Thames Water

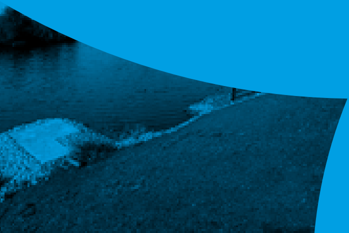
Here for you, in a changing world

Annual report and annual performance report 2017/18

Thames Water


Here for our 15 million customers



Welcome to our combined Annual report and annual performance report for 2017/18.

As a provider of essential services to over 15 million people, our report focuses on how we will deliver our vision for those at the heart of Thames Water, our customers, and is aimed at stakeholders who want to understand more about the way we operate the business.

As well as bringing the two reports into one, we've expanded the report to increase transparency and give our customers and stakeholders a better understanding of our performance and what drives our business decisions.

With a revised strategy in place we've also focused on individual employees, from our 6,245 people strong Thames Water family, who are helping deliver our strategic priorities for our customers and the environment.













Working together to build a better future

The purpose of this statement is to outline how, as the Board of Thames Water, we're committed to ensuring the Company is, and is recognised as, putting our customers at the heart of all our decisions now and in the future.

Our vision is to be **"Here for you, in a changing world"**. This means anticipating and delivering our customers' needs.

With a refreshed Board and Executive Team, we've spent a lot of time during the last 12 months clarifying what our vision means for our business and our customers, and we've been making changes to ensure this ambition is at the centre of our decision-making. We fully recognise the privilege of being a monopoly provider of essential services and the need to orientate ourselves around our customers.

We've redefined our strategic priorities and aspirations:

Be 'Here for you' – create lifelong customer advocates

Use technology to turn customer insight into action

Invest in resilient, proactively maintained digitised assets

Protecting the environment

A collaborative and capable team, dedicated to serving customers

For details of each of these priorities, and our aspirations associated with them, please see the strategy overview on page 16–17. To measure our performance against our aspirations we will use a combination of Net Promoter Scores, Environmental Performance Assessment (EPA) rating and customer and stakeholder endorsement.

Performance during the year

After extensive engagement with customers and our Customer Challenge Group (CCG), we set 55 performance commitments with Ofwat for this regulatory period. While there are areas where we are not delivering for customers, such as leakage and during periods of extreme weather, we have seen a solid performance this year. Of those commitments which attract a status for 2017/18, 59% are green, 19% are amber and 22% are red. More information about our performance against those that matter most to our customers can be found on pages 28–37 with further details in table 3A on pages 209–212. We're not just planning for the next regulatory period. Everything we're doing is designed to deliver our vision, to be **"Here for you, in a changing world"**.

Governance

During a time of unprecedented change, we, as a Board, need to be sure we are making the right decisions for our customers and the long-term sustainability of Thames Water. We're undergoing a major review of our governance to ensure it is best in class. To earn the respect of our customers, we are taking action to be very clear about the decisions we make, and increasing transparency is high on our agenda. We're simplifying our structure and closing our Cayman Islands subsidiaries is a significant step in this process.

+ **CFO review p58–63**

Stakeholder alignment with long-term aspirations

Whilst we focus on meeting the performance expectations of customers, investors support the Board's decision not to pay any dividends to external shareholders for the rest of the regulatory period, so the money they would have received can be reinvested.

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 vision. The Board is also mindful of the privilege of the Company's position as a monopoly provider of essential services and is developing a policy for 2020–2025 which goes beyond the principle of a typical commercial enterprise, to ensure the long-term financial viability of the business. The new policy will take into account:

- the payment of a proposed dividend should not impair the longer term financeability of the company's business
- the assessment of the impact that payment of the dividend may have on all stakeholders including employees, pension members and of course customers. This means the Board satisfying itself that Thames Water's social, financial and operational commitments to those stakeholders will not be compromised in the longer term by the payment of a dividend
- the Board should also be content that the company's financial performance, that 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
- how the overall combined interest costs on debt and dividend payments compare to the regulatory allowed cost of capital applied to the notional capital structure assumed by Ofwat, with any excess above this level triggering an assessment by the Board as to whether the additional returns result from performance that has benefited customers and may therefore reasonably be applied to finance a dividend.

Our CEO, Steve Robertson, has also agreed not to take any bonus payments until 2020, as a personal commitment to improving the performance of the business. He will only receive additional payments following the end of the regulatory period, if we meet our critical customer commitments.

Clockwise from top left:

Ian Marchant
Chairman

Dame Deirdre Hutton DBE
Independent Non-Executive Director

Brandon Rennet
Chief Financial Officer

Steve Robertson
Chief Executive Officer

Nick Land
Senior Independent Director

+ Full Board p84–87

We've changed the way we incentivise and reward our senior leaders too, to be directly aligned with our vision and what our customers value most. Further details of our revised policy can be found in our Remuneration Committee Report with details of how our performance for customers relates to rewards on pages 112–128.

When shareholder dividends are paid in the future, we will be clear about their level, how they relate to delivery for customers, and why they have been awarded. We will also set out how any dividend compares to the returns our shareholders would have received if our debt levels were lower.

+ CFO review p58–63

Refocusing the business

What we stand for hasn't always been clear, and after extensive research and analysis to understand what our customers want and need from their water and wastewater services company, we've crystallised our purpose – **"To build a better future for our customers, our region and our planet by caring for water, because without water there is no future"**. We've revised our brand values to make sure they reflect what matters to our customers so we're 'proactive and responsible', 'straight talking and inclusive', and 'positive and visible'.

Understanding our customers' voices

There's a common theme in all our activities – they are all grounded in extensive research and engagement with our customers and other stakeholders. And we've invested in our engagement programme to ensure we communicate with our customers via the channels of their choice – recognising our customers are all individuals with individual needs and preferences. We've bolstered our social media capabilities significantly during the last 12 months, offering a 24/7 service aligned with our operations as more customers embrace digital channels. We're in constant conversation with our customers by phone, focus groups, road shows, web chat, mail and text message too. As well as meeting the CCG, as a Board we host an annual stakeholder review, to hear the concerns of our stakeholders directly. There's more information about our comprehensive engagement programme on page 42–45 of this report.

To fulfil our vision we are committed to using the customer insight and data from our engagement to inform our business decisions. We've learned from the past and we're using this insight to shape our future, which means **data – information – insight – action** has become our mantra, driving us to continually innovate to meet customers' needs.

In a changing world, these needs continually evolve which is why our customer engagement programme is critical to the success of our plans. With open, ongoing, two-way dialogue, we can use insight to adapt our plans to respond to the challenges and needs of our customers and our region. We are committed to and confident that this approach will ensure customers are at the heart of our decision making processes, so that Thames Water is recognised in everything that it does as being **Here for you, in a changing world**.

A snapshot of our performance

Improving service and increasing investment given highest priority

- Underlying profits (excluding profit on sale of retail non-household business) down as investment is priority
- Maintained high level of investment – £13 billion invested in last 13 years
- External shareholder dividends foregone until 2020
- CEO bonus deferred until 2020, and dependent on meeting challenging customer commitments

On the road to operational recovery, but it will take time

- While leakage is up on last year, on track with recovery plan to meet target for 2019/20
- Applying learnings from 'Beast from the East'

Doing the right thing to position us for the long-term

- Revised internal structure, strategy, Board and supply chain to put customers at the centre of the business
- Following receipt of approvals we are closing Cayman subsidiaries
- Governance review well underway working towards a majority of INEDs

Total revenue
£2.0bn
2016/17: £2.1bn

Credit rating
Baa1 negative
2017: Baa1 stable
Corporate family rating

Reduction in lost-time injuries
33%

Leakage
695 Ml/d
2016/17: 677 Ml/d

Ofwat customer satisfaction rating (out of 5)
4.17
2016/17: 4.12

Investment in our assets
£1.1bn
2016/17: £1.1bn

Reduction in pollution incidents
7%

Water quality
99.96%
2017: 99.96%

Household written complaints resolved first time
95.2%
2016/17: 94.35%

Underlying profit before tax (excluding sale of NHH)
£34.6m
2016/17: £38.1m

Mains rehabilitated
143km
2016/17: 103km

Electricity generated from sewage
286 GWh
2016/17: 267 GWh

Each performance commitment is allocated a reference code, for example WC2 for leakage.

My Thames Water journey so far

Chairman
Ian Marchant

In my mind our goal is simple. We need to focus on what we're here to do, and to do it well.

Above: Meeting the team at Coppermills water treatment works

When I was first approached about joining Thames Water, I was hesitant. My impression of the Company indicated there were lots of issues and I was concerned that there might be an attitude of complacency. However, when I started engaging with people at Thames, I was impressed by the determination to turn over a new leaf and I can now say I'm delighted to be Chairman. There's a strong feeling that everyone; the Board, Executive team, employees and investors are committed to making Thames Water a Company we can all be proud of.

There's been a 47% change in ownership since May 2017. This injection of new investors and their clear alignment with our long-term plans was one of the things that encouraged me to become Chairman. With the rest of the shareholders, they are supportive of the changes that are needed to deliver more for customers. As evidence of that support they are foregoing a dividend this year (2017/18), and have accepted that they will not receive one for the rest of the regulatory period (2015–2020). This is allowing us to continue to invest to tackle both short term issues and to improve performance over the long term. During the last 12 months we have spent over £2 billion operating and investing in our business to serve our customers and manage our assets.

Since starting the role in January, I've seen more evidence of the determination of everyone at Thames. It's based on the reality that things haven't gone as well as planned in recent years and that we need to rebuild trust with all stakeholders. In my mind our goal is simple. We need to focus on what we're here to do, and to do it well. We exist to provide our customers with reliable and high quality water and wastewater services and we've made important progress since privatisation, but recognise we have the need and opportunity to do more.

I've been meeting people from across the business and have been impressed with the work they are doing, including driving important changes in innovation, customer service and our incident response. However, there is so much more to do as we tackle our high level of leakage and the disruption caused by mains bursts and sewer flooding. The importance of what we do was brought into sharp focus when the 'Beast from the East' hit. Although only a small proportion of our customers were directly affected we know we must do better to ensure adequate resilience in our water supply. We know our leakage performance let customers down and on top of £55 million of automatic penalties, we put forward a package of measures, including a further £65 million, with our customers benefiting from rebates on bills until 2025.

A customer focused structure

To give our customers what they want and deserve, we need to bring our operations into the 21st century and make sure our ageing network can cope with both what is demanded today and in the years ahead. One of my earliest tasks was to help the Executive team finalise a restructuring of the business to break down the barriers between individual water, wastewater and retail businesses, and form 'One Thames Water'. It was absolutely the right thing to do as it puts customers at the heart of the business, brings greater control and simplicity to how we operate and encourages more collaboration in the way we do things. Our structure now better reflects how our customers see and experience us as a business. From this platform we can now drive greater innovation. With that in mind, the digitalisation of our network is another important part of our huge investment plan. It will help us understand where we need to focus our efforts to ensure resilience.

Governance review

When I accepted the role, I was clear that one of my first tasks as Chairman would be to undertake a thorough review of our governance to ensure 'best in class' standards. The Board and investors are committed to this and have demonstrated willingness every step of the way. We need to be set up right to do the best for customers and we're already making progress. We've updated the terms of reference for our committees, clarified and brought up-to-date the relationship between the Board and shareholders, and we're restructuring the Board. We have appointed a leading search firm to help us find new Independent Non-Executive Directors (INEDs) both to refresh our Board and to ensure that we will have a majority of INEDs when the review is complete. As part of that, today we've announced the appointment in 2018/19 of Alistair Buchanan, former CEO of Ofgem for ten years, as a new INED in July. To increase separation between the Boards, I am the Independent Chairman of Thames Water Utilities Limited, the operating company, but not Kemble Water Holdings Limited, the ultimate parent company.

I also insisted that we needed to improve the transparency of how we operate and report. The first stage of that is the closure of our Cayman Islands financing companies and I'm pleased that we have now received approvals to close them. With rebuilding trust being so important to our new chapter, we're also committed to increasing the clarity and openness of our communications and reporting. I hope you can see that here in this combined Annual Report and Annual Performance Report. We have also set out a new and clear approach to setting dividends which, for the first time, sets out the clear importance of financial resilience and how we will ensure that customers' interests are fully considered.

Planning for the future

Planning for the long-term future is crucial for a company like ours. While we're working hard to fix the basics, to make sure we're doing things right for our customers now, we've been spending a lot of time working on our plans for 2020–2025 and beyond. We need to make sure everything is brought together around what's right for the customer and we've spoken to over 20,000 of them to understand what they want. As well as being grounded in what customers want, our plans for the next regulatory period are based on improved efficiency of our base operations and address the need to improve the resilience of both our networks and the availability of water itself. Intense storms, drought, and other effects of climate change will have an impact on the way we run our operations.

I have found my first six months at Thames Water absolutely fascinating. I've learned so much, visited impressive facilities and met so many committed and talented people. Our challenge in years ahead is to make sure that commitment and talent is always deployed in the interests of our customers and I look forward to playing a part in that journey.

Ian Marchant
Chairman

27 June 2018

A customer centric strategy

Chief Executive Officer
Steve Robertson

The water industry is unique.

Our customers actively participate in the water cycle we facilitate, in a symbiotic and personal relationship. In a cyclical process, they consume our product, and we remove their waste – we wouldn't exist without them and we rely on the money from their bills to run our operations. Our thousands of employees participate too – whether it's at work or in their homes.

Fundamentally we're a customer service and environmental protection company. We need to drive the water cycle in a way that is kind to the environment as we rely so heavily on environmental resources.

If we don't respect the environment, we won't be able to provide sustainable water and wastewater services for our customers now and in the future.

We deliver, on average, 2.7 billion litres of world-class drinking water direct to our customers' homes every single day of the year. In many countries you wouldn't drink the tap water, yet access to clean and safe drinking water is something we take for granted in the UK. And it's something we want to continue. As a company, we must never become complacent, and we're devoting ever more resources to ensuring our water continues to be of leading quality.

How would you summarise the last year?

Thames is a very different company to 18 months ago. And we are very aware of where we are, and what we need to achieve.

In the midst of a period of unprecedented change – with new shareholders, a new Chairman and changes to the executive team – 2017/18 has seen us thinking about our business through the eyes of our customers. As a result we've been aligning everything – our structure, our supply partnerships, our Board, our brand purpose and our strategy – to get us into the best place to deliver our longer-term vision – to be 'Here for you, in a changing world'. Our new chapter is very much the customers' chapter, and we're all committed to improving our service to them. We all know this is not a time for paying external shareholders a dividend – it's about making sure we're doing the right thing for our customers and setting ourselves up so everyone benefits in the longer-term. When our customers benefit, we and our shareholders will benefit too.

What have you been doing to tackle the challenges?

While there's no denying there have been challenges during the year, we've been making a positive difference in many areas of the business. For instance, we've continued to reduce pollutions and self-generated more electricity than ever, reducing our impact on the environment and reducing energy costs. Our water quality continues to be exceptional and we're continuing our strong performance in health and safety.

Our water network has failed some of our customers in recent years. While a small percentage of customers have been affected, every individual matters to us and we need to fix it. We're learning from the past and making sure we use insight to deliver a better performance for customers in the future. After a series of bursts between October and December 2016, I commissioned an independent report into the condition of our trunk mains, and we've been taking action as a result of the findings. And we learned important lessons in March about how we can support our customers and respond more efficiently, when climate change has an impact on our network and customer pipes (see page 10).

Reducing leakage significantly is still a massive task given the size, age, location and complexity of our network, but I'm pleased to see us starting to make a difference. We're completing 1,000 leakage jobs a week, our best performance since 2011, and that's testament to our new approach and the collaborative effort of the team at Thames. Our recovery plan is designed to get us back on track by 2020 and we beat the recovery plan target we set for ourselves this year. While there's a lot to do to achieve our longer-term goal we're confident we're going in the right direction.

One of the themes of the last year has been to focus on fixing the basics, so we're in a better position to deliver our strategic priorities. We've been investing heavily in our IT, to improve stability and reduce disruption to customers, and we've also been clearing backlogs of queries in the last year. Whilst they should never have been there in the first place, reducing a backlog means we can now focus on being much more proactive in our approach to improving customer service.

Although the speed of improvement has been hampered by a number of things including operational incidents during the year, our customer satisfaction scores continue to follow an upwards trajectory and our second stage household complaints are down 19% from last year as we focus on resolution for our customers. To us, it's not just about chasing targets – we're looking at improving customer experience in the round to make sure we do the right thing and every single customer is looked after. We still have lots of work to do, but we're pleased with the improvements we're making and foundations we are putting in place.

We tried an innovative alliance model for reducing leakage, but it meant we had less control over day-to-day operational work. It led to us missing our leakage target for 2016/17 and we've made changes to bring leakage management back into Thames Water. And we've applied similar thinking across all areas of the business. We've brought more resources in house, increasing recruitment in critical areas to ensure we're appropriately resourced to deliver for customers. This has had a positive impact on the local economy with an extra 267 people working in Thames compared to last year. The restructure of our business will also ensure more collaboration as we tackle our challenges and deliver more for customers.

Tell us about profits for the year?

If you take off the profit from the sale of our non household business to Castle Water, our underlying profit before tax was £34.6 million. This year has been about investing in customer service and operations to improve our performance. As part of that we've seen an increase in personnel costs as we bring more people into the business to deliver our vision. We've also increased our IT spend to improve the resilience of our business and enable us to be smarter in the way we work.

Our five strategic priorities

Over the last 12 months we have engaged our stakeholders. Their views have helped us develop our new strategy, which marks a new chapter for Thames Water.

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Protecting the environment

A collaborative and capable team, dedicated to serving customers

+ Read more p16–17

Fundamentally, we're a customer service and environmental protection company. We need to drive the water cycle in a way that is kind to the environment as we rely so heavily on environmental resources.

How are you investing in the future of the business?

We invested around £1 billion in our network again this year, meaning we've invested £13 billion in the last 13 years.

Water isn't a trend. Our product will never go out of fashion. The customers of tomorrow are relying on us to make sure the network can stand the test of time. So it's our responsibility to help make sure we invest in the right way to secure the future. We also need to balance investment with affordability, so we can't do everything we want to do right now. That's why we've increased our focus to make sure we invest in a more efficient way and we're being more proactive in the maintenance of our network to ensure its longevity.

We're investing to fix the basics, to make sure our existing equipment is more resilient. We increased our spend at our wastewater sites by £40 million to make sure everything is working as it should. It's helped drive further improvements in our performance, including sewage treatment works discharge compliance. We've also increased our investment in our largest water mains by nearly £100 million this regulatory period to improve resilience and protect our customers from the devastating effects of flooding.

Alongside all of our network and asset investment, one of our key priorities is to improve the way we support our customers and we are now at a crucial stage in the development of our new £150 million billing and customer service platform – when completed it will enable us to significantly improve the way we support our customers.

The Thames Tideway Tunnel is a landmark project that will drastically improve the health of the River Thames and update London's sewer network for the population of today, tomorrow and many years into the future. While the tunnel itself is being constructed by an independent company, known to the public as Tideway, we're responsible for connecting the tunnel to our existing network. With London in our catchment, population growth is something that will always have an impact on our network, and we've been updating our infrastructure to cope with increased demand – as well as facilitating the Thames Tideway Tunnel through our connecting works and upgrades of sewage treatment works, we're investing in innovation, such as smart bugs (page 41), to help our network cope with the population explosion across our entire region.

Above: Steve at the River Kennet, one of only around 200 chalk streams in the world, with river keeper John Hounslow.

How integral is health and safety?

In a business like Thames Water, the health, safety and well-being of our employees and those in the communities we serve is of utmost importance. Without our people we couldn't deliver our vision or strategic priorities for our customers and the environment around us. We've made a step change in our performance in recent years after adopting a zero tolerance approach. As well as physical safety and well-being, we've increased our focus on mental well-being during the last year, to reduce the stigma and support our employees, with 507 employees taking part in our MindFit mental health awareness programme during the year.

How important is customer engagement?

Customer engagement underpins everything we do. We listen to and engage with our customers every day. The rise of social media has meant we've become smarter at how we do this, but other methods of engagement are equally important. Our job is to use our know-how to translate the insight into what we need to do to deliver them an improved service. And we're using technology and innovation to help.

As we look to develop our strategy and long-term plans, we've been engaging with thousands of customers to understand what their needs are and what they want from us. We know, for example, affordability and security of their water supply are some of the things that matter most. And that's informing our PR19 business plan for 2020–2025, and our Water Resources Management Plan.

Our independent Customer Challenge Group (CCG) provides important challenge to our decisions, and provides a sounding board as we integrate our customer views into business decisions. You'll see more from Anne Heal, the Chair of the CCG, in this report on pages 38–39, with Sir Tony Redmond, Chair of the Finance Sub-committee interviewing Brandon, our CFO, on pages 59–60.

What have you been doing to help customers?

We look after over 15 million customers – each with individual needs – and every single one of them is important to us. It's our duty to make sure they receive a good quality product and service. While our customers have individual relationships with our services, none of them can live without us.

Our customer base is diverse, with customers in differing financial and physical circumstances and with London in our catchment, many of our customers also don't have English as a first language. Many customers in our region find themselves in vulnerable circumstances and need additional help to access our services, for example when they have a query or if their water supplies are interrupted. Our ambition is to raise awareness of our priority services and double the number of customers who are registered to receive them by

2020. We expect this number to grow four fold by 2025 as we work together with energy companies and the 'third sector' to introduce new services. We're also supporting more of our customers with their water debt through our customer assistance fund, helping 7,500 customers in 2017/18, a 20% year-on-year increase. Supporting our customers to remain debt free not only helps those customers, but also those around them, so we're offering more all-round debt support.

Q What role does technology play in a company like Thames?

We're living in the technological age, and embracing it is crucial to delivering for our customers and the environment. We have 19th century pipes and treatment works, and 20th century technology. While much of it is still in good working order, we're bringing it all into the 21st century to reflect the wants and needs of today's world. To improve our service to customers, we need to give our customers what they want and how they want it. Technology and innovation touch all areas of our business – from network monitoring, to digital communications, to predicting the impact of weather – and they are critical drivers in us delivering all our strategic priorities.

Q What are 'smarter water catchments'?

We've got a long history of projects that tackle problems at source, but 'catchment management' can – and must – make a much bigger impact if we are going to manage population growth and climate change; reduce our impact on the environment and give customers better value for money.

Our 'Smarter Water Catchments' initiative sets out a step change in our level of ambition and investment, and includes some genuinely innovative and ground-breaking projects, including a major scheme in west London that will really challenge the conventional association of catchment management with rural areas.

The biggest change we're making, though, is going beyond the historic approach of projects that address just one problem, such as pesticides or flooding. Instead we're working with partner organisations to tackle multiple challenges together, delivering greater benefits and better value. And the potential benefits are really exciting – as well as improving the quality of river water and reducing flooding risk, these projects can benefit wildlife, create green spaces that improve local amenities and provide mental health and well-being benefits for our customers.

Q What do you think about all the criticism Thames has had in recent months and years?

Our customers deserve and expect a reliable and worry-free service that delivers for them 24 hours a day, 365 days a year. It's so important to them that when things go wrong we rightly come under scrutiny. It's something we welcome. When we get things wrong, we should expect criticism and be open and honest about what happened. In the past we have been criticised about that and it's something I am passionate about changing. We also need to make sure we learn from times when we could do better – whether it's failing to meet our leakage target, meeting the challenges of the 'Beast from the East' or any other major incident.

One good example of this is how we've turned around our pollutions performance since those incidents in 2012–2014, for which we paid the price – we've seen a 37% reduction in the last three years and we will continue to focus on making things better every year. I'm confident we'll be able to perform much better with leakage too. I can't promise it's going to be quick and that there won't be stumbling blocks along the way, but I'm confident we're on the right track to deliver our long-term goals.

Steve Robertson
Chief Executive Officer

27 June 2018

Executive Team

Our Executive Team is responsible for the day-to-day running of our business. As at 27 June 2018, it consists of the CEO, the CFO, the Director of Strategy & Regulation, and seven functional directors.

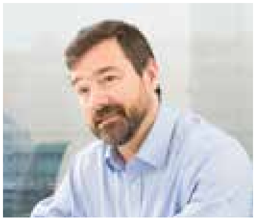
+ See biographies p88

Richard Aylard CVO
External Affairs & Sustainability Director

John Beaumont
Chief Digital Officer

Janet Burr
Human Resources Director

Nick Fincham
Director of Strategy & Regulation



Lawrence Gosden
Chief Operating Officer

Kelly Macfarlane
Director, Customer Experience

Sarah McMath
Director, Strategic Planning & Investment

Brandon Rennet
Chief Financial Officer

Steve Robertson
Chief Executive Officer

Steve Spencer
Chief Delivery Officer

Meeting the challenges of the water network

c.£140m to be invested in leakage during rest of regulatory period

80 years is the average age of our pipes

1,000 leakage repairs being completed every week

Tackling leakage

Reducing leakage is one of our greatest priorities.

Leaking water from our network is unacceptable and inefficient, and reducing leakage is one of our greatest priorities.

Being the custodian of London's water supply is both a unique honour and a challenge. With 34% of our pipes being over 100 years old and an average pipe age of 80 years, we have the oldest network in the UK and much of it is also intertwined with other utility pipes buried deep beneath the streets of the capital. 67% of leaks on our network of 31,000km water pipes are under London, the majority of which never reach the surface making it more difficult to locate them. Many of them cannot be accessed without causing significant disruption to those trying to go about their daily lives above ground.

Our leakage performance

After beating our leakage target for ten years in a row, we missed it in 2016/17 and we know the condition of our network has been failing some of our customers. We welcome the conclusion of Ofwat's investigation into our leakage performance, with all our customers benefiting from reductions on their bills until 2025 – with £55 million of automatic penalties, combined with the £65 million we have put forward to compensate for our performance, a total of £120 million will be returned to our customers.

In 2015 we developed an innovative model with our infrastructure partners, which outsourced leakage detection and repair. However, this was ineffective and led to us completing fewer repairs than were necessary to meet our 2016/17 target. Following our disappointing performance that year we put a structured recovery plan in place to bring performance back to our target performance level of 606Ml/d in 2020, backed with an extra circa £140 million investment. With the backlog from 2016/17, combined with new leaks appearing each year, we knew we wouldn't be able to catch up and get back on track with our target until 2020. With this in mind, we haven't met the regulatory target for this year, with leakage up on last year at 695Ml/d and we won't meet it next year either, however we are on track to meet our 2019/2020 regulatory target. We incurred a penalty of £13.1 million for our 2017/18 performance which is included in the £120 million being returned to customers.

Despite missing this year's target, we have been increasing the speed of our operational response to leaks, with our best 'find and fix' leakage repair rate since 2011/12.

St John's Wood circa1900 34% of our pipes are over 100 years old. While many of them are still in good working order, the size and age of our network provides a unique challenge.

Acoustic loggers c.20,000 of the 26,000 loggers have been installed during 2017/18 to help us use data to inform our leakage activities

We are now completing an average of 1,000 leakage repairs every week. With over 25% of leaks on customer pipes, we're also helping customers by fixing these leaks for free. During 2017/18 we repaired 3,424 leaks on top of the target of 1,410 (performance commitment WA5 – see table 3A on page 209).

The problems our customers experienced in March during the 'Beast from the East' had a negative impact on our leakage performance putting us back a few steps from where we wanted to be, however we are still on track to meet our target for 2020.

WC2: Leakage 695Ml/d (2016/17: 677Ml/d)

+ Read more on p28

Our aspiration is to bring leakage down by a further 15% during the next regulatory period (2020–2025) and to halve it in the longer term, and we've changed our approach to lay the right groundwork to achieve this.

Changes in our approach

With cost and disruption limitations we know we can't eliminate leaks overnight, but we're being smarter in our approach to leakage reduction to ensure we maximise the benefits of our investment and deliver more for customers over the long-term.

To make sure we have more 'real-time' control over leakage, we've brought important capabilities, such as leakage management, back in house.

We've been investing in new technology such as 26,000 acoustic loggers, which locate leaks through sound waves; smart meters, which can detect continual use at a customer's property; data analytics; and work management systems. These have improved our ability to use data about our network to inform our leakage activities, meaning we've been much more targeted in our replacement work.

You'll see the number of Thames Water employees has increased this year – partly because we've brought resources in-house, but we've also recruited more skilled front-line people to complement field teams and analysts who provide valuable insights harvested from our data.

Connecting to our network without permission is illegal, unfair on customers who pay their bills and also has an impact on our leakage calculation. In the interests of all our stakeholders, we've increased resources to tackle the problem in recent years and we've seen a 25% rise in investigations since 2016/17.

Join our journey

To help our customers and stakeholders follow our leakage reduction journey, and understand our performance, we're now publishing monthly leakage reports on our website.

While we know we have a way to go, we're confident we're on the right path to achieve our long-term leakage aspirations and that our focused investment will deliver more for customers.

Beast from the East

March 2018 saw weather have the most severe impact in living memory on our network and customers.

A prolonged period of sub-zero temperatures, followed by an extremely rapid thaw resulted in a dramatic loss of water for us and other water companies in England and Wales in March 2018.

The severity of the impact on customers was huge, between 2 and 3 March demand in London and the Thames Valley increased by c.270 Ml/d. More than 70% of that was caused by burst pipes on customer and business premises.

Although we had made plans for the terrible weather, the impact of sheer rapidity of the thaw caught us by surprise.

Thames Water employees responded to the challenging conditions admirably and worked tirelessly to restore supplies. This continued after the incident to make sure all the customers affected were compensated.

On the operational side we produced an extra 400 million litres of water a day to meet demand – that's an increase of 15%.

Our investment in the London ring main, which allows us to shift water around the capital quickly, also helped protect hundreds of thousands of customers from possible disruption and the speed of our recovery was notable.

Of course that was no consolation to the properties that were affected. In total, customers were affected by 62,289 supply interruptions of more than four hours (c.1.63% of total customers) of which 11,284 lasted more than 12 hours (c.0.29% of total customers).

We're really sorry we could not protect those customers affected and we have compensated them at a level considerably higher than the statutory rate.

The most important thing that has emerged from the incident is the lessons we've learned and the actions we can take to improve our response in the future. We realised there was a gap in our ability to identify the difference between problems on customer pipes and those on our own network. We also know we cannot underestimate the impact of climate change on our operations and we need to be better at forecasting the impact of weather on our network. Our incident management, communications with our customers and how we distribute bottled water are also areas where we can improve.

We have completed a thorough root cause analysis and will use the insight that delivers to implement further improvements. Ofwat's report – which covers all the companies affected – published in June 2018, entitled 'Out in the Cold', confirms that we are focusing on the right areas.

We are committed to working with the regulator and all stakeholders to make sure we act on all of those lessons to protect our customers better in the future.

We will submit a detailed, externally assured, action plan setting out how we are addressing the issues identified to Ofwat by 28 September.

Improving our incident response to be 'here for customers'.

We know we've not always been 'here for customers' during emergencies and we've been making changes to the way we support them. Following a series of bursts in late 2016, we launched a 24/7 social media service to reflect our 'round-the-clock' operations to make sure we're always 'here for customers' when they need us. To accommodate our exponential social media growth, we've invested in a more intelligent and resilient platform, as well as new research tools to give us the know-how to act when and how our customers need us to.

Recognising the lack of continuity in our care in the past and the need to be with our customers on their entire journey back to normality, we have a new team of in-house face-to-face customer care managers to support our customers every step of the way. Our Customer Reps have attended over 1,000 incidents over the last year, offering support and advice. We're also working hard, collaborating with our peers and the energy sector, to increase the number of people on our priority services register, so we can fully understand who needs extra help in an emergency.

We have seen noticeable improvements in our customer communications. However, the impact of the 'Beast from the East' highlighted our vulnerability during widespread, enduring incidents. We saw a huge increase in the number of customers contacting us, with an 11-fold increase in customers calling and a 12-fold increase in those contacting us through social media. With such an immediate surge in volumes of contacts we were not able to be here for every customer and in order to improve our performance during critical events we have developed our digital response. We proactively publish and signpost content on our website creating dedicated pages to provide customers with a single destination for incident related information and to advise customers on what to do when disruption is anticipated. During localised incidents, we also use our text messaging and social media platforms to provide real-time updates.

Minimising supply interruptions

The water incidents of 2017/18 have had an impact on a number of our performance commitments to customers, including our measure to reduce supply interruptions of four hours or more (WB5). With 0.21 hours per property we incurred a penalty of £10.7 million. Our performance in reducing supply interruptions of 12 hours or more, a submeasure of our 'asset health for below ground water' performance commitment (WB1) led to our performance for this measure being rated as marginal.

Performance commitment WB1 relates to the condition of our pipes underground. It also includes our performance in minimising chronic low water pressure (WB4) and the number of burst pipes – we received a penalty of £4.7 million for 2017/18. As well as the March bursts, two significant bursts near Hammersmith in January also had an impact on this measure. We ended the year with 23,457 properties affected for 12 hours or more, compared to 6,051 in 2016/17.

Given the balance between affordability, minimising disruption and the need for investment, it's not possible to replace all of our water mains, but we've accelerated our mains replacement programme in recent years to repair the pipes considered most at risk. To replace 1km of pipe it costs £363,000 in materials, labour and traffic disruption, and takes 7,025 working hours. Although the March events delayed some mains replacement works, we rehabilitated 143 km of water mains during 2017/18, a 40km increase on 2016/17. During the rest of this regulatory period we plan to rehabilitate a further 338 km of pipes, enough to stretch between London and Newcastle.

We also replaced 7,591 individual lead pipes during 2017/18, five times more than last year (2016/17: 1,483).

WB1: Below ground asset health – marginal

WB5: Supply interruptions of more than four hours – 0.21 hours

WB4: Properties experiencing chronic low water pressure – 206

+ Read more in the performance dashboard starting on p28

338km of mains to be rehabilitated before 2020

143km of water mains rehabilitated in 2017/18

7,591 lead water pipes replaced in 2017/18

Creating and sustaining long-term value

We're proud to serve over 15 million customers making us the largest water and wastewater services provider in the UK.

We provide clean and safe drinking water, and environmentally responsible wastewater treatment to our customers every day.

Our service is one of the building blocks of a healthy and prosperous society, both now and in the future. What we do is essential, and the way we do it is incredibly important.

Our resources and relationships

Our people
Our employees, suppliers and their know-how

6,245

people are employed by us (at 31 March 2018) and we work in partnership with many more

Financial
Revenue and investment.

£2.0 billion

in revenue in 2017/18

£2.2 billion

spent on investment and operations

Water
Abstracted from rivers and aquifers for treatment and supply

2.7 billion litres

of high quality drinking water supplied every day to our customers

Wastewater
Collected, treated and safely returned to the water cycle or used to generate energy to power our operations and reduce energy costs

4.4 billion litres

of wastewater treated at our water recycling centres every day

Our land and property
Needed to collect, treat and return water to the environment, and also rich in wildlife and recreational opportunities

97

water treatment works

351

sewage treatment works

How our water cycle works

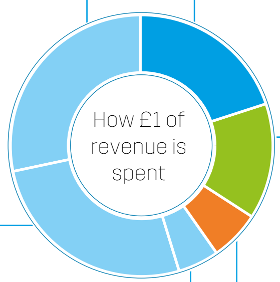
How we generate revenue

In a monopoly sector like the water industry it's our economic regulator, Ofwat, which provides an alternative to competition, driving performance and delivery, and sets limits on the prices we can charge. We're currently working on our next price review, PR19, which will set our bills for the five years from 2020–2025.

Re-investing for the long-term

For the last 13 years we've been investing, on average, more than £1 billion a year in our network. Our 2017/18 profits, after taking into account distributions made to service group debt obligations and working capital requirements, are being reinvested into the business.

The value we create for our stakeholders



60p
Customers (and suppliers)

28p – Operational expenditure

As well as supplying world-class drinking water to our customers every day, and removing wastewater, we're spending money to improve our service to customers. Our customers currently benefit from the second lowest combined bill in England and Wales (2018/19).

26p – Investment in our infrastructure.

We're generating value for customers and future generations by investing heavily in our business to ensure a resilient network for many years to come.

1p of this is passed to Tideway, the independent company responsible for the construction of the Thames Tideway Tunnel.

5p – Energy to power operations

Combining wind and solar power with electricity generated from sewage, we generated 293 GWh of energy in 2017/18, more than one fifth of our total requirements and equivalent to £30 million a year in energy costs. It also reduced our greenhouse gas emissions by 112.6 $kTCO_2e$.

1p net profit which is reinvested

Shareholders

Our shareholders have agreed not to receive dividends until at least the end of this regulatory period, so the money can be reinvested in the business to secure a better future.

20p
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.

14p
Our people

Our people include customer service agents, engineers, water scientists and archeologists to deliver for our customers and the environment.

6p
Government

We paid £192 million in business rates, PAYE and national insurance contributions in 2017/18, which help fund those vital public services we all rely on. We incurred £138 million directly and collected £54 million on behalf of our employees. 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. For more details see page 59.

Addressing our biggest opportunities and challenges

Our five Strategic Priorities

- Be 'Here for you' – create lifelong customer advocates
- Use technology to turn customer insight into action
- Invest in resilient, proactively maintained digitised assets
- Protecting the environment
- A collaborative and capable team, dedicated to serving customers

With

15 million

customers we serve about 25% of the population of England and Wales.

Providing almost

1/3

of the 9 billion litres of water used by people and businesses in the UK each day.

Affordability and customer expectations

Wage growth in the UK has not kept pace with inflation, with the average weekly earnings for employees in real terms falling by 0.2% in the year to November 2017. Brexit is creating financial uncertainty, which may be lowering the rate of corporate investment in the UK.

While employment in the UK is at record levels, the structure of employment is changing, for example with the rise of the 'gig economy', which can result in less predictability and greater volatility in customers' incomes.

The opportunity

- Using insight from our extensive customer engagement programme, we know affordability is one of the biggest concerns our customers have. We must address the fine balance between customer bill affordability and the need to invest in our infrastructure to ensure a resilient network.

Link to strategic priorities

+ Read more p16–17

Market and regulatory changes

Economic regulation of the water industry has evolved to become increasingly focussed on delivering the right outcomes for customers and the environment. The forthcoming price review, PR19, builds on this approach and challenges companies to develop more innovative and ambitious business plans that will deliver better customer service, more resilient services, while ensuring affordable bills.

The opportunity

- The water industry faces significant challenges from climate change and population growth. The introduction of new competitive markets in water resources, bioresources and direct procurement provides greater opportunities for cooperation with third parties to develop innovative solutions to these challenges, and will help us deliver resilient and affordable services to our customers and the environment in the long-term. Additionally, recent proposals to bring the "sector in balance" create an opportunity to strengthen our customers' trust and confidence in us and the whole water sector. We support Ofwat's principles to put the sector back in balance and we are engaging with Ofwat on how best to implement them.

Link to strategic priorities

+ Read more p16–17

Climate-driven change and environmental protection

We depend on the natural environment's precious resources to deliver our services and everything we do has an impact on it. It's our responsibility to help protect it.

By 2100, the picture becomes more uncertain with forecasts showing an 8% rise on summer mean temperature and more than a 50% rise in winter rainfall compared to today.

Media sources state the UK alone will use 10.8 billion wet wipes this year. Combined with fat, oil and grease, they can cause sewer blockages and sewer flooding.

The opportunity

- Climate change will have an impact on the long-term provision of water and wastewater services across the UK, so this trend encourages stakeholder collaboration and a dynamic approach to resilience in the face of unpredictable change.
- We're aware of our position in society and we have the opportunity to inform public opinion about flushing habits and the environmental damage caused by wet wipes.
- Sewage is a valuable asset which can deliver huge benefits to the environment as a source of renewable energy and drive efficiency in our operations.
- Protection of rare ecosystems requires close liaison with local stakeholders and encourages a wider catchment approach to environmental protection.

Link to strategic priorities

+ **Read more p16–17**

Population growth and urbanisation

The population of our region is predicted to grow by 2 million by 2045 putting increasing pressure on land, infrastructure and resources.

Urban development in our region, particularly in the capital, reduces the ability for water to drain away, with an increase in storms and floods due to climate change exacerbating the problem.

The opportunity

- With the UK's capital city in our catchment, population growth and urbanisation will always have an impact on our business. We must work with the other custodians of London and the Thames Valley to innovate for the future, enabling a finite geographical area to deal with increasing pressures.

Link to strategic priorities

+ **Read more p16–17**

Technology

Research suggests 85% of adults in the UK own a smart phone and a 21st century audience expects a 21st century service. Our increasingly connected customers also want to use digital tools to monitor their consumption, to put them more in control of their water use.

The UK is facing a significant skills shortage in STEM (science, technology, engineering and mathematics) subjects and the effects of this could be felt acutely in the water sector, as it relies on scientific and technical skills and experience.

The opportunity

- Digitalisation is a critical enabler in the delivery of our performance commitments. Embracing appropriate technology to monitor our network creates insight which can be converted into action to drive efficiency in our operations. The advent of new technology can be exploited to drive efficiency, while managing any anticipated risks including privacy and job security.
- The rapid rise in technology means the way our customers choose to contact us is evolving.
- Given the speed of technological innovation and development, we can leverage the skills of a 'tech-savvy' generation to drive improvements in our service.

Link to strategic priorities

+ **Read more p16–17**

A new chapter for Thames Water

Here for you, in a changing world is our vision.

Without our customers we wouldn't exist, which is why our strategy is all about delivering for them.

Read more about our principal risks and uncertainties p72

Be 'Here for you' – create lifelong customer advocates

Progress in 2017/18

- Making it easier for customers to contact us how and when they want to by investing in website improvements, webchat functionality and a new social media tool to improve our speed and quality of responses to customers
- Improvements in Ofwat service measures – the Service Incentive Mechanism (SIM) and Customer Satisfaction (CSAT) score, and 4% reduction in household complaints
- 18,000 more customers in receipt of social tariff and increased referrals to debt counselling support partners and Citizens Advice Bureau
- Helped 7,500 customers through customer assistance fund
- Increased our priority service customer support register to 60,000, working with partners including Age UK and piloting an innovative multi-utility sign up service
- Improving incident response capability, with dedicated support for priority services customers and new 'on the ground' customer service representatives, mobile support vehicles and targeted communications
- Innovative customer and media engagement including our Whitechapel 'fight the fatberg' campaign, water efficient garden and tap water bar at the RHS Chelsea Flower Show and opening of Walthamstow Wetlands

Priorities

- Double our priority service customer support register by 2020
- Provide dedicated and face-to-face customer support during and after incidents until a return to normality
- Launch an innovative online community to host and facilitate conversations between customers on key topics to reflect what matters to them, to continually enhance our customer insight
- Utilise mutually beneficial partnerships to improve the scope and scale of our customer support offering, working with partners such as Age UK and the Fire and Rescue Service
- Launch a new contact centre platform to improve operational resilience and the effectiveness and efficiency of resolving customer queries
- Use smart technology, enabled by investment in our metering programme, to proactively identify consumption related bill queries and help customers understand their usage

Read more about our strategy in action p18

KPI

60,000 on priority services register

95% first time resolution of household complaints

Use technology to turn customer insight into action

Progress in 2017/18

- Progress in building modern, robust and secure technology capabilities.
- Investing in 26,000 acoustic loggers to detect leaks and 'virtual' network blockage alarms to target sewer cleaning with 20,000 installed during the year
- Using new tools to better understand social media data to be able to respond to customers more effectively
- Smart meters installed to help with leak reduction and encourage water efficiency

Priorities

- Increase capability to allow quicker deployment of new technology to improve service to customers
- Build new field force management technology to allow us to get the right team to the right job, and make sure we are able to communicate with customers during the work
- Combine real-time 'on the ground' and 'operational' insight during incidents to improve the speed and quality of our response
- Enhance customer self-service functionality to improve customer advocacy and reduce voice call dependency to enable customer choice
- Develop the use of operational data to better manage our network, including applying new techniques to predict leaks and floods enabling us to be more proactive in our response
- Deliver a leading edge billing engine and customer service platform to support service ambitions and system resilience
- Develop an in-house function to monitor, measure and digitise our most important 'customer journeys'

Read more about our strategy in action p21

KPI

20,000 acoustic loggers installed to detect leaks during 2017/18

123,000 smart meters installed in 2017/18

Invest in resilient, proactively maintained digitised assets

Progress in 2017/18

- Invested over £1 billion in our network, and over £13 billion in the last 13 years
- Reducing leakage is one of biggest challenges. We missed our regulatory target, but outperformed our own recovery plan target by 24 Ml/d
- 29% increase in 'find and fix' repairs on water pipes saving 304ml/d of water – best performance since 2012
- 143 km of water mains rehabilitated in the year
- 7,591 lead water pipes replaced in 2017/18
- Investing £250 million to upgrade Deephams sewage treatment works as part of programme of upgrades
- Increased proactive cleaning of sewer network by 57% during the last two years
- New team dedicated to tackling third party sewer abuse
- Targeted 300,000 residential properties with our 'Bin it, don't block it' customer education campaign

Priorities

- Reduce leakage from our network by 15% between 2020 and 2025 and by 50% by 2050
- Continue significant investment programme with £2 billion committed before 2020
- Replace a further 338 km of water mains before 2020
- Help customers reduce leaks from their pipes, using smart meters to aid detection
- Install over 1,000 sewer depth monitors to be able to better understand where to target proactive sewer cleaning
- Investment at 11 further sewage treatment works by 2020 to meet population growth needs

+ Read more about our strategy in action p22

KPI

£1.1 billion
investment in our assets

143 km
of water mains rehabilitated

Protecting the environment

Progress in 2017/18

- 7% year-on-year reduction in pollution incidents
- Produced 286GWh of electricity from sewage, our record performance
- Self-generated one fifth of our electricity needs, equivalent of £30 million a year in energy costs, and decreased greenhouse gas emissions
- Walthamstow Wetlands, an operational site, opened as Europe's largest urban wetland nature reserve
- Built the first full-scale sustainable Nereda plant in the UK, to improve the quality of the water being returned to the environment in a more energy efficient way. It purifies water using aerobic granular biomass
- Sponsored a multi-award winning 'water efficient' garden at the RHS Chelsea Flower Show

Priorities

- Reduce the number of pollution incidents to zero in the medium to long term
- Become 4 star rated under the Environmental Performance Assessment (EPA) framework
- Maximise the potential of innovation to increase the amount of energy that we produce, targeting a further 17% increase in all renewable energy generation to 517GWh by 2025
- To extract and recycle 100% of energy and materials from the wastewater in our region
- To protect and enhance biodiversity during our activities through continued investment at our sites

+ Read more about our strategy in action p25

KPI

286 GWh
of electricity produced from sewage

7%
reduction in pollution incidents

A collaborative and capable team, dedicated to serving customers

Progress in 2017/18

- Redefined incentives plan for all employees to drive better performance for customers and the environment.
- 33% reduction in 'lost-time' injuries and 45% reduction in work related illness cases
- Restructure of the operating model, improving collaboration to deliver more for customers
- Positive action to drive diversity and inclusion with a positive effect on the gender pay gap
- Engaged all employees to encourage alignment with the redefined vision
- Recruiting apprentices and graduates to enhance current and future capability
- Employee engagement initiatives designed to make Thames a great place to work
- Up-skilling and cross-skilling programmes created to develop existing employees
- Enhancing senior manager capability and strengthening of our succession plan
- Developing the volunteer programme to help customers during incidents

Priorities

- Developing a high-performance culture to drive the right outcomes for our customers and the environment
- Building a resilient resource model allowing the organisation to be primed to deliver 24/7 in an efficient and cost effective way
- Build a skilled workforce that differentiates us both now and in the future
- Organise ourselves to deliver what our customers want and embed ways of working that deliver for customers
- Deliver a proactive, customer focused service to our people through robust processes and advice
- Continue to review and prioritise key health and safety risk areas to eliminate and mitigate risks to our people, contractors and members of the public
- Working with our operational teams and supply chain partners to continue to provide clear leadership direction and embrace new technology to enhance health and safety

+ Read more about our strategy in action p26

KPI

33%
reduction in 'lost-time' injuries

70%
employee engagement score

Strategy in action

Be 'Here for you' – create lifelong customer advocates

Sewer flusher, Natalie engages with customers through the media to highlight the problems caused by fatbergs

Customer engagement is fundamental to everything we do – and there's no 'one-size-fits-all' approach.

2017/18 saw us use the discovery of a giant fatberg in our sewers to proactively engage with millions of our customers. We used both traditional and social media to encourage a collaborative effort to eliminate the sewer-blocking beasts, which can cause devastating flooding of homes.

Our fatberg fighting story snowballed as people became intrigued by both the gruesome nature of these wet wipe monsters and their destructive side effects. It led the news agenda, was liked, shared or commented on by 6,100 people on Twitter, spawned a one-hour Channel Four documentary and is currently on show for all to see at the Museum of London. There are even plans for a fatberg musical.

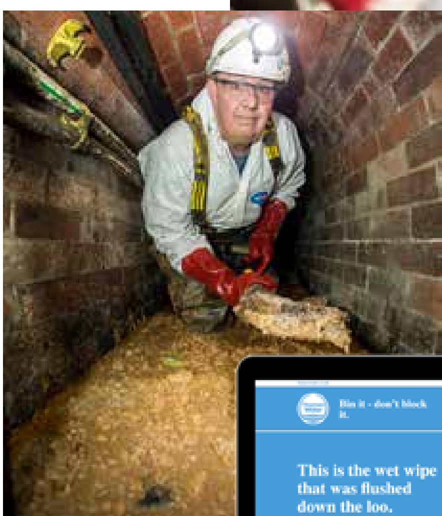
Fatbergs, a term coined by Thames Water, can have a catastrophic impact on the natural environment and the lives of customers when they form concrete-like obstructions in sewer pipes forcing sewage back where it came from. Every year we spend about £20 million to clear blockages from our network, predominantly made up of wet wipes and cooking oil, which is money that would be better spent improving network resilience. Working together with our customers and stakeholders we are changing flushing behaviours to make fatbergs and the widespread use of plastic-based wet wipes a thing of the past.

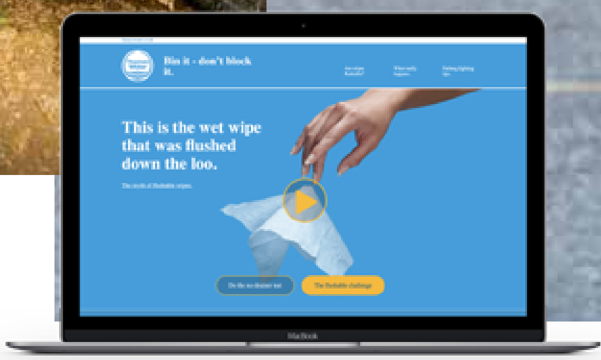
£1.3m

invested in our Bin it, don't block it awareness campaign in 2017/18

1.5 million

viewers watched the Fatberg Autopsy live on Channel 4





✚ **binit.thameswater.co.uk**


Thames Water
multi PRO 56
MaxiFlex

Engineer Matt installs smart meters to help customers make ends meet

Use technology to turn customer insight into action

We're working smarter to suit individual needs.

Over the last year, we've installed over 123,000 smart enabled meters which use state-of-the-art technology to provide regular updates on water usage – 239,000 customers across our regions now have fully activated smart meters.

As well as giving customers more control over their water use to encourage them to be 'water smart' to help the environment and reduce their water and energy bills, smart meters locate leaks at customer properties by detecting continual use. In 2017/18, 1,437 leaks were repaired at customer properties after being detected by smart meters. Undetected leaks have a negative impact on customer bills, as well as wasting precious resources.

Using insight into water usage means we can also help customers become water efficient by offering them a personalised smarter home visit, sharing valuable water saving tips suited to their water needs.

5.90Ml/d
were saved during 2017/18 through smart meter leak detection

£4.3m
equivalent savings for customers

Invest in resilient, proactively maintained digitised assets

‘Storm chaser’, Denise analyses weather data to help protect customers’ homes and livelihoods from sewer flooding

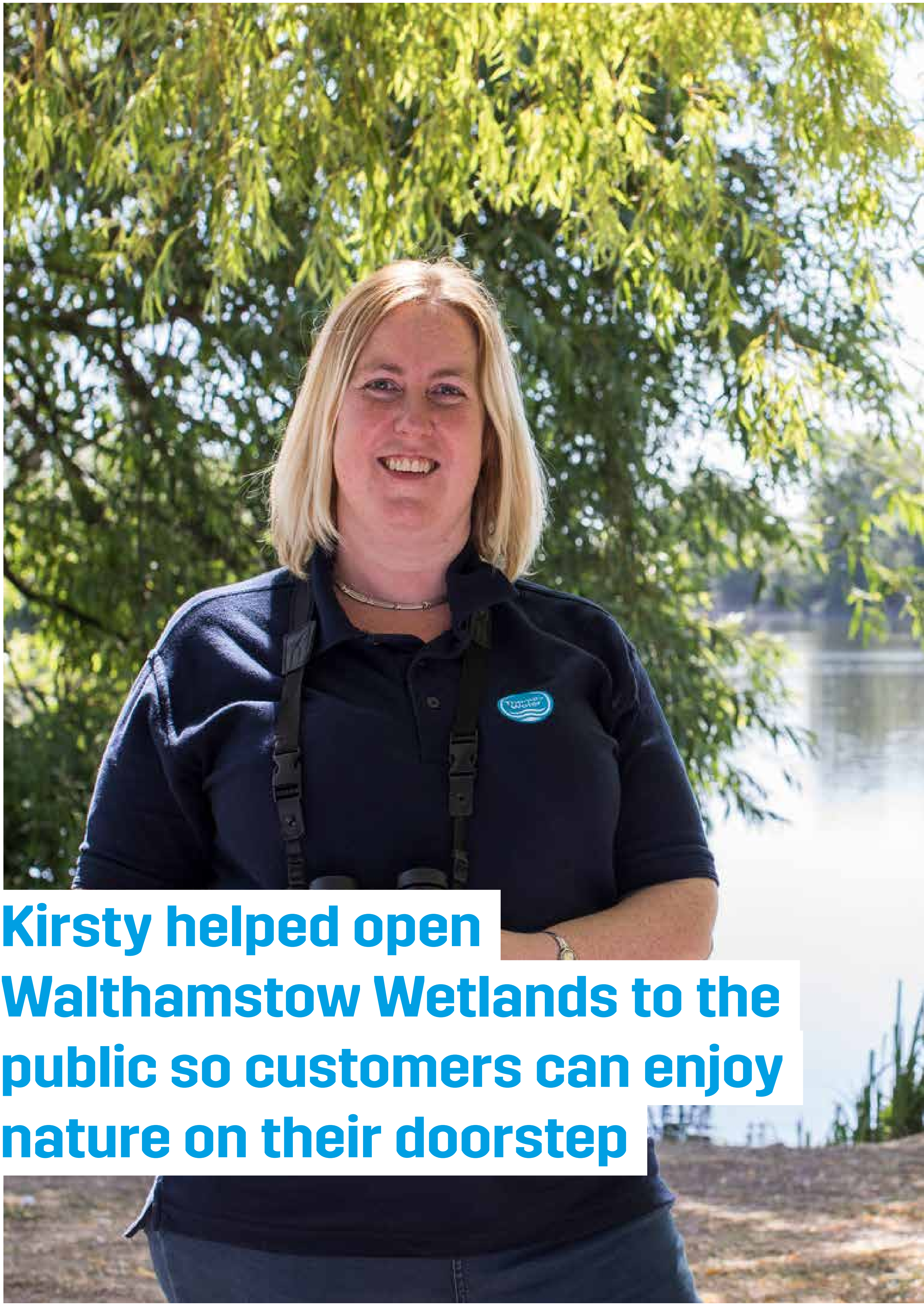
Sewer flooding can have a catastrophic effect on customers’ homes and livelihoods. With heavy rain leading to increased sewer flooding, we introduced storm-chasing as a way of better understanding weather data so we can proactively maintain our network.

Storm-chasing sees us use a range of weather forecast data combined with monitored ground water levels and asset data to create alerts through a modelling system called ICM Live when levels are high. There are three stages of alert – yellow, which means groundwater is likely to affect the sewers; amber, when sewers are starting to overflow; and, red when flooding is imminent. With increased monitoring, we can mobilise teams to check manholes in affected areas before problems occur. When there is an indication of rising sewage levels our control centre initiates a proactive incident management process which means we can start a range of interventions and send resources into an area to prevent sewer flooding and pollutions. For example, we can move the sewage away from the affected pipe by ‘over pumping’ the wastewater into another section of the network. Better insight also gives us more time to arrange for tankers and flooding barriers to travel to the area to remove or divert large volumes of sewage before it floods properties. To avoid sewage backing up through neighbouring pipes we can install ‘stoppers’ between customer pipes and affected sewers.

When sewage levels rise too high during bad weather, a blockage is often the cause. Storm-chasing can help us pinpoint these blockages, so we can proactively clear the pipe to keep our network flowing as it should.

12%

year-on-year reduction in sewer flooding incidents



Kirsty helped open Walthamstow Wetlands to the public so customers can enjoy nature on their doorstep

Protecting the environment

Being good custodians of the environment is integral to the way we run our business, and we're committed to opening some of our sites to the public, where possible, so customers can enjoy more of their local environment.

A first-of-its-kind private, public and charity partnership between Thames Water, the London Borough of Waltham Forest and London Wildlife Trust saw Walthamstow Wetlands open to the public as Europe's largest urban wetland nature reserve in October 2017. Teeming with wildlife and examples of industrial heritage, the reservoir complex at Walthamstow is also a fully operational site, supplying 500 million litres of drinking water every day to around 3.5 million people.

280,000+
visitors have enjoyed the site since it opened

60
resident species of birds on this 211 hectare site

"In London, where large green spaces are more difficult to find, it's particularly important we're 'here for customers' when they want to be able to embrace a healthier physical and mental well-being.

A collaborative and capable team, dedicated to serving customers

Restructuring ourselves as ‘One Thames Water’, so customers know we’re all working together to help

Our relationship with our customers is our primary focus and they see us as one company, not separate water, wastewater and billing companies as we were set up previously. To reflect this, we’ve broken down the barriers between business units to reorganise ourselves as a more cohesive company, as ‘One Thames Water’. Our new structure is simpler. It will allow the 6,245 of us to collaborate better across functions and teams, to put customers first. Organising ourselves in this way means we will be better able to resolve customer queries.

We’ve been running a pilot for customers moving home, by co-locating front line agents with back-office employees to streamline the process and improve customer experience. The project has seen some positive results with an increase in first time resolution of moving home queries, and direct debit rates increasing.

We’re now using the insight from this pilot to help shape our operating model in customer experience. Front line agents, back office agents and complaint teams will be brought together around our major ‘customer journeys’ and will be trained to be able to support across multi-channels including webchat. And managers will be accountable for the whole journey – not just elements of it.


Learning &
Performance

Measuring our performance

Ofwat's outcome delivery incentive (ODI) rewards and penalties link operational performance to company returns. The following pages give a summary of our performance against our key performance commitments with full details in table 3A on pages 209–212.

RAG Rating and Description

Green: Performance at, or favourable to, our committed performance level for 2017/18, or improving trend for T3

Amber: Performance within the range allowed without a penalty (the 'deadband') if defined or, if not, within 5% of our committed performance level, or marginal asset health, or stable trend for T3

Red: Performance below the deadband (if defined) or more than 5% adverse to our committed performance level, or deteriorating asset health, or declining trend for T3

Penalties

£13.1m
Leakage: WC2

This forms part of the £120 million being returned to customers from 2019/20

See p9

£4.7m
Asset health water (below ground): WB1

£10.7m
Supply interruptions of 4 hours of more: WB5

£6.8m
Security of Supply Index (SOSI): WB6

Rewards

£1.3m
Internal flooding of properties: SB4

£46,000
Modelled reduction in properties affected by odour: SC7

Outcome delivery incentives – overview of penalties and rewards for 2017/18

Average hours lost per property served due to interruptions >4hrs WB5

Performance

2017/18	2016/17	2015/16
Red: 0.21 hours	Green: 0.12 hours	Green: 0.12 hours

Target: 0.13 hours

Commentary
We are reporting an exceptionally high number against this measure for this year. This is mainly due to the freeze/thaw event in February and March which had an impact of around 0.05 average hours lost per property on the overall reported number. Around 28% of the total interruptions in 2017/18 occurred in March. There were also 13 capped events this year compared to an average of 3. Our performance this year results in an ODI penalty of £10.7 million for this year but we are forecasting to return to no penalty for the remainder of the AMP.

See p11

Leakage WC2

Performance

2017/18	2016/17	2015/16
Red: 695 Ml/d	Red: 677 Ml/d	Green: 642 Ml/d

Target: 620 Ml/d

Commentary
Although we were not able to recover our leakage position sufficiently to be able to deliver our performance commitment for 2017/18, we have successfully hit our annual average leakage recovery plan forecast for 2017/18 despite the severe winter weather event in early March 2018. This has been delivered through a wide range of activities such as find and fix, pressure management and mains replacement, but has been supported by large improvements to district meter and District Metered Area (DMA) availability to enhance the targeting of the leakage control activity and the deployment of acoustic loggers to enhance leak detection. Our calculated ODI penalty for the end of AMP6 in table 3A includes the removal of the collars in 2018/19 and 2019/20 as agreed with Ofwat.

See p9

Total category 1-3 pollution incidents from sewage related premises (inc. S105a transferred assets) SC2

Performance

2017/18	2016/17	2015/16
Green: 292	Green: 315	Green: 232

Target: 340

Commentary
Our current year performance shows a 7% reduction in pollution incidents since last year which is due to the environmental monitoring of our network, proactive planned maintenance and undertaking more detailed risk and impact assessments before taking assets out of service.

See p51

Compliance of sewage treatment works (numeric consents; calendar year) SC3

Performance

2017/18	2016/17	2015/16
99.43%	98.28%	99.13%

Target: 100.00%

Commentary

The numbers reported in table 3A are for the 2017 calendar year and the forecasts have been assumed based on known information at the time of publication. There is one sample for 2018 which is currently under investigation which may affect our ODI forecast for the end of the AMP. If this sample were to result in a failure, then we would incur a penalty of c.£0.1 million.

+ See p51

Service Incentive Mechanism (SIM) RA6

Performance

2017/18	2016/17	2015/16
78.4	77.3	76.7

Target: 80.1 (Regulatory period measure)

Commentary

With a performance of 78.4, our highest ever score, we ended the year with more than a one point year-on-year improvement in our SIM score, Ofwat's customer service measure. While we haven't achieved the speed of improvement we were aiming for, the upwards trajectory is a testament to our investment and refocus of our customer services strategy.

Our aggregated mean customer satisfaction score (CSAT), which makes up 75% of our SIM score, improved by 0.05 compared to 2016/17, with 4.17 for 2017/18. We saw a consistent performance during the year, with our highest score in Q2 at 4.25.

Quantitative elements make up 25% of our SIM score and we've seen a year on year improvement in all sub measures:

- At 17,039, household written complaint volumes were 4% lower than in 2016/17.
- We've achieved our best performance since 2009/10 in the number of household written complaints reaching the second stage of our complaints procedure, with 818. This represents a 19% year on year reduction and is less than half the volume of three years ago.
- For the first time we've reached the CC Water minimum standard for household written complaints resolution, with 95.20% resolved first time, up nearly 1% on last year. Zero cases were accepted for investigation by CC Water during the year, another first.
- With 509,964 unwanted household calls received during 2017/18, we saw a small improvement in our performance compared to 2016/17 with 2,000 fewer calls.

Compliance with drinking water quality WB3

Performance

2017/18	2016/17	2015/16
99.96%	99.96%	99.96%

Target: 100.00%

Commentary

Since the change in lead standard in 2013 we have consistently achieved a performance level of 99.96%. Due to tightening of the target in 2017/18 to 100%, driven by the Drinking Water Inspectorate to incentivise full compliance, we have moved from green to amber despite maintaining the same performance level. There's no financial penalty associated with performance level, with the penalty level set at 99.95%.

Security of Supply Index (SOSI) WB6

Performance

2017/18	2016/17	2015/16
97	99	100

Target: 100

Commentary

This measure represents our ability to supply water to meet demand in times of extreme weather. Customer demand, network leakage and customer side leakage are all taken into account for this calculation. Our leakage performance during 2017/18 (see page 9) had an impact on our SOSI performance and we finished the year 2 points down on 2016/17's performance of 99. This reduction in score is driven by the projected shortfall between supply and demand in London, but other areas, stretching from Guildford to Banbury and Cirencester, are in surplus. The score of 97 this year results in a penalty of £6.8 million and a projected penalty of £9.06million for the regulatory period.

Internal flooding of properties SB4

Performance

2017/18	2016/17	2015/16
1,062	1,214	1,410

Target: 1,085

Commentary

Our performance in this area has improved over the first two years of the regulatory period, and we beat our target for 2017/18, earning us a reward of £1.3 million. This is due to improvements delivered by the 'Bin it, don't block it' campaign, the media coverage of the fatberg and an increased sewer cleaning programme. We forecast that the improvements will continue to bring benefits over the last two years of the regulatory period, reducing the net penalty at the end of the period to £5.94 million.

+ See p51

Water asset health – below ground (infrastructure) WB1

Performance

2017/18	2016/17	2015/16
Marginal	Marginal	Marginal

Target: Stable

See p11

Water asset health – above ground (non-infrastructure) WB2

Performance

2017/18	2016/17	2015/16
Stable	Stable	Stable

Target: Stable

Commentary
We have maintained a 'stable' rating for our above ground (non infrastructure) assets, which include our pumping stations and water treatment works.

Waste asset health – above ground (non-infrastructure) SB1

Performance

2017/18	2016/17	2015/16
Stable	Stable	Stable

Target: Stable

Commentary
The health of our above ground (non-infrastructure) and below ground assets were assessed as stable in 2017/18, in line with our target and the previous year, and is forecast to remain at this level for the remainder of the regulatory period.

This measure is made up of a number of sub-measures including:

- Unconsented pollutions is a different measure to pollution incidents (SC2) – During the regulatory period to date we have met this target for two out of three years, missing the target in 2016/17. By continuing our focus on the day-to-day performance management of our sites and learning from the past we will be in a good position to continue to meet our target.
- SC3 – Sewage Treatment Discharge compliance
- Total Population equivalent served by sewage treatment works failing look up consents – We continue to meet the target for this sub-measure, having no treatment works failing this measure.

Waste asset health – below ground (infrastructure) SB2

Performance

2017/18	2016/17	2015/16
Stable	Stable	Stable

Target: Stable

Commentary
We have consistently maintained a 'stable' rating for the asset health of our infrastructure, which is made on the basis of indicators of number of sewer collapses, number of blockages, unconsented category 1 to 3 pollution incidents and properties internally flooded due to other causes.

Modelled reduction in properties affected by odour SC7

Performance

2017/18	2016/17	2015/16
1,980	1,305	n/a

Target: 1,771

Commentary
Following investment to upgrade sewage treatment works, we've exceeded our target for odour reduction by 12%. We are continuing to upgrade sites to reduce odour for local communities, with current projects at sites such as Deephams in our commitment to exceed our target of modelled reductions.

Launch new online account management RB1

Performance

2017/18	2016/17	2015/16
new online self serve channel	limited online	limited online

Target: New online self serve channel

Commentary
Following implementation in 2015/16, we continue to maintain our Online Account Management tool. Projects are in place to improve the customer experience and we continue to roll-out web chat to support our customers completing transactions.

Reputational

The following performance commitments do not attract a penalty or reward.

Resolve written complaints first time – water WA1

Performance

2017/18	2016/17	2015/16
96%	96%	91%

Target: 95%

Commentary

Our continued investment in improving our response to written water complaints continues to pay off, with a slight improvement on last year's performance of 96%. This led to a year on year reduction in second stage complaints of 25%.

Minimise the number of household complaints about bills (per 10,000 properties) RA1

Performance

2017/18	2016/17	2015/16
17	19	14

Target: 18 per 10,000 properties

Commentary

We beat our target by 1.11 properties, which represents a 10% decrease in complaint volumes compared to 2016/17. This is mostly due to significant reductions across the top four complaint drivers – inaccurate bills, debt recovery activities, payment of bills and customers not understanding their bills, which constitute over 80% of all complaints in this category.

Resolve written complaints first time – waste SA1

Performance

2017/18	2016/17	2015/16
94%	93%	87%

Target: 95%

Commentary

We saw a slight year on year improvement in the number of written wastewater complaints we resolved first time through changing the way we work together. We didn't meet our target of 95% resolution but overall we did achieve a 29% reduction in wastewater complaints reaching the second stage of our complaints procedure.

Minimise the number of customer complaints – water (per 10,000 properties) WA2

Performance

2017/18	2016/17	2015/16
12.39	9.12	8.84

Target: 8.58 per 10,000 properties

Commentary

We saw a significant 36% year on year increase in the volume of complaints we received about our water operations. We had almost double the number of complaints about no water compared to the previous year, which had a significant impact on this measure. There was also a 67% rise in complaints about our Customer Side Leakage process and a 51% rise about low pressure.

First time resolution of household written complaints about bills – retail RA2

Performance

2017/18	2016/17	2015/16
95%	94%	92%

Target: 95%

Commentary

We achieved our target for resolving household written complaints about bills for the first time this regulatory period with a result of 95.1%. This led to a 21% reduction in complaints of this nature reaching the second stage of our complaints procedure.

Minimise the number of customer complaints – waste (per 10,000 properties) SA2

Performance

2017/18	2016/17	2015/16
4.39	6.21	6.46

Target: 6.70 per 10,000

Commentary

With an average of 4.39 complaints per 10,000 customers, we saw our best ever performance against this measure during the year. We beat our target by 34%, with a year on year reduction of 29%. This is due to significant reductions across the top five complaint drivers – flooding from sewers, blocked sewers, and the condition and maintenance of our assets, which constitute over two thirds of all complaints in this category.

Improved customer satisfaction about bills RA3

Performance

2017/18	2016/17	2015/16
4.66 out of 5	4.63 out of 5	4.61 out of 5

Target: 4.45 out of 5

Commentary
We worked hard to provide a consistent and reliable service throughout the year when customers contacted us about their bills and this saw our customer satisfaction score of 4.66 exceed our target and score from the previous year.

Improved satisfaction of customers contacting our Operations Call Centre RA4

Performance

2017/18	2016/17	2015/16
4.43 out of 5	4.46 out of 5	4.27 out of 5

Target: 4.57 out of 5

Commentary
After a disappointing performance in quarter one in the year, we struggled to get back on target for our operations call centre customer satisfaction scores. This was a result of telephony and system issues, combined with operational events across multiple postcodes which led to major call spikes and wait times. We were not able to react quickly enough.

Improve customer satisfaction – water WA3

Performance

2017/18	2016/17	2015/16
4.42 out of 5	4.50 out of 5	4.44 out of 5

Target: 4.50 out of 5

Commentary
After a strong start to the new financial year, with an average score of 4.47, we had a disappointing performance during quarter two and three with a score of 4.3. This was largely caused by increased supply/demand and resource issues within our network during the summer months, increasing the number of customer no water and leakage issues reported. This increased backlogs which took time to reduce, increasing time to complete customer journeys. We recovered our performance slightly during quarter four, before finishing below target at 4.42.

Improve customer satisfaction score – waste SA3

Performance

2017/18	2016/17	2015/16
4.55 out of 5	4.57 out of 5	4.50 out of 5

Target: 4.65 out of 5

Commentary
In reverse to water performance, after a difficult start to 2017/18 we saw an improvement in our waste CSAT score as the year progressed, ending the year with a score of 4.55. This was due to increased focus on getting it right first time and giving operational and functional responsibility to the customer service team. We have also gained greater visibility of performance across all functions, allowing us to focus on problem areas when they arise.

Increase number of bills based on actual meter reads RA5

Performance

2017/18	2016/17	2015/16
96%	97%	91%

Target: 96%

Commentary
This measure relates to the percentage of bills that we generate for household customers which are calculated on actual meter reads taken in our planned meter reading cycle. Our programme of improvements and process reviews has seen us meet our target of 96%.

Increase number of customers on payment plan RC1

Performance

2017/18	2016/17	2015/16
58%	55%	54%

Target: 54%

Commentary
We beat our target for the year with more customers than expected moving to Direct Debit. We've had a strong start to 2018/19 for this measure. The target was revised following the sale of our non-household business to Castle Water in April 2017.

Increase cash collection rates RC2

Performance

2017/18	2016/17	2015/16
89.2%	87.9%	88.2%

Target: 89.7%

Commentary
We've seen a 1.3% year on year improvement in our performance. Our target was originally set based on cash collected from both household and non-household customers. Following the sale of our non-household business, our performance level represents only household customers against a combined target. This will remain the case for the rest of the regulatory period. While we didn't meet the combined external target, we beat our internal target for household only customers by 0.1%

Low pressure performance WB4

Performance

2017/18	2016/17	2015/16
206	5	0

Target: 34

Commentary
We missed our target for the number of properties on the register on 31 March 2018, due to the way the measure is calculated rather than a deterioration in asset health. 200 low pressure issues were subsequently resolved and removed from the register in April.

See p11

Net energy imported from the grid to run our water business WD1

Performance

2017/18	2016/17	2015/16
510 GWh	491 GWh	496 GWh

Target: 472 GWh

Commentary
Our performance remains behind target due to the following reasons:

- The wet weather in December enabled us to significantly increase our pumping from rivers, in order to refill our reservoirs to prioritise resilience of drinking water supply to our customers ahead of the coming summer months. This, in turn, increased our energy consumption for the year
- We also increased our pumping to supply more water last year. The increased supply was in part due to high summer demand, and partly to mitigate the 'Beast from the East' weather event

The challenges of meeting an increased demand for water is magnified when combined with the scarcity of water resources. Groundwater levels mean that since 2014/15 the work to abstract water from boreholes, and to transfer water from where it is available to where it is required has increased.

Despite efficiency improvements to treatment and surface water abstraction, the energy to supply the average litre of water has increased over 4%. So in addition to the grid import reductions we planned, we have had to become 5.3% more efficient to achieve our current performance levels.

See p49

Greenhouse gas emissions from water operations WC1

Performance

2017/18	2016/17	2015/16
46.2 $ktCO_2e$	151.4 $ktCO_2e$	275.9 $ktCO_2e$

Target: 201.0 $ktCO_2e$

Commentary
We've achieved a huge 69% reduction in our carbon emissions since last year, primarily due to our switch to a green tariff electricity supply in October 2016. We have restated previously reported performance for 2015/16 and 2016/17 following incorrect volume data provided by a third party supplier. The restated performance figures are lower than previously reported.

Besides the benefits of the green electricity tariff, we have achieved a 25% emissions reduction compared to the 2014/15 baseline. This drop is predominantly driven by reductions in the grid emission factor as the UK sources a higher proportion of its grid mix from renewable electricity generating sources.

