Our finances explained
December 2020
Financing life’s essential service

We’ve been going through a lot of change to rebuild trust and deliver improved performance for our customers. The last regulatory period saw new ownership, new senior management, an overhaul of governance and a new strategic direction. And it hasn’t stopped there. In September we welcomed our new CEO, Sarah Bentley, as we completed a major overhaul of our governance to ensure we’re set up in the right way.

The Covid-19 pandemic has had an impact on all of us – our customers, communities, employees and business – and it’s really important we’re focusing on what matters most right now. That said, our financial management is crucial, as we balance supporting our customers with the delivery of life’s essential service, so our customers, communities and the environment can thrive.

We know many of our customers are finding themselves in increasingly difficult financial circumstances, and we’ve been doing what we can to support them. We launched our new flexible payment plan, pledged to increase the investment in our independent trust fund to £1 million and donated £400,000 to support our community partners.

Supportive external shareholders

For the third consecutive year our Board, with the full support of our external shareholders, agreed to limit dividend payments to those required to service debt obligations, with no dividends being paid to external shareholders. Instead this money has been reinvested into the business to make improvements such as reducing leakage, improving the condition of our network and laying the foundations for improvements in customer service. Our external shareholders predominantly represent pension funds for key workers in Canada and the UK. They are committed to investing in our business for the long-term, as we improve performance and therefore our returns to those pension funds.

We launched a new cost efficiency programme during 2019/20, as we maximise every pound we spend to create the most value for our customers, communities and the environment.

We’ve embarked on our plan for 2020 to 2025. As we move through this new regulatory period, we’re planning one of our most ambitious projects to date, to replumb London and parts of the Thames Valley. It’s clear our network needs major investment, to ensure it’s resilient for today’s population and in the face of growth and climate change. We’re also continuing our work to ensure our network is ready to accommodate the landmark Thames Tideway Tunnel when it’s in operation towards the end of this regulatory period.

Engaging with our customers and stakeholders is so important to our decision-making and building trust. Given the nature of our business, we know our finances, including our corporation tax position, can appear complex. That’s why we publish this booklet each year – this being our 7th edition – to help explain our finances in a simple way based on our financial performance during the previous year.

If you have any comments or feedback on this document, please get in touch at ourfinances@thameswater.co.uk

Brandon Rennet
Chief Financial Officer
Our water cycle

We provide clean, safe drinking water and environmentally responsible wastewater treatment for our customers every day. Our service is one of the building blocks of a thriving society, both now and in the future. What we do is essential, and the way we do it is very important.

1. Abstract from rivers and aquifers
   To minimise the impact of our water abstraction, we monitor river levels carefully. This helps us to abstract water more efficiently and boost reservoir levels when water levels are high.

2. Clean water at our treatment works
   Every day, we supply drinking water to nearly 10 million people across London and the Thames Valley.

3. Deliver water to homes and businesses via our pipework
   Encouraging water efficiency is an essential part of our long-term plans to manage water more sustainably. We don’t just deliver world-class water to customers, we encourage water efficiency initiatives in households, businesses, schools, local authorities and housing associations across London and the Thames Valley as well.

4. Remove wastewater
   To protect public health and the environment, we collect and treat sewage from our 15 million customers, using our sewer network to transport it to one of our sewage treatment works.

5. Treat wastewater at our sewage treatment works
   We separate wastewater and the solid by-product, sludge, and treat them both to high standards.

6. Return clean water to the environment
   Treated wastewater is recycled safely to rivers.

Smarter water catchments
We work hard to improve river water quality at the source, avoiding the need for additional treatments that would affect the environment and customers’ bills.
How we spend our revenue

What we spent our money on in 2019/20

Net investment in our network*

£1,224 million**

This is the money we use to renew and improve our network and infrastructure. We’ve invested over £15 billion during the last 15 years, and we’re currently investing triple the amount per year compared to the five years pre-privatisation.

Net financing costs and dividends

£269 million**

We borrow money from banks and other lenders, such as pension funds and insurance companies, to help fund investment in our network. We keep customer bills low by borrowing debt on as favourable terms as possible and by spreading the repayment costs over a longer period. We also pay a dividend to our holding companies to fund their debt obligations and working capital requirements.

We did not pay dividends to external shareholders for the three years ending 31 March 2020.

