 1.3% is payable on the notes which are due to mature in July 2022.

In January 2013 the group issued £500 million 3.625% Guaranteed Notes under its Euro Medium Term Note programme. The notes have a 13 year term.

During the year, the group repaid a £200 million bank loan that was due for repayment in July 2013.

A 10 year bilateral bank facility of £100 million was drawn in the period.

At 31 March the group's equity and debt capital comprised the following:

|  | 2013<br>£m | 2012<br>£m |
|--|------------|------------|
| Cash and short term deposits                     | 403.6      | 295.1      |
| Bank overdrafts                                  | (0.4)      | (0.4)      |
| Bank loans                                       | (758.7)    | (852.5)    |
| Other loans                                      | (3,840.9)  | (3,326.9)  |
| Obligations under finance leases                 | (201.6)    | (219.0)    |
| Cross currency swaps                             | 100.7      | 135.9      |
| Net debt   | (4,297.3)  | (3,967.8)  |
| Equity attributable to the owners of the company | (833.2)    | (973.5)    |
| Total capital                                    | (5,130.5)  | (4,941.3)  |

## b) Categories of financial assets

|   | 2013<br>£m | 2012<br>£m |
|---|------------|------------|
| Fair value through profit and loss                          |            |            |
| Cross currency swaps – fair value hedges                    | 60.3       | 95.2       |
| Foreign exchange forward contracts – not hedge accounted    | 0.1        | –          |
| Interest rate swaps – not hedge accounted                   | 21.0       | 23.7       |
| Energy swaps – cash flow hedges                             | 0.9        | 2.5        |
| Cross currency swaps – not hedge accounted                  | 48.8       | 41.2       |
|   | 131.1      | 162.6      |
| Available for sale investments carried at fair value        |            |            |
| Unquoted shares   | 0.1        | 0.1        |
| Loans and receivables (including cash and cash equivalents) |            |            |
| Trade receivables   | 196.7      | 181.1      |
| Short term deposits   | 355.7      | 257.7      |
| Cash at bank and in hand                                    | 48.0       | 37.4       |
|   | 600.4      | 476.2      |
| Total financial assets                                      | 731.6      | 638.9      |
| Disclosed in the balance sheet as:                          |            |            |
| Non-current assets  |            |            |
| Derivative financial instruments                            | 130.1      | 132.6      |
| Available for sale financial assets                         | 0.1        | 0.1        |
|   | 130.2      | 132.7      |
| Current assets  |            |            |
| Derivative financial instruments                            | 1.0        | 30.0       |
| Cash and cash equivalents                                   | 403.6      | 295.1      |
| Trade receivables (note 22)                                 | 196.7      | 181.1      |
|   | 601.3      | 506.2      |
|   | 731.5      | 638.9      |



## Group financial statements Notes to the group financial statements

## 32 Financial instruments (continued)

## c) Categories of financial liabilities

|  | 2013<br>£m       | 2012<br>£m       |
|--|------------------|------------------|
| <b>Fair value through profit and loss</b>                |                  |                  |
| Cross currency swaps – not hedge accounted               | (8.4)            | (0.5)            |
| Interest rate swaps – cash flow hedges                   | (128.0)          | (91.6)           |
| Interest rate swaps – not hedge accounted                | (171.8)          | (194.4)          |
| Energy swaps – cash flow hedges                          | (1.8)            | (1.4)            |
| Foreign exchange forward contracts – not hedge accounted | (0.2)            | (0.6)            |
|  | (310.2)          | (288.5)          |
| <b>Other financial liabilities</b>                       |                  |                  |
| Bank loans   | (758.7)          | (852.5)          |
| Other loans  | (3,840.9)        | (3,326.9)        |
| Obligations under finance leases                         | (201.6)          | (219.0)          |
| Bank overdrafts  | (0.4)            | (0.4)            |
| Trade payables   | (30.7)           | (34.9)           |
|  | (4,832.3)        | (4,433.7)        |
| <b>Total financial liabilities</b>                       | <b>(5,142.5)</b> | <b>(4,722.2)</b> |
| <b>Disclosed in the balance sheet as:</b>                |                  |                  |
| <b>Non-current liabilities</b>                           |                  |                  |
| Derivative financial instruments                         | (309.6)          | (288.0)          |
| Borrowings   | (4,631.3)        | (4,309.5)        |
| Trade payables   | (2.0)            | -                |
|  | (4,942.9)        | (4,597.5)        |
| <b>Current liabilities</b>                               |                  |                  |
| Derivative financial instruments                         | (0.6)            | (0.5)            |
| Borrowings   | (170.3)          | (89.3)           |
| Trade payables (note 25)                                 | (28.7)           | (34.9)           |
|  | (199.6)          | (124.7)          |
|  | (5,142.5)        | (4,722.2)        |

## d) Fair values of financial instruments

Except as disclosed below, the directors consider that the carrying amount of financial assets and liabilities recorded in the financial statements approximate their fair values.

|   | 2013             |                  | 2012             |                  |
|---|------------------|------------------|------------------|------------------|
|   | Book value<br>£m | Fair value<br>£m | Book value<br>£m | Fair value<br>£m |
| Bank loans – amortised cost                       | (758.7)          | (781.6)          | (852.5)          | (858.3)          |
| Other loans                                       | (3,840.9)        | (4,585.2)        | (3,326.9)        | (3,936.2)        |
| Obligations under finance leases – amortised cost | (201.6)          | (208.2)          | (219.0)          | (215.4)          |
|   | (4,801.2)        | (5,575.0)        | (4,398.4)        | (5,009.9)        |

Discounted future cash flows are used to determine fair values for debt. Discount rates are derived from yield curves based on quoted interest rates and are adjusted for the group's credit risk.

*Fair value measurements recognised in the balance sheet*

In 2013 and 2012, all the fair values of financial instruments that were measured subsequent to initial recognition at fair value, were based on observable inputs other than quoted prices for identical instruments, defined as 'Level 2' in IFRS 7.

The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows estimated and discounted based on the application of yield curves derived from quoted interest rates.

Cross currency swaps and forward exchange contracts are valued by reference to quoted forward exchange rates at the balance sheet date and yield curves derived from quoted interest rates matching the maturities of the contracts.

## Group financial statements Notes to the group financial statements

## 32 Financial instruments (continued)

## e) Financial risk factors

The group's activities expose it to a variety of financial risks, market risk (including currency and interest rate 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. Group Treasury identifies, evaluates and hedges financial risks in close cooperation with the group's operating units. The board provides 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. Derivative financial instruments are used to hedge exposure to changes in exchange rates and interest rates.

The group's policy is that derivative financial instruments are not held for trading.

## (i) Market risk

The principal market risk that the group is exposed to is fluctuations in interest rates

*Interest rate risk*

The group's income and 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 cash flow interest rate risk. Borrowings issued at fixed rates expose the group to fair value interest rate risk. The group's policy is to maintain 45% to 90% of its net debt in fixed rate instruments. At 31 March 2013 76.8% of the group's net debt was at fixed rates (2012 74.0%)

The group manages its cash flow interest rate risk by using floating to fixed interest rate swaps. Such interest rate swaps have the economic effect of converting borrowings from floating rates to fixed rates. Under the terms of the interest rate swaps, the group agrees with other parties to exchange, mainly semi-annually, the difference between fixed contract and floating rate interest rates calculated by reference to the agreed notional principal amounts. The group has entered into a series of long dated interest rate swaps to hedge future interest payments. Economically these act to fix the interest cost of debt within the group which is denominated as floating rate, but do not achieve hedge accounting under the strict criteria of IAS 39. This has led to a £25.2 million charge (2012 charge of £80.3 million) in the income statement.

Some of the group's debt is index-linked, that is its cost is linked to changes in the Retail Price Index (RPI). This debt provides an economic hedge for Severn Trent Water's revenues and Regulatory Capital Value that are also RPI linked under its regulatory regime.

*Financial liabilities analysed by interest rate after taking account of various interest rate swaps entered into by the group*

| 2013   | Non-interest<br>bearing<br>liabilities<br>£m | Floating<br>rate<br>£m | Fixed<br>rate<br>£m | Index-<br>linked<br>£m | Total<br>£m |
|--|--|------------------------|---------------------|------------------------|-------------|
| Bank loans and overdrafts  | -  | (300.4)                | (191.0)             | (267.7)                | (759.1)     |
| Other loans  | (1.2)  | (195.2)                | (2,541.0)           | (1,103.5)              | (3,840.9)   |
| Finance leases   | -  | -                      | (201.6)             | -                      | (201.6)     |
| Other financial liabilities  | (30.7)                                       | -                      | -                   | -                      | (30.7)      |
|  | (31.9)                                       | (495.6)                | (2,933.6)           | (1,371.2)              | (4,832.3)   |
| Impact of interest rate swaps not matched against<br>specific debt instruments | -  | 364.9                  | (364.9)             | -                      | -           |
|  | (31.9)                                       | (130.7)                | (3,298.5)           | (1,371.2)              | (4,832.3)   |
| Weighted average interest rate   |  |                        | 5.44%               |                        |             |
| Weighted average period for which interest is fixed (years)                    |  |                        | 11.3                |                        |             |

## Group financial statements Notes to the group financial statements

## 32 Financial instruments (continued)

## e) Financial risk factors (continued)

## (i) Market risk (continued)

## Financial liabilities analysed by interest rate after taking account of various interest rate swaps entered into by the group (continued)

|  | Non-interest<br>bearing<br>liabilities<br>£m | Floating<br>rate<br>£m | Fixed<br>rate<br>£m | Index-<br>linked<br>£m | Total<br>£m |
|--|--|------------------------|---------------------|------------------------|-------------|
| 2012   |  |                        |                     |                        |             |
| Bank loans and overdrafts  | -  | (500.4)                | (192.2)             | (160.3)                | (852.9)     |
| Other loans  | (1.2)  | (265.2)                | (2,063.1)           | (997.4)                | (3,326.9)   |
| Finance leases   | -  | -                      | (219.0)             | -                      | (219.0)     |
| Other financial liabilities  | (34.9)                                       | -                      | -                   | -                      | (34.9)      |
|  | (36.1)                                       | (765.6)                | (2,474.3)           | (1,157.7)              | (4,433.7)   |
| Impact of interest rate swaps not matched against<br>specific debt instruments | -  | 463.6                  | (463.6)             | -                      | -           |
|  | (36.1)                                       | (302.0)                | (2,937.9)           | (1,157.7)              | (4,433.7)   |
| Weighted average interest rate   |  |                        | 5.84%               |                        |             |
| Weighted average period for which interest is fixed (years)                    |  |                        | 12.8                |                        |             |

## Financial assets analysed by interest rates

|                                     | Non-interest<br>bearing<br>assets<br>£m | Floating<br>rate<br>£m | Fixed<br>rate<br>£m | Index-<br>linked<br>£m | Total<br>£m |
|-------------------------------------|---|------------------------|---------------------|------------------------|-------------|
| 2013                                |   |                        |                     |                        |             |
| Available for sale financial assets | 0.1                                     | -                      | -                   | -                      | 0.1         |
| Loans and receivables               | 196.7                                   | -                      | -                   | -                      | 196.7       |
| Cash and cash equivalents           | -                                       | 403.6                  | -                   | -                      | 403.6       |
|                                     | 196.8                                   | 403.6                  | -                   | -                      | 600.4       |

|                                     | Non-interest<br>bearing<br>assets<br>£m | Floating<br>rate<br>£m | Fixed<br>rate<br>£m | Index-<br>linked<br>£m | Total<br>£m |
|-------------------------------------|---|------------------------|---------------------|------------------------|-------------|
| 2012                                |   |                        |                     |                        |             |
| Available for sale financial assets | 0.1                                     | -                      | -                   | -                      | 0.1         |
| Loans and receivables               | 181.0                                   | -                      | -                   | -                      | 181.0       |
| Cash and cash equivalents           | -                                       | 295.1                  | -                   | -                      | 295.1       |
|                                     | 181.1                                   | 295.1                  | -                   | -                      | 476.2       |