See p47 and 49

Greenhouse gas emissions from waste operations SC1

Performance

2017/18	2016/17	2015/16
231.7 $ktCO_2e$	346.7 $ktCO_2e$	468.5 $ktCO_2e$

Target: 315 $ktCO_2e$

Commentary
Our significant 33% year on year emissions reduction is a result of the switch to green tariff electricity and an increase in our renewable energy (electricity and heat) generation by implementing more efficient processes for the treatment of sewage sludge.

We increased consumption of self-generated electricity from sludge by 12% to 286 GWh in 2017/18 and our wastewater operations consumption of self-generated energy has risen to 38%, up 5% on last year. During this regulatory period we've reduced our net consumption of grid electricity by 140 GWh.

See p47 and 49

Net energy imported to power our waste operations SD1

Performance

2017/18	2016/17	2015/16
● **431 GWh**	● 477 GWh	● 533 GWh

Target: 329 GWh

Commentary
We have reduced our grid import by over 45GWh since 2016/17. We have achieved a 24% reduction against our 2014/15 volume and achieved a 10% reduction since the previous year. We have consumed 102GWh more grid electricity than planned.

These large reductions are due to an increase in self-generation to 292GWh compared to 261GWh last year, a 12% year-on-year increase. This strong performance doesn't fully mitigate the impact of starting this regulatory period with a 110 GWh deficit at 567GWh, delays in the delivery and commissioning of Thermal Hydrolysis Plants (THP), removal of government subsidies making our wind generation programme uneconomic, and the impacts of serving a catchment with the fastest growing population in the UK with growth being higher than forecast in the plan. We currently have seven innovative THP assets, and are constructing an eighth.

The main focus of our efforts in recovering our position will be:

- The ongoing delivery of energy efficiencies where they are economic, and where they support our process compliance or resilience;
- The continue targeting of opportunities to eliminate wasted energy (energy consumption exceeding plant design);
- Delivering the Beckton to Abbey Mills renewable electricity direct supply to reduce grid import.
- Complete CHP replacement at Maple Lodge
- Switching off Crossness incinerator and expanding the onsite THP
- Realise full benefits of Basingstoke and Riverside THPsAeration Blower Replacement

+ **See p49**

Thames Tideway Tunnel

In August 2015, we appointed an independent company, known the public as Tideway, to construct the landmark Thames Tideway Tunnel, which will transform the health of the River Thames. We are responsible for connections to our existing network. The following performance commitments relate to that work.

Completion of category 2-3 works T1C

Performance

2017/18	2016/17	2015/16
21 sites (cumulative)	19 sites (cumulative)	9 sites (cumulative)

Target: Regulatory period target of 23

Commentary

21 sites have been handed over to the Thames Tideway Tunnel delivery team. The remaining 2 sites are System Works, which are on track for delivery in year 5.

Delivery of land access T1B

Performance

2017/18	2016/17	2015/16
13 sites	13 sites	13 sites

Target: acquire land access rights in line with the programme in the development consent order and programme timetable to be agreed with Ofwat

Commentary

This commitment relates to land being made available to the Thames Tideway Tunnel delivery team as required. An additional 13 access requirements were fulfilled in 2017/18 in line with Tideway requirements. The forecast will be achieved through timely property administration, or through issue of appropriate permits for Thames Water's operational land.

Stakeholder and infrastructure provider engagement T2

Performance

2017/18	2016/17	2015/16
Effective engagement	Effective engagement	n/a

Target: effective engagement

Commentary

Stakeholder survey received for 2017/18, with a score of 4.2 of 6. This compares with 2015/16 (4.7) and 2016/17 (4.9). Whilst this is a reduction in performance, it remains above the target set for the AMP (3.5). The reduction is linked to challenges providing Tideway access to our assets following the review of our sewer access protocols in 2017, and the loss of key employees on the project. We remain committed to a collaborative and open relationship with the Thames Tideway Tunnel Stakeholders (Ofwat, the Environment Agency, DEFRA, Tideway, CCG) which has been recognised and acknowledged in the AMP to date.

Building customer understanding of the Thames Tideway Tunnel T3

Performance

2017/18	2016/17	2015/16
No	No	Yes

Target: improving trend

Commentary

Performance in 2017/18 has improved against 2016/17 scores. In April 2018 the methodology for this performance commitment was revised in agreement with the CCG. When compiled and assessed against scores these equate to a decreasing trend to date within AMP6. The revised methodology also shows a decreasing trend for 2016/17, meaning the RAG status for 2016/17 has been restated from amber to red.

Regulatory period (otherwise known as AMP) measures

The following measures have an end of regulatory period target.

Reduced water consumption from issuing water efficiency devices to customers WA4

Performance

2017/18
20.22 Ml/d

Target: End of AMP target 15.45 Ml/d

Commentary

The unit for this measure is cumulative so the 2017/18 actual is reported as a cumulative value from the beginning of the AMP. We continue to use the Ofwat assumed savings methodology, which is the basis on which the target was set. At the end of Year 3 we are well ahead of programme having delivered 4.77 Ml/d more than the end of AMP target of 15.45 Ml/d. This largely due to our extensive smarter home/ business visit programme which enables residents and businesses to reduce their water and energy use through education and water efficiency tips.

+ See p48

Compliance with Security and Emergency Measures Directive (SEMD) advice notes (water and waste) WB7 and SB6

Performance

WB7 2017/18	SB6 2017/18
21%	26%

Target: WB7: 100% SB6: 100%

Commentary

These five year measures have 100% target at the end of the AMP. We are currently behind where we would like to be at this point during the AMP, but intend to get back on track by the end of the five year period.

Flooding resilience (water and waste) WB8 and SB7

Performance

WB8 2017/18	SB7 2017/18
4	537,700

Target: WB8: 1,015, SB7: 1,700,000

Commentary

We are working hard to protect our sites from flooding. All residual work has moved into delivery phase from April 2018 and the forecasts for 2018/19 and 2019/20 are in line with the delivery programme. Whilst we are expecting to deliver the same number of sites, the population equivalent will be higher than the end of AMP target due to significant levels of population growth in the catchments that the sites serve, meaning we will outperform our target by the end of the AMP. The profiling of the work, with the majority planned for year 4, means that there is enough time for delivery of the scope and any further remedial actions if necessary to be delivered by the end of AMP. SB7 schemes have been delivered at two sites this year, Maple Lodge and Chesham which cover 537,700 population equivalent between them. They now have a flood resilience standard of a 1 in 200 year event.

Compliance with environmental regulations (water and waste) WC5 and SC8

Performance not available: This performance commitment was not designed to be measured mid –AMP

Target: WC5: 100, SC8: 100

Commentary

We successfully delivered our agreed 2017/18 Water National Environmental Programme (NEP), including an options appraisal for the Cherwell Drinking Water Protected Area and are bringing forward the completion of the wetlands at Walthamstow. We have robust plans in place to deliver the remaining programme for both water and waste on time.

Properties protected from flooding due to rainfall (including Counters Creek project) SB3

Performance

2017/18
40

Target: 2,127, cumulative performance to date 479

Commentary

This performance commitment sets out our commitment to protecting properties from sewer flooding caused by rainfall events. As part of this commitment, we have a specific incentive to deliver the outputs of the Counters Creek Flood Alleviation Scheme, which were funded at PR14 to protect customers in the Counters Creek catchment, rather than the outcome to protect properties at risk of flooding. Under the ODI, if we cancel the scheme or deliver it late, we receive a penalty.

Since PR14, we have had significant rainfall events in the Counters Creek catchment which have provided us with new information about the catchment and the number of properties at risk of sewer flooding. As a result, we have reviewed the overall scheme to ensure it will still protect properties at risk of flooding while representing value for money for customers. Through our review, we now understand that far fewer properties are at risk of flooding and that one element of the scheme, a large strategic sewer, is no longer the best solution for customers. We have, therefore, developed an alternative approach which will instead focus on protecting individual properties at risk of sewer flooding. This will provide those properties with greater localised protection, sooner, at a lower cost and with materially less disruption than our previously envisaged solution involving a strategic sewer.

The Counters Creek specific element of the SB3 performance commitment that we agreed at PR14 does not envisage a scenario where we do not cancel the scheme but instead deliver a different combination of outputs to those funded at PR14, while still protecting customers at risk of sewer flooding in the Counters Creek catchment. As we are neither cancelling the scheme nor delivering the scheme late, it is not possible to report the performance of our current Counters Creek programme against the PR14 ODI wording. We will, therefore, be proposing to Ofwat to amend SB3 so that it recognises our new approach to protecting customers in the Counters Creek catchment and that we are still delivering the right outcome for customers.

As we are not cancelling our flood alleviation work in the Counters Creek area, and our alternative approach will provide at risk properties with greater localised protection, sooner and for a lower cost than could be delivered by a strategic sewer, there should be no ODI penalty. We do recognise, however, that as a result of our alternative solution we will save a considerable amount of money £124.1 million (2012–13 prices). Half of this underspend will be automatically returned to customers at the end of this AMP through the totex sharing mechanism and assuming we will be able to agree with Ofwat that no ODI penalty applies, we propose to return the remainder of the underspend to customers at the end of this AMP. We think this is the right thing to do, as our change in approach is due to better information about flooding in the Counters Creek catchment. We will suggest a mechanism for implementing this solution in our ODI amendment proposal to Ofwat, which we will submit to them later this year. The forecast underspend is based on the amount we have spent since 2015 and our project forecasts for 2018/19 and 2019/20, compared to the final determination baseline for Counters Creek.

Since the beginning of the AMP we have delivered 479 properties which include 379 in year 1, 60 in year 2 and 40 in year 3. We expect to deliver a further 168 in year 4 and 322 in year 5 taking the cumulative total to 969 equivalent properties. We have not populated the forecast ODI column because it is not possible to report the performance of our current Counters Creek programme against the PR14 ODI wording. When we submit our PR14 reconciliation submission to Ofwat we will include within the commentary the full explanation of how we have calculated the saving of £124.1 million.

Sustainable drainage SB5

Commentary

We are on track to deliver the programme by the end of the AMP and plan to make significant progress with the work during the next two years.

Water bodies improved or protected from deterioration as a result of Thames Water’s activities SC4

Performance

2017/18
0

Target: 13, expected end of AMP performance 3

Commentary

Although excellent progress has and continues to be made on our pioneering catchment management trial to control phosphorus in all thirteen waterbodies featured in our Evenlode catchment project, we now believe our aspiration set out in the performance commitment to evidence the resulting river phosphorus concentration change across all the water bodies is unlikely to be achieved before the end of the AMP6 period. As the proving of the benefit after measures have been implemented is taking much longer than anticipated we are currently forecasting to be able to prove river concentration benefit in only 3 out of 13 catchments before the end of the AMP.

Reduce the amount of phosphorous entering rivers SC9

Performance

2017/18
0.0

Target: 59

Commentary

We are on track to deliver the target of phosphorus removal by the end of the AMP and we are accelerating the programme so that some sewage treatment works will be upgraded early, with phosphorus savings from 2018/19.

Monitoring commitment to customers

Anne Heal
CCG Chair

The Thames Water Customer Challenge Group (CCG) exists as a group which is independent of Thames Water. All water companies in England and Wales have similar groups drawn from a cross section of customers, regulators and other groups who play a part in the life of the region. The Thames Water CCG has two main roles. It monitors whether Thames Water is meeting its commitments and reports to Thames Water customers, the wider public and Ofwat what progress it finds on an annual basis. It also considers whether Thames Water's future plans reflect what customers need and want and reports on its findings to Ofwat.

This is the third year of Thames Water's business plan 2015–2020, and is the third time the Thames Water CCG has reported on Thames Water's commitments. Thames Water update the CCG every quarter and describe the progress they have – or have not – made.

Customer priorities

Last year the CCG said that while it felt Thames Water was meeting many of its targets, it was not delivering against what really mattered to customers – avoidance of supply interruptions, leakage, sewer flooding and floods and how they are dealt with when they contact Thames Water. This year, many of the measures are again green (and it is pleasing to see the progress that has been made with internal sewer flooding). However, the targets for leakage, supply interruptions and contact with Thames Water through their contact centres have emphatically- and publicly – not been met. And, to give a specific and recent example, the Ofwat report on the "freeze thaw" event shows all too clearly how Thames Water failed to plan to support its customers – especially its vulnerable ones – during a challenging (but expected) weather event.

Leakage

Leakage is of perhaps the greatest concern for customers. They see it as something that Thames Water must get right and they regard it as a test of their stewardship of the network. They are unwilling to see Thames Water invest in new infrastructure projects while leakage remains at the levels that it is. Throughout the year, the CCG has been having monthly briefings from Thames Water on their plans and actions regarding leakage. It appears that they are beginning to make some progress, by reversing flawed strategic and operational decisions, giving the issue greater senior management focus and investing innovatively in the relevant network. However, there is a need to do more and to have greater ambition. The CCG is pleased that Thames Water's future thinking appears to involve a reduction of 50% in leakage but is concerned that this does not yet appear in any published plan.

This year has shown the fragility of Thames Water's network and has underlined the CCG's view that investing appropriately to ensure asset health is key. The current asset health measures suggest that much more needs to be done and that securing asset health must indeed be an important part of Thames Water's future plans.

Lead pipe replacement

During the year, the CCG has pressed Thames Water on the progress it is making with its lead pipe replacement programme. Thames Water have made no public commitments for this programme but the CCG believe that making effective progress with it is a critical issue. In particular, the CCG has been keen to hear how Thames Water is planning to address the issue of lead pipes in schools and nurseries. The CCG was pleased therefore to see that in Thames's Business Plan consultation (*Shape your Water Future*) there is an intention to ramp up the programme and to focus efforts on those areas; customers were also asked their views on increasing spend even further to renew more pipes during the period. It is encouraging to see that those future plans are being put in place, however, the CCG will continue to press Thames Water to deliver on their plans during the current period.

Customer handling and contact

The CCG has previously expressed concerns about continuing problems with Thames Water's IT and telephony systems which have made it hard for customers to make contact with the Company on many occasions. The issue persisted throughout this reporting period and the CCG considers it has made things materially more difficult for customers.

A more transparent approach to reporting

The CCG has previously recorded its disappointment that Thames Water chose to separate the publication of its annual results and their summary of its performance against its commitments. The CCG was pleased that this separation will not happen this year and that performance and the annual results are being published at the same time for the first time this regulatory period.

The CCG is pleased to have had this opportunity to comment in Thames Water's Annual Report; our full commentary on Thames Water's performance commitments is available on the Thames Water website at thameswater.co.uk/annualresults.

Anne with fellow judges and winners at Thames Water's H2InnOvate innovation event (see page 40).

Integrating innovation into everything we do

Innovating is a critical driver in achieving our long-term vision of being **Here for you, in a changing world** and it's everyone at Thames Water's responsibility. Being innovative requires commitment and a challenge of the status quo to find new and unique ways of getting better outcomes for customers.

We run an extensive innovation programme with the industry's largest dedicated Research and Development team and a collection of test facilities. Working with experts from across the globe, both inside and outside the water industry, we apply new technology and ways of thinking to our business. Due to the scale of our operations and our open and collaborative approach to innovation, our research and development work also benefits those outside our region. We actively engage and lead through industry collaboration using our relationships with UK Water Industry Research, The Water Research Council, Future Water and others. To encourage fresh thinking and new energy to innovation at Thames Water we work with a number of UK universities including Cranfield University, Imperial College London and the University of Surrey and fund many collaborative research projects, including PhDs.

We are also offering customers the opportunity to help us with our biggest innovation challenges. In April we ran our H2InnOvate event at the Institute of Engineering and Technology, which involved 50 students taking part in workshops run by IBM, Microsoft, Amazon web services and PR Consulting. They were tasked to provide innovative solutions to preventing fatbergs and helping customers in vulnerable situations, with their prize being an internship in our innovation and digital team. We plan to run more of these events and increase engagement with customers, suppliers and other industries about innovation.

While we're at the forefront of innovation in many areas, we know there's more we can do to integrate innovation into everything we do and embracing technology is crucial to becoming smarter in our research. Our restructure as One Thames Water, a more cohesive organisational structure which better aligns technical and digital experts with innovators, takes us one step further to maximising the benefits of an innovative approach to our operations.

A spotlight on some of our current projects

Trunk main survey

Trunk mains are our largest water pipes – the motorways of the water network – and when they burst it has a significant impact on our customers. To be 'here for customers' we need to be smarter at how we monitor the condition of our pipes, so we're focused on understanding how we can determine the risk of bursts through in-pipe condition assessment devices. Armed with insight we will be able to invest money where it's needed most.

Following the burst in Lee High Road in December 2016, we conducted the first ever 'in-situ' 'trunk main survey' in the UK. It involved using a torpedo-shaped scanning device lowered into the pipe. While it didn't deliver the output we were looking for, we learned important lessons from this trial. We're now building a dedicated trunk main test facility at one of our sites, so we can test a variety of trunk main technologies without needing to interrupt water supplies to customers.

‘Smart bugs’

We’re working with national and international experts from the supply chain and academic communities to identify, develop and test novel ‘smart bugs’. They have the potential to revolutionise nutrient removal and recovery in the wastewater treatment process. We’re currently trialling several of these ‘smart bugs’ either in our labs, in pilot plants or even at full scale. They come in different shapes and forms and they have all been selected for further development as they have the ability to intensify our treatment process, while reducing the need for chemicals and energy intensive aeration.

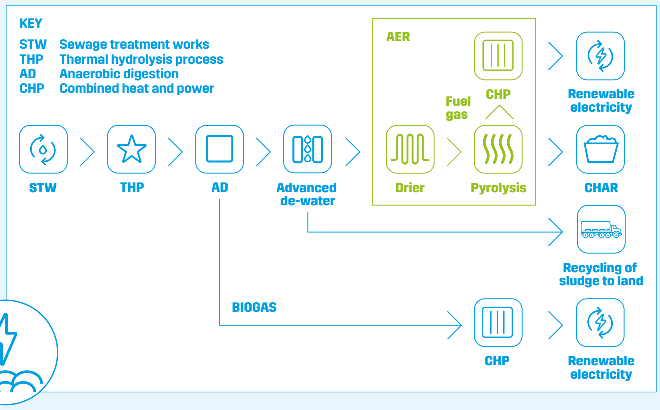
The use of ‘smart bugs’ also reduces the space needed for wastewater treatment. With population growth putting increasing pressure on our sewage treatment works to process more wastewater and urbanisation reducing the available space to expand our sites, ‘smart bugs’ are a cheaper and sustainable way to accommodate increased flows of wastewater.

Algae filters

Algal blooms are a natural phenomenon which can block the water treatment process, so work to minimise their impact is of huge importance. With climate change, blooms will become more prolific. Using a lateral approach to innovation, Mecana filters, which are traditionally wastewater filters, are now being trialled to prevent the flow of algae from reservoirs into the water treatment process. The research into the use of these filters hasn’t been straight forward, but its potential success is of huge significance to the industry.

Abstraction Tool

After a drier than average year in 2017, water resources were depleted – a reservoir in North East London, used to supply water to 3.5 million people, was only 39% full for example. So, during a period of heavy rain in early 2018 we responded quickly to devise a new interactive map to maximise the use of real-time data from the Environment Agency (EA) to fill our large London reservoirs. With this new tool we can better monitor river levels to abstract more water when rivers are full and slow the process down when levels are low. Using data from the EA, which is refreshed every 15 minutes, the abstraction tool reduces the need to relay information by phone, streamlining the process and driving efficiency in the process.



Spearheading innovation

We’re at the cutting-edge of the recovery of energy from sewage with the pilot of a full scale advanced energy recovery (AER) plant. Located at our Crossness sewage treatment works, the novel technology to the water industry uses pyrolysis, which involves processing sewage sludge at temperatures of up to 800 degrees Celsius in close to atmospheric pressure and absence of oxygen to produce fuel gas that can be used in engines to produce electricity. Although in its infancy, when maximised to its full potential AER is predicted to extract over 80% of available energy left in sewage after conventional processes, which would be used to power our operations. With effective use of the technology, the volume of residual bio-char is also 84% less than the volume of sewage entering the process. Bio-char itself, a residual carbon-based material is mineral-rich and can be used for the potential recovery of phosphorous and precious metals, contributing to circular economy.

While pyrolysis isn’t a new idea, the amount of energy needed to dry sewage sludge in preparation for the process was prohibitive. Through lateral thinking, which is an important part of our innovation strategy, we discovered Bucher press technology, imported from the cider industry, could be used to squeeze more water out of sewage sludge. By combining pyrolysis with low temperature drying of sludge, the Bucher press and existing processes – anaerobic digestion, combined heat and power engines and thermal hydrolysis – we’re hoping to be able to make AER economically beneficial and unlock huge benefits for customers, the wastewater industry and natural environment.

Understanding the views of our customers and other stakeholders

200%
increase in responses to customers through social media in 2017/18

23,000
customers engaged with as part of our long-term planning processes

21,000
engaged through our education programme

Customer engagement

We look after Thames Water on behalf of our customers, stakeholders and others who have a vested interest in the business. We run a comprehensive customer and stakeholder engagement programme aimed at understanding their expectations so we can balance their interests as we make business decisions.

Above: Our award-winning water efficient garden at the RHS Chelsea Flower Show.

Below: We introduced our new tap water bar at the show. It is travelling to other events during Summer 2018.

We exist to serve our customers – they are our priority. Engaging effectively with them is integral to the way we operate, whether it's to understand their views on our plans, to keep them up-to-date about local projects, assist them with their bills or help them in emergencies. They expect us to treat them as individuals, being on hand 24/7 to respond to their questions and concerns promptly via their communication channel of choice. Engagement enables us to use customer information and insight to make informed business decisions so we can focus on what matters most.

We engage with our customers in lots of different ways, both proactively and reactively, and we're ever-evolving with technological trends. While the percentage of customers contacting us via social media has increased exponentially, more traditional methods of contact such as face-to-face engagement, mail and phone remain extremely important to us and our customers. As well as investing to improve our channels we've also been spending a lot of time improving our customer communications during incidents (page 10).

We actively engage with our customers through other mediums too, such as the media and through our education programme, to encourage a collaborative effort to protecting customers and the environment for many years to come. As well as highlighting the consequences of flushing the wrong things down the drain with the media coverage of the Whitechapel fatberg, we also sponsored a multi-award winning garden at the 2018 RHS Chelsea Flower Show. Our Urban Flow garden was designed to thrive in the water-stressed south east and help encourage customers across the region to be water smart. The high profile of Chelsea allowed us to highlight the potential impact of climate change and the importance of sustainable urban drainage to a wide public audience. Visitors to our garden included Prime Minister Theresa May and Defra, The Environment Agency and Natural England. We also introduced our new tap water bar at the show to provide free tap water, while selling our not-for-profit 'Tap tastic not plastic' reusable bottles to encourage long-term behaviour change, with £1 for each sale going to WaterAid. By championing the hiqh quality of our tap water and making it more accessible to people in our region when they are on the move, we can help reduce the 16 million plastic bottles that are thrown away every day, polluting our rivers and oceans. This year we launched a pilot refill scheme in the capital.

To encourage young people to develop a healthy attitude to protecting their essential services, our education programme saw us engage with over 21,000 young people throughout our region during 2017/18. Covering a wide variety of topics, the programme offers site visits, workshops, talks and hands-on challenges. We also work in partnership with specialist education organisations and charities, providing funding and resources to help spread messages to a wider audience.

PR19 – Your water future

To inform our PR19 plans for the next regulatory period, we engaged in almost 6,000 conversations with our customers over 57 days in May and June 2017 to discuss a whole host of topics. Reducing leakage, improving water quality, better communication and coping with future growth were just some of the subjects we covered. We received 3,300 responses from customers, stakeholders and employees about our future plans. Of the options presented to customers, 76% stated on feedback forms that they'd prefer bills to stay the same, while seeing 'some' improvements in service.

Between February and April 2018 we engaged with over 7,000 customers as part of our official consultation for PR19 and WRMP, using an innovative tool to aid engagement. This customer engagement tool enables customers to interact with our plan; they can make decisions about what they think our priorities should be and the scale of improvements they believe are necessary, before seeing how their decisions would impact their bill.

Annual Stakeholder Review Every year we engage directly with over 100 of our stakeholders at our Annual Stakeholder Review. It's our chance to report back, share details of our plans and gain feedback.

Media engagement Engaging with the media during 'Beast from the East'.

Catchment management Thames Water employees working on a project with 'Action for the River Kennet' to restore the river.

Employees

Expectation To provide the best service for our customers, our over 6,000 employees need to feel highly engaged with Thames Water, understanding how their work contributes to our vision, and be able to work collaboratively.

How we engage

As well as tailored communications for different areas of the business, our CEO engages with employees on a regular basis through face-to-face visits, emails, quarterly #AskSteve yammer chats and update videos. Over 1,000 managers from across the business meet for an annual conference, with this year's focus being on 'working together, working smarter' to prepare for our transition to 'One Thames Water'. There is also an annual employee feedback survey to understand engagement levels (page 55)

Outcome of engagement

A happier and more engaged workforce leads to a better service to customers. For example, increased investment in building the morale of those on the 'front line' has seen the customer experience team's engagement scores increase from 70% to 75% this year. In turn, our revenue customer satisfaction score beat the industry average for the first time ever in Q2 2017/18 with a score of 4.51 – a testament to us being more 'here for customers'.

Policy makers and elected representatives

Expectation Policy and legislative changes have a significant influence on the water sector. At the same time, councillors and MPs are interested in how our activities affect the people they represent.

How we engage

We proactively engage with political representatives on a wide variety of issues. This includes a structured programme of discussions with MPs, peers, Council leaders and London Assembly Members. We discuss policies affecting water and the environment, and changes to legislation. We also invite stakeholders to our sites and projects to give them first-hand experience of Thames Water.

Outcome of engagement

Feedback from these stakeholders provides insight that can help us improve how we deliver projects in the communities we serve, and inform our future plans. We know many of our stakeholders expect us to play an active role in shaping the future direction of the sector, making sure that the capital and heart of the UK economy receive the service they need.

Investors

Expectation Our debt and equity investors play an important role in funding our investment needs which allows us to serve the long-term interests of customers and the environment. They expect an open dialogue with the business, so they can understand performance, opportunities, risks and challenges.

How we engage

We engage with our investors in a number of ways ranging from direct communications with the Board and Executive Directors to regulator information disclosures and face-to-face briefings. We have regular dialogue with our investors and actively exchange thoughts on a variety of matters.

1,000
managers from across the business meet for an annual conference

Outcome of engagement

Through active discussions our shareholders are committed to prioritising the long-term security of supply resilience and are supportive of the notion that financial returns should always flow from good business performance. Engagement is also a valuable tool to obtain constructive advice and different viewpoints from shareholders thereby underpinning long-term support for our business.

Regulators

Expectation Our regulators – Ofwat, the Environment Agency and the Drinking Water Inspectorate – expect us to pro-actively engage with them about our performance and notify them of issues that could have an impact on our customers and the environment. They also expect us to work collaboratively with them and our peers to help shape the future regulatory agenda and drive maximum benefit for customers and the environment. Serving 25% of the population of England and Wales, we have a significant voice in the industry.

How we engage
We work with our regulators on a wide variety of topics at all levels, ranging from day-to-day operational meetings to long-term strategic planning. We have regular performance meetings and continually strive towards achieving a constructive working relationship for the benefit of customers, the environment and society. We host our regulators at our sites so they can see 'Thames Water in action'.

Outcome of engagement
Fostering strong, trusting relationships with our regulators means we can openly discuss issues and opportunities effectively, while respecting their roles as regulators and ours as a service provider. This engagement helps them understand the business decisions we're making and gives them the opportunity to act as an important sounding board. It also helps our regulators consider the impact of regulatory decisions and new policies on the industry.

Suppliers

Expectation Our supply community wants to know about upcoming opportunities as early as possible. They want to understand how we view their performance, whilst being given the chance to feedback on our processes. As our business adapts to internal and external change, we must keep suppliers informed about how these changes affect the way we work.

How we engage
For our supply chain partners we communicate news and important updates via direct emails and newsletters and discuss best practice at health and safety conferences and category forums. We review performance at quarterly meetings and facilitate engagement with Operations via on-site "meet the supplier days".

We engage with the wider supply market through high profile pre-tender market engagement and launch events. We also host "innovation exchanges" to encourage new solutions and partner with organisations representing the supply chain such as Future Water and British Water.

Outcome of engagement
By engaging right across our market, we're building a diverse supply community. Engagement keeps us at the forefront of market trends and allows us to develop our operational approach alongside our supply chain, to assist the delivery of our strategic priorities. It provides us all with information that creates insight to help mitigate risk, improve resilience throughout our supply chain and drive added value for customers.

NGOs and community groups

Expectation Many community groups and Non-Governmental Organisations (NGOs), particularly those focused on the natural environment, take a keen interest in our activities. In particular they want us to proactively engage with them about local projects and initiatives, which will directly affect them, and to make a positive contribution to the biodiversity of our sites.

How we engage
We develop and seek to maintain good relationships with these organisations to understand their views on work taking place in their areas, inform neighbourhood plans and partner with them to deliver projects and programmes. At a national level, the groups we work with include the Blueprint for Water coalition, which is made up of organisations with an interest in water policy, including WWF, RSPB and the Wildlife Trusts. We also work with groups such as Age UK, Citizens Advice Bureau and debt advice charity StepChange.

Outcome of engagement
Our work with NGOs and community groups has significant impacts, enabling us to be 'here for customers' in local communities and to drive improved environmental performance. The opening of Walthamstow Wetlands was a product of NGO engagement. Similarly, work with the Evenlode Catchment Partnership is helping reduce pollution from farms and fields entering rivers. Our engagement with NGOs focused on social issues is ensuring customers receive specialised services better tailored to their needs, and in some cases they help deliver our services.

Media

Expectation The media expects us to be open and transparent, and they hold us to account on the public stage.

How we engage
We're committed to being open and transparent with all of our stakeholders. We proactively engage with the media about operational news, across all platforms, to deliver better outcomes for customers, with the fatberg story being a highlight of 2017/18. Recognising a gap in senior management engagement with the media, it has been high on our CEO Steve Robertson's agenda during the last 12 months.

Outcome of engagement
While we know there will inevitably be differing opinions about the business decisions we're making, our increase in openness and transparency about the issues that matter most helps set the context for these decisions.

Caring for our customers and the environment

Being a responsible business is a cornerstone of Thames Water. We're mindful that everything we do impacts our customers and the environment – protecting them both is our responsibility and it's one we take very seriously.

The Environment Agency and Natural Resources Wales give companies a star rating out of four, an EPA rating, for their overall performance in protecting the environment. We have a provisional rating of 3 stars and our aim is to be 4 star rated by 2019/20.

Our role in society

With 70% of the world covered in water and the UK being perceived to have a lot of rain, it can be difficult to understand the need to be careful with water. But, our heavily populated region is classified as seriously water stressed by the Environment Agency. With the combination of population growth and climate change putting increasing pressure on our precious water resources, the situation is only going to get worse. There is predicted to be a shortfall of around 360 million litres of water per day by 2045 if we don't take action. With each customer using, on average 146 litres of water a day, that's the equivalent of 2 million customers' needs.

As we look way beyond the next five year period, we're taking strides to protect our customers and the environment, navigating the fine balance between the need for investment and affordability. We must ensure resilient water resources for future generations and mitigate the impact of climate change. People will always need water and we have a responsibility to prepare for the future as Sir Joseph Bazalgette did for London's wastewater more than 150 years ago. At the same time, there is a lot more we need to do to reduce demand. This starts with our own urgent and determined work to reduce leakage and fit more smart meters, and also includes providing practical help and advice to our customers in reducing their own water use.

Protecting biodiversity

We also take great care of the ecosystems in the areas where we work and we're committed to continually improving our biodiversity performance at those sites and beyond, whilst aiming to deliver our services in the most sustainable way. We look after 12 sites of specific scientific interest and around 50% of the hectares on these sites have been given the highest status possible by Natural England. In 2017/18 we spent £470,000 on 33 different projects to improve biodiversity and public access at our sites, including building boardwalks, planting orchards and hedgerows, constructing bird hides and creating new wetland areas.

Around three quarters of the world's iconic and much-loved chalk streams are in the UK, with 41 of them in the Thames Water area. We recognise the importance of our role in protecting these unique ecosystems and our long-term ambition is to cease abstraction from these and other vulnerable water sources. Our recent £30 million investment in the Axford water pipeline has brought us one step closer with reduced abstraction from the River Kennet. As a next step in the protection of this iconic chalk stream, we're running a 'Smarter catchment management' programme in the area. We're working with our partners and the local community to boost their relationship with the river, to reduce demand for water and influence the way they use the sewers.

Sustainable development goals

The United Nations Sustainable Development Goals (SDGs) have been developed to make the world more sustainable by 2030. The goals cover challenges as diverse as ending poverty to tackling climate change. Supporting the aspiration of all 17 goals is not an additional task for us; it is part of what we do every day.

We focus on four specific SDGs where we can make a real contribution related to our expertise and main area of operation – delivering water and sanitation to around 25% of the population of England and Wales.

These four specific goals are:

SDG 6 – Clean Water and Sanitation – we provide safe water and sanitation to over 15 million customers 24 hours a day, 7 days a week, 365 days a year.

SDG 12 – Responsible Consumption and Production – last year, 100% of sewage sludge that was not incinerated to generate renewable energy was put to beneficial use with 98.7% applied to agricultural land as fertiliser and 1.3% used in land restoration or reclamation. We also generated 286 GWh of renewable electricity from safely treating sewage sludge.

SDG 7 – Affordable and Clean Energy – in 2017/18 we generated 293 GWh of our electricity needs from renewable sources including biogas, wind power and solar panels.

SDG 13 – Climate Action – we are working to increase our capacity to respond to the impacts of climate change and mitigate our contribution to its causes. As part of this, Europe's largest floating solar panel array was installed on our QE2 reservoir, generating enough electricity to power 1,700 homes.

We've also been working with Butterfly Conservation to understand the populations of butterflies living on three of our sites within the Chilterns Area of Outstanding Beauty. A survey of the water sites Chinnor, Wendover Dean and Winchester Wood confirmed the high ecological value of these areas, and we're working together to protect these species.

Sustainability

We aim to provide essential water and wastewater services in the most sustainable way possible. This means we need to strike a balance between what's right for our customers and employees, how to make our business as efficient as possible, and how we can best protect the environment, now and in the future. We describe how we will do this through the nine sustainability themes which make up our Sustainability policy. These themes cover key areas of our business activities ranging from water resources to sustainable finance.

Our nine sustainability themes are:

- Water, a precious resource
- Providing sustainable drainage
- Mitigating climate change
- Delivering efficient operations
- Climate change adaptation
- Sustainable and safe workforce
- Long-term sustainable investment
- Ensuring responsible operations
- Enhancing customer inclusion

Our sustainability policy is underpinned by more detailed policies including our biodiversity policy, climate change policy and health and safety policy. Through the Paris Pledge we are showing our support for the Paris Agreement and its goal to reduce the causes and impacts of climate change.

We know the decisions we make today need to safeguard the delivery of our services to our customers over the long term and we also know we cannot do this alone. We need to work collaboratively with our customers, employees, partners, suppliers and regulators.

Governance

We take our approach to becoming more sustainable very seriously and this is reflected in our business plan which is agreed by our Board, our Executive Team and our regulators. Members of our Executive Team have responsibility for specific parts of our sustainability programme, with overall direction on sustainability matters provided by our External Affairs and Sustainability Director.

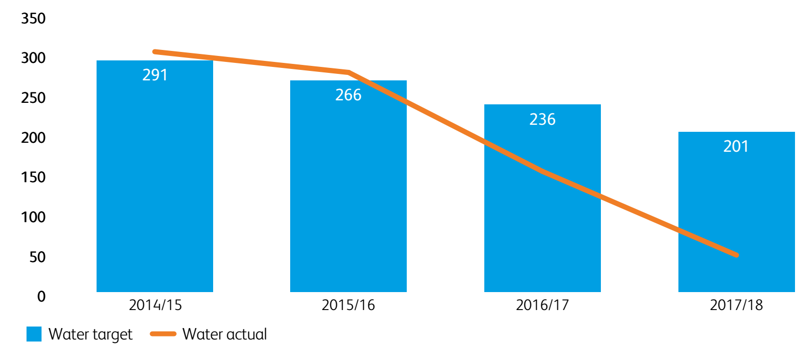
We regularly review the issues which are material to our business, customers, other stakeholders and the wider world. By focusing on these and reporting progress in our Annual Report and Corporate Responsibility and Sustainability Report, we aim to become a more transparent and sustainable business. We're committed to working collaboratively with partners who can align to our sustainability vision.

Key risks and opportunities

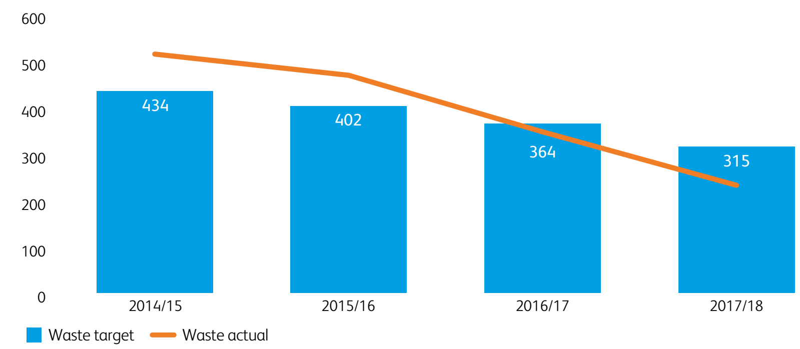
The risks and challenges we face in delivering essential services sustainably include meeting current and future regulatory requirements, tackling leakage and increasing energy costs, population growth, climate change and the need to keep bills affordable. In addressing these challenges we are provided with opportunities to become a more sustainable business, for example we are increasing our self-generation of energy, improving customer experience using learnings from past performance, supporting our customers in becoming more water-wise, and in 2017/18 we successfully placed our first Green Bond.

We will publish a full Corporate Sustainability and Responsibility Report on our website later this year.

Greenhouse gas emissions from water operations in ktCO2e – WC1



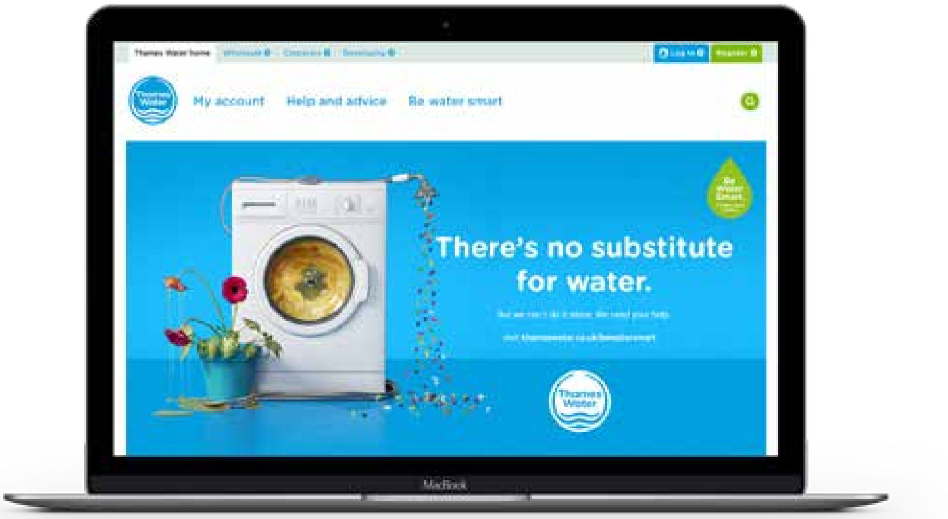
Greenhouse gas emissions from waste operations in ktCO2e – SC1



Protecting water resources

To manage demand for future water supplies, we're investing heavily in smart metering. Forty per cent of our household customers are now on a metered supply and we have 239,000 smart meters sending us hourly reads (see page 21). Smart meters provide far-reaching benefit, helping us to reduce leakage and drive more efficient use of water. By detecting continual hourly water use, they pinpoint leaks on customers' pipes. We were able to save 5.90 Ml/d in 2017/18 by fixing these leaks. As well as protecting the environment and future resources, meters put customers in control of their water use and bill, and we offer support to help them save money on both their water and energy bills.

To help our customers to save water, we run the industry's largest water efficiency programme, saving an estimated 11.57 million litres of water a day during 2017/18. As part of the programme, we conducted 69,000 Smarter Home Visits with Thames Water representatives visiting customers' homes to give them advice on how to save water and install free water saving devices. These free visits were estimated to save 5.33 million litres of water a day during 2017/18. We installed over 174,000 water and energy saving devices and fixed more than 6,000 'leaky loos' and taps – a leaking toilet can lose between 100 and 2,500 litres of water every single day. We also offer a free online calculator to help households understand their water consumption and how they can save water. In partnership with Greenredeem, we piloted the first ever gamification use of smart meter water data to encourage customers to save water, using incentive rewards such as shopping discounts, prize draws and charity donations.

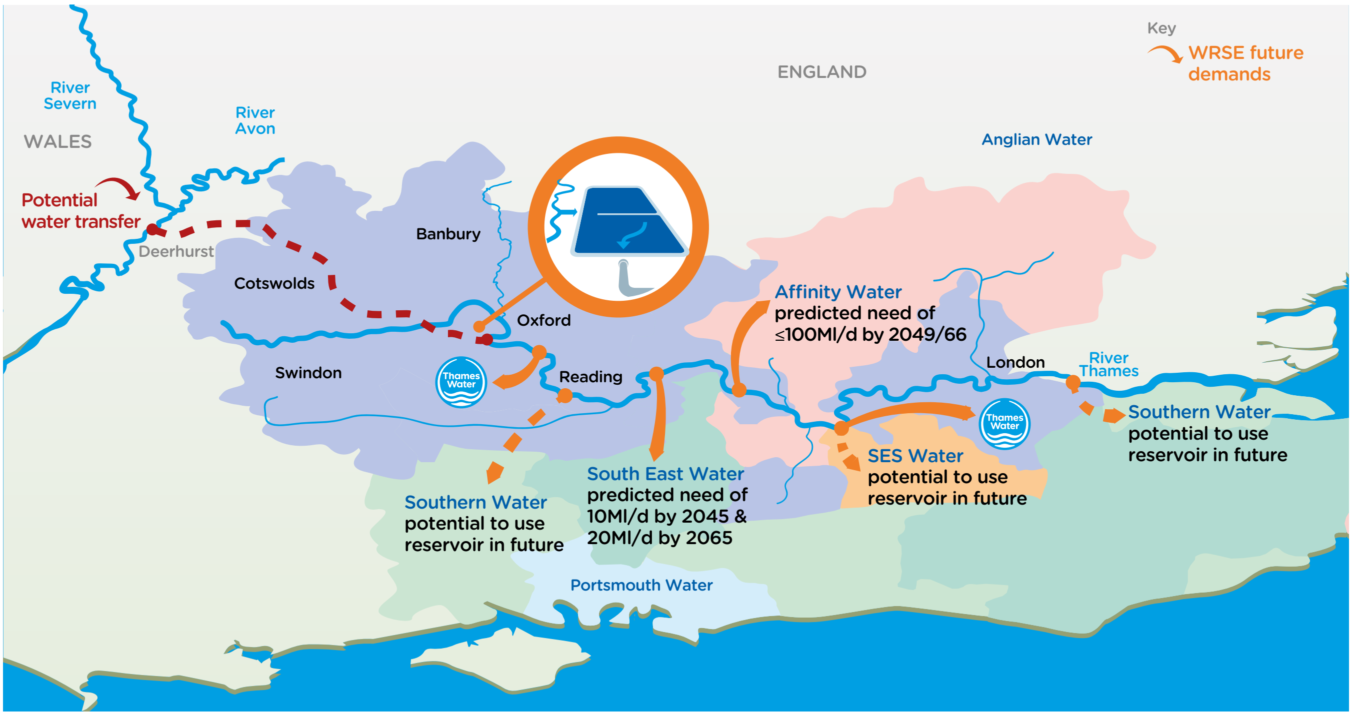


Water is vital to life, and we're planning for the very long term – we're actively exploring a whole range of options to ensure a resilient supply. Our draft Water Resources Management Plan, which was published in February 2018 for public consultation, sets out how we plan to provide a secure and sustainable supply of water for our customers over the next 80 years. Through extensive engagement as part of the planning process we know customers want us to do more about our leakage and over 70% said they want to be more water efficient themselves and we're now focusing on providing the help they need as a foundation to our plan.

To decide on our preferred longer term Water Resources Management Plan, we researched different factors including customer preferences, cost, environmental impact, deliverability and resilience. As part of the process we've also talked to other water companies about options for water transfer from areas which aren't as water stressed. Our preferred plan includes the creation of a large storage and transfer scheme, for ourselves and other companies, with a reservoir near Abingdon and using the River Thames to transfer water to London and other areas. This proposed strategic regional resource is part of a wider plan to insulate the South East from the damaging effects of drought.

We operate in a changing world, so our plan won't remain static. We'll continue to engage with customers every step of the way to ensure our plans reflect their evolving needs and those of the environment.

Strategic resource for the South East of England



Generating energy and our role in the circular economy

WC1: Greenhouse gas emissions by our water business – 46.2kT CO_2e

SC1: Greenhouse gas emissions by our waste business – 231.7kT CO_2e

WD1: Net energy imported from grid – water 510 GWh

SD1: Net energy imported from grid – waste 431 GWh

To protect the environment, address rising customer demand and reduce the impact of energy price volatility on our operational costs, our energy strategy covers three areas:

- To reduce the amount of energy we use through more efficient operations
- Efficient procurement to reduce energy costs
- To increase energy generation and reduce reliance on grid energy

To us, sewage is a valuable resource and we're dedicated to maximising its potential as fuel. We continue to be an industry leader in the production of energy from sewage sludge. Our aspiration is to maximise the recovery of energy and resources from wastewater and to reduce the need to dispose of biosolids to land or by incineration, and we're moving closer to achieving our long-term goal. During 2017/18 we produced 286GWh of renewable electricity from sewage, our best-ever performance and this is set to increase as we pave the way with our new AER process (see case study – Spearheading innovation on page 41). We're also increasing the speed of sewage travelling through our wastewater process, from 'flush to field'. This drives efficiency, maximises available capacity, reduces greenhouse gas emissions, and reduces the age of sludge going into the energy extraction process to improve generation. Improving the management of this component of wastewater meant sludge in our region travelled 335,000 fewer kilometres in 2017/18 compared to the previous year. It has also allowed us to save 1 ktCO_2e in carbon emissions while improving local air quality and reducing disturbance in local communities with fewer diesel tankers needed for transport.

Combined with wind and solar power, we generated 293GWh of our own renewable electricity to power our operations in 2017/18, meaning we self-generate more than one fifth of our energy needs. This decreases greenhouse gas emissions and is the equivalent of £30 million a year in energy costs. Our transition towards providing a lower carbon service has also been supported by our green tariff electricity supply contract which over the last year has caused a huge reduction in greenhouse gases from both our water and wastewater operations, with respective 69% and 33% reductions.

We've been performing well in our self-generation of electricity from sludge but we missed our targets for net energy imported from the grid (SD1 and WD1). This was predominantly caused by the need to ramp up water production to refill reservoirs after heavy rain and a knock on effect of the delays in commissioning thermal hydrolysis plants in previous years. Given the higher starting point, we don't expect to reach our target of 295 GWh in 2019/2020, but are on track to deliver a 35% reduction over the course of this regulatory period so will reach our percentage reduction target.

Right: Thermal hydrolysis plant.

Euston water main burst response

On 27 October 2017 a 16-inch water main burst in the early hours of the morning near London's Euston train station. Eversholt road, the scene of the burst, and a small number of properties were flooded, along with three platforms at Euston station.

Our dedicated incident management team quickly mobilised a cross-company, coordinated response to limit damage to property, look after customers, and make the necessary repairs as quickly and as safely as possible to minimise disruption.

Our team of face-to-face customer representatives arrived onsite promptly. Due to data system improvements, they were able to prioritise visits to customers who needed the most support. They contacted every affected customer to help manage their individual needs and remained onsite for six days until everything was returned to normal.

We also worked closely with Network Rail and Transport for London to update customers at the station and liaised with the local housing association and council to offer a coordinated response to help those with properties which had been affected.

We posted regular information, including videos to provide real-time visual updates. The collaborative, coordinated response, combined with aftercare calls and visits to the affected customers, meant we received zero complaints about the burst and received positive feedback about our response.

Being here for customers in vulnerable circumstances

We are committed to ensuring all our customers in financially vulnerable circumstances are supported as part of our longer-term customer experience plans. We offer a range of options to support them.

We have two social tariffs – Water Sure and Water Sure Plus – and in 2017/18 we helped over 56,000 households via these schemes, up 48% on 2016/17. The average discount per combined services customer is expected to be £231 and waste services £102. To understand who has affordability issues so we can be 'here for customers', we're raising awareness of our services through targeted campaigns and promotion via charities and partners.

We also run a customer assistance fund to support customers with their water debt, with the fund benefiting 7,500 customers in 2017/18. After helping customers with their debt, we work together with them to help them remain debt free, including enrolling them onto social tariffs and referring them to charities such as Step Change, for household debt advice.

We understand that customers in water debt may also have wider financial issues so we help customers with basic living costs outside our water and wastewater services through a dedicated trust fund. The fund was set up in 2009 and is an independent charity regulated by the Charities Commission. As well as helping nearly 1,300 customers directly during 2017/18, with donations of life-changing essential items such as a fridge or a washing machine, the fund also supports agencies providing debt advice, including the Citizens Advice Bureau. We contributed over £650,000 to the fund during 2017/18.

We're also committed to helping other customers in vulnerable circumstances who might need different support. As part of our long-term plan we aim to increase the number of customers on our priority services register to 400,000 by 2025, so we're ready to help them in an emergency. The priority services register includes people who need inclusive forms of communication such as braille or different coloured bills, more situation sensitive engagement or support during supply interruptions due to mobility issues or water dependency.

Reducing the impact of our wastewater operations

SC2: pollution incidents – 292

SC3: Compliance of Sewage treatment works – 99.43%

SB4: Sewer flooding other causes – 1,062

We're continuing to improve our pollutions (SC2) performance, with 292 incidents in 2017 (a calendar year measure) against a target of 340 and a 7% year-on-year reduction (2016: 315). Given the profile of our pollution fine in March 2017 for incidents which occurred between 2012 and 2014, we appreciate that there is increased interest in our current pollutions performance. We know that performing well here is a fundamental part of our existence and we've learned from the past. Our approach to pollutions prevention is very different now and our long-term aspiration remains to eliminate serious pollutions entirely. Pollution categories range from 1 for the most serious, to 4. There were nine serious (Category 1 or 2) pollutions in 2017 and we must do better. Sewer abuse was a contributory factor to some of these.

Two years ago problems in the way we recorded sewer flooding incidents (SB4) in the last regulatory period led to us setting an extremely challenging target for the current period. We've worked really hard to close the gap, seeing a 12% year-on-year reduction in the number of incidents at 1,062 for the year, and have received a reward of £1.3 million for our 'sewer flooding other causes' performance commitment. This compares to a penalty of £0.5 million in 2016/17. Our sewage treatment works compliance (SC3) has improved. While the target is 100% compliance, we reduced the number of non-compliant incidents during the year from six in 2016 to two in 2017 at Newbury and Great Bedwyn, with compliance of 99.43% for the year. This means we will not incur a penalty for 2017/18. This improvement in our performance is in part due to a £40 million increase in investment to repair equipment at wastewater sites ensuring our existing infrastructure is working to its full potential. There is more work to do, and, while we don't forecast meeting it before 2020, our long-term goal is to reach 100% compliance.

To maintain the improving trend we're applying our company mantra – data, information, insight, action – to inform our activities. We've increased investment in controls on our network, including sewer depth monitors, to help us locate and clear blockages before they cause sewer flooding. With the help of a new compliance steering group and dedicated network protection team, we're taking a more proactive approach to maintenance and we've reduced the occurrence of repeat incidents by increasing focus on the most affected areas. A change in culture, to highlight problems before they become issues, has led to an increase in the number of sewer flooding incidents being self-reported. This enables us to improve the speed of our response and to spend more time investigating problems that do occur to help inform changes to our approach.

With sewer blockages creating problems for the environment, our customers and the smooth running of our network, customer engagement and education is a key part of our approach to keeping our wastewater operations healthy. Alongside our extensive customer engagement programme following the discovery of the now infamous fatberg in our sewers (page 18), we continue to invest in our 'Bin it, don't block it' marketing campaign, particularly in hot spot areas, to highlight the dangers of flushing anything other than the three P's – pee, poo and (toilet) paper – down the drains. We invested £1.3 million in our campaign during 2017/18.

'Making a buzz'

We are mindful of the impact of our operations on the wildlife we share our sites with – protecting local ecosystems is an important part of us driving a leading environmental performance. As part of our established partnership with the Bumblebee Conservation Trust, in 2017 we again joined forces on the Heritage Lottery Funded 'Making a Buzz for the Coast' project, which focuses on restoring and creating habitat for wild bees. Bees are so important for the pollination of crops and wild flowers.

Our Long Reach Sewage Treatment Works is an estuarine site in north-west Kent and is home to an existing population of the rare and threatened Shrill Carder Bee (Bombus sylvarum), a late-emerging bee species which subsequently requires late flowering plants upon which to forage.

In 2017/18 we created a management plan at Long Reach for the species, which included making habitat management recommendations to six parcels of land, erecting signage for visitors and constructing over 600 metres of knee-rail fencing to separate these conservation areas.

We plan to build on these activities in 2018/19 delivering more community engagement, getting our site employees involved in bumblebee surveys and making further habitat improvements to help the bees flourish. There are only seven UK populations of Shrill Carder Bee, with the Thames Corridor being home to one, so this is a really important conservation project that we are proud to be involved in.

7%
reduction in pollution incidents

12%
reduction in sewer flooding incidents

£40m
increase in investment to repair broken equipment at wastewater sites

Our people are building a better future

6,245
total headcount at 31 March 2018

11.9%
employee turnover

13.3% to 10.8%
reduction in gender pay gap (mean)

Highlights of the year

Awarded higher status Disability Confident 'Employer' accreditation

Engaged with our communities at Pride events providing hydration stations at Reading and Swindon, with a presence at London Pride

Joined the Workplace Equality Index for the first time

Stonewall Diversity Champion, promoting an inclusive culture where all LGBT+ employees are accepted without exception

REBA Employee Wellbeing award won for our mental health strategy

21%

of people on our Give Someone a Start programme were subsequently offered an interview with us

66.6% : 33.4%

(2016: 67.6% : 32.4%) overall male to female ratio as at 31 March 2018

2,680

employees chose to take a Personal Medical Assessment

70%

employee engagement

Our people and culture

The delivery of our vision – **Here for you, in a changing world** – depends on the talent, commitment, collaboration and well-being of our people.

Through our people priorities (page 17) we outline how we build a working environment and culture which inspires us to live our values and do our best for every one of our customers every day.

A safe work environment

The safety and wellbeing of our employees and customers is of paramount importance. Our health and safety performance has improved significantly in recent years and initiatives to create a positive workplace and support a healthy lifestyle are leading to happier, healthier employees.

We're committed to achieving our vision of "zero incidents, zero harm, zero compromise, every day we are at work" and every employee, without exception, has the authority to stop any activity that can't be done safely. We encourage our employees to help make the workplace a safer environment, and through reporting safety observations we're able to put things right before they can cause incidents.

We measure lost time injury performance using frequency rates; in 2017/18 we moved from 0.21 incidents per 100,000 hours worked to 0.14 – a 33% reduction.

Under RIDDOR regulations, we're required to report to the Health & Safety Executive all specified injuries, lost time injuries involving more than seven days lost time, work-related diseases and certain types of incidents not involving injury known as dangerous occurrences. Our benchmark we set to outperform for 2017/18 was 19 notifiable injuries based upon a 20% reduction from injuries that we had incurred in the previous year; in 2017/18 we reduced notifiable injuries further to 17.

Unfortunately, during the year, we had a number of dangerous occurrences, resulting from lifting incidents and equipment failure, which took us over our agreed total notifiable incident benchmark on this measure. We are committed to learning from all incidents, to make sure we implement the necessary controls to prevent them happening again.

Well-being

Everyone at Thames Water is entitled to a free annual Personal Medical Assessment, with 2,680 employees taking advantage of the sessions last year. New sessions to support weight loss and quitting smoking have also been introduced as part of the wellbeing programme. For the fifth year in succession we held a Health and Wellbeing week focusing on positive physical and mental health and ran 57 activities known to boost positive mental and physical wellbeing. We also offer a cycle to work scheme and access to fitness and wellbeing discounts.

Promoting mental wellbeing has been a key focus for us. We are working to remove the stigma around mental health with our Time to Talk strategy and by supporting MIND's Time to Change pledge. During the year we have trained over 200 mental health first aiders and 507 employees have taken part in the Mind Fit mental health awareness programme.

We reduced the number of work related illness cases resulting in absence from work from 29 to 16 cases, a 45% reduction in cases reported since 2016/17.

Over 500 employees have taken part in the Mind Fit mental health awareness programme.

Representing a diverse customer base across London and the Thames Valley, the diversity of our people, backgrounds, skills and experience makes us both stronger and more effective as a team, leading to a better service for our customers.

Equality, diversity & inclusion

Representing a diverse customer base across London and the Thames Valley, the diversity of our people, backgrounds, skills and experience makes us both stronger and more effective as a team, leading to a better service for our customers. The attitude and behaviour of everyone working for Thames Water can have an impact on our reputation. We make sure everyone is provided with the same opportunities and is treated with respect, irrespective of their age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion and belief, gender or sexual orientation.

Human rights, modern slavery and ethics

We create an inclusive work environment, where people are supported throughout recruitment, induction, career development and progression. Our code of conduct expresses our approach to business activities and how we work, providing a clear, ethical and legal framework for our employees, customers and stakeholders. Underpinning the code of conduct and in line with human rights principles, we have a range of policies covering health and safety, equality, diversity and inclusion, anti-corruption and bribery, human rights and modern slavery and honest and ethical behaviour. All elements of our code of conduct apply to both our permanent and temporary employees and our contractors and alliance partners have agreed to follow the provisions of this code. We also have a 24 hour Employee Assistance Helpline available and a robust whistleblowing process in place.

Providing support

We are a Disability Confident Employer. During the year we actively focused on attracting people with disabilities to our organisation, promoting opportunities at disability job fairs and were invited as a keynote speaker at the Stronger Together Access to Work event. We support employees who become disabled during employment including offering flexibility and making reasonable adjustments to the workplace to ensure they can reach their full potential. During 2017/18 we upgraded our facilities such as installing hearing loops and improving accessible parking, lifts and toilets.

Our 'Give Someone a Start' programme offers work experience to people who are out of work, and those with mental and physical disabilities who may need extra support in finding a role.

Flexible & Smarter Working

We continue to promote the benefits of flexible working. 93% of women returned to their roles after maternity leave.

We offer mentoring for those returning to work after an extended break and have been granted a Bronze award by the Armed Forces Covenant Employer Recognition Scheme for our support of the Armed Forces community.

Mark Menezes
Customer Services Representative

Brand principle in action: Positive and visible

Supporting customers in vulnerable circumstances during incidents is a top priority for us. Mark, a face-to-face customer services representative, makes a positive difference to customers' lives during incidents, visiting their homes and delivering bottled water. But it doesn't stop there. As the customer's single point of contact he remains on-call for them, making sure their needs are met until everything is back to normal.

Time to Give Employees spent 6,393 hours taking part in volunteering opportunities in 2017/18.

Through our Time to Give programme, all employees receive two days per year to volunteer in different ways for charities that operate in the communities we serve.

Engaging with our communities

Through our Time to Give programme, all employees receive two days per year to volunteer in different ways for charities that operate in the communities we serve. From litter picks to upcycling furniture for charities, employees spent 6,393 hours taking part in 1,040 volunteering opportunities in 2017/18.

We have collaborated with the communities around us and continue to support local issues through our community investment programme. Projects this year have included a refurbishment of facilities and outside space at Acton Scout Hut, a huge litter collection along the Ridgeway spanning Greenwich and Bexley councils, a work experience programme specifically for Deephams residents and regular volunteer work for SOFEA, a charity supporting Didcot Parkway residents.

In 2017/18 our employees raised £316,675 for WaterAid, a charity we've supported for 30 years, with a further £46,344 of income pledged. This money will be used as part of our 'Thames loves Malawi' campaign, which aims to build partnerships and empower people in Malawi, particularly local council officers and water board employees, to make a sustainable change in two towns which had no access to clean water.

Employee engagement

Each year we canvass the views and opinions of our employees through our 'Hear for You' survey and the outputs of the survey inform our continuous improvement plans. For example, we made changes over the year for our Customer Experience team which have led to an increase in engagement scores (70% to 75%), a reduction in sickness absence and a number of internal promotions. Actions included introducing a career development framework for our operational teams, introducing a new specialist agent role in our contact centres to support front line agents and investing more time in our teams with daily huddles, team meetings, 121s and development conversations.

Alex Saunders
Sewer Network Manager

Brand principle in action: Straight talking and inclusive

Talking to more than 50 media outlets about the Whitechapel fatberg, Alex, Sewer Network Manager, has helped highlight the dangers of flushing the wrong things down the toilet to millions of our customers. Fatbergs can affect each and every one of us and we all need to work together to protect our homes and the environment. Our innovative 'Bin it, don't block it' awareness campaign tells customers that they are in a hot spot area and gives advice on what they should and shouldn't send down the drain.

£316,675
raised for WaterAid

33%
reduction in lost-time injuries

45%
reduction in work-related illness cases

We have a formal annual appraisal process and encourage employees to progress their careers using personal development plans, development modules, e-learning, networks, mentoring, sponsorship and development programmes.

Developing and rewarding employees

Employee reward and recognition

During the year we launched 'Share in Your Success 2020' for all employees in non-managerial grades. The incentive scheme, which offers a potential payment of up to 5% of salary in 2020, is linked to delivery of our transformation plan.

We celebrate success and when our people go the extra mile for our customers. In 2017 there were 1,117 nominations for our 'Spotlight' employee awards, an increase of 19.5% on the previous year. Chief Executive Recognition awards were given to a number of employees including the Grenfell Tower incident response team.

Learning & Development

Last year we held over 23,000 training days across the company. We have a formal annual appraisal process and encourage employees to progress their careers using personal development plans, development modules, e-learning, networks, mentoring, sponsorship and development programmes. We are investing in training technology across the business, for example upgrading our health and safety training to incorporate the innovative use of immersive virtual reality training scenarios and, recognising the threat of cyber security, particularly in our industry, we rolled out cyber security and general data protection regulation ("GDPR") training across the business.

Talent pipeline

We run traineeships, apprenticeships and graduate programmes to develop technical and leadership skills and nurture the talent we'll need for the future. In 2017/18 we welcomed another 37 apprentices and 38 graduates into the One Thames Water team. For waste operations we have built career pathways and have over 30 Technicians on a pathway called 'Technician to People Manager'.

We have also been driving our women's leadership pipeline and sponsor two development programmes alongside women's network groups. We have seen a number of promotions into our senior leadership roles and improvement in female representation across our grades. Within the year, 39% of people promoted are female and 67% of people promoted to Executive positions are female; 30% of our Executive Team is female.

We are also building our relationships with schools and colleges across our region, sponsoring the London Design and Engineering University Technical College, and supporting both Reading and Swindon University Technical Colleges, to promote science, technology, engineering and maths ("STEM") subjects and inspire the next generation of Thames Water employees.

Magdelena Szwed
Smarter Home Visits, Water Efficiency Team

Brand principle in action: Proactive and responsible

As part of the Smarter Home Visits water efficiency team, Magdelena visits customers in their homes to give them personalised tips on how to be more water wise, to help them save money off their bills. This programme, the largest of its type in the industry, also helps protect precious water resources, with visits estimated to save 5.33 million litres of water a day during 2017/18. We delivered over 69,000 visits last year as a collaborative effort with our customers to make a difference.

1,117
nominations for our 'Spotlight' awards

23,737
training days last year

37
apprentices and 38 graduates joined us in 2017/18

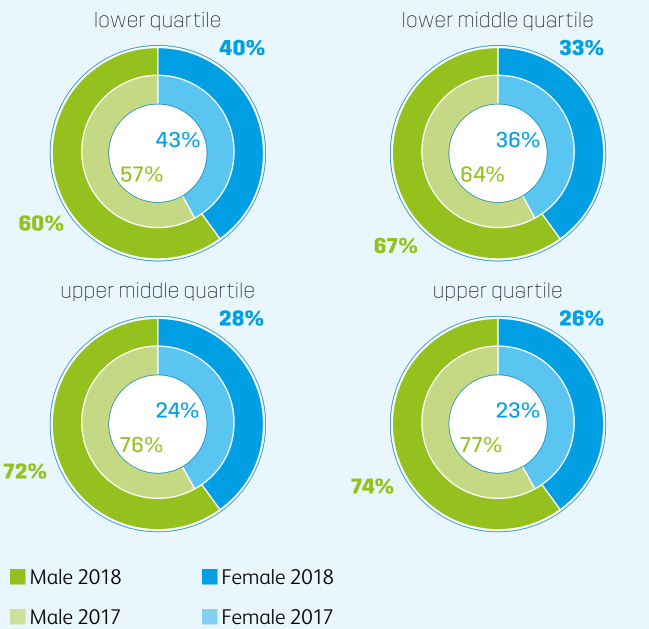
Our gender pay gap as at 5 April 2018

Embracing diversity in all its forms makes us both stronger and more effective as a company, leading to a better service for our customers. We published our first gender pay gap report in December 2017 using a snapshot date of 5 April 2017. Since then we have been taking positive steps towards reducing our gender pay gap as part of our wider diversity and inclusion strategy. Women make up 33% of our workforce and we are continuing to look at ways to increase the number of women within the company.

Pay gap

Our mean gender pay gap has reduced from 13.3% at 5 April 2017 to 10.8%* at 5 April 2018. Our median pay gap has also reduced, down from 15.4% to 12.5%. This is due to an increase in the number of women within our upper pay quartiles and less women in our lower pay quartiles.

* For this report we have excluded an allowance paid to our Network Service Technicians (NSTs) which most closely approximates "pre-paid" overtime and distorts the outcome. If this number were included the mean gender pay gap would be 12.82%, a reduction of 0.5% year on year.



Bonus gap

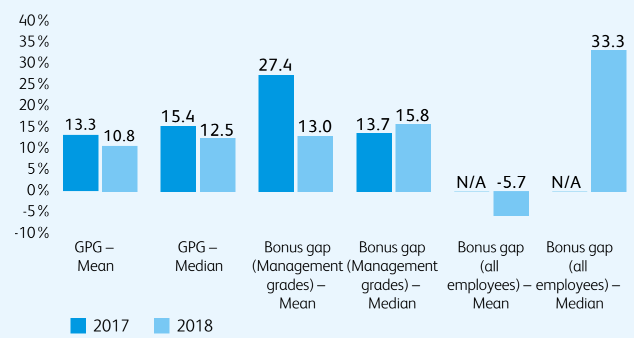
Our average (mean) bonus gap is 5.65% in favour of women, while the median bonus gap is 33.33% in favour of men. Under gender pay gap reporting rules, bonus payments include long service and recognition awards as well as annual management bonus. 15% of women and 18.65% of men received these types of bonus award.

Our long service awards are typically between £100 and £1000 and 77% were awarded to men reflecting the industry wide pattern of having more men with long service. Recognition awards which are typically between £10 and £50 have been awarded more evenly.

9% of our employees are eligible to receive an "annual management bonus". The mean bonus gap for these employees has reduced from 27.4% in 2017 to 13% in 2018 although the median gap has increased slightly.

This mix of different payments is reflected in the bonus pay gap.

Gender pay gap %



Reasons for our pay gap and plans to reduce the gap

The key reasons for our gender pay gap are common to our industry. These include more men in senior roles as well as more men in roles attracting shift pay and other working pattern allowances.

As noted, we have removed the Network Service Technician (NST) allowance which is effectively pre-paid overtime and which alone distorted the gender pay gap by over 2%.

Senior roles

A key driver in our pay gap is the smaller number of women in senior roles compared to men. We are pleased that actions we have taken in 2017 have had a positive impact on the pay gap.

Since April 2017:

x3
The number of women on our ten person Executive team has tripled from one to three.

53%
of those recruited to our 2017 graduate programme are female

52%
of people who were promoted into a management grade are female

33%
We are also continuing to sponsor female managers to attend leadership masterclasses. 33% of those who attended in 2016 have been promoted so far.

Working pattern allowances

Shift pay and other working pattern allowances often relate to technical and engineering roles, and there's a higher prevalence of men in these roles. As such 90% of these allowances are paid to men. We are seeking to promote these careers to females, through initiatives such as our 'women in water networks' and 'women in engineering' workshops.

If we exclude these allowances from our calculations our mean pay gap drops to 8.4% and our median pay gap drops to 8.1%.

Reviewing the way we pay people, and the effect on gender pay, is part of our people plan.

What is the 'gender pay gap'?

The gender pay gap is the difference in the average earnings between men and women, regardless of the roles they do. Gender pay differs from 'equal pay', which looks at pay differences between people carrying out the same or comparable work.

Mean versus median

The gender pay gap is reported on both a mean (average) and median (mid-point of a group) basis. The two measures are complementary and illustrate different aspects of the distribution of pay across an organisation. The mean gender pay gap is the difference in the average hourly pay for women compared to men. If you were to separately line up women and men from lowest to highest pay rate, the median pay gap would be the difference between the hourly pay rate for the middle woman compared to the hourly rate for the middle man.

Chief Financial Officer's statement

Resilient and transparent finances

Chief Financial Officer
Brandon Rennet

Increasing transparency

Since I joined Thames in March 2017, many stakeholders have asked me about my views on our financing arrangements and corporate structure – and I am always happy to discuss these important matters. Increasing transparency, as a key step in building trust, is a high priority and I am very pleased that Sir Tony Redmond agreed to ask me some of the big questions on behalf of customers.

Interview with Sir Tony Redmond

Brandon Rennet was interviewed by Sir Tony Redmond the Regional Chair of the Consumer Council for Water for London and the South East and Vice-Chair of the National body. He is also Chair of the Business Planning and Finance Group of Thames Water's Customer Challenge Group (CCG). The CCG has two main roles; to monitor whether Thames Water is meeting its commitments and reporting what progress it finds on an annual basis and also to see whether Thames Water's future plans will deliver what customers need and want.

His previous roles include Chairman and Chief Executive of the Commission for Local Administration in England and Local Government Ombudsman. This followed a substantial career in Local Government where he held the post of Chief Executive of the London Borough of Harrow as well as Finance Director roles at Knowsley Metropolitan Borough Council and the Merseyside Police Authority.

Q Transparency is really important for customers. How are you addressing this?

We recognise that in the past our annual reports have been light on some of the detail that our stakeholders, and some of our customers, want to understand. We are focused on improving our reporting so that it is moving towards being considered best-practise, using clear and concise communications with less jargon to help users understand how the business works and how we interact with the supply chain.

This combined report is more transparent this year, so customers will be able to learn more about the issues we've been facing, the investments we've been making in the business, and where we've started seeing some of the operational improvements come through. For example, leakage is an area that has a lot of emphasis this year and we have been transparent in the issues encountered and how we are responding as we appreciate the impact this has on all our customers.

We have been working to simplify our corporate structure to reflect where the business is today. It can be difficult to understand the structure, however it's important to realise it wasn't put in place to be confusing. Rather, it evolved over 30 years, including during periods when Thames Water had overseas operations. As we are fully focused on serving London, the Thames Valley, and the surrounding area we are closing the entities that are no longer required.

Q Customers have expressed concern about your offshore holdings and whether they help to avoid tax. What impact will the changes have on customers?

The first thing to say about the Cayman Islands companies is that they provide no tax advantage to Thames Water or its shareholders. In fact, there is no tax benefit whatsoever from having them. The reason they are in the structure dates back more than a decade to when Thames was acquired by Macquarie from the German utility, RWE. At that point in time there were rules in place that prevented UK public listed companies from issuing debt in order to fund the acquisition of their own shares, so entities registered in the Cayman Islands were used instead.

Although there has never been a tax benefit, we recognise the word "Cayman" conjures up thoughts of tax avoidance and complicated offshore arrangements, and that perception is not helpful. Because of this we have made the decision to close these entities down.

It is a complicated process because we needed to get approval from all the investors that hold debt that was issued by our active Cayman Islands company. However, we have now secured those approvals. No further debt will be raised through the Cayman Islands subsidiaries.

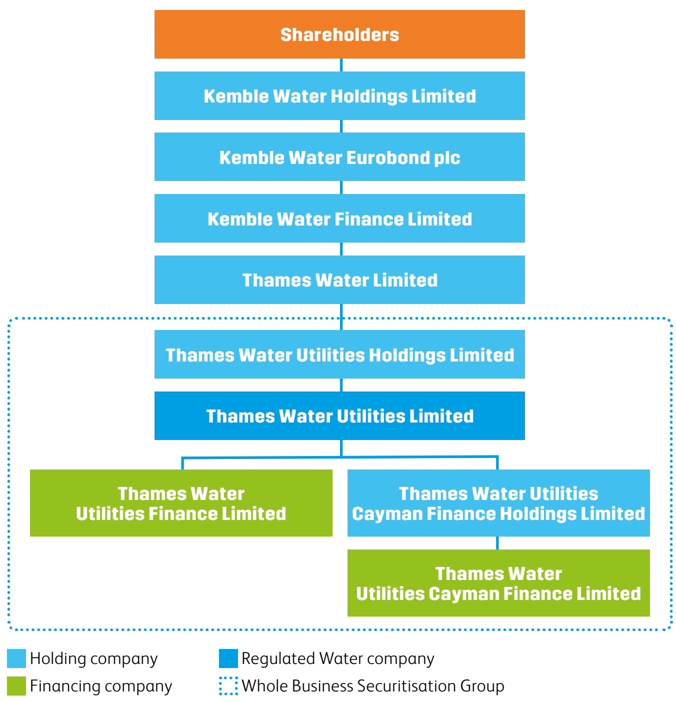
Q You haven't paid corporation tax for many years and this attracts a lot of media and political attention. What will the Company be doing to address this?

There certainly are a lot of misconceptions about tax, and we want to make the position as clear as possible. Thames Water is not paying corporation tax at the moment and the only people to benefit from this are our customers. This is because the reduced cost is fully passed to customers through lower bills. That is how the regulation of the water sector works.

Currently, Thames Water does not pay corporation tax because of the Government's capital allowances scheme, and the impact of our interest costs. The Government's scheme incentivises capital investment and effectively defers the time at which tax is paid. Interest costs are deductible for tax purposes and are substantial at the moment. Again, neither the Company nor its shareholders benefit from this – only our customers see the benefit in the form of lower bills.