Day-to-day operational expenses

£977 million**

This is the money we use to operate and maintain our network, pay our employees, cover our energy costs and pay for the technology we need. Due to our vast network of water pipes, sewers and treatment works, we need to manage this money carefully to keep our business running efficiently and provide the best possible service for our customers.

How we spend every £1

We provide water and wastewater services for an average of just over £1 per day per household. Our current average annual combined household bill is £397 (2020/21) per year, the third lowest in England and Wales. We keep our bills low through a combination of factors including:

- Efficient operations and investment: Operating our network efficiently drives down unnecessary costs.
- Low-cost financing: We borrow money in competitive markets to minimise our cost of debt.
- Investment allowances: Together with other factors, the Government’s capital allowances scheme enables us to keep our corporation tax bills lower than they would otherwise be (further detail on page 14).

17p Paying our people

So we’re able to deliver essential services to our customers and protect the environment

15p Lenders

By borrowing money at efficient rates, we’re able to continue investing heavily in our infrastructure while keeping customer bills as low as we can

External shareholders ***

Our external shareholders have not taken a dividend in the three years to 2019/20. This is so the money could be reinvested in our business to improve performance.

How we spend every £1 of revenue

4p Government

We paid over £196 million in business rates, PAYE and national insurance contributions in 2019/20

We have not paid any corporation tax, primarily due to tax deductions for our interest payments and because of heavy investment in our network, for which we receive tax relief under the Government’s “capital allowances” regime

64p Customers (and suppliers)

24p – Operational expenditure

To provide our day-to-day services and improve our customer service

30p – Investment in our infrastructure

To increase the long-term resilience of our services. Includes 3p for the Thames Tideway Tunnel

5p – Energy to power operations

To keep this cost down, we’re increasing the amount of electricity we self-generate

5p net profit, which we reinvest

External shareholders is the term used to describe the ultimate owners of the company. Most of our external shareholders are pension funds. They own the shares in our ultimate parent company, Kemble Water Holdings Limited. For more information and our structure chart go to page 16.
Some of our key expenses

Paying into pensions

We currently run three pension schemes to support our employees during retirement – two defined benefit schemes and one defined contribution scheme.

The assets of our defined benefit schemes, which support our ability to pay pensions, are held separately from those of any Thames Water Group company. Both the value of these assets and our pension obligations – the amount we need to pay retired employees – are affected by interest rate fluctuations and other external market factors.

Like many large companies, our obligations are larger than the value of our assets due to changes in market factors, so we currently have a net pension deficit on one of our defined benefit schemes. Our net deficit at 31 March 2019 was £114.6 million. We are expecting an increase in this net deficit in the next financial year due to the economic impact of Covid-19. We are not unique in this increase, as other companies with large defined benefit pension schemes are similarly affected by the economic impact of Covid-19.

Every three years, our defined benefit schemes are valued by an independent actuary and these valuations are updated biannually for accounting purposes.

For 2019/20, we paid £43.0 million into our defined benefit pension schemes, which included both regular contributions and payments to reduce the deficit. This is part of our recovery plan to sustainably reduce our pension deficit to zero by 2027, which was agreed with the scheme trustees as part of the last triennial valuation dated 31 March 2019. We also contributed £13.1 million to the defined contribution scheme, which currently serves 55% of our employees.

Powering our sites

Our power costs were over £113 million last year, which equals our second biggest single cost. That’s why we’re continuing to increase the amount of electricity we self-generate.

During 2019/20, we produced 23% of our own electricity and the equivalent of £37 million in electricity from sludge. As well as producing energy from ‘poo’, we also use solar and wind power.

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Investing for customers

We’ve invested over £15 billion as part of our significant investment programme over the last 15 years, with 56% of our investment in our water assets during 2019/20, 41% in waste and 3% in other assets to help us improve our service to customers. Some of our key areas of spend during the year were:

- Over £20 million as part of our investment in our new customer relationship management and billing system, which will help transform our approach to customer service. All our customers have now been moved to this new platform.

- £47 million on our metering programme, which has enabled us to reach the milestone of installing more than 400,000 smart meters to date.

Thames Tideway Tunnel

The Thames Tideway Tunnel will be a 25km long sewer, diverting millions of tonnes of sewage away from the River Thames.

To minimise the costs and remove risk for our customers, we ran a comprehensive and competitive process to identify the best company to build the tunnel. And in August 2015, an independent company, Bazalgette Tunnel Limited (BTL), which is known to the public as Tideway, secured a licence from Ofwat as a separate regulated utility business to deliver the landmark construction project.