## Interest rate sensitivity analysis

The sensitivity of the group's profit after tax, cash flow and equity, including the impact on derivative financial instruments, to changes in interest rates at 31 March is as follows.

|                  | 2013        |             | 2012        |             |
|------------------|-------------|-------------|-------------|-------------|
|                  | +1.0%<br>£m | -1.0%<br>£m | +1.0%<br>£m | -1.0%<br>£m |
| Profit after tax | 62.8        | (74.4)      | 75.3        | (90.1)      |
| Cash flow        | (2.1)       | 2.1         | 0.1         | (0.1)       |
| Equity           | 112.8       | (130.6)     | 121.7       | (143.1)     |

## Inflation rate sensitivity analysis

The sensitivity of the group's profit after tax and equity to changes in inflation at 31 March is set out in the following table. This analysis excludes any impact on Severn Trent Water's revenues and Regulated Capital Value, or accounting for defined benefit pension schemes.

|                  | 2013        |             | 2012        |             |
|------------------|-------------|-------------|-------------|-------------|
|                  | +1.0%<br>£m | -1.0%<br>£m | +1.0%<br>£m | -1.0%<br>£m |
| Profit after tax | (10.4)      | 10.4        | (8.8)       | 8.8         |
| Equity           | (10.4)      | 10.4        | (8.8)       | 8.8         |

## Group financial statements Notes to the group financial statements

## 32 Financial instruments (continued)

## e) Financial risk factors (continued)

## (i) Market risk (continued)

## Exchange rate risk

The group operates internationally and is exposed to exchange risk arising from net investments in foreign operations, primarily with respect to the US dollar and the euro. However, since 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, the sensitivity of the group's results to changes in exchange rates is not material.

The group's net debt includes foreign currency borrowings, primarily denominated in yen and euros. The group's policy is to manage the exchange risk arising from foreign currency borrowings by entering into cross currency swaps or forward contracts with external parties.

The group's gross and net currency exposures arising from currency borrowings are summarised below.

|  | Euro<br>€m | US dollar<br>\$m | Japanese yen<br>¥bn | Czech krona<br>CZKm |
|--|------------|------------------|---------------------|---------------------|
| 2013                                       |            |                  |                     |                     |
| Borrowings by currency                     | (721.6)    | (50.0)           | (24.5)              | (620.0)             |
| Cross currency swaps – hedge accounted     | 19.9       | 50.0             | 14.5                | 620.0               |
| Cross currency swaps – not hedge accounted | 700.0      | –                | 10.0                | –                   |
|  | (1.7)      | –                | –                   | –                   |
| Cash                                       | 3.9        | 38.1             | –                   | –                   |
| Net currency exposure                      | 2.2        | 38.1             | –                   | –                   |

|  | Euro<br>€m | US dollar<br>\$m | Japanese yen<br>¥bn | Czech krona<br>CZKm |
|--|------------|------------------|---------------------|---------------------|
| 2012                                       |            |                  |                     |                     |
| Borrowings by currency                     | (720.6)    | (50.0)           | (30.0)              | (1,970.0)           |
| Cross currency swaps – hedge accounted     | 19.9       | 50.0             | 20.0                | 1,970.0             |
| Cross currency swaps – not hedge accounted | 700.0      | –                | 10.0                | –                   |
|  | (0.7)      | –                | –                   | –                   |
| Cash                                       | 5.3        | 22.1             | –                   | –                   |
| Net currency exposure                      | 4.6        | 22.1             | –                   | –                   |

The euro and US dollar net cash balances relate to operations in which the euro or US dollar is the functional currency.

## Monetary assets and liabilities by currency, excluding functional currency

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.

## (ii) 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, whose operating licence obliges it 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 22.

For financing purposes, derivative counterparties and cash transactions are limited to high credit quality financial institutions. 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 |            |
|----------------|--------------|------------|------------------|------------|
|                | 2013<br>£m   | 2012<br>£m | 2013<br>£m       | 2012<br>£m |
| AAA            | 20.0         | 20.0       | 1.3              | 0.1        |
| Double A range | 150.0        | 150.0      | 82.0             | 111.1      |
| Single A range | 625.0        | 450.0      | 272.4            | 146.5      |
|                | 795.0        | 620.0      | 355.7            | 257.7      |

## Group financial statements Notes to the group financial statements

## 32 Financial instruments (continued)

## e) Financial risk factors (continued)

## (ii) Credit risk (continued)

## Credit risk analysis (continued)

The fair values of derivative assets analysed by credit ratings of counterparties were as follows:

| Rating         | Derivative assets |            |
|----------------|-------------------|------------|
|                | 2013<br>£m        | 2012<br>£m |
| Double A range | 29.7              | 44.6       |
| Single A range | 101.4             | 118.0      |
|                | 131.1             | 162.6      |

## (iii) Liquidity risk

Prudent liquidity management implies maintaining sufficient cash balances and the availability of funding through an adequate amount of committed facilities 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:

|                            | 2013<br>£m | 2012<br>£m |
|----------------------------|------------|------------|
| Within one year            | —          | —          |
| 1-2 years                  | —          | —          |
| 2-5 years                  | 500.0      | 500.0      |
| After more than five years | —          | 100.0      |
|                            | 500.0      | 600.0      |

## Non-derivative financial instruments analysed by maturity date

The following tables detail the group's remaining contractual maturity for its 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.

| 2013                         | Within one<br>year<br>£m | Between<br>one and two<br>years<br>£m | Between<br>two and five<br>years<br>£m | Between<br>five and ten<br>years<br>£m | Between ten<br>and twenty<br>years<br>£m | Greater<br>than twenty<br>years<br>£m | Total<br>£m |
|------------------------------|--------------------------|---------------------------------------|--|--|--|---------------------------------------|-------------|
| <b>Financial liabilities</b> |                          |                                       |  |  |  |                                       |             |
| Overdraft                    | (0.4)                    | —                                     | —                                      | —                                      | —  | —                                     | (0.4)       |
| Bank loans                   | (182.3)                  | (12.3)                                | (336.3)                                | (319.7)                                | (29.0)                                   | —                                     | (879.6)     |
| Other loans                  | (199.4)                  | (401.2)                               | (2,071.0)                              | (606.7)                                | (2,179.9)                                | (5,677.9)                             | (11,136.1)  |
| Finance leases               | (4.6)                    | (28.2)                                | (81.3)                                 | (37.9)                                 | (113.1)                                  | —                                     | (265.1)     |
| Other financial liabilities  | (30.7)                   | —                                     | —                                      | —                                      | —  | —                                     | (30.7)      |
|                              | (417.4)                  | (441.7)                               | (2,488.6)                              | (964.3)                                | (2,322.0)                                | (5,677.9)                             | (12,311.9)  |
| <b>Financial assets</b>      |                          |                                       |  |  |  |                                       |             |
| Trade receivables            | 196.7                    | —                                     | —                                      | —                                      | —  | —                                     | 196.7       |
| Cash and short term deposits | 403.6                    | —                                     | —                                      | —                                      | —  | —                                     | 403.6       |
|                              | 600.3                    | —                                     | —                                      | —                                      | —  | —                                     | 600.3       |
| <b>Net cash flows</b>        | 182.9                    | (441.7)                               | (2,488.6)                              | (964.3)                                | (2,322.0)                                | (5,677.9)                             | (11,711.6)  |

## Group financial statements Notes to the group financial statements

## 32 Financial instruments (continued)

## e) Financial risk factors (continued)

## (iii) Liquidity risk (continued)

## Non-derivative financial instruments analysed by maturity date (continued)

| 2012                         | Within one<br>year<br>£m | Between<br>one and two<br>years<br>£m | Between<br>two and five<br>years<br>£m | Between<br>five and ten<br>years<br>£m | Between ten<br>and twenty<br>years<br>£m | Greater<br>than twenty<br>years<br>£m | Total<br>£m       |
|------------------------------|--------------------------|---------------------------------------|--|--|--|---------------------------------------|-------------------|
| <b>Financial liabilities</b> |                          |                                       |  |  |  |                                       |                   |
| Overdraft                    | (0.4)                    | -                                     | -                                      | -                                      | -  | -                                     | (0.4)             |
| Bank loans                   | (20.7)                   | (384.6)                               | (191.4)                                | (340.1)                                | (33.9)                                   | -                                     | (970.7)           |
| Other loans                  | (262.1)                  | (175.1)                               | (1,908.9)                              | (837.7)                                | (2,224.8)                                | (6,022.7)                             | (11,431.3)        |
| Finance leases               | (4.4)                    | (25.4)                                | (103.6)                                | (35.6)                                 | (123.1)                                  | -                                     | (292.1)           |
| Other financial liabilities  | (34.9)                   | -                                     | -                                      | -                                      | -  | -                                     | (34.9)            |
|                              | (322.5)                  | (585.1)                               | (2,203.9)                              | (1,213.4)                              | (2,381.8)                                | (6,022.7)                             | (12,729.4)        |
| <b>Financial assets</b>      |                          |                                       |  |  |  |                                       |                   |
| Trade receivables            | 181.1                    | -                                     | -                                      | -                                      | -  | -                                     | 181.1             |
| Cash and short term deposits | 295.1                    | -                                     | -                                      | -                                      | -  | -                                     | 295.1             |
|                              | 476.2                    | -                                     | -                                      | -                                      | -  | -                                     | 476.2             |
| <b>Net cash flows</b>        | <b>153.7</b>             | <b>(585.1)</b>                        | <b>(2,203.9)</b>                       | <b>(1,213.4)</b>                       | <b>(2,381.8)</b>                         | <b>(6,022.7)</b>                      | <b>(12,253.2)</b> |

Other loans include index-linked debt with maturities up to 55 years. The principal is revalued at fixed intervals and is linked to movements in the Retail Price Index. Interest payments are made biannually based on the revalued principal. The principal repayment equals the revalued amount at maturity. The calculations above are based on forward inflation rates at the balance sheet date.

The group has bank loans which may become repayable in certain circumstances following a change in control of Severn Trent Plc. The carrying value at 31 March 2013 of bank loans subject to such conditions was £617.3 million.