It's also useful to consider the context. While Thames is not paying corporation tax right now, we are paying around £192 million in other forms of tax like business rates, payroll taxes and environmental taxes – and this is at a time when we're investing over £1 billion a year, spending a further £1 billion a year on operating costs, and our shareholders are not taking any dividend.

Our structure explained



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

The most important thing is to present the facts in a clear and transparent way. I'm confident that customers want us to sustain the high level of investment in our vital infrastructure across our supply area, and they appreciate the positive effects the corresponding tax deferral has on their bills. If you were to ask a customer whether they would want Thames Water to pay more tax and their water bills to go up, I expect many would prefer things as they are.

> **Thames Water is not paying corporation tax at the moment and the only people to benefit from this are our customers. This is because the reduced cost is fully passed to customers through lower bills.**

Q You have had major changes in the Board at Executive level recently. How are you going to be explain that to customers, especially around pay?

We have a more comprehensive remuneration section in this report. One of the main changes is that our Chief Executive Steve Robertson is deferring any bonus until 2020, and it will be entirely driven by the challenging customer-focused operational results that we deliver over the period.

We have also looked closely at how we incentivise senior and middle management and are clear about aligning these structures with customer delivery, rather than things that might benefit shareholders alone, such as dividends. Everyone at Thames is aligned with the same goals and will only receive variable pay based on how we perform against our targets.

We believe variable incentives are the right way to achieve our goals as management can be held to account for performance. To ensure there is complete transparency, we are communicating the performance on key areas such as leakage on a monthly basis.

Q There has been a lot of discussion about the balance of customer and shareholder interests and particularly the level of debt the Company has – the highest of any UK water company. How do you justify that?

Our level of debt has increased steadily over the last decade driven largely by the scale of our investment programme. We are very focused on ensuring that we run the business efficiently and effectively for the benefit of all stakeholders – and a component of that means being financially resilient.

Our current level of gearing – the ratio of debt to Regulatory Capital Value – is 81.3%. We carry out stress tests regularly and are confident that this is sustainable. Others agree – we have strong investment grade credit ratings with two of the major credit ratings agencies.

That said, the Board and our shareholders are all committed to bringing the gearing down over time, and I expect this will start to be noticed over the next few years.

Q Have your customers seen any benefits from Thames Water's new shareholders?

More than half of our shares changed hands last year, and most of our investors are now pension funds, meaning they have a very long-term investment horizon. The immediate benefit we've seen from that is their willingness to suspend dividend payments to enable more investment in fixing issues such as leakage.

When we do start paying dividends again that money will largely be going into the pockets of the pensioners our shareholders represent.

The organisations that manage those funds are experts in investing in infrastructure and will be supporting Thames Water for a very long time.

Q Shareholder dividends have also attracted a lot of attention recently. How do you go about setting dividends?

The main point here is that we've decided not to pay any dividends to our external shareholders until 2020 at the earliest – which means three consecutive years without dividends. We've agreed with our shareholders that we want to invest the money in the business instead right now, in important areas like leakage, to help us improve the service we provide customers. All our current shareholders are aligned with our long-term plans, with our newest shareholders agreeing not to receive a dividend for their first three years of investing in Thames Water. You will see that we have paid £55 million of dividends this year, and I want to be clear that this money is not going to shareholders. Rather, it's being used to pay interest costs on debt sitting at our holding company level – this debt has been loaned by third parties.

We're also in the process of reviewing our dividend policy, which will explicitly set out how the Board will take account of the level of service we've been delivering for customers, and whether we're striking the right balance between our customers and other stakeholders.

Q One big area of concern for customers is bills. Although your bills are at the lower end, they always cause worries. Can you provide any assurances that bills will be affordable?

We have been consulting customers on this heavily as we develop our plans for the next five year period from 2020. From the discussions we've had with customers we've found that affordability is always an issue on their minds, but when they weigh that up against what their expectations are of service levels and overall resilience, there is a willingness to pay as long as the money is being spent efficiently and effectively.

However, we know that we do serve a number of customers in vulnerable circumstances who find the burden of utility bills especially hard to bear, and we are greatly expanding the financial support we can provide to those who really struggle to pay.

Q How will you be communicating your new approach?

When we issue these results, we will be publicising them widely and will be fully engaging with the media. We fully recognise the privilege of our monopoly position and we have to hold ourselves to account to a very high bar. So, we will definitely be on the front foot in terms of telling people what is going on in Thames Water. Hopefully stakeholders will agree that our annual report and performance report, which have been combined to help provide the right balance between operational and financial performance, are much clearer this year.

Q How are you fixing some of your oldest problems?

There is a lot of detail in our annual report about the improvements around key issues of leakage and pollutions. We are dealing with some very old infrastructure, in some very inaccessible places at times, so we cannot promise that there won't ever be incidents affecting customers – that is the nature of our networks for now. However, we are very focused on improving our ability to react to these issues. With the help of advanced monitoring technologies, we can now get the right people with the right skills on the ground very quickly when things go wrong, giving us the opportunity to look after our customers better than we ever did in the past.

Financial performance

Key financial metrics are summarised below:

	Underlying 2018	BTL 2018	Total 2018	Underlying 2017	BTL 2017	Total 2017
Revenue (£m)	2,018.0	26.9	2,044.9	2,027.1	33.0	2,060.1
Operating expenses (£m)	(1,595.1)	(0.4)	(1,595.5)	(1,515.4)	–	(1,515.4)
Operating profit (£m)	517.0	26.5	543.5	605.4	33.0	638.4
Net finance expense (£m)	(435.7)	–	(435.7)	(361.8)	–	(361.8)
Net losses on financial instruments (£m)	(46.7)	–	(46.7)	(205.5)	–	(205.5)
Profit before tax (exc. sale of NHH) (£m)***	34.6	26.5	61.1	38.1	33.0	71.1
Profit before tax (£m)	124.3	26.5	150.8	38.1	33.0	71.1
Profit after tax (£m)	108.8	24.9	133.7	108.4	30.8	139.2
Capital expenditure (£m)	1,148.8	–	1,148.8	1,218.0	–	1,218.0
Net debt (£m)	11,336.2	–	11,336.2	10,749.4	–	10,749.4
Dividends paid (£m)	55.0	–	55.0	157.0	–	157.0
Interest cover (PMICR)*	1.6	–	–	1.4	–	–
Gearing (%)*	81.3	–	–	81.5	–	–
Credit rating**	–	–	Baa1 negative	–	–	Baa1 stable
Profit before tax (exec. sale of NHH) (£m)	34.6	26.5	61.1	38.1	33.0	71.1

* As defined on page 147.
** Representing the consolidated Corporate Family Rating assigned by Moody's.
***This measure is statutory profit before tax less the profit recognised on sale of the non-household business per note 6.

Financial resilience

A key theme over the last year has been the financial resilience of the water sector as a whole, and of companies such as Thames Water, with relatively high levels of debt. As you would expect, financial resilience is another of my top priorities and I appreciate the public interest in ensuring critical businesses such as Thames Water are resilient. Importantly, the Whole Business Securitisation structure, which was put in place over a decade ago, helps to strengthen our overall level of resilience as it effectively places limitations on the level of risk we can take when it comes to managing the finances of Thames Water.

I welcome the prompting from Ofwat to be more open about our long-term financial resilience and have worked with my team to engage people across the business in carrying out a detailed review of the potential impact of our principal risks. This is reflected in the Long Term Viability Statement on page 79–82, which considers a ten year time horizon.

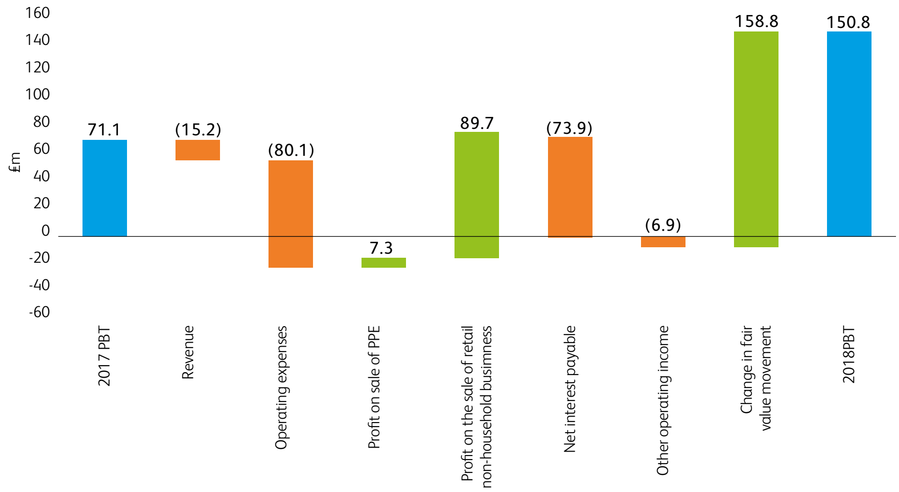
Another key measure of our financial strength is our credit rating. We continue to maintain a strong investment grade credit rating assigned by external rating agencies Moody's and Standard and Poor's ("S&P").

In May 2018, Moody's affirmed our Baa1 Corporate Family Rating ("CFR") however placed us on negative outlook (2017: stable outlook). This continues to be a strong investment grade credit rating supporting our ratings of A3 and Baa3 for our Class A and Class B debt respectively. The change to negative outlook was primarily driven by a change in assessment of the stability and predictability of the UK water regulatory regime rather than a reflection of our operational performance. In September 2017, S&P assigned us a credit rating of BBB+ and BBB- (2017: A- and BBB) in respect of our Class A debt and our Class B debt respectively and placed us on stable outlook (2017: negative outlook). These ratings allow us to issue efficiently priced debt to fund our investment programmes, whilst keeping bills affordable for our customers.

Overall performance

Total profit before tax ("PBT") for the year was £150.8 million (2017: £71.1 million). This includes recognition of £89.7 million profit on the sale of the non-household business to Castle Water Limited, which completed on 1 April 2017 – the date of non-household retail market opening and favourable movements on our financial instrument portfolio.

A summary of the movement in our total PBT is shown below:



Revenue

As a regulated business, the amount we bill our customers was agreed by Ofwat through the price review process before the start of the current five year regulatory period. As such our underlying revenue does not significantly fluctuate year-on-year. Overall, underlying revenue for the year has decreased slightly compared to the previous year by 0.5% to £2,018.0 million.

Our bills include amounts relating to the construction of the Thames Tideway Tunnel and therefore movements in our total revenue are affected by movements in these billings. As we collect the cash this is passed onto Bazalgette Tunnel Limited ("BTL") and is excluded from our underlying results. Revenue related to BTL has decreased by 18.4% to £26.9 million. The reduction is due to the phasing of construction works.

Capital expenditure

During the year, we invested a total of £1,148.8 million (2017: £1,218.0 million) in our assets, including £446.0 million on the water network, £395.1 million on the wastewater network, £81.7 million on our sludge assets and £38.7 million on the Thames Tideway Tunnel ("TTT"). This spend includes the following key projects:

- Water network: Metering (£52.1 million), Infrastructure Alliance boundary capital works (£50.3 million)
- Wastewater network: Deephams sewage treatment works upgrade (£64.9 million), network capital works (£36.5 million)
- Sludge: Crossness sludge (£19.7 million)
- TTT: TTT interface works (£38.7 million)

Our capital expenditure also includes amounts invested in our intangible assets including £32.5 million on the implementation of our new customer relationship management and billing ("CRMB") system and £6.5 million on a new meter data management system.

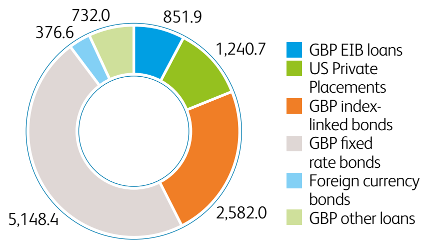
Our capital expenditure has decreased by £69.2 million (5.7%) to £1,148.8 million (2017: £1,218.0 million) due to the phasing of our capital projects.

Financing our investment

As we continue to invest heavily in the business, our statutory net debt (as defined on page 147) has increased by £586.8 million to £11,336.2 million (2017: £10,749.4 million). This has been accompanied by an increase in the Regulatory Capital Value ("RCV") of £760.4 million to £13,704.8 million (2017: £12,944.4 million), meaning that overall gearing has reduced. Additionally, our PMICR in the current year is 1.6x (2017: 1.4x) and is above the mandated minimum of 1.1x.

We continue to borrow through external public and private debt capital markets and through financial institutions across a diverse range of currencies, geographies and sources. The last year has seen us focus on increasing diversity with the issue of a £705.1 million US Private Placement in March 2018, our debut green bond and our CAD 250 million (£43.6 million) inaugural Maple bond in the Canadian market. The overall debt mix is shown below, excluding the impact of swaps held in subsidiaries:

Borrowings carrying value – £m



The associated net finance expense has increased by £73.9 million to £435.7 million (2017: £361.8 million), which has been driven primarily by higher RPI accretion on borrowings, in addition to the increased borrowing levels. Some of our interest expense is incurred in relation to borrowings raised to deliver major capital projects. Under the IFRS accounting framework we capitalise the interest costs related to major capital projects with the finance expense in the income statement being shown net of these capitalised costs. Capitalised interest costs were £100.7 million this year (2017: £76.3 million). The increase in the capitalised borrowing costs is partly due to a higher effective rate, 5.58% (2017: 4.86%) as a result of higher RPI accretion.

Bad debt

Bad debt arises predominantly from those who choose not to pay their bill, despite being financially able to, as opposed to those who cannot pay. This year we had an overall increase in bad debt cost of £7.1 million to £57.5 million (2017: £50.4 million). This is split between bad debt relating to current year bills of £28.7 million, which is shown as a deduction in revenue, and bad debt relating to bills from prior years of £28.8 million, which is shown within operating expenses. The overall increase in bad debt is due to a number of factors including:

- An increase in write offs for our waste only customers who are billed by other water companies, over which we have no control of collections
- Lower cash collection rates on our customer bills that have been cancelled and then rebilled. Where there has been a change of occupier and a bill is cancelled and split between incoming and outgoing occupier, the portion of debt associated with the outgoing occupier is more difficult to collect

Operating expenses

Our underlying operating expenses have increased by £80.1 million (5.3%) to £1,595.5 million from 2016/17, driven mainly by:

- A £20.6 million increase in our business rates costs
- A £19.1 million increase in our personnel costs, as we have increased employee numbers, particularly in the Customer Experience and Digital teams, to focus on improving customer satisfaction
- A £24.5 million increase in the element of bad debt relating to operating expenses
- A £9.2 million increase in depreciation and amortisation, in line with our ongoing investment programme

Financial instruments

Our borrowings, revenue and totex (as defined on page 238) are exposed to fluctuations in external market variables such as changes in interest rates, inflation and foreign exchange rates. We manage these exposures by entering into derivative contracts in order to hedge against future changes in these external rates.

We have approximately £5.5 billion of derivative financial instruments (face value), which include £0.6 billion of forward starting interest rate swaps that have fixed a significant element of the cost of debt we expect to borrow before 31 March 2020. A total loss on financial instruments of £46.7 million was recognised in the income statement during the year (2016: £205.5 million). This is primarily driven by a £84.3 million loss on cash flow hedge transferred from reserves, partially offset by £31.8 million fair value gains on swaps and £5.8 million net foreign exchange gain on foreign currency loans. The fair value gain on swaps includes a £27.7 million credit resulting from an improvement in the methodology that we use in our fair value calculations. Note 8 to the financial statements provides detail of the amounts charged to the income statement in relation to financial instruments.

Dividends

No dividends or interest on shareholder debt was paid to external shareholders in 2017/18 after our Board decided to reinvest profits back into the business to improve our service to customers.

During the year, we paid dividends of £55.0 million (2017: £157.0 million) to our parent company Thames Water Utilities Holdings Limited ("TWUHL"), with all of these current year dividends being applied to servicing debt obligations and working capital requirements of other companies within the Kemble Water Group. Last year, £100.0 million of the dividend was paid to external shareholders of which £77.2 million was used to pay interest on shareholder debt. The diagram below summarises how the dividends the Company paid during 2017/18 have been utilised and distributed by the Group:

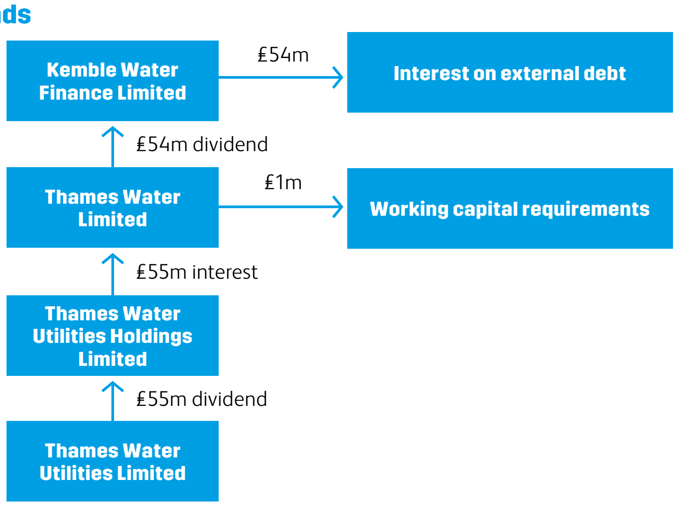
Financial flows

Our revenues are set according to a very detailed regulatory process which allows for the recovery of efficient costs plus a return for investors in the business. The actual return to shareholders in any period is therefore determined by these allowed revenues, and by the degree to which actual costs are higher or lower than the efficient levels allowed. Other key factors affecting returns are the level of rewards or penalties, and the amount of equity invested by the shareholders.

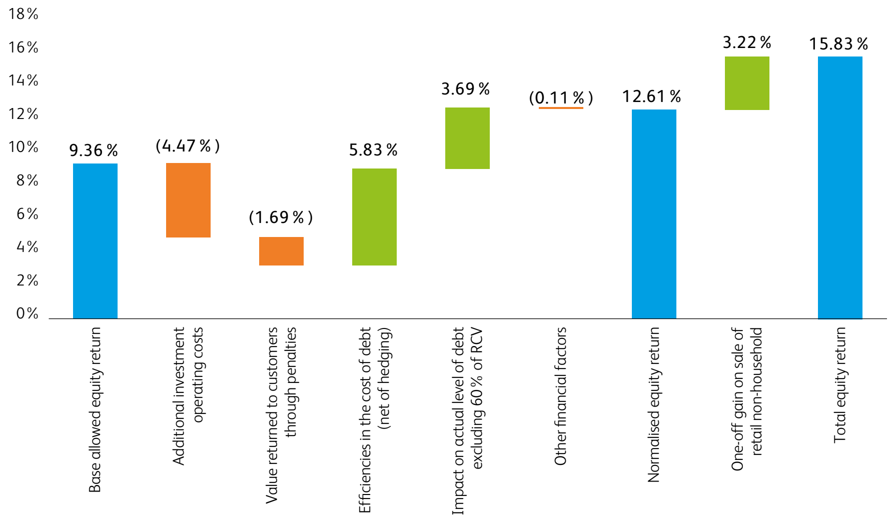
In order to provide a consistent metric capable of being used as a basis of comparison, we are presenting returns based on a measure of "regulatory equity" that has been developed with Ofwat. Here, the value of equity is calculated as the Regulatory Capital Value less the amount of net debt in the regulated business. Directly observable share prices of listed companies in the sector show that market values of equity have historically been higher than this "regulatory equity" value, but this is not factored in to this analysis.

In the year to 31 March 2018, the efficient allowed level of return for shareholders for a company with the notional capital structure (i.e. debt equal to 62.5% of RCV) was 9.36%.

Dividends



Breakdown of 2017/18 actual return



Total shareholder return on an equivalent basis was 12.61% (before the sale of the retail non-household business), which is 3.25% above the base level. Adding on the one-off gain from this sale gives an overall return of 15.83% – albeit this gain (equivalent to a return of 3.22%) is offset by reduced returns in future periods.

Outperformance in this financial year has been driven primarily by our cost of debt being lower than the allowed level, and by the level of debt being higher than the "notional" level, giving higher returns of 5.83% and 3.69%, respectively. Taking the cost of debt first, there are two drivers:

- Firstly, underlying lower cost of debt than the allowance, before considering the effects of inflation; and
- Secondly, because around half of our debt is fixed rate, its cost does not increase with inflation, meaning that it remains relatively low even when inflation moves higher, as was the case in 2017/18.

When it comes to the overall level of debt, or gearing, levels above the regulatory assumption of 62.5% debt to RCV have the effect of amplifying the percentage return to shareholders, because debt is less expensive than equity. Another impact of higher gearing levels is that it increases the volatility of shareholder returns, which become proportionately more sensitive to levels of out or under performance. Our average gearing level in 2017/18 was around 83%, which resulted in a 3.69% increase in overall shareholder returns.

We are responsible for financing our business as efficiently as possible. Our financing structure, the Whole Business Securitisation, offers additional protections to debt investors enabling us to have higher levels of debt without reducing our credit worthiness. For the avoidance of doubt, any additional risk associated with having a higher level of debt remains with our shareholders, and is not transferred to customers.

Placing a number of the other factors in context, our investment levels, and spend on operating the business (together "Totex") were £100.9m above our allowance for the year, and we are returning £38.1m to customers through penalties.

Of the total regulatory return noted above, the vast majority (88%) was retained in the business, with the remainder distributed to cover financing costs elsewhere in the group. No dividends were paid to external shareholders.

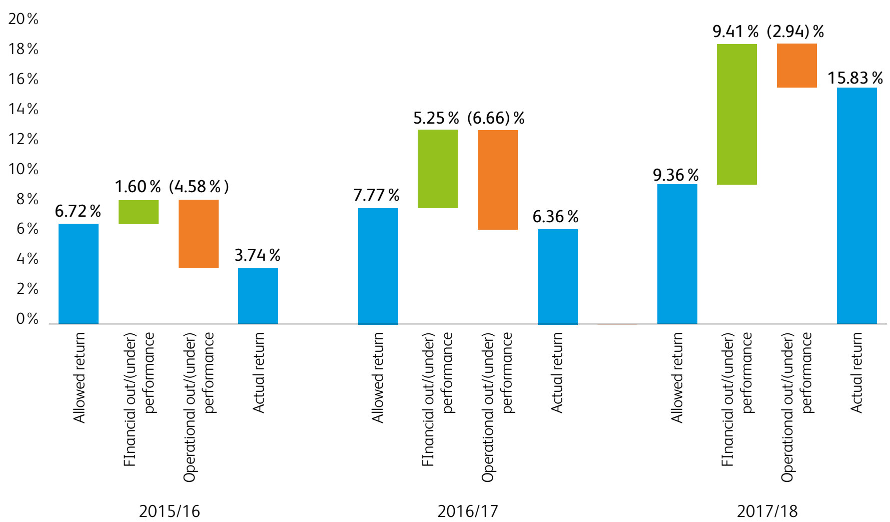
Over the past 3 years, only in 2017/18 has the actual shareholder return exceeded the allowed return, as shown below. The 2017/18 actual return, in the graph above, includes the one-off benefit from the sale of the retail non-household business. In 2015/16 and 2016/17 operational underperformance outweighed the benefits from financial factors. The operational underperformance is mainly driven by the additional totex spend in excess of our allowance which reflects our commitment to prioritise customer interests through higher investment levels. The increase in financial outperformance over the period is mostly due to increases in inflation over the past 3 years.

Pensions

We operate three pension schemes for our employees – two defined benefit schemes and one defined contribution scheme. During 2017/18, we contributed £8.1 million (2017: £6.8 million) to the defined contribution scheme.

The most recent funding valuation of the defined benefit pension schemes as at 31 March 2016 resulted in a combined funding deficit across the two schemes of £364.9 million (2013: £288.3 million). A recovery plan was agreed with the schemes' Trustees in June 2017 at which point, taking into account post valuation experience, the funding deficit was £351.3 million. Under this recovery plan the deficit would be fully repaid by 2027. In the current year the associated pension deficit repair payment was £22.0 million (2017: £20.8 million).

Breakdown of actual return for the past three years



For the purposes of our financial statements, the latest funding valuation has been updated to 31 March 2018 on our behalf by independent consulting actuaries, Hymans Robertson LLP. This accounting valuation is different from the funding valuation due to the use of different assumptions and changes in market conditions from 31 March 2016 to 31 March 2018. The accounting valuation shows that overall there is a combined deficit of £300.8 million across the two schemes (2017: £379.8 million). This decrease is mainly driven by a fall in RPI due to expectations of future inflation decreasing over the year, and an update to the mortality assumptions, which has resulted in a reduction in the expected future life expectancy of scheme members.

Capital, financial and actuarial risk management policies and objectives

The Company's operations expose it to a variety of capital, financial and actuarial risks.

Capital and financial risks

The Kemble Water Holdings Limited Group's ("the Group's") treasury operations are managed centrally by a specialist team, which operates with delegated authority of, and under policies approved by, the Board of Directors. Risks are therefore managed on a Group-wide basis. These policies and procedures set out guidelines for the management of capital, liquidity, credit and market risks associated with the financing activities of the Group. For further details of the capital and financial risks and their management, please refer to note 20.

Actuarial risks

The defined benefit pension schemes are exposed to actuarial risks including investment risk, inflation risk and longevity risk. For further details of these risks, please refer to note 24. The trustees continue to control the level of investment risk within the schemes by reducing the schemes' exposures to higher risk assets and increasing the level of protection against adverse movements in interest rates and inflation. The trustees also review the risk exposures taking into consideration the longer term objectives of the respective schemes.

Brandon Rennet
Chief Financial Officer

27 June 2018

Maintaining control over our risks

Introduction

We recognise that risk is inherent in our business due to strategic threats, operational issues, compliance with laws, regulations and ethical standards, and financial conditions and obligations.

The accurate and timely identification, understanding, evaluation and response to the risks we face are fundamental to the effective development and delivery of strategic objectives to ensure longer term viability and resilience.

The aim of risk management is not to eliminate risk completely from business activities, but to ensure that every effort is made to manage risk appropriately to maximise potential opportunities and minimise the adverse effects of risk.

We are, therefore, wholly committed to the implementation and continuous improvement of a risk framework, including prudent and reliable controls, which enable risk to be managed effectively.

Through understanding and management of risk across our business we increase our ability to effectively deliver value to our customers, people, environment, stakeholders and shareholders.

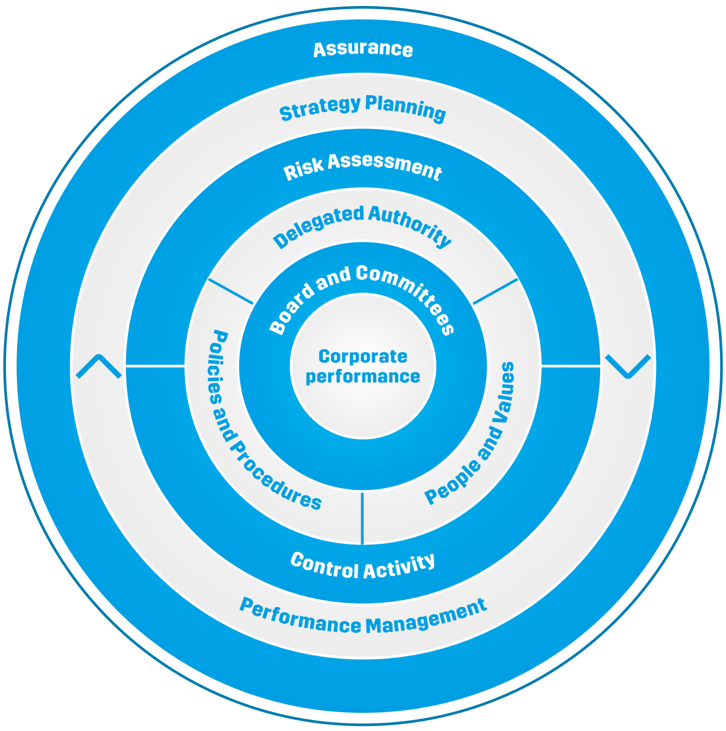
Governance and oversight

Our Board has ultimate responsibility for maintaining a sound system of risk management and internal control. This includes the determination of the nature and extent of the principal risks we are prepared to accept to achieve our strategic objectives, and for ensuring that an appropriate culture has been embedded throughout the organisation.

The diagram below shows some of the key elements of our framework by which our operations are conducted, and which, combined, provide the overall arrangements for implementing, monitoring, reviewing, and continually improving our system of risk management and internal control. At the heart of the process, the Board and its Committees:

- articulate and endorse risk management policy;
- ensure alignment of risk management objectives with the strategies and objectives of the Company;
- oversee legal and regulatory compliance;
- assign management accountabilities and responsibilities at appropriate levels within the Company; and,
- ensure that necessary resources are assigned to achieve a balanced and transparent approach to the management of risks facing our operations, and to measure the effectiveness of the key controls in place to manage them.

The work of the Board and its Committees is underpinned by delegations of authority and policies and procedures covering key areas of our operation.



Risk management is a fundamental element of this framework and helps to ensure that risks are identified and assessed and that risk responses are appropriate. This is achieved across the Company through policies, procedures, systems, monitoring and reporting tools, and the core risk management competencies of all staff.

Key aspects of the risk management reporting and oversight process are illustrated below.

Risks are identified and analysed at four senior management levels:

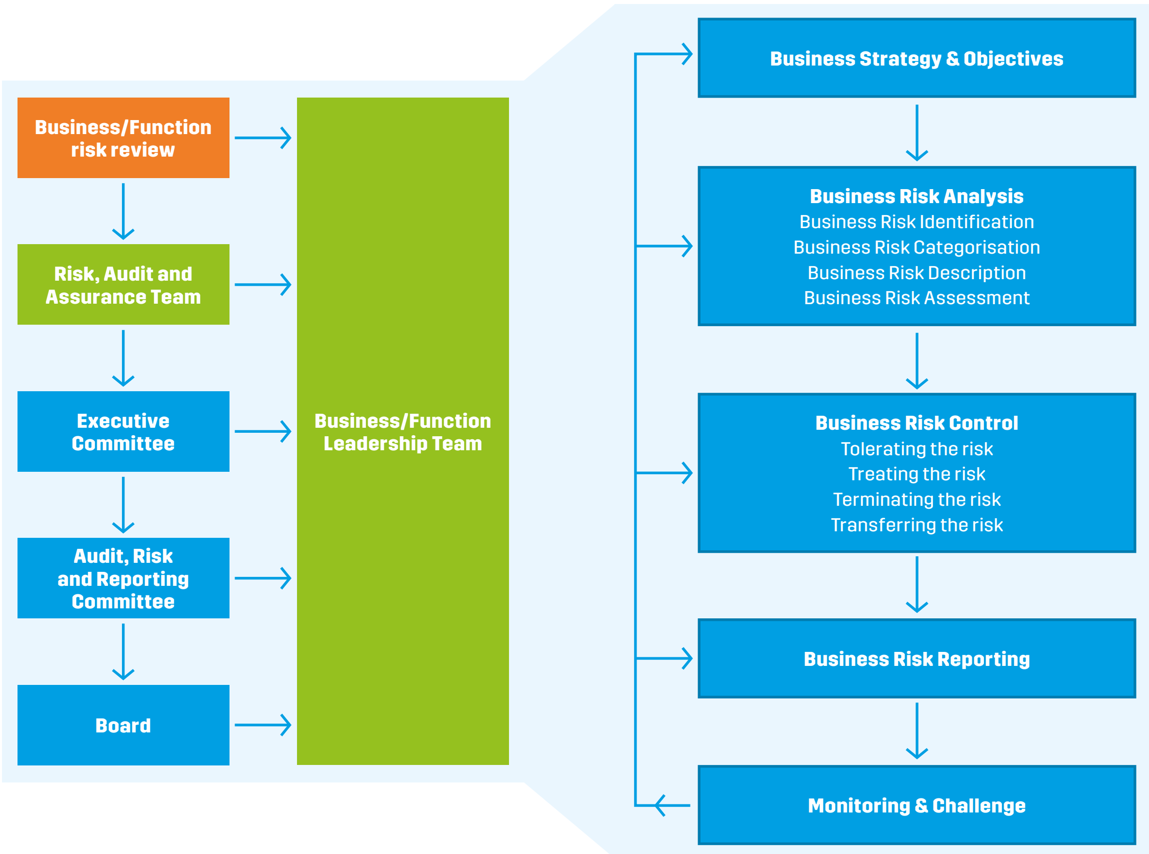
- Business/Function leadership;
- Executive;
- Non-Executive; and,
- Board.

At all four levels, risks are regularly reviewed in terms of their potential impact on our business. The key steps of our risk management process are detailed below.

Risk analysis and control is recorded via an electronic risk management software tool, which helps improve our risk management consistency and performance.

The Audit, Risk and Reporting Committee evaluates the effectiveness of our overall risk management framework and makes recommendations for improvement.

Key aspects of the risk management process



Governance structure for the management of risk:

Oversight	Membership	Key Risk Responsibilities
Audit, Risk and Reporting Committee update to the Board Frequency: Five times a year	**Standing:** Chairman Chief Executive Officer Chief Financial Officer Director of Strategy and Regulation Five Independent Non-Executive Directors Four Non-Executive Directors	▸ Oversee and have overall responsibility for risk management; ▸ Promote a supportive risk management culture; and, ▸ Assess the risk environment, possible risk impacts and appropriate action.
Audit, Risk and Reporting Committee Frequency: Five times a year	**Standing:** Three Independent Non-Executive Directors Two Non-Executive Directors **Invited:** Chief Executive Officer Chief Financial Officer Director of Strategy and Regulation Head of Risk, Audit and Assurance Group Financial Controller External Auditor	▸ Ensure appropriate processes are in place to identify and manage risk; ▸ Review the adequacy and effectiveness of internal controls and risk management systems; and, ▸ Consider the risk and control environment through relevant reporting from management and the external auditor.
Risk Management Meeting of the Executive Team Frequency: Quarterly	**Standing:** Chief Executive Officer Chief Financial Officer Director of Strategy and Regulation External Affairs & Sustainability Director Human Resources Director Chief Digital Officer Chief Operating Officer Director, Customer Experience Director, Strategic Planning and Investment Chief Delivery Officer Head of Risk, Audit and Assurance Enterprise Risk Manager	▸ Establish a strategic and coordinated approach to enterprise risk management; ▸ Review, oversee and advise on internal control and risk management systems; and, ▸ Ensure processes are in place to comply with statutory requirements and protect customers, employees and assets.
Business/Function Leadership Team Risk Management Meeting Frequency: Quarterly	**Standing:** Director of Function Business/Function Senior Management Invited: Enterprise Risk Manager Business/Function Risk Champion	▸ Establish appropriate roles and responsibilities for risk management; ▸ Develop risk management processes & procedures, and implement risk management strategies; and, ▸ Manage risk effectively, including the identification of potential and emerging risks.

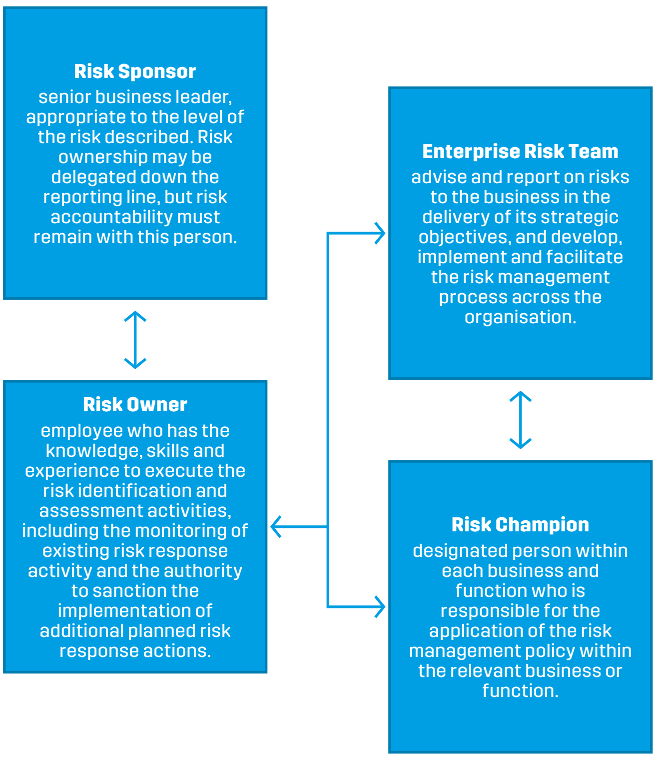
Approach

Our risk management process is developed to align with the Risk Management International Standard, ISO 31000, which aids our compliance with the Financial Reporting Council's UK Corporate Governance Code guidance on risk management. Risks are identified, assessed and managed across all our operations, change programmes, support and corporate functions on a rolling basis and reported to the relevant committee regularly throughout the year. Effects on the Company are based on the likelihood of the following impacts:

- **Health and Safety** – people hazards associated with our operations;
- **Environmental** – environmental hazards associated with our operations;
- **Customer Service** – threats to providing good quality customer service;
- **Regulatory** – potential non-compliance or not achieving regulatory requirements;
- **Legislative** – potential non-compliance with legal requirements;
- **Operational** – threats to effective and efficient performance;
- **Reputational** – threats to the reputation of the Company from events that occur; and,
- **Financial** – potential exposure to unbudgeted financial loss.

Through the risk management process, management consider inherent or unmitigated risks, before assessing the adequacy of controls and the actions planned to mitigate those risks. Risks are prioritised, according to our defined risk scoring criteria, allowing for the most significant risks to be monitored quarterly by Senior and Executive Management, the Audit, Risk and Reporting Committee and the Board. These reviews form the basis for our annual principal risks and uncertainties disclosure.

Our risk management structure consists of fundamental roles in the process:



During the year we self-assured our risk management effectiveness through the annual controls self-assessment process. Each Director of a business or head of function is required to assess the maturity of their risk management system and any material gaps are addressed through clear action plans for improvement, which are regularly monitored.

We are, therefore, wholly committed to the implementation and continuous improvement of a risk framework, including prudent and reliable controls, which enable risk to be managed effectively.

Our system of risk management and internal control aims to ensure that every effort is made to manage risk appropriately, rather than eliminate risk completely, and can only provide reasonable, rather than complete, assurance against material impact. Our management of risk supports this through a number of key company level internal controls and responses:

- **Business planning, budgeting and forecasting** – reviewed by the Executive Team and approved by the Board. These activities support resilient operations and sustainable and robust finances. Our business plan demonstrates how we are going to deliver our strategy, our priorities and what we believe is important to focus on and invest in. The annual budgeting exercise includes a detailed budget for the year and a view for remainder of the asset management plan ("AMP"). Forecasts are prepared quarterly;
- **Performance reporting** – senior management, Executive Team, Board and shareholders receive monthly management reports, including an overview of operational, financial and regulatory commitments performance. Executive Directors report monthly to the Board and on any material matters of strategic importance;
- **System of delegated authority** – delegated levels of decision making authority are reviewed and approved by the Board;
- **Insurance** – insurance programme and insurance team in place. Board review and approval process over the strategic approach being taken to level and type of cover across our operation;
- **Company policies, standards, guidelines and procedures** – governance documentation is reviewed, covering a wide range of our operations and is intended to manage our inherent risk;
- **Training and awareness** – programme in place for key aspects of our operations such as health and safety, data protection, competition, honest and ethical behaviour and cyber security; and,
- **Code of conduct and Whistleblower hotline** – code of conduct and confidential whistleblowing processes are in place to be investigated by a dedicated team, and brought to Executive and Non-Executive attention through formal reporting on cases and conclusions.

Risk universe:

The Executive Team reviewed our inherent Risk Universe during 2017/18 confirming our areas of Principal Risk and Uncertainties. Following our review, we have identified 12 areas of Principal Risk, separated into four categories: Strategic, Operational, Compliance and Financial (with the potential to impact on our strategy in addition to contributing to our business environment). The Principal Risks have been used as the basis for the adverse assumptions and risk scenarios in the Long-Term Viability Statement disclosed on pages 79–82.

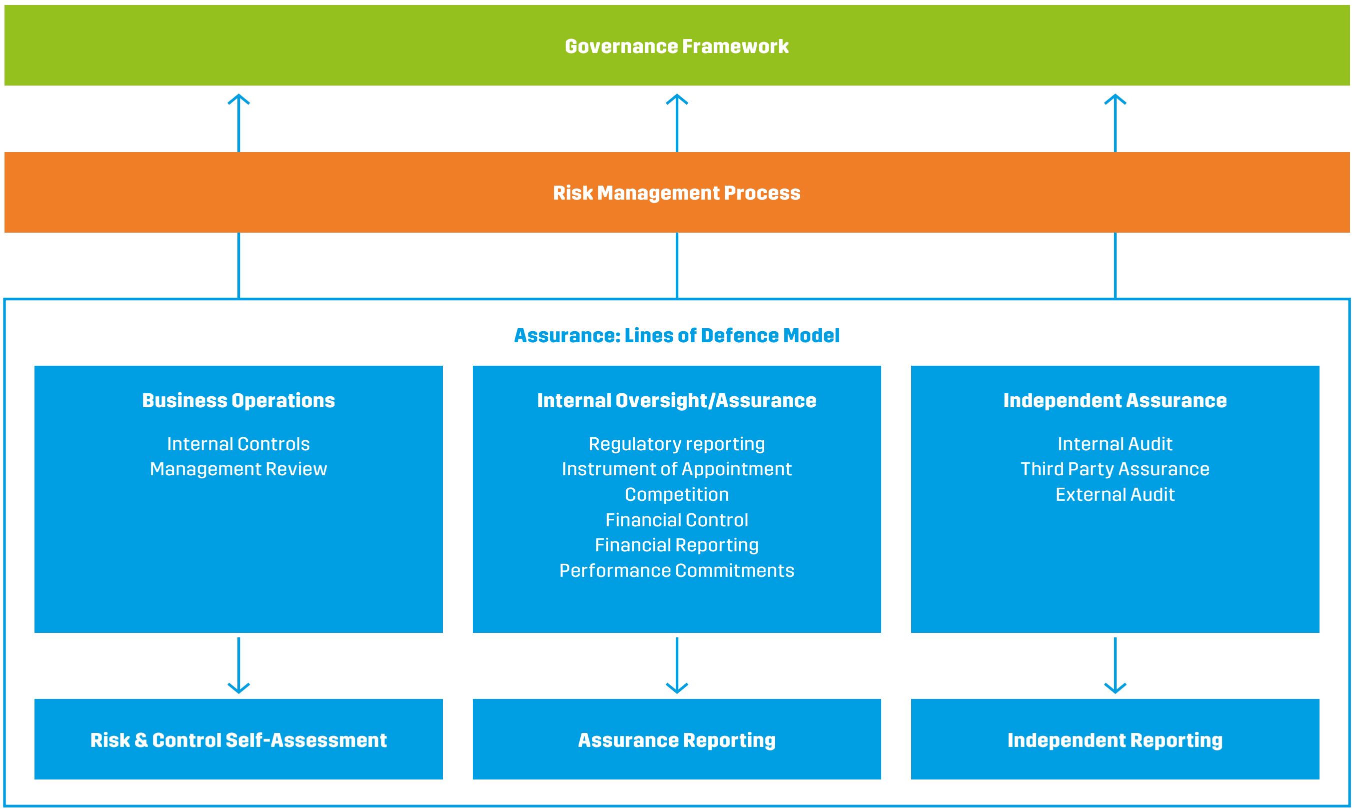
The management of risk supports better decision-making, ensures that our Board and management respond promptly to risks when they arise, and ensures that shareholders and other stakeholders are well informed about the key principal risks and prospects of the company.

During 2017/18 we began to review, update and adapt the risk management framework to clarify, simplify and standardise how risk is currently managed and reported across the company and in business areas and functions.

Over the year we have worked with the business and functions to determine an approach to our principal risk appetite statements that we will continue to progress and align with the development of defined principal risk tolerance levels and Key Risk Indicators ("KRI"). This will be supported by the implementation of a fully documented risk and control framework. This risk appetite and tolerance framework will assist in defining and driving the risk culture of our company.

We are continuing to embed a lines of defence model for our assurance activity that demonstrates a clear and robust structure for Board oversight of our risk, control and audit elements. Increasing the maturity and sustainability of our assurance environment will allow us to integrate governance processes and align with the business planning and investment cycle. We continue to enhance the risk management process, implement a fully documented risk and control framework as well as develop our audit capability and embed a risk-based audit programme.

Risk management framework



Our key focus areas over the year were:

- **Risk Policy** – reviewed and rewritten to define key responsibilities and overall approach to risk management;
- **Principal Risks** – implementation of a structured framework to identify areas of risk as a result of the current Company strategic and business objectives;
- **Risk Reporting** – reviewed and improved the oversight of risk through a more robust reporting process for senior management, Executive, Non-Executive and Board levels;
- **Risk Identification** – improved visibility and implemented a more consistent approach to risk identification through Executive Committee, business and function risk identification workshops resulting in an update to the Company risk register; and,
- **Controls Self-Assessment** – amended the process to focus on the maturity of key areas of control within the business.

Key priorities in 2018/19 to further develop our risk management framework:

- **Risk Standard & Guidelines** – introduction of a formalised risk management methodology;
- **Risk, Control and Assurance Glossary** – standardisation and defining key terms and a common language for the governance framework;
- **Risk Assessment Criteria** – refresh our impact and likelihood categories to ensure they are fit for purpose against the current operating environment;
- **Catastrophic Loss Risks** – formalise a process for the identification, response and effectiveness of business continuity to high impact, low likelihood scenarios;
- **Lines of Defence** – continue to embed a robust "lines of defence" model that describes the accountability for risk management and the control environment within the company;
- **Business Continuity, Disaster Recovery and Resilience** – enhance and test our crisis and event management processes to ensure appropriate levels of preparedness and resilience; and,
- **Risk and Control Framework** – implement a consistent approach to the identification, design and testing of key controls within our operations.

Other priorities through to the end of this regulatory period:

- **Risk Appetite** – agree appetite statements and tolerance levels for principal risks to understand our exposure to risk and the proportionate response;
- **Key Risk Indicators** – implement KRIs to provide insight and measurable information to assist with the decision making process;
- **Training Materials** – deliver risk management training for a consistent approach in embedding our risk practices through the business;
- **Risk Tools and Software** – develop tools and software to support the risk and control processes; and,
- **Integrated Governance** – embed sustainable assurance processes within an integrated governance model and the business planning and investment cycle.

Updating our risk management approach enables us to operate within an acceptable risk environment to make risk-informed decisions in pursuit of improving our customer service and outcome delivery incentive (ODI) performance, reducing penalties and fines and increasing the accuracy of our reporting to build a sustainable business that operates in line with our vision.

Changes from 2016/17 and Realised Risks

The most notable movements across the Company risk register are associated with our strategic transformation, movement in the regulatory landscape, and our operational resilience following a tumultuous period.

During the year, we made a number of changes to our principal risks to reflect our assessment of their effect on the Company and the current environment for the business.

- Key risks **Competition Regulation** and **Legal and Regulatory Compliance** have been combined as **Legal and Regulatory Compliance** to represent the overarching risk to the business;
- **Financial Market** has been refocussed as **Credit and Liquidity** to reflect risks to the balance sheet and financing the company being the main drivers for the business rather than economic factors such as inflation;
- New key principal risks have been included to take account of:
  - the **Climate and Societal** environment, in areas such as long-term climate change and population growth;
  - the **Political, Regulatory and Economic Environment,** in the heightened climate of political and regulatory positions on the industry, our operational performance, PR19 and the general economic outlook;
  - the level of **Trust and Reputation** in the business from our recent operational performance;
  - our level of **Business Planning, Forecasting and Execution** as we reset the business; and,
  - the current and future attraction, retention and capacity pressures on our **People** as the business moves forward.

The following material risks were realised within our business:

- **Asset Management and Performance** – The business experienced a challenging leakage performance in the network, resulting in customer service and supply being affected by a number of water main bursts over the period, worsened by the consequences of extreme weather on our infrastructure.
  - Causes:
    Infrastructure leakage performance
    Extreme weather events
    Asset network resilience
  - Management responses:
    Investment programme to improve network infrastructure
    Event response plan continuously reviewed
    Further develop network modelling to increase resilience in our network
- **Legal and Regulatory Compliance** – We were placed in the prescribed category of Ofwat's Company Monitoring Framework during the year, primarily attributed to shortcomings in the reporting of our leakage performance and errors that were identified within some of our financial tables within our 2016/17 Annual Performance Report.
  - Causes:
    Infrastructure leakage performance
    Data quality and Internal assurance and reporting process
    Decision making governance
  - Management responses:
    Review of control environment underpinning publication and provision of information
    Specific team in place for external reporting assurance
    Alignment of Annual Report and Annual Performance Report for consistency

Special interest risks

Special interest risks are those that may have a material impact on the financial results, reputation or strategy of the Company in the year ahead. While these areas form part of our Principal Risks, further details of their specific nature are provided below.

Brexit:
As a consequence of the UK's decision to exit the EU, there may be changes to the UK Government's policy regarding the water market and carbon emissions that result in a substantial increase in the estimated cost to fulfil our obligations. Assumptions underlying our estimates may change or prove to be incorrect, affecting investment in current or new assets and markets. In the long-run, Brexit uncertainty represents risks for the evolution of our markets and how regulations will now change over time, including other areas of UK government policy such as anti-money laundering, data protection, competition, financial services, consumer rights and pensions. The impact of Brexit on existing employment rights from EU legislation, the ability to hire skilled and unskilled employees, possible wage pressure, and the consequences on existing employees are emerging. A high rate of employee turnover increases the risk of poor knowledge management and forces increased spending on attracting and hiring talent. More importantly, this risk widens the gap between available and required skill sets, which would limit our ability to grow and execute our strategy at the speed required.

Regulatory implications:
Our regulator, Ofwat, will set price limits in December 2019 as part of the next periodic review ("PR19"). The industry is expecting a tougher price control than before with greater efficiency challenge and we anticipate higher potential downside for the Company if we sit in the significant scrutiny category through more significant penalties for poor delivery. This is at a time when we are also in the prescribed category of Ofwat's Company Monitoring Framework. The recent appointment of Rachel Fletcher as the new Ofwat Chief Executive may also signal a different focus and/or interpretation on expectations and outcomes. Our relationship with Ofwat is crucial in this current period whilst our business plan is being agreed. An unfavourable PR19 outcome and Ofwat categorisation and the consequences of the penalty notice received as conclusion to the Ofwat leakage performance investigation (Contravention of Statutory Obligation Under Section 203 of the 1991 Water Industry Act) could result in an adverse reaction from the investment community.

General Data Protection Regulation:
A number of incidents across organisations has increased scrutiny in the processes and controls that companies have in place to protect customer and employee data. The introduction of enhanced requirements for General Data Protection Regulation ("GDPR") come into force in May 2018. There is a dedicated Data Protection Officer, team and programme in place to drive compliance across our business. If we do not have clear visibility of the scale of any exposure across our operations or in our supply chain we run the risk of any incident being penalised under new and increased measures with no precedent set, making the outcome uncertain.

Case Study

Risk Case Study: Prevention of the presence of *Cryptosporidium* within our water supply network

Description: Drinking water quality is a key priority. Following industry events we reviewed our systems against the potential for contamination with the parasite *Cryptosporidium*, which could pose a potential danger to human health if steps aren't taken to treat the water supply effectively.

Risk Identification and Assessment:
- Continuously improving identification and understanding of water quality risk in the network; and
- Developing consistent assessment of water quality risks and critical network site classification.

Risk Response:
- Event exercise run to assess our current level of prevention and event management maturity; and
- Deep-dive of our crisis management procedures considered by the Audit, Risk Reporting Committee.

Risk Monitoring:
- Asset inspection, cleaning and monitoring programme in place; and
- Continuous sampling within the network carried out.

Key risks summary

The Executive Team reviewed the 12 principal risks and consider the following areas of focus key to business impact:

- Health, Safety, Environment and Security;
- Customer Service;
- Asset Management and Performance;
- Trust and Reputation; and,
- Climate and Societal.

Over the course of the year, the Audit, Risk and Reporting Committee considered a deep-dive review of the following principal risks to enable a thorough assessment of the impact of these risks on the company and its ongoing viability:

Key principal risk	Deep-dive considered by the Audit, Risk and Reporting Committee
Customer Service	Company's crisis management procedures
Asset Management and Performance	New retail customer relationship management and billing system
Asset Management and Performance	Wholesale Water Infrastructure Alliance
Health, Safety, Environment and Security	Wholesale Water Asset Health

The table below maps our five key strategic priorities with our principal risks to show where the material impacts lie in effective development and delivery of our strategic priorities.

	Strategic Priorities				
Principal Risks	Be 'Here for you' – create lifelong customer advocates	Use technology to turn customer insight into action	Invest in resilient, proactively maintained digitised assets	Protecting the environment	A collaborative and capable team, dedicated to serving customers
Strategic					
Climate and Societal	✓	✓	✓	✓	
Political, Regulatory and Economic Environment	✓		✓		
Trust and Reputation	✓		✓	✓	✓
Business Planning, Forecasting and Execution	✓	✓	✓		✓
Operational					
Customer Service	✓	✓	✓	✓	✓
People	✓	✓	✓		✓
Asset Management and Performance	✓	✓	✓	✓	
Supply Chain Management		✓	✓	✓	
Health, Safety, Environment and Security	✓			✓	✓
Technology Systems and Security	✓	✓	✓		
Compliance					
Legal and Regulatory Compliance	✓		✓	✓	✓
Financial					
Credit and Liquidity	✓		✓		

Our five Strategic Priorities

- **Be 'Here for you' – create lifelong customer advocates**
- **Use technology to turn customer insight into action**
- **Invest in resilient, proactively maintained digitised assets**
- **Protecting the environment**
- **A collaborative and capable team, dedicated to serving customers**

Climate improving   Climate stable   Climate deteriorating

Descriptions

Our principal risks are all currently overseen by the Executive Committee. As part of our improved governance arrangements across the Company the principal risks will be covered in specific Board delegated Committees going forward.

Health, safety, environment and security

Description
Failure to manage risks resulting from our operations could result in fatality or injury, significant environmental damage, personal health and safety lapses, crime and sabotage and internal security related attack.

Link to strategic priorities:

Risk Climate:

Key Drivers
- Public subsurface work operations;
- Reservoir tunnel integrity;
- Catastrophic asset failure; and
- Water main bursts in populated areas.

Mitigation
- Zero tolerance approach when safeguarding the health, safety and wellbeing of employees, partners and the public;
- Clearly defined strategy, safety policies, protocols and standards that are set, monitored and reported;
- Close work with partners and suppliers to ensure a safe environment; and
- Continue to increase workforce competency through new and innovative training.

Potential business impact
Health and Safety; Environment; Reputation; Financial; Regulatory; Legal; Operations

Opportunity
Lead the industry in Health, Safety, Environment and Security ("HSES") to reduce incident levels.

Executive responsibility
Sarah McMath – Director, Strategic Planning & Investment

Role of the Executive Team
- Debated any risk management matters raised by the Health, Safety & Wellbeing function and the actions being taken by management to respond; and
- Debated specific areas of HSES risk, including subsurface work.

Movement in the period
- There has been no significant change in the inherent risk profile during 2017/18.

Looking forward
- Continue to regularly review performance and inspection programme levels; and
- Review and continuously improve business continuity and resilience programmes.

Customer Service

Description
Unacceptable customer service levels, or the perception that we are failing to maintain and improve service quality will have a detrimental effect on customer satisfaction and complaints, and our performance commitments.

Link to strategic priorities:

Risk Climate:

Key Drivers
- Short and long-term management of water supply;
- Customer service performance and SIM targets;
- Billing system implementation; and
- Water main bursts and network leakage targets.

Mitigation
- Incidents and events that arise are managed through Executive-led response teams with a new dedicated field based customer facing representative team;
- Creation of a team to provide focus on customer insight and satisfaction measurement;
- Improved customer case management capability to proactively manage and resolve follow on work; and
- Engagement with the Customer Challenge Group ("CCG") to provide independent challenge to our business and independent assurance to Ofwat on the quality and results of our customer engagement.

Potential business impact
Customer Service; Reputation; Financial; Regulatory; Legal; Operations

Opportunity
Enhance and consider the needs of our customers in our future plans.

Executive responsibility
Kelly Macfarlane – Director, Customer Experience

Role of the Executive Team
- Monitored progress and trends in customer satisfaction and complaint resolution; and
- Evaluated future customer service requirements and provisions as part of the PR19 business plan.

Movement in the period
- There has been no significant change in the inherent risk profile during 2017/18.

Looking forward
- Implement a new customer relationship management and billing system, as well as stabilising existing IT architecture; and
- Engage with the CCG to deliver customer advocacy through our PR19 business plan.

Asset Management and Performance

Description
Maintenance, operational and weather issues affect the performance of existing ageing assets and lead to potential interruptions to supply and services, environmental breaches, failure to achieve regulatory targets or health and safety threats. High levels of investment to ensure security and resilience are required for existing assets. Capital asset projects are vulnerable to becoming uneconomic and damage stakeholder relationships.

Link to strategic priorities:

Risk Climate:

Key Drivers
- Wholesale infrastructure asset health;
- Water main bursts and network leakage targets;
- Environmental pollution incidents and targets; and
- Asset data driven operational performance and management decision.

Mitigation
- The Board takes a direct interest in ensuring the highest operational standards for significant assets;
- Asset based risk assessment, forecasting, quality assurance procedures and structural integrity monitoring in place to inform investment decisions;
- 2015–20 investment programme to maintain and improve network and asset resilience; and
- Review business contingency plans for asset based incidents.

Potential business impact
Health and Safety; Environment; Customer Service; Reputation; Financial; Regulatory; Legal; Operations

Opportunity
Deliver resilient infrastructure that supports the future needs of our customers.

Executive responsibility
Lawrence Gosden – Chief Operating Officer

Role of the Executive Team
- Monitor progress of business and regulatory metrics and performance commitments; and
- Monitor the delivery of plans and the appropriate allocation of resources to improve infrastructure.

Movement in the period
- The inherent risk profile increased during 2017/18 following operational network issues, regulatory investigation and penalty and leakage target performance.

Looking forward
- Continue to improve and invest in enhancing asset performance and resilience; and
- Implement overarching coordinated approach to wholesale operations.

Trust and Reputation

Description

Future investor funding, regulatory requirements and stakeholder relationships are affected by our transparency of operations and reputation, including that of senior management and the Executive Team.

Link to strategic priorities:

Risk Climate:

Key Drivers

- Water main bursts and network leakage targets;
- Environmental pollution incidents and targets;
- Company financing structure; and
- Customer service performance and SIM targets.

Mitigation

- Engage with customer groups, political parties, regulators, and other stakeholders to understand views and concerns;
- Customer service metrics and performance commitments regularly reviewed by Executive Team and the Board;
- Work to deliver a fair, simplified and transparent offering to consumers; and
- Protect the most vulnerable households through initiatives to improve water efficiency or with financial advice and aid.

Potential business impact

Health and Safety; Environment; Customer Service; Reputation; Financial; Regulatory; Legal; Operations

Opportunity

Enhance our standing as a trusted and responsible utility company.

Executive responsibility

Richard Aylard – External Affairs & Sustainability Director

Role of the Executive Committee

- Monitor progress of business and regulatory metrics and performance commitments; and
- Provide Executive Team oversight to event response, crisis management and business continuity plans.

Movement in the period

- The inherent risk profile increased during 2017/18 following corporate scrutiny and a number of operational issues.

Looking forward

- Continue to build a robust business to move out of Ofwat's Company Monitoring Framework, Prescribed category; and
- Align our governance framework with the revised UK Corporate Governance Code, 2018.

Climate and Societal

Description

Strategic execution, customer behaviour and demand can change due to external influences outside of our control, such as population growth, climate change, long-term weather patterns and new technologies.

Link to strategic priorities:

Risk Climate:

Key Drivers

- Climate change and long-term weather patterns;
- Adverse and unseasonal weather events;
- Population growth; and
- Uncertainty around the UK leaving the EU (Brexit).

Mitigation

- Long-term investment in the network and assets to strengthen customer relationships, secure future water requirements, develop resilience and reduce the impact of adverse weather patterns and events, and population growth;
- Work to manage the unavoidable impacts of climate change to the business and reduce carbon and greenhouse gas emissions;
- Continue to find solutions that balance competing environmental, social and economic demands in a more sustainable way through the five-year business plan; and
- Concentrate on demand reduction activity such as smart metering and water efficiency solutions to help build resilience within the network and assets.

Potential business impact

Customer Service; Financial; Regulatory; Operations; Reputation

Opportunity

Increase operational effectiveness by recognising and managing external trends.

Executive responsibility

Richard Aylard – External Affairs & Sustainability Director

Role of the Executive Team

- Monitor the delivery of plans and the appropriate allocation of resources to long-term strategic drivers; and
- Regularly debated capital investment and any challenges and opportunities.

Movement in the period

- There has been no significant change in the inherent risk profile during 2017/18.

Looking forward

- Continue to regularly review our forecast planning and investment programme; and
- Review the effect the UK leaving the European Union has on our people and market.

Business Planning, Forecasting and Execution

Description

Failure to maintain robust processes for business assumptions, business planning, accurate forecasting and reporting, price reviews, operational performance and change management adversely affect management and investment decisions, execution of strategic initiatives, benefit realisation and performance commitments.

Link to strategic priorities:

Risk Climate:

Key Drivers

- Investment appraisal process;
- Strategic business planning and price review process;
- Change management benefits realisation measurement; and
- Regulatory submissions.

Mitigation

- Performance and financial management reporting process with an external audit provision and internal audit schedule;
- Board, Audit Committee and Executive oversight and challenge;
- Change management, investment and business planning processes in place; and
- Our change activity is managed through a combination of project and programme boards with a dedicated Delivery Office in place and regular review at both business and Executive level.

Potential business impact

Customer Service, Reputation, Financial; Regulatory; Operations

Opportunity

Maximise investment and deliver targets to meet stakeholder expectations.

Executive responsibility

Brandon Rennet – Chief Financial Officer

Role of the Executive Team

- Monitor the delivery of plans and the appropriate allocation of resources to long-term strategic drivers; and
- Encourage improvements in data capability and quality, management reporting and assurance activity.

Movement in the period

- There has been no significant change in the inherent risk profile during 2017/18.

Looking forward

- Implement the new company strategy and initiatives within the parameters of PR19 and our obligations; and
- Continue to re-focus the business to deliver improved efficiency and customer advocacy.

Political, Regulatory and Economic Environment

Description

Oversight from various political and regulatory bodies in the UK that set and oversee the terms of our licences, and the conduct of our operations. We are also directly affected by the general economic outlook, including downturns and fluctuations. As a result, significant obligations or operational changes could be imposed and there may be a substantial increase in the estimated cost to fulfil our obligations and assumptions underlying our estimates may change or prove to be incorrect, affecting investment in current or new assets and markets.

Link to strategic priorities:

Risk Climate:

Key Drivers

- Adverse PR19 determination;
- Significant amendment to industry economic regulation or industry renationalisation;
- Enforced change to the Thames Water ownership structure; and
- General economic environment.

Mitigation

- Monitor for new and changing legislation with training provided to relevant individuals for key legislation;
- Engage with regulators to find a better approach to intervention that agrees clear targets against which progress can be demonstrated;
- Engage with political parties with the aim of moving towards water policy differences converging rather than polarising; and
- Review effect on energy costs, water markets, investment and financial markets from the process of the UK leaving the EU.

Potential business impact

Customer Service; Financial; Regulatory; Legal; Operations

Opportunity

Support sustainable industry economic regulation and shape regulatory frameworks

Executive responsibility

Nick Fincham – Director of Strategy and Regulation

Role of the Executive Team

- Monitored the preparations for our PR19 submission and reviewed alignment to the published Ofwat methodology; and
- Debate and review potential impact of general economic conditions, external exposures to external institutions and our capital structure and offshore holdings against business requirements.

Movement in the period

- The inherent risk profile increased during 2017/18 following heightened political and regulatory scrutiny and the advent of PR19.

Looking forward

- Ofwat determine through PR19 the five-year price, service and incentive package that we will deliver between 2020 and 2025; and
- Economic and market effects from the UK departure from the EU by the end of March 2019 and potential for a further UK General Election as a result.

Principal risks and uncertainties continued

Legal and Regulatory Compliance

Description

Subject to a wide range of regulations, laws and rules that are overseen by statutory and regulatory bodies in the UK and, currently, the EU. There is currently significant legislative and regulatory change and scrutiny which, along with the introduction of new or amended legislation, may require additional compliance and reporting arrangements as well as amendments to existing policies and procedures to be in place.

Link to strategic priorities:

Risk Climate:

Key Drivers

- Protection of data;
- Environmental permitting regulations;
- Drinking water inspectorate; and
- Competition Law.

Mitigation

- The Board promotes high ethical standards of behaviour and ensures the effective contribution of all Directors;
- Honest and ethical behaviour policy, corporate responsibility approach and policy framework govern how we conduct our affairs;
- Clear understanding of regulatory and key legal obligations and identify impending new legislation, and changes to existing legislation and licence conditions, with assurance programmes in place; and
- Provide training programmes to employees and service delivery partners to ensure compliance with key laws such as data protection, competition, honest and ethical behaviour and cyber security.

Potential business impact

Health and Safety; Environment; Customer Service; Reputation; Financial; Regulatory; Legal; Operations

Opportunity

Lead the industry in compliance with legal and regulatory frameworks.

Executive responsibility

Nick Fincham – Director of Strategy and Regulation

Role of the Executive Team

- Monitored exposures to regulatory obligations and legal vulnerabilities; and
- Oversaw the transition and handover to a new Head of Risk, Audit and Assurance.

Movement in the period

- There has been no significant change in the inherent risk profile during 2017/18.

Looking forward

- Strengthening of our Governance framework; and
- Enhancing and embedding the internal risk, audit and assurance capability.

People

Description

Attraction, development, retention and succession of senior management and individuals with key skills are critical factors in the successful execution of our strategic initiatives, and business operations.

Link to strategic priorities:

Risk Climate:

Key Drivers

- Volume of change management affecting senior management capacity and capability;
- Effective prioritisation and appropriate resourcing;
- Attract, retain and maintain capacity in key technical roles; and
- Organisational design change.

Mitigation

- People strategy based on culture and engagement, equality and wellbeing, talent development, training, reward and recognition;
- Regular review of organisational capability, reward strategies for key skills, talent management pipeline and learning and development programmes, which are externally benchmarked;
- Recruitment pipelines and practices extended to attract a wider audience and promote a healthy work life balance; and
- Strong relationship maintained with trade unions, to ensure that issues are openly discussed and addressed, to promote an environment of trust and honesty.

Potential business impact

Customer Service; Reputation; Operations

Opportunity

Create sustainable expertise, capability and capacity to deliver our long-term strategy

Executive responsibility

Janet Burr – Human Resources Director

Role of the Executive Team

- Monitor employee engagement performance and metrics; and
- Review organisational structure and future requirements to deliver the long-term strategy.

Movement in the period

- There has been no significant change in the inherent risk profile during 2017/18.

Looking forward

- Review effect of changes to organisational design on our people capability and engagement; and
- Monitor effect of the volume of change management on employee engagement.

Technology Systems and Security

Description
Effective operations and protection of data relies on the availability, integrity and security of complex technology systems and networks. This includes those of our third-party service providers and alliance partners.

Link to strategic priorities:

Risk Climate:

Key Drivers
- IT change management;
- Cyber security;
- IT infrastructure asset health; and
- Resilience and business continuity planning.

Mitigation
- Collaborate across utility industry and public and private sectors to manage security threats to national infrastructure;
- Information security strategy integrating data, physical and personnel security through our Security Board;
- Solutions in place to detect and investigate security threats and incidents to ensure potentially vulnerable systems are identified and vulnerability gaps closed; and
- Review adequacy and effectiveness of infrastructure and technology security controls, undertake employee security awareness training, and test contingency and recovery processes.

Potential business impact
Customer Service; Reputation; Financial; Regulatory; Operations

Opportunity
Increase the sustainability, resilience and security of our technology infrastructure.

Executive responsibility
John Beaumont – Chief Digital Officer

Role of the Executive Team
- Debated specific areas, including cyber security, system resilience and the effectiveness of the TTA alliance; and
- Monitor the delivery of plans and the appropriate allocation of resources to improve infrastructure.

Movement in the period
- There has been no significant change in the inherent risk profile during 2017/18.

Looking forward
- Develop and implement an improved technology function for our business; and
- Review and continuously improve business continuity and resilience programmes.

Supply Chain Management

Description
Operations rely on the resilience, availability and cost-effective quality of the supply chain for outsourced capability, goods, services and third party infrastructure.

Link to strategic priorities:

Risk Climate:

Key Drivers
- Third party outsourcing capabilities;
- Supply chain resilience;
- Critical supplier contingency; and
- Corporate responsibility.

Mitigation
- Executive-led Contracts Committee in place to review and approve contracts of significant value;
- Policy requirement for compliance with OJEU and third party due diligence checks carried out prior to contract award;
- Standard contract language and templates embedded to drive consistency; and
- Contract management in place with responsibility for completing assurance checks on contract compliance.

Potential business impact
Health and Safety; Environment; Customer Service; Reputation; Financial; Regulatory; Legal; Operations

Opportunity
Increase the effectiveness and financial efficiency of operations

Executive responsibility
Brandon Rennet – Chief Financial Officer

Role of the Executive Team
- Reviewed the performance and cost-effectiveness of the supply chain and alliances; and
- Monitored how management tracked and responded to rising levels of risk within the supply chain and alliances.

Movement in the period
- There has been no significant change in the inherent risk profile during 2017/18.

Looking forward
- Consider the most effective delivery route for our PR19 business plan objectives; and
- Drive financial efficiency and effectiveness through our business wide improvement projects.

Credit and Liquidity

Description

Sufficient liquidity is required to meet our significant funding requirement in the AMP period and fund our investment programme. Inaccurate forecasting, exposure to adverse conditions in debt or capital markets, counterparty payment obligation default or adverse actuarial pension scheme valuation may hinder or prevent business activity.

Link to strategic priorities:

Risk Climate:

Key Drivers

- Capital structure sustainability;
- Counterparty credit risk;
- Credit agency rating; and
- Long-term financial obligations.

Mitigation

- Cash forecasts on liquidity requirements and assessed for different scenarios;
- Planning, committed facilities and investment processes in place;
- Long-term refinancing with staggered maturity dates to minimise the effect of short-term downturns; and
- Hedging strategies employed to stabilise market fluctuations.

Potential business impact

Reputation; Financial

Opportunity

Increase stakeholder confidence through a stronger balance sheet and liquidity

Executive responsibility

Brandon Rennet – Chief Financial Officer

Role of the Executive Team

- Monitored liquidity performance against business and regulatory requirements; and
- Reviewed capital and funding requirements to achieve long-term strategic drivers.

Movement in the period

- There has been no significant change in the inherent risk profile during 2017/18.

Looking forward

- Continue to focus on improving operational performance and delivering further improvements within our business plan; and
- Monitor volatility in financial markets as the future trading and political relationship between the UK and the EU is redefined.

Introduction

In accordance with provision C.2.2 of the UK Corporate Governance Code the Directors have undertaken a robust assessment of the long-term viability of the Company. This reflects an extension of the Company's usual business planning process, and incorporates the key matters concerning resilience that will feature in the Company's business plan submission for the next five year regulatory period 2020–2025. Importantly the Board has looked forward over a longer period than in prior years recognising the longer-term horizon that needs to be considered when measuring the benefits that the Company's investment plan can deliver to its customers.

This viability statement is set out in four sections:

1) The Board's approach to the viability assessment;
2) Severe but plausible downsides and the Board's conclusion;
3) The resilience downsides identified in the recent consultation publication issued by Ofwat in April 2018 '*Putting the sector back in balance*'; and
4) The Board's considerations of a more severe outcome and how the customer will always be protected in terms of the Company's ability to continue to deliver an effective service.

The Board's viability assessment is subject to review by our external auditor who comment on whether there are any inconsistencies between this and the rest of the financial statements. Their audit opinion on pages 134–136 of this Report has not highlighted any inconsistencies.

Board's approach to the viability assessment

Throughout the year the Board assesses, on a regular basis, the key risks facing the Company, and the actions available to help mitigate against the impact of such risks – both individually and collectively, recognising that different risks can, and do, materialise at the same time. The assessment includes robust challenge by the Board over financial forecasting, the risk management assessment process, regular and timely budget reviews and finally scenario planning incorporating severe but plausible scenarios. The overriding objective is for the Board to assess the long-term prospects for the Company, ensuring the operations and financing arrangement are sustainable to support the delivery of excellence in terms of our customer service.

In prior years the Board's assessment covered a period of three years. The Board has reconsidered this period in light of the longer-term risk assessment that has been undertaken in the year, and given the Board's longer-term outlook as it works with the Company's new shareholders to reflect on the investments required to secure and support enhanced customer experiences over an extended period. Importantly, the Directors do not want to limit the period assessed to any one five-year Asset Management Plan ("AMP"). The Board has concluded that a rolling ten year period is appropriate as this will always capture the current AMP, the following AMP and, in most cases, a period of the next AMP.

For this assessment, therefore, the Board has assessed the prospects and viability of the Company over an extended (ten year) period to 31 March 2028.

In making this assessment, the Directors have considered the current position of the Company, its ability to effectively and efficiently manage its finances, the current regulatory regime, its continued access to debt markets and ability to maintain a strong investment grade credit rating, whilst having regard to the principal risks and uncertainties as described on pages 72–78.

Due to the prolonged look-forward period, the level of certainty of the assumptions used reduces the further into the future we look. The high degree of confidence for the remainder of the current price control period to 31 March 2020, is followed by moderate confidence in the next five year price control period to 31 March 2025 based on our business plan for this period, and a lower level of confidence for the first three years of the following five year regulatory period. In spite of the reduced confidence levels in the later years of the look forward period, the Directors consider the ten year period to be appropriate given the long term nature of the business, the necessity to adopt a sustainable approach and the longer-term focus required to deliver excellence in terms of customer service and experience.

Severe but plausible downsides and conclusion

The Board's approach has been to test the financial resilience of the business against a range of severe but plausible downside events derived primarily from the principal risks and uncertainties set out on pages 72–78. Stress testing has considered the impact on covenants attached to the Company's funding position as these are key to the overall assessment of financial resilience. Each event has been considered individually, with the aim of identifying and quantifying the impact of severe but plausible outcomes, which typically manifest themselves as cost increases, reductions in revenue, performance penalties, regulatory fines and/or reputational damage. Timing has been an important consideration and the Board has also considered the impacts being sustained for periods of multiple years. As part of the review, the Directors have identified and factored in certain preventative and mitigating controls which could be used to reduce the financial and/or reputational impact. Furthermore, the Board has considered a range of combined scenarios whereby two or more of the individual principal risks compound each other, to reflect circumstances that can arise in practice where often two or more events can combine in the same time frame. Descriptions of the individual events and how they relate to the principal risks (see pages 72–78) are outlined overleaf.