As a result of this robust process, the impact on customers’ wastewater bills will be significantly lower than was originally anticipated – initial estimations of an average increase of up to £80 a year were reduced to a maximum of £25. Just over £18 is included in the 2020/21 bill with £11.09 passed to BTL for the construction, and £7.40 being used by us for our connecting works. As part of the cash isn’t retained by us, we present amounts relating to BTL separately in our financial statements.

During 2019/20, we spent over £16 million as part of our work to connect our existing network to the landmark new tunnel that will be in operation later this decade and will transform the health of the River Thames in London.
Helping customers and communities

Supporting those in need
We offer a range of options to help our customers in financially vulnerable circumstances, which includes providing 50% discounts. Over 180,000 customers are now on our social tariffs and over 80,000 are now helped through our priority services register.

We run a customer assistance fund to support customers with their water debt, which helped over 5,600 customers in 2019/20. We also offer a range of payment plan options, free meter fits and water efficiency devices to help our customers.

We understand customers in water debt may also have wider financial issues, so we can also help with basic living costs outside our services, through a dedicated independent trust fund, set up in 2009. We pledged to increase our investment in the trust fund to £1 million.

Setting affordable bills
Making our bills affordable, while setting them at a level that enables us to meet our commitments, is something we need to get right.

We continually evaluate what we need to do to maintain and improve our services to customers. And we undertake research to understand the future impact of things like climate change and population growth on our network.

We consult with our customers at length about what they value most from Thames Water and what they’re willing to pay for. We’re also challenged independently by representative bodies such as our Customer Challenge Group (CCG).

Reviewing our prices
In a monopoly sector like the water industry, it’s our economic regulator, Ofwat, that provides an alternative to competition and sets limits on the prices we can charge.

Every five years, we develop our plans and bills for the next five-year regulatory period based on our extensive planning and customer research. We then seek to agree this with Ofwat. This is a very rigorous process known as a price review. In 2019/20, we concluded our most recent process and accepted our final determination from Ofwat for 2020 to 2025. You can find more information here.

Setting performance commitments
We work closely with our customers to set performance commitments for each regulatory period, designed to deliver what’s most important to our customers in the most cost-effective way. For some of these commitments we can earn financial rewards if we perform above expectations, and we can also incur penalties for underperformance. For more information see our Annual Report.
Bridging the gap

For every £1 we collect from bills, we need an additional 23p (2019/20) to help fund our spending (page 4). To bridge this gap and avoid significant fluctuations to bills, we borrow money at attractive rates. By spreading the cost of our investment and managing our debt over a number of years, we also ensure the generations that will benefit from the improvements are those who will be helping to pay for it – this makes our bills fairer and more sustainable.

Our borrowings

We borrow money through a combination of loans from banks and institutions as well as corporate bonds. Our corporate bonds are typical debt ‘instruments’, consistent with the way that many large UK companies use to raise funding. They’re sold to third-party investors such as pension fund managers and insurance companies, and, as with any other loan, we pay interest on these bonds. Most of our bonds are publicly listed on major stock exchanges such as the London Stock Exchange and Irish Stock Exchange. While the majority of our funding requirement is in sterling, we monitor investor demand in other currencies to optimise our average cost of funding.

<table>
<thead>
<tr>
<th>Additional borrowing</th>
<th>Net investment</th>
<th>Day-to-day operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>£361 million</td>
<td>£1,224 million</td>
<td>£977 million</td>
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</table>

Interest on our debt

The water industry has traditionally been considered low risk, making it a particularly attractive investment for pension funds and other similar financial institutions that seek long-term, steady returns. We maintain relatively long-dated debt maturities (currently with an average tenor of approximately 16 years) to minimise refinancing risks. The average interest rate we incurred during 2019/20 was 4.2%, and we paid net interest of £301 million on our debt.

Managing financial risk

As with any company, our normal business activities expose us to a variety of financial risks, including changes to inflation and interest rates. By borrowing money from different sources, on different interest payment bases and for varying lengths of time, we’re able to proactively manage and spread these risks, reducing them to an acceptable level. As a regulated water company, our customers’ bills are linked to movements in inflation, which increases or decreases the amount of money we have available to pay for the interest on our debt. For that reason we’ve also linked slightly more than half of our debt interest to inflation. Most of the remaining debt is borrowed at fixed rates of interest, sometimes for many years, which helps provide certainty and maintains stable borrowing charges relative to changes in revenue.