## Derivative financial instruments analysed by maturity date

The following table details the group's liquidity analysis for its 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.

| 2013                             | Within one<br>year<br>£m | Between<br>one and two<br>years<br>£m | Between<br>two and five<br>years<br>£m | Between<br>five and ten<br>years<br>£m | Between ten<br>and twenty<br>years<br>£m | Greater<br>than twenty<br>years<br>£m | Total<br>£m    |
|----------------------------------|--------------------------|---------------------------------------|--|--|--|---------------------------------------|----------------|
| <b>Derivative liabilities</b>    |                          |                                       |  |  |  |                                       |                |
| <b>Instruments settled net</b>   |                          |                                       |  |  |  |                                       |                |
| Interest rate swaps              | (36.3)                   | (41.2)                                | (110.9)                                | (97.6)                                 | (55.9)                                   | (2.2)                                 | (344.1)        |
| Energy swaps                     | (0.3)                    | (1.5)                                 | -                                      | -                                      | -  | -                                     | (1.8)          |
|                                  | (36.6)                   | (42.7)                                | (110.9)                                | (97.6)                                 | (55.9)                                   | (2.2)                                 | (345.9)        |
| <b>Derivative assets</b>         |                          |                                       |  |  |  |                                       |                |
| <b>Instruments settled net</b>   |                          |                                       |  |  |  |                                       |                |
| Interest rate swaps              | 8.6                      | 8.6                                   | 4.1                                    | -                                      | -  | -                                     | 21.3           |
| Energy swaps                     | 1.0                      | -                                     | -                                      | -                                      | -  | -                                     | 1.0            |
| <b>Instruments settled gross</b> |                          |                                       |  |  |  |                                       |                |
| <b>Gross currency swaps</b>      |                          |                                       |  |  |  |                                       |                |
| - cash receipts                  | 37.3                     | 125.4                                 | 683.5                                  | 5.6                                    | 40.7                                     | -                                     | 892.5          |
| - cash payments                  | (36.2)                   | (98.3)                                | (600.2)                                | (3.2)                                  | (23.7)                                   | -                                     | (761.6)        |
|                                  | 10.7                     | 35.7                                  | 87.4                                   | 2.4                                    | 17.0                                     | -                                     | 153.2          |
| <b>Net cash flow</b>             | <b>(25.9)</b>            | <b>(7.0)</b>                          | <b>(23.5)</b>                          | <b>(95.2)</b>                          | <b>(38.9)</b>                            | <b>(2.2)</b>                          | <b>(192.7)</b> |

## Group financial statements Notes to the group financial statements

## 32 Financial instruments (continued)

## e) Financial risk factors (continued)

## (iii) Liquidity risk (continued)

## Derivative financial instruments analysed by maturity date (continued)

|                           | Within one<br>year<br>£m | Between<br>one and two<br>years<br>£m | Between<br>two and five<br>years<br>£m | Between<br>five and ten<br>years<br>£m | Between ten<br>and twenty<br>years<br>£m | Greater<br>than twenty<br>years<br>£m | Total<br>£m |
|---------------------------|--------------------------|---------------------------------------|--|--|--|---------------------------------------|-------------|
| 2012                      |                          |                                       |  |  |  |                                       |             |
| Derivative liabilities    |                          |                                       |  |  |  |                                       |             |
| Instruments settled net   |                          |                                       |  |  |  |                                       |             |
| Interest rate swaps       | (33.5)                   | (39.4)                                | (110.6)                                | (93.6)                                 | (74.9)                                   | (4.6)                                 | (356.6)     |
| Energy swaps              | -                        | (0.4)                                 | (1.1)                                  | -                                      | -  | -                                     | (1.5)       |
|                           | (33.5)                   | (39.8)                                | (111.7)                                | (93.6)                                 | (74.9)                                   | (4.6)                                 | (358.1)     |
| Derivative assets         |                          |                                       |  |  |  |                                       |             |
| Instruments settled net   |                          |                                       |  |  |  |                                       |             |
| Interest rate swaps       | 3.8                      | 3.2                                   | 3.4                                    | -                                      | -  | -                                     | 10.4        |
| Energy swaps              | 1.8                      | 0.7                                   | -                                      | -                                      | -  | -                                     | 2.5         |
| Instruments settled gross |                          |                                       |  |  |  |                                       |             |
| Cross currency swaps      |                          |                                       |  |  |  |                                       |             |
| - cash receipts           | 125.9                    | 37.4                                  | 814.9                                  | 5.2                                    | 44.7                                     | -                                     | 1,028.1     |
| - cash payments           | (97.8)                   | (37.0)                                | (715.4)                                | (3.7)                                  | (24.8)                                   | -                                     | (878.7)     |
|                           | 33.7                     | 4.3                                   | 102.9                                  | 1.5                                    | 19.9                                     | -                                     | 162.3       |
| Net cash flow             | 0.2                      | (35.5)                                | (8.8)                                  | (92.1)                                 | (55.0)                                   | (4.6)                                 | (195.8)     |

## f) 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.

## (i) Fair value hedges

The group raises debt denominated in currencies other than sterling – principally yen and euro. 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. The terms of the receivable leg of the swap closely match the terms of the underlying debt hence 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 |            |
|-------------|---------------------------|------------|------------|------------|
|             | 2013<br>£m                | 2012<br>£m | 2013<br>£m | 2012<br>£m |
| US dollar   | 27.0                      | 27.0       | 8.7        | 7.6        |
| Euro        | 11.4                      | 11.4       | 9.3        | 7.8        |
| Yen         | 71.4                      | 98.4       | 35.3       | 59.0       |
| Czech krona | 14.7                      | 47.2       | 7.0        | 20.8       |
|             | 124.5                     | 184.0      | 60.3       | 95.2       |

## (ii) Cash flow hedges

The group has entered into interest rate swaps under which it has agreed to exchange the difference between fixed and floating interest rate amounts calculated on agreed notional principal amounts. Such contracts enable the group to mitigate the risk of changing interest rates on future cash flow exposures arising from issued variable rate debt. The group also entered into a number of interest rate contracts with future start dates during the AMP5 regulatory period. Such contracts enable the group to mitigate the risk of changing interest rates on debt which is highly probable to be issued over the AMP5 period to fund Severn Trent Water's capital programme and have been accounted for as cash flow hedges. The fair value of interest rate swaps at the balance sheet date is determined by discounting the future cash flows using the yield curve prevailing at the balance sheet date and the credit risk inherent in the contract.

The interest rate swaps primarily settle net on a biannual basis. The floating rate on the interest rate swaps is six month LIBOR.

## Group financial statements Notes to the group financial statements

## 32 Financial instruments (continued)

## f) Hedge accounting (continued)

## (ii) Cash flow hedges (continued)

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 |            |
|--------------------|--------------------------------------|-----------|---------------------------|------------|------------|------------|
|                    | 2013<br>%                            | 2012<br>% | 2013<br>£m                | 2012<br>£m | 2013<br>£m | 2012<br>£m |
| Less than 10 years | —                                    | —         | —                         | —          | —          | —          |
| 10-20 years        | 5.07%                                | 5.07%     | (491.0)                   | (492.3)    | (128.0)    | (91.6)     |
| More than 20 years | —                                    | —         | —                         | —          | —          | —          |
|                    | 5.07%                                | 5.07%     | (491.0)                   | (492.3)    | (128.0)    | (91.6)     |

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 2015

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 |            |
|--------------------|------------------------|---------------|----------------------------|-------------|------------|------------|
|                    | 2013<br>£/MWh          | 2012<br>£/MWh | 2013<br>MWh                | 2012<br>MWh | 2013<br>£m | 2012<br>£m |
| Less than 1 year   | 53.3                   | 48.8          | 550,368                    | 725,088     | 0.6        | 1.8        |
| 1-2 years          | 62.9                   | 53.3          | 174,720                    | 550,368     | (1.5)      | 0.3        |
| 2-5 years          | —                      | 62.9          | —                          | 174,720     | —          | (1.0)      |
|                    | 55.6                   | 52.2          | 725,088                    | 1,450,176   | (0.9)      | 1.1        |

Changes in the amounts deferred in equity during the period relating to cash flow hedges were as follows:

|   | 2013<br>£m | 2012<br>£m |
|---|------------|------------|
| Fair value (losses)/gains deferred in equity at the start of the period | (64.4)     | 18.4       |
| Fair value losses recognised in equity in the period                    | (39.0)     | (86.5)     |
| Fair value gains transferred to finance costs in the period             | 14.8       | 3.7        |
| Fair value losses deferred in equity at the end of the period           | (88.6)     | (64.4)     |

## (iii) Interest rate swaps not hedge accounted

The group has a number of interest rate swaps which are not accounted for as cash flow hedges. During the year, the group terminated three of these swaps, with a notional value of £100.0 million, at a cash outlay of £44.3 million

Contracts where the group pays fixed rate interest are summarised below:

| Period to maturity | Average contract fixed interest rate |           | Notional principal amount |            | Fair value |            |
|--------------------|--------------------------------------|-----------|---------------------------|------------|------------|------------|
|                    | 2013<br>%                            | 2012<br>% | 2013<br>£m                | 2012<br>£m | 2013<br>£m | 2012<br>£m |
| Less than 1 year   | —                                    | —         | —                         | —          | —          | —          |
| 1-2 years          | —                                    | —         | —                         | —          | —          | —          |
| 2-5 years          | 6.32                                 | 6.32      | 225.0                     | 225.0      | (31.7)     | (37.9)     |
| 5-10 years         | —                                    | —         | —                         | —          | —          | —          |
| 10-20 years        | 5.37                                 | 5.41      | 214.9                     | 313.6      | (90.6)     | (114.6)    |
| 20-30 years        | 5.10                                 | 5.10      | 125.0                     | 125.0      | (49.5)     | (41.9)     |
|                    | 5.59                                 | 5.61      | 564.9                     | 663.6      | (171.8)    | (194.4)    |

Contracts where the group receives fixed interest are summarised below:

| Period to maturity | Average contract fixed interest rate |           | Notional principal amount |            | Fair value |            |
|--------------------|--------------------------------------|-----------|---------------------------|------------|------------|------------|
|                    | 2013<br>%                            | 2012<br>% | 2013<br>£m                | 2012<br>£m | 2013<br>£m | 2012<br>£m |
| Less than 1 year   | —                                    | —         | —                         | —          | —          | —          |
| 1-2 years          | —                                    | —         | —                         | —          | —          | —          |
| 2-5 years          | 5.18                                 | 5.18      | 200.0                     | 200.0      | 21.0       | 23.7       |
|                    | 5.18                                 | 5.18      | 200.0                     | 200.0      | 21.0       | 23.7       |



## Group financial statements Notes to the group financial statements

## 33 Share based payments

The group operates a number of share based remuneration schemes for employees. During the year, the group recognised total expenses of £6.8 million (2012: £4.1 million) related to equity settled share based payment transactions.

The weighted average share price during the period was £16.49 (2012: £15.00)

At 31 March 2013, there were no options exercisable (2012: none) under any of the share based remuneration schemes.

## a) Long Term Incentive Plans (LTIPs)

Under the LTIPs conditional awards of shares may be made to executive directors and senior staff. Awards are subject to performance conditions and continued employment throughout the vesting period. Awards have been made on different bases to Severn Trent Plc and Severn Trent Water employees (the LTIP) and to Severn Trent Services employees (the Services LTIP).

## (i) Awards outstanding

## Awards made under the LTIP

In July 2012 awards over 99,886 shares (2012: 112,446 shares) with a fair value of £15.36 (2012: £12.16) were made to 16 employees (2012: 18 employees) under the LTIP. These awards are 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. It has been assumed that performance against the LTIP non-market conditions will be 100% (2012: 100%).

## Awards made under the Services LTIP

In July 2012 awards over 28,599 shares (2012: 38,493 shares) with a fair value of £15.36 (2012: £12.16) were made to nine employees (2012: 10 employees) under the Services LTIP. These awards are subject to achievement of turnover and profit targets in the year ending 31 March 2015. It has been assumed that performance against the 2011 Services LTIP non-market conditions will be 10% (2012: 75%) and the 2012 Services LTIP will be 75%.

The awards granted in July 2008 vest in three equal tranches which are subject to achievement of turnover and profit targets in the years ending 31 March 2011, 2012 and 2013. It has been assumed that performance against the 2008 Services LTIP non-market conditions will be 0% (2012: 0%).