Event A:	**Economic downturn**
Principal risks:	**Political, Regulatory and Economic Environment, Credit and Liquidity**

- In the event of a poor macroeconomic environment materialising over a prolonged period of time, growth would be adversely affected resulting in low inflation. The Company's wholesale revenue, RCV growth and totex is linked to the underlying rate of inflation. As such our financial performance is likely to be negatively affected by low inflation or in a severe scenario deflation.
- In response to depressed economic growth, it is expected that interest rates would be relatively low to promote growth. This would in turn reduce interest costs for the Company, partially mitigating the adverse financial impact arising from low inflation.
- We have stressed tested for low growth taking place over the majority of the assessment period.

Event B:	**Increase in bad debt**
Principal risks:	**Political, Regulatory and Economic Environment, Credit and Liquidity**

- Regulations prohibit water companies from disconnecting domestic/residential properties for non-payment of water supplies. This can present difficulties in recovering full and timely payments from customers. We have conservatively modelled an adverse trend where bad debt would increase by up to 20% for each year, starting in the second year of the assessment period. This would take into account unforeseen shortfalls in achieving the expected cash collection rates as well as an economic recession where certain customers would be unwilling to pay their bills.

Event C:	**Adverse weather**
Principal risks:	**Health, Safety, Environment and Security, Customer Service, Trust and Reputation, Climate and Societal**

- Adverse weather includes a number of the following events, which take place for the majority of the assessment period. These events are listed in order of descending magnitude:
  - (a) severe wet weather event causing additional sewer flooding which is in excess of operational limits
  - (b) severe cold weather event leading to higher than expected burst pipes due to "freeze/thaw" conditions
  - (c) severe dry summer event resulting in higher than normal number of droughts which require emergency reinforcement of water supplies and temporary usage bans resulting in compensating customers for interruptions.

Event D:	**Loss of operational capacity/asset failure**
Principal risk:	**Health, Safety, Environment and Security, Customer Service, Trust and Reputation, Climate and Societal, Asset Management and Performance**

- Assumed catastrophic failure of a major asset causing severe water supply interruptions. This leads to the use of more expensive alternative water production facilities and the provision of customer compensation. Additional costs are incurred to repair/replace the associated assets.
- We have also investigated the impact of a significant failure in the wastewater network which could potentially lead to adverse consequences on transportation routes
- We have modelled that this takes place for the majority of the assessment period.

Event E:	**Significant non-compliance of regulations**
Principal risks:	**Trust and Reputation, Legal and Regulatory Compliance**

- Unforeseen non-compliance with regulations such as General Data Protection Regulation (GDPR), environmental legislation, and water quality legislation could result in significant fines.

Event F:	**Failure to achieve performance commitments**
Principal risks:	**Business Planning, Forecasting and Execution, Political, Regulatory and Economic Environment, Legal and Regulatory Compliance**

- The adverse effect of more stringent performance targets has been taken into account. We have assumed a similar penalty pattern to risk event E.
- We have modelled that this takes place for the majority of the assessment period.

Event G:	**Significant water quality incident**
Principal risks:	**Health, Safety, Environment and Security, Customer Service, Trust and Reputation, Legal and Regulatory Compliance**

- We have assumed a *Cryptosporidium* outbreak taking place twice over the assessment period, with each incident crystallising five years apart.
- Such an incident would involve the contamination of a localised water treatment site which serves a significant customer base.
- Significant totex would be required to compensate customers, address reputational damage, temporarily provide alternative water sources to customers and provide additional investment to monitor and neutralise the microscopic bug.

Event H:	**Significant comprise of cyber security**
Principal risks:	**Customer Service, Trust and Reputation, Legal and Regulatory Compliance, Technology Systems and Security**

- A severe compromise of technology and systems such as through a cyber-attack has been assessed. Systems are essential in the effective and efficient control and operation of our infrastructure assets.

Event I:	Loss of IT capability
Principal risks:	**Customer Service, Trust and Reputation, Asset Management and Performance, Technology Systems and Security**

- As we continue to invest in strengthening our IT estate, we face significant delivery challenges. To reflect the risks of cost overruns associated with delayed implementation, additional operating costs have been assumed. Specifically these costs cover remedial works, parallel running of both the legacy and new Customer Relationship Management and Billing System whilst issues are addressed, attrition of service staff and customer compensation to address reputational damage.

Event J:	Failure to achieve Business Plan objectives
Principal risks:	**Business Planning, Forecasting and Execution, Asset Management and Performance, People, Supply Chain management**

- We have modelled further totex investment over and above what is allowed by the regulator in order for the Company to deliver its performance commitments and maintain its asset base at the expected levels, is required.

In addition to the specific risks highlighted above, for completeness the Board has also considered how the forecast economic downsides would impact the Company's defined benefit pension liability as recognised in the statement of financial position. In conclusion the Board determined that a decrease in inflation would probably result in a decrease in the pension liability and a decrease in interest rates would likely result in an increase in the pension liability. These two impacts would not be expected to directly offset each other, however, overall the impact of such macroeconomic factors is not considered to have a severe impact on the defined benefit pension liability over the assessment period. Additionally, for the assumption around longevity the Directors concluded that it is not considered that a plausible change in this assumption would be significant enough to have a severe impact on the defined benefit pension liability.

In conducting the viability assessment, the Board has assessed the intercompany arrangements and the corporate structure of the Group (as detailed on page 110). No scenarios were identified that would impact the viability of the Company.

The impact of each event identified above has been considered and for the purpose of the longer-term viability assessment the Board has considered four combined severe but plausible downside scenarios. These merge various risk events together and descriptions of these linked scenarios, along with the underlying constituent risk events, are detailed below. All downsides include the impact of an adverse macroeconomic environment, significant cash flow shocks from regulatory penalties for failure to achieve certain performance targets and additional expenditure required to achieve business plan objectives.

	Scenario	Description/rationale
1	**Adverse weather with economic downturn**	▸ Various adverse weather incidents resulting in regulatory and performance penalties • A severe wet weather event causing flooding that is in excess of pumping capacity leads to major asset failure • A severe cold weather event creating severe 'freeze/thaw' conditions that over stress our asset integrity limits leads to major asset failure • A severe dry weather event causing short-term drought that is in excess of our reserves capacity leads to a significant interruption to supply ▸ Presence of other significant asset failures including interruptions to water supply and compromises in the wastewater networks ▸ Consequently, we overspend on our business plan to remediate and compensate for the damage experienced ▸ Backdrop of prolonged economic downturn leading also to increases in bad debt ▸ Combining risk events: A, B, C, D, E, F, J
2	**IT failure with economic downturn**	▸ A cyber-attack on our IT systems leads to a short-term IT asset failure and data breach, which results in regulatory and performance penalties ▸ Overspend is incurred to remediate and compensate for the incident and impact to customer service ▸ Backdrop of prolonged economic downturn leading also to increases in bad debt ▸ Combining risk events: A, B, E, F, H, I, J
3	**Poor water quality with economic downturn**	▸ A loss of process control results in *Cryptosporidium* contamination of a localised water treatment asset. Consequently, the interruption of water supplies impacts a significant customer base. ▸ Regulatory and performance penalties are incurred as a result ▸ Overspend is incurred to remediate and compensate for the incident and impact to customer service ▸ Backdrop of prolonged economic downturn leading also to increases in bad debt ▸ Combining risk events: A, B, E, F, H, J
4	**Cyber and asset failure with economic downturn**	▸ A cyber-attack on IT systems which are integrated with our operational asset infrastructure leads to short-term operational asset failure ▸ Presence of other significant asset failures including interruptions to water supply and compromises in the wastewater networks ▸ Regulatory and performance penalties are incurred as a result ▸ Overspend is incurred to remediate and compensate for the incident and impact to customer service ▸ Backdrop of prolonged economic downturn leading also to increases in bad debt ▸ Combining risk events: A, B, D, E, F, H, I, J

Board's conclusion

In assessing the impact of the principal risks, the Board has considered the preventative and mitigating actions that are available to address the aggregated impact and importantly the impact on the covenants that attach to the Company's key funding facilities. Based on this robust assessment the Board has a reasonable expectation that the Company will be able to operate within its financial covenants and maintain sufficient liquidity facilities to meet its funding needs over the ten year assessment period. This conclusion has been made assuming capital markets continue to operate under normal market conditions.

Resilience assessment and Ofwat downside scenarios

The Directors will continue to assess the long term viability of the Company as our plans evolve for the next five year price control period commencing in 2020. In April 2018, Ofwat published its "*Putting the sector back in balance*" consultation document which involved, amongst other matters, seeking views on a number of proposed stress tests. These stress tests are different to the downside scenarios described above underpinning this viability statement. A full assessment of the proposed scenarios will be conducted once they have been finalised by Ofwat. While a number of the stress tests that Ofwat has consulted on are more severe than a number of those considered by the Board, the Board consider that were they to call in to question the viability of the Company, then shareholder support would be available to ensure its ongoing viability. Notwithstanding this, we consider the process underpinning this viability assessment contemplates scenarios which are appropriate and therefore the conclusion on viability is appropriate.

Extreme events and protection for our customers

In the spirit of customer governance, the Directors have deliberately sought to identify extreme but low likelihood outcomes which would challenge the viability of the current model, all else being equal, and what the ultimate outcome would be for our customers in terms of the ability of the Company to continue to deliver water and waste services. Such scenarios apply more extreme assumptions (for example sustained deflation, acute cost overruns over a prolonged period, and unforeseen regulatory penalties). The analysis revealed that the Company would be able to withstand such extreme individual risk events and continue to support our customer base. Unsurprisingly, where risk events were combined to create even more extreme downsides, which do attach a remote likelihood of occurrence, there were scenarios which would call into question the Company's standalone viability assuming no further external support is provided.

This led to a consideration as to what would happen in the case of such extreme events so as to assess whether the Company could be concluded to be sufficiently resilient as to be viable in the long term.

In the unlikely circumstance of such extreme events crystallising in combination, the Company's forecasts indicate that certain financial covenants would not be satisfied. Absent successful renegotiation with our external funding parties to waive any non-compliance this would result in an 18 month standstill of creditor claims which would automatically take effect as per the Company's financing arrangements. During this standstill period, secured creditors cannot take enforcement action on the Company and the period allows creditors and management time to resolve the cause of the non-compliance so as to prevent the Company being placed into "Special Administration". Mitigating actions would be required to alleviate the non-compliance, and these would include but not be limited to, modifying or temporarily waiving existing financial covenants and raising additional equity capital from shareholders.

An assessment is required to determine whether it would be reasonable to assume that additional equity investment could be secured to overcome the challenges associated with these extreme scenarios. A key consideration undertaken by the Board was that the financial impact of even the most extreme scenario was still relatively low when compared to the equity value that shareholders have invested in the Company, and thus it is reasonable to conclude that existing shareholders would be prepared to provide additional equity support, if required, in order to protect their existing investment.

If upon expiry of the standstill period, equity was not available from either existing and/or new shareholders, for whatever reason, then the ultimate consequence of such extreme financial shocks would most likely be for Ofwat or the Secretary of State to apply to place the Company in "Special Administration". Under this regime, a Special Administrator would be appointed whose primary duty would be to act in the best interests of customers, to ensure continuity of services, and to seek new owners who are deemed to be "fit and proper".

The outcomes set out above are extreme and considered by the Board to be remote and unlikely to occur. They have been considered to provide comfort to our customers that actions are available to the Company to address and mitigate such extreme events and to demonstrate that the underlying regulated business would survive so as to protect customer interests.

Putting customers at the heart of our business

Ian Marchant
Chairman

You have recently become Chairman of Thames Water. What are your priorities?

My priority when I joined Thames Water was to undertake a full governance review, and I sought input from each of the Directors which helped form the programme of change.

This programme covers a wide range of topics: the Board structure and membership, which required a review of the skills and experience mix on the Board particularly among the Independent Non-Executive Directors; the streamlining of Board meeting arrangements including what should be brought to the Board in its information packs; a review of Board committees and their terms of reference; how we meet the UK Governance Code and Ofwat's Governance principles including the monitoring of new developments; and the Board's relationship with our shareholders.

We are in the process of refreshing a number of Board appointments which will be announced as and when they are made. As part of this Alistair Buchanan, the former CEO of Ofgem, will join the Board in July. We have reviewed the committee arrangements and re-established the Health, Safety & Environment Committee, and we are committed to disclosing more of our governance arrangements on our website.

The review and consequent changes will continue during the course of this year, which will be a very demanding period with the price review process taking up a significant part of the Board's focus.

You have recently undertaken a governance review, what were the results?

We have made significant progress on governance and agreed a number of recommendations at our June meeting. We have now simplified and clarified the role of the Board including both its relationship with shareholders and the business decisions that are reserved to the board. We have also updated the terms of reference of the Board Committees – all these documents are available on our website.

We have made clear that our relationship with shareholders should generally be similar to that of other stakeholders with additional oversight of some key strategic frameworks such as the five year business plan and policies on dividends and remuneration. We are now looking at the next stage in this review which will include considering how we further embed stakeholder views and the public interest into the Board's deliberations.

What role does the Board play in setting the culture of the business?

The business has seen a significant amount of change in the past 18 months with a new CEO, CFO, refreshed Executive Team, new Board members and shareholders. As a result we have worked together to ensure that we have a clear strategy, vision, and that this is embedded across the business. I wanted the Company's employees to hear first-hand from me, as their new Chairman, about how important culture is and the changes we are putting in place as we look towards the future. I presented my thoughts on video at our managers' conference in February. Our recent reorganisation is a first step in ensuring that the culture we have set is embraced through this change.

How integral is sustainability to the business?

Becoming a more sustainable business is an important consideration for our customers, employees, Board and investors and we need to strike a balance between what's best for customers, the environment, local communities and the future provision of our essential services. We are working hard to deliver upon our commitments and promises to customers and the environment, as reported in our Corporate Responsibility and Sustainability Report, as well as this Report.

We know the decisions we make today need to ensure delivery of our services for our customers for the longer term. Importantly we know we cannot do this alone and rely on delivering better outcomes in partnership with our customers, stakeholders, alliances, suppliers and regulators.

What engagement with stakeholders has the Board had during the year?

Thames has a wide range of stakeholders, from customers and employees to regulators, environmental groups, Government and non-government organisations, as well as our shareholders and bondholders. Members of our Board have had a number of opportunities during the year to interact with representatives from all of these stakeholder groups. Specifically, members of our Board have undertaken site visits, attended our annual stakeholder event in November 2017 and attended a Customer Challenge Group (CCG) meeting. Anne Heal, the Chair of our CCG, also attended one of our Board meetings.

I would like to thank all of our people for their hard work and dedication, particularly during this time of change for Thames Water. I would also like to thank the Board for its hard work and commitment to the Company, and to thank you, our stakeholders, for your support over the past 12 months. Finally, the Board would like to thank Sir Peter for his service and commitment to the Company over the past 12 years.

Ian Marchant
Chairman

27 June 2018

The right skills and experience to deliver our strategy

Our Chairman

Ian Marchant (57)
Chairman

N R S

Ian was appointed as an Independent Non-Executive Director on 1 December 2017, and became our Chairman on 26 January 2018 following Sir Peter Mason's retirement.

Ian spent 21 years at SSE Plc, most recently as Chief Executive and prior to that as Finance Director, before his retirement in June 2013. Ian was an Independent Chairman of Maggie's Cancer Charity and, is currently Independent Chairman of John Wood Group plc, Chair of Nova Innovation Ltd and a Non-Executive Director of Aggreko plc. Through his company Dunelm Energy Limited, he advises and invests in start-up businesses.

He is a visiting professor at Edinburgh and Durham University Business Schools and chairs the Strathclyde University CEP advisory Board. Ian is also the founder of the Scotland lights up Malawi Campaign for Climate Justice and was recently appointed Honorary President of the Royal Zoological Society of Scotland. Ian is the former Chairman, and founder of Scotland 2020 Climate Group, and served as the President of the Energy Institute and Chairman of the renewable energy Firm, Infinis.

Our Executive Directors

Steve Robertson (60)
Chief Executive Officer

Steve became our CEO in September 2016, having previously held the position of Chief Executive Officer at Truphone, where he developed ground-breaking technology allowing it to become a disruptive player in the global market.

Prior to joining Truphone, Steve served as CEO of BT Openreach from its inception in 2005 until 2010.

He has gained extensive experience in the telecoms industry with a wide variety of roles in the BT Group and at COLT Telecommunications, including having responsibility for the overall performance and operation of the whole of BT's UK mainland telecommunications network, as Managing Director of Wholesale Operations.

Brandon Rennet (45)
Chief Financial Officer

Brandon joined us in March 2017 as CFO, having previously worked for energy company SSE since February 2007, where he held a number of senior finance roles before being appointed Managing Director of Finance in July 2013.

Brandon's focus at SSE included leading the execution of more than £7 billion of funding, primarily in the public debt capital markets, driving significant acquisitions and disposals, and initiating its finance transformation programme.

As a chartered accountant, his earlier career included finance roles in Edinburgh, London, Philadelphia, and Toronto for companies including PwC, HSBC, and British Energy, as well as a secondment to the Prime Ministers Delivery Unit (part of the Cabinet Office).

Nick Fincham (47)
Director of Strategy and Regulation

Nick was appointed to our Board in April 2016. Since April 2011 Nick has been a member of our Executive Team as Director of Strategy and Regulation. Before joining Thames Water, Nick spent six years as Director of Economic Regulation and Competition Policy at the Civil Aviation Authority.

Prior to that, he held senior positions at a number of economic regulators including OFFER, Ofgas, Ofgem and Postcomm.

+ Read more about our diversity policy p130

Key to Committees

(A) = Audit, Risk and Reporting Committee

(S) = Strategy and Business Planning Committee

(R) = Remuneration Committee

(N) = Nominations Committee

(C) = Customer Service Committee

(H) = Health, Safety & Environment Committee

● = Committee Chair

Our Non-Executive Directors

Kenton Bradbury (48)

(A) (H) (N) (R) (S)

Kenton was appointed a Non-Executive Director of Thames Water Utilities Limited in May 2017. He is currently Managing Director, Asset Management at OMERS Investments, with a focus on Europe. His asset management experience includes: Caruna, Ellevio, NET4GAS, Scotia Gas Networks, and Tank & Rast.

Kenton previously served as a Non-Executive Director of Yorkshire Water and Affinity Water and was a Director at Infracapital (the infrastructure investment arm of M&G Investments), where he sat on the boards of various portfolio companies. Prior to Infracapital, he was SVP Infrastructure and Regulation at e.on, based in Germany. He began his career as a consultant working in the utilities and space sectors, and has held various senior operational and strategic roles in infrastructure businesses. Kenton is a Chartered Engineer and currently sits on the boards of London City Airport, Caruna in Finland and Net4Gas in the Czech Republic amongst others.

Christopher Deacon (70)

(A) (N) (R)

Christopher became a Non-Executive Director of Thames Water Utilities Limited in December 2006. He is an independent infrastructure and project finance consultant, adviser to Ofgem, and a Non-Executive Director of various companies in the infrastructure and PPP market place.

His career in banking and structured/infrastructure finance has spanned over 20 years, acting as adviser and banker in major infrastructure and project financings around the world. He has acted as a consultant on large infrastructure projects in both the public and private sectors, with assignments including Eurotunnel, Channel Tunnel Rail Link, Tube PPP, and other transport infrastructure projects.

Christopher is a director of the trading company of London Business School and a past School Governor. He is Treasurer/Trustee of the Franco British Council UK Section.

Guy Lambert (41)

Guy became a Non-Executive Director of Thames Water Utilities Limited in October 2014. He has been with the Abu Dhabi Investment Authority in the Infrastructure Division since February 2008 and currently heads up the utilities business globally within the Infrastructure Division. He is responsible for sourcing and executing new investments in the utilities sector and overseeing the existing utilities portfolio.

His previous roles include Corporate Finance and Advisory Manager at Macquarie Capital London and Corporate Finance and Advisory Analyst at Dresdner Kleinwort Wasserstein. Guy has an MSc in Economics from Erasmus University in Rotterdam, Netherlands.

Greg Pestrak (46)

(S)

Greg Pestrak was appointed as a Non-Executive Director of the Company in November 2017. Greg is an Executive Vice President at Wren House Infrastructure, where his focus is on Asset Management across the portfolio, which in addition to Thames Water includes other regulated and non-regulated global assets. Prior to joining Wren House, Greg was a Partner in KPMG's Global Strategy Group based in the UK, where he was the Infrastructure lead since 2009.

Greg has over 17 years consulting experience, working with Investors and Corporates to drive performance improvement in response to transactions, changes in the market, customer or regulatory environment or financial pressure, bringing an independent and constructively challenging perspective to business and operating models.

Greg's experience includes working across multiple sectors over his career, and most recently, he has led performance improvement programmes in the UK and Globally in the Water, Power Generation, Transmission, and Distribution, Telecoms, Transport, and Infrastructure Services sectors.

Prior to his career in consulting, Greg worked in Finance with Rothschild Asset Management and Jardine Fleming Asset Management in Hong Kong and the UK. Greg holds a Sloan Fellowship Masters in Management from the London Business School and B.A. from The University of King's College, Canada.

Our Independent Non-Executive Directors

Nick Land (70)

A H R N

Nick became an Independent Non-Executive Director of Thames Water Utilities Limited in February 2017 and appointed Senior Independent Director in July 2017. A chartered accountant, Nick retired as Chairman of Ernst & Young LLP in 2006 after a career spanning 36 years with the firm. He became an audit partner in 1978 and held a number of management appointments before becoming Managing Partner in 1992. He was elected Chairman in 1995 and joined the Global Executive Board at that time. He was also Chairman of Ernst & Young's Northern Europe, India, Middle East and Africa Region.

Nick is a Non-Executive Director of the Financial Reporting Council and stepped down as Non-Executive Director of Vodafone Group plc in July 2017, Ashmore Group plc in October 2016, BBA Aviation plc in May 2016, Alliance Boots GmbH in 2015 and Royal Dutch Shell plc in 2010. He is an adviser to the board of Dentons UKEMEA LLP and chairs the Private Equity Reporting Group of the British Venture Capital Association.

He is also Chairman of the board of trustees of the Vodafone Group Foundation.

Lorraine Baldry OBE (69)

A C

Lorraine was appointed as an Independent Non-Executive Director of Thames Water Utilities Limited in September 2014.

Lorraine has over 40 years' experience in a wide range of industries, including technology, broadcasting, distribution, real estate, and financial services. She is Chairman of London & Continental Railways, Schroder Real Estate Investment Trust Limited and Inventa Partners Limited and a Governor at the University of the Arts, London.

Lorraine was Chief Executive of Chesterton International plc and prior to that held various senior positions at Prudential Corporation, Morgan Stanley and Regus, and a former Board Member of the Olympic Delivery Authority where she chaired the Planning Committee.

Lorraine is an Honorary Member of the Royal Institution of Chartered Surveyors and a Past President of the British Property Federation. She was awarded an OBE in the Queen's Jubilee Honours.

Dame Deirdre Hutton DBE (69)

C H

Dame Deirdre was appointed as an Independent Non-Executive Director of Thames Water Utilities Limited in July 2010 and is the Chair of the Company's Customer Service Committee. She is Chair of the Civil Aviation Authority, Pro-Chancellor of Cranfield University and was a Non-Executive Director of Castle Trust until March 2016.

Dame Deirdre was a non-executive member of HM Treasury Board, and was previously Chair of both the National Consumer Council and Food Standards Agency and Deputy Chair of the Financial Services Authority. Dame Deirdre has held a number of positions on a variety of bodies dealing with food issues. She is currently Vice President of the Trading Standards Institute.

Ian Pearson (59)

A S R N

Ian Pearson was appointed as an Independent Non-Executive Director of Thames Water Utilities Limited in September 2014. He is Chairman of Code Investing Ltd and for five years and he was Chairman of Octopus VCT2 plc.

Ian is an advisor to BAI Communications and was a member of PwC's UK Advisory Board for five years. Amongst other advisory roles, Ian held various roles in government between 1994 and 2010 when he stood down as an MP before the general election. He was Economic Secretary to the Treasury between 2008 and 2010, and prior to that he had roles as Science and Innovation Minister, Minister for Climate Change and the Environment, Minister for Trade and as a Minister in Northern Ireland.

Ian studied PPE at Balliol College, Oxford, before gaining a Masters and Doctorate at the University of Warwick.

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(H) = Health, Safety & Environment Committee

● = Committee Chair

Ed Richards CBE (52)

S C

Ed was appointed as an Independent Non-Executive Director of Thames Water Utilities Limited in July 2010.

Ed began his career as a researcher with Diverse Production Limited where he worked on programmes for Channel 4. He was a senior policy advisor to the Prime Minister for media, telecoms, the internet, and e-Government and Controller of Corporate Strategy at the BBC. He has worked in consulting at London Economics Limited, as an advisor to Gordon Brown MP and led the independent review of financial services trade associations. He was previously a Vice Chairman of the Body of European Regulators for Electronic Communications (BEREC) and was Chief Executive of Ofcom until December 2014, having previously been the Chief Operating Officer.

He is currently a Managing Partner at Flint Global, a business advisory firm, a non-executive director of SETL Developments Limited and Donmar Warehouse, and a Governor of the London School of Economics. Ed was awarded a CBE for services to the communications industry in the Queen's birthday honours list in 2015.

Former Directors

Sir Peter Mason (71)
N R S
Chairman
(1 December 2006 to 25 January 2018)

Nick Horler (59)
C
Non-Executive Director
(14 April 2014 to 19 December 2017)

Dipesh Shah (65)
A C
Non-Executive Director
(15 October 2007 to 2 August 2017)

Mark Braithwaite (52)
A N R
Non-Executive Director
(16 June 2015 to 31 May 2017)

We have made significant progress on governance and agreed a number of recommendations at our June meeting. We have now simplified and clarified the role of the Board including both its relationship with shareholders and the business decisions that are reserved to the board.

We are now looking at the next stage in this review which will include considering how we further embed shareholder views and the public interest into the Board's deliberations.

Our executive team is responsible for the day-to-day running of our business. As at 27 June 2018, it consists of the CEO, the CFO, the Director of Strategy and Regulation and seven functional directors.

Richard Aylard CVO

External Affairs & Sustainability Director

Richard joined Thames Water in 2002 as Corporate Responsibility Director. He leads our engagement with external stakeholders, including Government, the Environment Agency, non-Government organisations, and the Consumer Council for Water and is the principal spokesperson with the media and other audiences.

In his role as External Affairs and Sustainability Director, Richard has responsibility for environmental and social issues.

John Beaumont

Chief Digital Officer

John took up the newly-established role of Chief Digital officer in September 2017. John has spent 12 years in customer focused and operational-led transformations as a partner at Bain & Company, where he worked extensively in the digital and technology space across many industries. John is responsible for IT, data analytics, and the application of digital technologies across the business.

Janet Burr

Human Resources Director

Janet was appointed Human Resources Director in November 2010, having previously served as Interim Human Resources Director from June 2010. Janet has responsibility for all employee issues.

The HR function contributes to the overall business strategy, particularly through the Company's People Strategy, which underpins the vision, mission, and values required to achieve the business goals of profitable growth and operational delivery.

Lawrence Gosden

Chief Operating Officer

Lawrence became Chief Operating Officer in April 2018, having previously held the role of Managing Director, Wastewater since June 2014 with responsibility for overhauling Thames Water's environmental, and customer service performance. He joined Thames Water in October 2007 to lead the delivery of the company's £1 billion annual capital programme culminating in the creation of the innovative Eight20 Alliance, having previously held senior positions at Southern Water and South East Water.

As Chief Operating Officer, Lawrence oversees the efficient running of water and wastewater operations and is responsible for delivering safe wholesome drinking water and reducing leakage, then safely collecting wastewater and transforming it into renewable power and clean water recycled to our rivers. The transformation of service for Thames Water's 15 million customers and protecting the environment through proactive, preventative operations and the utilisation of technology to enable 'smart' system optimisation.

Kelly Macfarlane

Director, Customer Experience

Kelly joined Thames Water in December 2016 and took up the role of Director, Customer Service and Retail in March 2017. In April 2018, following a business re-organisation, Kelly's role evolved to the Director of Customer Experience. Kelly is responsible for all customer interfaces at Thames Water, including leading our Wholesale Market Services division and has group wide responsibility for the design and delivery of our customer service and engagement strategies.

Kelly previously worked at Openreach, the infrastructure division of BT Group since 2008 and has significant experience managing customer service operations and infrastructure in regulated environments. She has a demonstrable track record of achieving strong operational results and service transformation having held a variety of key regulatory, commercial and operational roles at Deloitte, Tiscali and nPower.

Sarah McMath

Director, Strategic Planning & Investment

Sarah joined the Water Research and Development team in 1994 and in April 2017, she led a number of technical, asset management, and operational teams as Managing Director, of Water before becoming Director of Strategic Planning and Investment in April 2018.

Her new role provides the technical heart of Thames Water. Sarah is responsible for Thames Water's asset investments and strategic business planning, driving innovation, research, and development, and providing specialist engineering and scientific support for the whole organisation. Sarah's pivotal role is to function as a centre of excellence by setting standards, monitoring performance, challenging and building technical centres of expertise which set standards and assure and challenge performance, including Health and Safety, Water Quality, and Environmental Compliance teams.

Sarah completed her doctorate in 1998, moving to lead the Water Quality team, before the taking on the management of the Wastewater Western Provinces team in 2000. Sarah has led Wastewater technical teams, Maintenance and operational teams and Asset Management functions and in 2012, Sarah led the preparation and submission of our business plans for PR14 and took on the additional responsibility of Programme Director for Competition 2017 in November 2015.

Steve Spencer

Chief Delivery Officer

Steve joined Thames Water in 2012 and took up the role of Chief Delivery Officer in April 2017, having previously held a number of senior management positions in Thames Water. Steve is responsible for the successful delivery of our customer focused goals and strategic plans across the business.

Steve has significant experience managing in the water industry and has a proven track record of improving performance and delivering strong operational results. His career has been dedicated to the water sector with senior roles in Operations, Customer Service, and Capital Delivery, both in the UK and overseas. His earlier career included various roles at Southern Water and MWH Australia.

Board composition

The Board, chaired by Ian Marchant, consists of 13 Directors: the chairman, three Executive Directors (the Chief Executive Officer, ("the CEO"), Chief Financial Officer ("the CFO") and the Director of Strategy and Regulation), four Non-Executive Directors and five Independent Non-Executive Directors, (together the "Directors").

The composition of the Board has evolved significantly in the past year, with the appointment of a new chairman, two new Non-Executive Directors and three Non-Executive Directors stepping down. As previously reported Mark Braithwaite resigned as a Non-Executive Director in May 2017 and Dipesh Shah and Nick Horler, both Non-Executive Directors, resigned as Directors of the Company with effect from August and December 2017, respectively.

Kenton Bradbury and Greg Pestrak, were both appointed as Non-Executive Directors with effect from May and November 2017, respectively.

The Board considers that each Director is able to devote sufficient time to fulfil their roles, including preparation for and attendance at the Board and Committee meetings, giving support and advice to the Executive Directors as well as providing new ideas, healthy challenge and an appropriate balance of governance. We continue to meet Ofwat's expectations for independent non-executive directors forming the largest single group on the Board, compared to investor-appointed non-executive directors and executive directors.

The Board looks closely at the other appointments held by Directors, details of which are contained in their biographies on pages 84–89.

Roles and responsibilities:

The Board has a clearly defined framework of roles, responsibilities and delegated authorities in place to support its primary responsibility to promote the long term success of the Company for the benefit of its customers, employees, shareholders and other stakeholders. During the year the roles of the Chairman and CEO have been reviewed and approved by the Board and are available on the website.

Role	Name	Responsibility
Chairman	Ian Marchant	As Chairman, Ian leads the Board in its shared responsibilities, to encourage and facilitate the contributions of its members and to ensure adherence to the governance principles and processes of the Board. The Chairman works collaboratively with the Chief Executive Officer, Steve Robertson, in setting the Board agenda and ensuring that any actions agreed by the Board are effectively implemented. During the year, the Chairman maintained regular contact and met with the Senior Independent Director and other Non-Executive Directors outside of formal Board meetings. The Chairman also met with the Non-Executive Directors without the Executive Directors being present. The Chairman also makes himself available to meet with the Company's shareholders.
Chief Executive Officer ("CEO")	Steve Robertson	Our Chief Executive Officer is responsible for the leadership and operational management of the Company, developing the Company's business plan and strategic direction for consideration and approval by the Board and implementing the agreed strategy. He is supported by the CFO, the Director of Strategy and Regulation and seven functional directors (together, the "Executive Team"), who support him in driving the implementation of strategy in the company.
Independent Non-Executive Director ("INED")	Nick Land Lorraine Baldry OBE Dame Deirdre Hutton DBE Ian Pearson Ed Richards	Our five Independent Non-Executive Directors are independent in character, judgement, and persons of standing with relevant experience, collectively having connections with, and knowledge of the company's area and understanding of the interests of our customers and how these can be respected and protected. The Independent Non-Executive Directors are valued members of the Board who bring overall independent advice, review and challenge on behalf of all stakeholders, including customers. Each Independent Non-Executive Director has been appointed for his or her individual expertise and experience following a rigorous recruitment process. All Independent Non-Executive Directors are subject to annual re-election.
Senior Independent Director ("SID")	Nick Land	Nick Land was appointed as an Independent Non-Executive Director in February 2017, and the Board appointed him as the Senior Independent Director in July 2017 in accordance with provision A.3.1 of the Code. He is available to all stakeholders to answer any queries that cannot be addressed by the Chairman or other Executive Directors. He is also available to chair the Board and Committee meetings if the Chairman of Committee Chairman is unable to attend. Nick supports the Chairman, Ian Marchant, in his role and leads the Non-Executive Directors in the oversight of the Chairman. The Senior Independent Director is also available as an additional point of contact for shareholders.
Non-Executive Director ("NED")	Kenton Bradbury Chris Deacon Guy Lambert Greg Pestrak	Our four Non-Executive Directors are nominated and appointed by the shareholders of Kemble Water Holdings Limited and are not classified as independent. The Non-Executive Directors provide strong experience and constructively challenge and monitor the performance and delivery of the strategy within the risk parameters set by the Board. All Non-Executive Directors are subject to annual re-election.
Company Secretary ("CoSec")	David Hughes	The Company Secretary, David Hughes, acts as Secretary to the Board and all the Board's Committees and is responsible for supporting the Chairman and Chief Executive Officer in the delivery of the corporate governance agenda. All Directors have access to the advice and services of the Company Secretary and the Company Secretariat team. The Company Secretary is responsible for ensuring that the Board operates in accordance with the governance framework and that there are good information flows to the Board and its committees. The appointment and removal of the Company Secretary is a matter for the Board as a whole.

Board statements:

Requirement	Board statement	Where to find further information
Compliance with the UK Corporate Governance Code 2016 ("the Code")	The Directors consider that, throughout the financial year, the Company complied with the main principles, provisions and practice of the Code, with the exception of those provisions which are explained on page 92.	**Compliance Statement, p92**
Going concern basis	The Directors are satisfied that the Company has sufficient financial resources to continue operating in the foreseeable future and, therefore, have adopted the going concern basis in preparing the Company's financial statements.	**Basis of preparation, p142** **Directors' Report, p129–132**
Viability statement	The Directors have assessed the viability of the Company over a ten-year period ending 31 March 2028 taking into account the Company's current position and certain of the principal risks and uncertainties set out on pages 72–78 (inclusive). Following this assessment, the Directors have a reasonable expectation that the Company will continue in operation and meet its liabilities as they fall due over this period.	**Viability Statement, p79–82**
Robust assessment of the principal risks facing the group	The Directors confirm that they have carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency, or liquidity. The Directors also considered the systems required to mitigate and manage them.	**Principal Risks and Uncertainties, p72–78**
Annual review of systems of risk management and internal control	During the financial year, the Board monitored the Company's systems of risk management and internal control, and carried out a review of their effectiveness.	
Fair, balanced and understandable	The Directors consider that this Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.	**Directors' Report, p129–132**
General Data Protection Regulation ("GDPR")	The Directors have considered the obligations under the GDPR because of the nature of our activities. The protection, security and integrity of data under our control is of utmost importance because the Company holds and processes large quantities of data considered sensitive within the meaning of the GDPR and Data Protection Act 1998, including personal data on our customers and employees. Accordingly, all of our policies have been updated, clearly identifying the need to have in place safeguards surrounding the collection, handling, storage and destruction of personal data to ensure our compliance with the GDPR.	
Gender pay gap reporting	The Directors complied with the requirement to publish a gender pay gap report that came into effect on 6 April 2017. During the year, the Company undertook a thorough analysis of the diversity of our people and looked at the average earnings for women and men, regardless of their role. The Company published its first report in December 2017. The Company is working to better understand and address some of the obstacles for women in our industry and the sector. Our diversity and inclusion strategy already includes plans to do this and we continue to work towards equality for all.	**corporate.thameswater.co.uk/about-us/corporate-responsibility-and-sustainability/gender-pay-gap=reporting and p57**
Modern slavery statement	The Board remains fully committed to ensuring that there is no slavery or human trafficking in our supply chain or in any part of our business. Our anti-slavery policy, contained within our Honest & Ethical Behaviour Policy, reflects our commitment to acting ethically and with integrity in all our business relationships and to implementing and enforcing effective systems and controls to ensure slavery and human trafficking is not taking place anywhere within our business or supply chain.	**thameswater.co.uk/legal**

Compliance statement

The UK Corporate Governance Code 2016 (the "Code") applies to accounting periods beginning on or after 17 June 2016. In addition to the Code, the Board ensures that the Company's governance framework and processes adhere to Ofwat's Principles of Board Leadership, Transparency, and Governance Principles (the "Ofwat Principles") and considers that the Disclosure and Transparency Rules ("DTR") set out the standard of disclosure that regulated companies should operate, whether they be publicly or privately owned. The Company endeavours, where applicable, to comply with the DTR.

While we have fully reflected the Ofwat Principles and drawn extensively on the appropriate principles of the Code, the Code is founded on the principle of "comply or explain" which recognises that departure from specific provisions may be justified provided reasons for the departure are clearly explained. During the financial year ended 31 March 2018, the Board considers that the company complied with the principles of the Code, with the exception of the following provisions:

Independence of the Chairman (Provision A.3.1 – The Chairman should on appointment meet the independence criteria set out in B.1.1)	Provision A.3.1 of the Code requires that the Chairman be independent on appointment. Until 25 January 2018, the Chairman of the Company was Sir Peter Mason, who although considered by the Board to be independent, was for the purpose of the Code not considered independent on his appointment as he was appointed by shareholders of the Company's parent company, Kemble Water Holdings Limited. Our new Chairman, Ian Marchant, was considered independent on appointment, therefore, we were compliant with this provision from 25 January 2018 and will be able to fully comply during 2018/19.
Senior independent Director (Provision A.4.1 – The Board should appoint one of the Independent Non-Executive Directors to be the Senior Independent Director)	Provision A.4.1 requires that the Board should appoint one of the Independent Non-Executive Directors to be the Senior Independent Director to provide a sounding board for the Chairman and to serve as an intermediary for the other Directors when necessary. Following Michael Pavia's resignation in February 2017, the Company was without a Senior Independent Director until Nick Land was appointed to this role on 22 July 2017.
Board composition (Provision B.1.2 – At least half the Board, excluding the Chairman, should comprise Non-Executive Directors determined by the Board to be independent)	Provision B.1.2 of the Code requires that at least half of the Board, excluding the Chairman, is independent. Five out of 13 Directors are considered independent, therefore, we have not complied with this provision. In accordance with Ofwat principles, the composition of our Board is such that no single Director or group of Directors can dominate the Board's decision making and our Independent Non-Executive Directors, including the Chairman, represent the largest single group on the Board (six out of 13 Directors). The Board considers its composition to be appropriate for balancing the needs of customers, the environment, our shareholders and a company owned by private investors. With the appointment of Alistair Buchanan in 2018/19, we will be compliant from next year.
Terms of Reference for Board Committee	Provision B.2.1, C.3.3, and D.2.1 requires that the Company make available the terms of reference for the nominations, audit and remuneration committees explaining their role and the authority delegated to it by the Board. Each respective committee periodically reviews its terms of reference and the Board approves any changes. Following the governance review that commenced in November 2017, the Board decided to review all the committee terms of reference to ensure they align with the new governance framework. The Board acknowledges this departure from the relevant provisions of the Code. The terms of reference of each committee are available on our website as they were approved by the Board in June 2018.
Remuneration Committee (Provision D.2.1 – The Board should establish a Remuneration Committee of at least three, or in the case of smaller companies, two, Independent Non-Executive Directors. In addition the Company Chairman may also be a member of, but not Chair, the Committee if he or she was considered independent on appointment as Chairman.)	Provision D.2.1 requires that we establish a remuneration committee including at least three Independent Non-Executive Directors. In addition, the Company Chairman may also be a member of, but not Chair, the committee if he or she was not considered independent on appointment as Chairman. During the year, the committee consisted of five Non-Executive Directors, three of whom the Board considered independent, including the Chairman and Senior Independent Director. Sir Peter Mason KBE, who was considered independent by the Board, but not independent on appointment, was Chairman and Chair of the Committee; therefore, the Company was not compliant with this provision of the Code but this will be rectified during the year. As part of an effective succession plan, Ian Marchant, who succeeded Sir Peter Mason as Chairman of the Company and is considered independent on appointment, is acting as an interim Chair of the Committee whilst a new Independent Non-Executive Director is appointed to fulfil this role on a permanent basis. This is expected to be in 2018/19.

Board and committee composition

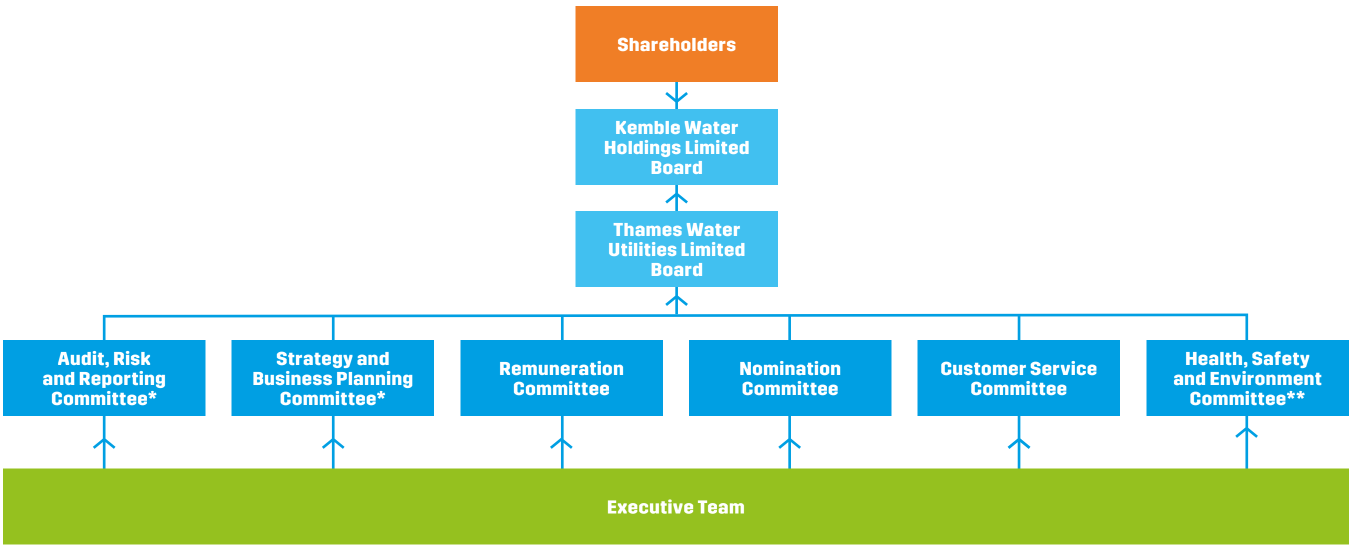
The Board, led by the Chairman, is responsible for ensuring that the company's Directors have a diverse range of backgrounds and skills. The Board values the contribution that all our Directors bring to the stewardship of the Company and believe that their balance of skills, experience and knowledge of the company ensure strong leadership and governance.

Board Committees

Whilst the Board retains overall responsibility, the Board delegates certain roles and responsibilities to its principal Board committees. Our Board and its committees have the appropriate balance of skills, experience, independence, and knowledge to enable them to discharge their respective duties and responsibilities effectively.

The Board has six sub-committees: the Audit, Risk and Reporting Committee, the Strategy and Business Planning Committee, the Remuneration Committee, the Nominations Committee, the Customer Service Committee and the Health, Safety and Environment Committee.

Board committees:



* During the year, the Audit Risk and Reporting Committee (previously the Audit, Risk and Regulatory Committee) was split to form a new Committee, the Strategy and Business Planning Committee. Full details of each committee can be found on pages 100–105 and page 106.

** During the year, the Health, Safety, and Environment Committee was established. Full details of this committee can be found on page 109.

Our principal Board committee structure allows each committee to review the subject matter more deeply to gain a greater understanding of the detail and then report to the board on the matters discussed, decisions taken and, where appropriate, make recommendations to the board on matters requiring its approval. The membership and constitution of each committee is a matter for the Board. In accordance with Ofwat's governance principles, each of the Board committees are comprised of a majority of Independent Non-Executive Directors and are chaired by an Independent Non-Executive Director.

During 2017/18, the chair of each of committee provided an update at each Board meeting on the work of their respective committee's activities and the minutes from each committee meeting are available to the Board. The current membership and reports of the principal board committees can be found on pages 98–109.

Board meetings

The Board held 11 meetings during the year, six scheduled and five additional meetings. In addition, there was a workshop and four informal sessions held to facilitate in-depth discussions on matters such as current operational performance, Periodic Review 2019 (PR19), leakage and network performance overview, budget proposals, performance updates from the alliances (Eight2O, Infrastructure Alliance and Technology & Transformation Alliance) and financial and treasury updates. The Board holds separate meetings on a regular basis, without the Executive Directors being present, to discuss any issues or concerns. In addition, the Chairman meets only with the Independent Non-Executive Directors at least once a year. There are also a number of informal opportunities for the Directors to meet and discuss specific areas of the business with individual members of the executive team and other employees across the organisation.

Attendance

Membership of the Board during 2017/18	Scheduled meetings attended/ eligible scheduled meetings	Additional meetings attended/ eligible additional meetings
Ian Marchant* (appointed 1 December 2017)	3/3	1/1
Sir Peter Mason* (resigned 25 January 2018)	5/5	4/4
Steve Robertson	6/6	5/5
Brandon Rennet	6/6	5/5
Nick Fincham	6/6	5/5
Lorraine Baldry	6/6	5/5
Kenton Bradbury (appointed 31 May 2017)	4/5	2/3
Mark Braithwaite (resigned 31 May 2017)	0/2	1/1
Christopher Deacon	5/6	4/5
Nick Horler (resigned 19 December 2017)	2/4	2/2
Dame Deirdre Hutton	6/6	5/5
Guy Lambert	6/6	5/5
Nick Land	6/6	5/5
Ian Pearson	6/6	5/5
Greg Pestrak (appointed 15 November 2017)	2/2	1/1
Ed Richards	4/6	4/5
Dipesh Shah (resigned 2 August 2017)	3/3	2/2

* Chair

Board activities during 2017/18

People

- reviewed and discussed the health and safety reports, performance and initiatives
- considered the results of the annual employee engagement survey and the actions being taken by management
- reviewed and considered changes to the pension schemes

Operational

- reviewed the delivery of the AMP6 capital programme and performance against AMP6 performance commitments and associated outcome delivery incentives
- reviewed general operating performance, including water quality, leakage, supply interruptions, developer services, customer satisfaction, financial and IT systems
- received an update on the Trunk Mains Strategic Review and Forensic Report
- approved the Bio-Resources RCV Allocation
- approved the Water Resources RCV Allocation
- considered and approved the 2018–19 Charges
- considered and discussed a report on the leakage investigation
- considered the Company's response to the freeze/thaw event

Governance

- undertook a governance review
- separation of the Audit, Risk and Regulatory Committee and establishment of the Strategy & Business Planning Committee
- establishment of the Health, Safety & Environment Committee
- noted the Ofwat process for pre-appointment meetings with prospective Non-Executive Directors
- reviewed the Modern Slavery Act statement
- considered all the Committee terms of reference
- Annual General Meeting
- update from each of the Chairs of the Committees at every meeting
- external audit tender process
- succession planning for the Chairman and Senior Independent Director

Strategic

- Market Readiness update
- Strategy and Business Planning updates
- Water Resources Management Plan – understanding process and timetable through to assurance and approval
- PR19 Consultation approval
- approved the Company's plans to transition to 'One Thames Water'

HR

- received an update on Pensions strategy
- approved the 2017/18 Managers Bonus
- approved the 2017/18 Customer Incentive, Executive Directors' incentives
- approved the 2018/19 Incentive Schemes
- received a report on Gender Pay Gap Reporting
- approved the appointment of Ian Marchant, as Chairman

Regulatory Matters

- met the Chair of the Customer Challenge Group – Anne Heal, to discuss the Company's annual report and its work
- reviewed Ofwat's proposals to modify water companies' licence conditions to facilitate the non-household retail market opening and revised forms of price control at PR19
- Ofwat's leakage investigation
- considered Ofwat's consultation on its final 2010–2015 reconciliation proposals for PR19
- received an update on the non-household retail market exit

Finance/Tax/Treasury/Regulatory

- approval of the 2018/19 Budget
- review and approval of the 2016/17 Annual Performance Report
- review and approval of the 2016/17 Annual Report and Financial Statements
- review and approval of the overall Funding Strategy Plan
- considered various capital project approvals
- approval of Our Taxes Explained document
- approval of 2017/18 Interim Financial Statements
- approval of 2017/18 Statement of Risks, Strengths and Weaknesses
- review and approval of the draft and final Assurance Plans
- considered the preparations and plans being implemented for the General Data Protection Regulation
- received an update on the Company Monitoring Framework
- reviewed and approved the interim and full-year financial statements and the Annual Regulatory Performance Report, including the long term viability statement and regulatory certificates
- agreed the revised schedule of contributions in the Pension Plan in respect of the defined benefit scheme
- considered and approved the insurance programme renewal
- reviewed and approved interim dividend proposals

Risk Management

- reviewed the principal risks of the company
- considered the effectiveness of the Company's internal control systems and risk management processes, including those relating to cyber security, information strategies and data protection
- reviewed the Company's preparations for managing and mitigating risk

Induction and development

Bespoke induction programmes are arranged for each new Director. The induction programme is tailored to their specific requirements and is designed to build upon and develop their knowledge of the industry and sector, understanding of our operations and culture. The programme provides an overview of our customer service, financial and operational performance, along with an explanation of the regulatory regime and governance framework. It includes meetings with the Chairman and CEO, as well as the Executive team, shareholders, the Company Secretary, other members of the senior management team and external advisers who provide support to the Board or Committees.

In addition, key site visits are arranged during the first few months to allow each director to experience, first hand, the operational challenges of the business.

Induction Programme

Each Director is provided with briefings on:

- Company history, business background and Operational Review of Business and operating plans, Key Performance Indicators and targets.
- Group structure, Board procedures, Governance Framework and Code of Ethics and Behaviours.
- Overview of the business including key personnel.
- Overview of the key operational areas and water and waste production processes.
- Explanation of the regulatory and governance frameworks.
- A briefing about our customer engagement in order to understand our customers' views including a meeting with our Customer Challenge Group and other key stakeholders.
- Strategic and business plan.
- Financial & commercial overview including group funding and dividend policy.
- Major risks and internal risk management strategy.
- Overview of the Company pension schemes.
- Understanding of key stakeholder relations including employees, customers, suppliers and service providers.
- Our people and company culture; including health, safety and wellbeing, talent and succession, trade unions and an overview of our remuneration policy.
- Visits to operational and key corporate sites.

Director Inductions 2017/18

- Nick Land (Senior Independent Director)
- Ian Marchant (Independent Non-Executive Director and Independent Chairman)

The induction programmes for Nick and Ian were comprehensive and tailored to their individual understanding of the group. They covered the opposite and below topics, with supporting meetings with members of Executive management, shareholders and external advisers as appropriate.

In addition, Nick and Ian, along with two newly appointed Non-Executive Directors, Kenton Bradbury and Greg Pestrak undertook an extensive tour of our key operational and office sites in order to understand the operational aspects of the business including the water treatment and distribution processes and the customer journey, in a live environment, as follows:

- Water process – from rain to tap.
- Wastewater process – from drain to river.
- Customer journey – from moving into a new home, to moving out.

Training and continued professional development

In addition to the informal sessions held during the year, with specific focus on topics of interest to the Board, continuous training is provided for Directors during the year by way of site visits, presentations, and regular updates and briefings. The informal board sessions also serve as an opportunity for the Board to discuss strategy and risks with management below Executive Team level and gain further insight into our businesses and management capability.

The Directors have access to professional development provided by external bodies and our advisers. We aim to continually refresh and expand the Board's knowledge and skills to enable them to effectively fulfil their roles on the Board and its Committees and contribute to discussions on technical and regulatory matters. We continue to enhance the Board's induction process to ensure we meet individual needs where appropriate.

Above: Abbey Mills

Board site visits

During the year, some of our Directors visited a number of sites, including:

Aylesbury Sewage Treatment Works

On 19 June 2017, several Directors and shareholder representatives, attended Aylesbury Sewage Treatment works in Buckinghamshire to see the improvements that had been made following a series of historic pollutions in 2013/14 that resulted in a £20 million fine being handed down in March 2017. The Directors were shown how new processes and investment had enhanced the operations on site and the steps that had been taken to ensure the environment around the site would be effectively protected from pollution incidents of this magnitude in the future.

Abbey Mills Pumping Station and Beckton Sewage Treatment Works

On 22 August 2017, a group of Directors and shareholders undertook a tour of the Company's iconic sewage works at Abbey Mills pumping station, where they were briefed on the history of the sewage network. They then visited Wick Lane where they went into the sewers to see how the network is operated on a day-to-day basis. They also attended Beckton sewage treatment works for a tour of the £675 million Lee Tunnel, which removes more than 16 million tonnes of sewage overflowing into the River Lee every year and were told of the Company's successful 'Bin it – don't block it' campaign and showed how Thames Water is transforming sewage into renewable energy.

Health and Safety Conference

On Thursday 15 March 2018, Thames Water held its annual Health and Safety conference, bringing together over 250 business leaders from across the business, as well as those working for our supply chain partners. The event this year centred on robotics and automation and the delegates were fortunate enough to be joined by Dame Deirdre Hutton, one of our Independent Non-Executive Directors, who is also the Chair of the Civil Aviation Authority. Dame Deirdre presented on the remarkable advancements in safety technology and innovation that the aviation industry has undertaken in recent years and how these may be applied to the water industry.

Information flow

The Company Secretary, David Hughes, ensures that the Board receives all relevant information in a timely manner, organises induction and training programmes for new Directors and facilitates the Board evaluation in years when this is conducted internally. He is also responsible for ensuring that the correct Board and committee procedures are followed and advises the Board on corporate governance matters. He will also ensure that any concerns that are raised by the Directors are recorded clearly in the Board minutes and that Directors have access to independent professional advice, at the Company's expense.

Agenda setting process

The Board's agenda is carefully planned to ensure focus on the Company's key strategic priorities, as well as reviews of significant issues and updates from key areas of the business. During the year the Board's core agenda continued to include a review of the monthly management report which includes updates from across the business on financial, regulatory and operational performance; reports from the Chair of each Board Committee on matters discussed at previous meetings. In addition, health and safety is of fundamental importance to the business and an update on the Company's performance is considered in detail at every scheduled Board meeting.

Board evaluation

An external Board evaluation was carried out, as part of the Chairman's programme of governance refreshment. The key points from this were presented to the Board at the June 2018 meeting. The findings of the evaluation review included: improvements to Board meeting arrangements and the streamlining of the Board and committee information packs; clarifying and making more transparent the strategic matters for Board decision, and those exceptional matters for shareholder consideration; the skills and experience mix of the Non-Executive Directors; Board meeting forward planning; and the role of the Board committees and reporting back arrangements.

The results of this evaluation have identified areas of focus for 2018/19.

Re-election

All of the Directors are required to seek annual re-election at the Annual General Meeting of the Company.

Directors and their other interests

As a matter of good governance all Directors are required to disclose their other significant commitments to the Board. They are also required to advise the Company Secretary of any actual or potential conflicts of interests as soon as they arise, so they can be considered by the Board at the next available opportunity. Any Director with a potential conflict of interest in relation to a specific matter under consideration by the Board or one of its Committees is required to recuse him/herself from the relevant meeting while this item is discussed and may not vote on the matter. It is the Board's view that this procedure operated effectively during 2017/18.

During the year no Director declared a material interest in any contract of significance with the Company or any of its subsidiary undertakings.

None of the Executive Directors act for any FTSE company in the capacity of a non-executive director or chairman.

Nomination Committee report

Ian Marchant
Chair of the Nomination Committee

Role of the Committee

The main duties of the Committee are:

- to review, from time to time, the structure, size and composition of the Thames Water Utilities Limited Board and its committees and to make recommendations to the Board with regard to any adjustments that are deemed necessary;
- to keep under review the leadership needs of the Company and to satisfy itself that plans are in place for orderly succession for appointments to the Board so as to maintain an appropriate balance of skills and experience on the Board;
- to review the proposed recommendation of any individuals for the appointment to the post of Executive Director or Non-Executive Director; and
- to review the recommendations of the CEO in relation to the appointment of all senior executives and senior management of the Group (other than in relation to the CEO, which shall be a matter for the Committee to review).

At a glance

The composition of the Board has evolved significantly in the past year. As noted earlier, Sir Peter Mason resigned as the Company's Chairman after twelve years with effect from 25 January 2018. Three Non-Executive Directors stepped down and the Board welcomed a new Chairman, Ian Marchant, in December 2017. Nick Land was appointed as Senior Independent Director in July 2017 and two new Non-Executive Directors joined the Board.

As previously reported Mark Braithwaite resigned as a Non-Executive Director on 31 May 2017 and Dipesh Shah and Nick Horler, both Non-Executive Directors, resigned in August and December 2017, respectively. Kenton Bradbury and Greg Pestrak were both appointed Non-Executive Directors in May and November 2017, respectively.

On 23 November 2017, the Company announced the appointment of Ian Marchant as an Independent Non-Executive Director. Ian Marchant succeeded Sir Peter Mason as Chair of the Nominations committee in December 2017, and as Chairman of the Company on 26 January 2018.

As well as these specific appointments, much focus continues to be given to the Company's succession and contingency planning. Over the coming year, the Committee expects to conclude its search for additional Independent Non-Executive Directors, to further strengthen the skills and experience of the Board.

Membership and attendance

Whilst the Nomination Committee did not meet formally this year, the members of the Committee met informally at the request of the Board to initiate and support the process to find a successor to Sir Peter Mason as the Company Chairman. The membership of the Nomination Committee was as follows:

Membership of the Committee during 2017/18:	Independent
Sir Peter Mason* (Chair)	Yes
Ian Marchant** (Chair)	Yes
Mark Braithwaite***	No
Kenton Bradbury****	No
Christopher Deacon	No
Nick Land (Chair)*****	Yes
Ian Pearson	Yes

* Sir Peter Mason resigned as Director of the Company on 25 January 2018.
** Ian Marchant was appointed as a Director of the Company on 1 December 2017.
*** Mark Braithwaite resigned as a Director of the Company on 31 May 2017.
**** Kenton Bradbury was appointed Director of the Company on 31 May 2017.
***** Nick Land was appointed Senior Independent Director by the Board on 22 July 2017.

The Company Secretary is invited to attend all meetings in order to ensure that all the information required by the Committee for it to operate effectively is available. When appropriate, members of the Thames Water senior management team and external advisors may attend the meeting as observers, by invitation.

Appointment of Ian Marchant

A separate Independent Chairman Nomination Committee (ICNC) was established to lead the search for the successor to Sir Peter Mason. The ICNC was chaired by the Senior Independent Director, Nick Land and consisted of the five Independent Non-Executive Directors along with three Non-Executive Directors (Kenton Bradbury, Christopher Deacon and Guy Lambert).

The Company engaged the services of Spencer Stuart, an executive search firm unconnected to the company, to evaluate, screen and identify suitable candidates to succeed Sir Peter Mason.

The search timeline is set out below:

July 2017

Search decision
Following Sir Peter Mason's announcement that he would retire in January 2018, Spencer Stuart were appointed to support the search process and develop a list of potential candidates.

5 Sep 2017

Independent Chairman Nomination Committee meeting
The ICNC, CEO and HR Director met to review the long list of candidates researched by Spencer Stuart. The Committee identified a short list of candidates for interview.

Sep/Oct 2017

Interview process
The shortlisted candidates were interviewed by a panel from the ICNC along with the CEO and HR Director.

20 Oct 2017

Independent Chairman Nomination Committee Meeting
The Committee met to consider the feedback from the interviews. Ian Marchant was identified as the preferred candidate and the Committee recommended his appointment to the Board.

26 Oct 2017

Board Meeting
Following the recommendation from the ICNC, subject to satisfactory references being received along with compliance with Ofwat's pre-appointment process, the appointment of Ian Marchant to the Board was approved.

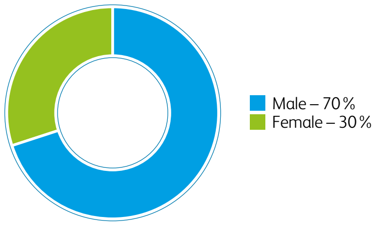
2 Nov 2017

Ofwat Pre-appointment Meeting
In accordance with Ofwat's pre-appointment process, whereby prospective Non-Executive Directors are required to meet with senior directors of Ofwat, or in the case of a prospective Chairman the Chairman of Ofwat, ahead of any formal appointment being made. Accordingly, Ian Marchant met with Jonson Cox and Aileen Armstrong on 2 November 2017 with feedback from the meeting provided to the Senior Independent Director.

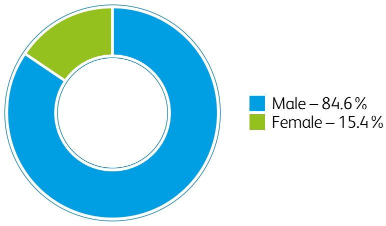
23 Nov 2017

Announcement
The appointment of Ian Marchant to the Board of TWUL and as Sir Peter Mason's successor was duly announced.

Executive Team diversity



Board diversity



Board appointment and tenure

Name	Appointment Date	Tenure (as at 27 June 2018)
Ian Marchant	01/12/2017	0 Years, 6 Months
Steve Robertson	01/09/2016	1 Years, 9 Months
Brandon Rennet	13/03/2017	1 Years, 3 Months
Nick Fincham	01/04/2016	2 Years, 2 Months
Nick Land	06/02/2017	1 Years, 4 Months
Dame Deirdre Hutton	22/07/2010	7 Years, 11 Months
Lorraine Baldry	01/09/2014	3 Years, 9 Months
Christopher Deacon	01/12/2006	11 Years, 6 Months
Ian Pearson	01/09/2014	3 Years, 9 Months
Kenton Bradbury	31/05/2017	1 Years, 0 Months
Ed Richards	22/07/2010	7 Years, 11 Months
Guy Lambert	15/10/2014	3 Years, 8 Months
Greg Pestrak	15/11/2017	0 Years, 7 Months

Ian Marchant
Chair of the Nomination Committee

27 June 2018

Audit, Risk and Reporting Committee report

Nick Land
Chair of the Audit, Risk and Reporting Committee

At a glance

I am pleased to present our Audit, Risk and Reporting Committee (the "Committee" or "ARRC") report which details the role of the Committee and describes our activities and areas of focus during the year.

In October 2017, with an anticipated increase from a business planning and PR19 perspective, it was agreed that the Audit, Risk and Regulatory Committee be separated into two committees – Audit, Risk and Reporting Committee and Strategy and Business Planning Committee (further details on the work of the Strategy and Business Planning Committee can be found on page 106). Up until October 2017, the Audit, Risk and Regulatory Committee continued to focus on exercising oversight over the accuracy and completeness of the financial statements including any matters of significance relating to the regulation of the Company.

The scope of the revised ARRC includes traditional audit risk and review, along with financial, non-financial and regulatory reporting requirements.

We're pleased that our 2016/17 Annual Report received a favourable review from the Private Equity Reporting Group, with respect to transparency and disclosure in our reporting.

During the year the Committee's work focussed on embedding business as usual, as well as undertaking an audit tender. KPMG LLP ("KPMG") were originally appointed after a competitive tender process for the 31 March 2009 audit. The Company has previously stated that it will operate a ten-year audit tender process, in alignment with the EU regulatory framework for statutory audit, therefore the tender was undertaken to determine which firm would be appointed as auditor for the year ending 31 March 2019. Following a competitive tender process, the ARRC recommended to the Board that PricewaterhouseCoopers LLP ("PwC") succeed KPMG as auditor following completion of the audit for 31 March 2018. We would like to thank the KPMG team for their services as auditor to the Company and the group for the past ten years and look forward to working with the PwC team.

As we move into the year ahead, the Committee will:

- continue to focus on ensuring that the new General Data Protection Regulations that came into force in May 2018 become more fully embedded into the business;
- continue to oversee the PR19 assurance process;
- continue to promote clarity and transparency in all our reporting;
- oversee the Company's assurance framework ensuring processes are appropriate and ensure that published information is accurate, complete and reliable;

The role of the Committee

The Committee understands and acknowledges its key role of protecting the interests of shareholders as regards the integrity of published financial information by the company. The Committee has primary responsibility for exercising oversight over the accuracy and completeness of the Company's annual and interim financial statements, as well as its regulatory accounts. The Committee is also responsible for the regulated information in the annual report published for the benefit of customers.

In addition, it is responsible for monitoring compliance with the risk management framework applied by the Board for financial operational matters. In this role, the Committee oversees the relationship with our external auditor including assessment of their ongoing objectivity, assurance of regulatory returns to Ofwat, oversees the internal audit function, and approves its annual plan. In performing its duties, the Committee has access to the services of the Risk, Audit and Assurance function, the Company Secretary and, if required, external professional advisers.

The Committee will advise the Board on matters falling within the scope of its responsibilities. Such advice may be in the form of minutes of its meetings, supporting papers and written and oral reports at Board meetings.

The main responsibilities of the Committee are:

Financial reporting

- to exercise oversight over the accuracy and completeness of the combined Annual Report and Financial Statements and Annual Performance Report (the "Report"), including advising the Board on whether the Report presents a fair, balanced and understandable view of the Company;
- to ensure the Report gives a true and fair view of the Company's results and performance and is in compliance with IFRS financial reporting requirements, Ofwat's Regulatory Accounting Guidelines, the UK Corporate Governance Code, Disclosure and Transparency Rules ("DTR") and the Companies Act 20016 ("CA2006"); and
- to ensure that accounting policies, practices and disclosures are appropriate and assess whether the key estimates and judgements made by management are reasonable and appropriate.

External auditor

- to review the effectiveness of the external auditor;
- to make recommendations to the Board on the appointment of the auditor, to agree the fees paid to the auditor and to be responsible for the tender of the audit from time to time.
- to review the scope and results of external audits.

Internal audit, risk and controls

- to promptly review reports of the Company from the internal auditors; and
- to monitor and review the effectiveness of the Company's internal audit function in the context of the Company's overall risk management systems.
- to monitor and review the effectiveness of the Company's risk management framework.

Whistleblowing and fraud

- to review the Company's arrangements for whistleblowing, reporting fraud and other unethical or inappropriate behaviour; and
- to ensure that arrangements allow proportionate and independent investigation of such matters and appropriate follow up action.

Assurance

- to provide independent review and validation of reporting of statutory data and regulatory data, in particular ensuring compliance with Ofwat's Company Monitoring Framework and ensuring assurance is in line with Ofwat's requirements; and
- to assess (on a frequent basis) the adequacy and effectiveness of our internal controls framework.

- ensure the Company goes above and beyond the requirements of Ofwat's Company Monitoring Framework.

In conclusion, the Committee is further satisfied that the 2017/18 annual report and financial statements, taken as a whole, provide:

- a fair, balanced and understandable assessment of the company's position; and
- the information necessary for shareholders to assess the company's performance, business model and strategy.

To make this assessment, members of the Committee received drafts of the annual report to review early in the process to ensure that key messages set out in the annual report are aligned with the company's position, performance, and strategy, and that the narrative sections were consistent with the financial statements. The significant issues considered by the Committee in relation to the 2017/8 financial statements included those identified by the external auditor in its report on pages 134–136.

Membership and attendance

Nick Land, the Senior Independent Director, is the Chair of the ARRC. Nick is a Chartered Accountant and the Board is satisfied that Nick possesses recent and relevant financial experience and that the ARRC, as a whole, have the competence relevant to the sector to effectively execute their duties.

Our external auditors, KPMG, the Executive Directors, Head of Risk, Audit and Assurance, the Group Financial Controller and Company Secretary are invited to attend all meetings in order to ensure that all the information required by the Committee for it to operate effectively is available. Other members of the Thames Water senior management team attend by invitation as appropriate. In conjunction with each meeting, the external auditors hold a private session with the Committee without Thames Water management being present.

Attendance table

Attendance table of Audit, Risk & Regulatory Committee (April 2017 – September 2017)

Membership of the Committee during 2017/18:	Independent	Meetings attended/ eligible meetings
Nick Land* (Chair)	Yes	4/4
Lorraine Baldry	Yes	4/4
Mark Braithwaite**	No	–
Kenton Bradbury***	No	2/2
Christopher Deacon	No	4/4
Ian Pearson	Yes	4/4
Dipesh Shah* ***	No	2/3
Ed Richards*****	Yes	4/4

* Nick Land was appointed Senior Independent Director by the Board on 22 July 2017.
** Mark Braithwaite resigned as a Director of the Company on 31 May 2017.
*** Kenton Bradbury was appointed Director of the Company on 31 May 2017 and was appointed to the Committee on 25 July 2017.
**** Dipesh Shah resigned as a Director of the Company on 2 August 2017.
***** Due to the separation of the ARRC and the SBPC, Ed Richards stepped down from the Committee to join the SBPC.

Attendance table of Audit, Risk & Reporting Committee (October 2017 – onwards)

Membership of the Committee during 2017/18:	Independent	Meetings attended/ eligible meetings
Nick Land (Chair)	Yes	3/3
Lorraine Baldry	Yes	3/3
Kenton Bradbury	No	3/3
Christopher Deacon	No	3/3
Ian Pearson	Yes	3/3

Audit, Risk and Reporting Committee report continued

Overview of the actions taken by the Audit, Risk and Reporting Committee to discharge its duties

Core agenda

Financial and Regulatory Reporting	▸ Reviewed and recommended to the Board the 2016/17 Annual Report and Annual Performance Report, including specific review of going concern, formal considerations for making the F6A statement for 2016/17 and Risk and Compliance statement ▸ Acknowledged and responded to Jonson Cox's public letter requesting five disclosures to be made within the year end reporting ▸ Reviewed and recommended to the Board the 2017/18 Interim Financial Statements ▸ Reviewed and recommended to the Board the Statement of Risks, Strength and Weaknesses and Draft Assurance Plans for 2017/18 ▸ Reviewed the results of Ofwat's Company Monitoring Framework Assessment and plans to address the Company's downgrade to prescribed ▸ Reviewed and recommended to the Board the updated Statement of Risks, Strength and Weaknesses and Draft Assurance Plans for 2017/18 ▸ Considered Financial Resilience and proposed changes to the Viability Statement ▸ Considered proposed changes to the Principal Risks and Uncertainties for 2017/18 ▸ Considered the proposed additions to the F6A Directors' Statement for 2017/18 ▸ Reviewed our prioritised register of regulatory and legislative obligations
Treasury & Tax	▸ Reviewed and approved the Annual Debt Prospectus ▸ Reviewed and approved the Company's capital allowance and tax strategy and 'Our Taxes Explained' ▸ Received an update on the Corporate Criminal Offence for Failure to Prevent Criminal Facilitation of Tax Evasion
External Audit	▸ Received and reviewed regular reports from KPMG ▸ Undertook an audit tender and recommended to the Board that PricewaterhouseCoopers LLP be appointed as external auditor for the year ended 31 March 2019
Risk, Audit and Assurance	▸ Received regular reports from Risk, Audit and Assurance ▸ Received regular updates on business planning and assurance ▸ Considered and approved the Audit Plan for 2018/19
Risk Management and Internal Control	▸ Received and reviewed regular updates on the Company's top risks ▸ Undertook a deep dive on risks associated with Project Spring ▸ Undertook a deep dive on the risks associated with the Infrastructure Alliance ▸ Undertook a deep dive on risks associated with Water Asset Health ▸ Undertook a deep dive on the Company's crisis management procedures ▸ Received an update on the Health, Safety and Wellbeing crisis management review ▸ Received an update on Internal Controls – Controls Self-assessment ▸ Received regular updates on the Enterprise Risk Management improvement programme
Other	▸ Received regular progress reports on the Trunk Mains and Forensic Review ▸ Received an update on the Technology and Transformation Alliance and on the Company's response to cyber-attacks ▸ Reviewed and approved the Bio-resources RCV Allocation ▸ Reviewed and approved the Water resources RCV Allocation ▸ Received an update on the Company's subsidiary simplification programme ▸ Received an update on Whistleblowing ▸ Received regular updates on the General Data Protection Regulations

Significant financial statement and reporting issues

The Committee considered the integrity of the 2017/18 combined Annual Report and Financial Statements and Annual Performance Report of the Company. In undertaking this review, the ARRC discussed the critical accounting policies and judgements applied with management and the external auditor, including meetings with KPMG without members of management being present. It discussed a report from KPMG identifying the significant accounting and judgemental issues that arose in the course of the audit. The ARRC also considered the management letter for issues and judgements raised and is monitoring action taken by management as a result of a number of audit recommendations.

After discussion with both management and the external auditor, the ARRC reviewed work on the following key estimates and judgements within the Company's combined report. Based on the Committee's review of papers presented, it is satisfied on the appropriateness of the basis for key judgemental areas. In reaching this conclusion the members of the Committee also considered the responses received to their questions and the reporting provided by KPMG in these judgemental areas.

Significant judgements

The matters, below, relate to the key estimates and significant judgements reviewed by the ARRC in respect of the financial statements for the year under review.