Our credit rating

The responsible way we operate our finances ensures we maintain investment grade credit ratings, as assigned by external ratings agencies Moody’s and Standard & Poor’s (S&P). The ongoing assessment of Thames Water by these two agencies provides an independent view of our performance and future outlook. The majority of our debt is rated Baa1 by Moody’s (stable outlook) and BBB+ by S&P (negative outlook), allowing us to continue to raise funding at competitive rates which, in turn, allows us to keep costs down for customers.
Our finances explained 2020

Our gearing

We’re financed by a combination of debt from our lenders and shareholder equity retained in the company.

After deducting cash and other cash-like assets, the amount we’ve borrowed from lenders is referred to as our net debt.

Our financial gearing is calculated as the ratio between our net debt and our regulatory capital value (RCV), which represents the value of a company’s assets as agreed with Ofwat.

This relationship – also known as the ‘gearing ratio’ – shows the extent to which our operations are funded by our debt investors, rather than by shareholders.

On 31 March 2020 our net debt (covenant basis) was £12.12 billion and our RCV was £14.73 billion, meaning our gearing ratio was 82.3%.

You could consider this similar to funding the purchase of a house with a mortgage, where the loan-to-value ratio is the value of debt (mortgage) relative to the value of the house. Our lenders require the Group to operate within certain financial metrics, including a maximum gearing level. The covenant net debt figure used in these calculations was £12.12 billion, which is slightly lower than the £12.52 billion statutory net debt shown in our 2019/20 accounts, due to the specifics of the covenant calculations.
Our taxes explained

Tax transparency is a cornerstone in building trust with our customers and other stakeholders.

In 2019/20 we paid over £196 million in business rates, PAYE, National Insurance contributions and other taxes, which helped fund the vital public services we all rely on. We incurred £127 million directly, mainly through business rates, and collected and paid £69 million on behalf of our employees.

We manage our taxes appropriately and efficiently, within both the letter and the spirit of tax legislation, for the benefit of our customers, shareholders and the communities they live in. Our tax strategy and policy can be found as a standalone document on our website here.

Preventing tax evasion

The Corporate Criminal Offence of the Failure to Prevent the Facilitation of Tax Evasion rules require companies to have procedures in place to prevent the facilitation of tax evasion. We take this responsibility very seriously and this is reflected in our policies, which include:

- Ensuring that we have prevention procedures in place, including obtaining assurances from suppliers, training our employees, providing a whistle-blowing hotline, and reviewing our processes regularly.
- Applying a zero-tolerance attitude towards the facilitation of tax evasion and reporting any instances to the authorities.
- Not using suppliers who are unable to provide assurance that they have adequate prevention procedures.

Our tax strategy

Our tax strategy is straightforward and is underpinned by five key principles to ensure we’re a responsible business. It applies to all our Group entities. Our principles are:

- We comply with all tax legislation requirements at all times, both within the letter and spirit of the law.
- We do not use tax avoidance schemes or aggressive tax planning.
- We engage fully and transparently with HMRC and other Government bodies and seek to resolve disputes in a co-operative manner.
- We adopt a conservative approach to tax risk management and apply a strong tax governance framework.
- We accept only a low level of risk in relation to taxation.

In 2019, HMRC reconfirmed our classification as ‘low risk’. We work hard to maintain this coveted status, and the tax policies above ensure our behaviour is consistent with, and contributes towards maintaining this status.
Our tax breakdown

This illustration shows the areas in our value chain where we incur and collect taxes.

Wholesale and retail operations
- Insurance
- Fleet
- Network investment
- Waste to landfill
- Electricity and gas consumption
- Property
- Suppliers
- People
- Financing
- Customer

Tax incurred indirectly
- Taxes incurred indirectly are taxes that represent a cost to us, but are included in the costs our suppliers and contractors charge us. Therefore, we do not pay these directly to the Government, but incur them indirectly as a consequence of our activities.

- Insurance premium tax
- Fuel duty
- Aggregate levy
- Landfill tax
- Climate change levy

Tax incurred directly
- Taxes incurred directly are taxes that represent a cost to us, are accounted for in our financial statements, and are paid directly to the UK Government by us.

- Carbon reduction commitment
- Stamp duty land tax
- Business rates
- Irrecoverable VAT
- Employer NICs
- Employee NICs and PAYE
- Withholding tax
- VAT

Tax collected for HMRC

- Taxes collected by us are tax costs of another party that we collect on their, or the Government’s, behalf. These costs do not affect our financial results. As we undertake the commercial activity, it generates the tax that contributes to the economy.