Details of changes in the number of awards outstanding during the year are set out below:

|                              | Number of awards |               |
|------------------------------|------------------|---------------|
|                              | LTIP             | Services LTIP |
| Outstanding at 1 April 2011  | 402,701          | 101,387       |
| Granted during the year      | 112,446          | 38,493        |
| Forfeited during the year    | (14,946)         | (10,329)      |
| Lapsed during the year       | (116,714)        | (34,607)      |
| Outstanding at 1 April 2012  | 383,487          | 94,944        |
| Granted during the year      | 99,886           | 28,599        |
| Vested during the year       | (46,025)         | -             |
| Lapsed during the year       | (116,324)        | (33,671)      |
| Outstanding at 31 March 2013 | 321,024          | 89,872        |

Details of LTIP and Services LTIP awards outstanding at 31 March were as follows:

| Date of grant | Normal date of vesting | Number of awards |         |
|---------------|------------------------|------------------|---------|
|               |                        | 2013             | 2012    |
| July 2008     | 2012                   | -                | 33,671  |
| July 2008     | 2013                   | 31,145           | 31,145  |
| July 2009     | 2012                   | -                | 151,786 |
| July 2010     | 2013                   | 125,568          | 127,727 |
| July 2011     | 2014                   | 129,209          | 134,102 |
| July 2012     | 2015                   | 124,974          | -       |
|               |                        | 410,896          | 478,431 |

## Group financial statements Notes to the group financial statements

## 33 Share based payments (continued)

## a) Long Term Incentive Plans (LTIPs) (continued)

## (ii) Fair value

The share price at the grant date was £17.49 (2012: £13.98). The vesting period commences before the grant date.

Performance in the vesting period prior to the grant date is taken into account in determining the fair value of the award.

The fair value of the LTIP awards made during the year was calculated using the Black-Scholes method with the principal assumptions set out below:

| Assumptions                            | 2013 | 2012 |
|--|------|------|
| Expected volatility – Severn Trent Plc | 18%  | 27%  |
| Expected dividend yield                | 4.3% | 4.7% |

Expected volatility is measured over a historical period, prior to grant, commensurate with the expected term of the awards. Volatility has been calculated based on historical share price movements over the three years prior to the date of the grant.

The risk free rate is derived from yields at the grant date of gilts of similar duration to the LTIP awards.

The dividend yield is calculated using the expected dividend for the year divided by the share price at the date of grant.

Details of the basis of the LTIP schemes are set out in the remuneration report on pages 67 and 68.

## 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.

## (i) Options outstanding

The number of employees entering into Sharesave contracts and the number of options granted during the year were as follows:

|                           | 2013          |               | 2012          |               |
|---------------------------|---------------|---------------|---------------|---------------|
|                           | 3 year scheme | 5 year scheme | 3 year scheme | 5 year scheme |
| Number of employees       | 1,872         | 412           | 1,610         | 363           |
| Number of options granted | 456,821       | 144,594       | 440,930       | 127,631       |

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 2011  | 3,128,185               | 904p                            |
| Granted during the year      | 568,561                 | 1,177p                          |
| Forfeited during the year    | (60,732)                | 903p                            |
| Cancelled during the year    | (51,578)                | 947p                            |
| Exercised during the year    | (442,593)               | 928p                            |
| Lapsed during the year       | (57,357)                | 913p                            |
| Outstanding at 1 April 2012  | 3,084,486               | 950p                            |
| Granted during the year      | 601,415                 | 1,241p                          |
| Forfeited during the year    | (41,494)                | 1,005p                          |
| Cancelled during the year    | (44,590)                | 1,094p                          |
| Exercised during the year    | (757,623)               | 928p                            |
| Lapsed during the year       | (7,708)                 | 1,028p                          |
| Outstanding at 31 March 2013 | 2,834,486               | 1,027p                          |

## Group financial statements Notes to the group financial statements

## 33 Share based payments (continued)

## b) Employee Sharesave Scheme (continued)

## (i) Options outstanding (continued)

Sharesave options outstanding at 31 March were as follows.

| Date of grant | Normal date of exercise | Option price | Number of share options |           |
|---------------|-------------------------|--------------|-------------------------|-----------|
|               |                         |              | 2013                    | 2012      |
| January 2005  | 2012                    | 759p         | -                       | 52,912    |
| January 2006  | 2013                    | 823p         | 20,468                  | 20,468    |
| January 2007  | 2012 or 2014            | 1,172p       | 11,392                  | 78,280    |
| January 2008  | 2013                    | 1,221p       | 74,976                  | 78,488    |
| January 2009  | 2012 or 2014            | 862p         | 511,960                 | 1,141,447 |
| January 2010  | 2013 or 2015            | 806p         | 774,028                 | 810,413   |
| January 2011  | 2014 or 2016            | 1,137p       | 315,258                 | 334,910   |
| January 2012  | 2015 or 2017            | 1,177p       | 525,534                 | 567,568   |
| January 2013  | 2016 or 2018            | 1,241p       | 600,870                 | -         |
|               |                         |              | 2,834,486               | 3,084,486 |

## (ii) Fair value

The fair value of the Sharesave options granted during the year was calculated using the Black-Scholes model.

The principal assumptions were as follows:

| Assumptions             | 2013          |               | 2012          |               |
|-------------------------|---------------|---------------|---------------|---------------|
|                         | 3 year scheme | 5 year scheme | 3 year scheme | 5 year scheme |
| Expected volatility     | 18%           | 18%           | 27%           | 27%           |
| Expected dividend yield | 4.7%          | 4.7%          | 4.6%          | 4.6%          |
| Risk free rate          | 0.46%         | 0.96%         | 0.53%         | 1.75%         |
| Fair value per share    | 257p          | 239p          | 320p          | 339p          |

Expected volatility is measured over a historical period, prior to grant, commensurate with the expected term of the awards. Volatility has been calculated based on historical share price movements over the three years prior to the date of the grant.

The risk free rate is derived from yields at the grant date of gilts of similar duration to the Sharesave contracts.

The dividend yield is calculated using the expected dividend for the year divided by the share price at the date of grant.

The following data was used in calculating the fair value of the Sharesave options:

|                           | 2013          |               | 2012          |               |
|---------------------------|---------------|---------------|---------------|---------------|
|                           | 3 year scheme | 5 year scheme | 3 year scheme | 5 year scheme |
| Share price at grant date | 1,605p        | 1,605p        | 1,520p        | 1,520p        |
| Vesting period (years)    | 3             | 5             | 3             | 5             |
| Option life (years)       | 3.5           | 5.5           | 3.5           | 5.5           |

## c) Share Incentive Plan (SIP)

Under the SIP the board may grant share awards to employees of group companies. During the year the board has announced that it will make awards under the SIP based on performance against Severn Trent Water's targets for its Key Performance Indicators. Eligible employees will be entitled to shares to a maximum value of £750. It is expected that these awards will be made in August 2013. SIP shares vest with the employee on the date of grant.

## 33 Share based payments (continued)

## d) Share Matching Plan (SMP)

Under the Share Matching Plan members of the Executive Committee receive matching share awards over those shares which have 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 one deferred share and are subject to a three year vesting period. During the year matching shares were awarded at a ratio of 0.5:1

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). This replicates the LTIP performance condition for the July 2010 award.

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.

## (i) Awards outstanding

During the year 18,024 (2012: 19,072) matching shares with a fair value of £11.43 (2012: £8.84) were awarded to 10 employees (2012: 11).

|                              | Number of awards |
|------------------------------|------------------|
| Outstanding at 1 April 2011  | 25,187           |
| Granted during the year      | 19,072           |
| Cancelled during the year    | (1,900)          |
| Vested during the year       | (909)            |
| Outstanding at 1 April 2012  | 41,450           |
| Granted during the year      | 18,024           |
| Cancelled during the year    | (2,091)          |
| Outstanding at 31 March 2013 | 57,383           |

Details of share matching awards outstanding at 31 March were as follows

| Date of grant | Normal date of vesting | Number of awards |        |
|---------------|------------------------|------------------|--------|
|               |                        | 2013             | 2012   |
| May 2010      | June 2013              | 20,748           | 22,378 |
| May 2011      | May 2014               | 18,611           | 19,072 |
| May 2012      | May 2015               | 18,024           | -      |
|               |                        | 57,383           | 41,450 |

## (ii) Fair value

The fair value of the share matching awards made during the year was calculated using the Monte Carlo method using the principal assumptions set out below:

| Assumptions                            | 2013  | 2012  |
|--|-------|-------|
| Expected volatility – Severn Trent Plc | 18.2% | 25.8% |
| Risk free rate                         | 0.3%  | 1.4%  |

Share price volatility is based on observations over a historical period prior to the date of grant, commensurate with the expected term of the performance period. Volatility has been calculated based on historical share price movements over the three years prior to the grant date.

The share price at the grant date was £17.01 (2012: £15.02).

Dividends paid on the shares during the vesting period are accumulated during the vesting period and released subject to the achievement of the performance condition, in the same manner as the underlying shares. As a result a dividend yield assumption is not required.

**Group financial statements** Notes to the group financial statements**34 Acquisitions**

In July 2012 the group acquired the trade and assets of Chlorine Engineers' CECHLO business (CEC) for cash consideration of £1.3 million. This transaction has been accounted for by the purchase method of accounting.

|                      | Book value<br>£m | Fair value<br>£m |
|----------------------|------------------|------------------|
| Net assets acquired: |                  |                  |
| Intangible assets    | 13               | 13               |
| Total consideration  |                  | 13               |
| Satisfied by:        |                  |                  |
| Cash                 |                  | 13               |

CEC contributed £2.1 million to revenue and incurred a loss before tax of £0.1 million for the period between the date of acquisition and the balance sheet date.

**35 Disposal of businesses**

On 22 June 2012 the group completed the sale of its meter installation, repair and replacement business to Enterprise Plc.

On 4 February 2013 the group disposed of Severn Trent Analytical Services to ALS Limited.

The net assets of the businesses at the dates of disposal were as follows:

|   | Total<br>£m |
|---|-------------|
| Net assets disposed of:                             |             |
| Intangible assets                                   | 0.5         |
| Property, plant and equipment                       | 9.5         |
| Inventory   | 1.2         |
| Trade and other receivables                         | 5.0         |
| Trade and other payables                            | (2.9)       |
| Bank overdraft                                      | (2.1)       |
| Provisions  | (2.4)       |
|   | 8.8         |
| Costs associated with disposals:                    |             |
| Disposal costs                                      | 0.9         |
| Provisions arising on disposal                      | 2.1         |
| Net loss on disposal                                | (1.5)       |
| Total consideration                                 | 10.3        |
| Satisfied by:                                       |             |
| Cash  | 10.3        |
| Net cash flow arising from disposals:               |             |
| Consideration received in cash and cash equivalents | 10.3        |
| Bank overdraft disposed of                          | 2.1         |
|   | 12.4        |

## Group financial statements Notes to the group financial statements

## 36 Cash flow statement

## a) Reconciliation of operating profit to operating cash flows

|   | 2013<br>£m | 2012<br>£m |
|---|------------|------------|
| Profit before interest and tax  | 492.2      | 469.8      |
| Depreciation of property, plant and equipment                         | 264.6      | 256.0      |
| Amortisation of intangible assets                                     | 30.5       | 30.8       |
| Exceptional impairment  | 8.2        | 22.9       |
| Pension service cost  | 23.2       | 22.6       |
| Curtailment gain  | -          | (23.1)     |
| Pension contributions   | (43.5)     | (53.5)     |
| Share based payments charge   | 6.8        | 4.1        |
| Profit on sale of property, plant and equipment and intangible assets | (10.4)     | (4.4)      |
| Loss on disposal of businesses  | 1.5        | -          |
| Deferred income movement  | (9.3)      | (8.7)      |
| Provisions charged to the income statement                            | 11.6       | 16.8       |
| Utilisation of provisions for liabilities and charges                 | (14.3)     | (11.1)     |
| Decrease/(increase) in inventory                                      | 1.9        | (7.4)      |
| (Increase)/decrease in amounts receivable                             | (29.4)     | 6.1        |
| (Decrease)/increase in amounts payable                                | (2.4)      | 5.0        |
| Cash generated from operations  | 731.2      | 725.9      |
| Tax paid  | (72.5)     | (72.0)     |
| Net cash generated from operating activities                          | 658.7      | 653.9      |

## b) Non-cash transactions

No additions to property, plant and equipment during the year were financed by new finance leases (2012: nil). Assets transferred from developers were £23.0 million (2012: £37.0 million).