Significant judgements	Action taken
Bad Debt provision The level of bad debt provision recognised by the Company, including the judgemental impact of the level of historic and current cash collections, the effect of cancelling billings on expected debt recovery (for example where the property occupier has moved without informing the Company or where the Company was unable to invoice for a period of time when the property was unoccupied) and the levels of debtors due to be collected on the Company's behalf (Water-only Company and non-household debtors).	The Committee reviewed management's key assumptions underlying the bad debt provision via reviews of papers presented by management on the topic throughout the year, including a review of the debtors' ageing and the basis for cash collection and write-off rates in the year. The Committee also reviewed a report from KPMG in relation to the work they had undertaken. Based on this review, the Committee was satisfied that potential bad debt was adequately provided for in the financial statements. The Committee acknowledged the change in risk profile for non-household debt, following the transfer of the Company's non-household retail customers to Castle Water.
Other provisions Management's judgement of the completeness and valuation of the provisions in relation to potential legal and regulatory claims and other matters.	The Committee reviewed the levels of provisions held by the Company throughout the year, questioning and challenging the basis for such provisions. The Committee was provided with details of the main assumptions around the recognition and valuation criteria applied over provisions. The Committee also received a report from KPMG on their audit work in respect of provisions. Based on the reviews and report the Committee concurred with the level of provisions made.
Capex vs Opex Given the significant investments that the Company makes in maintaining and improving its network infrastructure the allocation of such expenditure between capital and operating costs is a critical area.	The Committee has reviewed the classification of costs within the financial statements, gained an understanding of the key investment projects and year-on-year movements. The Committee also reviewed reports on the audit work KPMG had undertaken in this area. Based on these reviews and discussions with both management and KPMG, the Committee considers the classification of expenditure is appropriate.
Valuation of financial derivatives During the year, the Company has introduced more sophisticated modelling techniques to calculate credit risk adjustments that are required when valuing derivative financial instruments. These address changes in market practice, reducing the acceptable range of derivative valuations. By nature, the introduction of new techniques, combined with the underlying complexity of calculating the credit risk adjustments creates a heightened risk for 2017/18.	The Committee received a report from KPMG on their audit work in this area, and also discussed with the Group Treasurer the techniques applied. Based on the review and discussions the Committee were content with the revised techniques used to support the fair values recorded.

Audit, Risk and Reporting Committee report continued

Review of the annual financial statements

Prior to the 2017/18 combined Annual Report and Financial Statements and Annual Performance Report being presented to the Board for formal approval, the ARRC, at the request of the Board, considered whether the Report is fair, balanced and understandable and whether it provides the necessary information for all stakeholders to assess the Company's position and performance, business model and strategy. The ARRC considered the consistency of accounting policies across the Company; the methods used to account for significant or unusual transactions; whether the Company had followed appropriate accounting standards; and whether the Company had made appropriate estimates and judgements, taking into account the views of KPMG LLP. The ARRC further considered whether appropriate disclosure had been made in the financial statements, the Strategic Report, Directors' Report, Remuneration Committee Report and the Corporate Governance Report.

Based on consideration of the above items and the other work performed by the ARRC, the Committee advised the Board that, taken as a whole, the Annual Report and Financial Statements is fair, balanced and understandable and provides the information necessary for stakeholders to assess the Company's position and performance, business model and strategy.

External audit

The Committee is responsible for overseeing relations with the external auditors, including the approval of fees, and makes recommendations to the Board on their appointment and re-appointment.

The Committee reviewed KPMG's terms of engagement, the scope and execution of their audit work. The Committee assessed the independence and objectivity of the external auditors, taking into account relevant UK professional and regulatory requirements and the relationship with the auditors as a whole, including the provision of any non-audit services in accordance with the Policy for the Provision of Non-Audit Services.

Audit tender

During the year, the Company undertook an audit tender process for the year ending 31 March 2019, which was led by the Chairman and complied with OJEU rules. Day-to-day management of the process was undertaken by the Company and supported by the Committee. Each firm participating in the tender process was invited to meet with Committee members and management in order to inform their overall offering. The firms submitted written proposals and were invited to present to a panel consisting of members of the Committee and senior management from the Company.

Having considered both the written proposals and presentations, the ARRC recommended that the Board appoint PwC as its auditors for the year ending 31 March 2019.

The Committee would like to thank Robert Brent and the audit team from KPMG for their services over the past ten years.

Auditor independence and objectivity

The independence of the external auditors is essential to the provision of an objective opinion on the true and fair view presented by the financial statements. Auditor independence and objectivity is safeguarded by reviewing the nature and value of non-audit services performed by the external auditors, ensuring that employees of the external auditors who have worked on the audit in the past two years are not appointed to senior financial positions within the Company and the rotation of the lead engagement partner at least every five years and key audit partner every five years. The current lead engagement partner has held the position for three years, and has been a key audit partner for three years.

The ARRC met with KPMG on several occasions during the year without management present providing the external auditors with the opportunity to raise any matters in confidence. In addition, the Chair of the ARRC met privately with KPMG.

Following this year's annual review, the ARRC is satisfied with the effectiveness, independence and objectivity of KPMG LLP.

Non-audit services

To safeguard the objectivity and independence of KPMG, approval from the Committee Chairman is required for any services provided by the external auditor for which the fee is likely to be in excess of £100,000. As part of this process the Committee ensures that the external auditors are not permitted to perform any work that they may subsequently need to audit, or which could create a conflict of interest or constitute a breach of the external auditor's independence and objectivity. Non-audit services are normally limited to assignments which are closely related to the performance of the audit or where detailed knowledge of the Company is necessary for its completion.

Total fees paid to the external auditor during the year ended 31 March 2018 for audit and non-audit services amounted to £1.1 million (2017: £1.1 million). Further detail can be found in note 3 to the statutory financial statements.

The Committee considered the level of non-audit fees and safeguards put in place relating to non-audit work, including written representations from KPMG which confirmed their independence, and was satisfied that the non-audit fees incurred have not resulted in a loss of independence or objectivity of the external auditor.

Auditor appointment

The Company adopts the same approach to audit tendering as a FTSE 100 company ensuring the Company's compliance with the 2016 UK Corporate Governance Code and the reforms of the audit market by the UK Competition and Markets Authority. In alignment with the EU regulatory framework for statutory audit the Company plans to operate a ten-year tender process for its auditors, however the ARRC may recommend that the Company puts the audit out to tender at any time, based on the results of the assessments of auditor independence and audit quality outlined above. KPMG were appointed after a competitive tender for the 31 March 2009 financial year end audit. There are no contractual obligations restricting our choice of external auditors and no auditor liability agreement has been entered into by the Company.

As detailed above, the Company undertook a competitive audit tender exercise during the year and it was recommended that the Board appoint PwC as its auditors for the year ending 31 March 2019.

Internal audit

The Committee monitored and reviewed the effectiveness of the Company's internal audit function in the context of the Company's overall risk management systems. In particular, in 2017/18 the Committee considered and approved the remit and activities of the internal audit function ensuring that it had adequate resources and appropriate access to information to enable it to perform its function effectively, in accordance with the relevant professional standards and was free from management or other restrictions.

The Committee reviewed and assessed the annual internal audit plan which contains a mix of risk based and cyclical reviews. The plan is delivered through appropriately skilled and qualified internal resources supported with external resources where more specialised skill sets are required, typically within Information Systems and Treasury.

Inputs to the plan include principal risks, corporate priorities and objectives, external research and benchmarking of emerging risks and trends and discussions with members of the Executive Team and Senior Managers.

The plan is approved by the Committee in January each year with focus given to not only the areas which are being covered but also those that are not, to ensure that the plan aligns with the Committee's view of risks.

During the year the Committee considered reports on the Company from the internal auditors, including management's responsiveness to the findings and recommendations of the internal audit team. The Committee Chairman discussed high priority issues directly with the relevant members of management to ensure he had a thorough understanding of the matters raised and the process for resolution and held private meetings with the internal auditors.

Internal control, risk and compliance

The Board has overall responsibility for the Company's risk management framework and systems of internal control. These systems aim to ensure that risk is managed effectively, rather than eliminate risk completely, and can only provide reasonable, not absolute, assurance against material impact. We are increasing our focus in this area to make it more effective and provide increased levels of support to the business. The key features of risk management and our systems of internal control are:

- a governance model whereby our Board delegates responsibility for certain matters of risk and control to a number of committees in line with best practice. As part of our continuous improvement process, we are reviewing our Board governance and how decision making is delegated through our organisation as well as making these arrangements more transparent; comprehensive business planning, risk assessment and financial reporting procedures, including the annual preparation of detailed operational budgets for the year ahead and projections for subsequent years;
- a risk management process that reports on the Company's risk profile, identifies risks to the delivery of our strategic business objectives, assesses the impact of these risks should they materialise, and the likelihood of this happening. Risks are prioritised, according to our defined risk scoring criteria, allowing for the most significant risks to be monitored quarterly by Senior and Executive Management, our Audit, Risk and Reporting Committee and our Board. These reviews form the basis for our annual principal risks and uncertainties disclosure.
- a framework of corporate policies, supported by operating standards and procedures, and authorisation and approval processes that provide the necessary guidance to our employees and business partners as to how they should operate and conduct themselves when acting on behalf of the Company;
- an annual Controls Self-Assessment process, that has evolved during the year, and which requires senior management to report on the maturity and effectiveness of the key internal controls in operation within their business area, identify opportunities for improvement and to implement remedial action where required. A holistic view of the outcomes of this process provides a targeted and effective programme for improvement of our internal control environment;
- an annual internal audit programme that independently reviews the design and effectiveness of key controls that help mitigate risks to the delivery of our strategic business objectives; and
- reports on risk and systems of internal control produced by the Risk, Audit and Assurance team and external auditor.

The ARRC routinely reviews the effectiveness of the risk management arrangements and systems of internal control and, principally by means of reports in respect of the above activities and makes reports to the Board thereon.

The ARRC kept the adequacy and effectiveness of the Company's risk management and systems of internal control under review in 2017/18. The ARRC approved for recommendation to the Board the statements to be included in the 2017/18 statutory and regulatory reports concerning risk management and systems of internal control.

The ARRC ensured that there were clear reporting lines for all issues associated with risk management and reviewed the adequacy of structures, processes and responsibilities for identifying and managing risks facing the organisation. The Committee was satisfied that appropriate work was undertaken developing the maturity of risk management.

The ARRC reviewed the principal risks and uncertainties appearing on pages 72–78.

Nick Land
Chair of the Audit, Risk and Reporting Committee

27 June 2018

Strategy and Business Planning Committee report

Ian Marchant
Chair of the Strategy and Business Planning Committee

At a glance

I am pleased to present our first Strategy and Business Planning Committee (the "Committee" or "SBPC") report which describes the activities and areas of focus during the year.

The Committee was established in October 2017, following the separation from the Audit, Risk and Reporting Committee ("ARRC"), to enhance Board engagement and time available to focus on the Company's strategy, business planning and PR19 planning activities during a critical time for the business.

Since the Committee was formed, it has primarily focussed on overseeing and constructively challenging the development of the Company's strategy and business plan and the associated regulatory submissions, including the water resources management plan ("WRMP").

As we move into 2018/19, the Committee's focus will be on providing guidance and challenge on the finalisation of the PR19 submission and being aware of the outputs of the assurance carried out on the submission, working alongside the ARRC (who oversee our assurance framework and outcomes) before a review by the full Board. Following the business plan submission to Ofwat on 3 September 2018, the Committee will continue to oversee the further development of the business plan and WRMP and any additional regulatory submissions required following Ofwat's initial assessment of the plan, Draft Determination and Final Determination.

Membership and attendance

During the year, Ian Marchant succeeded Sir Peter Mason as Committee Chair in December 2017. Including the Chairman, the Committee consists of three Independent Non-Executive Directors and two Non-Executive Directors.

The Executive Directors, Head of Risk, Audit and Assurance, the Group Financial Controller and Company Secretary are invited to attend all meetings in order to ensure that all the information required by the Committee for it to operate effectively is available. Other members of the Thames Water senior management team attend by invitation as appropriate.

The role of the Committee

The Committee has primary responsibility for developing and implementing the Company's strategy, including regulatory and compliance matters linked to the strategy and business plan development process. The Committee will advise the Board on matters falling within the scope of its responsibilities. Such advice may be in the form of minutes of its meetings, supporting papers and written and oral reports at Board meetings.

The main responsibilities of the Committee are:

- to review the governance, policy and strategy of decisions with regulatory implications;
- to review guidance on current, emerging and future regulatory matters and advise the Board on regulatory strategy;
- to review the Company's progress in delivering against the regulatory outputs as established through the regulatory price review process;
- to be aware of the assurance arrangements for the reporting of regulatory data as required by Ofwat under its Company Monitoring Framework; and
- to oversee the preparation of formal regulatory publications and submissions including those relating to price determinations, regulatory commitments, Ofwat action plans, and consultations

Attendance table

Membership of the Committee during 2017/18:	Independent	Meetings attended/ eligible meetings
Sir Peter Mason* (Chair)	No	4/4
Ian Marchant** (Chair)	Yes	3/3
Greg Pestrak	No	4/6
Kenton Bradbury	No	6/6
Ian Pearson	Yes	6/6
Ed Richards	Yes	4/6

* Sir Peter Mason resigned as Director of the Company on 25 January 2018.
** Ian Marchant was appointed as Director of the Company on 1 December 2017.

Committee activities during the year 2017/18

- The Committee was updated and provided feedback on the work undertaken on the PR19 Business Plan on a regular basis.
- The Committee reviewed and recommended to the Board the Water Resources Management Plan (WRMP) and the approach to the associated public consultation.
- The Committee received regular and detailed updates on the Company's approach to the PR19 plan, including the Board member engagement timetable, customer's consultation interim results, Ofwat's Final PR19 methodology, and the submission timetable;
- The Committee considered and recommended to the Board the Water Resources and Bioresources RCV Allocation proposals;
- The Committee received and reviewed updates on other regulatory developments including consultations on licence modifications
- The Committee reviewed the Company's proposed performance commitments and outcome delivery incentives for AMP7.
- The Committee reviewed, commented on and approved the Company's strategic objectives.

Ian Marchant
Chair of the Strategy and Business Planning Committee

27 June 2018

Customer Service Committee report

Dame Deirdre Hutton DBE
Chair of the Customer Service Committee

The role of the Committee

The core activities of the Committee are to review, advise and challenge across a numbers of areas focussing on operational performance, customer management strategy and customer consultation and engagement. The main objectives of the Committee include the following areas:

- Performance – the review of current Company position and performance against industry comparators and external best practice companies.
- Strategy – reviewing the development and execution of the customer service strategy to ensure it reflects the opportunities and challenges relating to the service experience of our customers over the next five years; and
- Customer consultation and engagement – to review and advise on the proposed communications approach and channels with consumers and customers to ensure our plans meet their needs and preferences.

At a glance

During the year, the Committee (the "Committee" or "CSC") received regular updates on the Company's customer service performance and in particular reviewed the programme undertaken to improve the overall customer experience. The committee undertook a site visit to the Customer Solution Centre in Slough to experience first-hand the new customer service teams from Thames Water and Lanes Group plc.

Following several high profile operational incidents during the year, the committee were briefed on how the events were managed and in particular received updates on improvements that were made to the various contact channels – telephone, website, social media and face-to-face.

The committee also considered the enhancements being made to ensure that adequate support is provided to customers who are considered financially vulnerable.

Membership and attendance

The Committee is made up of three Independent Non-Executive Directors Dame Deirdre Hutton (Chair), Lorraine Baldry and Nick Land.

The Executive Directors, the Director, Customer Experience and Company Secretary are invited to attend all meetings in order to ensure that all the information required by the Committee for it to operate effectively is available. Other members of the Executive team and senior management attend by invitation when appropriate.

Membership of the Committee during 2017/18:	Independent	Meetings attended/ eligible meetings
Dame Deirdre Hutton (Chair)	Yes	3/3
Lorraine Baldry	Yes	3/3
Nick Land*	Yes	0/1
Nick Horler**	No	3/3
Dipesh Shah***	No	0/2
Ed Richards****	Yes	2/2

* Nick Land was appointed to the Committee in October 2017
** Nick Horler resigned as Director of the Company on 19 December 2017.
** Dipesh Shah resigned as Director of the Company on 2 August 2017.
***Ed Richards stepped down from the Committee on the separation of the ARRC.

Committee activities during the year 2017/18

During the year, the Committee reviewed the work undertaken on the customer experience programme, including how teams were sharing best practices across the Water and Waste businesses and the increased utilisation and development of social media to proactively engage with customers. The Committee have been actively engaged in the wider engagement strategy for PR19. In particular, there have been four core areas of activity for the Committee:

Customer Solutions Centre Visit

- The Committee visited the Customer Solutions Centre in Slough and as well as holding a committee meeting there toured the modern facilities that bring together the planning, scheduling and customer assurance teams from Thames Water and the field service teams from Lanes to improve the customer experience. The committee met the teams that bring all of these functions together under one roof and provide a new way of working, reducing frustrating hand-offs between departments, ensuring that customers are well looked after throughout their entire journey.

Making it easier for customers to contact us how, and when, they want

- Throughout the year there has been great focus on reducing the effort it takes for customers to get in touch. Multiple high profile customer impacting incidents have pressure tested the contact channels, however, the time taken to answer calls in particular has continued to improve. Significant investment has been made in our digital capability to optimise the customer experience when visiting the our website, including better site navigation to meet customers' needs, improved site functionality to increase task completion rates, and improvements in the 'contact us' experience enabling quicker access when customers want to speak to a representative.
- During 2018/19 focus will continue on providing an effortless experience for customers. This will result in changes to opening hours of our contact centres, contact channels and ways of working.

Customer Service Committee report continued

Supporting customers in vulnerable circumstances

- The Committee reviewed the hierarchy of support to provide holistic care for vulnerable customers, from payment plans and the installation of meters and water efficiency advice to support customers falling into arrears with their bill. For those in financially vulnerable circumstances 18,000 more customers received this support this year with social tariffs and the plan for the year ahead is to continue growing this support. The customer assistance fund has been utilised to write off debt for those that can't repay it, as has the Thames Water trust fund that provides household essentials for those in extreme poverty. We have also reviewed the schemes offered to refer customers to income maximisation services to help them get the support they need.
- A further 5% of customers in vulnerable circumstances have been added to our registers to ensure they receive our free priority service, increasing the register to approximately 60,000. This has been achieved working with partners such as Citizens Advice, through employee advocacy when supporting customers, and piloting an innovative multi-utility sign up with the energy companies in the region. This ease of registration for multiple organisations and the collaborative approach has been described as refreshing by the energy sector. This will open the door for Thames to broaden the number of partners it works with to grow the register further, such as Age UK, Kidney Care UK and Fire and Rescue services. The team is working hard to lay foundations for data sharing at scale between energy and water, with customers' consent, by 2020, to create a step change in scale of register growth.

Provide an excellent incidence response

- A critical area of focus has been in developing core capability to respond to customer incidents 24/7, over the phone, through social media and face to face, with a focus on supporting Priority Service customers. The establishment of Customer Representatives who have attended over 1,000 incidents, including seven major flooding incidents has made a tangible difference for customers. Digitally, where there is opportunity to pre-empt potential incidents, the teams are proactively publishing content to advise customers on a course of action. During incidents, we have reviewed the use of social media platforms as a real-time channel to provide information for customers on a localised basis, and during major events. The teams have created specific event update pages on our website to provide customers with a single destination for incident related information. We have received regular updates from the team regarding recent operational incidents and reviewed and challenged the lessons learned.

Dame Deirdre Hutton
Chair of the Customer Service Committee

27 June 2018

Health, Safety & Environment Committee report

Dame Deirdre Hutton DBE
Chair of the Health, Safety & Environment Committee

The role of the Committee

The Committee is responsible for reviewing and advising on our health and safety policy and the implementation of and compliance with agreed policies, applicable guidance and standards. The Committee reviews significant health & safety incidents and the learnings in order to develop and promote a culture conducive to accident prevention. The Committee also undertakes deep dives into specific areas of interest or concern to the Board.

In addition, the Committee also considers the strategy and performance for pollution and environmental impact prevention/reduction and receives updates on any current or potential pollution prosecutions.

At a glance

An early recommendation from the governance review was that a Health, Safety & Environment Committee be established to provide greater visibility of both health and safety, and environmental and pollution performance. The establishment of this Committee was approved by the Board in April 2018. The Committee is chaired by Dame Deirdre Hutton and comprises of Nick Land and Kenton Bradbury with the CEO, Chief Operating Officer, Director Strategic Planning & Investment, and Chief Health & Safety Officer being permanent attendees. It is proposed that the Committee will meet quarterly and report back to the Board.

The inaugural meeting of the Committee was held on 6 June 2018 and the Committee, at the request of the Board, reviewed and refined its terms of reference which will be presented to the Board for approval.

The meeting also considered:

- the health and safety governance and risk management framework along with the strategic objectives for 2018/19 including the proposed performance indicators.
- a detailed update on the water tunnel and shaft inspection programme.
- an update on current pollution prosecutions along with an environmental performance assessment programme update.

Membership and attendance

The Committee is made up of two Independent Non-Executive Directors Dame Deirdre Hutton (Chair) and Nick Land.

Membership of the Committee during 2017/18:	Independent	Meetings attended/ eligible meetings
Dame Deirdre Hutton (Chair)	Yes	1/1
Nick Land	Yes	0/1
Kenton Bradbury	No	1/1
Steve Robertson	No	1/1
Lawrence Gosden	No	1/1
Sarah McMath	No	1/1
Karl Simons	No	1/1

Dame Deirdre Hutton
Chair of the Health, Safety & Environment Committee

27 June 2018

Shareholder relations

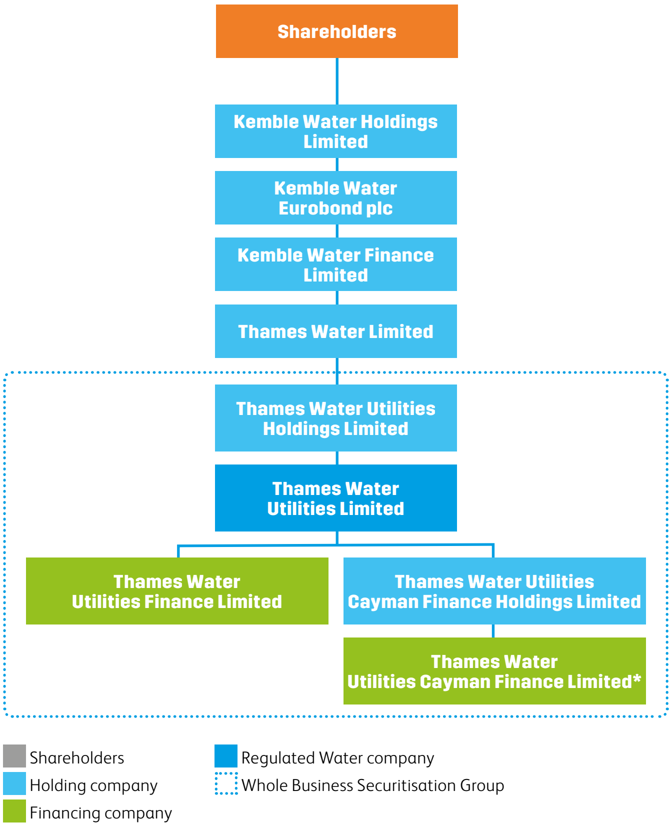
Dialogue with shareholders

The presence of shareholder appointed Non-Executive Directors on our Board allows effective face-to-face dialogue with our shareholders and allows all the members of the Board, in particular, the Independent Non-Executive Directors, to develop an understanding of shareholders' views. The current Board composition includes four shareholder appointed Non-Executive Directors. Kenton Bradbury was appointed by OMERS; USS and Wren House is represented by Greg Pestrak; Infinity and CIC are represented by Guy Lambert; and Aquila, bcIMC, QIC and PGGM are represented by Christopher Deacon.

The shareholders have opportunity for open and transparent dialogue with the Chairman, the Board, the Executive team and senior management on its stewardship of the Company and understand any issues and concerns.

Ownership

The chart opposite sets out an abridged version of the ownership of the Company and those group companies that connect Kemble Water Holdings Limited ("KWH"), our ultimate parent company, to the regulated company, Thames Water Utilities Limited.



* Both Cayman Island companies are, and always have been, registered in the United Kingdom for tax purposes. We have now secured approvals for closing both of these companies.

Our ultimate holding company is Kemble Water Holdings Limited and the shareholders as at the year ended 31 March 2018 and at the date of this report are:

Shareholders	% holding
Ontario Municipal Employees Retirement System (OMERS) OMERS is the defined benefit pension plan for 482,000 active, deferred and retired employees of nearly 1,000 municipalities, school boards, libraries, police and fire departments, and other local agencies in communities across Ontario, Canada.	27.433
Universities Superannuation Scheme (USS) Universities Superannuation Scheme was established in 1975 as the principal pension scheme for universities and other higher education institutions in the UK. It has circa 390,000 scheme members across more than 350 institutions and is one of the largest pension schemes in the UK, with total fund assets of over £60 billion (as at March 2017).	10.939
Infinity Infinity Investments S.A is a subsidiary of the Abu Dhabi Investment Authority (ADIA). ADIA manages a global investment portfolio that is diversified across more than two dozen asset classes and sub-categories.	9.900
Wren House Wren House Infrastructure Management Limited, an English limited liability company, was set up in late 2013 as the global direct infrastructure investment vehicle of the Kuwait Investment Authority ("KIA"). The KIA is the sole shareholder of Wren House. Wren House has been assigned responsibility for building partnerships, sourcing and execution of transactions, as well as asset management. Wren House's strategy is targeting the creation of a long-term focused, sustainable infrastructure platform and Wren House seeks to do so through partnership investment models for sizeable transactions where large sums of capital can be deployed.	8.772
bcIMC bcIMC is one of Canada's largest institutional investors within the capital markets. It invests on behalf of public sector clients in British Columbia and its activities help finance the retirement benefits of more than 538,000 plan members, as well as the insurance and benefit funds that cover over 2.3 million workers in British Columbia.	8.706
Hermes (BT Pension Scheme) Hermes GPE is one of Europe's leading independent specialists in global private markets. It manages the asset on behalf of the BT Pension Scheme, which has 300,000 scheme members. Hermes GPE invests in and advises on infrastructure, private equity and credit products on behalf of its clients and is specialised in co-investments, primary fund and secondary investments.	8.699
Cicero Investment Corporation As a sovereign wealth fund, Cicero Investment Corporation is a vehicle to diversify China's foreign exchange holdings and seek maximum returns for its shareholder within acceptable risk tolerance.	8.688
QIC QIC is a global diversified alternative investment firm offering infrastructure, real estate, private equity, liquid strategies, and multi-asset investments. It is one of the largest institutional investment managers in Australia.	5.352
Aquila 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.	4.995
Stichting Pensioenfonds ABP Stichting Pensioenfonds ABP is a pension plan sponsor. The firm provides its services to employers and employees in the government and education sectors. It invests in the public equity markets.	4.344
PGGM (Stichting Pensioenfonds Zorg en Welzijn) PGGM are a pension fund service provider and manage the pensions for different pension funds, the affiliated employers and their employees.	2.172

During the year and up to the date of this report on 27 June 2018, the following changes to the equity interests in KWH took place:

25 April 2017 – SAS Trustee Corporation agreed to sell its 2.389% stake to Aquila GP Inc., a Canadian entity managed by the Aquila Sonnet Limited Partnership. Following the transfer Aquila GP Inc. holds 4.995% of the total shareholding in Kemble Water Holdings Limited.

28 April 2017 – QIC Diversified Infrastructure (Jersey) Limited sold 3.336% of their interest to QS Infrastructure Pty Limited. QIC Diversified Infrastructure (Jersey) Limited then transferred its remaining 5.352% interest in the Company to QIC Infrastructure Management Pty Ltd.

31 May 2017–Kemble Water International Holdings Limited, an entity managed by the Macquarie Group, sold its entire 26.315% shareholding in Kemble Water Holdings Limited. This 26.315% holding was split between, Farmoor Holdings B.V., an entity registered in The Netherlands and an affiliate of OMERS, which acquired 17.543%, and Wren House Infrastructure Management Limited the global direct infrastructure investment arm of the Kuwait Investment Authority, which acquired a 8.772% stake.

6 November 2017 – AMP Capital Investors (Kemble Water) S.à.r.l., an entity registered in Luxembourg, sold its entire 5.530% shareholding in Kemble Water Holdings Limited, to OMERS Farmoor 2 Holdings B.V., an entity registered in the Netherlands and an affiliate of OMERS.

15 November 2017 – PIP2 TW LP, an entity registered in Canada and managed by Alberta Investment Management Corporation, alongside OPTrust Infrastructure Europe I Inc., an entity registered in Canada and managed by OPSEU Pension Plan, and QS Infrastructure Pty Ltd, an entity registered in Australia and managed by QS UK Infrastructure Trust No. 1, respectively sold their entire shareholdings in Kemble Water Holdings Limited to Church Water Investment Limited, an entity registered in the United Kingdom and managed by Universities Superannuation Scheme. Church Water Investment Limited Inc. acquired 10.939% of the total shareholding in Kemble Water Holdings Limited.

19 December 2017 – BriTel Fund Trustees Ltd; the custodian Trustee of the BT Pension Scheme, an entity registered in the United Kingdom and managed by Hermes GPE on behalf of the BT Pension Scheme sold 4.36% of its shareholdings in Kemble Water Holdings Limited to OMERS and BriTel Fund Trustees Ltd; the custodian Trustee of the BT Pension Scheme, retained 8.699% of the total shareholding in Kemble Water Holdings Limited.

Thames Water Utilities Limited continues to operate in the ordinary course of business. There is no direct financial effect on the financial statements of the Company, and there is no expectation that the shareholding transfers will result in any changes at an operational level.

Highlights

- All CEO incentives deferred to 2020.
- CEO has had 0.9% increase in earnings in 2017/18 compared to average employees 3.0%. Pay ratio of CEO to other employees of approximately 1:20 is very low by comparison to the average FTSE 100 of 1:132.
- Targets, which are aligned to be the same for all Executive Directors, Executive Team and Senior Managers along with front line staff, are focussed on customer, operational and environmental performance not shareholder value, across all longer term incentives.

Interim Chairman's statement

I am pleased to present, as the interim Chairman, our Remuneration Committee Report for 2017/18. This year the Committee has sought to further improve our disclosures to capture not only the required regulatory information but also to provide context and greater clarity around our pay arrangements for our Directors and employees.

Our approach to remuneration

Our approach to remuneration of our Directors and employees is based on our commitment to the following key principles:

- it aligns the interests of our senior management with customers' needs and the long-term objectives of all stakeholders;
- it drives behaviours that support what our customers want, need and expect, which are key factors that have defined our strategy and business objectives;
- it has a clear link between performance-related pay and excellent operational performance; and
- it seeks to offer competitive pay and benefits which are simple, transparent and fair.

Based on these key principles, and in light of recent operational performance, we have re-considered our approach to Directors' remuneration and all manager incentives to ensure we are better focused on delivering for our customers. Additionally, we have extended a simplified "Share in your success" initiative for all non-manager grade employees. This will align every employee's goals to ensure we are all working together, towards the same common objectives.

Linking performance and reward

We are committed to ensuring our remuneration framework supports our strategy; to differentiate our business through the provision of superior customer service, conducted transparently and with due regard to the environment. Our effectiveness as a business is built on long-term sustainable performance and it is important that our reward arrangements encourage long-term strategic thinking and resilience, rather than focusing on short-term fixes.

As detailed in the Strategic Report, the business has encountered challenges in recent years in a number of areas, including customer service and unacceptable leakage performance. As a result, we have made changes to our incentives, ensuring a closer link to operational performance to drive better behaviours and ensure that poor performance is not rewarded, particularly with respect to leakage. For the duration of our leakage recovery plan (2017/18 – 2019/20), all incentives will be based on the delivery of a stretching recovery plan including an element directly linked to the achievement of our original 2020 leakage target of 606 ML/d.

To make these principles real, we have developed new incentives using a consistent approach:

CEO Incentive	A three year incentive introduced in 2017/18 which replaces Steve Robertson's annual managers' bonus and longer term incentive.
Transformation Incentive	A two year incentive which applies from 1 April 2018 for all other Executive Directors, the Executive Team and Senior Managers.

Both schemes include deferred consideration to 2020 with a further two year clawback period. This means that no payment will be made for all of the CEO Incentive and one third of the incentives for senior managers until after March 2020 when we have delivered our transformation plan and achieved stretching customer, environmental and asset health outcomes, including the committed leakage target. This will support delivery of our transformation programme and achievement of excellent customer and regulatory outcomes.

The schemes, as part of total remuneration, are in line with market benchmarks. For on-target performance the CEO package is below equivalent packages at comparable water and sewerage companies.

2017/18 performance and reward

When we published our report for the year ended 31 March 2017, our incentive scheme targets for 2017/18 had not been finalised. As such the plans and targets have been included in this report. Having developed our new transformation plan covering the remaining years of AMP6 from April 2017 to March 2020, we reviewed and revised the incentives for the CEO, developing a three year CEO Incentive. For the other Executive Directors, the Executive Team and Senior Managers, an interim Customer Incentive was put in place for 2017/18 while the new Transformation Incentive was being developed. Details of both schemes, including potential outcomes and targets, are included in this report.

Amendments to remuneration arrangements

The 2015 Long Term Incentive Plan ("LTIP") scheme has resulted in no payment and the 2016 scheme has been voided. These LTIPs were developed as incentives under the old business plan and had no relevance to the transformation plan. As such it was clear that developing new incentives for the remainder of the AMP would best support meeting the necessary challenges rather than using Board discretion to adjust inappropriate schemes.

Business performance during the year included the development of a number of key strategic programmes, including capital investment in our IT infrastructure, and continued work on our new Customer Relationship Management and Billing ("CRMB") System. Another core programme, announced in April 2018, is our Organisational Design strategy which aims to improve accountability, remove wastage and make the organisation more efficient and effective – yielding customer, environmental and financial benefits.

The bonus and Customer Incentive scheme applicable to our Executive Directors (excluding the CEO) are due to pay out 50% of the maximum opportunity for the performance period 2017/18. While customer service and leakage outcomes are not where we want them to be, significant improvements have been made in the underlying activities. For example leakage detection and "find and fix" targets were surpassed and leakage repair cycle times fell year-on-year by over 40%. Customer service KPIs improved year-on-year and we expect to see these positively impact our Net Promoter Scores ("NPS") as the new systems come online. From a wastewater perspective, we saw good outcomes in general, including a reduction in one of our key metrics: our Numeric Consent failures for Sewage Treatment Works reduced from six in the previous year to only two. This is our best result since 2011.

New Remuneration Committee Chairman

As reported on page 83, Sir Peter Mason has relinquished his role as Chairman following his retirement and also leaves his role as Chair of the Remuneration Committee. We are currently undertaking a search and selection process for an experienced Independent Non-Executive Director who will chair one Remuneration Committee Chair and expect to confirm an appointment during 2018/19. In the interim I have agreed to combine the Chair of the Remuneration Committee with my role as Chairman.

Ian Marchant
Interim Chair, Remuneration Committee

Executive Directors' remuneration policy

Our three Executive Directors are, Steve Robertson (CEO), Brandon Rennet (CFO) and Nick Fincham (Director of Strategy and Regulation).

The remuneration of our Executive Directors includes different elements, some of which are long-term and performance-linked and remain 'at risk' of clawback, whereby the Committee are able to recover sums paid.

CEO: All incentive payments deferred to 2020

Steve Robertson (CEO) has had 100% of incentives deferred until the transformation plan is delivered in 2020, including regulatory targets on leakage, environment and asset health as well as stretching customer and operational outcomes. The details of this scheme are provided on page 118 of this report.

This means that for the period 2017/18 (and 2018/19) no incentive is due. This compares to the period 2019/20 when the CEO Incentive is due based on performance for the three year period from 2017/18 to 2019/20. As such the ratios of fixed and variable pay, short and long term remuneration shown below will be distorted:

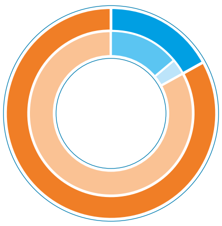
Elements of CEO remuneration 2017/18

Fixed short term pay – 100%
Salary – 80%
Pension and benefits – 20%

Elements of CEO remuneration 2018/19

Fixed short term pay – 100%
Salary – 78%
Pension and benefits – 22%

Elements of CEO remuneration 2019/20 'on target' scenario



Fixed short term pay – 17%
Salary – 14%
Pension and benefits – 3%

Variable long term pay – 83%
CEO incentive (target) – 83%

Note: no graph is shown with respect to elements of CEO remuneration 2019/20 "stretch" (maximum) scenario as the amount payable is at complete discretion of the Board. Any payment would be capped at two times on target earnings and be fully funded by investors.

CFO and Director of Strategy & Regulation

For the period 2017/18 both an Annual Management Bonus and Customer Incentive are due. In 2018/19 only an Annual Managers' Bonus is due, with an Annual Management Bonus and Transformation Incentive due in 2019/20. The Transformation Incentive is due for performance for the two year period from 2018/19 to 2019/20. As such the ratios of fixed and variable pay, short and long term remuneration shown below will be distorted:

Elements of CFO and Director of Strategy and Regulation remuneration 2017/18

Fixed short term pay – 49%
Salary – 38%
Pension and benefits – 11%

Variable short term pay – 51%
Customer incentive and Annual Managers' Bonus – 51%

Elements of CFO and Director of Strategy and Regulation remuneration 2018/19

Fixed short term pay – 56%
Salary – 43%
Pension and other benefits– 13%

Variable short term pay – 44%
Annual Managers' Bonus (target) – 44%

Elements of CFO and Director of Strategy and Regulation remuneration 2019/20 'on target' scenario

Fixed short term pay – 40%
Salary – 31%
Pension and other benefits– 9%

Variable short term pay – 30%
Annual Managers' Bonus (target) – 30%

Variable long term pay – 30%
Transformation incentive (target) – 30%

Elements of CFO and Director of Strategy and Regulation remuneration 2019/20 'stretch' (maximum) scenario

Fixed short term pay – 24%
Salary – 18%
Pension and other benefits– 6%

Variable short term pay – 38%
Annual Managers' Bonus (target) – 38%

Variable long term pay – 38%
Transformation incentive (stretch) – 38%

The longer term CEO and Transformation Incentives, are determined by delivery of regulatory outcomes for environment and asset health, as well as stretching targets for customer service performance. Shorter term incentives for all managers under the Annual Management Bonus focus on delivery of the programmes which will achieve these outcomes. Fixed annual elements, such as salary, pension and benefits, are set to ensure current and future market competitiveness enabling us to attract and retain high performing Executive Directors.

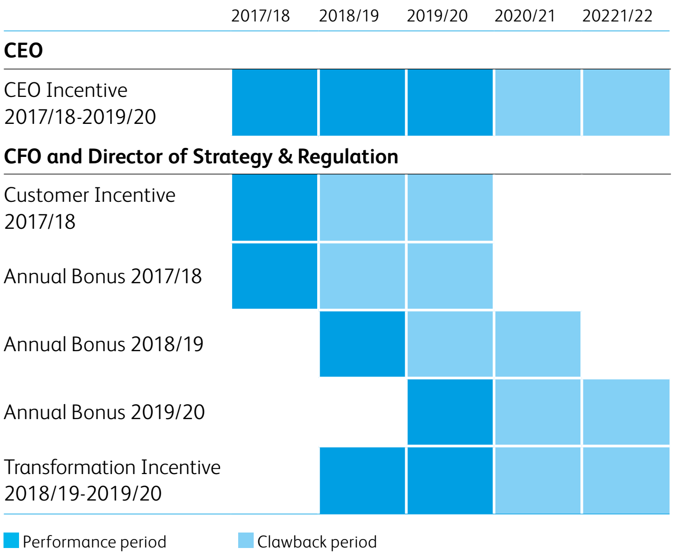
The Remuneration Committee will continue to review arrangements regularly to ensure that they remain effective and appropriate to the Company's circumstances and prospects, and to monitor the level of potential awards.

Pay at risk

In accordance with the principle of linking reward to excellent operational and customer performance, between 54% and 60% of total reward is at risk for the CFO and Director of Strategy and Regulation. For the CEO all incentives have been deferred for three years, when all variable pay will be at risk.

In addition all incentives are subject to a two year clawback period. Further details on what triggers clawback can be found on page 116.

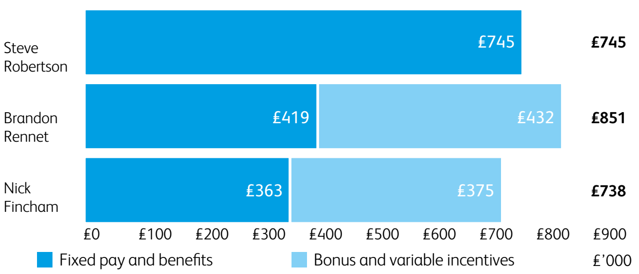
All performance-linked pay is subject to clawback as illustrated below.



Single figure remuneration 2017/18

The chart below summarises the total payments due to Executive Directors in respect of the 2017/18 financial year (including the bonus and variable incentive payments which will be paid in July 2018). Further information on the single total figure of remuneration can be seen on page 112.

Total payments due to Executive Directors 2017/18

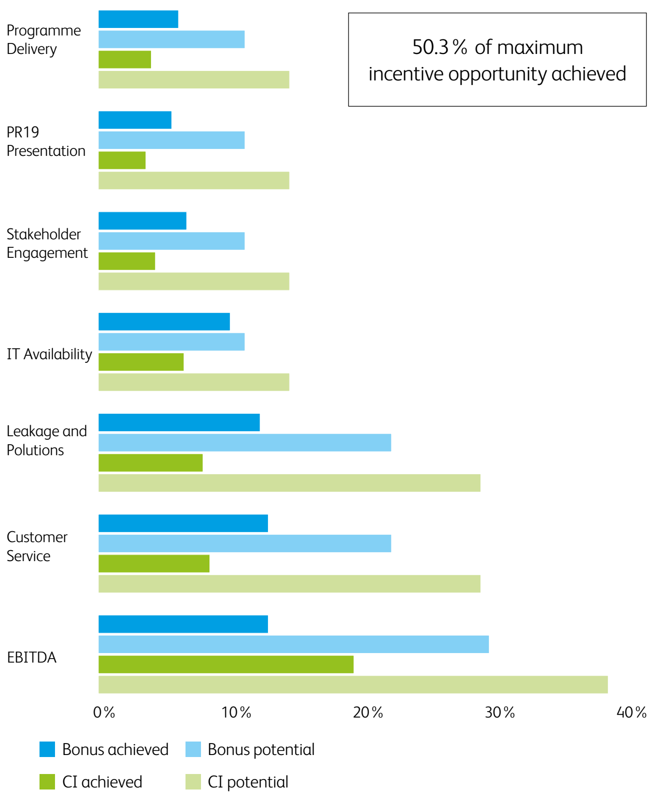


Annual bonus and Customer Incentive outcomes 2017/18

The CEO is ineligible to receive a payment either under the Annual Managers' Bonus scheme or an award for the Customer Incentive and instead is eligible for an award under the CEO incentive scheme as explained above. His award will pay out following the end of the 2019/20 financial year subject to delivery of specified targets.

The CFO and Director of Strategy and Regulation are eligible to receive an award under both the Annual Managers' Bonus scheme and Customer Incentive in relation to 2017/18 performance. The graph below details the performance against targets for these schemes.

Brandon Rennet and Nick Fincham received 50.3% of maximum incentive opportunity,



Overview

The Remuneration Committee formulates its position on remuneration policy for the Executive Directors and Executive Team against the following list of principles:

- remuneration should be aligned with the interests of the Company's stakeholders, in particular our customers and external shareholders;
- the policy should promote the long-term success of the Company and ensure that it clearly links with Company strategy;
- the remuneration policy should establish firm links between all of our employees', including Executive Directors', reward and the Company's performance;
- remuneration should be commensurate with packages provided by other companies of similar size and complexity, taking into account individual contribution and experience; and
- remuneration should include a mix of fixed and variable pay comprising of basic salary plus performance related incentives.

Executive Directors' remuneration policy table

The overall principles to the remuneration policy will remain unchanged in 2018/19. We summarise the key elements of our policy below, and for transparency have highlighted those areas which are new or where amendments have been made.

Element of pay	Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Base salary	To attract and retain high calibre Executive Directors and to recognise their responsibility to deliver our strategy.	Payable in cash in 12 monthly instalments during the year and reviewed annually, with changes typically effective from 1 July. The Committee's review will take into account an individual's performance, the external market and internal and external economic factors.	Annual salary increases will not normally exceed average increases for the wider workforce. Significant increases may be applied where the Committee considers this to be necessary due to one or more of the following factors: - increased scope and responsibility of a role; - where market conditions indicate a level of under-competitiveness; or - there is considered to be a risk in respect of attracting and retaining Executives. Where the Remuneration Committee exercises its discretion to recommend increases above the average for other employees, the resulting salary will not exceed the competitive market range.	None
Benefits	To provide market competitive benefits consistent with role, which drive employee engagement and commitment to our business.	Provision of benefits such as: - car allowance; - private medical insurance; - relocation assistance; - group income protection; - life assurance; and - 26 days holiday, increasing with length of service to 30 days maximum after 6 years completed service. The CEO may also receive a housing allowance where appropriate. Executive Directors will be eligible for other benefits which are available to the wider workforce.	Whilst there is no set maximum, benefits will be provided at a rate commensurate with the market.	None
Pension allowance	To attract and retain high calibre Executive Directors through the provision of cost effective saving benefits for retirement.	Payable in cash in 12 monthly instalments during the year, directly to the individual or into their pension scheme.	Contribution of 25% of base salary for Executive Directors.	None

New for 2017/18, 2018/19 and 2019/20 **CEO Incentive (CEO – only)**	To motivate and incentivise the CEO to deliver the transformation programme and achieve the Company's key strategic customer, environmental, and asset health commitments.	The CEO Incentive is a one-off award which will be payable four months after the end of the 2019/20 financial year based on performance over a three year performance period (1 April 2017 to 31 March 2020). Any payment remains subject to the absolute discretion of the Board to reduce in whole or in part. The scheme is subject to a clawback arrangement for a period of two years after the payment is made.	Payment for on-target performance under the scheme will be £3,750,000. The maximum payment for stretch performance above target will be at the absolute discretion of the Board. Any payment would be capped at two times on target earnings and be fully funded by investors. The minimum payment under the scheme is £nil. Change for 2017/18, 2018/19 and 2019/20 This scheme replaces all incentives the CEO was entitled to under his contract of employment.	Payment is based on delivery of key strategic customer, environmental and asset health commitments. Further details are provided on page 118.
Annual Managers' Bonus Change for 2018/19 **This element is not available for the CEO but remains in place for all other Executive Directors**	To motivate and incentivise the Executive Directors to achieve the Company's key financial, customer, operational and strategic objectives through a combination of financial, customer and personal performance targets.	Payable four months after the end of the financial year to which they relate. Payments are made subject to the satisfaction of predetermined targets set at the start of the year and approved by the Committee. Any payment remains subject to the absolute discretion of the Board to reduce in whole or in part. The scheme is subject to a clawback arrangement for a period of two years after the payment is made.	A maximum annual potential of up to 200% of annual salary. The minimum payment under the scheme is £nil. Change for 2018/19 The maximum annual potential for Executive Directors is up to a maximum 200% of annual salary (see page 120).	Payments are predominantly based on customer, operational and financial performance, with a minority based on achievement of personal objectives. Further details are provided on page 120.
New for 2018/19 and 2019/20 **Transformation Incentive (available for all Executive Directors excluding the CEO)**	To motivate and incentivise the Executive Directors to deliver the stretching transformation plan. This includes the delivery of outstanding performance for our customers, and the achievement of the Company's, key strategic customer, environmental, and asset health commitments.	The Transformation Incentive will be payable four months after the end of the 2019/20 financial year based on performance over a two year performance period (1 April 2018 to 31 March 2020). Any payment remains subject to the absolute discretion of the Board to reduce in whole or in part. The scheme is subject to a clawback arrangement for a period of two years after the payment is made.	The scheme has a maximum opportunity of 200% of annual salary. The minimum payment under the scheme is £nil.	Payment is based on key strategic customer, environmental, and asset health commitments. Further details are provided on page 119.

Notes to the policy table

Each year, the Remuneration Committee and Board review and approve the basic salaries, bonus scheme design, bonus payments and longer-term incentive plan payments that are recommended for the Executive Directors. The Board is made up of representatives of each of the shareholders therefore their views are directly taken into account when determining these matters.

Clawback

As previously disclosed, there is a degree of flexibility built into this policy by the Committee to ensure it can be applied practically over the period. The Company is committed to ensuring that the Executive Directors are appropriately motivated through the remuneration policy in place to achieve outstanding performance for our customers and other stakeholders in the context of taking appropriate risks. As such clawback provisions apply to the Executive Directors' incentive arrangements. These provisions allow the Committee, in its discretion, to reclaim awards paid to individuals for up to two years with respect to the Annual Managers' Bonus, the CEO Incentive and the Transformation Incentive. Such circumstances for clawback may include, but are not limited to, the following:

- Results announced for the financial year(s) relating to the Plan Year(s) have subsequently been found to include a material misstatement;
- There is any error in the calculation of an award or an error in the underlying results that leads to an overpayment of any bonus or incentive payment;
- There is reasonable evidence of employee misbehaviour or material wrongdoing; or
- The Remuneration Committee in its absolute discretion reasonably considers it appropriate to do so for example if the Company fails to reach minimum financial, health and safety or regulatory goals.

Selection of performance measures and targets

The Remuneration Committee gives careful consideration to produce a balance of fixed pay, short-term and long-term remuneration, linked to exceptional performance for our customers. The introduction of the CEO Incentive and the Transformation Incentive for Executive Directors, the Executive team and Senior Managers, means that this balance is not seen unless viewed across multiple years. For the CEO, the three-year performance period between 2017 and 2020 is considered, and for the other Executive Directors, Executive Team and Senior Managers the two-year performance period between 2018 and 2020 is applicable.

Performance measures for these schemes along with the Annual Managers' Bonus scheme are selected to align to the Company's strategic goals for the remainder of the AMP. They reflect customer, operational, financial and personal objectives.

Our approach to remuneration on recruitment

Executive Directors

The Committee and Board approve the remuneration to be offered to Executive Directors on recruitment. The remuneration package offered will be in line with the market and will be no more than is necessary to attract appropriate candidates to a role. Any new Executive Director's remuneration would include the same elements, and be subject to the same constraints, as those for existing Executive Directors (as set out on pages 115 –116 of this report).

It is at the discretion of the Committee whether to make any additional payments to a new Executive Director, arising from forfeited remuneration when leaving a previous employer.

Non-Executive Directors ("NEDs")

Remuneration levels are set to enable us to attract NEDs who have a broad range of relevant experience and skills to oversee the performance of the Company and the implementation of our strategy. The Chairperson and NED fees are proposed by the Remuneration Committee and approved by the Board. Annual fees are paid in 12 equal monthly instalments throughout the year and are reviewed on a regular basis against those of NEDs in companies of a similar scale and complexity and requiring a similar time commitment. The fees were last reviewed in September 2015 when it was agreed that they were outside of market benchmarks, and increased with effect from 1 July 2015. The Remuneration Committee considered NED fees in November 2017 and decided to undertake a full review as part of a wider governance review in 2018. NEDs are not eligible to receive further benefits, do not participate in any performance related arrangements and do not participate in pension plans.

Service contracts and policy on payment for loss of office

The following table sets out the key features of the service contracts for Executive and Non-Executive Directors:

Standard Provision	Policy	Details
Notice periods in Executive Director contracts	12 months' notice from Company 6 months' notice from Executive Director.	Executive Directors may be required to work during the notice period or may be provided with pay in lieu of notice or placed on "garden leave" at the discretion of the Company.
Compensation for loss of office in service contracts	Any payment as compensation for loss of office would be made at the complete discretion of the Board on recommendation from the Remuneration Committee.	In the event that the Company wishes to terminate an Executive Director's contract, other than in circumstances where the Company is entitled to summarily dismiss an Executive Director, it would need to give either 12 months' notice or make a payment in lieu of salary. If the reason for dismissal is redundancy then the Executive Director would be entitled to a statutory redundancy payment.
Non-Executive Directors ("NEDs")	No notice period from either party. NEDs are appointed for an initial three year term. Shareholder appointed NEDs are appointed without a fixed end date.	No compensation would be payable in the event of early termination.
Treatment of unvested long-term incentive awards (including CEO Incentive and Transformation Incentive) on termination under the plan rules	No payment unless employed on the date of vesting except for "special circumstances" including, death, ill-health, agreed retirement, redundancy, TUPE (Transfer of Undertakings Protection of Employment), change of control and other circumstances at the discretion of the Remuneration Committee.	Directors leaving under "special circumstances" will be entitled to a payment pro-rated to the period of service during the year, in line with the specific plan rules on pro-ration. Payments will normally be made on the payment date and based on actual performance. The Remuneration Committee has discretion to recommend variations to the rules and level of vesting.
Treatment of Annual Managers' Bonus or Transformation Incentive on termination under plan rules	No payment unless employed on the date of payment of bonus except for 'special circumstances' including, death, ill-health, redundancy and other circumstances at the Remuneration Committee's discretion.	Leavers through ill-health or death will be entitled to a bonus pro-rated to the period of service during the year. Leavers who have left through compulsory redundancy having completed the full bonus year remain eligible for a payment even if they are not employed on the payment date. Payments are made on normal payment date and are based on actual performance. The Remuneration Committee has discretion to vary the rules and level of payment. This is intended to be used only to provide flexibility in unusual circumstances.
Outside appointments	Executive Directors may accept external appointments with consent. Consideration is given to the appropriateness of the outside appointment and whether it may impact on their ability to perform the role appropriately.	The Chairman's approval must be sought before accepting an external appointment. Fees may be retained by the Executive Director for services relating to outside appointments.

Executive Directors' remuneration for the final three years of AMP6 (2017 to 2020)

As explained throughout this report and outlined in the policy above, the Committee have taken the opportunity to review the incentives for our Executive Directors, Executive Team and Senior Managers for the remaining years of AMP6 to make sure they support the delivery of our transformation plan and offer appropriate reward for outstanding performance. The details below show the link between these incentives and performance for our customers.

CEO Incentive (2017 – 2020)

The CEO Incentive replaces Steve Robertson's entitlement to any payment under the Annual Managers' Bonus and any other longer term incentive for the period from 2017 to 2020. The incentive plan runs from 1 April 2017 to 31 March 2020 with the potential for a single payment which would typically be paid in July 2020. Under this scheme no payments vest or accrue on any interim targets before 31 March 2020. Payments are only made on delivering great performance against the challenging targets at the end of the performance period.

Under the incentive Steve Robertson's on-target and maximum payments have been reviewed and agreed by the Board as follows;

- Delivery of the 'targets', which are considered to be stretching as previously described, will result in a payment of up to £3.75 million
- Delivery of outstanding performance above the target could result in an additional payment, the amount of which is at complete discretion of the Board. Any payment would be capped at two times on target earnings and be fully funded by investors.

These sums offer a potentially higher incentive than previous schemes but only for significantly improved customer outcomes across a range of measures, however this reflects the following;

- 100% of the CEO's incentives have been deferred for a three year period.
- The targets have been set to achieve outstanding customer and regulatory targets which were considered 'stretch targets' under the previous incentives. On this basis we believe that Steve Robertson's award offers 73% his potential maximum under previous schemes for equivalent levels of performance and significantly higher payments for exceptional performance beyond this level.
- Total remuneration benchmarks appropriately with CEO roles in comparable businesses including Water and Sewerage Companies.

As with all incentives for Executive Directors, the Executive Team and Senior Managers, any payment is made at the complete discretion of the Board which can adjust or withhold any payment in whole or in part. In addition the CEO incentive is subject to a two year clawback period under which the Company may require Steve Robertson to repay an identified 'clawback sum' as detailed on page 116.

Unlike previous schemes at Thames Water and those across the industry, the targets for the CEO Incentive scheme have been specifically designed to focus on critical customer, environmental, operational and regulatory outcomes. These are detailed in the table and notes below:

Incentive Element	Measures	Element as % of Total Bonus	Target	Payment (£'000)	Stretch Target	Payment
Leakage	ML/d	50.0%	606 ML/d	£1,875	576 ML/d	
Customer	Contactor NPS	12.5%	27	£469	29	Determined at the discretion of the Board. Capped at two times on-target earnings. Fully funded by investors
	Non-Contactor NPS		–19		–17	
Asset Health	Asset Health Measures	12.5%		£469		
Environment	Environmental Performance Assessment	12.5%	3 stars and on track for 4 stars	£469	4 stars	
Shareholder Value	PR19 Outcome	12.5%	Acceptable outcome based on shareholder feedback	£469	Good outcome based on shareholder feedback	
Total as a % of opportunity		**100%**	**OTE Payment £'000**	**£3,750**		

Notes:

Leakage: Half of the incentive is dependent on delivering leakage reductions in line with our promises to our customers and Ofwat. On target incentive will only be achieved if leakage has been reduced to the Ofwat target for 2020 of 606 ML/d (Mega litres per day).

Customer: Improving customer service is a critical outcome for the business. This will be assessed by stretching improvements in our Net Promoter Scores (NPS) for both those people who contact us as well as those who do not.

Asset Health: While leakage remains a focus, we cannot lose focus on the performance of our assets. This will be determined by the Ofwat assessed asset stability index.

Environment: Taking care of our environment is one of our most vital objectives and as such the Environment Agency's Environmental Performance Assessment (EPA) will be used as the target for this element. The Environment Agency award stars for performance based on a number of objectives including water quality, pollutions and customers out of supply.

Shareholder Value: Continued investment in our assets on behalf of our customers is essential to our future and as such it is critical that we deliver appropriate investment returns to our shareholders. The framework for this will be determined by the outcome of the 2019 Price Review with Ofwat (PR19) and as such the shareholders will assess the outcome of the review.

CEO total remuneration opportunity

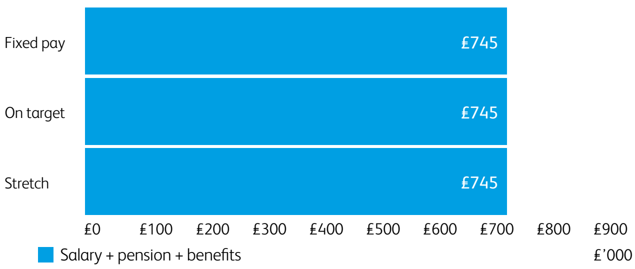
In 2017/18 and 2018/19 Steve Robertson (CEO) will only receive the fixed payments (basic salary + car allowance + pension) detailed in this report.

All incentive opportunities have been deferred and payment is entirely linked to longer-term performance between April 2017 and March 2020. No payment or part payment of this incentive is due before the end of the performance period.

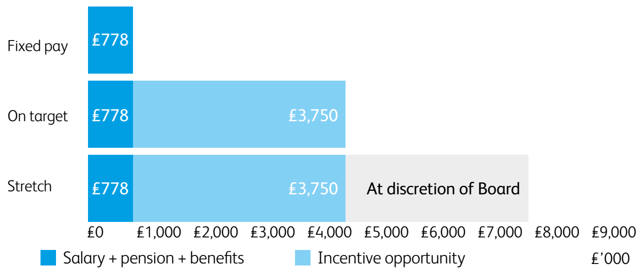
The total remuneration that could result under different performance scenarios using the remuneration policy in 2017/18, 2018/19 and 2019/20 is shown in the tables below.

The fixed pay represents the base salary plus the value of benefits and pension contributions at the start of 2018/19.

Steve Robertson (CEO) total remuneration opportunity 2018/19 under three performance scenarios



Steve Robertson (CEO) total remuneration opportunity 2019/20 under three performance scenarios



Other Executive Directors incentive schemes for 2018/19 and 2019/20

Transformation Incentive (2018 – 2020) – not applicable to CEO

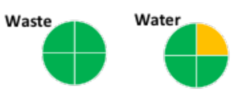
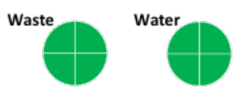
The Transformation Incentive is awarded at the discretion of the CEO to other Executive Directors, the whole Executive Team and invited Senior Managers. The incentive plan runs from 1 April 2018 to 31 March 2020 with the potential for a single payment which would typically be paid in July 2020. Under this scheme no payments vest or accrue on any interim targets before 31 March 2020. Payments are only made on delivering great performance against the target at the end of the performance period.

Under the incentive the Executive Directors' on-target and maximum payments have also been reviewed and approved as follows;

- Delivery of the 'targets' will result in a payment of up to 100% of annual salary.
- Delivery of the 'stretch' will result in a payment of up to 200% of annual salary.

It should be noted that for this incentive, the payment is based on the individual's annual salary as at 31 March 2020 and does not mean a payment equivalent to 100% or 200% of two years' salary.

As with the CEO incentive, the targets all focus on critical customer, environmental, operational and regulatory outcomes, rather than shareholder returns. The targets for the Transformation Incentive scheme are aligned to that of the CEO Incentive. The only difference is the absence of the shareholder element for PR19 which is instead included in the Annual Managers' Bonus scheme for other Executive Directors and the Executive Team. Measures and targets are detailed in the table below:

Element	Measures	Element as % of Total	Targets	Maximum Payment	Stretch Targets	Maximum Payment
Leakage Target	ML/d	40.0%	606 ML/d	100% of annual salary as at 31/03/20	576 ML/d	200% of annual salary as at 31/03/20
Customer Advocacy	Contactor NPS	20.0%	27		29	
	Non-Contactor NPS		–19		–17	
Asset Health	Asset Health Measures	20.0%				
Environmental Performance	Environmental Performance Assessment	20.0%	3 stars and on track for 4 stars		4 stars	

Notes: For measures see CEO notes above. Differences are as follows;
- Leakage accounts for 40% of maximum incentive for other Executive Directors.
- There is no PR19 element.

As with all incentives for Executive Directors, the Executive Team and Senior Managers, any payment is made at the complete discretion of the Board which can adjust or withhold any payment in whole or in part. In addition all incentives for these executives and senior managers are subject to a two year clawback period under which the Company may require them to repay an identified 'clawback sum' as detailed on page 116.

Annual Managers' Bonus

All managers of the Company, excluding the CEO, are eligible to participate in the Annual Managers' Bonus plan. The plan runs from 1 April 2018 to 31 March 2019 with the potential for a payment which would normally be paid in July 2019.

Under this bonus plan the Executive Directors' maximum payments have also been reviewed for the period from 2018 to 2020. Delivery of targets will result in a maximum payment of up to 200% of annual salary.

The maximum payment opportunity for other Executive Directors from the combined Transformation Incentive and Annual Managers' Bonus is higher than the maximum opportunity in the year ended 31 March 2017. As with the CEO Incentive, this reflects the very stretching nature of the targets while providing an appropriate level of total remuneration when benchmarked against equivalent roles in comparable businesses. Additionally, as reported on page 112, the 2016 LTIP which was due to pay out in 2019 has been voided, ensuring that there is no duplication of payment for the Executive Directors.

The structure, quantum and performance targets for the 2018/19 Annual Managers' Bonus for Executive Directors (excluding the CEO) are set out below.

Bonus Element	Objective	Measures	Element of % of Total Bonus	Target	Maximum opportunity (% of basic salary)
Customer	Project Spring	Programme complete and benefits on track	20%	Quality milestones delivered on time and in budget	40%
	Customer Advocacy	Contactor NPS on track		25	
		Non-contactor NPS on track		–21	
Corporate Challenges	Organisation Design ("OD")	Deliver successful OD programme	20%	OD delivered within the budget and benefits on track	40%
	Company Monitoring Framework	Company Monitoring Framework assessment		Out of 'prescribed' measures	
PR19	PR19 successful	Deliver successful PR19 outcome	20%	Slow track	40%
Financial	Group EBITDA	Group EBITDA	20%	£1 billion	40%
Personal	Annual personal performance assessment, including delivery of budgets, will determine the percentage applied.		20%	PDR outcome	40%
Total maximum opportunity					**Up to 200% of basic salary**

Notes:

Customer: Improving customer service is a critical outcome for the business. This will be assessed by stretching improvements in our Net Promoter Scores (NPS) for both those people who contact us as well as those who do not. A critical enabler is "Project Spring" – a replacement for our customer facing digital systems, which will make Thames Water even easier to do business with.

Corporate Challenge: Organisation Design: Thames Water is undertaking a re-organisation to enable the "One Thames" approach and deliver outstanding outcomes for our customers. Delivering the benefits of this change on time is critical to setting the business up for success.

Corporate Challenge: Company Monitoring Framework: Transparency in reporting our all aspects of our performance is a priority for Thames Water. This will allow customers, regulators, investors and other stakeholders to understand and assess our performance. Assessment will be based on the Ofwat assessment of our reporting.

Financial: In keeping with the "One Thames" strategy, Group level EBITDA is the target for all Executives and managers, with no business unit or functional level EBITDA as in previous years.

PR19: Continued investment in our assets on behalf of our customers is essential to our future and as such it is critical that we deliver an appropriate potential for investment returns to our shareholders. The framework for this will be determined by the outcome of the 2019 Price Review with Ofwat (PR19) and as such the shareholders will assess the outcome.

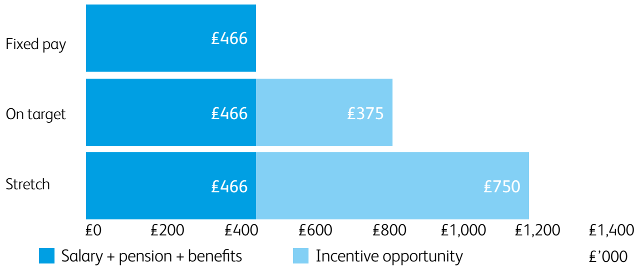
Other Executive Directors' total remuneration opportunity

The total remuneration that could result under different performance scenarios using the remuneration policy in 20108/19 and 2019/20 is shown in the tables below:

Brandon Rennet – Chief Financial Officer

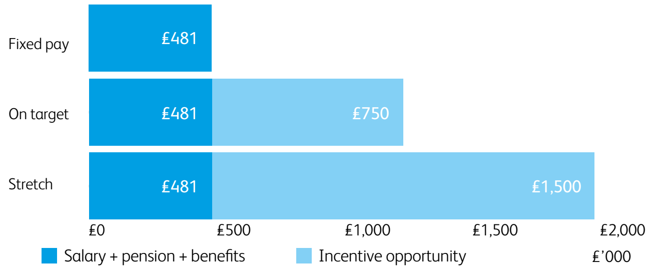
The chart below summarises the structure of the CFO's remuneration package for both 2018/19 and 2019/20, under three performance scenarios showing the value and pay mix for each.

Brandon Rennet (CFO) total remuneration opportunity 2018/19 under three performance scenarios



Salary is three months of salary as at 1 April 2018 (£325,00) and nine months of salary as at 1 July 2018 (£375,000).
For incentive opportunity
Transformation Incentive no payment is due in 2019.
Annual Managers' Bonus scheme:
Maximum performance results in the maximum Annual Managers' Bonus (200% of annual salary).
Performance is also shown in the graph at 50% of maximum which results in 50% of maximum payment (100% of annual salary).

Brandon Rennet (CFO) total remuneration opportunity 2019/20 under three performance scenarios

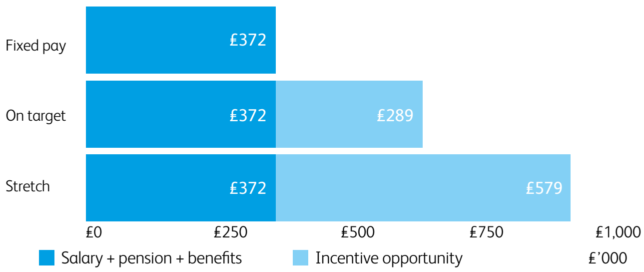


Salary the full year is assumed to be at the 1 July 2018 level (£375,000) for 12 months.
For incentive opportunity
Transformation Incentive
Stretch performance results in the maximum payment (200% of salary).
On-target performance results in 50% of maximum payment (100% of annual salary).
Annual Managers' Bonus scheme:
Maximum performance results in the maximum Annual Managers' Bonus (200% of annual salary).
Performance is also shown in the graph at 50% of maximum which results in 50% of maximum payment (100% of annual salary).

Nick Fincham – Director of Strategy and Regulation

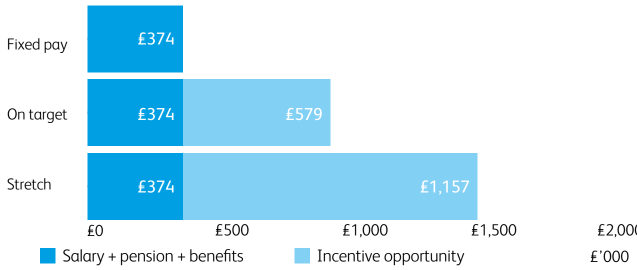
The chart below summarises structure of the Director of Strategy and Regulation's remuneration package for both 2018/19 and 2019/20, under three performance scenarios showing the value and pay mix for each.

Nick Fincham (Director of Strategy and Regulation) total remuneration opportunity 2018/19 under three performance scenarios



Salary is three months of salary as at 1 April 2018 (£281,875) and nine months of salary as at 1 July 2018 (£289,345).
For incentive opportunity
Transformation Incentive no payment is due in 2019.
Annual Managers' Bonus scheme:
Maximum performance results in the maximum Annual Managers' Bonus (200% of annual salary).
Performance is also shown in the graph at 50% of maximum which results in 50% of maximum payment (100% of annual salary).

Nick Fincham (Director of Strategy and Regulation) total remuneration opportunity 2019/20 under three performance scenarios



Salary the full year is assumed to be at the 1 July 2018 level (£289,345) for 12 months.
For incentive opportunity
Transformation Incentive
Stretch performance results in the maximum payment (200% of salary).
On-target performance results in 50% of maximum payment (100% of salary).
Annual Managers' Bonus scheme:
Maximum performance results in the maximum Annual Managers' Bonus (200% of annual salary).
Performance is also shown in the graph at 50% of maximum which results in 50% of maximum payment (100% of annual salary).

Directors' remuneration in the context of wider workforce remuneration

The Company's philosophy is to provide a fair and consistent approach to pay. Remuneration for other employees is determined by level and is broadly aligned to the Executive Directors', resulting in all employees working towards achieving outstanding outcomes for our customers and stakeholders.

The Remuneration Committee invites the HR Director to present proposals for the annual salary review for managers and employees (including the Executive Team) in February each year. Any other changes to remuneration policy within the Company are presented as and when they arise. The Remuneration Committee takes into account the salary increases and remuneration arrangements for the wider employee population when approving the salary increases for Executive Directors. Although employees are not consulted directly on the Executive Directors' remuneration policy, annual employee engagement surveys include metrics and encourage feedback on pay and benefits. In addition regular discussions take place with trade union and employee representatives on the pay and benefits not only for employees covered by collective bargaining but on the wider employee population.

Annual Managers' Bonus for other managers

All managers below Executive Director are entitled to participate in the Annual Managers' Bonus scheme. While on target and maximum payments vary by grade, the corporate objectives, measures and targets applied are the same as those for Executive Directors which are detailed above.

The HR Director consults with the Remuneration Committee to approve the performance targets for all bonuses and long-term incentive arrangements along with the remuneration packages offered to Executive Directors, the Executive Team and senior managers (not limited to the Executive Team) below Board level within the Company. The Remuneration Committee approves any payments made under these schemes to Executive Directors and also approves the levels of payments under the corporate elements of these schemes for all levels of management.

Share in Your Success 2020 for all non-manager employees

All employees in non-managerial grades have also been offered a potential payment of up to 5% of salary in 2020 for delivery of the transformation plan under an arrangement called Share in Your Success 2020. The objectives and measures for this payment are the same as those detailed in the Transformation Incentive and CEO Incentive relating to Leakage, Asset Health, Environment and Customer Service.

Unlike previous plans launched in 2015 and 2016, Share in Your Success 2020 does not require employees to actively enrol or sacrifice salary. Eligible Employees are automatically enrolled and the payment is awarded pro rata to service during the performance period on delivery of the objectives, subject to employees being in service at the payment date.

Together these incentives and payments demonstrate the Company's commitment to providing a coherent and consistent approach to rewarding delivery of excellent customer, regulatory and stakeholder performance.

Annual report on remuneration for 2017/18

This section has been prepared in accordance with the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013. The information has been audited as indicated.

Remuneration for Executives and Non-Executives (audited) for 2016/17 and 2017/18

	Salary/fees £'000		Taxable benefits £'000		Annual bonus/ Customer Incentive £'000		LTIP £'000		Pension related benefit £'000		Total Group £'000	
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
Executive Directors:												
S Robertson[1]	595	321	15	7	–	54	–	–	135	80	745	462
B Rennet[2]	325	17	13	601	432	–	–	–	81	–	851	618
N Fincham[3]	280	272	13	13	375	46	–	103	70	68	738	502
Chairman:												
Sir P Mason	325	325	–	–	–	–	–	–	–	–	325	325
I Marchant[4]	68	n/a	–	–	–	–	–	–	–	–	68	n/a
Independent NEDs:												
L Baldry	60	60	–	–	–	–	–	–	–	–	60	60
Dame D Hutton	70	70	–	–	–	–	–	–	–	–	70	70
I Pearson	60	60	–	–	–	–	–	–	–	–	60	60
E Richards	60	60	–	–	–	–	–	–	–	–	60	60
N Land[5]	75	11	–	–	–	–	–	–	–	–	75	11
Non-Executive Directors:												
C Deacon	60	60	–	–	–	–	–	–	–	–	60	60
G Lambert	50	50	–	–	–	–	–	–	–	–	50	50
K Bradbury	50	n/a	–	–	–	–	–	–	–	–	50	n/a
G Pestrak[6]	25	n/a	–	–	–	–	–	–	–	–	25	n/a
M Braithwaite[7]	8	60	–	–	–	–	–	–	–	–	8	60
N Horler	43	60	–	–	–	–	–	–	–	–	43	60
D J Shah[8]	25	60	–	–	–	–	–	–	–	–	25	60
Total	**2,179**	**1,486**	**41**	**621**	**807**	**100**	**–**	**103**	**286**	**148**	**3,313**	**2,458**

1 Steve Robertson's 2017 salary and benefits pro-rated to contract start date 1 September 2016 as detailed in the 2017 report. Remuneration for 2018 reflects annual salary (£550,000 for three months and £610,000 for nine months), car allowance £15,000 and annual pension of 25% of salary.
2 Brandon Rennet's 2017 salary and benefits pro-rated to contract start date 13 March 2017, included a payment of £600,000 mitigation for loss of bonus and LTIP payments already earned from his previous employment as detailed in the 2017 report. Remuneration for 2018 reflects annual salary £325,000, car allowance £12,500 and annual pension of 25% of salary.
3 Nick Fincham's remuneration for 2018 reflects annual salary (£275,000 for three months and £281,875 for nine months), car allowance £12,500 and annual pension of 25% of salary.
4 Ian Marchant's 2018 fee pro-rated to contract start date 1 December 2017.
5 Nick Land's 2017 fee pro-rated to contract start date 1 February 2017 as detailed in the 2017 report.
6 Greg Pestrak's 2018 fee pro-rated to contract start date 3 October 2017.
7 Mark Braithwaite's 2018 fee pro-rated to end of contract date 17 May 2017.
8 Dipesh Shah's 2018 fee pro-rated to end of contract date 2 August 2017.