Tax descriptions

Whilst we incur and collect all of the below, only the largest amounts are shown on page 19.

- **Insurance Premium Tax**
  A tax levied on insurance premiums.

- **Fuel Duty**
  A duty on petrol, diesel and fuel used in vehicles.

- **Aggregate Levy**
  A tax on the extraction of rock, gravel and sand.

- **Landfill Tax**
  A tax on waste sent to landfill.

- **Climate Change Levy**
  A tax on the industrial or commercial use of electricity, gas and solid fuels.

- **Carbon Reduction Commitment**
  A tax on one gas and electricity consumption, calculated by reference to associated carbon dioxide emissions. This ceased in July 2019.

- **Stamp Duty Land Tax**
  A tax on the purchase of land and property.

- **Business Rates**
  A tax on non-domestic properties we own or occupy.

- **VAT**
  A tax levied on the sale of goods and services.

- **National Insurance (NIC)**
  A tax on wages incurred by employers and employees.

- **PAYE**
  Pay As You Earn income tax incurred by employees on their wages. It’s deducted by employers and paid to Her Majesty’s Revenue & Customs (HMRC).

- **Withholding tax**
  A tax on interest payments on loans.
Our corporation tax

The UK Government has for many years allowed companies to claim tax relief on capital investment in their UK operations – these allowances are a common feature of national tax regimes across the world. At the same time, the UK Government also provides tax relief for interest costs on debt that’s been raised to fund investment.

Due to our significant capital investment programme and interest costs on our debt, we don’t currently pay corporation tax. Our interest costs are deductible for tax purposes and are substantial at the moment. The Government’s capital allowances regime allows us to delay payment of corporation tax (creating a “deferred tax” liability) until a time when our level of investment is lower. Our deferred tax liability on fixed assets was £1.2 billion at 31 March 2020.

You can find our draft tax calculation for Thames Water Utilities Limited and its subsidiary for 2019/20 to the right. The reduced cost associated with us not paying corporation tax is fully passed on to customers through lower bills, so our customers benefit fully from us not paying corporation tax.

If our investment levels were to reduce, our capital allowances claim would also reduce. This would lead to an increase in our taxable profits and we would pay corporation tax. Although tax we pay would be funded through customer bills, any increase in bills to cover our corporation tax charge would be offset, to a degree, by a bill reduction due to lower investment costs. The long life span of our assets would also protect customers from a sudden bill increase, if and when the deferred tax becomes payable.

It’s difficult to reliably estimate when the Group as a whole will pay corporation tax. It depends on a number of factors:

- our profitability, which is influenced by our performance
- the regulatory return and level of debt
- our level of capital investment, which gives rise to capital allowances
- tax legislation and accounting changes

Although the plan we submitted to Ofwat for 2020 to 2025 requested funding to cover tax costs in our operating company, Thames Water Utilities Limited, the Group as a whole may not pay corporation tax because of losses in other Group companies.

Group operations

All of the Group’s operational activities are located in the UK. Historically, the Group traded in overseas countries and had a number of legacy entities incorporated overseas. However, as part of our commitment to simplify our structure we have now closed or disposed of all of these overseas legacy entities except one incorporated in Singapore.

Our draft corporation tax calculation 2019/20

This calculation is for Thames Water Utilities Limited and its subsidiary, Thames Water Utilities Finance Plc in 2019/20.

A company’s UK corporation tax liability is based on its accounting profit before tax, as shown in its statutory accounts. Tax adjustments must be made to that accounting profit, and the resulting “taxable profits” are multiplied by the corporation tax rate, which was 19% in 2019/20.

<table>
<thead>
<tr>
<th>Profit before tax* per statutory accounts</th>
<th>£m</th>
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<tbody>
<tr>
<td>Deduct:</td>
<td></td>
</tr>
<tr>
<td>1 Capital allowances</td>
<td>(581)</td>
</tr>
<tr>
<td>2 Interest costs on debt</td>
<td>(98)</td>
</tr>
<tr>
<td>3 Group relief</td>
<td>(78)</td>
</tr>
<tr>
<td>4 New service connections to our network</td>
<td>(23)</td>
</tr>
<tr>
<td>5 Fair value gains on derivatives</td>
<td>(257)</td>
</tr>
<tr>
<td>6 Pension contributions</td>
<td>(10)</td>
</tr>
<tr>
<td>Add back:</td>
<td></td>
</tr>
<tr>
<td>7 Depreciation of infrastructure and other assets</td>
<td>581</td>
</tr>
<tr>
<td>8 Accounting restatements</td>
<td>29</td>
</tr>
<tr>
<td>9 Disallowable costs (e.g. fines)</td>
<td>3</td>
</tr>
<tr>
<td>Taxable profits</td>
<td>Nil</td>
</tr>
</tbody>
</table>

*Interest costs on debt of £335 million, which are deductible for tax purposes, are already included in the profit before tax figure.