## c) Exceptional cash flows

The following cash flows arose from items classified as exceptional in the income statement.

|                               | 2013<br>£m | 2012<br>£m |
|-------------------------------|------------|------------|
| Restructuring costs           | (4.4)      | (14.4)     |
| Disposal of fixed assets      | 15.1       | -          |
| Customer contractual disputes | (0.6)      | -          |
| Regulatory matters            | -          | (3.9)      |
| Finance costs                 | -          | (16.5)     |
|                               | 10.1       | (34.8)     |

## d) Reconciliation of movement in cash and cash equivalents to movement in net debt

|                               | As at<br>1 April<br>2012<br>£m | Cash flow<br>£m | Fair value<br>adjustments<br>£m | RPI uplift on<br>index-linked<br>debt<br>£m | Foreign<br>exchange<br>£m | Other<br>non cash<br>movements<br>£m | As at<br>31 March<br>2013<br>£m |
|-------------------------------|--------------------------------|-----------------|---------------------------------|---|---------------------------|--------------------------------------|---------------------------------|
| Cash and cash equivalents     | 295.1                          | 108.4           | -                               | -   | 0.1                       | -                                    | 403.6                           |
| Bank overdrafts               | (0.4)                          | -               | -                               | -   | -                         | -                                    | (0.4)                           |
| Net cash and cash equivalents | 294.7                          | 108.4           | -                               | -   | 0.1                       | -                                    | 403.2                           |
| Bank loans                    | (852.5)                        | 101.3           | -                               | (7.5)                                       | -                         | -                                    | (758.7)                         |
| Other loans                   | (3,326.9)                      | (509.7)         | 3.4                             | (32.1)                                      | (1.1)                     | 25.5                                 | (3,840.9)                       |
| Finance leases                | (219.0)                        | 17.4            | -                               | -   | -                         | -                                    | (201.6)                         |
| Gross currency swaps          | 135.9                          | -               | (8.0)                           | -   | -                         | (27.2)                               | 100.7                           |
| Net debt                      | (3,967.8)                      | (282.6)         | (4.6)                           | (39.6)                                      | (1.0)                     | (1.7)                                | (4,297.3)                       |

## Group financial statements Notes to the group financial statements

### 37 Contingent liabilities

#### a) Bonds and guarantees

Group undertakings have entered into bonds and guarantees in the normal course of business. No liability is expected to arise in respect of either bonds or guarantees.

The group has given certain guarantees in respect of the borrowings of its associate, Servizio Idrico Integrato S.c.p.a. The guarantees are limited to €11.2 million (2012: €11.2 million). The group does not expect any liabilities that are not provided for in these financial statements to arise from these arrangements.

#### b) Disposal of subsidiaries

The group has given certain guarantees and indemnities in relation to disposals of businesses.

Following a hearing in the Commercial Court in Belgium in February 2010 in relation to a claim from Veolia Proprete S.A. (Veolia) arising from the sale of Biffa Belgium to Veolia in 2006, the Court rendered judgement in favour of the group on 1 April 2010 and declared all of Veolia's claims to be unfounded. Veolia has filed an appeal against this decision, however, the group considers that Veolia's case remains unfounded and no provision has been recorded in respect of this matter.

The group is not aware of any other liability that is likely to result from these guarantees and indemnities that has not been provided for in these financial statements.

### 38 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 1,523 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. The maintenance and upgrade services are charged at an agreed rate, adjusted for inflation, that is agreed in the contract. The operating services are charged under an agreed volumetric tariff.

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 2013 the amounts receivable were £26.8 million (2012: £25.5 million).

There have been no significant changes to the arrangement during the year.

### 39 Financial and other commitments

#### a) Investment expenditure commitments

|   | 2013<br>£m | 2012<br>£m |
|---|------------|------------|
| Contracted for but not provided in the financial statements | 224.9      | 159.8      |

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 sewerage services.

#### b) Leasing commitments

At the balance sheet date the group had outstanding commitments for future minimum operating lease payments under non-cancellable operating leases, which fall due as follows:

|                         | 2013<br>£m | 2012<br>£m |
|-------------------------|------------|------------|
| Within 1 year           | 4.7        | 4.7        |
| 2-5 years               | 10.9       | 12.0       |
| After more than 5 years | 7.0        | 8.1        |
|                         | 22.6       | 24.8       |

Operating lease payments represent rentals payable by the group for certain of its office properties, plant and equipment.

## Group financial statements Notes to the group financial statements

## 40 Post balance sheet events

Following the year end the board of directors has proposed a final dividend of 45.51 pence per share. Further details of this are shown in note 14.

## 41 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. Transactions between the group and its associates and joint ventures are disclosed below.

## Trading transactions

|     | Sole of goods |            | Purchase of goods |            | Amounts due from related parties |            | Amounts due to related parties |            |
|-----|---------------|------------|-------------------|------------|----------------------------------|------------|--------------------------------|------------|
|     | 2013<br>£m    | 2012<br>£m | 2013<br>£m        | 2012<br>£m | 2013<br>£m                       | 2012<br>£m | 2013<br>£m                     | 2012<br>£m |
| SII | 6.9           | 5.6        | -                 | -          | 16.4                             | 16.1       | -                              | -          |

The related parties are associates and joint ventures in which the group has a participating interest. 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 27.

## Remuneration of key management personnel

Key management personnel comprise the members of the Executive Committee 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 57 to 70.

|                              | 2013<br>£m | 2012<br>£m |
|------------------------------|------------|------------|
| Short term employee benefits | 6.0        | 5.1        |
| Post employment benefits     | 0.1        | 0.5        |
| Share based payments         | 1.0        | 0.8        |
|                              | 7.1        | 6.4        |



## Group financial statements Notes to the group financial statements

### 42 Subsidiary undertakings

#### Principal subsidiary undertakings

Details of the principal operating subsidiaries as at 29 May 2013 are given below. A complete list of subsidiary undertakings is available on request to the company and will be filed with the next Annual Return.

All shareholdings are in ordinary shares.

All subsidiary undertakings have been included in the consolidation.

| Name                                     | Country of incorporation | Principal activity  | Proportion of ownership interest |
|--|--------------------------|---|----------------------------------|
| Derwent Insurance Limited                | Gibraltar                | Provision of insurance services to other group companies    | 100%                             |
| Severn Trent Costain Limited             | Great Britain            | Operation of water and sewerage infrastructure              | 60%                              |
| Severn Trent Costain Water Limited       | Great Britain            | Provision of water and sewerage services to MoD             | 80%                              |
| Severn Trent Environmental Services Inc. | US                       | Operation of water and sewerage infrastructure              | 100%                             |
| Severn Trent Select Limited              | Great Britain            | Provision of licensed water and sewerage services           | 100%                             |
| Severn Trent Services Limited            | Great Britain            | Distribution of water purification products                 | 100%                             |
| Severn Trent Water Limited               | Great Britain            | Provision of regulated water and sewerage services          | 100%                             |
| Severn Trent Water Purification Inc.     | US                       | Manufacture and distribution of water purification products | 100%                             |

#### Subsidiary audit exemptions

Severn Trent Plc has issued guarantees over the liabilities of the following companies at 31 March 2013 under section 479C of the Companies Act 2006 and therefore auditors have not been appointed for these entities.

|   | Company number |
|---|----------------|
| City Analytical Services Limited                                | 2050581        |
| 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 Holdings Limited                                   | 5656363        |
| Severn Trent Investment Holdings Limited                        | 7560050        |
| Severn Trent Overseas Holdings Limited                          | 2455508        |
| Severn Trent Power Generation Limited                           | 2651131        |
| Severn Trent Property Solutions Limited                         | 8181033        |
| Severn Trent Services Holdings Limited                          | 4395572        |
| Severn Trent Services International (Overseas Holdings) Limited | 3125131        |
| Severn Trent Services Purification Limited                      | 2409826        |
| Severn Trent Systems Limited                                    | 2394552        |
| Severn Trent Utility Services Limited                           | 4125386        |
| Severn Trent Wind Power Limited                                 | 7742177        |

# Independent auditor's report to the members of Severn Trent Plc

We have audited the parent company financial statements of Severn Trent Plc for the year ended 31 March 2013 which comprise the company balance sheet, the company statement of total recognised gains and losses, and the related notes 1 to 17. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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.

## Respective responsibilities of directors and auditor

As explained more fully in the Directors' responsibility statement, the directors are responsible for the preparation of the parent company financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the parent company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

## Scope of the audit of the financial statements

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

## Opinion on financial statements

In our opinion the parent company financial statements

- give a true and fair view of the state of the parent company's affairs as at 31 March 2013,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

## Opinion 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 Companies Act 2006; and
- the information given in the Directors' report for the financial year for which the financial statements are prepared is consistent with the parent company financial statements.

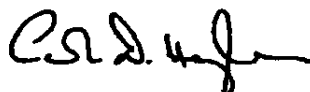
## Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion,

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us, or
- the parent company financial statements and the part of the Directors' remuneration report to be audited are not in agreement with the accounting records and returns, or
- certain disclosures of directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit.

## Other matter

We have reported separately on the group financial statements of Severn Trent Plc for the year ended 31 March 2013.