Of total Executive Directors' remuneration of £2,333,883 (2017: £2,183,408), £1,633,718 (2017: £1,528,386) is for the Executive Directors for their services to Thames Water Utilities Limited and has been disclosed within note 4 to the financial statements. In addition, the Executive Directors received total remuneration of £700,165 (2017: £655,022) for their services to other companies within the Kemble Water Holdings Limited Group. No operational distinction is made between services provided by the Directors to one or the other.

Additional requirements in respect of the single total remuneration figure table

Base salary (audited)

Base salaries are a fixed sum payable monthly in arrears. For the Executive Directors, these are reviewed annually, taking into account their individual performance, the external market and internal and external economic factors, with any changes taking effect from 1 July each year. Base salaries are a fixed sum payable monthly in arrears.

Status	Name	Annual base salary 01/07/2017	Annual base salary 01/07/2016 (or at date of appointment, if later)	Percentage increase
Current Directors	Steve Robertson	£610,000	£550,000	10.9%
	Brandon Rennet	£325,000	£325,000	0.0%
	Nick Fincham	£281,875	£275,000	2.5%

During the last 12 months, the Remuneration Committee reviewed the total remuneration for the CEO in the context of deferring all incentive payments until 2020. In accordance with our policy Steve Robertson's salary was benchmarked against CEO roles in businesses of comparable size and complexity. During 2017/18 Steve's total reward increased by 0.9% as reported on page 125.

As reported on page 125 a similar review has been undertaken for Brandon Rennet (CFO) and from July 2018 an increase will be awarded bringing his salary and total package closer to these benchmarks.

Annual Managers' bonus scheme and Customer Incentive (audited)

The 2017/18 Annual Managers' Bonus scheme and Customer Incentive were assessed by the Board against a number of performance areas. These performance areas included customer service, operational, environmental and financial performance as well as progress in delivering some transformation programmes, critical in delivering customer, regulatory and other stakeholder outcomes by 2020. Performance was assessed by the Remuneration Committee and approved by the Board as follows:

			% Customer Incentive by Element		
Performance Element	Weighting as % Maximum	Performance Assessment	Bonus	Customer Incentive	Total Incentive Opportunity
EBITDA	25.00%	100%	28.8%	18.8%	47.6%
Customer Service	18.75%	58%	12.5%	8.2%	20.7%
Leakage and Pollutions	18.75%	55%	11.9%	7.7%	19.6%
IT Availability	9.38%	90%	9.7%	6.3%	16.0%
Stakeholder Engagement	9.38%	60%	6.5%	4.2%	10.7%
PR19 Preparation	9.38%	50%	5.4%	3.5%	8.9%
Programme Delivery	9.38%	55%	5.9%	3.9%	9.8%
Maximum Opportunity as % Salary			**115%**	**150%**	**265%**
Payment as % Salary			**80.6%**	**52.6%**	**133.2%**
Payment as % Maximum Opportunity			**70%**	**35%**	**50.27%**

In assessing the performance above the Remuneration Committee considered a basket of performance outcomes. Some of the key performance outcomes included the following;

Customer: SIM has improved by 1.3 points, a greater increase than all but four companies in the industry. Abandonment rates were on track for target (<5%) before the winter freeze/thaw event.

Leakage and Pollutions: The leakage target of 606 ML/d will not be hit until 2020 and this is reflected in the significant reduction in this element. Significant improvements were made during the year on programmes aimed at delivering the leakage target, "Find and fix" targets were exceeded and the active leak repair cycle times fell from 47 days in 2016/17 to 25.2 days in 2017/18. At the same time the Security of Supply Index (SOSI) was favourable to budget/forecast. On pollutions we are on track to deliver a 3 star rating from the Environmental Protection Agency with total pollutions, serious pollutions and self-reporting of pollutions all stable or improved year on year.

IT Availability: Networks have been stabilised with critical systems availability exceeding 97% across quarter 4.

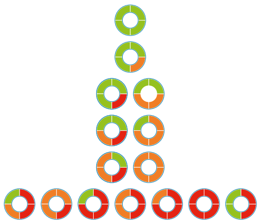
The outcome for 2017/18 Annual Managers' Bonus scheme and Customer Incentive is a payment to Executive Directors excluding the CEO equivalent to 133.2% of salary, which is 50.3% of the maximum incentive available. While this reflects the improvements in financial, customer, operational and environmental performance compared to 2016/17, it is significantly impacted by our under performance on leakage and SIM.

Details of the CEO Incentive scheme, which is due to pay out in July 2020, are set out on page 118.

The payments under this scheme will be made in July 2018 for Brandon Rennet (£432,250) and Nick Fincham (£374,894), at the same time as Annual Managers' Bonus payments for all other managers within the Company.

LTIP (audited)

The 2015 LTIP, which covered the performance period from 2015 to 2018, was designed to pay out in 2018. The performance outcomes, detailed in the table below, resulted in no payment being triggered under the scheme rules.

Objective	Measure	Targets	Performance	Payment
Financial Performance	Adjusted Regulatory Capital Value less Net Debt	Threshold / Target / Maximum Adjusted RCV: £1,441 / £1,516 / £1,666 less Net Debt Payout (% of maximum): 25% / 50% / 100%	£1,321	0.0%
Customer Performance	Customer Service (Relative SIM)	Rank – Payout (% of maximum) **1 to 3 – 100%** 4 – 80% 5 – 60% 6 – 40% 7 – 20% **8 to 10 – 0%**	9.0	0.0%
Asset Health Underpin	Asset Health	Asset Health Performance – Total proportion of LTIP outcome permitted to vest as a result of Asset Health assessment  100% 85% 70% 55% 40% 0% 		85.0%
Payment				0.0%

RCV less net debt: This target provides an assessment of Company "value" and as such acts as a proxy for share value.

Customer performance: This target is assessed using the Ofwat assessed SIM score, specifically the score relative to other Water and Sewerage Companies.

Asset Health: This target applies the Ofwat assessment of asset health. The following four asset classes are independently assessed at the end of the three year performance period to determine the impact of the underpin:
- Water above ground;
- Water below ground;
- Wastewater above ground; and
- Wastewater below ground.

Each asset can be classified into one of four categories: stable, improving, marginal and deteriorating.

Following the review of the Company business plan and development of the Transformation Strategy for the period 2017 to 2020, it is considered that this scheme fails to operate as an incentive for Executive Directors, the Executive Team and Senior Managers, including the Executive Team. As there is a potential for duplication, the Customer Incentive for 2017/18 included a condition that any payment would be offset should any payment become due under the 2015 LTIP scheme.

In order to further avoid any potential duplication the Remuneration Committee has formally approved the voiding of the 2016 LTIP scheme which was due to pay out in 2019.

Total pension entitlements (audited)

The Executive Directors are eligible to participate in the Company's defined contribution pension scheme, with the Company making contributions up to a maximum of 25% of base salary. No element of Annual Managers' Bonus, Customer Incentive Scheme or LTIP is pensionable. Executive Directors may choose to receive a cash allowance in lieu of these pension contributions. For 2017/18, Steve Robertson, Brandon Rennet and Nick Fincham received only a cash allowance. None of the Executive Directors participate in a defined benefit pension scheme.

Executive Director	Cash Allowance in Lieu of Pension 2017/18	Cash Allowance in Lieu of Pension 2016/17
Steve Robertson, CEO	£135,000	£80,208
Brandon Rennet, CFO	£81,250	£218
Nick Fincham, Strategy & Regulation Director	£70,039	£67,985
Total	£286,289	£148,411

Scheme interests awarded in the year – CEO Incentive and Transformation Incentive

No payments vest or benefits accrue on interim targets before 31 March 2020 under the CEO or Transformation Incentive schemes. Details of the performance targets are set out on pages 118 and 119 above.

Aggregate Directors' emoluments (audited)

Executive Director	2017/18, £	2016/17, £
Salaries	1,200,156	1,062,522
Taxable benefits/allowances	40,075	655,475
Bonuses	807,144	100,212
Pension payments	286,289	261,968
NED fees	979,395	949,822
Total	3,313,059	3,029,999

LTIPs are not deemed to be emoluments therefore they are not included within this table. Information relating to LTIPs can be found within the Single Figure for Remuneration table and LTIP section of this report.

Payments to past Directors (audited)

No payments were made to past Directors other than those payments made to Directors who resigned during the year and were no longer employed by the Company as at 31 March 2018.

Percentage change in CEO remuneration compared to all employees

The figures below present the percentage change in CEO remuneration from 2016/17 to 2017/18, by comparison to all employees in the Company, showing remuneration on a like-for-like basis to the prior year.

Employee Group	Annual base salary	Annual benefits	Annual bonus	Total Pay
CEO	+10.90%	0%	n/a	+0.9%
Other Executive Directors	+2.5%	0%	Changes to schemes and new Directors distort data. For detail see notes below	+54.7%
Executive Team	+5.0%	0%		+38.9%
All Managers (ex Executive Team)	+2.5%	0%		+16.2%
All Employees (ex Managers)	+2.5%	0%	n/a	+3.0%

As a result of the deferral of all CEO incentives, along with the changes to the composition of the Executive team, a simple comparison of changes in pay elements between 2016/17 and 2017/18 is not meaningful. The notes below detail the key changes.

CEO: Steve Robertson's total pay increased by 0.9% between 2016/17 and 2017/18. As detailed in this report, his total remuneration has been reviewed, deferring all incentive opportunities for three years and increasing his salary closer to market comparators.

Other Executives: The data shown in the table only relates to Nick Fincham (Director of Strategy and Regulation). Brandon Rennet (CFO) was not entitled to any incentive payment in 2016/17 and received no pay increase in 2017/18 and as such inclusion would have distorted the data. Details of the quantum and calculation of both Executive Director's incentive payments are provided on page 114.

The 54.7% increase in Nick Fincham's total pay is predominantly driven by an increase in total incentives between 2016/17 £149,000 (bonus + LTIP) and 2017/18 £375,000 (bonus + Customer Incentive). This reflects performance against targets between the two years. In 2016/17 the corporate elements of the bonus scheme which made up 90% of total opportunity, only paid out 5.0% as financial and customer threshold targets were missed. The remaining 10% was based on personal performance. In 2017/18, corporate elements made up 100% of maximum with no personal element. As detailed in this report, the incentives paid out 50% of maximum.

Executive Team: The data shown has again been limited to only reflect those members of the Executive Team in post across both 2016/17 and 2017/18 to allow a more realistic like for like comparison with other employees. The increase in basic salary reflects changes to one Executive Team member's salary being reviewed while others received increases in line with the 2.5% pay increase awarded to other employees. The total pay increase of 38.9% reflects the improved performance in 2017/18 compared to the previous year.

Other managers: The total pay for other managers also reflects the same performance improvements in 2017/18 as for the Executive Team. The basic pay increase provided is the average increase provided in the annual pay review and excludes any increases on promotion.

Other employees: Non-managerial employees are not entitled to any incentive payments. As such the table reflects only annual pay and performance related pay increases and not promotions.

Ratio of CEO remuneration to average for workforce

There is currently no requirement to report the ratio of CEO to average employee remuneration and as such no method of calculation has been determined. The "All-employee" average hourly rates shown here are the same as used for Gender Pay Gap reporting, using salary after salary sacrifice and excluding incentives and pension contributions. As noted in this report the CEO's pay in 2017/18 does not include any element for incentive payments as these have been deferred until 2020. The table below shows a summary of the 2017/18 ratio:

	CEO	All Employees (ex CEO)	All Employees (ex Managers)
Average hourly rate	£324.74	£18.39	£16.27
Ratio		1:18	1:20

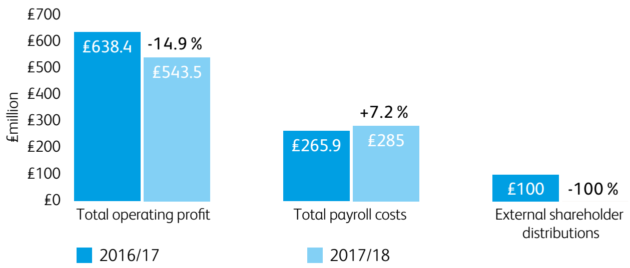
If incentives were included in the average hourly rates, it would increase to £22.72/hr for "All employees (excluding CEO)" a ratio of 1:14 as Steve Robertson earned no incentive in 2017/18. As there is no entitlement to Annual Managers' Bonus adding other incentives (e.g. long service awards and recognition payments) has no material impact on the "All employee (excluding managers)" ratio.

If the employer's pension contributions are included (CEO = 25%, average employee = 9.79%) this would change the ratios "All employee (ex CEO)" to 1:20 and "All employee (excluding managers) to 1:23".

FTSE 100 companies mean pay ratio is 1:132 (Source: CIPD Report, "Review of FTSE 100 executive pay packages" August 2017).

Relative importance of spend on pay

The following table sets out the percentage change in operating profit, external shareholder distributions and overall spend on pay for the year ended 31 March 2018.



Shareholder distributions are those made to external shareholders outside of the Kemble group in respect of the relevant financial year. The Directors believe that this is the most relevant measure to use as a comparison. No distributions were made to external shareholders relating to 2017/18 (2016/17: £100m).

Directors' service contracts

The dates of the service contracts for the Executive Directors and their notice periods are set out below. There is no maximum or minimum service period for any of the Executive Directors.

	Contract start date	Notice period (by employee/ Company)
Steve Robertson, CEO	01/09/2016	6 months /12 months
Brandon Rennet, CFO	13/03/2017	6 months /12 months
Nick Fincham, Director of Strategy and Regulation	01/04/2016	6 months /12 months

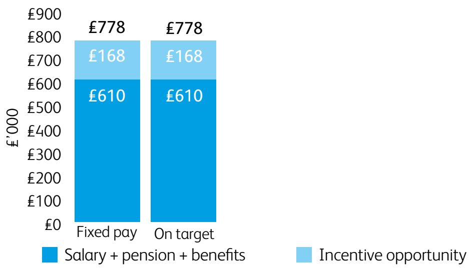
Implementation of remuneration policy in 2018/19

The charts below illustrate the application of the remuneration policy for 2018/19. The Committee believe that the mixture of short and long-term incentives, which have both fixed and performance-related elements remain appropriate for the Directors in 2018/19.

CEO

The CEO will be eligible to receive the payments outlined in the table below in 2018/19. There has been no increase in salary, pension and other benefits from the previous financial year.

Steve Robertson



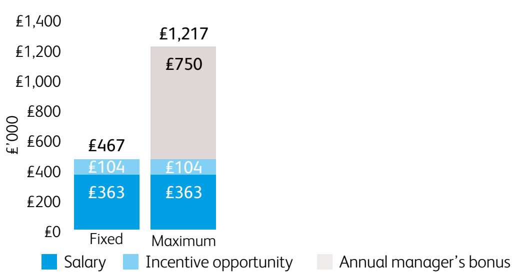
Under the CEO Incentive which is explained in the remuneration policy on page 118, there will be a one-off award for the period 2017 to 2020, which will potentially pay out in 2020/21. No payments vest or accrue on any interim targets before 31 March 2020.

CFO and Director of Strategy and Regulation

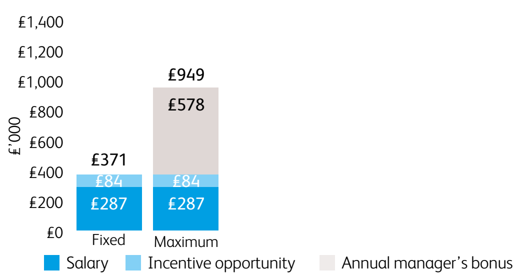
The CFO and Director of Strategy and Regulation will be eligible to receive the payments outlined in the tables below in 2018/19. This illustration includes the 15% increase in salary from £325,000 to £375,000 which Brandon Rennet will receive effective from 1 July 2018, and the 2.65% increase in salary from £282,000 to £289,000 which Nick Fincham will receive effective from 1 July 2018. There have been no other percentage increases to pension and other benefits from the previous financial year.

As with the CEO, the remuneration for other Executive Directors is benchmarked with packages provided by other companies of similar size and complexity, taking into account individual contribution and experience. Reviewing Brandon's salary and total remuneration after his first 15 months highlighted a need to address a significant variance to CFOs in comparable organisations.

Brandon Rennet



Nick Fincham



Under the Transformation Incentive which is explained in the remuneration policy on page 119, there will be a one-off award for the period 2018 to 2020, which will potentially pay out in 2020/21. No payments vest or accrue on any interim targets before 31 March 2020.

No long-term incentives will be awarded to Executive Directors in 2018/19 other those described above.

Non-Executive Directors

NED annual fees (audited)

The Chairman and NEDs receive a fixed fee for their duties which reflects their responsibilities and time commitments. They are not entitled to any Annual Managers' Bonus, long-term incentives, pension benefits or benefits in kind. There are no changes to the fee rates for 2018/19:

	Total annual fees 01/07/2018	Total annual fees 01/07/2017	Percentage increase
Chairman	£325,000	£325,000	0%
Independent NED/NED (non-committee member)	£50,000	£50,000	0%
Independent NED/NED (committee member)	£60,000	£60,000	0%
Chair of the Customer Service Committee	£70,000	£70,000	0%
Chair of the Audit, Risk and Reporting Committee	£75,000	£75,000	0%

The fee for the Chair of the Customer Service Committee is the normal Non-Executive Director fee plus an additional £10,000 in respect of services as a committee member, plus an additional £10,000 in respect of services as the Chair of the Customer Service Committee.

The fee for the Chair of the Audit, Risk and Reporting Committee is the normal Non-Executive Director fee plus an additional £10,000 in respect of services as a committee member, plus an additional £15,000 in respect of services as Chair of the Audit, Risk and Reporting Committee.

NED service agreements

The dates of the service contracts for the Non-Executive Directors are set out below.

The Chairman and Independent Non-Executive Directors have an agreement for service for an initial three-year period which can be terminated be either party with no notice period. Shareholder-appointed Non-Executive Directors are appointed with no fixed end date to their contract and are appointed and terminated without notice by the shareholders of the Company in line with the Shareholder Agreement.

	Initial Contract Start Date	Expiry Date of Contract
Chairman:		
Sir Peter Mason	01/12/2006	01/04/2018
Ian Marchant	01/12/2017	30/11/2020
Independent Non-Executive Directors:		
Dame Deirdre Hutton	22/07/2010	21/07/2018
Edward Richards	22/07/2010	21/07/2018
Lorraine Baldry	01/09/2014	31/08/2018
Ian Pearson	01/09/2014	31/08/2018
Nick Land	01/02/2017	31/01/2020
Non-Executive Directors:		
Christopher Deacon	01/12/2006	n/a
Guy Lambert	15/10/2014	n/a
Kenton Bradbury	31/05/2017	n/a
Greg Pestrak	03/10/2017	n/a
Mark Braithwaite (resigned 31 May 2017)	16/06/2015	17/05/2017
Dipesh Shah (resigned 2 August 2017)	15/10/2007	02/08/2017
Nicholas Horler (resigned 19 December 2017)	14/04/2014	19/12/2017

The Remuneration Committee

Members and attendance

The Remuneration Committee is currently chaired, on an interim basis, by Ian Marchant and consists of two further independent Non-Executive Directors and two Non-Executive Directors. They are appointed to the Committee on an ongoing basis. The following table sets out the attendance of the members of the Committee during the year.

Committee Member	Number of meetings attended/eligible meetings
Sir Peter Mason* (Chair)	6/6
Ian Marchant (Chair)**	2/2
Christopher Deacon	6/7
Ian Pearson	7/7
Mark Braithwaite***	1/2
Nick Land	7/7
Kenton Bradbury****	3/5

* Sir Peter Mason was Chair to December 2017. He was considered independent by the Board but not on appointment.
** Ian Marchant was appointed interim Chair from January 2018
*** Mark Braithwaite resigned on 31 May 2017
**** Kenton Bradbury was appointed on 1 June 2017

Committee's key activities and responsibilities

The role of the Remuneration Committee is to make recommendations to the Board regarding the remuneration strategy and framework to ensure that the Executive Directors and Senior Management are appropriately rewarded for their contribution to the Company's performance. The Committee's activities cover a range of subjects along with Executive Director remuneration, including succession planning and people strategy. They are also responsible for recommending the structure of other aspects of remuneration for all employees, including setting a budget for employee pay reviews, reviewing the appropriateness and effectiveness of employee benefits including pensions and the structure of annual and long-term incentive arrangements for managers.

For this reporting period, the following remuneration activities in respect of Senior Executives were carried out by the Remuneration Committee:

Meeting	Activities
April 2017	Review of performance against targets for the 2016/17 bonus and 2015 LTIP targets Review of proposals for incentives 2017/18 Review of draft 2016/17 Remuneration Committee Report
May 2017	Further review of draft of 2016/17 Remuneration Committee Report Update on pension scheme valuation and challenges Update on employee pay review Review of Executive Team pay Review of 2016/17 bonus recommendations Review of performance measures and targets for the 2017/18 bonus Review of performance measures and targets for the 2017 LTIP scheme
September 2017	Further review of proposals for incentives 2017 to 2020 Update on pension scheme proposals Update on "Share in your success 2020" proposals Review of Gender pay gap 2017 report.
November 2017	Update on progress of defined benefit pension closure consultation Review of Thames Water pension schemes Review of NED fees Review of CEO incentives 2017 to 2020 Update on Executive pay review
December 2017	Update on year to date performance against 2017/18 bonus objectives Review of proposals for Executive bonus scheme 2018/19 Review of proposals for Executive bonus scheme 201/20
January 2018	Further update on year to date performance against 2017/18 bonus objectives Review of proposed measures for Executive incentives 2018/19 and 2019/20 Further review of proposals for CEO incentive 2020 Update on defined benefit pension scheme closure consultation
March 2018	Review of Gender Pay and Statutory Reporting in 2018 Further update and proposals on 2016 pension scheme valuation Review of performance against targets for the 2016/17 bonus Review of performance against targets for the 2015 LTIP Review of proposed structure, performance measures and appropriate weighting for the 2017/18 bonus and 2017 LTIP schemes Review and approval of Pay Review budget
June 2018	Review of final plans for annual report disclosure purposes

This year's remuneration reporting has been prepared in accordance with the remuneration reporting regulations which came into effect on 1 October 2014, and is compliant with UK listing rules, as required by Ofwat as part of our operating licence.

The Remuneration Committee report was approved by the Board on 27 June 2018, and signed on its behalf by:

Ian Marchant
Interim Remuneration Committee Chairman

The Directors present their annual report and the audited financial statements for the year ended 31 March 2018. These are the Company's statutory accounts as required to be delivered to the Registrar of Companies. This Directors' Report includes certain disclosures required under the Companies Act 2006.

The Directors consider that the annual report and the audited financial statements, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy.

The Directors have carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity, and details of these risks and their management or mitigation can be found on pages 72–78. The nature of the Company's operations and its principal activities are set out in the Strategic Report on pages 1–82. The Strategic Report includes details of the market overview; key growth drivers; business model; strategic objectives; principal risks and uncertainties; key performance indicators and a summary of the Company's performance during the year.

The Directors have voluntarily complied with the Disclosure and Transparency Rules ("DTR"), to the extent that these can be reasonably applied to the Company. The Company is required, under its licence, to publish information about its results as if it were a company with a Listing on the London Stock Exchange. Consequently, the Company has prepared Corporate Governance, Remuneration Committee and Audit, Risk and Reporting Committee reports that are included within this Annual Report.

Corporate Governance

The Company's compliance with the 2016 UK Corporate Governance Code is reported on page 92.

Directors

The current Directors of the Company, including their biographical details can be found on pages 84–87. Details of the Directors' remuneration, service contracts and any interest in the shares of the Company are included within the Remuneration Committee report on pages 112–128.

Sir Peter Mason, who became Chairman in 2006, delayed his retirement in 2016 to oversee a transitional phase for the Company following the arrival of Chief Executive Officer, Steve Robertson, and Chief Financial Officer, Brandon Rennet in 2016/17, as well as welcoming several new investors during 2017/18. The Board formed an Independent Chairman Nomination Committee (ICNC) and worked with Spencer Stuart, an executive search firm, to identify a suitable successor for Sir Peter Mason.

On 23 November 2017, the Board announced the appointment of Ian Marchant as an Independent Non-Executive Director and confirmed that he would succeed Sir Peter Mason, as the Chairman, on his retirement in January 2018. After serving the Company for over twelve years, Sir Peter Mason retired as Chairman of the Board on 25 January 2018. Ian Marchant has undergone a thorough induction process which has provided him with a good basis to make an early contribution to our Board discussions and to have a good grounding of our business and the Company strategy before he became the Chairman.

Other Board changes were as follows:

- Mark Braithwaite resigned as Non-Executive Director on 31 May 2017;
- Dipesh Shah resigned as Non-Executive Director on 2 August 2017;
- Nick Horler resigned as Non-Executive Director on 19 December 2017;
- Kenton Bradbury was appointed as Non-Executive Director on 31 May 2017; and
- Greg Pestrak was appointed as Non-Executive Director on 15 November 2017.

Additionally, Nick Land, Independent Non-Executive Director and Chair of the Audit, Risk and Reporting Committee was appointed as Senior Independent Director on 22 July 2017.

Directors' indemnities

Subject to the conditions set out in Section 234 of the Companies Act 2006 and subject to shareholder approval, the Company has made qualifying third party indemnity provisions for the benefit of its Directors and for the benefit of other persons who are directors of associated companies and these remain in force at the date of this report.

Political donations

No political donations were made by the Company (2017: £nil).

Branches

The Company does not have any branches outside of the UK.

Share capital

As at 27 June 2018, the Company's issued share capital was 29,050,000 ordinary shares of £1 each amounting to £29,050,000. There were no movements in the Company's share capital during the year. Further details of the Company's share capital can be found in note 23.

Dividends

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' current and expected regulatory and financial performance, regulatory restrictions, management of economic risks and debt covenants. Directors, in assessing the dividend to be paid (to a maximum of statutory distributable reserves), are required to ensure that:

- sufficient liquidity is maintained to enable the business to meet its financial obligations for at least 15 months;
- the Company maintains a minimum of 2% headroom on its Regulated Asset Ratio covenant restrictions (see page 61); and
- post-dividend financial ratios remain within their agreed limits at both the balance sheet date and on a forward-looking basis.

We are also considering a new approach to dividends for the 2020-2025 regulatory period as discussed in the Board Statement inside the front cover. This takes into account the following principles:

- the payment of a proposed dividend should not impair the longer term financeability of the company's business
- the assessment of the impact that payment of the dividend may have on all stakeholders including employees, pension members and of course customers. This means the Board satisfying itself that Thames Water's social, financial and operational commitments to those stakeholders will not be compromised in the longer term by the payment of a dividend
- the Board should also be content that the company's financial performance, that 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
- how the overall combined interest costs on debt and dividend payments compare to the regulatory allowed cost of capital applied to the notional capital structure assumed by Ofwat, with any excess above this level triggering an assessment by the Board as to whether the additional returns result from performance that has benefited customers and may therefore reasonably be applied to finance a dividend.

The Company paid a total dividend of £55.0 million (2016/17: £157.0 million) during the financial year to its immediate parent company, Thames Water Utilities Holdings Limited. The dividends paid in the current financial year were utilised solely to service the debt obligations and working capital requirements of other companies in the Group. No distributions were ultimately paid to external shareholders during the year (2016/17: £100.0 million).

Material financial instruments

Financial risk management and information on financial instruments is covered in note 20.

Research and development

The Company's research and development programme consists of a portfolio of projects designed to address technical needs across the range of water cycle activities, delivering innovative technical solutions aligned with business needs to address challenges for AMP6 and beyond and also provide specialist technical support to the business.

The development and application of new techniques and technology is an important part of the Company's activities. The Company is a member of UK Water Industry Research ('UKWIR'), and participates and benefits from its research programme. The UKWIR research programme relating to Thames Water is currently divided into the following topics: drinking water quality and health; toxicology; water resources; climate change; water mains and services; leakage, customers, and regulatory issues. In addition, the Company carried out more specific research in the fields of large meters, metaldehyde removal, water quality monitoring and pipeline materials during the year.

Expenditure on research and development totalled £3.5 million for the year (2017: £4.0 million).

Intellectual property

The Company protects intellectual property of material concern to the business as appropriate, including the filing of patents where necessary.

Charitable fundraising

During the year, the Company raised £316,675 (2016/17: £350,147) for WaterAid, with a further £46,344 (2016/17: £93,000) of income pledged, which is being used to improve access to clean water for two towns in Malawi.

In addition, the Company raised a further £38,174 (2016/17: £42,450) for other local and national charities through internal fundraising activities. The company match funded employee fundraising efforts with £31,534 (2016/17: £34,483). The Company supports the local community through volunteering events and contributions to community investment funds.

Employee involvement

We undertake significant levels of communication with our people, through regular business review conferences, team briefs and varied written communications. During the year the Executive Team launched a series of company-wide discussions sharing our Strategy, Vision and Values which built towards the announcements on our new strategic plan and organisational structure in early April 2018.

Thames Water recognises three trade unions, UNISON, GMB and Unite, working with them through an agreed Partnership approach. We regularly meet trade unions, and where appropriate non-union representatives, at senior and working levels, to discuss issues affecting employees. Significant work has been undertaken during the year in relation to developing proposals to make our pension schemes sustainable. This included town hall events and workshops with some 2,000 affected employees, as well as formal consultation meetings with trade union and scheme representatives. In addition specific groups consider issues relating to Health, Safety and Wellbeing, as well as undertaking reviews of Company policies. The Partnership trade unions, which in 2017/18 delivered a two year pay deal to June 2019, negotiate pay and conditions for non-managerial grades.

All Managers and Senior Leaders in the Company are incentivised to deliver Company performance against the same key objectives including measures designed to deliver critical customer, environmental, asset health, and financial performance outcomes as well as the delivery of strategic and personal objectives. During the year the Company also launched a plan for all non-managerial employees which will make a payment in 2020 for delivery of the same critical performance outcomes over the performance period April 2017 to March 2020.

The Company regularly shares key performance and other critical business information to employees through the various communications mentioned above, including business reviews and written communications. Specifically a monthly "Team Talk" session includes key customer, operational and financial performance which is communicated to every team. This session includes key messages from the CEO and other Executive Team members, typically in video format.

Equal opportunities, diversity, and inclusion

We recognise that our people are at the heart of our business. To help us succeed in our aim to provide best-in-class water and sewerage service, to be efficient and sustainable and to act in the long-term interests of our wider community, we need a range of skills and capabilities, representative of society, throughout our business.

We seek to attract, develop, reward, promote, and retain a mix of colleagues who can offer different but complementary attitudes, ideologies, talents, and knowledge. We understand the importance of appreciating and harnessing the unique skills, experiences, and backgrounds that each individual brings to our family.

To support an equal opportunity, fair, diverse, and inclusive Thames Water free from discrimination, bullying, harassment, or victimisation, we are committed to building a working environment and culture that inspires our people to live our values.

Everyone has a part to play to ensure people feel comfortable to bring their whole self to work.

The attitude and behaviour of all our colleagues has a profound impact on our reputation and ability to ensure that everyone is provided with the same opportunities, treated with respect and valued, irrespective of their protected characteristic including; age, disability, gender identity, marriage or civil partnership, pregnancy or maternity, race, religion and belief, sex or sexual orientation.

Employees with disability

Thames Water are proud to be a Disability Confident accredited employer.

We were delighted to be invited to speak at a recent local government 'Stronger Together, Access to Work' careers event about our Give Someone a Start (GSAS) scheme which offers those not in employment, education or training and those with mental and physical disabilities who may need extra support in finding a role, three weeks experience of working life at Thames Water. We have been supporting this programme for the past six years.

We are fully committed to ensuring that existing or potential future employees with disabilities are not treated less favourably than any other such person without a disability and that they are fully integrated into the work environment. This includes supporting individuals with their personal requirements and we currently have a programme of work to ensure our key buildings have disability friendly facilities.

As well as focussing on attracting, supporting and retaining people with disabilities we also raised awareness of physical disabilities via our own version of 'dining in the dark' at some of our key sites which generated money for Guide Dogs for the Blind as part of our celebration of International Day of Disabled Persons.

Going concern

The Directors believe, after due and careful enquiry, that the Company has sufficient resources to meet its present obligations as they fall due and, therefore, consider it appropriate to adopt the going concern basis in preparing the 2017/18 financial statements. In forming this assessment the Directors have considered the following information:

- The Company's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic Report on pages 1–82. The financial position of the Company, its cash flows, liquidity position and borrowing facilities are described in the Strategic Report on pages 58–63;
- Day-to-day working capital requirements are funded by the business cash flows and by utilising revolving credit facility, as needed. During the year, £2,247.7 million, gross of issuance costs, of new external debt was secured and £1,799.8 million of debt repaid. There is no current requirement to raise additional finance to meet future project obligations. There are also cash balances and liquid resources of £107.0 million and undrawn committed facilities of £1,450.0 million;
- The committed facilities consist of £1,450.0 million facilities with a group of banks made up of a £950.0 million revolving credit facility that expires in 2022 that is not expected to be drawn down in full in the ordinary course of business, and £500.0 million of 364-day liquidity facilities due for renewal in August 2018. The liquidity facilities are not designed to be used in the ordinary course of business;
- The Company is in compliance with its financial covenant requirements as at 31 March 2018; and
- The Company's forecasts and projections, taking account of reasonably possible changes in trading performance, show that the Company should be able to operate within the level of its current facilities and covenant restrictions for at least 12 months from the date of this report.

Funding

On 3 May 2017, Thames Water Utilities Cayman Finance Limited issued £550.0 million new class B sterling bonds, with a £300.0 million 2.38% tranche maturing in 2023 and £250.0 million 2.88% tranche maturing in 2027. The proceeds were used to fund the redemption of the £550.0 million class B bonds due to mature in 2025 but with a first call date in July 2017.

On 12 December 2017, Thames Water Utilities Cayman Finance Limited issued Canadian Dollar 250.0 million Class A bonds and swapped to £143.6 million at a weighted average interest rate of 2.30%. The bonds have a 7 year maturity. The cash raised was used for general corporate purposes, as well as for repaying and servicing the financial indebtedness of Thames Water Utilities Limited.

On 22 March 2018, Thames Water Utilities Limited raised a total of £705.1 million Class A debt at a weighted average interest rate of 2.43% via the United States Private Placement market. The issue consisted of five tranches, 5 year ($55.0 million swapped to £38.7 million), 7 year ($285.0 million swapped to £200.4 million), 10 year (£216.0 million), 12 year (£210.0 million) and 15-year (£40.0 million). The transaction was the first to be issued under our Green Bond Framework, with proceeds used to refinance existing major investment projects that have a positive environmental impact such as our ongoing trunk mains replacement and metering work.

During the year, a total of £849.0 million was drawn down and repaid from the Thames Water Utilities Cayman Finance Limited, £950.0 million revolving credit facility in various tranches. The amounts were used for general corporate purpose and to pre-finance long term debt issued in March 2018.

Greenhouse gas emissions

We have continued to make strong progress throughout 2017/18 in reducing our emissions, both by reducing our energy consumption and by increasing our renewable self-generation. Where we're not able to produce our own energy, we source Renewable Energy Guarantees of Origin ("REGO") accredited sourcing renewable electricity through a contract with Haven Power. As a result we have achieved our 2017/18 emissions targets.

In the last year we have reduced our emissions by 229.5 ktCO_2e to 277.9 ktCO_2e (2017: 245.9 ktCO_2e to 507.4 ktCO_2e). We calculate our greenhouse gas emissions using the UK Water Industry Research Carbon Accounting Workbook ("CAW"). The CAW is the industry standard which is updated annually to reflect changes to emission factors and carbon reporting guidance from the Department of Environment, Food and Rural Affairs (Defra). Operational Greenhouse Gas Emissions ("GHG") within the regulated business are calculated annually reflecting the six major greenhouse gases and the Defra Environmental Reporting Guidelines. The emissions reported are associated with the operational emissions of the regulated business and include:

- Scope 1 (Direct emissions);
- Scope 2 (Indirect energy use emissions);
- Scope 3 (Emissions from outsourced services and business travel); and
- Carbon intensity ratios per mega-litre day (MLd) of service delivered.

Emissions from the greenhouse gases are standardised to global warming potential represented as carbon dioxide equivalents ("CO_2e").

Insurance

The Company maintains a comprehensive insurance programme, renewed annually. This includes cover for a range of insurance classes including Public Liability, Property, Employers Liability, Construction, Motor, and Directors' & Officer Liability cover.

The insurance coverage has been reviewed and approved by an independent insurance adviser retained to ensure that the Company's insurances are consistent with good industry practice, have regard to the risk being covered and address the interests of the Company.

Statement of Directors' responsibilities in respect of the annual report and financial statements

The Directors are responsible for preparing the annual report, and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union ("EU") and applicable law.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant and reliable;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- assess the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

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 responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

The Directors have decided to prepare voluntarily a Corporate Governance Statement as if the Company were required to comply with the Listing Rules and the Disclosure Guidance and Transparency Rules of the Financial Conduct Authority in relation to those matters.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report and a Directors' report that complies with that law and those regulations.

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.

The Directors consider that the annual report and accounts, taken as a whole, is fair, balanced, and understandable and, provide the necessary information for shareholders to assess the company's performance, business model, and strategy.

Disclosure of information to the auditor

In accordance with Section 418 of the Companies Act 2006, the directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware and each director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Independent auditor

Pursuant to Section 487 of the Companies Act 2006, the Company and wider Group undertook a formal tender process for its external audit. Following a competitive audit tender process and after ten years of being the auditor of the Company and the wider Group, KPMG LLP will resign as auditor on completion of the 2018 audits for the Company and all related subsidiaries.

Following the conclusion of the formal tender process, the Board recommended that PricewaterhouseCoopers LLP be appointed as the Company and wider Group's external auditor. In accordance with Section 485 of the Companies Act 2006, a resolution to appoint PricewaterhouseCoopers LLP will be approved at the June Board meeting.

The Directors' Report was approved by the Board of Directors on 27 June 2018 and signed on its behalf by:

David Hughes
Company Secretary

Thames Water Utilities Limited
Clearwater Court
Vastern Road
Reading
Berkshire
RG1 8DB

Statutory accounts

Contents

Our statutory financial statements, set out on pages 133–180, comprise:

- A summary of our financial performance for the year;
- A summary of our financial position as at 31 March 2018;
- A summary of changes in equity;
- A summary of our cash flows for the year;
- Accounting policies stating the basis on which the statutory financial statements have been prepared;
- An overview of the key judgements, estimations and uncertainties; and
- Notes providing further detail on financial performance and position.

Our statutory financial statements have been audited by our external auditors, KPMG. Their audit opinion is included on pages 134–136.

Independent auditor's report

to the members of Thames Water Utilities Limited

1. Our opinion is unmodified

We have audited the financial statements of Thames Water Utilities Limited ("the Company") for the year ended 31 March 2018 which comprise the income statement, statement of other comprehensive income, statement of financial position, statement of changes in equity, statement of cash flows and the related notes, including the accounting policies in the notes.

In our opinion:

- the financial statements give a true and fair view of the state of the Company's affairs as at 31 March 2018 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU); and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Company in accordance with, UK ethical requirements including the FRC Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

Overview

Materiality: financial statements as a whole	£22.0m (2017: £22.0m) 0.12% (2017: 0.13%) of total assets	
Risks of material misstatement		**vs 2017**
Recurring risks	Provision for trade receivables	◀▶
	Classification of costs between operating and capital expenditure	◀▶
New risk	Valuation of financial derivatives	▲

2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In arriving at our audit opinion above, the key audit matters, in decreasing order of audit significance, were as follows:

	The risk	Our response
Doubtful debt provision (£174.3 million; 2017: £176.4 million) *Refer to page 103 (Audit Risk and Reporting Committee report), page 143 (accounting policy) and page 159 (financial disclosures)*	**Subjective estimate:** A significant level of judgement is needed to calculate the doubtful debt provision. Key assumptions are made based on past history of non-collection of bills across the wide ranging portfolio of properties to which water and waste services are supplied. **Data transfer:** In addition, there is a risk that the data captured by the billing system and input into the calculation of the doubtful debt provision is incomplete and/or inaccurate.	Our procedures included: ▸ **Control design:** with assistance from our own IT specialists, testing the completeness and accuracy of the data extracted from the Company's billing system used to calculate the provision, including data in respect of the debt ageing profile, historical cash collections, write-offs, cancellation and loss on rebill rates; ▸ **Benchmarking assumptions:** assessing the key inputs used, including the forecast cash collection rates, cancellations and rebill recoverability against historical trends; and ▸ **Assessing transparency:** assessing the adequacy of the disclosures made in relation to the Company's provisioning policy applied and the level of provisions recorded.
Classification of costs between operating and capital expenditure The Company's substantial investment programme, totalling over £1bn per annum, involves the enhancement and maintenance of the Company's property, plant and equipment assets. Own work capitalised (£198.2 million; 2017: £188.2 million) Capital expenditure (£1,087.0 million; 2017: £1,115.3 million) *Refer to page 103 (Audit, Risk and Reporting Committee Report), page 143 (accounting policy) and pages 152 and 157 (financial disclosures).*	**Accounting treatment:** Certain projects may contain a mixture of asset enhancement and maintenance, particularly where assets are being replaced or upgraded. Judgement is therefore required to ensure an appropriate allocation of costs between operating and capital expenditure. This allocation between operating and capital expenditure is inherently judgemental and there is a risk that the allocation is incorrect with expenditure misstated between the income statement and statement of financial position. In addition, expenditure, including employee and other internal expenditure, on capital assets is capitalised only if it can be demonstrated that it is directly attributable to the asset, provides probable economic benefit to the Company and can be measured reliably. There is a risk costs capitalised do not meet these criteria.	Our procedures included: ▸ **Control design:** inspection of a sample of Investment Committee meeting minutes for evidence of the authorisation and assessment of capital projects; ▸ **Accounting analysis:** for any new types of expenditure in the current year, challenging whether the Company's capitalisation policy remains compliant with applicable accounting standards, and in particular the criteria for capitalisation; ▸ **Expectation vs. outcome:** assessing the proportion of overhead costs which are capitalised using historical comparisons and expected changes based upon corroborated enquiry; ▸ **Test of detail:** assessing the appropriateness of the cost classification for a sample of projects, including by inspecting supporting documentation, such as vendor statements of work completed for an understanding of the nature and type of costs incurred, assessing this against the criteria for capitalisation or expensing; and ▸ **Assessing transparency:** assessing the adequacy of the disclosures made in relation to the Company's policy of capitalisation of expensing of costs and the judgements involved.

	The risk	Our response
Valuation of financial derivatives (£762.1 million; 2017: £840.9 million) *Refer to page 103 (Audit Risk and Reporting Committee Report), page 145 (accounting policy) and pages 163–169 (financial disclosures).*	**Subjective valuation:** The net derivative financial liability represents 5.1% of the Company's total liabilities at 31 March 2018. IFRS 13 requires the use of an exit price to value derivatives, defining this as the price that would be received to sell an asset or be paid to transfer a liability. This exit price must include credit risk, both the counterparty credit risk and the Company's own credit risk. Given the length of the swaps that the Company enters in to, the impact of these adjustments is material. In the current year the Company has updated the methodology used to value the credit risk adjustments. The complexity and level of judgment required in credit risk calculations, in particular the estimation of the Company's own credit risk, increases the risk of error.	Our procedures included: ▸ **Accounting analysis:** utilising our own valuation specialists to assess the appropriateness of the methodologies used and inputs driving the valuations; and the accounting treatment for complex instruments. As part of their procedures, our valuation specialists benchmarked the Company's valuation methodologies against externally derived data; ▸ **Benchmarking assumptions:** testing the fair value estimates through the use of our own valuation experts' fair value estimates, establishing an acceptable range to benchmark the Company's valuations against; and ▸ **Assessing transparency:** testing the accuracy of the fair value disclosures, including assessing the Fair Value Hierarchy (Level 1,2,3) as stipulated by the relevant standards and comparing to the Company's conclusions.

We continue to perform procedures over the completeness and valuation of other provisions, however, following settlement of historical material claims during the previous financial year, we have not assessed this as one of the most significant risks in our current year audit and, therefore, it is not separately identified in our report this year.

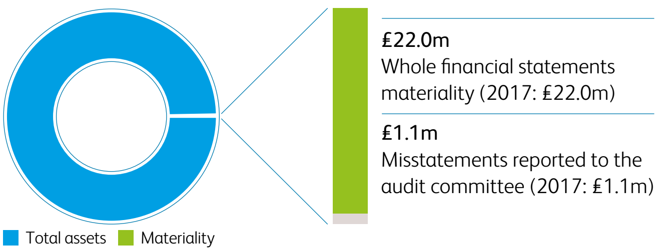
3. Our application of materiality and an overview of the scope of our audit

Materiality for the financial statements as a whole was set at £22.0m (2017: £22.0m), determined with reference to a benchmark of the Company's total assets, of which it represents 0.12% (2017: 0.13%).

We agreed to report to the Audit, Risk and Reporting Committee any corrected or uncorrected identified misstatements exceeding £1.1m (2017: £1.1m), in addition to other identified misstatements that warranted reporting on qualitative grounds.

Total assets
£18,003.2m (2017: £17,360.8m)

Materiality
£22.0m (2017: £22.0m)



4. We have nothing to report on going concern

We are required to report to you if we have anything material to add or draw attention to in relation to the directors' statement in the basis of preparation note to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Company's use of that basis for a period of at least twelve months from the date of approval of the financial statements. We have nothing to report in these respects.

5. We have nothing to report on the other information in the Annual Report

The directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Strategic report and directors' report

Based solely on our work on the other information:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

Directors' remuneration report

In addition to our audit of the financial statements, the directors have engaged us to audit the information in the Directors' Remuneration Report that is described as having been audited, which the directors have decided to prepare as if the company were required to comply with the requirements of Schedule 8 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008 No. 410) made under the Companies Act 2006.

In our opinion the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006, as if those requirements applied to the company.

Disclosures of principal risks and longer-term viability
Based on the knowledge we acquired during our financial statements audit, we have nothing material to add or draw attention to in relation to:

- the directors' confirmation within the viability statement (pages 79–82) that they have carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency and liquidity;
- the Principal Risks disclosures describing these risks and explaining how they are being managed and mitigated; and
- the directors' explanation in the viability statement of how they have assessed the prospects of the Company, over what period they have done so and why they considered that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Corporate governance disclosures
We are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our financial statements audit and the directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy; or
- the section of the annual report describing the work of the Audit, Risk and Reporting Committee does not appropriately address matters communicated by us to the Audit, Risk and Reporting Committee.

In addition to our audit of the financial statements, the directors have engaged us to review their Corporate Governance Statement as if the company were required to comply with the Listing Rules and the Disclosure Guidance and Transparency Rules of the Financial Conduct Authority in relation to those matters. Under the terms of our engagement we are required to review the part of the Corporate Governance Statement relating to the Company's compliance with the eleven provisions of the UK Corporate Governance Code specified for our review.

We have nothing to report in these respects.

6. We have nothing to report on the other matters on which we are required to report by exception
Under the Companies Act 2006, we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements 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.

We have nothing to report in these respects.

7. Respective responsibilities
Directors' responsibilities
As explained more fully in their statement set out on pages 131–132, the directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities

8. The purpose of our audit work and to whom we owe our responsibilities
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.

Robert Brent (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants

15 Canada Square
London
E14 5GL

27 June 2018

Income statement
For the year ended 31 March

	Note	2018 Underlying £m	2018 BTL £m	2018 Total £m	2017 Underlying £m	2017 BTL £m	2017 Total £m
Revenue	2	2,018.0	26.9	2,044.9	2,027.1	33.0	2,060.1
Operating expenses	3	(1,595.1)	(0.4)	(1,595.5)	(1,515.4)	–	(1,515.4)
Profit on the sale of property, plant and equipment		11.4	–	11.4	4.1	–	4.1
Other operating income	5	82.7	–	82.7	89.6	–	89.6
Operating profit		517.0	26.5	543.5	605.4	33.0	638.4
Profit on the sale of retail non-household business	6	89.7	–	89.7	–	–	–
Finance income	7	102.9	–	102.9	94.5	–	94.5
Finance expense	7	(538.6)	–	(538.6)	(456.3)	–	(456.3)
Net losses on financial instruments	8	(46.7)	–	(46.7)	(205.5)	–	(205.5)
Profit on ordinary activities before taxation		124.3	26.5	150.8	38.1	33.0	71.1
Taxation on profit on ordinary activities	9	(15.5)	(1.6)	(17.1)	70.3	(2.2)	68.1
Profit for the year		108.8	24.9	133.7	108.4	30.8	139.2

The Company's activities above are derived from continuing activities.

Bazalgette Tunnel Limited ("BTL") is an independent company un-related to Thames Water Utilities Limited and was appointed in 2015 to construct the Thames Tideway Tunnel. We have recognised revenue on the arrangement with BTL and so we have disclosed our underlying performance separately.

The arrangement with BTL means the Company has included construction costs of the Thames Tideway Tunnel within its bills to wastewater customers during the year ended 31 March 2018. As cash is collected, these amounts are subsequently paid to BTL. Accounting standards require the Company to present the amounts billed as revenue in our financial statements, and with an associated cost representing bad debt on amounts billed, this also gives rise to reporting profit which is taxable. This non-appointed revenue and profit are excluded from our key performance indicators, which is consistent with our banking covenants. The revenue and resulting profit on this arrangement has been disclosed separately to the Company's underlying performance in the statements above. As a result of this arrangement with no cash retained, a prepayment is created and recorded by the Company as BTL will transfer the use of the tunnel to Thames Water Utilities Limited once construction is complete under a finance lease arrangement.

The accounting policies and notes on pages 142–180 are an integral part of these financial statements.

Statement of other comprehensive income

For the year ended 31 March

		2018			2017		
	Note	**Underlying £m**	**BTL £m**	**Total £m**	Underlying £m	BTL £m	Total £m
Profit for the year		108.8	24.9	133.7	108.4	30.8	139.2
Other comprehensive income							
Will not be reclassified to the income statement:							
Net actuarial gains/(losses) on pension schemes	24	74.0	–	74.0	(151.2)	–	(151.2)
Deferred tax (charge)/credit on net actuarial movement	21	(12.6)	–	(12.6)	21.6	–	21.6
May be reclassified to the income statement:							
Gains/(losses) on cash flow hedges		16.3	–	16.3	(50.7)	–	(50.7)
Cash flow hedge transferred to income statement	8	84.3	–	84.3	2.1	–	2.1
Deferred tax (charge)/credit on cash flow hedge movement	21	(17.1)	–	(17.1)	6.1	–	6.1
Other comprehensive income/(loss) for the year		144.9	–	144.9	(172.1)	–	(172.1)
Total comprehensive income/(loss) for the year		253.7	24.9	278.6	(63.7)	30.8	(32.9)

The accounting policies and notes on pages 142–180 are an integral part of these financial statements.

Statement of financial position

As at 31 March

	Note	2018 Underlying £m	2018 BTL £m	2018 Total £m	2017 Underlying £m	2017 BTL £m	2017 Total £m
Non-current assets							
Intangible assets	11	168.6	–	168.6	140.5	–	140.5
Property, plant and equipment	12	14,675.3	–	14,675.3	14,094.5	–	14,094.5
Investment in subsidiaries	13	0.1	–	0.1	0.1	–	0.1
Derivative financial assets	20	59.3	–	59.3	83.6	–	83.6
Intercompany loans receivable	14	2,274.7	–	2,274.7	2,274.7	–	2,274.7
Trade and other receivables	16	4.0	56.7	60.7	2.8	30.4	33.2
		17,182.0	56.7	17,238.7	16,596.2	30.4	16,626.6
Current assets							
Inventories and current intangible assets	15	18.1	–	18.1	21.7	–	21.7
Assets held for sale		–	–	–	1.0	–	1.0
Intercompany loans receivable	14	17.9	–	17.9	16.8	–	16.8
Trade and other receivables	16	616.1	5.4	621.5	634.2	3.0	637.2
Short term investments	20	–	–	–	1.0	–	1.0
Cash and cash equivalents	17	104.4	2.6	107.0	52.7	3.8	56.5
		756.5	8.0	764.5	727.4	6.8	734.2
Current liabilities							
Trade and other payables	18	(804.1)	(9.2)	(813.3)	(924.4)	(6.6)	(931.0)
Borrowings	19	(320.2)	–	(320.2)	(383.4)	–	(383.4)
Derivative financial liabilities	20	(12.3)	–	(12.3)	(23.8)	–	(23.8)
		(1,136.6)	(9.2)	(1,145.8)	(1,331.6)	(6.6)	(1,338.2)
Net current (liabilities)/assets		(380.1)	(1.2)	(381.3)	(604.2)	0.2	(604.0)
Non-current liabilities							
Trade and other payables	18	(446.0)	–	(446.0)	(404.9)	–	(404.9)
Borrowings	19	(11,123.0)	–	(11,123.0)	(10,423.5)	–	(10,423.5)
Derivative financial liabilities	20	(809.1)	–	(809.1)	(900.7)	–	(900.7)
Deferred tax	21	(919.8)	–	(919.8)	(877.4)	–	(877.4)
Provisions for liabilities and charges	22	(111.3)	–	(111.3)	(112.5)	–	(112.5)
Retirement benefit obligations	24	(300.8)	–	(300.8)	(379.8)	–	(379.8)
		(13,710.0)	–	(13,710.0)	(13,098.8)	–	(13,098.8)
Net assets		3,091.9	55.5	3,147.4	2,893.2	30.6	2,923.8
Equity							
Called up share capital	23	29.0	–	29.0	29.0	–	29.0
Share premium	23	100.0	–	100.0	100.0	–	100.0
Cash flow hedge reserve	23	(138.9)	–	(138.9)	(222.4)	–	(222.4)
Revaluation reserve	23	1,021.2	–	1,021.2	1,053.1	–	1,053.1
Retained earnings	23	2,080.6	55.5	2,136.1	1,933.5	30.6	1,964.1
Total equity		3,091.9	55.5	3,147.4	2,893.2	30.6	2,923.8

Bazalgette Tunnel Limited ("BTL") is an independent company un-related to Thames Water Utilities Limited, and was appointed in 2015 to construct the Thames Tideway Tunnel. We have recognised revenue on the arrangement with BTL and so we have disclosed our underlying performance separately.

BTL is responsible for the construction of the Thames Tideway Tunnel. For the year ended 31 March 2018 the Company has included construction costs of the Thames Tideway Tunnel within its bills to wastewater customers. These amounts are subsequently paid to BTL. The revenue and profit on this arrangement, which are excluded from our key performance indicators in line with our banking covenants, has been disclosed separately to the Company's underlying performance in the income statement. The statement of financial position above separately recognises the associated assets and liabilities as a result of this arrangement.

The accounting policies and notes on pages 142–180 are an integral part of these condensed financial statements.

The financial statements for Thames Water Utilities Limited, registered in England & Wales company number 02366661, were approved by the Board of Directors on 27 June 2018 and signed on its behalf by:

Brandon Rennet
Chief Financial Officer

Statement of changes in equity

For the year ended

	Share capital £m	Share premium £m	Cash flow hedge reserve £m	Revaluation reserve £m	Retained earnings £m	**Total equity £m**
At 1 April 2016	29.0	100.0	(179.9)	1,071.9	2,092.7	**3,113.7**
Profit for the year	–	–	–	–	139.2	**139.2**
Loss on cash flow hedge	–	–	(50.7)	–	–	**(50.7)**
Cash flow hedges transferred to income statement	–	–	2.1	–	–	**2.1**
Deferred tax credit on cash flow hedge loss	–	–	6.1	–	–	**6.1**
Actuarial loss on pension scheme	–	–	–	–	(151.2)	**(151.2)**
Deferred tax credit on actuarial loss	–	–	–	–	21.6	**21.6**
Total comprehensive (loss)/income	–	–	(42.5)	–	9.6	**(32.9)**
Transfer of depreciation	–	–	–	(38.4)	38.4	**–**
Deferred tax on depreciation transfer	–	–	–	6.9	(6.9)	**–**
Reduction in deferred tax rate	–	–	–	12.7	(12.7)	**–**
Dividends paid	–	–	–	–	(157.0)	**(157.0)**
At 31 March 2017	29.0	100.0	(222.4)	1,053.1	1,964.1	**2,923.8**
Profit for the year	–	–	–	–	133.7	**133.7**
Gain on cash flow hedge	–	–	16.3	–	–	**16.3**
Cash flow hedges transferred to income statement	–	–	84.3	–	–	**84.3**
Deferred tax charge on cash flow hedge gain	–	–	(17.1)	–	–	**(17.1)**
Actuarial gain on pension scheme	–	–	–	–	74.0	**74.0**
Deferred tax charge on actuarial gain	–	–	–	–	(12.6)	**(12.6)**
Total comprehensive income	–	–	83.5	–	195.1	**278.6**
Transfer of depreciation	–	–	–	(38.4)	38.4	**–**
Deferred tax on depreciation transfer	–	–	–	6.5	(6.5)	**–**
Dividends paid	–	–	–	–	(55.0)	**(55.0)**
At 31 March 2018	29.0	100.0	(138.9)	1,021.2	2,136.1	**3,147.4**

The accounting policies and notes on pages 142–180 are an integral part of these financial statements.

Statement of cash flows

For the year ended 31 March

		2018			2017		
	Note	**Underlying £m**	**BTL £m**	**Total £m**	Underlying £m	BTL £m	Total £m
Net cash generated by/(used in) operating activities	29	1,064.5	(1.2)	1,063.3	1,046.0	3.8	1,049.8
Investing activities:							
Decrease in current asset investments		1.0	–	1.0	288.5	–	288.5
Interest received		93.7	–	93.7	81.9	–	81.9
Purchase of property, plant and equipment		(1,101.4)	–	(1,101.4)	(1,144.5)	–	(1,144.5)
Purchase of intangible assets		(61.8)	–	(61.8)	(102.7)	–	(102.7)
Proceeds from sale of property, plant and equipment		18.8	–	18.8	5.9	–	5.9
Proceeds from repayment of loans to group companies		–	–	–	40.3	–	40.3
Net proceeds from sale of non-household business		–	–	–	97.3	–	97.3
Net cash used in investing activities		(1,049.7)	–	(1,049.7)	(733.3)	–	(733.3)
Financing activities:							
New loans raised		2,239.7	–	2,239.7	568.1	–	568.1
Repayment of borrowings		(1,799.8)	–	(1,799.8)	(841.3)	–	(841.3)
Derivative paydown		(29.9)	–	(29.9)	–	–	–
Interest paid		(318.1)	–	(318.1)	(352.3)	–	(352.3)
Dividends paid		(55.0)	–	(55.0)	(157.0)	–	(157.0)
Net cash generated by/(used in) financing activities		36.9	–	36.9	(782.5)	–	(782.5)
Net increase/(decrease) in cash and cash equivalents		51.7	(1.2)	50.5	(469.8)	3.8	(466.0)
Net cash and cash equivalents at beginning of year		52.7	3.8	56.5	522.5	–	522.5
Net cash and cash equivalents at end of year		104.4	2.6	107.0	52.7	3.8	56.5

No additions to property, plant and equipment during the period, or the immediately preceding period, were financed through new finance leases.

Bazalgette Tunnel Limited ("BTL") is an independent company un-related to Thames Water Utilities Limited, and was appointed in 2015 to construct the Thames Tideway Tunnel. BTL is responsible for the construction of the Thames Tideway Tunnel. For the period ended 31 March 2018 the Company has included construction costs of the Thames Tideway Tunnel within its bills to wastewater customers. These amounts are subsequently paid to BTL. The revenue and profit on this arrangement, which are excluded from our key performance indicators in line with our banking covenants, has been disclosed separately to the Company's underlying performance in the statements above. The cash balance included above reflects amounts collected and not paid over at the balance sheet date.

The accounting policies and notes on pages 142–180 form an integral part of these financial statements.

Accounting policies

The principal accounting policies adopted in the preparation of these financial statements, which have been applied consistently, unless otherwise stated, are set out below.

General information

Thames Water Utilities Limited ("the Company") is a company incorporated in England and Wales and domiciled in the United Kingdom under the Companies Act 2006. The trading address and address of the registered office is Clearwater Court, Vastern Road, Reading, RG1 8DB.

The Company's principal activity is that of an appointed water and wastewater service provider, including acting as a retailer for household customers in London, the Thames Valley and surrounding area in accordance with its licence of appointment. The Company has a number of operations as described in the segmental analysis in note 1. The Company is also an intermediate holding company within the Kemble Water Holdings Limited Group of companies ("the Group").

Basis of preparation

The financial statements for the year ended 31 March 2018, set out on pages 137–141, have been prepared on the going concern basis (see the Directors' report on page 131), under the historical cost convention, as modified by the revaluation of certain financial assets and liabilities at fair value, and the Disclosure and Transparency Rules ("DTR") issued by the Financial Conduct Authority.

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union ("EU").

The Company has exercised exemption under section 400 of the Companies Act 2006 from the requirement to prepare group financial statements as the Company and its subsidiaries are included within the consolidated financial statements of its ultimate parent company, Kemble Water Holdings Limited, an entity registered in England and Wales. The trading address and address of the registered office of Kemble Water Holdings Limited is Clearwater Court, Vastern Road, Reading, Berkshire, RG1 8DB.

These financial statements present information about the Company as an individual undertaking and not about its group.

Revenue recognition

Underlying revenue represents the fair value of the consideration received or receivable in the ordinary course of business and excludes amounts collected on behalf of third parties, value added tax and trade discounts. Revenue is recognised at the time of delivery of the service. Should the Company consider that the criteria for full revenue recognition are not met at the time of a transaction, recognition of the associated revenue would be deferred until such time as the criteria have subsequently been met. Bad debt on bills raised in the year, which are considered uncollectable based on historic experience, is recognised as a deduction to revenue to ensure revenue is recorded at fair value.

Revenue includes an estimate of the amount of mains water and wastewater charges unbilled at the period end, which are recorded within accrued income. The usage is estimated using a defined methodology based upon historical data and assumptions.

For unmetered customers, the amount to be billed is dependent upon the rateable value of the property, as assessed by an independent rating officer. The amount billed is recorded within deferred income and is apportioned to revenue over the period to which the bill relates.

The Company only raises bills in the name of the "occupier" when it has evidence that an unmeasured property is occupied but cannot confirm the name of the occupier. When the Company identifies the occupants the bill is cancelled and re-billed in the customer's name. If the Company has not identified an occupant within six months, and the bill remains unpaid, the bill is cancelled and the property is classified as empty.

Revenue includes amounts that the Company billed to wastewater customers in respect of construction costs for the Thames Tideway Tunnel. Under specific arrangements with Bazalgette Tunnel Limited ("BTL"), the Company (in its capacity as principal) is responsible for the billing and collection of cash. The Company passes the associated cash on to BTL within a maximum of 50 working days after the month end in which the cash is collected. Under the 'pay when paid' principle, the cost of any bad debt is borne by BTL in the current year however, this can be recovered in future years and therefore overall BTL does not suffer bad debt. Accounting standards require the Company to present the amounts billed as revenue in our financial statements, and with minimal associated costs, this also gives rise to reporting profit which is taxable. The cash collected is not retained by the Company and accordingly the revenue and resulting profit on this arrangement have been disclosed separately in the Company's financial statements, and is excluded from our key performance indicators in line with covenant requirements. As a result of this arrangement with no cash retained, a prepayment is created and recorded by the Company as BTL will transfer the use of the tunnel to us once construction is complete under a finance lease arrangement.

Interest income

Interest income is accrued on a time basis by reference to the principal outstanding and the Effective Interest Rate ("EIR") applicable. The EIR is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or liability. Interest income is presented within finance income in the income statement.

Taxation

Tax on the profit or loss for the period comprises current and deferred tax. Tax is recognised in the income statement except to the extent that it relates to items recognised directly within equity, in which case it is recognised within the statement of other comprehensive income.

Current tax

Current tax is the expected tax payable or receivable on the taxable profit or loss for the period, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustments to tax payable in respect of previous periods.

Taxable profit differs from the profit on ordinary activities before tax as reported in the income statement as it excludes items of income or expense that are taxable or deductible in other periods and items that are never taxable or deductible. It also includes the effect of tax allowances.

Deferred tax

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax is measured on a non-discounted basis using tax rates enacted or substantively enacted at the balance sheet date and that are expected to apply in the period when the deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are recognised only to the extent that it is probable that sufficient future taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax assets and deferred tax liabilities are offset when there is a legally enforceable right to set off tax assets against 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.

Uncertain tax positions

Tax rules can be subject to interpretation and a tax provision is recognised where it is considered more likely than not that an amount will be paid to the tax authorities. Management use their experience, and seek professional advice where appropriate, to prudently assess the likelihood of an outflow arising. The amount recognised is the single most likely outcome.

Non-current intangible assets

Separately acquired intangible assets are stated at cost, less accumulated amortisation and any provision for impairment. Amortisation is charged to the income statement on a straight-line basis over the estimated useful economic life of the intangible asset from the date the intangible asset becomes available for use. The estimated useful economic lives are as follows:

	Years
Software	5–10

Property, plant and equipment

Property, Plant and Equipment ("PP&E") is comprised of network assets (including water mains, sewers, pumped raw water storage reservoirs and sludge pipelines) and non-network assets (including buildings, operational structures and fixtures & fittings). PP&E is stated at cost (or at deemed cost in the case of network assets, being the fair value at the date of transition to IFRS) less accumulated depreciation and provision for impairment.

The Company capitalises the directly attributable costs of procuring and constructing PP&E, which include labour and other internal costs incremental to the business. Subsequent costs are capitalised only when it is probable that future economic benefits associated with the item will flow to the Company and the cost can be measured reliably.

Where a qualifying asset takes a substantial period of time to get ready for its intended use, the borrowing costs directly attributable to the acquisition, construction or production of the asset are added to the cost. All other borrowing costs are included as finance expenses within the income statement.

Where items of PP&E are transferred to the Company from customers or developers, generally in the form of adopted water mains, self-lay sewers or adopted pumping stations, the fair value of the asset transferred is recognised in the statement of financial position. Fair value is determined based on estimated replacement cost. Where the transfer is in exchange for connection to the network and there is no further obligation for ongoing services, the corresponding credit is recognised immediately within revenue. Where the transfer is considered to be linked to the provision of ongoing services, the corresponding credit is recorded in deferred income and is released to other operating income over the expected useful economic lives of the associated assets as shown opposite.

PP&E 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 they are commissioned. The estimated useful economic lives are as follows and refer to non-current assets disclosed in note 12:

	Years
Network assets:	
Reservoirs	250
Strategic sewer components	200
Wastewater network assets	150
Water network assets	80–100
Raw water tunnels and aqueducts	80
Non-network assets:	
Land and buildings:	
Buildings	15–60
Operational structures	30–100
Plant and equipment:	
Other operational assets	7–40
Fixtures & fittings	5–7
Vehicles	4–5
Computers	3–5
Fixed and mobile plant	4–60

Leased assets

Leases of PP&E where the Company has substantially all the risks and rewards of ownership are treated as finance leases.

All other leases are classified as operating leases. Payments made under operating leases are recognised in the income statement on a straight line basis over the term of the lease. Leases of land are ordinarily treated as operating leases, unless ownership is transferred to the Company at the end of the lease.

On completion of construction of the Thames Tideway Tunnel, substantially all the risks and rewards of ownership will lay with the Company. The Company will therefore account for the transaction arrangement with BTL post construction as a finance lease. The tunnel will be recognised as an asset within PP&E and depreciated over the life of the lease. On inception of the lease, the tunnel will be recognised at fair value, being the BTL prepayment (see revenue policy) plus the present value of the future minimum lease payments, with a corresponding liability being recognised as a finance lease payable. Interest will be recognised in the income statement over the period of the lease.

Grants and contributions

Contributions received in respect of certain infrastructure charges made as a result of new connections to the water or sewerage networks, are treated as deferred income and released to other operating income over a 30 year period. Contributions which are given in compensation for expenses incurred with no future related costs, are recognised within other operating income in the period that they become receivable.

Impairment of non-financial assets

The carrying amounts of the Company's non-financial assets, other than inventories and deferred tax assets, are reviewed at each financial reporting date to determine whether there is any indication of impairment. If any such indication exists then the recoverable amount of the asset is estimated, which is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generate cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit").

An impairment loss is recognised if the carrying amount of an asset or its cash generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement, and those recognised in prior periods are assessed at each financial reporting date for any indications that the loss has decreased or no longer exists.

Investment in subsidiaries

Investments in subsidiary undertakings are stated at cost, less any provision for impairment. Impairment reviews are performed on an annual basis.

Non-derivative financial instruments

Non-derivative financial instruments comprise trade and other receivables, trade and other payables, cash and cash equivalents and loans and borrowings.

Trade and other receivables

Trade and other receivables are measured at fair value on initial recognition and subsequently at amortised cost using the effective interest method. If there is objective evidence that the asset is impaired it is written down to its recoverable amount and the irrecoverable amount is recognised as an expense within operating costs. Debt is only written off after all available economic options for collecting the debt have been exhausted and the debt has been deemed to be uncollectable. This may be because the debt is considered to be impossible, impractical, inefficient or uneconomic to collect, and is assessed by management on a case-by-case basis.

Included within trade receivables is an assessment of the recoverability of debts which will ultimately be cancelled, and may or may not be rebilled, and of debts which have not yet been billed but are part of the metered sales accrual. This assessment is made by reference to the Company's historical collection experience, including comparisons of the relative age of the individual balance and consideration of the actual write-off history. The provisioning rates applied in the calculation are reviewed on an annual basis to reflect the latest historical collection performance data and management's expectation of future performance and industry trends. A provision is also made against debts due from Water Only Companies ("WOCs") who bill their customers for sewerage services provided by the

Company. As the bills relate to services provided by the Company, and the WOCs are acting in an agent capacity, any associated bad debt rests with the Company. As detailed information about the debt, including the ageing, is not readily available, the level of provision is calculated with reference to the level of historical, current and forecast write-offs.

A financial asset is derecognised when the rights to receive cash flows from the asset have expired.

Included within prepayments are amounts paid and payable to BTL which represent a prepayment for the use of the Thames Tideway Tunnel once the tunnel has been constructed and is available for use.

Trade and other payables

Trade and other payables include amounts owed to BTL that represent revenue collected and due to BTL for the construction of the Thames Tideway Tunnel, which have not yet been paid at the reporting date.

Cash and cash equivalents

Included within cash and cash equivalents are amounts collected in relation to BTL revenue which have not yet been paid across to BTL at the reporting date.

Interest bearing borrowings including those issued to other group companies

Interest bearing borrowings are financial liabilities recognised initially at fair value less attributable transaction costs and subsequently at amortised cost using the effective interest method.

An exchange or modification of interest bearing borrowing with substantially different terms is accounted for as an extinguishment of the original financial liability and the recognition of new financial liability, with any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. Otherwise, any costs or fees incurred adjust the carrying amount of the financial liability and are amortised over the remaining term of the modified financial liability.

Inventories and current intangible assets

Inventories are stated at the lower of cost and net realisable value ("NRV").

Purchased carbon emission allowances (relating to the emission of carbon dioxide in the UK) are recorded as current intangible assets, stated at cost, less accumulated amortisation and any provision for impairment. A provision is simultaneously recorded in respect of the obligation to deliver emission allowances in the period in which the emissions are made and the associated charge is recognised as an operating expense within the income statement.

Retirement and other employment benefits

Defined benefit schemes

The Company operates two, independently administered, defined benefit pension schemes, both of which are closed to new employees. Actuarial valuations are carried out as determined by the Trustees, at intervals of not more than three years. The rates of contributions payable and the pension cost are determined on the advice of the actuaries, having regard to the results of these valuations.

The difference between the value of defined benefit pension scheme assets and liabilities is recorded within the statement of financial position as a retirement benefit surplus or obligation. Defined benefit pension scheme assets are measured at fair value using the bid price for assets with quoted prices. Defined benefit pension scheme liabilities are measured at the reporting date by an independent actuary using the projected unit credit method and discounted at the current rate of return on high quality bonds of equivalent term and currency to the liability.

Service costs, representing the cost of employee service in the period, and scheme administration expenses are included within operating expenses in the income statement. The net finance cost is calculated by applying the discount rate used for the scheme liabilities to the net deficit.

Changes in the retirement benefit surplus or obligation may arise from:

- differences between the return on scheme assets and interest included in the income statement;
- actuarial gains and losses from experience adjustments; or
- changes in demographic or financial assumptions.

Such changes are classified as re-measurements and are charged or credited to equity and recorded within the statement of comprehensive income in the period in which they arise.

Defined contribution schemes

The Company operates a Defined Contribution Stakeholder Pension Scheme ("DCSPS") managed through Standard Life Assurance Limited. From 1 April 2011 the DCSPS is the only scheme to which new employees of the Company are eligible. The assets of the DCSPS are held separately from those of the Company and obligations for contributions to the scheme are recognised as an expense in the income statement in the periods during which they fall due.

The Company also operates a closed defined contribution pension scheme. The Company has no further payment obligations, however defined funds for individuals are held within this scheme.

Long-term incentive plans ("LTIP") and bonus

Cash based LTIP awards are accrued in the financial statements for the duration of the award. The accrual is based on the values assessed for the applicable schemes, taking into account the duration of the individual scheme, and by comparing the Company's performance against the assumptions used to award payments. These are recognised as the present value of the benefit obligation. Where Company performance does not meet the criteria for the LTIP to be awarded, no accruals are recognised.

Bonus payments are accrued in the period based on assessments of performance against targets set at the beginning of the financial year. Bonuses are paid in the following financial year, once performance has been measured against targets set.

In the previous year, the Company opened 'Share in Your Success 2016' which enrolled employees in the financial year ended 31 March 2017. This follows the successful launch of 'Share in Your Success 2015' which enrolled employees in the financial year ended 31 March 2016. Both schemes are open to all employees. Employees are able to contribute between £20 and £250 per month from their salary into a savings account over a three year period. At the end of the three years, the employee is then entitled to all of the cash they have sacrificed during that period, plus interest that has accrued on that balance, and a 'bonus' element paid by the Company of up to 35% of the amount invested.