Tax deductions

1 Capital allowances
Companies can claim a deduction for investment in critical infrastructure.

2 Interest costs on debt
Some costs are not recognised in the income statement.

3 Group relief
Tax losses generated from interest expenses in our holding companies can be transferred under “group relief” rules. Broadly speaking, these rules ensure that corporation tax is paid on the profits of the whole group.

4 New service connections to our network
This income is taxed by reducing capital allowances instead.

5 Derivatives
These are taxed based on their cash flows rather than accounting profits or losses.

6 Pension contributions
Only actual pension contributions are deductible that are more than the cost in the income statement.

Added back

7 Depreciation of infrastructure
Capital allowances are deducted instead. In the early years, the depreciation costs are generally lower than capital allowances, which defers our tax.

8 Accounting restatements
Profits arising in earlier years from changes in accounting standards are taxed in the current year.

9 Disallowable costs
E.g. fines
Green financing

Becoming more sustainable

Our commitment to becoming more sustainable extends to the way we run our finances. In 2018, we signed an agreement to link the interest rate on our £1.65 billion 5-year Revolving Credit Facility (RCF) to our annual performance against Environmental, Social and Governance (ESG) metrics for the first time. The deal made us the first UK corporate to tie the interest rate we pay on the RCF to such a measure and we use our Infrastructure Global Real Estate Sustainability Benchmark (GRESB) score.

GRESB is an independent, external ESG benchmark that assesses the sustainability performance of real estate and infrastructure portfolios and assets worldwide. This year, with a score of 89/100, we’ve ranked 37 out of 406 world infrastructure firms – putting us in the top 10 per cent – and third out of 12 for participating water and sewerage companies. The GRESB five-star rating recognises entities placed in the top 20 per cent of the benchmark. This agreement followed the creation of our green bond framework and our inaugural green bond, which we issued in March 2018. Proceeds from this green bond have been used to refinance major projects including the upgrade of Deephams sewage treatment works, our metering programme and the rehabilitation of water mains.

We published our first Environment, Social and Governance statement in October 2018 to increase the accessibility of information. Giving a balanced view of performance against key ESG measures over three years, our third statement, published in November 2020, can be found on our website.
Our structure explained

The Kemble Water group

Thames Water Utilities Limited is one company within a larger group of companies, known as the Kemble Water Group. Each of the companies within our Group serves its own function. Our investors have invested equity and debt in the Group.

The debt provided by our shareholders of £310 million (plus accrued interest) is listed, which allows interest payments to be paid free from withholding tax under the Government’s ‘quoted Eurobond’ rules.

Kemble Water Holdings Limited
This is the ultimate, UK incorporated company of the Group, set up in 2006 for investors to hold shares in the group.

Kemble Water Eurobond plc
This is a UK incorporated company, originally set up to raise debt from shareholders to help buy TWUL in 2006.

Kemble Water Finance Limited
This is a UK incorporated company, originally set up to raise debt from external lenders to help buy TWUL in 2006. External lenders require greater security than shareholders, so their debt is held in a separate company, which is closer to TWUL.

Thames Water Limited
This is a UK incorporated company and was at one point listed on the London Stock Exchange. Now it holds pension obligations and other non-regulated companies.

Thames Water Utilities Holdings Limited
This is a UK incorporated company, set up in 2007 for the whole business securitisation (WBS), and provides security to WBS lenders over the shares in TWUL.

In 2007, we established a ‘whole business securitisation’ debt structure to insulate our credit-worthiness from our ultimate shareholders and holding companies. We introduced comprehensive covenant and security arrangements for secured creditors within Thames Water Utilities Limited to secure and maintain a strong investment grade credit rating.