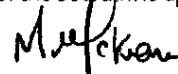
Carl D Hughes (Senior statutory auditor)  
for and on behalf of Deloitte LLP  
Chartered Accountants and Statutory Auditor  
London, UK  
29 May 2013

## Company balance sheet

At 31 March 2013

|  | Note | 2013<br>£m     | 2012<br>£m     |
|--|------|----------------|----------------|
| <b>Non-current assets</b>                              |      |                |                |
| Tangible fixed assets                                  | 2    | 0.8            | 0.2            |
| Investments in subsidiaries                            | 3    | 3,641.6        | 3,638.0        |
| Derivative financial instruments                       |      | 15.8           | 20.8           |
|  |      | <b>3,658.2</b> | <b>3,659.0</b> |
| <b>Current assets</b>                                  |      |                |                |
| Debtors  | 4    | 40.5           | 44.3           |
| Derivative financial instruments                       |      | 0.1            | 6.7            |
| Cash at bank and in hand                               |      | 3.0            | 234.6          |
|  |      | <b>43.6</b>    | <b>285.6</b>   |
| Creditors amounts falling due within one year          | 5    | (185.6)        | (181.0)        |
| Net current (liabilities)/assets                       |      | <b>(142.0)</b> | <b>104.6</b>   |
| Total assets less current liabilities                  |      | <b>3,516.2</b> | <b>3,763.6</b> |
| Creditors amounts falling due after more than one year | 6    | (163.8)        | (96.9)         |
| Net assets   |      | <b>3,352.4</b> | <b>3,666.7</b> |
| <b>Capital and reserves</b>                            |      |                |                |
| Called up share capital                                | 8    | 233.3          | 232.6          |
| Share premium account                                  | 9    | 89.7           | 83.8           |
| Other reserves   | 9    | 154.4          | 152.4          |
| Retained earnings                                      | 9    | 2,875.0        | 3,197.9        |
| Total capital and reserves                             | 9    | <b>3,352.4</b> | <b>3,666.7</b> |

Signed on behalf of the board who approved the accounts on 29 May 2013

   
 Andrew Duff      Michael McKeon  
 Chairman      Finance Director

Company number: 2366619

## Company statement of total recognised gains and losses

For the year ended 31 March 2013

|  | 2013<br>£m   | 2012<br>£m   |
|--|--------------|--------------|
| (Loss)/profit for the year                                   | (6.8)        | 993.3        |
| Transfers to the profit and loss account on cash flow hedges | 2.5          | 2.3          |
| Deferred tax on transfers to the profit and loss account     | (0.6)        | (0.6)        |
| Total recognised gains and losses for the year               | <b>(4.9)</b> | <b>995.0</b> |

## Notes to the company financial statements

For the year ended 31 March 2013

### 1 Accounting policies

#### a) Basis of accounting

The financial statements have been prepared under the historical cost convention as modified by the revaluation of financial assets and liabilities (including derivative instruments) at fair value through profit or loss and in accordance with applicable United Kingdom Accounting Standards and comply with the requirements of the United Kingdom Companies Act 2006 (the Act).

As permitted by Section 408 of the Companies Act 2006, no profit or loss account is presented for this company. The company has taken advantage of the exemption under Financial Reporting Standard 1 'Cash flow statements' and has not produced a cash flow statement.

The company meets the definition of a qualifying entity under FRS 100 issued by the Financial Reporting Council (FRC). Accordingly, in the year ending 31 March 2014, the company intends to transition to reporting under FRS 101 as issued by the FRC. The company intends to take advantage of the disclosure exemptions available under that standard. Any shareholder who objects to this proposal should write to the Company Secretary at the Registered Office (address set out on the back of this document).

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 Severn Trent Plc consolidated accounts, the 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.

#### b) Tangible fixed assets and depreciation

Tangible fixed assets are included at cost less accumulated depreciation. Freehold land is not depreciated. Other assets are depreciated on a straight line basis over their estimated economic lives, which are principally as follows.

|                        | Years |
|------------------------|-------|
| Buildings              | 30-60 |
| Computers and software | 2-15  |

#### c) Impairment of fixed assets and investments

Impairments of fixed assets and investments are calculated as the difference between the carrying values of net assets of income generating units, including where appropriate investments and goodwill, and their recoverable amounts. Recoverable amount is defined as the higher of net realisable value or estimated value in use at the date the impairment review is undertaken. Net realisable value represents the net amount that can be generated through sale of the assets. Value in use represents the present value of expected future cash flows, discounted on a pre-tax basis using the estimated cost of capital of the income generating unit. Impairment reviews are carried out if there is an indication that an impairment may have occurred, or where otherwise required, to ensure that goodwill and fixed assets are not carried above their estimated recoverable amounts. Impairments are recognised in the profit and loss account.

#### d) Financial instruments

##### i) Financial assets

Financial assets are classified into the following categories.

- at fair value through profit or loss,
- held to maturity investments;
- available for sale financial assets; and
- loans and receivables.

##### Financial assets at fair value through profit or loss

A financial asset is classified at fair value through profit or loss if it is so designated or if it is classified as 'held for trading'. Derivative financial assets that are not designated and effective as hedging instruments are required to be classified as 'held for trading' by FRS 26. However, the group's Treasury Policy, described in the Financial review on page 37, is that the group does not hold or issue derivative financial instruments for trading. Financial assets at fair value through profit or loss are stated at fair value, with any gains or losses arising on remeasurement being recognised in the profit and loss account. Fair value is determined using the methodology described in note 32 to the group's financial statements.

##### Held to maturity investments

Where the company has the ability and intent to hold an investment to maturity the financial asset is classified as held to maturity. Such financial assets are measured at amortised cost using the effective interest rate method, with any gains or losses being recognised in the profit and loss account.

##### Available for sale financial assets

After initial recognition at cost (being the fair value of the consideration paid), investments which are classified as available for sale are measured at fair value, with gains or losses recognised in equity. When an available for sale investment is disposed of or impaired, the gain or loss previously recognised in equity is taken to the profit and loss account. Where there is no active market in the investments and the fair value cannot be measured reliably, the investments are held at cost.

##### Loans and receivables

Trade receivables, loans and other receivables that have fixed or determinable payments and that are not quoted in an active market are classified as loans and receivables. Such assets are measured at fair value on initial recognition and are subsequently measured at amortised cost using the effective interest rate method unless there is objective evidence that an asset is impaired, when it is written down to its recoverable amount and the irrecoverable amount is recognised as an expense.

##### ii) Financial liabilities

Financial liabilities are classified as either

- financial liabilities at fair value through profit or loss; or
- other financial liabilities.

##### Financial liabilities at fair value through profit or loss

A financial liability is classified at fair value through profit or loss if it is so designated or if it is classified as "held for trading". Derivative financial liabilities that are not designated and effective as hedging instruments are required to be classified as 'held for trading' by FRS 26. However, the group's Treasury Policy, described in the Financial review on page 37, is that the group does not hold or issue derivative financial instruments for trading. Financial liabilities at fair value through profit or loss are stated at fair value, with any gains or losses arising on remeasurement being recognised in the profit and loss account. Fair value is determined using the methodology described in note 32 in the group financial statements.

##### Other financial liabilities

Other financial liabilities, including borrowings, are initially recognised at fair value less transaction costs. After initial recognition, other financial liabilities are subsequently measured at amortised cost using the effective interest rate method.

## 1 Accounting policies (continued)

### d) Financial instruments (continued)

#### iii) Hedge accounting

The company 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. Such derivative instruments are recognised and measured in accordance with the accounting policies described above.

At the inception of the hedge relationship the company documents

- the relationship between the hedging instrument and the hedged item,
- its risk management objectives and strategy for undertaking hedge transactions, and
- whether the hedging instrument is highly effective in offsetting changes in fair values or cash flows (as appropriate) of the hedged item.

The company 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

#### 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 the profit and loss account.

When hedge accounting is discontinued the fair value adjustment to the carrying amount of the hedged item arising from the hedged risk is amortised to the profit and loss account from that date.

#### Cash flow hedges

The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in equity and the ineffective portion in the profit and loss account. The gains or losses deferred in equity in this way are recycled through the profit and loss account in the same period in which the hedged underlying transaction or firm commitment is recognised in the profit and loss account.

When hedge accounting is discontinued any cumulative gain or loss on the hedging instrument recognised in equity is kept in equity until the forecast transaction occurs, or transferred to the profit and loss account if the forecast transaction is no longer expected to occur.

#### Hedges of net investments in foreign operations

Where forward currency contracts and foreign currency borrowings are used to hedge net investments in foreign currency denominated operations, to the extent that they are designated and effective as net investment hedges, they are matched in equity against changes in value of the related assets. Any ineffectiveness is taken to the profit and loss account.

#### iv) Embedded derivatives

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contract and the host contract is not carried at fair value, with gains and losses reported in the profit and loss account.

#### e) Investments

Investments in subsidiary undertakings are held 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 gains or losses recognised in profit and loss 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 profit and loss account.

#### f) Share based payments

The company 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 a pricing model, excluding the impact of any non-market conditions. The number of awards 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 based condition.

#### g) Deferred taxation

Deferred taxation is fully provided for in respect of timing differences between the treatment of certain items for taxation and accounting purposes only to the extent that the company has an obligation to pay more tax in the future or a right to pay less tax in the future. Deferred tax assets are only recognised to the extent that taxable profits are expected to arise in the future. Material deferred taxation balances arising are discounted by applying an appropriate risk free discount rate.

#### h) Pensions

The company participates in the group's defined benefit and defined contribution pension schemes, details of which are set out in note 27 to the group financial statements. However, the company is currently unable to identify its share of assets and liabilities relating to the defined benefit schemes. The pension costs charged in the profit and loss account are the contributions payable to the scheme in respect of the accounting period in respect of the defined benefit and defined contribution schemes.

## 2 Tangible fixed assets

|                       | Land and buildings<br>£m | Computers and software<br>£m | Total<br>£m |
|-----------------------|--------------------------|------------------------------|-------------|
| <b>Cost</b>           |                          |                              |             |
| At 1 April 2012       | 0.7                      | 0.8                          | 1.5         |
| Additions             | 0.1                      | 0.6                          | 0.7         |
| Amounts written off   | (0.7)                    | -                            | (0.7)       |
| At 31 March 2013      | 0.1                      | 1.4                          | 1.5         |
| <b>Depreciation</b>   |                          |                              |             |
| At 1 April 2012       | (0.7)                    | (0.6)                        | (1.3)       |
| Charge for the year   | -                        | (0.1)                        | (0.1)       |
| Amounts written off   | 0.7                      | -                            | 0.7         |
| At 31 March 2013      | -                        | (0.7)                        | (0.7)       |
| <b>Net book value</b> |                          |                              |             |
| At 31 March 2013      | 0.1                      | 0.7                          | 0.8         |
| At 31 March 2012      | -                        | 0.2                          | 0.2         |

## 3 Investments

|                          | Subsidiary undertakings |             |             |
|--------------------------|-------------------------|-------------|-------------|
|                          | Shares<br>£m            | Loans<br>£m | Total<br>£m |
| At 1 April 2012          | 3,307.3                 | 330.7       | 3,638.0     |
| Additions/loans advanced | 3.2                     | 0.4         | 3.6         |
| At 31 March 2013         | 3,310.5                 | 331.1       | 3,641.6     |

Details of principal subsidiaries of the company are given in note 42 of the group financial statements

## 4 Debtors

|                                    | 2013<br>£m | 2012<br>£m |
|------------------------------------|------------|------------|
| Amounts owed by group undertakings | 4.5        | 34.4       |
| Deferred tax                       | 6.1        | 7.9        |
| Corporation tax recoverable        | 29.5       | -          |
| Other debtors                      | -          | 0.3        |
| Prepayments and accrued income     | 0.4        | 1.7        |
|                                    | 40.5       | 44.3       |

## 5 Creditors: amounts falling due within one year

|                                   | 2013<br>£m | 2012<br>£m |
|-----------------------------------|------------|------------|
| Bank overdrafts                   | (19.6)     | (31.0)     |
| Other loans                       | -          | (22.8)     |
| Borrowings (note 7)               | (19.6)     | (53.8)     |
| Derivative financial instruments  | (0.2)      | (0.4)      |
| Trade creditors                   | (0.6)      | (0.4)      |
| Amounts due to group undertakings | (155.2)    | (120.1)    |
| Other creditors                   | (6.0)      | (5.9)      |
| Accrued expenses                  | (4.0)      | (0.4)      |
|                                   | (185.6)    | (181.0)    |