Share in Your Success 2020 was introduced during the year. The scheme's performance period runs from April 2017 to March 2020 and is open to all non-manager grade employees. The scheme entitles eligible employees to earn an amount of up to 5% of their salary following the end of the performance period.

Provisions for liabilities and charges

Provisions are recognised when:

- the Company has a present legal or constructive obligation as a result of past events;
- it is probable that an outflow of resources will be required to settle the obligation; and
- the amount can be reliably estimated.

Provisions for insured liabilities arise from insurance claims from third parties received by the Company and are recognised or released by assessing their adequacy using current estimates of future cash flows under insurance contracts. Where we have insurance cover for these claims, we recognise a receivable for the reimbursement value from captive and third party insurance companies net of retentions.

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.

The Company is subject to Outcome Delivery Incentives ("ODIs") where failure to achieve targets can lead to financial penalties and outperformance can result in financial rewards. These penalties and rewards are in the form of revenue adjustments or Regulatory Capital Value ("RCV") adjustments. The

Company does not recognise a provision for penalties or rewards in the period in which they are incurred or achieved as the financial impact of these is taken in the following Asset Management Plan ("AMP") period.

Risks, opportunities and innovation ("ROI") funds

The Company has entered into certain alliance arrangements with a number of third parties. The alliance agreements include incentive mechanisms which result in the alliance partners sharing in any over or underspend on contracted works. Remuneration for services provided under the contract are also linked to TWUL's performance commitments. During the year ended 31 March 2018 there were three alliances responsible for delivering works over AMP6.

A notional ROI fund for each alliance is created and built up over the AMP and is ultimately paid to alliance partners at contractual percentages. This occurs once certain conditions are satisfied, as specified in the alliance contracts between the Company and the alliance partners.

A provision for ROI amounts is recognised when the Company has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated. Conversely, a receivable for ROI will be recognised when: the Company has a right to receive cash at a future date; the amount can be reliably estimated; and receipt is virtually certain.

ROI amounts arising from an over or underspend against the contracted cost for a capital project, where the spend is directly attributable to the asset created, are deemed to be an integral cost in bringing an asset into the condition and location for use as intended by management. They are therefore capitalised as part of the cost of the asset and depreciated over the asset's useful life.

ROI amounts arising from operating expenditure over or underspend against the contracted cost, where spend cannot be directly attributed to a capital asset, are recognised directly in profit or loss as the spend is incurred.

ROI amounts linked to an ODI or Service Incentive Mechanism ("SIM") penalty or reward are recognised in the income statement at the point the penalty has been incurred or reward has been achieved.

Derivative financial instruments and hedging

Derivatives are used to manage exposure to movements in interest rates, foreign exchange rates and inflation. Derivatives are measured at fair value at each financial reporting date, using the methodology described in note 20.

Derivative financial instruments not designated as hedging instruments

Initially recognition is at fair value, with transaction costs being taken to the income statement. Gains or losses on re-measurement to fair value are recognised immediately in the income statement.

Derivative financial instruments designated as hedging instruments

The Company uses derivative financial instruments, such as forward currency contracts and interest rate swaps to hedge its foreign currency risks and interest rate risks, respectively. At the inception of each hedge relationship the Company documents:

- the relationship between the hedging instrument and the hedged item;
- its risk management objectives and strategy for undertaking the hedge transaction; and
- the results of tests to determine whether the hedging instrument is expected to be highly effective in offsetting changes in cash flows or fair values (as applicable) of the hedged item.

The Company continues to test and document the effectiveness of the hedge on an ongoing basis. Hedge accounting discontinues when the hedging instrument expires, is sold, terminated or exercised, or no longer qualifies for hedge accounting.

Cash flow hedges

The effective part of any gain or loss on the derivative financial instrument designated as a cash flow hedge is recognised directly in the cash flow hedge reserve. Any ineffective portion of the hedge is recognised immediately in the income statement.

When the underlying transaction results in the recognition of a non-financial asset or liability, the associated cumulative gain or loss is removed from the cash flow hedge reserve and reclassified to the income statement.

When a hedging instrument expires or is sold, terminated or exercised, or the Company revokes designation of the hedge relationship but the hedged forecast transaction is still expected to occur, the cumulative gain or loss at that point remains in the cash flow hedge reserve within equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to take place, the cumulative unrealised gain or loss recognised in equity is recognised in the income statement immediately.

Embedded derivatives

Where a contract includes terms that cause some of its cash flows to vary in a similar way to a derivative financial instrument, that part of the contract is considered to be an embedded derivative. Embedded derivatives are separated from the host contract and measured at fair value with gains and losses taken to the income statement if:

- the risks and characteristics of the embedded derivative are not closely related to those of the host contract; and
- the contract is not carried at fair value with gains and losses reported in the income statement.

In all other cases embedded derivatives are accounted for in line with the accounting policy for the contract as a whole.

Financial guarantees

The Company is part of a whole business securitisation ("WBS") group as described in note 19. Companies in the WBS group raise debt in external debt markets through the issuance of secured bonds and the issue of loans and those companies have guaranteed the principal and interest payments due under the terms of the bonds. Where the Company enters into financial guarantee contracts to guarantee the indebtedness of other companies within this group, the Company considers these to be insurance arrangements and accounts for them as such. In this respect, the Company treats the guarantee contract as a contingent liability until such a time as it becomes probable that the Company will be required to make a payment under the guarantee.

Foreign currency

Transactions in foreign currencies are translated to sterling, the Company's functional and presentational currency, at the foreign exchange rate ruling at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies at the financial reporting date are retranslated to the functional currency at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement except for differences arising on the retranslation of qualifying cash flow hedges, which are recognised directly in the cash flow hedge reserve.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are retranslated to the functional currency at foreign exchange rates ruling at the dates the fair value was determined.

Discontinued operations

Components of the Company will be classified as a discontinued operation if that component has either been disposed of, or is classified as held for sale. A component comprises operations that can be clearly distinguished, operationally and for financial reporting purposes from the rest of the Company. A component will only be classified as discontinued given that either: it represents a separate major line of business, or geographical area; or is part of a single co-ordinated plan to dispose of a separate major line of business

New accounting policies and financial reporting changes

The following standards are new, revised or include changes to existing standards which have been adopted by the Company in the year ended 31 March 2018. These have not impacted the balance sheet or reported results for the year, nor any previously reported results, but may have impacted how such results are disclosed:

- Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12), clarifies that the existence of a deductible temporary difference depends solely on a comparison of the carrying amount of an asset and its tax base at the reporting date, and is not affected by possible future changes in the carrying amount or expected manner of recovery of the asset.
- Disclosure Initiative (Amendments to IAS 7), requires new disclosures that help users evaluate changes in liabilities arising from financing activities.

The following issued standards have not yet been adopted by the Company:

- IFRS 9 *Financial instruments*, which will be effective on 1 January 2018 (and thus to the Company 1 April 2018);
- IFRS 15 *Revenue from Contracts with Customers*, which will be effective on 1 January 2018 (and thus to the Company 1 April 2018); and
- IFRS 16 *Leases*, which will be effective on 1 January 2019 (and thus to the Company 1 April 2019), subject to EU endorsement.

In addition to these, there are a number of other amendments and annual improvement project recommendations that are not yet effective but which have been endorsed by the EU. These are not anticipated to have a material impact on the financial statements of the Company.

IFRS 9 impact assessment

IFRS 9 *Financial Instruments*, which replaces IAS 39 *Financial Instruments: Recognition and Measurement*, introduces new requirements for recognition, classification and measurement, a new impairment model for financial assets based on expected credit losses, and simplified hedge accounting. The Company will adopt IFRS 9 as at 1 April 2018 and apply the new rules retrospectively, including the practical expedients permitted in the standard. As a result, comparatives for 2017/18 in our 31 March 2019 accounts will not be restated. Management has conducted an assessment of the impact of IFRS 9 and is expecting the following impact:

Classification and Measurement

The review has included an assessment of the contractual cash flow characteristics of financial instruments, in order to determine their classification and measurement under IFRS 9. Management does not expect any changes in classification or measurement of its assets and liabilities as a result of adopting IFRS 9.

Trade receivables will continue to be measured at amortised cost as they are held to collect contractual cash flows which represent solely payment of principal and interest, in accordance with the Company's business model.

There will be no impact on classification and measurement of financial liabilities as the new requirements only affect the accounting for financial liabilities which are designated at fair value through profit and loss, of which the Company has none. However, the International Accounting Standards Board ("IASB") has confirmed that under IFRS 9 when a financial liability measured at amortised cost is modified and does not result in de-recognition, a gain or loss should be recognised in the income statement.

During December 2016, a £400m Class A Puttable, Callable, Resettable ("PCR") bond issued by Thames Water Utilities Cayman Finance Limited ("TWUCF") with a final maturity of 9 April 2058 was exchanged for a new £400m Class A 2058 bond with the same final maturity. In turn a PCR bond issuance related intercompany loan from TWUCF to TWUL was also exchanged for a new intercompany loan with a final maturity of 9 April 2058. On IFRS 9 adoption, due to different measurement provisions under IFRS 9, a loss of £26.2m related to the intercompany loan exchange would be recognised within retained earnings.

Derivative assets and liabilities will continue to be recognised at fair value with movements recognised in the income statement or the cash flow hedge reserve where the instrument has been designated in a hedge relationship.

Impairment Methodology

IFRS 9 introduces a new impairment model which requires the recognition of impairment provisions based on expected credit losses rather than incurred credit losses, as was required under IAS 39. Management has assessed the impact on trade receivables and expect no significant change in the Company's impairment methodology, and therefore no material impact on the provision for losses against trade receivables presented in the financial statements.

Hedge Accounting

IFRS 9 provides increased flexibility for hedge accounting, introducing a new, simpler hedge accounting model with a principles-based approach designed to align the accounting result with the economic hedging strategy. The Company currently uses cash flow hedge relationships to hedge interest rate risk on borrowings. Management has confirmed that the current hedge relationships will continue to qualify as hedges upon the adoption of IFRS 9.

An assessment is planned for the forthcoming financial year which will involve identifying and evaluating the potential impact of any existing contracts which are currently not hedge accounted, but may be eligible for hedge accounting under IFRS 9. Therefore, to date, it is not possible to estimate the impact of any changes in hedge accounting on the financial statements.

IFRS 15 impact assessment

IFRS 15 *Revenue from Contracts with Customers* addresses the recognition of revenue and replaces IAS 18 *Revenue* and IFRIC 18 *Transfer of Assets from Customers*. The standard requires the identification of performance obligations in contracts with customers and allocation of the total contractual value to each of the performance obligations identified. Revenue is recognised as each performance obligation is satisfied either at a point in time or over time.

Management has reviewed the contractual arrangements that comprise our current income streams to determine how IFRS 15 will impact the recognition and disclosure of these arrangements. The work performed to date has identified that for the Company's main source of income, which accounts for 96.1% of the Company's income in 2017/18 (being that disclosed as total revenue and other operating income in the income statement) and is derived from the enforceable right of the Company to bill customers, there is no impact on the revenue recognition of adopting IFRS 15. The timing and the amount of revenue recognised for these activities under the new standard will be unchanged, but we will include a further disaggregation of revenue.

Management's review has not identified any contracts with customers which contain, at the outset of the contract, a significant financing component. An example of a significant financing component is when a customer is given an extended credit period (e.g. 12 months interest-free).

Further work is still required in 2018 to complete the impact assessment of IFRS 15 on certain revenue streams which relate to capital contributions. Discussions are continuing within the industry and the accounting profession. Management's current view is that income associated with service connections, requisitions and diversions will continue to be recognised at a point in time in the income statement, whilst infrastructure charges will continue to be deferred on the balance sheet and amortised to the income statement over time. However management will continue to actively participate in industry discussion and await further guidance from the accounting profession. Infrastructure charges deferred on the balance sheet as at 31 March 2018 are £353.6 million.

IFRS 16 impact assessment

IFRS 16 *Leases* replaces IAS 17 *Leases* and related interpretations and sets out the principles for the classification, measurement, presentation and disclosure of lease arrangements. Under the provisions of IFRS 16, most leases, including those previously classified as operating leases, will be recognised in the statement of financial position as both a right-of-use asset and a largely offsetting lease liability. The right-of-use asset and lease liability are both based on the present value of lease payments due over the term of the lease, with the asset being depreciated in accordance with IAS 16 *Property, Plant and Equipment* and the liability increased for the accretion of interest and reduced by lease payments.

Management anticipates that the Company will adopt this standard on its effective date and has no plans for early adoption. In considering the transition options available under IFRS 16, it is likely that the Company will adopt the fully retrospective method which has the advantage of having, in the first reporting period, a comparative period prepared on the same basis.

Management have substantially completed the project to assess the impact of the implementation of IFRS 16 on the Company. The work performed to date has indicated that there will be a material impact to the statement of financial position primarily due to the Company's property lease portfolio. Initial assessments of the Company's property leases, estimates an additional aggregate lease liability of at least £65 million under the fully retrospective method, will be recognised on transition to the new standard. We will also see an increase in property, plant and equipment. We will continue to review relevant contracts during the period to adoption.

The Company is subject to a loan covenant under which lease liabilities are classified as unsecured debt, the level of which cannot exceed a specified ratio. A risk that this covenant may be breached in future has been identified. As this change in accounting standard is outside of the control of the Company, management will address the risk of covenant breach through either limiting the execution of new lease liabilities, ensuring that some liabilities are classified as secured debt or seeking approval for an amendment to the covenant calculations.

The actual impact of applying IFRS 16 will depend on the composition of the Company's lease portfolio at the adoption date and the extent to which the Company chooses to use practical expedients and recognition exemption. It is anticipated that under IFRS 16, the Company will continue to account for short-term (under 12 months) and immaterial leases on the same basis as is required for operating leases under IAS 17. That is, recognising the lease payments as an expense on a straight-line basis over the lease term.

Alternative performance measures

In the reporting of financial information, the Directors have adopted various Alternative Performance Measures ("APMs"). These measures are not defined by IFRS and therefore may not be directly comparable with other companies' APMs, including those in the Company's industry. These APMs are not intended to be a substitute for, or superior to, IFRS measurements. Directors and management use APMs to provide additional useful information on the performance and position of the Company, and to enhance the comparability of information between reporting periods.

Capital expenditure ("capex")

Management review capex, which is the expenditure to acquire or upgrade tangible and intangible assets such as property, pipes, treatment works and software. The capex measure equates to intangible and tangible asset additions in the financial year including capitalised borrowing costs (see notes 11 and 12 respectively).

Net debt

Net debt is presented in note 20 on both a statutory and covenant basis. The covenant basis of net debt is the measure used when assessing the Company's gearing (see below) against the level stipulated in the banking covenants. Net debt on a statutory basis consists of borrowings less cash. Net debt on a covenant basis consists of borrowings less cash, excluding amounts owed to other group companies for which there is no related external debt, accrued interest, unamortised debt issuance costs and discounts, and including certain derivative financial liabilities as explained in note 20.

Regulatory Capital Value ("RCV")

The RCV has been developed for regulatory purposes by Ofwat and is one of the critical components for setting our customers' bills. When assessing the revenues that the Company needs, Ofwat consider the return on capital invested in the business, and the RCV is the capital base used in this assessment. There is no equivalent statutory measure.

Gearing

Gearing is the percentage of the Company's covenant net debt to RCV, and is a key covenant ratio for the Company's financing arrangements with its lenders. There is no equivalent statutory measure.

Post Maintenance Interest Cover Ratio ("PMICR")

PMICR measures the amount of underlying cash generated by operating activities of the Company, adjusted for RCV depreciation, relating to the interest paid on the Company's debt. This ratio is a key covenant set by our lenders, and in modified forms, also used by rating agencies as part of their analysis when determining credit ratings. There is no equivalent statutory measure.

Credit rating

The Company must maintain an investment grade credit rating in accordance with our licence of appointment as a water and wastewater service provider. An investment grade rating equates to BBB- or higher from Standard & Poor's and Baa3 or higher from Moody's. The assessment by these two agencies provides an independent view of the Company's performance and future prospects. There is no equivalent statutory measure.

Significant accounting judgements and key sources of estimation uncertainty

In the process of applying the Company's accounting policies, the Directors are required to make certain judgements, estimates and assumptions that they believe are reasonable based on available information at the time. These judgements, estimates and assumptions can have a significant effect on the amounts recognised in the financial statements and therefore any changes to these could have a material impact on the financial statements.

On an ongoing basis, management evaluate their estimates, judgements and assumptions using current information, historical experience, consultation with experts and other reasonable methods. Subsequently, actual figures may differ materially from the estimates, with the difference being recognised in the period in which the facts give rise to the difference become known or in the period of the revision and future periods if the revision affects both the current and future periods.

The following paragraphs detail the judgements, estimates and assumptions management believe to have the most significant impact on the financial statements.

Revenue recognition and allowance for doubtful debt

Accounting judgement – revenue recognition

The Company bills customers in accordance with its entitlement to receive revenue in line with the limits established by the periodic regulatory review processes. Revenue is recognised when performance obligations are met and when collection of the resulting receivable is probable. Determination of the probability of collection and hence the fair value of revenue recognised during the year is judgemental. Management considers historical trends in determining an adjustment to revenue to reflect instances where collection is not probable at the point of delivery. This has resulted in a decrease in revenue for the current year of £28.7 million (2017: £46.5 million), with a corresponding decrease in receivables as shown in note 16.

When the criteria for revenue recognition for a transaction are not met, recognition of the revenue is delayed until collectability is reasonably certain. Payments received in advance of entitlement are recorded as deferred income. The deferred income for the year ended 31 March 2018 was £75.6 million (2017: £81.1 million).

Accounting estimate–provision for doubtful debt

Provisions are made against trade receivables based on an assessment of the recovery of debts including those which will:

- ultimately be cancelled and may or may not be rebilled; and
- of debts which have not yet been billed but are part of the metered sales accrual.

This assessment is made by reference to the Company's historical collection experience, including comparisons of the relative age of the individual balance and consideration of the actual write-off history. The actual level of receivables collected may differ from the estimated level of recovery which could affect operating results positively or negatively. The bad debt provision at 31 March 2018 was £174.3 million (2017: £176.4million). The actual level of receivables collected may differ from the estimated level of recovery which could have a positive or negative impact on financial statements.

Accounting estimate–unbilled revenue

For water and wastewater customers with water meters, the amount billed is the sales value of the volume supplied including an estimate of the volume supplied between the date of the last meter reading and the billing date. Meters are read on a cyclical basis and the Company recognises revenue for unbilled amounts based on the estimated usage from the last billing date to the financial reporting date with these amounts being included within accrued income. The estimated usage is based on historical data, looking at the most recent actual consumption and any difference in the prior year estimate, and management assumptions. When a new property is connected to the infrastructure network, an estimate is made of the sales value of water supplied and wastewater charged incurred between the date of connection and the financial reporting date. The actual consumption may differ from management's estimates which would result in revenues being adjusted in the period in which the difference is identified. The unbilled revenue for the year ended 31 March 2018 was £218.7 million (2017: £244.6 million).

Property, plant and equipment and intangible assets

Accounting judgement – capitalisation of costs

The Company's activities involve significant investment in construction and engineering projects and assessing the classification of these costs between capital expenditure and operating expenditure requires management to make judgements. The Company capitalises expenditure relating to water and wastewater infrastructure where such expenditure enhances assets or increases the capacity of the network. Maintenance expenditure is taken to the income statement in the period in which it is incurred. Differentiating between enhancement and maintenance works is subjective, particularly in the instances where a single project may include a combination of both types of activities. Property, plant and equipment additions for the year ended 31 March 2018 were £1,087.0 million (2017: £1,115.3 million). Intangibles additions for the year ended 31 March 2018 were £61.8 million (2017: £102.7 million). Both figures include capitalised overheads and capitalised borrowing costs.

Management capitalises employee time and other expenses incurred by central functions on capital programmes and consequently judgement is applied concerning the capitalisation rate used. In addition, management capitalises borrowing costs incurred for significant projects that meet certain criteria and judgement is required to identify which projects qualify for this. The capitalised borrowing costs for both property, plant and equipment and intangibles for the year ended 31 March 2018, net of commissioning, were £100.7 million (2017: £76.3 million).

Accounting estimate – depreciation and amortisation

Calculation of the depreciation and amortisation charges requires management to make estimates regarding the useful economic lives ("UELs") of the assets. These estimates are based on the Company's experience of similar assets and engineering data. Where management identifies that actual UEL materially differs from the estimate used to calculate the charge, that charge will be adjusted in the period that the difference occurred and future periods. The total depreciation charge for the year ended 31 March 2018 was £498.7 million (2017: £492.0 million). As the Company makes significant investment in PP&E and intangible assets, the differences between the estimated and actual UELs could have a positive or negative impact on the financial statements.

Provisions for other liabilities and charges

Accounting judgement – recognition of other provisions

A provision is recognised when it is probable that the Company has an obligation for which a reliable estimate can be made of the amount of the obligation. The Company is subject to commercial and legal claims that are incidental to the day-to-day operation of its business. These include contractual, employment and environmental matters which are defended and managed in the ordinary course of business. Assessing the outcome of uncertain commercial and legal cases requires judgement to be made regarding the extent to which any claim against the Company is likely to be successful. On a case-by-case basis, management evaluates the likelihood of adverse verdicts or outcomes to these matters and makes a judgement about whether or not a provision should be recognised. Other provisions, which are detailed in note 22, total £40.7 million (2017: £35.9 million).

For situations where the obligation is possible or the amount of the obligation cannot reliably be estimated these are disclosed as contingent liabilities unless the probable outflow of economic benefits is remote. An assessment of contingent liabilities is included in note 26.

Accounting estimate – valuation of liabilities

Assessing the financial outcome of uncertain commercial and legal cases requires estimates to be made regarding the amount by which the Company is liable. These estimates are made after considering available information including notifications, settlements, estimates performed by independent parties and legal counsel, available facts, identification of other potentially responsible entities and their ability to contribute, and prior experience. The amount provided may change in the future as additional information becomes available as a result of new developments. In such circumstances the provision will be adjusted in the future period the new information becomes available. Provisions for liabilities and charges as at 31 March 2018 totalled £111.3 million (2017: £112.5 million).

Retirement benefit obligations

Accounting estimate – actuarial assumptions

The Company operates two defined benefit pension schemes for which full actuarial valuations are carried out as determined by the Trustees at intervals of not more than three years. In June 2017, the latest triennial valuations of these two defined benefit pension schemes as at 31 March 2016, were signed off by the independent consulting actuary, Aon Hewitt. The pension liability and net cost recognised under IAS 19 Employee Benefits are assessed using the advice of an independent, qualified actuary based on the latest actuarial valuation and assumptions determined by the actuary. These assumptions are based on information supplied to the actuary by the Company, supplemented by discussions between the actuary and management and are used to estimate the present value of defined benefit obligations.

The actuarial assumptions used in determining the pension obligations and net costs recognised affect the profit before tax figure in the Income Statement and the net asset figure in the Statement of Financial Position and are a source of estimate. These assumptions include:

- the discount rate;
- pay growth;
- mortality; and
- increases to pensions in payment.

The actual rates may materially differ from the assumptions due to changes in economic conditions and changes in the life expectancy of the members of the pension schemes. This could have a positive or negative impact on the financial statements. The total net retirement benefit obligation for the two schemes as at 31 March 2018 was £300.8 million (2017: £379.8 million).

Derivative financial assets and liabilities

Accounting estimate – valuation of derivatives

The Company holds derivative financial instruments that fall into the following categories:

- index linked swaps;
- cross currency swaps; and
- interest rate swaps.

The fair value of financial assets and liabilities represents the price that would be received to sell an asset or paid to transfer a liability. The techniques for determining the fair value of financial instruments are classified under the hierarchy defined in IFRS 13 Fair Value Measurement which categorises inputs to valuation techniques into levels 1-3 based on the degree to which the fair value is observable. All of the Company's inputs to valuation techniques are level 2 – the fair value is determined from inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. This technique uses discounted future cash flows to value the financial assets and liabilities. The future cash flows are estimated based on observable forward interest rates and inflation rates and are discounted at a rate that reflects the credit risk of the Company and counterparties. Currency cash flows are translated at spot rate. The net total of derivative financial assets and liabilities as at 31 March 2018 was a liability of £762.1 million (31 March 2017 a liability of: £840.9 million).

1. Segmental analysis

The Company has three principal business segments:

Retail: comprises the household business segment and provides certain customer-facing activities including billing and revenue collection, including amounts relating to construction of the Thames Tideway Tunnel (TTT) that is shown separately in the financial statements.

Water: responsible for all aspects of raw water abstraction and treatment as well as the distribution of high quality drinking water to household and non-household customers. From 1st April 2017, this business segment is also responsible for billing and cash collection of wholesale market charges to licensed non-household retailers for both water and wastewater, including amounts relating to construction of the TTT that is shown separately in the financial statements; and

Wastewater: responsible for all aspects of wastewater collection, treatment and safe disposal for household and non-household customers. Wastewater will be responsible for the construction of interface works for the TTT.

Segmental information on these three segments is reported internally on a monthly basis to the Executive Committee. The Executive Committee is responsible for the day-to-day running of the business and consequently the Executive Committee is considered to be the Chief Operating Decision Maker ("CODM") of the Company.

Other activities conducted by the Company primarily relate to certain non-regulated activities and shared corporate services that have not been included within the above segments. Management does not consider these activities to represent a separate reportable segment and consequently for the below disclosures they have been aggregated into a single caption designated "Unallocated".

Following the balance sheet date, the Company has undergone an internal reorganisation and as such has modified its operating structure from 2018/19. As such, at subsequent reporting dates, the reporting segments will be updated accordingly to reflect the new way in which the Company will report its financial information internally to the CODM.

From 1 April 2017, our customer profile has changed following the sale of our non-household retail business to Castle Water Limited. The household customer profile remains large and diverse and consequently there is no significant reliance on any single household customer. There are now a smaller number of non-household customers, being retailers rather than the end user, and as result of this one of these customers exceeds 10% of total revenues in each of the water and wastewater segments.

The Company is subject to economic regulation by Ofwat and operates under a licence to provide water and wastewater services within a defined geographical region, being London, the Thames Valley and the surrounding area, therefore management considers the UK to be the geographical location of business.

Segmental performance

Transactions between reportable segments are included within segmental results in accordance with the Company's accounting policies. These are eliminated on production of the Company's financial statements, as shown within the reconciliation presented. Information regarding the performance results of each reportable segment are provided in line with that evaluated by the CODM and is based on Earnings before Interest and Tax ("EBIT").

A segmental analysis of the management revenue and EBIT figures has been presented with a reconciliation to statutory revenue and EBIT below:

Revenue and EBIT – Management figures

Year ended 31 March 2018	**Retail £m**	**Water £m**	**Wastewater £m**	**Unallocated £m**	**Total £m**
External revenue excluding BTL	1,593.2	231.6	215.3	12.3	2,052.4
Inter-segment revenue	(1,420.4)	616.2	804.2	–	–
Total management revenue	172.8	847.8	1,019.5	12.3	2,052.4
Operating expenses	(168.7)	(451.0)	(413.3)	(50.6)	(1,083.6)
Income from sale of PP&E and the sale of the non-household business	(0.9)	(3.4)	(0.5)	112.5	107.7
Management earnings before interest, tax, depreciation and amortisation	3.2	393.4	605.7	74.2	1,076.5
Depreciation of property, plant and equipment	(7.9)	(226.7)	(212.5)	(18.9)	(466.0)
Amortisation of intangible assets	(1.4)	(1.2)	(0.9)	(23.1)	(26.6)
Management EBIT	(6.1)	165.5	392.3	32.2	583.9

Year ended 31 March 2017	Retail £m	Water £m	Wastewater £m	Unallocated £m	Total £m
External revenue excluding BTL	2,026.4	20.8	20.4	14.8	2,082.4
Inter-segment revenue	(1,820.6)	816.4	1,004.2	–	–
Total management revenue	205.8	837.2	1,024.6	14.8	2,082.4
Operating expenses	(191.8)	(382.9)	(401.4)	(59.2)	(1,035.3)
Income from sale of PP&E and the sale of the non-household business	(4.0)	(1.5)	(0.2)	5.8	0.1
Management earnings before interest, tax, depreciation and amortisation	10.0	452.8	623.0	(38.6)	1,047.2
Depreciation of property, plant and equipment	(0.7)	(177.8)	(208.7)	(22.1)	(409.3)
Amortisation of intangible assets	(1.1)	(0.4)	(1.5)	(22.0)	(25.0)
Management EBIT	8.2	274.6	412.8	(82.7)	612.9

1. Segmental analysis continued

Revenue and EBIT – Management to statutory reconciliation

The business segments' revenue is reconciled to the Company's statutory revenue below:

Year ended	31 March 2018 £m	31 March 2017 £m
Management revenue	2,052.4	2,082.4
Statutory reclassification of bad debt from operational expenditure[1]	(28.7)	(46.5)
Household BTL revenue	22.0	26.9
Non-household BTL revenue	–	6.7
Statutory reclassification of other operating income	(0.8)	(9.4)
Total statutory revenue	2,044.9	2,060.1

The business segments EBIT is reconciled to the Company's statutory EBIT below:

Year ended	31 March 2018 £m	31 March 2017 £m
Management EBIT	583.9	612.9
Statutory recognition of other operating income[2]	67.7	62.5
Statutory reclassification of pension costs	13.0	11.3
Statutory depreciation and write off adjustments[3]	(51.5)	(82.6)
Household BTL revenue[4]	22.0	26.9
Non-household BTL revenue	–	6.7
Profit on sale of the retail non-household business[5]	(89.7)	–
Other statutory adjustments	(1.9)	0.7
Total statutory operating profit	543.5	638.4

1 Please refer to note 2 for further information on this balance.

2 Requisitions and diversion charges, service connection charges and the release from deferred income of infrastructure charges as disclosed in note 5.

3 Depreciation of adopted fair value assets, borrowing costs and write-offs required for statutory purposes only.

4 The portion of BTL revenue related to our household customers.

5 Please refer to note 6 for further information on this balance.

Segmental assets and liabilities

Following changes in executive management during the latter part of 2016/17 the financial information provided on a monthly basis to the CODM has been updated to focus on our operational performance and spend. As such separate segmental analyses of assets and liabilities are no longer reviewed by the CODM. The CODM continue to review our capital expenditure on a segmental basis.
A segmental analysis of the level of capital expenditure is presented below:

Capital expenditure on property, plant and equipment and intangible assets for the year ended	Retail £m	Water £m	Wastewater £m	Unallocated £m	Total £m
31 March 2018	32.7	456.4	481.7	178.0	1,148.8
31 March 2017	41.1	443.0	451.1	282.8	1,218.0

2. Revenue

	2018			2017		
	Underlying £m	**BTL £m**	**Total £m**	Underlying £m	BTL £m	Total £m
Gross revenue	**2,046.0**	**27.6**	**2,073.6**	2,073.0	33.6	2,106.6
Charge for bad and doubtful debts	**(28.0)**	**(0.7)**	**(28.7)**	(45.9)	(0.6)	(46.5)
Total	**2,018.0**	**26.9**	**2,044.9**	2,027.1	33.0	2,060.1

We have presented a further disaggregation of our revenue below:

Gross revenue for the year ended	**31 March 2018 £m**	31 March 2017 £m
Household market		
Water services	**628.0**	615.8
Wastewater services	**802.1**	813.6
Retail services	**168.3**	167.4
Total gross revenue from household market	**1,598.4**	1,596.8
Non-household market		
Water services	**214.0**	203.9
Wastewater services	**187.7**	192.1
Retail services	**(0.9)**	30.3
Total gross revenue from non-household market	**400.8**	426.3
Other appointed revenue	**20.9**	21.8
Total appointed revenue	**2,020.1**	2,044.9
Other non-appointed revenue (excluding amounts billed for the Thames Tideway Tunnel)	**25.9**	28.1
Total gross underlying revenue	**2,046.0**	2,073.0
Amounts billed for the Thames Tideway Tunnel	**27.6**	33.6
Total gross revenue	**2,073.6**	2,106.6

All revenue is derived from activities based in the UK.

Appointed revenue is revenue generated from the regulated activities of the Company as defined in Condition A of its licence of appointment. These are activities necessary in order for a company to fulfil the function and duties of a water and sewerage undertaker under the Water Industry Act 1991. Non-appointed revenue is revenue generated from non-appointed activities. These activities include third-party discharges to sewage treatment works and other commercial activities including property searches and cess treatment (treatment of waste from private receptacles not linked to the network).

Bazalgette Tunnel Limited ("BTL") is responsible for the construction of the Thames Tideway Tunnel. For the year ended 31 March 2018 the Company has included construction costs of the Thames Tideway Tunnel within its bills to wastewater customers. As cash is collected it is paid over to BTL under the 'pay when paid' principal. The revenue on this arrangement, which is excluded from our key performance indicators, has been disclosed separately to the Company's underlying performance in the table above.

3. Operating expenses

	2018			2017		
	Underlying £m	**BTL £m**	**Total £m**	Underlying £m	BTL £m	Total £m
Wages and salaries	223.2	–	223.2	210.6	–	210.6
Social security costs	23.9	–	23.9	23.3	–	23.3
Pension costs – defined benefit schemes	28.0	–	28.0	24.1	–	24.1
Pension costs – defined contribution schemes	8.1	–	8.1	6.8	–	6.8
Severance costs	0.8	–	0.8	1.1	–	1.1
Apprenticeship Levy	1.0	–	1.0	–	–	–
Total employee costs	285.0	–	285.0	265.9	–	265.9
Power	108.4	–	108.4	104.3	–	104.3
Carbon reduction commitment	4.8	–	4.8	6.6	–	6.6
Raw materials and consumables	55.3	–	55.3	53.4	–	53.4
Charge for bad and doubtful debts	28.4	0.4	28.8	3.9	–	3.9
Rates	115.1	–	115.1	94.5	–	94.5
Write-off of costs from assets in development	–	–	–	3.1	–	3.1
Operating lease rental – plant and machinery	5.2	–	5.2	1.0	–	1.0
Operating lease rental – other	5.6	–	5.6	15.1	–	15.1
Research and development expenditure	3.5	–	3.5	4.0	–	4.0
Insurance	37.1	–	37.1	35.6	–	35.6
Legal and professional fees	19.5	–	19.5	21.7	–	21.7
Other operating costs	599.2	–	599.2	577.5	–	577.5
Own work capitalised	(198.2)	–	(198.2)	(188.2)	–	(188.2)
Net operating expenses before depreciation and amortisation	1,068.9	0.4	1,069.3	998.4	–	998.4
Depreciation of property, plant and equipment	498.7	–	498.7	492.0	–	492.0
Amortisation of intangible assets	27.5	–	27.5	25.0	–	25.0
Net operating expenses	1,595.1	0.4	1,595.5	1,515.4	–	1,515.4

Other operating costs primarily relate to costs for hired and contracted services and repairs and maintenance of assets, including associated labour costs, which do not qualify as capital expenditure under IAS 16: *Property, plant and equipment*.

Amounts payable to the Company's auditor are shown below in respect of the following services to the Company:

	2018 £'000	2017 £'000
Fees payable to the Company's auditor:		
Fees payable for the audit of the Company's financial statements	370	397
Fees payable to the Company's auditor for other services:		
Audit related assurance services	205	170
Other assurance services	410	403
Other tax advisory services	–	14
Other services	140	80
Total aggregate remuneration	1,125	1,064

Fees payable for the audit of the Company's financial statements include £30,000 (2017: £30,000) for out of pocket expenses incurred for delivery of the audit.

Other assurance services include certain agreed upon procedures performed by KPMG LLP in connection with the Company's regulatory reporting requirements for Ofwat.

No fees, other than those disclosed, were payable to KPMG LLP in respect of this Company in the current or preceding financial year.

4. Employees and Directors

Employees

All Company employees are based in the United Kingdom. The average monthly number of persons employed by the Company (including Executive Directors) during the year, analysed by category, was as follows:

	2018 Number	Restated 2017 Number
Retail	961	851
Water	1,947	1,850
Wastewater	1,937	1,873
Group services	576	526
Total persons employed	**5,421**	**5,100**

It was identified that a certain group of employees were omitted from the disclosure in the prior year. The comparatives have been restated by 133 from 4,967 persons to 5,100 persons.

Directors

The Directors' emoluments were as follows:

	2018 £'000	2017 £'000
Salary and fees	1,677	1,563
Pension and pension allowances	201	183
Bonus	565	70
Long-term incentive plan	–	73
Payment on loss of office	–	1,583
Other benefits	28	459
Total aggregate emoluments	**2,471**	**3,931**

Included in the table above, is £1,634,000 (2017: £1,528,000) for the Executive Directors for their services to the Company. In addition, the Executive Directors received total remuneration of £700,000 (2017: £655,000) for their services to other companies within the Group.

In the current and preceding financial years no amounts were accruing to any Directors under the Group's defined benefit pension scheme in respect of services to the Company. The Company contributed cash of £201,000 (2017: £183,000) as a pension supplement for three Directors (2017: five Directors). In the current and preceding years the Company made no contributions into the Company's defined contribution pension scheme in relation to the Directors.

Amounts disclosed in respect of the long-term incentive plan ("LTIP") are those where all performance and service conditions have been met. Detailed disclosures of items of remuneration, including those accruing under LTIPs can be found within the Remuneration Committee Report on pages 112–128.

Highest paid Director

Total emoluments, including payments and accruals under long term incentive schemes of the highest paid Director in respect of work done for the Company during the year were £596,000 (2017: £918,000). In addition, emoluments of £255,000 (2017: £393,000) were paid to the highest paid Director for services to other companies within the Group.

5. Other operating income

	2018 £m	2017 £m
Power income	10.1	10.1
Requisitions and diversions charges	25.5	21.7
Service connections charges	23.4	25.4
Release from deferred income – infrastructure charges	18.8	15.4
Rental income	4.0	7.6
Other income	0.9	9.4
Total	**82.7**	**89.6**

Power income comprises income from the sale of internally generated electricity.

6. Profit on sale of non-household business

From 1 April 2017 the Water Act 2014 allows all non-household customers to choose their supplier of water and wastewater retail services. On 1 April 2017 we disposed of our economic interest in the retail non-household business and transferred our non-household customers to Castle Water Limited, which resulted in the recognition of a profit on sale of the business. The profit on sale of the business of £89.7 million has been recognised within the income statement, and consists of the amounts below:

	2018 £m	2017 £m
Gross proceeds	98.8	–
Legal fees	(1.3)	–
Asset impairment	(6.2)	–
Transfer/handover costs	(1.6)	–
Profit on sale of non-household business	89.7	–

7. Finance income and expense

Finance income

	2018 £m	2017 £m
Interest income on bank deposits	0.6	2.8
Interest income on intercompany loans receivable	23.2	26.6
Interest income on swaps	78.5	65.1
Other interest income	0.6	–
Total finance income	102.9	94.5

Finance expense

	2018 £m	2017 £m
Interest in relation to bank and other loans:		
Interest expense	28.6	31.0
RPI accretion on loans	50.0	33.2
Interest in relation to intercompany borrowings:		
Interest expense	355.3	356.8
RPI accretion on loans	122.0	69.8
Interest expense on swaps	74.4	35.7
Net interest expense on defined benefit obligation	9.0	6.1
Gross finance expense	639.3	532.6
Capitalised borrowing costs	(100.7)	(76.3)
Total finance expense	538.6	456.3

8. Net losses on financial instruments

	2018 £m	2017 £m
Exchange gains/(losses) on other loans and private placements	5.8	(19.7)
Gain/(loss) arising on swaps where hedge accounting is not applied	31.8	(183.7)
Loss on cash flow hedge transferred from equity	(84.3)	(2.1)
Total	(46.7)	(205.5)

9. Taxation

	2018			2017		
	Underlying £m	**BTL £m**	**Total £m**	Underlying £m	BTL £m	Total £m
Current tax						
Amounts payable in respect of group relief	2.7	1.6	4.3	6.4	2.2	8.6
Current tax subtotal	2.7	1.6	4.3	6.4	2.2	8.6
Deferred tax						
Origination and reversal of timing differences	11.8	–	11.8	(9.9)	–	(9.9)
Adjustment in respect of prior periods	1.0	–	1.0	(7.0)	–	(7.0)
Adjustment in respect of corporation tax rate changes	–	–	–	(59.8)	–	(59.8)
Deferred tax subtotal	12.8	–	12.8	(76.7)	–	(76.7)
Tax charge/(credit) on profit on ordinary activities	15.5	1.6	17.1	(70.3)	2.2	(68.1)

The tax charge for the year ended 31 March 2018 is lower (2017: lower) than the standard rate of corporation tax in the UK. The differences are explained below:

	2018				2017			
	Underlying £m	**BTL £m**	**Total £m**	**Effective tax rate %**	Underlying £m	BTL £m	Total £m	Effective tax rate %
Profit on ordinary activities before taxation	124.3	26.5	150.8		38.1	33.0	71.1	
Tax at 19% (2017: 20%)	23.7	5.0	28.7	19.0%	7.6	6.6	14.2	20.0%
Effects of recurring items								
Depreciation on assets that do not qualify for tax relief	4.4	–	4.4		4.0	–	4.0	
Disallowable expenditure[1]	0.8	–	0.8		2.0	–	2.0	
Non-taxable income[2]	(4.9)	–	(4.9)		(5.2)	–	(5.2)	
Property disposals[3]	(2.2)	–	(2.2)		(0.1)	–	(0.1)	
Group relief paid for at lower than statutory rate[4]	(5.9)	(3.4)	(9.3)		(12.9)	(4.4)	(17.3)	
Tax as adjusted for recurring items	15.9	1.6	17.5	11.6%	(4.6)	2.2	(2.4)	(3.4%)
Non-recurring items								
Effect of tax rate differences[5]	(1.4)	–	(1.4)		(58.7)	–	(58.7)	
Adjustments to tax charge in respect of prior periods – deferred tax[6]	1.0	–	1.0		(7.0)	–	(7.0)	
Total tax charge/(credit)	15.5	1.6	17.1	11.4%	(70.3)	2.2	(68.1)	(95.8%)

1 Disallowable expenditure primarily relates to fines included in operating expenses.

2 Non-taxable income relates primarily to income from new service connections. This income is reflected in the accounts as non-taxable income under IFRS principles; however, such income is ultimately taxed through capital allowances.

3 Tax chargeable on gains arising on property disposals is lower than the accounting profits recognised for these disposals because of additional deductions available for tax purposes.

4 The Company has decided to utilise tax losses available in its parent Company for the year ended 31 March 2018. As a result, the Company has reduced its claims for tax relief on its capital expenditure in the year. This tax relief is deferred to later periods and as a result, a deferred tax credit of £12.2 million is included in the current year deferred tax charge. The Company will pay £4.3 million to its parent Company for the tax losses, which is shown in the income statement as a current year current tax charge. The Company is paying for the tax losses at a rate which is lower than the standard rate of corporation tax, which reflects the value of the tax losses to the Company. This results in a reduction of the current tax charge of £9.3 million. Utilising tax losses in this way should ultimately benefit customers through lower tax funding in future regulatory settlements.

5 A reduction in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) was substantively enacted on 26 October 2015. A further reduction to the UK corporation tax rate to 17% (effective from 1 April 2020) was substantively enacted on 6 September 2016. This will reduce the company's future current tax charge accordingly. The net deferred tax liability at 31 March 2018 has been calculated based on these rates. Opening deferred tax balances at 31 March 2017 were also calculated at 17%. The effect of temporary differences in the year in current tax calculated at 19% and deferred tax calculated at 17% produces a net £1.4m reduction in the total tax charge for the year. The 1% rate change to 17% enacted in the prior year resulted in an overall deferred tax credit in the income statement in the prior year of £59.8 million.

6 Following the agreement of tax computations with HMRC up to and including 31 March 2016, the provision for uncertain tax positions has been reduced resulting in a prior year deferred tax credit of £0.3 million, which is included in the total prior year deferred tax charge of £1.0 million.

9. Taxation continued

The Company is not currently in a tax paying position with HMRC (although it does pay for group relief), primarily due to capital allowances on capital expenditure, tax deductions for borrowing costs and group relief which has arisen on interest expenses in holding companies. The differences between profit on ordinary activities before taxation at the standard tax rate and the current tax charge for the year are set out below.

	2018			2017		
	Underlying £m	BTL £m	Total £m	Underlying £m	BTL £m	Total £m
Profit on ordinary activities before taxation	124.3	26.5	150.8	38.1	33.0	71.1
Tax at 19% (2017: 20%)	23.7	5.0	28.7	7.6	6.6	14.2
Effects of						
Depreciation on assets that do not qualify for relief	4.4	–	4.4	4.0	–	4.0
Disallowable expenditure	0.8	–	0.8	2.0	–	2.0
Non-taxable income	(4.9)	–	(4.9)	(5.2)	–	(5.2)
Property disposals	(2.2)	–	(2.2)	(0.1)	–	(0.1)
Capital allowances for the year lower than/(in excess of) depreciation	9.0	–	9.0	(8.8)	–	(8.8)
Capitalised borrowing costs allowable for tax[7]	(19.1)	–	(19.1)	(15.3)	–	(15.3)
(Gains)/losses on financial derivatives[8]	(0.8)	–	(0.8)	35.2	–	35.2
Pension cost charge in excess of pension contributions	(0.9)	–	(0.9)	(6.3)	–	(6.3)
Other short term timing differences	(1.4)	–	(1.4)	6.3	–	6.3
Group relief not paid at standard rate	(5.9)	(3.4)	(9.3)	(13.0)	(4.4)	(17.4)
Current tax charge for the year	2.7	1.6	4.3	6.4	2.2	8.6

7 Capitalised borrowing costs are allowable for a full tax deduction in the year.

8 Accounting fair value profits and losses arising on our derivatives are non-taxable and non-deductible respectively, as instead they are taxed as the cash flows arise. Deferred tax is provided on these temporary differences.

Uncertain tax positions

Provisions for uncertain corporation tax positions are included in the deferred tax liability as any liability is likely to crystallise as deferred tax. At 31 March 2018 the total value of these provisions was £nil million (2017: £0.3 million). It is possible that amounts agreed will be different from the amount provided.

Effective tax rate

The effective tax rate, as adjusted for recurring tax items, of 11.6% is low primarily due to the effect of group relief paid for at below the statutory rate.

The deferred tax (charged)/credited directly to other comprehensive income during the year is as follows:

	2018 £m	2017 £m
Deferred tax		
Tax on actuarial (gain)/loss	(12.6)	21.6
Tax on cash flow hedge (gain)/loss	(17.1)	6.1
Total	(29.7)	27.7

10. Dividends

During the year, the Company paid total dividends of £55.0 million (2017: £157.0 million) to its immediate parent, Thames Water Utilities Holdings Limited. These dividends were used to fund interest obligations and activities of other group companies and were distributed within the group as follows:

	2018 £m	2017 £m
Distribution to ultimate shareholders		
External dividend distributions	–	22.8
Interest on Kemble Water Eurobond Plc debt	–	77.2
	–	100.0
Distributions not distributed to ultimate shareholders		
Interest on Kemble Water Finance Limited debt	54.0	55.0
Distribution to Thames Water Limited	1.0	2.0
	55.0	57.0
Total	55.0	157.0

The aggregate amount of dividends proposed but not paid nor recognised as liabilities at the period end is £1.0 million (2017: £nil).

Dividends paid to Kemble Water Finance Limited were used to enable it to continue to service its interest obligations for both external and intercompany debt. Dividends paid to Thames Water Limited were used to fund activities of the Company.

Further information on dividend payments can be found in Resilient and transparent finances on page 62.

11. Intangible assets

	Software £m	Assets in development £m	**Total £m**
Cost			
At 1 April 2016	152.0	16.9	**168.9**
Additions	–	102.7	**102.7**
Transfers	37.6	(37.6)	**–**
Write-off	–	(3.1)	**(3.1)**
At 31 March 2017	189.6	78.9	**268.5**
Additions	–	61.8	**61.8**
Transfers	24.8	(24.8)	**–**
Write-off	–	(6.2)	**(6.2)**
At 31 March 2018	214.4	109.7	**324.1**
Amortisation			
At 1 April 2016	(103.0)	–	**(103.0)**
Amortisation charge	(25.0)	–	**(25.0)**
At 31 March 2017	(128.0)	–	**(128.0)**
Amortisation charge	(27.5)	–	**(27.5)**
At 31 March 2018	(155.5)	–	**(155.5)**
Net book value			
At 31 March 2018	58.9	109.7	**168.6**
At 31 March 2017	61.6	78.9	**140.5**

The write-off of costs relate to software under development that is no longer required as a result of the transfer of non-household customers to Castle Water. Additions related to IT projects undertaken including the implementation of new customer relationship management and billing ("CRMB") system and a new meter data management system. £4.3 million borrowing costs were capitalised during the year (2017: £2.1 million). The effective rate of borrowing costs for the year was 5.58% (2017: 4.86%).

12. Property, plant and equipment

	Land & buildings £m	Plant & equipment £m	Network assets £m	Assets under construction £m	**Total £m**
Cost					
At 1 April 2016	3,321.2	6,191.9	6,475.2	1,991.5	**17,979.8**
Additions	–	24.2	15.9	1,075.2	**1,115.3**
Transfers between categories	95.0	626.3	255.9	(977.2)	**–**
Disposals	(3.7)	(3.8)	–	–	**(7.5)**
At 31 March 2017	3,412.5	6,838.6	6,747.0	2,089.5	**19,087.6**
Additions	1.1	–	13.2	1,072.7	**1,087.0**
Transfers between categories	18.7	382.4	323.4	(724.5)	**–**
Disposals	(1.8)	(13.1)	(1.8)	–	**(16.7)**
At 31 March 2018	3,430.5	7,207.9	7,081.8	2,437.7	**20,157.9**
Depreciation					
At 1 April 2016	(834.8)	(3,427.7)	(244.3)	–	**(4,506.8)**
Depreciation charge	(52.7)	(318.8)	(120.5)	–	**(492.0)**
Disposals	2.0	3.7	–	–	**5.7**
At 31 March 2017	(885.5)	(3,742.8)	(364.8)	–	**(4,993.1)**
Depreciation charge	(52.2)	(318.4)	(128.1)	–	**(498.7)**
Disposals	0.3	8.9	–	–	**9.2**
At 31 March 2018	(937.4)	(4,052.3)	(492.9)	–	**(5,482.6)**
Net book value					
At 31 March 2018	2,493.1	3,155.6	6,588.9	2,437.7	**14,675.3**
At 31 March 2017	2,527.0	3,095.8	6,382.2	2,089.5	**14,094.5**

£96.4 million borrowing costs were capitalised during the year (2017: £74.2 million). The effective rate of borrowing costs for the year was 5.58% (2017: 4.86%).

13. Investment in subsidiaries

	2018 £m	2017 £m
Cost of shares in subsidiary undertakings	0.1	0.1

The Company has no interest in joint ventures or associates. The Company had the following investments in subsidiary undertakings as at 31 March 2018:

	Holding	Principal undertaking	Country of incorporation	Country of tax residence	Class of shares held	Proportion of voting rights & shares held
Thames Water Utilities Finance Limited	Direct	Finance Company	United Kingdom	United Kingdom	£1 Ordinary	100%
Thames Water Utilities Cayman Finance Holdings Limited	Direct	Holding Company	Cayman Islands	United Kingdom	KYD1 Ordinary	100%
Thames Water Utilities Cayman Finance Limited	Indirect	Finance Company	Cayman Islands	United Kingdom	KYD1 Ordinary	100%

All subsidiary undertakings are wholly owned by the Company.

The trading address for Thames Water Utilities Finance Limited, Thames Water Utilities Cayman Finance Holdings Limited and Thames Water Utilities Cayman Finance Limited is Clearwater Court, Vastern Road, Reading, Berkshire, RG1 8DB.

The address of the registered office of Thames Water Utilities Finance Limited is Clearwater Court, Vastern Road, Reading, Berkshire, RG1 8DB. The address of the registered office for both Thames Water Utilities Cayman Finance Holdings Limited and Thames Water Utilities Cayman Finance Limited is PO Box 309GT, Ugland House, South Church Street, George Town, Grand Cayman, Cayman Islands. Both are, and always have been, resident in the United Kingdom for tax purposes.

The Company is at an advanced stage in the closure of its overseas subsidiaries, Thames Water Utilities Cayman Finance Holdings Limited and Thames Water Utilities Cayman Finance Limited.

14. Intercompany loans receivable

	2018 £m	2017 £m
Amounts owed by group undertakings		
Thames Water Utilities Holdings Limited	1,974.7	1,974.7
Thames Water Utilities Finance Limited	200.0	200.0
Thames Water Utilities Cayman Finance Limited	100.0	100.0
	2,274.7	2,274.7
Interest receivable on amounts owed by group undertakings		
Thames Water Utilities Holdings Limited	3.2	7.2
Thames Water Utilities Finance Limited	14.4	9.4
Thames Water Utilities Cayman Finance Limited	0.3	0.2
	17.9	16.8
Total	2,292.6	2,291.5
Disclosed within non-current assets	2,274.7	2,274.7
Disclosed within current assets	17.9	16.8

The above intercompany loans are unsecured and the Directors do not anticipate any repayment of the principal within 12 months. These balances have not been included within the Company's net debt and covenant calculations.

Interest on all of the above loans is charged at a floating rate (2017: floating rate).

15. Inventories and current intangible assets

	2018 £m	2017 £m
Raw materials and consumables	11.5	14.1
Current intangible assets – emissions allowances	6.6	7.6
Total	18.1	21.7

Emission allowances represent purchased carbon emission allowances (relating to the emission of carbon dioxide in the UK). A provision (see note 22) is simultaneously recorded in respect of the obligation to deliver emission allowances in the period in which the emissions are made and the associated charge is recognised as an operating expense within the income statement.

16. Trade and other receivables

	2018			2017		
	Underlying £m	**BTL £m**	**Total £m**	Underlying £m	BTL £m	Total £m
Non-current						
Prepayments and accrued income	–	56.7	56.7	–	30.4	30.4
Amounts owed by group undertakings	1.0	–	1.0	–	–	–
Other receivables	3.0	–	3.0	2.8	–	2.8
	4.0	56.7	60.7	2.8	30.4	33.2
Current						
Gross trade receivables	462.5	6.4	468.9	421.9	3.2	425.1
Less doubtful debt provision	(172.6)	(1.7)	(174.3)	(175.8)	(0.6)	(176.4)
Net trade receivables	289.9	4.7	294.6	246.1	2.6	248.7
Amounts owed by group undertakings	1.1	–	1.1	2.0	–	2.0
Insurance claims receivable	36.1	–	36.1	39.0	–	39.0
Prepayments and accrued income	253.0	0.4	253.4	286.2	0.4	286.6
Other receivables	36.0	0.3	36.3	60.9	–	60.9
	616.1	5.4	621.5	634.2	3.0	637.2
Total	620.1	62.1	682.2	637.0	33.4	670.4

The Directors consider that the carrying amount of trade and other receivables is approximately equal to their fair value.

Prepayments and accrued income at 31 March 2018 includes £218.7 million (31 March 2017: £244.6 million) of water and wastewater income not billed.

Doubtful debt provision

Movements in the doubtful debt provision were as follows:

	2018 £m	2017 £m
At 1 April	(176.4)	(189.7)
Charged against revenue	(28.7)	(46.5)
Included within operating expenses	(28.8)	(3.9)
Amounts written off	59.6	63.7
Total at 31 March	(174.3)	(176.4)

The ageing of receivables which are past due but not impaired cannot be performed. Ageing of gross receivables is as follows:

	2018 £m	2017 £m
Up to 365 days	281.8	252.0
1 – 2 years	83.5	77.4
2 – 3 years	47.4	41.5
More than 3 years	56.2	54.2
Total	468.9	425.1

The ageing of gross BTL receivables is as follows:

	2018 £m	2017 £m
Up to 365 days	4.9	3.2
1 – 2 years	1.5	–
Total	6.4	3.2

A collective provision is recorded against assets which are past due but for which no individual provision is made. This is calculated based on historical experience of levels of recovery. Ageing of impaired receivables is as follows:

	2018 £m	2017 £m
Up to 365 days	66.2	71.5
1 – 2 years	40.9	32.7
2 – 3 years	23.9	23.7
More than 3 years	43.3	48.5
Total	174.3	176.4

16. Trade and other receivables continued

Ageing of impaired BTL receivables is as follows:

	2018 £m	2017 £m
Up to 365 days	0.7	0.6
1 – 2 years	1.0	–
Total	1.7	0.6

17. Cash and cash equivalents

	2018			2017		
	Underlying £m	BTL £m	Total £m	Underlying £m	BTL £m	Total £m
Cash at bank and in hand	4.2	0.1	4.3	2.1	3.8	5.9
Short-term deposits	100.2	2.5	102.7	50.6	–	50.6
Total	104.4	2.6	107.0	52.7	3.8	56.5

BTL cash represents amounts collected from wastewater customers, for the construction costs of the Thames Tideway Tunnel, which has not yet been paid at the reporting date.

18. Trade and other payables

	2018			2017		
	Underlying £m	BTL £m	Total £m	Underlying £m	BTL £m	Total £m
Non-current						
Accruals and deferred income	446.0	–	446.0	404.9	–	404.9
Current						
Trade payables – operating	304.6	–	304.6	282.9	–	282.9
Trade payables – capital	141.1	–	141.1	179.5	–	179.5
Amounts owed to group undertakings	–	–	–	1.1	–	1.1
Other taxation and social security	6.5	–	6.5	6.7	–	6.7
Amounts payable in respect of group relief	2.0	1.6	3.6	17.7	2.2	19.9
Accruals and deferred income	312.1	4.1	316.2	429.4	0.2	429.6
Amounts owed to Bazalgette Tunnel Limited	–	3.5	3.5	–	4.2	4.2
Other payables	37.8	–	37.8	7.1	–	7.1
	804.1	9.2	813.3	924.4	6.6	931.0
Total	1,250.1	9.2	1,259.3	1,329.3	6.6	1,335.9

Accruals and deferred income at 31 March 2018 includes £75.6 million (31 March 2017: £81.1 million) of receipts in advance from customers for water and wastewater charges, £nil (31 March 2017: £97.3 million) of net proceeds in relation to the transfer of all non-household retail customers to Castle Water and £353.6 million (2017: £326.2 million) of deferred infrastructure charges. External shareholders do not benefit from amounts payable in respect of group relief that is paid up the group. For further details of this mechanism please refer to footnote 4 in note 9. Other payables includes excess credits, where customers have overpaid, which is all recognised as a current liability as at 31 March 2018.

The Directors consider that the carrying amount of trade and other payables is approximately equal to their fair value.

19. Borrowings

	2018 £m	2017 £m
Secured bank loans and private placements	2,290.2	1,890.8
Amounts owed to group undertakings	8,944.3	8,732.6
	11,234.5	10,623.4
Interest payable on secured bank loans and private placements	4.8	4.3
Interest payable on amounts owed to group undertakings	203.9	179.2
	208.7	183.5
Total	11,443.2	10,806.9
Disclosed within non-current liabilities	11,123.0	10,423.5
Disclosed within current liabilities	320.2	383.4
Total	11,443.2	10,806.9

Secured bank loans refers to an arrangement whereby each Obligor (representing each of the companies within the whole business securitisation group) has entered into a Security Trust and Intercompany Deed ("STID") with the Security Trustee. Pursuant to this arrangement, Thames Water Utilities Holdings Limited has guaranteed the obligations of each other Obligor under the finance agreement. Additionally, Thames Water Utilities Limited, and its wholly owned subsidiaries, has guaranteed the obligations of each other under the finance agreement, in each case to the Security Trustee.

As at 31 March 2018, amounts owed to group undertakings, including interest, are unsecured and include the following:

- £2,944.8 million (2017: £2,888.3 million) owed to Thames Water Utilities Finance Limited, a subsidiary undertaking. Financing costs arising in Thames Water Utilities Finance Limited are directly recharged under mirrored interest terms for all loans except for one loan, a £225.0 million 6.59% secured bond due in 2021, which was loaned on with a margin of one basis point.
- £6,203.4 million (2017: £6,023.4 million) owed to Thames Water Utilities Cayman Finance Limited, a subsidiary undertaking. All costs are directly recharged under mirrored interest terms, and an additional margin of ten basis points.

Maturity analysis with respect to borrowings is presented in note 20.

Breakdown of secured bank loans and private placements

	2018 £m	2017 £m
£150.0m floating rate loan due 2017	–	150.0
£100.0m floating rate loan due 2018 (a), (g)	–	99.9
£60.0m 1.230% Index linked loan due 2019	76.8	73.9
£60.0m 1.415% Index linked loan due 2020	76.6	73.7
£60.0m 1.513% index linked loan due 2020	76.2	73.3
£60.0m 1.380% index linked loan due 2020	76.0	73.1
£60.0m 1.356% index linked loan due 2020	76.0	73.1
£100.0m floating rate loan due 2020 (a), (c)	99.9	99.8
£75.0m 1.350% index linked loan due 2021 (e)	87.0	83.7
£100.0m floating rate loan due 2021 (a), (c), (g)	–	99.7
£215.0m 0.460% index linked loan due 2023 (a)	241.9	232.6
£215.0m 0.380% index linked loan due 2032 (a), (b)	228.4	227.0
£100.0m 3.280% index linked loan due 2043 (a), (d)	126.4	121.5
£100.0m 0.790% index linked loan due 2025 (a), (e)	107.2	103.1
£125.0m 0.598% index linked loan due 2026 (a), (e)	133.3	128.2
£70.0m Class B 3.867% fixed rate loan due 2026 (a)	69.7	69.7
£50.0m Class B 3.875% fixed rate loan due 2026 (a)	49.8	49.8
£20.0m Class B floating rate loan due 2026 (a)	19.9	19.9
£39.0m Class B 3.918% fixed rate loan due 2026 (a)	38.8	38.8
$55.0m 3.380% private placement due 2023 (a), (f)	39.2	–
$285.0m 3.570% private placement due 2025 (a), (f)	202.8	–
£216.0m 2.450% private placement due 2028 (a)	215.3	–
£210m 2.550% private placement due 2030 (a)	209.2	–
£40m 2.620% private placement due 2033 (a)	39.8	–
Total secured bank loans and private placements	2,290.2	1,890.8

All loans and private placements are Class A except where highlighted.

(a) These loans and private placements are shown net of issue costs.

(b) This debt amortises in equal tranches from 2017 onwards.

(c) The interest margins of these two loans are based on a ratings grid and will increase should the securitisation group senior debt credit rating be downgraded by both Standard and Poor's and Moody's.

(d) This debt amortises from 2023 to 2033 in tranches of £3.0 million, followed by tranches of £750,000 until maturity where there will be a bullet payment of £25.0 million.

(e) These loans contain a collar mechanism that limits total accretion repayment within a predetermined range.

(f) The Company has entered into Cross currency swap agreements which convert this debt into sterling debt.

(g) These loans were repaid early on 22 March 2018.

19. Borrowings continued
Breakdown of amounts owed to group undertakings

These amounts are intercompany loans from Thames Water Utilities Finance Limited and Thames Water Utilities Cayman Finance Limited.

	2018 £m	2017 £m
£96.6m 5.196% class B fixed rate due 2019 (a), (c)	96.3	96.0
£100.0m 5.050% fixed rate due 2020 (b)	100.0	100.0
£225.0m 6.590% fixed rate due 2021 (b), (d)	225.0	225.0
£175.0m 3.375% index linked due 2021 (b), (c)	273.5	263.9
£100.0m 1.985% index linked due 2022 (a), (f)	117.3	112.9
£96.6m 4.146% fixed rate due 2022 (a)	96.6	96.6
£128.7m 4.300% fixed rate due 2024 (a)	128.7	128.8
£550.0m 5.375% class B Fixed rate due 2025 (a), (c), (g)	–	548.5
£161.1m 4.534% fixed rate due 2027 (a)	161.1	161.0
£330.0m 6.750% fixed rate due 2028 (a), (c)	327.4	327.3
£100.0m 1.790% index linked due 2029 (b), (f)	108.6	103.5
£300.0m 5.750% class B Fixed rate due 2030 (a), (c), (h)	297.8	297.5
£200.0m 6.500% fixed rate due 2032 (b), (c)	197.7	197.6
£300.0m 4.375% fixed rate due 2034 (a), (c)	295.5	295.3
£600.0m 5.125% fixed rate due 2037 (b), (c)	596.5	596.3
¥20.0bn 3.280% fixed rate due 2038 (a), (k)	134.2	143.3
£200.0m 0.205% index linked due 2039 (a), (f)	219.5	209.3
£50.0m 3.853% index linked due 2040 (a), (e)	63.3	60.9
£500.0m 5.500% fixed rate due 2041 (a), (c)	489.6	489.4
£50.0m 1.980% index linked due 2042 (a)	67.1	64.4
£55.0m 2.091% index linked due 2042 (a), (c)	71.0	68.3
£40.0m 1.974% index linked due 2045 (a), (c)	46.3	45.6
£300.0m 4.625% fixed rate due 2046 (a), (c)	293.1	293.0
£100.0m 1.846% index linked due 2047 (a)	134.2	128.9
£200.0m 1.819% index linked due 2049 (a), (c)	267.9	257.3
£300.0m 1.680% index linked due 2053 (b), (c)	421.7	406.9
£300.0m 1.681% index linked due 2055 (b), (c)	421.6	406.9
£200.0m 1.771% index linked due 2057 (a), (c)	267.9	258.4
£100.0m index linked due 2060 (a)	108.5	103.7
£350.0m 1.760% index linked due 2062 (a), (c)	468.8	450.2
£500.0m 4.000% fixed rate due 2025 (a), (c)	495.3	494.8
£40.0m 0.750% index linked loan due 2034 (a), (c)	42.4	40.8
£45.0m 0.721% index linked loan due 2027 (a), (c)	47.7	45.8
£300.0m 3.500% fixed rate loan due 2028 (a), (c)	296.3	296.0
£400.0m 7.738% fixed rate bond due 2058 (a), (c)	394.1	393.8
£250.0m 1.875% fixed rate bond due 2024 (a), (c)	247.8	247.4
£250.0m 2.625% fixed rate bond due 2032 (a), (c)	247.2	247.1
£42.0m floating rate loan due 2017 (a), (j)	–	42.0
£300m 2.375% class B Fixed rate bond due 2023 (a), (c)	298.5	–
£250m 2.875% class B Fixed rate bond due 2027 (a), (c)	246.6	–
£143.6m 2.296% fixed rate bond due 2024 (a), (c)	143.2	–
Fees (i)	(11.5)	(11.8)
Total amounts owed to group undertakings	**8,944.3**	**8,732.6**

All debt is class A except where highlighted.

(a) These loans are back-to-back inter-group loans from Thames Water Utilities Cayman Finance Limited to the Company. Thames Water Utilities Cayman Finance Limited charges the Company a margin of ten basis points in respect of the loans.

(b) These loans are back-to-back inter-group loans from Thames Water Utilities Finance Limited to the Company.

(c) These loans are shown net of issue costs.

(d) Thames Water Utilities Finance Limited charges the Company a margin of one basis point in respect of this loan.

(e) This is a Limited Price Index ("LPI") loan. Accretion charged is calculated using an adjusted UK Retail Price Index.

(f) These amounts have been swapped into index linked debt within the financing subsidiary and the net proceeds lent to TWUL.

(g) In July 2017 this Bond had a 'Step Up and Call' meaning the interest rate changed to 3 months LIBOR plus 7.96% at which point the issuer exercised a call option to redeem the nominal value of the debt at par value.

(h) In September 2022 this Bond has a 'Step Up and Call' meaning the interest rate changes to 3 months LIBOR plus 7.97% at which point the issuer can exercise a call option to redeem the nominal value of the debt at par value.

(i) These fees have been shown within amounts owed to group undertakings to reflect that they relate to index linked debt that was raised in Thames Water Utilities Cayman Finance Limited and passed on to TWUL.

(j) In March 2017 £42m was drawn out of the £950m revolving credit facility and repaid in April 2017. During the year ended 31 March 2018, a total of £849.0m was drawn in various tranches and repaid using revolving credit facility

(k) The Company has entered into Cross currency swap agreements which convert this debt into sterling debt.

20. Financial instruments

Categories of financial instruments

The carrying values of the financial assets and liabilities of the Company are as follows:

Financial assets

	2018 £m	2017 £m
Fair value through profit and loss		
Index linked swaps	57.4	83.0
Interest rate swaps	–	0.6
Cross currency swaps	1.9	–
	59.3	83.6
Loans and receivables (including cash and cash equivalents)		
Amounts owed by group undertakings	2,292.6	2,291.5
Trade and other receivables	682.2	670.4
Short term investments	–	1.0
Cash and cash equivalents	107.0	56.5
Total	3,141.1	3,103.0

Financial liabilities

	2018 £m	2017 £m
Fair value through profit and loss		
Cross currency swaps – not hedge accounted	(60.7)	(71.6)
Interest rate swaps – not hedge accounted	(176.2)	(108.4)
Index linked swaps – not hedge accounted	(539.2)	(589.2)
Derivatives designated as hedging instruments		
Forward starting interest rate swaps – cash flow hedges	(45.3)	(155.3)
	(821.4)	(924.5)
Other financial liabilities		
Trade and other payables	(1,259.3)	(1,335.9)
Borrowings	(11,443.2)	(10,806.9)
Total	(13,523.9)	(13,067.3)

Fair value measurements

The fair value of financial assets and liabilities represents the price that would be received to sell an asset or paid to transfer a liability between informed and willing parties, other than in a forced or liquidation sale at the measurement date. The techniques for determining the fair value of financial instruments are classified under the hierarchy defined in IFRS 13 Fair Value Measurement which categorises inputs to valuation techniques into levels 1-3 based on the degree to which the fair value is observable. Unless otherwise stated all of the Company's inputs to valuation techniques are level 2 – the fair value is determined from inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. The fair values of interest rate and index linked swaps are determined, in part, from unobservable inputs but the use of these unobservable inputs does not significantly impact the result. As a result, we have concluded that it is appropriate to continue to classify the derivative instruments as level 2. The table below sets out the valuation basis of financial instruments held at fair value as at 31 March 2018:

	Level 2[1]	
	2018 £m	2017 £m
Financial assets – derivative financial instruments		
Index linked swaps	57.4	83.0
Interest rate swaps	–	0.6
Cross currency swaps	1.9	
	59.3	83.6
Financial liabilities – derivative financial instruments		
Cross currency swaps	(60.7)	(71.6)
Interest rate swaps	(176.2)	(108.4)
Index linked swaps	(539.2)	(589.2)
Forward starting interest rate swaps	(45.3)	(155.3)
	(821.4)	(924.5)
Net total	(762.1)	(840.9)

1 The fair value of derivative financial instruments, including interest rate swaps, cross currency swaps, index linked swaps and options, are measured using discounted cash flows. The future cash flows are estimated based on observable forward interest rates, inflation rates and discounted at a rate that reflects the credit risk of the Company and counterparties. Currency cash flows are translated at spot rate. During the year, the Company has introduced more sophisticated modelling techniques to calculate credit risk adjustments that are required when valuing derivative financial instruments. These address changes in market practice. The fair value gain on swaps includes £27.7 million credit resulting from these improvements.

20. Financial instruments continued

In mid-2014 the Company executed £2.25 billion of forward-starting fixed to floating interest rate swaps of a 5-7 year maturity with various financial institutions to fix the future interest costs of an element of the new debt to be issued from 2017 to 2020. £800.0 million of these swaps commenced during the year (2017: £900.0 million). On commencement these swap were reclassified from forward starting interest rate swaps to interest rate swaps. The fair value movements till commencement were recognised on cash flow hedge reserve. Subsequent to commencement the fair value movement on these swaps has been recognised as changes in fair value through the income statement and the cash flow hedge has been discontinued prospectively. During the year £16.3 million gain (2017: loss of £50.7 million) was recognised on cash flow hedge reserve and £84.3 million (2017: £2.1 million) was recycled from cash flow hedge reserve to income statement, see Statement of changes in equity. The loss of £84.3 million consisted of £23.5 million loss related to hedged exposure that crystallised during the year and a £60.8 million loss due to hedge accounting discontinuation.

Comparison of fair value of financial instruments with their carrying amounts

The carrying amounts of the Company's trade and other receivables and trade and other payables are considered to be approximate to their fair values. The fair values and carrying values of the Company's other financial assets and financial liabilities are set out in the tables below.

Financial liabilities

	2018		2017	
	Book value £m	**Fair value £m**	Book value £m	Fair value £m
Non-current				
Bank loans and private placements				
Floating rate	**(119.8)**	**(120.0)**	(319.4)	(319.4)
Index linked	**(1,291.8)**	**(1,506.5)**	(1,256.3)	(1,687.7)
Fixed rate	**(864.7)**	**(853.9)**	(158.2)	(189.5)
Amounts owed to group undertakings	**(8,846.7)**	**(11,472.7)**	(8,689.6)	(12,153.9)
Derivative financial instruments				
Cross currency swaps	**(60.7)**	**(60.7)**	(71.6)	(71.6)
Interest rate swaps	**(176.2)**	**(176.2)**	(107.3)	(107.3)
Index linked swaps	**(526.9)**	**(526.9)**	(566.5)	(566.5)
Forward starting interest rate swaps	**(45.3)**	**(45.3)**	(155.3)	(155.3)
	(11,932.1)	**(14,762.2)**	(11,324.2)	(15,251.2)
Current				
Bank loans and private placements				
Floating rate	**–**	**–**	(150.0)	(150.0)
Index linked	**(13.9)**	**(13.9)**	(6.9)	(6.9)
Amounts owed to group undertakings	**(97.6)**	**(100.8)**	(43.0)	(43.0)
Interest payable	**(208.7)**	**(208.7)**	(183.5)	(183.5)
Derivative financial instruments				
Index linked swaps	**(12.3)**	**(12.3)**	(22.7)	(22.7)
Interest rate swaps	**–**	**–**	(1.1)	(1.1)
	(332.5)	**(335.7)**	(407.2)	(407.2)
Total	**(12,264.6)**	**(15,097.9)**	(11,731.4)	(15,658.4)

Financial assets

	2018		2017	
	Book value £m	**Fair value £m**	Book value £m	Fair value £m
Non-current				
Amounts owed by group undertakings	**2,274.7**	**2,274.7**	2,274.7	2,274.7
Derivative financial instruments	**59.3**	**59.3**	83.6	83.6
	2,334.0	**2,334.0**	2,358.3	2,358.3
Current				
Short term investments	**–**	**–**	1.0	1.0
Cash and cash equivalents	**107.0**	**107.0**	56.5	56.5
Amounts owed by group undertakings	**17.9**	**17.9**	16.8	16.8
	124.9	**124.9**	74.3	74.3
Total	**2,458.9**	**2,458.9**	2,432.6	2,432.6

Amounts owed to group entities include bonds and private placements issued by subsidiary entities, which are publicly traded and the proceeds from these transactions are loaned to the Company through intercompany agreements. The Company does not issue any bonds directly to the public markets.