This chart sets out an abridged version of the Kemble Water Holdings Limited Group Structure.
Our external shareholders

Thames Water is jointly owned by 10 institutional investors made up mostly of pension funds, representing key workers, and sovereign wealth funds. The two largest investors represent pension funds—one based in Canada and one in the UK. All of our investors take a long-term view of the company’s infrastructure, our customers and the natural environment.

Shareholders by geography

- Canada: 45.5%
- UK: 19.6%
- Middle East: 18.7%
- China: 8.7%
- Australia: 5.4%
- Europe: 2.2%

Shareholders by type

- Dedicated pension fund: 53.6%
- Sovereign wealth funds: 27.4%
- Partially pension backed: 13.7%
- Other investors: 5.4%

Our shareholders

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Percentage</th>
<th>Note</th>
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<tbody>
<tr>
<td>OMERS</td>
<td>31.777%</td>
<td>Ontario Municipal Employees Retirement System (OMERS) is one of Canada’s largest pension plans with C$109bn of net assets and considerable experience of managing essential infrastructure globally. Acquired stake through a series of 4 transactions between May 2017 and July 2018.</td>
</tr>
<tr>
<td>USS</td>
<td>10.939%</td>
<td>The Universities Superannuation Scheme (USS) is a UK pension scheme for academic staff of UK universities. Acquired stake in July 2017.</td>
</tr>
<tr>
<td>Infinity</td>
<td>9.900%</td>
<td>Infinity Investments S.A is a subsidiary of the Abu Dhabi Investment Authority (ADIA), one of the world’s largest sovereign wealth funds. Acquired stake in December 2011.</td>
</tr>
<tr>
<td>Wren House</td>
<td>8.772%</td>
<td>Wren House is the global direct infrastructure investment vehicle of the Kuwait Investment Authority (KIA), one of the world’s largest sovereign wealth funds. Acquired stake in May 2017.</td>
</tr>
<tr>
<td>BCI</td>
<td>8.706%</td>
<td>British Columbia Investment Management Corporation (BCI) provides investment management services to British Columbia’s public sector. Shareholders since 2006.</td>
</tr>
<tr>
<td>Hermes</td>
<td>8.699%</td>
<td>Hermes GPE is one of Europe’s leading independent specialists in global private markets – it manages the BT Pension Scheme (BTPS), one of the largest UK private-sector pension schemes. Shareholder since 2012.</td>
</tr>
<tr>
<td>CIC</td>
<td>8.688%</td>
<td>China Investment Corporation (CIC) is one of the world’s largest sovereign wealth funds. Shareholder since 2012.</td>
</tr>
<tr>
<td>QIC</td>
<td>5.352%</td>
<td>Queensland Investment Corporation (QIC) is a global diversified alternative investment firm, one of the largest institutional investment managers in Australia. Shareholder since October 2006.</td>
</tr>
<tr>
<td>Aquila</td>
<td>4.995%</td>
<td>Aquila GP Inc. is a leading infrastructure management firm and a wholly owned subsidiary of Fiera Infrastructure Inc., a leading investor across all subsectors of the infrastructure asset class. Shareholder since May 2013.</td>
</tr>
<tr>
<td>PGGM</td>
<td>2.172%</td>
<td>PGGM (Stichting Pensioenfonds Zorg en Welzijn) is a pension fund service provider managing the pensions for different pension funds, the affiliated employers and their employees. Shareholder since October 2006.</td>
</tr>
</tbody>
</table>
Profits and dividends

Profits
Our profit is the revenue we have left after taking into account all of our day-to-day running costs, depreciation and amortisation, finance expense and taxes.

In 2019/20, our underlying profit after tax was £186.6 million, which excludes the money passed over to Bazalgette Tunnel Limited for the construction of the Thames Tideway Tunnel.

Dividends
Dividends are used for two purposes:

To pay for holding company obligations
Thames Water’s dividends are initially paid to its immediate parent company (see p14), and then money will flow up through the Group, in part to enable the holding companies to pay for their own debt obligations and their own working capital requirements. In 2019/20, £56.5 million was paid to holding companies and other group companies to service their debt and cover day-to-day cash needs.

External shareholder returns
To focus on meeting the performance expectations of our customers, our investors supported the Board’s decision not to pay any distributions to external shareholders for the three years 2017/18, 2018/19 and 2019/20, so the money they would have received can be reinvested – that means our newest external shareholders have not received dividends or interest for the first three years of ownership.