## Company financial statements Notes to the company financial statements

## 6 Creditors: amounts falling due after more than one year

|                                   | 2013<br>£m | 2012<br>£m |
|-----------------------------------|------------|------------|
| Borrowings – other loans (note 7) | (129.1)    | (59.0)     |
| Amounts due to group undertakings | (3.0)      | –          |
| Derivative financial instruments  | (31.7)     | (37.9)     |
|                                   | (163.8)    | (96.9)     |

## 7 Borrowings

|   | 2013<br>£m | 2012<br>£m |
|---|------------|------------|
| Borrowings due within one year                | 19.6       | 53.8       |
| Borrowings due after more than one year       |            |            |
| Between one and two years                     | 32.3       | –          |
| Between two and five years                    | 21.6       | 59.0       |
| After more than five years                    | 75.2       | –          |
| Total borrowings due after more than one year | 129.1      | 59.0       |
|   | 148.7      | 112.8      |

Borrowings analysed by interest rate after taking account of interest rate swaps entered into by the company were.

|  | Non-interest<br>bearing<br>liabilities<br>£m | Floating<br>rate<br>£m | Fixed<br>rate<br>£m | Index<br>linked<br>£m | Total<br>£m |
|--|--|------------------------|---------------------|-----------------------|-------------|
| 2013   |  |                        |                     |                       |             |
| Bank loans and overdrafts  | –  | 19.6                   | –                   | –                     | 19.6        |
| Other loans  | –  | 53.9                   | –                   | 75.2                  | 129.1       |
| Other financial liabilities  | 0.6  | –                      | –                   | –                     | 0.6         |
|  | 0.6  | 73.5                   | –                   | 75.2                  | 149.3       |
| Impact of interest rate swaps not matched against<br>specific debt instruments | –  | (225.0)                | 225.0               | –                     | –           |
|  | 0.6  | (151.5)                | 225.0               | 75.2                  | 149.3       |
| Weighted average interest rate   |  |                        | 6.32%               |                       |             |
| Weighted average period for which interest is fixed (years)                    |  |                        | 2.5                 |                       |             |

|  | Non-interest<br>bearing<br>liabilities<br>£m | Floating<br>rate<br>£m | Fixed<br>rate<br>£m | Index<br>linked<br>£m | Total<br>£m |
|--|--|------------------------|---------------------|-----------------------|-------------|
| 2012   |  |                        |                     |                       |             |
| Bank loans and overdrafts  | –  | 31.0                   | –                   | –                     | 31.0        |
| Other loans  | –  | 81.8                   | –                   | –                     | 81.8        |
| Other financial liabilities  | 0.4  | –                      | –                   | –                     | 0.4         |
|  | 0.4  | 112.8                  | –                   | –                     | 113.2       |
| Impact of interest rate swaps not matched against<br>specific debt instruments | –  | (225.0)                | 225.0               | –                     | –           |
|  | 0.4  | (112.2)                | 225.0               | –                     | 113.2       |
| Weighted average interest rate   |  |                        | 6.32%               |                       |             |
| Weighted average period for which interest is fixed (years)                    |  |                        | 3.5                 |                       |             |

**7 Borrowings (continued)**

The company's borrowings are denominated in sterling, after taking account of cross currency swaps the company has entered into. There is no significant difference between the book value and the fair value of the company's borrowings. Fair values are based on the expected future cash flows discounted using zero coupon forward interest rates related to the expected timing of payments. At the balance sheet date the company had committed undrawn borrowing facilities expiring as follows:

|                 | 2013<br>£m | 2012<br>£m |
|-----------------|------------|------------|
| Within one year | -          | -          |
| 1-2 years       | -          | -          |
| 2-5 years       | 200.0      | 200.0      |
|                 | 200.0      | 200.0      |

This facility is shared with Severn Trent Water Limited.

**8 Share capital**

|   | 2013<br>£m | 2012<br>£m |
|---|------------|------------|
| Total issued and fully paid share capital   | -          | -          |
| 238,365,734 ordinary shares of 97 <sup>17</sup> / <sub>16</sub> p (2012: 237,608,111) | 233.3      | 232.6      |

Changes in share capital were as follows

|   | Number      | £m    |
|---|-------------|-------|
| Ordinary shares of 97 <sup>17</sup> / <sub>16</sub> p     |             |       |
| At 1 April 2012   | 237,608,111 | 232.6 |
| Shares issued under the group's Employee Sharesave Scheme | 757,623     | 0.7   |
| At 31 March 2013  | 238,365,734 | 233.3 |

**9 Reconciliation of movements in shareholders' equity**

|                                  | Share capital<br>£m | Share<br>premium<br>£m | Hedging<br>reserve<br>£m | Capital<br>redemption<br>reserve<br>£m | Retained<br>earnings<br>£m | Total<br>£m |
|----------------------------------|---------------------|------------------------|--------------------------|--|----------------------------|-------------|
| At 1 April 2011                  | 232.2               | 80.0                   | (5.5)                    | 156.1                                  | 2,359.5                    | 2,822.3     |
| Cash flow hedges                 |                     |                        |                          |  |                            |             |
| - transfers to net profit        | -                   | -                      | 1.8                      | -                                      | -                          | 1.8         |
| Share based payments             |                     |                        |                          |  |                            |             |
| - proceeds from shares issued    | 0.4                 | 3.8                    | -                        | -                                      | -                          | 4.2         |
| - awards granted by subsidiaries | -                   | -                      | -                        | -                                      | 4.1                        | 4.1         |
| Net profit for the year          | -                   | -                      | -                        | -                                      | 993.3                      | 993.3       |
| Dividends                        | -                   | -                      | -                        | -                                      | (159.0)                    | (159.0)     |
| At 1 April 2012                  | 232.6               | 83.8                   | (3.7)                    | 156.1                                  | 3,197.9                    | 3,666.7     |
| Cash flow hedges                 |                     |                        |                          |  |                            |             |
| - transfers to net profit        | -                   | -                      | 2.0                      | -                                      | -                          | 2.0         |
| Share based payments             |                     |                        |                          |  |                            |             |
| - proceeds from shares issued    | 0.7                 | 5.9                    | -                        | -                                      | -                          | 6.6         |
| - awards granted by subsidiaries | -                   | -                      | -                        | -                                      | 6.0                        | 6.0         |
| Net profit for the year          | -                   | -                      | -                        | -                                      | (6.9)                      | (6.9)       |
| Dividends                        | -                   | -                      | -                        | -                                      | (322.0)                    | (322.0)     |
| At 31 March 2013                 | 233.3               | 89.7                   | (1.7)                    | 156.1                                  | 2,875.0                    | 3,352.4     |

The capital redemption reserve arose on the repurchase of B shares. This is not distributable.

In previous years £1,221.2 million of the company's retained profit arose as a result of group restructuring exercises, and is not considered likely to be distributable.



**Company financial statements** Notes to the company financial statements

## 10 Employee costs and auditors' remuneration

|                       | 2013<br>£m | 2012<br>£m |
|-----------------------|------------|------------|
| Wages and salaries    | 1.7        | 1.4        |
| Social security costs | 0.3        | 0.2        |
| Pension costs         | 1.1        | 1.7        |
| Total employee costs  | 3.1        | 3.3        |

For details of directors' remuneration see the Directors' remuneration report on pages 57 to 70.

Fees payable to Deloitte LLP and its associates for non-audit services to the company are not required to be disclosed because the consolidated financial statements are required to disclose such fees on a consolidated basis.

## 11 Employee numbers

Average number of employees of the company (including executive directors) during this year was 12 (2012: 12).

All were based in the United Kingdom.

## 12 Employee share schemes

For details of employee share schemes and options granted over the shares of the company, see note 33 of the group financial statements. Details of the LTIP conditional awards and share options granted by the company to its employees are set out below.

The company has charged £0.1 million (2012: £0.1 million) to the profit and loss account in respect of share based payments.

At 31 March 2013, there were no options (2012: no options) exercisable under any of the share based remuneration schemes.

### a) Long Term Incentive Plan

Changes in the number of awards outstanding during the year:

|                              | Number of awards |
|------------------------------|------------------|
| Outstanding at 1 April 2011  | 12,801           |
| Granted during the year      | 3,702            |
| Lapsed during the year       | (3,566)          |
| Outstanding at 1 April 2012  | 12,937           |
| Granted during the year      | 3,356            |
| Vested during the year       | (1,366)          |
| Lapsed during the year       | (3,447)          |
| Outstanding at 31 March 2013 | 11,480           |

Awards outstanding at 31 March were

| Date of grant | Normal date of vesting | Number of awards |        |
|---------------|------------------------|------------------|--------|
|               |                        | 2013             | 2012   |
| July 2009     | 2012                   | –                | 4,813  |
| July 2010     | 2013                   | 4,422            | 4,422  |
| July 2011     | 2014                   | 3,702            | 3,702  |
| July 2012     | 2015                   | 3,356            | –      |
|               |                        | 11,480           | 12,937 |

## 12 Employee share schemes (continued)

## b) Employee Sharesave Scheme

Changes in the number of options outstanding during the year:

|  | Number of share options | Weighted average exercise price (p) |
|--|-------------------------|-------------------------------------|
| Outstanding at 1 April 2011            | 4,395                   | 856                                 |
| Granted during the year                | 916                     | 1,177                               |
| Forfeited during the year              | (445)                   | 862                                 |
| Transferred from other group companies | 1,301                   | 996                                 |
| Exercised during the year              | (314)                   | 1,221                               |
| Outstanding at 1 April 2012            | 5,853                   | 918                                 |
| Granted during the year                | 1,932                   | 1,241                               |
| Exercised during the year              | (2,561)                 | 930                                 |
| Transferred during the year            | 4,858                   | 947                                 |
| Outstanding at 31 March 2013           | 10,082                  | 991                                 |

Options outstanding at 31 March were:

| Date of grant | Normal date of vesting | Option price | Number of share options |       |
|---------------|------------------------|--------------|-------------------------|-------|
|               |                        |              | 2013                    | 2012  |
| January 2009  | 2012 or 2014           | 862p         | 4,352                   | 3,723 |
| January 2010  | 2013 or 2015           | 806p         | 1,602                   | 898   |
| January 2011  | 2014 or 2016           | 1,137p       | 949                     | 316   |
| January 2012  | 2015 or 2017           | 1,177p       | 1,247                   | 916   |
| January 2013  | 2016 or 2018           | 1,241p       | 1,932                   | -     |
|               |                        |              | 10,082                  | 5,853 |

## c) Share Matching Plan

Changes in the number of awards outstanding during the year:

|                              | Number of awards |
|------------------------------|------------------|
| Outstanding at 1 April 2011  | 457              |
| Granted during the year      | 360              |
| Outstanding at 1 April 2012  | 817              |
| Granted during the year      | 348              |
| Outstanding at 31 March 2013 | 1,165            |

Awards outstanding at 31 March were:

| Date of award | Normal date of vesting | Number of awards |      |
|---------------|------------------------|------------------|------|
|               |                        | 2013             | 2012 |
| May 2010      | May 2013               | 457              | 457  |
| May 2011      | May 2014               | 360              | 360  |
| May 2012      | May 2015               | 348              | -    |
|               |                        | 1,165            | 817  |

**Company financial statements** Notes to the company financial statements**13 Pensions**

The company participates in two defined benefit pension schemes (being the Severn Trent Pension Scheme and the Severn Trent Mirror Image Pension Scheme). In addition, the company operates an unfunded arrangement for certain employees whose earnings are above the pension cap.