We recognise the importance of paying dividends in future years to continue attracting the right type of long-term investors who will remain committed to our long-term goals. The Board is also mindful of the privilege of our position as a monopoly provider of essential services and has agreed the parameters of a new and fair dividend policy, with full support of shareholders, which has the following features:

Our dividend policy
The Company’s dividend policy is to pay a progressive dividend commensurate with the long-term returns and performance of the business, after considering the business’s current and expected regulatory and financial performance, regulatory restrictions, management of economic risks and debt covenants.

Directors, in assessing the dividend to be paid, are required to ensure that:

- Payment of a proposed dividend should not impair short-term liquidity or compliance with our covenants
- Payment of a proposed dividend should not impair the longer term financeability of the company’s business
- There is an assessment of the impact that payment of the dividend may have on all stakeholders including employees, pension members and customers
- Our financial performance, which underpins the opportunity to pay the dividend, is as a result of operational performance that meets the level required of a supplier of essential services
- If a net dividend is declared above Ofwat’s 5% dividend yield guidance, applied to Ofwat’s notional company, the Board will consider whether the additional returns result from performance (including progress towards de-gearing) that has benefited customers and may therefore be reasonably applied to finance a dividend.

When dividends are paid, we’ll be clear about their level, how they relate to delivery for customers and why they’ve been awarded.
Remuneration

Our remuneration policy is built on principles designed to attract, retain and motivate our leaders and senior management and ensure they’re focused on delivering business priorities within a framework designed to promote the long-term success of Thames Water.

The principles are to:

- Align with the interests of the all our key stakeholders, including customers, external shareholders, suppliers and employees
- Link remuneration to our strategic ambitions, promote our long-term success and reinforce our culture
- Promote demonstrable links between reward for Executive Directors and performance for customers and external shareholders, as well as performance against our environmental targets
- Align with packages by other companies of similar size and complexity, and considering individual contribution and experience
- Include a mix of fixed and variable pay

### Annual Management Bonus 2020/21

<table>
<thead>
<tr>
<th>Bonus Element</th>
<th>Objective Measure</th>
<th>Element as % of Total Bonus Opportunity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer Service</td>
<td>Customer complaints</td>
<td>10%</td>
</tr>
<tr>
<td></td>
<td>Drive channel shift (improve core processes, complaints, CSAT)</td>
<td>10%</td>
</tr>
<tr>
<td></td>
<td>End year exit rate reduction of voice to other digital channels</td>
<td></td>
</tr>
<tr>
<td>Customer &amp; Environmental Delivery</td>
<td>Supply interruptions (SI&gt;3)</td>
<td>10%</td>
</tr>
<tr>
<td></td>
<td>Water networks Transformation</td>
<td>10%</td>
</tr>
<tr>
<td></td>
<td>Blockages</td>
<td>10%</td>
</tr>
<tr>
<td>Safe People</td>
<td>Safety – Lost time injuries reduction</td>
<td>10%</td>
</tr>
<tr>
<td></td>
<td>Safety – Strategic safety improvement assessment</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Culture – Improvement in H4U engagement score</td>
<td>10%</td>
</tr>
<tr>
<td>Financial</td>
<td>Group EBITDA (millions)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Gross OPEX annualised run rate achieved through actions taken by 31 March 2021</td>
<td>15%</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>100%</td>
</tr>
</tbody>
</table>
Our investment history

Average yearly investment in 2019/20 prices

Five years prior to privatisation

1989 – 2001

Post-privatisation – rebuilding infrastructure as Thames Water Plc (floated on the London Stock Exchange)

One of the key reasons the industry was privatised was to address the many years of underinvestment in water and wastewater infrastructure during public ownership. During this period, we constructed the Thames Water ring main and upgraded our major treatment works in London.

£357 million

The water industry was privatised in 1989

2001 – 2006

International expansion as part of RWE

After the German utility company, RWE, acquired Thames Water, we accelerated the rate of our international expansion. As part of this, we purchased the US’s largest privately owned water company, American Water Works.

£641 million

£730 million*

2006 – 2017

£1.1 billion

Focusing on the UK as part of the Kemble Group

After the Kemble Group, made up of national and international investors, bought Thames Water in 2006, all of our global interests were sold or closed. This allowed us to focus our attention on the UK.

£1.2 billion

2017 – present

Current ownership

Since 2017, new investors OMERS, USS and Wren House have, in aggregate, acquired over 51% of Thames Water. Our external shareholders agreed not to take dividends until at least 2020 with the focus being to improve performance for our customers.

*Investment in UK business