Further details regarding the operation of these schemes are given in note 27 of the group financial statements

The company is currently unable to identify its share of the underlying assets and liabilities from the group's defined benefit pension schemes, and hence it continues to account for the cost of contributions as if the scheme was a defined contribution pension scheme

The pension charge for the year was £1.1 million (2012: £1.7 million).

**14 Related party transactions**

The company has taken advantage of the exemption under FRS 8 'Related Party Disclosures' and not disclosed details of transactions with other undertakings within the Severn Trent group of companies

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 13.

**15 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 other's overdrawn balances to the extent of their credit balances, which can be offset against balances of participating companies.

**16 Post balance sheet events**

Following the year end the board of directors has proposed a final dividend of 45.51 pence per share.

**17 Dividends**

For details of the dividends paid in the years ended 31 March 2013 and 31 March 2012 see note 14 in the group financial statements.

## Five year summary

|  | 2013<br>£m | 2012<br>£m | 2011<br>£m | 2010<br>£m | 2009<br>£m |
|--|------------|------------|------------|------------|------------|
| Turnover   | 1,831.6    | 1,770.6    | 1,711.3    | 1,703.9    | 1,642.2    |
| Profit before interest, tax and exceptional items  | 498.0      | 504.2      | 519.1      | 557.1      | 469.9      |
| Net exceptional items before tax   | (5.8)      | (50.9)     | (21.4)     | (49.7)     | (18.9)     |
| Net interest payable before losses on financial instruments and exceptional finance costs            | (231.9)    | (229.0)    | (230.6)    | (218.8)    | (196.4)    |
| Losses on financial instruments  | (45.3)     | (67.7)     | (14.2)     | 45.7       | (87.0)     |
| Results of associates and joint ventures   | 0.2        | 0.1        | 0.1        | 0.1        | -          |
| Profit before taxation   | 215.2      | 156.7      | 253.0      | 334.4      | 167.6      |
| Current taxation   | 12.6       | (60.5)     | (32.1)     | (40.7)     | (52.1)     |
| Deferred taxation  | 2.6        | 78.2       | 53.6       | (42.2)     | (171.5)    |
| Profit after taxation  | 230.4      | 174.4      | 274.5      | 251.5      | (56.0)     |
| Net assets employed  |            |            |            |            |            |
| Fixed assets   | 6,906.1    | 6,743.6    | 6,635.3    | 6,516.1    | 6,169.9    |
| Other net liabilities excluding net debt, retirement benefit obligation, provisions and deferred tax | (273.8)    | (341.3)    | (320.4)    | (317.2)    | (287.2)    |
| Derivative financial instruments <sup>1</sup>  | (279.8)    | (261.8)    | (90.5)     | (125.3)    | (153.9)    |
| Retirement benefit obligation  | (383.7)    | (345.8)    | (292.1)    | (354.9)    | (233.0)    |
| Provisions for liabilities and charges and deferred tax  | (827.5)    | (845.5)    | (957.4)    | (1,010.3)  | (988.0)    |
| Net assets held for sale   | -          | -          | -          | -          | 4.2        |
|  | 5,141.3    | 4,949.2    | 4,974.9    | 4,708.4    | 4,512.0    |
| Financed by  |            |            |            |            |            |
| Called up share capital  | 233.3      | 232.6      | 232.2      | 231.6      | 231.0      |
| Reserves   | 599.9      | -          | 867.6      | 709.1      | 715.1      |
| Total shareholders' funds  | 833.2      | 973.5      | 1,099.8    | 940.7      | 946.1      |
| Non-controlling interests  | 108        | 79         | 63         | 63         | 60         |
| Net debt <sup>2</sup>  | 4,297.3    | 3,967.8    | 3,868.8    | 3,761.4    | 3,559.9    |
|  | 5,141.3    | 4,949.2    | 4,974.9    | 4,708.4    | 4,512.0    |
| Statistics   |            |            |            |            |            |
| Earnings per share – pence   | 95.7       | 72.5       | 115.2      | 105.6      | (24.6)     |
| Adjusted earnings per share – pence  | 98.9       | 88.9       | 105.6      | 122.8      | 92.7       |
| Dividends per share (excluding special dividend) – pence   | 75.8       | 70.1       | 65.1       | 72.3       | 67.3       |
| Dividend cover (before exceptional items and deferred tax)   | 1.3        | 1.3        | 1.6        | 1.7        | 1.4        |
| Gearing  | 83.6%      | 80.2%      | 77.8%      | 79.9%      | 78.9%      |
| Ordinary share price at 31 March – pence   | 1,712.0    | 1,544.0    | 1,446.0    | 1,195.0    | 990.0      |
| Average number of employees  |            |            |            |            |            |
| – Severn Trent Water   | 5,458      | 5,162      | 5,237      | 5,686      | 5,624      |
| – Other  | 2,763      | 2,889      | 3,045      | 3,102      | 3,144      |

1 Excludes instruments hedging foreign currency debt

2 Includes instruments hedging foreign currency debt

Gearing has been calculated as net debt divided by the sum of equity and net debt.

## Severn Trent Water – delivering against our KPIs

| Base   | KPI   | 2012/13<br>Outturn | 2011/12<br>Outturn |
|--------|---|--------------------|--------------------|
| MAT 1  | Lost time incidents per 100,000 hrs worked <sup>1</sup>   | 0.2                | 0.3                |
| QR 2   | Employee motivation % <sup>2</sup>                        | 79%                | 75%                |
| MAT 3  | DWI Reportable events (Category 3,4,5) <sup>6</sup>       | 23                 | 30                 |
| MAT 4  | Service Incentive Mechanism – Qualitative <sup>3</sup>    | 4.36               | 3.96               |
| MAT 5  | Service Incentive Mechanism – Quantitative <sup>3,4</sup> | 167                | 205                |
| MAT 6  | Unplanned interruptions (per 1,000 properties)            | 12.48              | 11.12              |
| MAT 7  | Serviceability Waste                                      | 78                 | n/a                |
| MAT 8  | Serviceability Water                                      | 80                 | n/a                |
| ACT 9  | Capex – £m  | 541.8              | n/a                |
| ACT 10 | Debtor days <sup>5</sup>                                  | 36.7               | 35.8               |
| ACT 11 | Opex – £m   | 567                | 548                |
| MAT 12 | Pollution incidents (Category 1,2,3) <sup>3,6</sup>       | 376                | 458                |
| ACT 13 | Sewage treatment works – failing consent limits %         | 0.85%              | 2.54%              |
| ACT 14 | Security of Supply <sup>3</sup>                           | 99                 | 99                 |
| MAT 15 | Net energy use GWh <sup>4</sup>                           | 690                | 679                |
| MLE 16 | Leakage ML/d – Post MLE <sup>3</sup>                      | 441                | 464                |

### Notes

MAT = Moving Annual Total

QR = Quarterly Review

MLE = Maximum Likelihood Estimate

ACT = Year End Actual

1. Actual performance across all employees and agency staff.
2. Performance based on annual survey of all employees.
3. As reported in the Annual Regulatory Performance Report. Performance figures are provisional at this stage as the Annual Regulatory Performance Report will be published on the Severn Trent Water website ([www.stwater.co.uk](http://www.stwater.co.uk)) on 17 June 2013.
4. Actual performance based wholly or partially on internal data.
5. Actual performance based on audited UK GAAP financial statements for the year ended 31 March 2013.
6. Measure for calendar year to 31 December 2012.

KPI 3 Drinking Water Inspectorate – Reportable events. This KPI measures the number of significant events reported to the DWI

KPI 7 Serviceability Waste Water. This KPI is an index based on pollutions and blockages (both measures of how our below ground assets are performing) and sewage treatment works non compliance (above ground). The index reflects a 50:50 weighting for above and below ground assets.

KPI 8 Serviceability Water. This index is based on mains bursts and supply interruptions greater than 12 hours (both measures of how our below ground assets are performing) and Water Treatment Works (WTW) non compliance (above ground). The index reflects a 50:50 weighting for above and below ground assets.

KPI 14 Security of Supply Index (SOSI) is a measure of how resilient we are against periods of drought. The index calculation is based upon the difference between the water available to use and the volume of water we expect to put into our supply network in order to meet demand.

## Information for shareholders

### Severn Trent shareholder helpline

The company's registrar is Equiniti Limited. 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](http://www.shareview.co.uk) from here, you will be able to securely email Equiniti with your query

Telephone: 0871 384 2967\*

Overseas enquiries: +44 121 415 7044

Text phone: 0871 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](http://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](http://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 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](http://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: 0871 384 2268\*

Telephone number from outside the UK: +44 121 415 7173

### Buying and selling shares in the UK

If you wish to buy or sell certificated Severn Trent Plc shares, you will 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](http://www.shareview.co.uk) or 0845 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

Share fraud includes scams where investors are called and offered shares that often turn out to be worthless or non-existent, or an inflated price for shares they own. These calls come from fraudsters operating in 'boiler rooms' that are mostly based abroad.

If you are offered unsolicited investment advice, discounted shares, a premium price for shares you own, or free company or research reports, you should take these steps before handing over any money:

- get the name of the person and organisation contacting you;
- check the Financial Services Register (the Register) at [www.fca.org.uk](http://www.fca.org.uk) to ensure they are authorised;
- use the details on the Register to contact the firm;
- call the Financial Conduct Authority (FCA) Consumer Helpline on 0800 111 6768 if there are no contact details on the Register or you are told they are out of date;
- search the FCA list of unauthorised firms and individuals to avoid doing business with, and
- remember, if it sounds too good to be true, it probably is.

\* Calls cost 8 pence per minute plus network extras. Lines are open from 8.30am to 5.30pm Monday to Friday

\*\* Lines are open Monday-Friday, 8.00am to 4.30pm for dealing, and until 6.00pm for enquiries.

**Other information** Information for shareholders

If you use an unauthorised firm to buy or sell shares or other investments, you will not have access to the Financial Ombudsman Service or Financial Services Compensation Scheme if things go wrong.

If you are approached about a share scam you should tell the FCA using the share fraud reporting form at [www.fca.org.uk](http://www.fca.org.uk), where you can find out about the latest investment scams. You can also call the Consumer Helpline on 0800 111 6768

You should contact Action Fraud on 0300 123 2040 if you have already paid money to share fraudsters.

**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](http://www.mpsonline.org.uk) or call the MPS Registration line on 0845 703 4599.

**Financial calendar**

|   |                  |
|---|------------------|
| Ex dividend date – final dividend                           | 19 June 2013     |
| Record date to be eligible for the final dividend           | 21 June 2013     |
| AGM   | 17 July 2013     |
| Interim management statement – Q1 Year ending 31 March 2014 | 17 July 2013     |
| Final dividend payment date                                 | 26 July 2013     |
| Interim results announcement – Year ending 31 March 2014    | 26 November 2013 |
| Ex dividend date – interim dividend                         | 4 December 2013  |
| Record date to be eligible for the interim dividend         | 6 December 2013  |
| Interim dividend payment date                               | 10 January 2014  |

All dates are indicative and may be subject to change.

**American Depositary Receipts (ADRs)**

Severn Trent has a sponsored Level 1 American Depositary 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 enquires regarding Severn Trent ADRs please contact The Bank of New York Mellon.

By post: The Bank of New York Mellon, PO Box 358516, Pittsburgh, PA 15252 – 8516, 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: [sharerelations@bnymellon.com](mailto:sharerelations@bnymellon.com)

Website: [www.bnymellon.com/shareowner](http://www.bnymellon.com/shareowner)

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