The fair value of amounts owed to group entities represents the market value of the publicly traded underlying bonds and associated derivatives. For private placements the fair value is determined by discounting expected future cash flows using a risk-free rate plus the Company's credit spread.

The fair value of floating rate debt instruments is assumed to be the nominal value of the primary loan and adjusted for credit risk if this is significant. The fair value of index linked debt instruments is based on the nominal value of the debt plus accretion already accrued and accretion expected to accrue to maturity. Amounts owed by group entities include floating rate loans, the fair value of these loans is assumed to be the nominal value of the primary loan.

Capital risk management

Capital risk primarily relates to whether the Company is adequately capitalised and financially solvent. The Board reviews the Company's exposure to these risks and actively oversees the treasury activities, reviewing the treasury policy and approving the treasury strategy and funding plan.

The Company's key objectives in managing capital are:

- To maintain a broad portfolio of debt, diversified by source and maturity
- To retain the Company's investment grade credit rating
- To provide liquidity sufficient to fund ongoing obligations for a minimum of a 15-month forward period on an ongoing basis
- To maintain customer bills at a level which is both affordable and sustainable

Derivative financial instruments are used, where appropriate to manage the risk of fluctuations in interest rates, inflation and foreign exchange rates. No open or speculative positions are taken.

The Company is part of a Whole Business Securitisation ("WBS") Group of companies. The Company guarantees the funding activity of subsidiary companies in the WBS group who raise debt finance in external debt markets through the issuance of secured bonds and the issuance of loans. The Securitisation Group is required to comply with certain covenants, which include, amongst others:

- An interest cover ratio
- A gearing ratio
- An obligation to manage the maturity profile of debt arrangements
- An obligation to manage the proportion of future interest cost which is fixed and/or index linked

The Securitisation Group complied with these covenants throughout the financial year.

The capital structure of the Company consists of net debt and equity as follows:

	2018 £m	2017 £m
Cash and cash equivalents	**107.0**	56.5
Short term investments	**–**	1.0
Secured bank loans and private placements	**(2,290.2)**	(1,890.8)
Amounts owed to group undertakings	**(8,944.3)**	(8,732.6)
Interest payable on secured bank loans and private placements	**(4.8)**	(4.3)
Interest payable on amounts owed to group undertakings	**(203.9)**	(179.2)
Net debt (statutory basis)	**(11,336.2)**	(10,749.4)
Amounts owed to group undertakings	**300.0**	300.0
Interest payable on secured bank loans and private placements	**4.8**	4.3
Interest payable on amounts owed to group undertakings	**203.9**	179.2
Unamortised debt issuance costs and discount	**(78.0)**	(75.2)
Derivative financial liabilities	**(234.9)**	(208.4)
Net debt (covenant basis)	**(11,140.4)**	(10,549.5)
Equity attributable to owners of the Company	**3,147.4**	2,923.8

Net debt (covenant basis) excludes amounts owed to group undertakings for which there is no related external debt, accrued interest, unamortised debt issuance costs and discounts, and includes derivative financial liabilities related solely to accretion on index-linked swaps and the effect of movement in foreign exchange rate to cross currency swap held in TWUL. Amounts owed to group undertaking include loan from intermediate subsidiaries, Thames Water Utilities Cayman Finance Limited of £100.0 million (2017: £100.0 million), and Thames Water Utilities Finance Limited of £200.0 million (2017: £200.0 million).

20. Financial instruments continued

Reconciliation of liabilities arising from financing activities

The reconciliation below between the opening and closing balances for liabilities arising from financing activities evaluates changes in liabilities including both changes arising from cash flow and non-cash changes.

	2018		2017	
	Borrowings £m	**Derivative financial liabilities £m**	Borrowings £m	Derivative financial liabilities £m
Opening balance	(10,806.9)	(924.5)	(10,964.9)	(940.9)
Non-Current	(10,423.5)	(900.7)	(9,928.0)	(940.9)
Current	(383.4)	(23.8)	(1,036.9)	–
Cash flows				
New loans raised	(2,239.7)	–	(568.1)	–
Repayment of borrowings	1,799.8	–	841.3	–
Derivative paydown	–	29.9	–	–
Interest paid	351.3	67.2	394.9	33.3
Interest received	–	(70.4)	–	(64.8)
	(88.6)	26.7	668.1	(31.5)
Non-cash changes				
Net interest (charge)/income and fees amortisation	(383.6)	4.0	(386.6)	29.4
Accretion	(172.0)	–	(103.0)	–
Fair value changes	–	72.4	–	18.5
Other	7.9	–	(20.5)	–
	(547.7)	76.4	(510.1)	47.9
Closing balance	(11,443.2)	(821.4)	(10,806.9)	(924.5)
Non-Current	(11,123.0)	(809.1)	(10,423.5)	(900.7)
Current	(320.2)	(12.3)	(383.4)	(23.8)

Financial risk management

The Company's activities expose it to a number of financial risks: market risk (including interest rate risk, exchange rate risk and inflation risk), credit risk, and liquidity risk. Details of the nature of each of these risks along with the steps the Company has taken to manage them is described below and overleaf.

(a) Market risk

Market risk relates to fluctuations in external market variables such as interest rates, inflation and foreign exchange rates that could affect the Company's income or the value of the financial instruments it holds. Below is the effective interest rate and foreign currency risk profile of the debt held by the Company after taking into account the derivative financial instruments used to manage market risk:

As at 31 March 2018:	**Total at fixed rates £m**	**Total at floating rates £m**	**Total at RPI linked rates £m**	**Total £m**
Interest bearing loans and borrowings				
Net of corresponding swap assets				
‣ £ Sterling	5,681.1	93.4	5,694.9	11,469.4

As at 31 March 2017:	Total at fixed rates £m	Total at floating rates £m	Total at RPI linked rates £m	Total £m
Interest bearing loans and borrowings				
Net of corresponding swap assets				
‣ £ Sterling	5,238.0	76.4	5,517.4	10,831.8

The weighted average interest rates of the debt held by the Company, after taking into account the derivative financial instruments used to manage market risk, and the period until maturity for which the rate is fixed and index-linked, are given below:

	Weighted average interest rate		Weighted average period until maturity	
	2018 %	2017 %	**2018 Years**	2017 Years
Fixed	**5.0**	5.1	**12.5**	13.9
Index-Linked	**5.5**	3.9	**22.4**	23.7

(i) Interest rate risk sensitivity analysis

The Company holds both fixed and floating rate borrowings. Fixed rate borrowings are exposed to a risk of change in their fair value due to changes in interest rates. Floating rate borrowings are exposed to a risk of change in interest cash flows due to changes in interest rates. The Company uses interest rate swaps which economically hedge future cash flows to protect against interest rate movements. For details of the interest rate swaps please see the Cash flow hedges section of this note on page 169.

The table below summarises the impact, on pre-tax profits, of 1% increase or decrease in interest rate at 31 March 2018. This analysis considers effect of variable interest rate instruments and assumes that all other variables, in particular exchange rates, remain constant.

	2018		2017	
	+1% £m	**–1% £m**	+1% £m	–1% £m
Profit	**143.0**	**(159.5)**	171.5	(189.1)
Equity	**167.1**	**(185.6)**	250.2	(272.2)

(ii) Exchange rate sensitivity analysis

The Company's foreign currency risk exposure results from debt raised in currencies other than Sterling. The Company uses cross currency swaps to hedge the foreign currency exposure of bonds issued in a foreign currency. All hedges are undertaken for commercial reasons with the objective of minimising the impact of exchange rate fluctuations. The Company has no material unhedged monetary assets or liabilities denominated in a currency other than sterling.

The table below summarises the impact of changes in the year end valuations of financial assets and liabilities denominated in foreign currency on pre-tax profits of a 10% strengthening or weakening of GBP (£) against the respective currencies in which the financial assets and liabilities are denominated at 31 March 2018. This analysis assumes that all other variables in the valuation remain constant.

	2018		2017	
	+10% £m	**–10% £m**	+10% £m	–10% £m
Profit	**(3.4)**	**1.7**	(6.8)	8.3
Equity	**(3.4)**	**1.7**	(6.8)	8.3

(iii) Inflation risk sensitivity analysis

The Company has entered into financial instruments that are directly linked to inflation including RPI linked bonds, loans and swaps. In addition, the Company as a regulated water company is subject to fluctuations in its revenues due to movements in inflation. Therefore the Company's RPI linked borrowings and swaps form a partial economic hedge as the assets and liabilities partially offset.

The table below summarises the impact on pre-tax profits of a 1% increase or decrease in inflation rates at 31 March 2018. This analysis assumes that all other variables, in particular exchange rates, remain constant.

	2018		2017	
	+1% £m	**–1% £m**	+1% £m	–1% £m
Profit	**(425.5)**	**381.1**	(493.7)	387.9
Equity	**(425.5)**	**381.1**	(493.7)	387.9

20. Financial instruments continued

(b) Credit risk

Credit risk relates to the potential financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. This arises principally from the Company's trade receivables, its loan with its immediate parent entity Thames Water Utilities Holdings Limited, short-term investments and cash flows receivable from counterparties to the derivative financial instruments.

The Company has a statutory obligation to provide water and sewerage services to customers within its region. Due to the large area served by the Company and the significant number of households within this area, there is considered to be no concentration of trade receivables credit risk, however, the Company's credit control policies and procedures are in place to minimise the risk of bad debt arising from its household trade receivables. Amounts provided against trade receivables and movements in the provision in the year are disclosed in note 16. For non-household customers, the credit risk lies with a small number of retailers rather than the end user and exposure to retailer default would be limited due to conditions that exist within the non-household market.

Under the terms of the WBS agreement, counterparties to the Company's short term investments and derivative transactions have to meet minimum credit rating criteria as assigned by both Moody's and S&P. For derivative counterparties there is a mechanism for the counterparty to post collateral when amounts due to the Company under outstanding derivative contracts exceed a contractually agreed threshold amount or the counterparty fails to meet the necessary credit rating criteria.

The Company's maximum exposure to credit risk is the carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, less collateral cash held under the terms of the whole business securitisation agreement. The following table summarises amounts held on short term investments by credit rating of counterparties.

	2018 £m	2017 £m
A	–	1.0
Total	–	1.0

The following table summarises fair value of derivatives assets by credit rating of counterparties.

	2018 £m	2017 £m
AA-	0.4	0.2
A+	57.4	83.2
A	1.5	0.2
Total	59.3	83.6

(c) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company manages long-term liquidity by maintaining continuity of funding through access to different market and debt instruments, raising funds in the capital markets and ensuring that manageable debt maturity profiles are maintained. The Company also maintains a level of committed liquidity facilities provided by a range of financial institutions. Details of the Company's borrowings are disclosed in note 19.

The maturity profile of interest bearing loans and borrowings disclosed in the statement of financial position are given below.

	2018 £m	2017 £m
Within one year	111.2	199.9
Between one and two years	496.3	210.8
Between two and three years	214.9	481.7
Between three and four years	697.0	314.6
Between four and five years	171.5	684.1
After more than five years	9,543.6	8,732.3
Total	11,234.5	10,623.4

(i) Cash flows from non-derivative financial liabilities

The maturity profile of the anticipated future cash flows including interest in relation to the Company's non-derivative financial liabilities on an undiscounted basis (excluding non-current trade payables), which, therefore, differs from both the carrying value disclosed in the statement of financial position and fair values, is as follows:

Undiscounted amounts payable

	2018 £m	2017 £m
Within one year	**(1,295.4)**	(1,483.4)
Between one and two years	**(953.3)**	(601.9)
Between two and three years	**(598.2)**	(973.0)
Between three and four years	**(1,108.2)**	(717.2)
Between four and five years	**(537.4)**	(1,125.0)
After more than five years	**(22,047.1)**	(21,997.2)
Total	**(26,539.6)**	(26,897.7)

(ii) Cash flows from derivative financial instruments

The maturity profile of the Company's financial derivatives (which include interest rate swaps, cross currency swaps and index linked swaps), based on undiscounted cash flows, is as follows:

Undiscounted amounts (payable)/receivable

	2018 £m	2017 £m
Within one year	**(14.4)**	(21.9)
Between one and two years	**1.3**	1.3
Between two and three years	**0.6**	17.4
Between three and four years	**1.2**	16.8
Between four and five years	**(37.8)**	21.2
After more than five years	**(1,157.4)**	(1,202.0)
Total	**(1,206.5)**	(1,167.2)

Cash flow hedges

The Company has designated a number of contracts which qualify, in accordance with IAS 39 Financial Instruments: Recognition and Measurement, as cash flow hedges. The accounting policy on cash flow hedges is explained on page 145.

In mid-2014 the Company executed £2.25 billion of forward-starting fixed to floating interest rate swaps of a 5-7 year maturity with various financial institutions to fix the future interest costs of an element of the new debt to be issued from 2017 to 2020. This protects the Company against adverse movements in underlying interest rates by matching debt issuance against a derivative instrument with fixed cash flow.

During the year £800.0 million (2017: £900.0 million) of forward starting swaps commenced. These were reclassified from forward starting interest rate swaps to interest rate swaps and the cash flow hedge for these swaps has been discontinued prospectively, see Fair value measurements section above for more details.

The expected cash flows of the Company's cash flow hedging instruments are as follows:

Undiscounted amounts payable

	2018 £m	2017 £m
Interest rate swaps		
Within one year	**–**	(4.6)
Between one and two years	**(6.5)**	(15.3)
Between two and three years	**(8.4)**	(23.1)
Between three and four years	**(8.4)**	(25.5)
Between four and five years	**(8.4)**	(25.5)
After more than five years	**(10.4)**	(45.7)
Total	**(42.1)**	(139.7)

In respect of the above cash flow hedges, a gain of £16.3 million was recognised in other comprehensive income in the year (2017: loss of £50.7 million). The amount reclassified from equity to the income statement for the year was £84.3 million (2017: £2.1 million).

21. Deferred tax

An analysis of movements in the major deferred tax liabilities and assets recognised by the Company is set out below:

	Accelerated depreciation £m	Retirement benefits £m	Cash flow hedge £m	Other £m	**Total £m**
At 1 April 2016	(1,105.4)	46.8	76.6	0.2	**(981.8)**
Credit/(charge) to income	43.0	(3.8)	27.7	9.8	**76.7**
Credit to other comprehensive income	–	21.6	6.1	–	**27.7**
At 31 March 2017	(1,062.4)	64.6	110.4	10.0	**(877.4)**
Charge to income	(10.4)	(0.9)	(0.6)	(0.9)	**(12.8)**
Charge to other comprehensive income	–	(12.6)	(17.1)	–	**(29.7)**
Government grant for research and development	0.1	–	–	–	**0.1**
At 31 March 2018	(1,072.7)	51.1	92.7	9.1	**(919.8)**

Deferred tax assets and liabilities have been offset in the balance sheet. The offset amounts, which are to be recovered/settled after more than 12 months are as follows:

	2018 £m	2017 £m
Deferred tax asset	**152.9**	185.0
Deferred tax liability	**(1,072.7)**	(1,062.4)
Total	**(919.8)**	(877.4)

A deferred tax liability arises in respect of accelerated tax depreciation, because the rate of tax relief specified in UK tax legislation on most of our capital expenditure is quicker than the rate of accounting depreciation on that expenditure. These temporary differences unwind and affect current tax over the life of the relevant assets, but the continued high levels of capital investment within the Company mean that the temporary differences currently tend to increase every year.

Deferred tax assets have arisen on the following temporary differences:

- Retirement benefit obligations: A deferred tax asset is provided on the retirement benefit obligations booked in the accounts. Current tax relief will be available in the future for pension contributions paid to reduce these obligations. Deferred tax movements will also arise on any non-cash changes in the obligations, for example those arising from actuarial valuations.
- Cash flow hedge: A deferred tax asset is provided on certain fair values booked in respect of financial instruments in the accounts. Current tax relief will be available in the future as the cash flows arise over the lives of the derivatives. Deferred tax movements will also arise on any non-cash changes in the fair value of the derivatives.
- Other: A deferred tax asset is provided on the temporary differences arising on amounts for which a tax deduction is spread over a number of years in accordance with tax legislation, including certain pension contributions. Current tax relief will be available in future when tax relief is available in accordance with the legislation.

22. Provisions for liabilities and charges

	Emissions provision £m	Insured liabilities £m	Restructuring provision £m	AMP4 provision £m	Other provisions £m	**Total £m**
At 1 April 2016	7.0	45.4	0.6	3.9	40.7	97.6
Utilised during the year	(6.5)	–	(0.4)	(2.2)	(13.1)	(22.2)
Charge to income statement	6.5	22.0	0.5	–	3.8	32.8
Transfer (to)/from current liabilities	–	–	–	(0.2)	4.5	4.3
At 31 March 2017	7.0	67.4	0.7	1.5	35.9	112.5
Utilised during the year	(7.0)	–	(0.5)	(1.7)	(8.7)	(17.9)
Charge/(credit) to income statement	5.7	(3.8)	–	–	13.5	15.4
Transfer from current liabilities	–	–	–	1.3	–	1.3
At 31 March 2018	5.7	63.6	0.2	1.1	40.7	111.3

Emissions provisions relate to the obligation to purchase carbon emissions allowances.

The insured liability provision arises from insurance claims from third parties received by the Company, and represents the estimated cost of settlement. Where we have insurance cover for these claims, we recognise the reimbursement value from captive and third party insurance companies net of retentions. The receivable is disclosed in note 16. Timing of settlement for these claims is uncertain and therefore amounts provided have been classified as non-current.

The AMP4 provision represents agreed settlement in respect of an information request received from Ofwat issued under section 203 of the Water Industry Act 1991 concerning the properties claimed as safeguarded from internal sewer flooding by capital schemes completed in 2009/10. The provision is utilised against contributions to various charity schemes. The associated outflows are expected to arise over AMP6.

Other provisions principally relate to a number of contractual and legal claims against the Company and potential fines for non-compliance with the various regulations the Company is obliged to meet. The amount recorded represents management's best estimate of the value of settlement and associated costs. Timing of settlement for these claims is uncertain and therefore amounts provided have been classified as non-current.

23. Share capital and other reserves

Share capital

	2018			2017		
	Underlying £m	**BTL £m**	**Total £m**	Underlying £m	BTL £m	Total £m
Allotted, called up and fully paid						
29,050,000 ordinary shares of £1 each	29.0	–	29.0	29.0	–	29.0

The Company has one class of ordinary share which carries no right to fixed income. The holders of ordinary shares are entitled to receive dividends as declared and are entitled to one vote per share at meetings of the Company.

Other reserves

	2018			2017		
	Underlying £m	**BTL £m**	**Total £m**	Underlying £m	BTL £m	Total £m
Share premium	100.0	–	100.0	100.0	–	100.0
Cash flow hedge reserve	(138.9)	–	(138.9)	(222.4)	–	(222.4)
Revaluation reserve	1,021.2	–	1,021.2	1,053.1	–	1,053.1
Retained earnings	2,080.6	55.5	2,136.1	1,933.5	30.6	1,964.1
Total	3,062.9	55.5	3,118.4	2,864.2	30.6	2,894.8

The revaluation reserve reflects the revaluation of infrastructure assets to fair value on transition to IFRS, net of deferred tax.

The cash flow hedge reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

24. Retirement benefit obligations

Background

The Company operates two defined benefit pension schemes and a defined contribution pension scheme.

	What are they?	How do they impact the Company's financial statements?
Defined Contribution Scheme This scheme was set up in April 2011, is managed through Standard Life, and is open to all new employees of the Company.	In a defined contribution pension scheme the benefits are linked to: ▸ contributions paid; ▸ the performance of the individual's chosen investments; and ▸ the form of benefits	A charge of £8.1 million (2017: £6.8 million) was recognised in the income statement relating to the contributions payable by the Company based upon a fixed percentage of employees' pay. There were £1.1 million (2017: £0.9 million) of outstanding contributions at the year-end recognised in the statement of financial position. These were paid in the following financial year. The Company has no exposure to investment and other experience risks.
Defined Benefit Schemes Defined benefit arrangements for the Company's eligible employees are provided through two defined benefit pension schemes: ▸ Thames Water Pension Scheme ("TWPS"); and ▸ Thames Water Mirror Image Pension Scheme ("TWMIPS"). Both are career average pension schemes. Their assets are held separately from the rest of the Kemble Water Holdings Limited Group in funds in the United Kingdom which are independently administered by the Pension Trustees. TWMIPS has been closed to new entrants since 1989 and on 1 April 2011 TWPS closed to new entrants, who now join the defined contribution scheme.	In a defined benefit pension scheme the benefits: ▸ are defined by the scheme rules ▸ depend on a number of factors including age, years of service and pensionable pay; and ▸ do not depend on contributions made by the members or the Company	A charge was recognised in the income statement of £37.0 million (2017: £30.2 million) relating to the following: ▸ service cost representing the increase in the defined benefit liability arising from pension benefits earned by active members in the current period; ▸ administrative expenses for the pension schemes; ▸ the net interest expense on pension scheme assets and liabilities; and ▸ the effect of restriction in the surplus. A gain of £74.0 million (2017: loss of £151.2 million) on the value of the pension scheme was recognised in the statement of other comprehensive income. This reflects the impact of changes in financial assumptions and the demographic of the scheme members when compared with those at the start of the year, as well as the return on the schemes' assets over and above the amount included in the net interest expense. The net pension liability of £300.8 million (2017: £379.8 million) is recognised in the statement of financial position. The Company is exposed to investment and other experience risks. Where it is estimated that the benefits will not be met by regular contributions, assets held or expected investment income, additional contributions are being made by the Company.

In addition to the cost of the defined benefit pension arrangements, the Company operates arrangements under which it augments benefits on retirement in certain cases of redundancy. These augmentations are funded by way of additional employer contributions to the schemes. In the year to 31 March 2018 these related payments amounted to £0.5 million (2017: £0.5 million).

The defined benefit pension schemes are subject to a full actuarial valuation every three years using assumptions agreed between the Trustees of the pension schemes and the Company. The purpose of this triennial valuation is to evaluate and if necessary modify the funding plans of the pension schemes to ensure have sufficient funds to meet future benefit payments. The most recent full actuarial valuation of the defined benefit pension schemes was carried out at 31 March 2016 on behalf of the Trustees by David Gardiner of Aon Hewitt Limited, the independent and professionally qualified consulting actuary to the schemes. This resulted in a combined funding deficit across the two schemes of £364.9 million (2013: £288.3 million) with the market value of the assets being £1,905.5 million (2013: £1,699.8 million).

This funding valuation is different from the accounting valuation presented in the financial statements due to the use of different assumptions and changes in market conditions from 31 March 2016 to 31 March 2018. The 2016 funding valuation has been updated to an accounting valuation as at 31 March 2018 by Hymans Robertson LLP, an independent and professionally qualified consulting actuary, using revised assumptions that are consistent with the requirements of IAS 19 Employee Benefits and shown in this note to the financial statements.

Amounts recognised in the financial statements

Income Statement

The amounts recognised in the income statement with respect to the defined benefit pension schemes are detailed below:

	2018		2017	
	TWPS £m	TWMIPS £m	TWPS £m	TWMIPS £m
Current service cost	19.4	3.8	13.9	3.0
Scheme administration expenses	2.7	1.2	3.4	1.1
Effect of restriction of surplus	–	0.9	–	2.7
Net interest cost/(income)	9.5	(0.5)	8.2	(2.1)
Total	31.6	5.4	25.5	4.7

The net expense is recognised in the following captions within the income statement:

	2018		2017	
	TWPS £m	TWMIPS £m	TWPS £m	TWMIPS £m
Operating expenses	22.1	5.9	17.3	6.8
Net finance expense/(income)	9.5	(0.5)	8.2	(2.1)
Total	31.6	5.4	25.5	4.7

Statement of other comprehensive income

Actuarial gains and losses on the defined benefit schemes have been recognised within other comprehensive income. An analysis of the amount presented is set out below:

	2018 £m	2017 £m
Actual return less expected return on pension scheme assets	2.7	304.0
Experience (loss)/gain arising on scheme liabilities	(10.9)	28.7
Gain/(loss) arising due to change in assumptions	95.2	(526.0)
Change in asset ceiling	(13.0)	42.1
Total actuarial gain/(loss)	**74.0**	**(151.2)**
Cumulative actuarial losses recognised	(484.7)	(558.7)

Statement of financial position

The net pension liability recognised within the statement of financial position is as follows:

	2018			2017		
	TWPS £m	TWMIPS £m	Total £m	TWPS £m	TWMIPS £m	Total £m
Fair value of scheme assets	1,442.9	805.6	2,248.5	1,411.4	828.5	2,239.9
Present value of defined benefit obligations	(1,743.7)	(755.0)	(2,498.7)	(1,776.2)	(806.8)	(2,583.0)
(Deficit)/surplus	(300.8)	50.6	(250.2)	(364.8)	21.7	(343.1)
Effect of asset limit	–	(50.6)	(50.6)	–	(36.7)	(36.7)
Retirement benefit obligations	**(300.8)**	**–**	**(300.8)**	**(364.8)**	**(15.0)**	**(379.8)**

IFRIC 14 considerations

For some defined benefit pension schemes IFRIC 14: *The limit on a defined benefit asset, minimum funding requirements and their interaction* potentially limits the surplus that can be recognised on the balance sheet or requires additional liabilities to be recognised where future deficit contributions are greater than the unadjusted accounting deficit.

The Directors have reviewed the scheme rules of the defined benefit pension schemes and have concluded that, for the TWMIPS scheme, as the Company does not have an unconditional right to a refund of any surplus, including as a deduction to future contributions payable, the provisions of IFRIC 14 apply. Consequently the surplus for this scheme has been restricted with an obligation recognised for the present value of deficit funding contributions payable to the scheme.

24. Retirement benefit obligations continued

Reconciliation of defined benefit plan assets and liabilities

The movement in the present value of the defined benefit obligations were as follows:

	2018		2017	
	TWPS £m	**TWMIPS £m**	TWPS £m	TWMIPS £m
At 1 April	**1,776.2**	**806.8**	1,385.1	694.8
Current service cost	**19.4**	**3.8**	13.9	3.0
Interest cost	**46.4**	**20.1**	50.0	23.7
Contributions from scheme members	**0.4**	**–**	0.1	–
Benefits paid	**(52.8)**	**(37.8)**	(45.5)	(39.9)
Termination benefits	**0.5**	**–**	0.5	–
Actuarial (gains)/losses	**(46.4)**	**(37.9)**	372.1	125.2
At 31 March	**1,743.7**	**755.0**	1,776.2	806.8

The movements in the fair value of scheme assets were as follows:

	2018		2017	
	TWPS £m	**TWMIPS £m**	TWPS £m	TWMIPS £m
At 1 April	**1,411.4**	**828.5**	1,142.8	753.2
Interest income on scheme assets	**36.9**	**20.6**	41.8	25.8
Contributions by sponsoring employers	**41.3**	**0.7**	51.6	10.0
Contributions from scheme members	**0.4**	**–**	0.1	–
Administration costs paid from scheme assets	**(2.7)**	**(1.2)**	(3.4)	(1.1)
Benefits paid	**(52.8)**	**(37.8)**	(45.5)	(39.9)
Contributions for termination benefits	**0.5**	**–**	0.5	–
Gains/(losses) on assets above interest	**7.9**	**(5.2)**	223.5	80.5
At 31 March	**1,442.9**	**805.6**	1,411.4	828.5

Analysis of assets

	2018				2017			
	Quoted £m	**Unquoted £m**	**Total £m**	**Total %**	Quoted £m	Unquoted £m	Total £m	Total %
Equities								
UK	**34.8**	**–**	**34.8**	**1.5**	29.6	–	29.6	1.3
Rest of World	**344.0**	**1.8**	**345.8**	**15.4**	338.2	–	338.2	15.1
Private Equity	**–**	**1.1**	**1.1**	**0.0**	–	34.3	34.3	1.5
Bonds								
Government – UK	**34.8**	**–**	**34.8**	**1.5**	92.5	–	92.5	4.1
Government – Rest of World	**195.3**	**–**	**195.3**	**8.7**	112.7	–	112.7	5.0
Corporates – UK	**9.4**	**–**	**9.4**	**0.4**	9.4	–	9.4	0.4
Corporates – Rest of World	**193.6**	**–**	**193.6**	**8.6**	216.4	–	216.4	9.7
Property								
UK	**5.7**	**103.4**	**109.1**	**4.9**	9.2	106.5	115.7	5.2
Rest of world	**3.9**	**–**	**3.9**	**0.2**	4.2	–	4.2	0.2
Alternative assets								
Liability driven instruments	**1,105.5**	**–**	**1,105.5**	**49.2**	1,102.9	–	1,102.9	49.2
Other (including derivatives)	**106.5**	**3.1**	**109.6**	**4.9**	61.8	4.0	65.8	2.9
Cash	**105.6**	**–**	**105.6**	**4.7**	118.2	–	118.2	5.3
Total market value of assets	**2,139.1**	**109.4**	**2,248.5**	**100.0**	2,095.1	144.8	2,239.9	100.0

The assets of the defined benefit schemes do not include any directly held shares issued by the Company or property occupied by the Company.

The Pension Trustees determine the investment strategy of the defined benefit pension schemes after taking advice from their investment advisor, Willis Towers Watson. 49.2% of the scheme assets are invested in Liability Driven Investment ("LDI") portfolios managed by Schroder Investment Management Limited. These use government bonds and derivative instruments such as interest rate swaps, inflation swaps and gilt repurchase transactions to hedge the impact of interest rate and inflation movements on the long-term liabilities of the schemes.

Under the LDI strategies, if interest rates fall the value of investments rises to help match the increase in actuarial liabilities arising from the resulting fall in discount rate. Similarly if interest rates rise, the value of the LDI investments will fall, as will the liabilities, as a result of the increase in the discount rate. Interest rates and inflation risks are not fully matched by the LDI portfolios, representing the residual interest rate and inflation risk to which the schemes remain exposed.

The credit risk arising on the derivatives held in the LDI mandate depends on whether the derivative is traded on an exchange or over the counter ("OTC"). OTC derivative contracts are not guaranteed by any regulated exchange and therefore the schemes are subject to risk of failure of the counterparty. The credit risk for OTC swaps held in the LDI portfolio is reduced by collateral arrangements and the counterparty exposure of each scheme is appropriately diversified and within the limits specified by the Investment Association.

IAS 19 Assumptions

The approach used to set the IAS 19 assumptions is detailed below:

	Approach to set the assumptions
Discount rate	As per IAS 19, the discount rate is determined using the market yields on high quality corporate bonds as at the reporting date with the currency and term of these bonds being consistent with the currency and term of the pension liabilities. The TWPS and TWMIPS discount rate is calculated by applying the projected cash flows of these schemes to an AA-corporate bond yield curve as at 31 March 2018.
RPI inflation	The RPI inflation assumption uses the inflation curve weighted by projected future cash flows of TWPS and TWMIPS with an adjustment made for an inflation risk premium.
CPI inflation	This CPI inflation assumption is taken at a margin below RPI factoring in market forces and third party estimates of the difference expected.
Salary increases	Both defined benefit schemes provide benefits on a Career Average ("CARE") benefit structure whereby past entitlements are linked to movements in CPI therefore an assumption for increase in salary is not required.
Pension increases	It is assumed that benefits will increase in line with the RPI and CPI inflation assumptions detailed above, based on the appropriate index for increasing benefits.
Longevity	The mortality assumptions are based on standard mortality tables and the recent actual mortality experience of members within the schemes. The assumptions also allow for future improvements to mortality rates.

The main assumptions used in the valuation of these schemes are as follows:

	2018		2017	
	TWPS	**TWMIPS**	TWPS	TWMIPS)
Price inflation – RPI	**3.15%**	**3.15%**	3.35%	3.30%
Price inflation – CPI	**2.15%**	**2.15%**	2.35%	2.30%
Rate of increase to pensions in payment – RPI	**3.15%**	**3.15%**	3.35%	3.30%
Rate of increase to pensions in payment – CPI	**2.15%**	**2.15%**	2.35%	2.30%
Discount rate	**2.65%**	**2.60%**	2.65%	2.55%

	2018		2017	
	TWPS Years	**TWMIPS Years**	TWPS Years	TWMIPS Years
Life expectancy from age 60				
Male	**27.4**	**26.6**	27.9	26.9
Female	**29.4**	**29.0**	29.4	29.3
Life expectancy from age 60 currently age 40				
Male	**29.0**	**28.1**	29.8	28.8
Female	**31.0**	**30.6**	31.4	31.3

24. Retirement benefit obligations continued

Actuarial risk factors

The schemes are exposed to actuarial risks including investment risk, inflation risk and longevity risk.

	Definition of risk
Investment risk	Assumptions are made about the returns expected from the schemes' investments. If the investments underperform these assumptions in the long term then additional contributions will need to be made to the schemes in order to fund the payment of future benefits.
Discount rate risk	A fall in AA-rated corporate bond yields, which are used to set the discount rate, will increase the value of the scheme's liabilities. This may be partially offset by an increase in the value of the scheme's bond holdings.
Inflation risk	The benefits payable to the members of the schemes are linked to inflation and as such higher inflation will lead to higher liabilities. Additionally, the Company's contributions to the schemes are based on assumptions about the future levels of inflation. Therefore an increase in inflation above that assumed in the actuarial calculations will create a deficit.
Longevity risk	An increase in the life expectancy of scheme members will result in benefits being paid out for longer, leading to an increase in the defined benefit schemes' liabilities.

The sensitivity of the present value of scheme liabilities (reduction/(increase)) to changes in the principal assumptions used is set out below:

	2018		2017	
	TWPS £m	**TWMIPS £m**	TWPS £m	TWMIPS £m
Change in discount rate (+ 1% p.a.)	**315.0**	**90.0**	380.0	120.0
Change in rate of inflation (- 1% p.a.)	**205.0**	**75.0**	280.0	80.0
Change in life expectancy (- 1 year)	**70.0**	**30.0**	50.0	25.0

Future expected cash flows

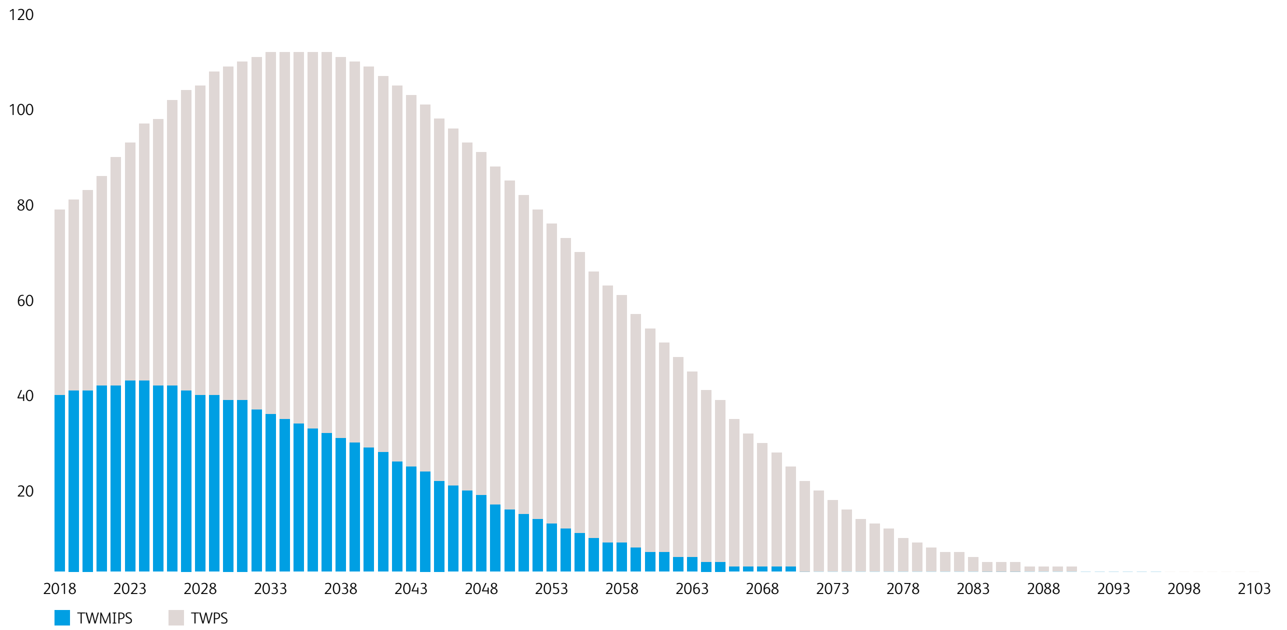
The Company made a pension deficit repair payment of £22.0 million during March 2018 in relation to 2017/18 having made a similar payment of £20.8 million on 31 March 2017 in relation to 2016/17. The Company expects to contribute approximately £42.0 million in aggregate to the defined benefit pension schemes in the next financial year. The average duration of the benefit obligation at the end of the year is 20 years for TWPS and 13 years for TWMIPS (2017: 20 years for TWPS and 13 years for TWMIPS).

In June 2017, the funding valuation as at 31 March 2016 was finalised and agreed with the scheme Trustees and actuaries. In order to address the combined funding deficit the Company is scheduled to make future deficit repair payments in line with the table below:

Year to 31 March	2019	2020	2021	2022	2023	2024	2025	2026	2027
Deficit contribution (£m)	22.6	22.8	23.1	23.3	23.5	23.7	24.0	24.2	17.9

The expected cash flows payable from the schemes are presented in the graph below:

Expected benefit payments (£ millions)



The expected cash flows are undiscounted liability cash flows based on the funding valuation as at 31 March 2016. The future cash flows are sensitive to the assumptions used and therefore actual cash flows may differ from those expected.

25. Capital commitments

	2018 £m	2017 £m
Contracted for but not provided	**392.5**	305.6

In addition to these commitments, the Company has long-term capital investment plans, under its business plan submitted to Ofwat, to provide for future growth and maintenance of the infrastructure network.

26. Contingent liabilities

Contingent liabilities represent potential future cash outflows which are either not probable or cannot be measured reliably.

The Company needs to determine the merit of any litigation against it and the chances of a claim successfully being made, the likelihood of an outflow of economic benefits occurring and whether there is a need to disclose a contingent liability or whether a provision is required based on this assessment.

There are claims against the Company arising in the normal course of business, which are in the process of negotiation. Judgement is required in measuring and recognising provisions related to pending litigation or other outstanding claims that are subject to negotiated settlement or Court assessment. This includes evaluating the likelihood that an outstanding claim will succeed and to quantify the possible range of any financial settlement and outflow of economic benefits.

The Directors have undertaken such an assessment and based on the outcome has set aside amounts considered appropriate for all legal and similar claims. However because of the inherent uncertainty in this evaluation process, there is always a possibility that actual losses may be materially different from the originally estimated provision.

27. Operating leases

Lease payments under operating leases of £10.8 million (2017: £16.1 million) were recognised as an expense in the year.

At the balance sheet date, the group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2018 £m	Restated 2017 £m
Within one year	**10.0**	10.4
Between one and five years	**34.6**	38.0
After more than five years	**67.0**	73.7
Total	**111.6**	122.1

Operating lease payments represent rentals payable by the Company for certain office properties, and plant and equipment. Where the Company has the ability and intent to exit a property lease prior to the term end date and it is probable that this option will be exercised, we have only included lease payments up to the assumed lease exit date.

The Company's project to prepare for adopting IFRS 16 Leases has initiated a comprehensive review of all lease arrangements and how these should be disclosed within this lease commitment note. This review included a wide-ranging search of all leases and highlighted certain properties that were omitted from the disclosed commitments in the prior year. The comparatives have been restated by £25.8 million from £96.3 million to £122.1 million.

28. Off-balance sheet arrangements

The Company is party to a number of contractual arrangements for the purposes of its principal activities that are not required to be included within the statement of financial position. These are:

- operating leases;
- outsourcing contracts; and
- guarantees.

In respect of outsourcing contracts, the Company has entered into various arrangements to outsource the provision of certain back-office and operational functions with third party providers. These outsourced arrangements include aspects such as legal services, metering and capital delivery. These arrangements are on commercial terms and no associated penalty or termination clauses will have a material effect on the financial position of the Company.

The Company is part of a whole business securitisation group. Thames Water Utilities Holdings Limited, Thames Water Utilities Limited and its direct subsidiaries are Obligators under the whole business securitisation entered into in 2007. The Obligators have all entered into a Security Trust and Inter-creditor Deed. Under this document each Obligator will guarantee the obligations of each other Obligator with their future cash flows. The guaranteed debt as at 31 March 2018 was £11.2 billion (2017: £10.6 billion).

29. Statement of cash flows

Reconciliation of operating profit to operating cash flows

	2018			2017		
	Underlying £m	**BTL £m**	**Total £m**	Underlying £m	BTL £m	Total £m
Profit for the financial year	108.8	24.9	133.7	108.4	30.8	139.2
Less profit on sale of retail non-household business	(89.7)	–	(89.7)			
Less finance income	(102.9)	–	(102.9)	(94.5)	–	(94.5)
Add finance expense	538.6	–	538.6	456.3	–	456.3
Add net losses on financial instruments	46.7	–	46.7	205.5	–	205.5
Add/(less) taxation on profit on ordinary activities	15.5	1.6	17.1	(70.3)	2.2	(68.1)
Operating profit	517.0	26.5	543.5	605.4	33.0	638.4
Depreciation on property, plant and equipment	498.7	–	498.7	492.0	–	492.0
Amortisation of intangible assets	27.5	–	27.5	25.0	–	25.0
Write-off of costs from assets in development	–	–	–	3.1	–	3.1
Profit on sale of property, plant and equipment	(11.4)	–	(11.4)	(4.1)	–	(4.1)
Difference between pension charge and cash contribution	(14.0)	–	(14.0)	(37.5)	–	(37.5)
Decrease/(increase) in inventory	3.6	–	3.6	(0.9)	–	(0.9)
Decrease/(increase) in trade and other receivables	19.7	(28.7)	(9.0)	(72.5)	(32.9)	(105.4)
Increase in trade and other payables	43.2	3.2	46.4	20.6	3.7	24.3
Decrease in group relief payable	(18.6)	(2.2)	(20.8)	–	–	–
(Decrease)/increase in provisions	(1.2)	–	(1.2)	14.9	–	14.9
Cash generated from/(used in) operations	1,064.5	(1.2)	1,063.3	1,046.0	3.8	1,049.8)

No additions to property, plant and equipment during the year, or the immediately preceding year, were financed through new finance leases. Assets transferred from developers and customers for nil consideration were recognised at their fair value.

Movement in cash and cash equivalents

	2018 £m	2017 £m
Unrestricted cash movement	(1.6)	3.7
Movement in short-term deposits	52.1	(469.7)
Total	50.5	(466.0)

30. Related party transactions

Details of transactions with associated companies as required by Ofwat's regulatory accounting guidelines can be also found under the 'supply of trade' disclosure in the Annual Performance Report section on pages 222–224.

Trading transactions

	2018		2017	
	Services provided by the Company £'000	**Services provided to the Company £'000**	Services provided by the Company £'000	Services provided to the Company £'000
Intermediaries between the immediate and ultimate parent				
Thames Water Limited	2,163	1,129	1,606	82
Immediate parent				
Thames Water Utilities Holdings Limited	16,627	59,300	19,736	166,708
Subsidiaries				
Thames Water Utilities Cayman Finance Limited	1,551	309,936	1,607	284,006
Thames Water Utilities Finance Limited	5,015	167,270	5,271	112,759
Other entities within the Kemble Water Holdings group				
Kennet Properties Limited	120	14	33	8
Thames Water Commercial Services Limited	403	–	1,401	–
Thames Water Property Services Limited	364	451	29	334
Entities external to the Kemble Water Holdings group				
Dunelm Energy Limited	–	4	–	–
Total	26,243	538,104	29,683	563,897

The related party transactions were made on terms equivalent to those that prevail in arm's length transactions.

As at 31 March 2017, the Macquarie Group held a 26.3% shareholding in the Kemble Water Holdings ("KWH") Group and qualified as an entity related to the KWH Group. During the year ended 31 March 2018, the Macquarie Group sold their entire shareholding in the Group and therefore ceased to be a related party. During the year ended 31 March 2018 Macquarie Infrastructure and Real Assets (Europe) Limited, a wholly owned member of the Macquarie Group, provided Thames Water Utilities Limited with advisory services of £0.7 million (2017: £3.6 million).

Outstanding balances

The following amounts were owed to the Company from related entities, and owed to related entities by the Company at the balance sheet date:

	2018		2017	
	Amounts owed to the Company £'000	**Amounts owed by the Company £'000**	Amounts owed to the Company £'000	Amounts owed by the Company £'000
Ultimate parent				
Kemble Water Holdings Limited	5	–	5	–
Intermediaries between the immediate and ultimate parent				
Kemble Water Finance Limited	1,014	–	964	–
Thames Water Limited	121	–	18	1,081
Immediate parent				
Thames Water Utilities Holdings Limited	1,974,745	4,300	1,981,971	20,600
Subsidiaries				
Thames Water Utilities Cayman Finance Limited	104,844	6,203,362	162,788	6,084,372
Thames Water Utilities Finance Limited	214,455	2,961,960	221,156	2,900,055
Other entities within the Kemble Water Holdings group				
Kennet Properties Limited	79	–	–	–
Thames Water Property Services Limited	24	–	–	–
Total	2,295,287	9,169,622	2,366,902	9,006,108

The amounts outstanding are unsecured and will be settled in cash. No guarantees have been given or received. No provisions have been made for doubtful debts in respect of the amounts owed by related parties.

30. Related party transactions continued

Key management personnel

Key management personnel comprise the members of the Board and 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 Remuneration Committee Report on pages 112–125.

	2018 £'000	2017 £'000
Fees	837	819
Salary	2,541	2,162
Pension and pension allowance	365	333
Bonus	2,055	256
Long-term incentive plan	–	530
Payment on loss of office	222	1,583
Redundancy	–	520
Other benefits	987	529
Total	7,007	6,732

Information regarding transactions with post-employment benefits plans is included in note 24.

31. Intermediate and ultimate parent Company and controlling party

Thames Water Utilities Holdings Limited, a company incorporated in the United Kingdom, is the immediate parent company. Kemble Water Finance Limited, a company incorporated in the United Kingdom, is an intermediate parent company and is the smallest group to consolidate these financial statements. The Directors consider that Kemble Water Holdings Limited, a company incorporated in the United Kingdom, is the ultimate and controlling party and the largest group to consolidate these financial statements.

The address of the registered office of Thames Water Utilities Holdings Limited, Kemble Water Finance Limited and Kemble Water Holdings Limited is Clearwater Court, Vastern Road, Reading, Berkshire, RG1 8DB. Copies of the accounts for all entities may be obtained from The Company Secretary's Office at this address.

Regulatory accounts

Contents

Our regulatory accounts and related information, as required by Ofwat, are set out on pages 181–239 and comprise:

- A reconciliation from our statutory financial statements to our regulatory accounts position (section 1);
- Accounting policies stating the basis on which the regulatory accounts have been prepared;
- A summary of our regulatory accounts by price control (section 2);
- A summary of our performance against our 55 performance commitments (section 3);
- Additional regulatory information (section 4);
- A summary of transactions with associated companies;
- Our F6A statement;
- Our risk and compliance statement; and
- Our data assurance summary.

Sections 1 and 2 have been audited by our external auditors, KPMG, with the exception of 1F. Sections 3 and 4 and the related information have been subject to independent review and assurance by our external auditors KPMG. Their audit opinion on our regulatory accounts is included on pages 234–236.

Regulatory accounts and additional information

The regulatory accounts and additional information which form part of this Annual Performance Report ("APR") are disclosed on pages 183–233 and are provided to comply with Condition F of the Instrument of Appointment ("licence") of Thames Water Utilities Limited (the "Company") as a water and sewerage undertaker under the Water Industry Act 1991. Our licence can be found on the Ofwat website at: https://www.ofwat.gov.uk/wp-content/uploads/2015/10/lic_lic_tms.pdf.

The regulatory accounts are prepared in accordance with the Regulatory Accounting Guidelines ("RAGs") issued by Ofwat, which are based on International Financial Reporting Standards ("IFRS"), International Accounting Standards ("IAS") and International Financial Reporting Interpretations Committee ("IFRIC") interpretations issued, as ratified by the European Union.

Where different treatments are specified by Ofwat, the Regulatory Accounting Guidelines take precedence.

A glossary of regulatory terms is shown on pages 237–238.

The APR, including the regulatory accounts and additional information, should be read in conjunction with the statutory Annual Report and Financial Statements ("AR&FS") for the year ended 31 March 2018, which can be found on pages 1–180. The AR&FS include disclosures which are relevant to the regulatory accounts including but not limited to those made in the:

- Strategic Report for the year ended 31 March 2018 (pages 1–82) which contains information in respect of the Company's strategy, operational and financial performance and principal risks and uncertainties to which the business is exposed;
- Directors' Report (pages 129–132), which contains a statement as to the disclosure of information to the auditor (page 131);
- Remuneration Committee Report (pages 112–128) which provides a description of the link between Directors' pay and standards of performance (as required by section 35A of the Water Industry Act 1991 (inserted into that Act by section 50 of the Water Act 2003). The Remuneration Committee Report also includes reference to rewards and incentives for senior management, including the Executive Team; and
- Corporate Governance report (pages 83–128).

Definitions of appointed and non-appointed business

The appointed business comprises the regulated activities of the Company as defined in Condition A of its licence of appointment. These are activities necessary in order for a company to fulfil the function and duties of a water and sewerage undertaker under the Water Industry Act 1991.

In addition to its duties as an appointed business, the Company also undertakes certain non-appointed activities. All of these activities are conducted on an arm's lengths basis from the appointed business. These activities include third-party discharges to sewage treatment works and other commercial activities including property searches and cess treatment (treatment of waste from private receptacles not linked to our network). The results of the non-appointed business include charitable donations. These donations are considered to be made out of shareholder interests and are not funded by customers.

Statement of Directors' responsibilities for regulatory information

Further to the requirements of Company law, the Directors are required to prepare financial statements which comply with the requirements of Condition F of the Instrument of Appointment of the Company as a water and sewerage undertaker under the Water Industry Act 1991 and Regulatory Accounting Guidelines issued by Ofwat.

This requires the Directors to:

- confirm that, in their opinion, the Company has sufficient financial resources and facilities, management resources and systems of planning and internal control for the next 12 months;
- confirm that, in their opinion, the Company has sufficient rights and assets to enable a special administrator to manage the affairs, business and property of the Company;
- confirm that, in their opinion, the Company has contracts with any associate company with the necessary provisions and requirements concerning the standard of service to be supplied to ensure compliance with the Company's obligations as a water and sewerage undertaker;
- report to Ofwat changes in the Company's activities, which may be material in relation to the Company's ability to finance its regulated activities;

- undertake transactions entered into by the appointed business, with or for the benefit of associated companies or other businesses or activities of the appointed business, at arm's length; and
- keep proper accounting records, which comply with Condition F and RAG 5.07.

These responsibilities are additional to those already set out in the statutory accounts. For further details of the additional responsibilities refer to the Directors' Certificate under condition F6A on page 225–227 and the Risk and Compliance Statement on pages 228–232.

Condition K: Ring fencing and disposal of land

Paragraph 3.1 of Condition K of the Instrument of Appointment requires that the Company shall at all times ensure, so far as reasonably practicable, that if a special administration order were made in respect of the Company, the Company would have available to it sufficient rights and assets (other than financial resources) to enable the special administrator to manage the affairs, business and property of the Company so that the purposes of such an order could be achieved.

In the opinion of the Directors, the Company was in compliance with paragraph 3.1 of Condition K of the Instrument of Appointment throughout the year and to the date of signing of this APR.

Additional information required by the Licence

The regulatory accounts are separate from the statutory accounts of the Company and have also been prepared on a going concern basis. The regulatory accounts have been prepared in compliance with the following RAGs:

- RAG 1.08 – Principles and guidelines for regulatory reporting under the 'new UK GAAP' regime;
- RAG 2.07 – Guideline for classification of costs across the price controls;
- RAG 3.10 – Guideline for the format and disclosures for the APR;
- RAG 4.07 – Guideline for the table definitions in the APR; and
- RAG 5.07 – Guideline for transfer pricing in the water and sewerage sectors.

Disclosure of information to the auditor

The Directors who held office at the date of approval of this report confirm that:

- so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware; and
- each Director has taken all the steps that they ought to have taken as a Director to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of the information.

Viability statement

The viability statement can be found on pages 79–82.

Tax strategy

The Company's aim is to be clear and transparent about its approach to tax and its tax profile. The Company's tax strategy has five key principles, which are unchanged from 2016/17:

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

You can find more detail on our tax strategy on our website at: www.thameswater.co.uk/ourtaxesexplained.

Cost assessment

The Company has chosen to publish the 2017/18 cost assessment tables 4J – 4W, as a separate document to the APR as per RAG 3.10. These tables have been prepared in accordance with the RAGs and are to be read in conjunction with the APR. You can view these tables on our website at: www.thameswater.co.uk/annualresults

1A. Income statement

For the year ended 31 March 2018

This table takes the information from the statutory income statement on page 137 and shows the adjustments made in order to arrive at the regulatory income statement for the appointed business. The adjustments include both differences between IFRS and the RAGs and the removal of non-appointed income and costs.

	Statutory £m	Differences between statutory and RAG definitions £m	Non-appointed £m	**Total adjustments £m**	**Total appointed activities £m**
Revenue	2,044.9	26.5	51.3	(24.8)	2,020.1
Operating costs	(1,595.5)	(15.9)	(12.7)	(3.2)	(1,598.7)
Other operating income	94.1	9.2	0.8	8.4	102.5
Operating profit	543.5	19.8	39.4	(19.6)	523.9
Other income	89.7	(18.1)	0.3	(18.4)	71.3
Interest income	102.9	–	–	–	102.9
Interest expense	(538.6)	(91.7)	–	(91.7)	(630.3)
Other interest expense	–	(9.0)	–	(9.0)	(9.0)
Profit before tax and fair value movements	197.5	(99.0)	39.7	(138.7)	58.8
Fair value losses on financial instruments	(46.7)	–	–	–	(46.7)
Profit before tax	150.8	(99.0)	39.7	(138.7)	12.1
UK Corporation tax	(4.3)	–	(2.4)	2.4	(1.9)
Deferred tax	(12.8)	–	(0.6)	0.6	(12.2)
Profit for the year	133.7	(99.0)	36.7	(135.7)	(2.0)
Dividends	(55.0)	–	(11.6)	11.6	(43.4)
Tax analysis					
Current Year	4.3	–	2.4	(2.4)	1.9
Adjustments in respect of prior years	–	–	–	–	–
UK Corporation tax	4.3	–	2.4	(2.4)	1.9

Analysis of non-appointed revenue	**£m**
Imported sludge	–
Tankered waste	5.1
Other non-appointed revenue	46.2
Revenue	51.3

Note: signage convention for non-appointed activities follows Ofwat guidance. Total adjustments comprise of the difference between statutory and RAG definitions and removal of non-appointed activities.

Explanation of reconciling items:

Adjustments are made to the statutory numbers to ensure compliance with the Ofwat guidance detailed in RAG 3.10 and RAG 4.07. The most significant include:

- reclassification of bad debt from revenue to operating costs;
- borrowing costs capitalised within fixed assets in the statutory accounts are recognised as interest expense for regulatory purposes. The associated depreciation of borrowing costs is recognised in operating costs; and
- reclassification of certain costs to align with regulatory presentation requirements.

Full reconcilliations of the differences between statutory and regulatory figures are provided on the following pages:

- Revenue – page 194
- Operating profit, other income and profit before tax – page 196.

Non-appointed activities include revenue in relation to Bazalgette Tunnel Limited ("BTL"). BTL is an independent company unrelated to Thames Water Utilities Limited, and was appointed in 2015 to construct the Thames Tideway Tunnel.

The arrangement with BTL means that the Company has included construction costs of the Thames Tideway Tunnel within its bills to wastewater customers during the year ended 31 March 2018. As cash is collected, these amounts are subsequently paid to BTL within a maximum of 50 business days under 'pay when paid' principle. Accounting standards and Ofwat guidance require the Company to present the amounts billed and any associated costs as non-appointed; this also gives rise to non-appointed profit which is taxable.

The dividend presented in the non-appointed column is a notional dividend moving the non-appointed profit, excluding profit related to BTL, to the appointed business. This is not an equity dividend and therefore has not been included in the 'equity dividend' line in table 1D.

1B. Statement of comprehensive income

For the year ended 31 March 2018

The statement of comprehensive income shows the changes to our statement of financial position reserves from the statutory accounts on page 138 adjusting for the differences between IFRS and the RAGs as well as removing the results of the non-appointed business.

	Statutory £m	Differences between statutory and RAG definitions £m	Non-appointed £m	**Total adjustments £m**	**Total appointed activities £m**
Profit/(loss) for the year	133.7	(99.0)	36.7	(135.7)	(2.0)
Actuarial gain on post-employment plans	74.0	–	–	–	74.0
Other comprehensive income	70.9	–	–	–	70.9
Total comprehensive income for the year	**278.6**	**(99.0)**	**36.7**	**(135.7)**	**142.9**

Note: Signage convention for non-appointed activities follows Ofwat guidance. Total adjustments comprise of the difference between statutory and RAG definitions.

1C. Statement of financial position

As at 31 March 2018

Table 1C takes the statement of financial position from the statutory accounts on page 139 and adjusts for the differences between IFRS and RAGs as well as removing the non-appointed business.

	Statutory £m	Differences between statutory and RAG definitions £m	Non-appointed £m	**Total adjustments £m**	**Total appointed activities £m**
Non-current assets					
Fixed assets	14,675.3	(361.1)	1.0	(362.1)	**14,313.2**
Intangible assets	168.6	(6.5)	–	(6.5)	**162.1**
Investments – loans to group companies	2,274.7	–	–	–	**2,274.7**
Investments – other	60.8	–	56.7	(56.7)	**4.1**
Financial instruments	59.3	–	–	–	**59.3**
Retirement benefit assets	–	–	–	–	**–**
	17,238.7	**(367.6)**	**57.7**	**(425.3)**	**16,813.4**
Current assets					
Inventories	18.1	–	–	–	**18.1**
Trade & other receivables	639.4	–	6.3	(6.3)	**633.1**
Financial instruments	–	–	–	–	**–**
Cash & cash equivalents	107.0	–	2.6	(2.6)	**104.4**
	764.5	**–**	**8.9**	**(8.9)**	**755.6**
Current liabilities					
Trade & other payables	(813.3)	(52.8)	(11.1)	(41.7)	**(855.0)**
Capex creditor	–	(141.1)	–	(141.1)	**(141.1)**
Borrowings	(320.2)	196.4	–	196.4	**(123.8)**
Financial instruments	(12.3)	12.3	–	12.3	**–**
Current tax liabilities	–	–	–	–	**–**
Provisions	–	(16.6)	–	(16.6)	**(16.6)**
	(1,145.8)	**(1.8)**	**(11.1)**	**9.3**	**(1,136.5)**
Net current liabilities	**(381.3)**	**(1.8)**	**(2.2)**	**0.4**	**(380.9)**
Non-current liabilities					
Trade & other payables	(446.0)	444.1	–	444.1	**(1.9)**
Borrowings	(11,123.0)	(222.6)	–	(222.6)	**(11,345.6)**
Financial instruments	(809.1)	204.8	–	204.8	**(604.3)**
Retirement benefit obligations	(300.8)	–	–	–	**(300.8)**
Provisions	(111.3)	–	–	–	**(111.3)**
Deferred income – grants & contributions	–	(337.2)	–	(337.2)	**(337.2)**
Deferred income – adopted assets	–	(89.1)	–	(89.1)	**(89.1)**
Preference share capital	–	–	–	–	**–**
Deferred tax	(919.8)	–	–	–	**(919.8)**
	(13,710.0)	**–**	**–**	**–**	**(13,710.0)**
Net assets	**3,147.4**	**(369.4)**	**55.5**	**(424.9)**	**2,722.5**
Equity					
Called up share capital	29.0	–	–	–	**29.0**
Retained earnings & other reserves	3,118.4	(369.4)	55.5	(424.9)	**2,693.5**
Total equity	**3,147.4**	**(369.4)**	**55.5**	**(424.9)**	**2,722.5**

Note: Signage convention for non-appointed activities follows Ofwat guidance. Total adjustments comprise of the difference between statutory and RAG definitions.

1C. Statement of financial position continued

Explanation of reconciling items:

Adjustments are made to the statutory numbers to ensure compliance with the Ofwat guidance detailed in RAG 3.10 and RAG 4.07. The most significant include:

- capitalised interest for borrowing costs is removed from fixed assets (£100.7 million less related depreciation of £3.2 million);
- capital creditors are disclosed separately;
- a reclassification is made from current borrowings to trade and other payables in respect of accrued interest (see below);
- a reclassification is made from financial instruments to non-current borrowings due to derivative financial liabilities (see below); and
- the non-appointed business shows retained earnings of £55.5 million relating to BTL.

Borrowings reconciliation

Please see the reconciliation below which outlines the differences between statutory and regulatory definitions of current and non-current borrowings.

	Appointed activities £m)
Current liabilities	
Current borrowings included in statutory accounts	320.2
Difference between statutory and regulatory definitions:	
Accrued interest taken to trade and other payables	(208.7)
Accretion moved to borrowings from financial instruments	12.3
Current borrowings included in regulatory accounts (per Table 1C)	123.8
Non-current liabilities	
Non-current borrowings included in statutory accounts:	11,123.0
Difference between statutory and regulatory definitions	
Accretion moved to borrowings from financial instruments	206.6
FX gains moved to borrowings from financial instruments	16.0
Non-current borrowings included in regulatory accounts (per Table 1C)	11,345.6
Total borrowings included in statutory accounts	11,443.2
Total borrowings included in regulatory accounts (per Tables 1C and 1E)	11,469.4

Financial derivatives reconciliation

Please see the reconciliation of financial derivatives below which outlines the differences between regulatory tables 1C Statement of financial position and 4I Financial derivatives.

	£m
Per Table 1C:	
Non-current assets – financial instruments	(59.3)
Current liabilities – financial instruments	–
Non-current liabilities – financial instruments	604.3
	545.0
Per Table 4I:	
Total financial derivatives – mark-to-market	527.2
Accrued interest	17.8
	545.0

1D. Statement of cashflows

For the year ended 31 March 2018

This table takes the information from the statement of cashflows from the statutory accounts on page 141 and adjusts for the differences between IFRS and the RAGs as well as removing the cash flows of the non-appointed business to show the cash flows of our regulated business.

	Statutory £m	Differences between statutory and RAG definitions £m	Non-appointed £m	**Total adjustments £m**	**Total appointed activities £m**
Operating profit	543.5	19.8	39.4	(19.6)	523.9
Other income	89.7	(18.1)	0.3	(18.4)	71.3
Depreciation	526.2	(3.2)	(0.3)	(2.9)	523.3
Amortisation – Grants & Contributions	–	–	–	–	–
Changes in working capital	(48.7)	1.9	(40.5)	42.4	(6.3)
Pension contributions	(14.0)	9.0	–	9.0	(5.0)
Movement in provisions	(1.2)	–	–	–	(1.2)
Profit on sale of fixed assets	(11.4)	–	–	–	(11.4)
Cash generated from operations	1,084.1	9.4	(1.1)	10.5	1,094.6
Net interest paid	(224.4)	(109.7)	–	(109.7)	(334.1)
Tax paid	(20.8)	–	–	–	(20.8)
Net cash generated from operating activities	838.9	(100.3)	(1.1)	(99.2)	739.7
Investing activities					
Capital expenditure	(1,163.2)	100.3	–	100.3	(1,062.9)
Grants & Contributions	–	–	–	–	–
Disposal of fixed assets	18.8	–	–	–	18.8
Other	1.0	–	–	–	1.0
Net cash used in investing activities	(1,143.4)	100.3	–	100.3	(1,043.1)
Net cash (used)/generated before financing activities	(304.5)	–	(1.1)	1.1	(303.4)
Cash flows from financing activities					
Equity dividends paid	(55.0)	–	–	–	(55.0)
Net loans received	410.0	–	–	–	410.0
Cash inflow from equity financing	–	–	–	–	–
Net cash generated from/(used in) financing activities	355.0	–	–	–	355.0
Increase in net cash	50.5	–	(1.1)	1.1	51.6

Explanation of reconciling items:

- the cash flow has been prepared to align with the regulatory reporting format. As a result the net cash position by activity (operating, investing and financing) does not agree to what has been presented in the statutory statement of cash flows;
- the difference is primarily due to the classification of all interest related balances including amounts capitalised in the statutory statement of financial position to the 'Net interest paid' category.

1E. Net debt analysis

As at 31 March 2018

Table 1E provides further breakdown of our borrowings and net debt (total borrowings less cash and cash equivalents) position at year end. For further information on how our gearing (debt to RCV) impacts our business, please see out financial flows metrics in table 1F on pages 189–192.

	Interest rate risk profile			
	Fixed rate £m	Floating rate £m	Index-linked £m	**Total £m**
Borrowings (excluding preference share capital)	5,681.1	93.4	5,694.9	**11,469.4**
Preference share capital				**–**
Total borrowings				**11,469.4**
Less cash				**(104.4)**
Short term deposits				**–**
Net debt				**11,365.0**
Gearing				**82.93%**
Adjusted gearing[1]				**81.30%**
Full year equivalent nominal interest cost	286.2	2.5	313.9	**602.6**
Full year equivalent cash interest payment	286.2	2.5	91.3	**380.0**
Indicative interest rates				
Indicative weighted average nominal interest rate	4.98 %	2.68 %	5.50 %	**5.22%**
Indicative weighted average cash interest rate	4.98 %	2.68 %	1.60 %	**3.28%**
Weighted average years to maturity	12.5	1.9	22.4	**17.3**

1 Adjusted gearing represents gearing on a covenant basis – this excludes certain balances owed to Kemble Water Holdings Limited Group companies from net debt.

The regulatory definition of short term deposits is all 'investments that are readily convertible into known amounts of cash'; this definition differs from short term deposits as disclosed in note 17 of our statutory accounts on page 160. In 2017/18, the Company has no investments that are readily convertible into known amounts of cash.

1F. Financial flows

The tables below show the various components of actual returns achieved for each financial year and the average for the past 3 years. The actual return has been benchmarked against the allowed return permitted under the regulatory regime. Commentary on the actual returns is contained in the Chief Financial Officer's statement.

Due to rounding, percentages and numbers presented in section 1F may not precisely reflect the absolute figures which have been calculated in accordance to Ofwat's methodology.

For the 12 months ended 31 March 2018

	(%)			(£m, 2012/13 real)		
	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
Return on regulatory equity	5.61%	2.52%	5.61%	250.3	112.7	112.7
Actual performance adjustment 2010–2015	0.01%	–	0.01%	0.3	0.1	0.1
Adjusted return on regulatory equity	5.62%	2.52%	5.62%	250.6	112.8	112.8
Regulatory equity base (£m, 2012/13 real)	4,464	4,464	2,010			
Financing						
Gearing	–	1.66%	3.69%	–	74.1	74.1
Variance in corporation tax	–	(0.15%)	(0.33%)	–	(6.6)	(6.6)
Group relief	–	0.10%	0.22%	–	4.5	4.5
Cost of debt	–	2.37%	6.99%	–	105.6	140.5
Hedging instruments	–	(0.39%)	(1.16%)	–	(17.5)	(23.3)
Sub total	5.62%	6.11%	15.03%	250.6	272.9	302.0
Operational performance						
Totex out/(under) performance	–	(1.65%)	(3.68%)	–	(73.9)	(73.9)
ODI out/(under) performance	–	(0.76%)	(1.69%)	–	(33.9)	(33.9)
Retail out/(under) performance	–	1.09%	2.43%	–	48.8	48.8
Sub Total	–	(1.32%)	(2.94%)	–	(59.0)	(59.0)
Total earnings	5.62%	4.79%	12.09%	250.6	213.9	243.0
RCV growth (due to inflation)	3.74%	3.74%	3.74%	167.1	167.1	75.2
Total shareholder return	9.36%	8.53%	15.83%	417.7	381.0	318.2
Net dividend	4.00%	0.87%	1.92%	178.6	38.6	38.6
Retained value	5.36%	7.66%	13.91%	239.1	342.4	279.6
Dividends reconciliation						
Gross dividend	4.00%	0.87%	1.92%	178.6	38.6	38.6
Interest receivable on Intercompany loans	–	–	–	–	–	–
Net dividend	4.00%	0.87%	1.92%	178.6	38.6	38.6

1F. Financial flows continued

For the 12 months ended 31 March 2017

	(%)			(£m, 2012/13 real)		
	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
Return on regulatory equity	5.62%	2.53%	5.62%	244.8	110.4	110.4
Actual performance adjustment 2010–2015	0.01%	–	0.01%	0.2	0.1	0.1
Adjusted return on regulatory equity	5.63%	2.53%	5.63%	245.0	110.5	110.5
Regulatory equity base (£m, 2012/13 real)	4,359	4,359	1,966			
Financing						
Gearing	–	1.66%	3.68%	–	72.4	72.4
Variance in corporation tax	–	(0.32%)	(0.71%)	–	(13.9)	(13.9)
Group relief	–	0.20%	0.44%	–	8.7	8.7
Cost of debt	–	0.71%	2.10%	–	31.0	41.2
Hedging instruments	–	(0.09%)	(0.26%)	–	(3.8)	(5.0)
Sub total	5.63%	4.69%	10.88%	245.0	204.9	213.9
Operational performance						
Totex out/(under) performance	–	(2.00%)	(4.42%)	–	(87.0)	(87.0)
ODI out/(under) performance	–	(0.34%)	(0.76%)	–	(15.0)	(15.0)
Retail out/(under) performance	–	(0.67%)	(1.48%)	–	(29.1)	(29.1)
Sub total	–	(3.01%)	(6.66%)	–	(131.1)	(131.1)
Total earnings	5.63%	1.68%	4.22%	245.0	73.8	82.8
RCV growth (due to inflation)	2.14%	2.14%	2.14%	93.4	93.4	42.1
Total shareholder return	7.77%	3.82%	6.36%	338.4	167.2	124.9
Net dividend	4.00%	2.31%	5.13%	174.3	100.8	100.8
Retained value	3.77%	1.51%	1.23%	164.1	66.4	24.1
Dividends reconciliation						
Gross dividend	4.00%	2.31%	5.13%	174.3	100.8	100.8
Interest receivable on intercompany loans	–	–	–	–	–	–
Net dividend	4.00%	2.31%	5.13%	174.3	100.8	100.8

1F. Financial flows continued
For the 12 months ended 31 March 2016

	(%)			(£m, 2012/13 real)		
	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
Return on regulatory equity	5.63%	2.66%	5.63%	238.2	112.8	112.8
Actual performance adjustment 2010–2015	0.01%	0.01%	0.01%	0.6	0.3	0.3
Adjusted return on regulatory equity	5.64%	2.67%	5.64%	238.8	113.1	113.1
Regulatory equity base (£m, 2012/13 real)	4,235	4,235	2,006			
Financing						
Gearing	–	1.60%	3.37%	–	67.7	67.7
Variance in corporation tax	–	(1.51%)	(3.19%)	–	(64.0)	(64.0)
Group relief	–	1.02%	2.14%	–	43.0	43.0
Cost of debt	–	(0.26%)	(0.72%)	–	(10.9)	(14.4)
Hedging instruments	–	–	–	–	–	–
Sub total	5.64%	3.52%	7.24%	238.8	148.9	145.4
Operational performance						
Totex out/(under) performance	–	(1.38%)	(2.91%)	–	(58.3)	(58.3)
ODI out/(under) performance	–	(0.31%)	(0.66%)	–	(13.3)	(13.3)
Retail out/(under) performance	–	(0.48%)	(1.01%)	–	(20.2)	(20.2)
Sub total	–	(2.17%)	(4.58%)	–	(91.8)	(91.8)
Total earnings	5.64%	1.35%	2.66%	238.8	57.1	53.6
RCV growth (due to inflation)	1.08%	1.08%	1.08%	45.6	45.6	21.6
Total shareholder return	6.72%	2.43%	3.74%	284.4	102.7	75.2
Net dividend	4.00%	1.01%	2.12%	169.4	42.5	42.5
Retained value	2.72%	1.42%	1.62%	115.0	60.2	32.7
Dividends reconciliation						
Gross dividend	4.00%	1.56%	3.29%	169.4	66.0	66.0
Interest receivable on intercompany loans	–	0.55%	1.17%	–	23.5	23.5
Net dividend	4.00%	1.01%	2.12%	169.4	42.5	42.5

1F. Financial flows continued

Average for AMP6

	(%)			(£m, 2012/13 real)		
	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
Return on regulatory equity	5.62%	2.57%	5.62%	244.5	112.0	112.0
Actual performance adjustment 2010–2015	0.01%	–	0.01%	0.4	0.2	0.2
Adjusted return on regulatory equity	5.63%	2.57%	5.63%	244.9	112.2	112.2
Regulatory equity base (£m, 2012/13 real)	4,353	4,353	1,994			
Financing						
Gearing	–	1.64%	3.58%	–	71.4	71.4
Variance in corporation tax	–	(0.65%)	(1.41%)	–	(28.2)	(28.2)
Group relief	–	0.43%	0.94%	–	18.7	18.7
Cost of debt	–	0.96%	2.80%	–	41.9	55.8
Hedging instruments	–	(0.16%)	(0.47%)	–	(7.1)	(9.4)
Sub total	5.63%	4.79%	11.07%	244.9	208.9	220.5
Operational performance						
Totex out/(under) performance	–	(1.68%)	(3.66%)	–	(73.0)	(73.0)
ODI out/(under) performance	–	(0.48%)	(1.04%)	–	(20.7)	(20.7)
Retail out/(under) performance	–	–	(0.01%)	–	(0.2)	(0.2)
Sub total	–	(2.16%)	(4.71%)	–	(93.9)	(93.9)
Total earnings	5.63%	2.63%	6.36%	244.9	115.0	126.6
RCV growth (due to inflation)	2.32%	2.32%	2.32%	101.0	101.0	46.3
Total shareholder return	7.95%	4.95%	8.68%	345.9	216.0	172.9
Net dividend	4.00%	1.39%	3.05%	174.1	60.7	60.7
Retained value	3.95%	3.56%	5.63%	171.8	155.3	112.2
Dividends reconciliation						
Gross dividend	4.00%	1.57%	3.44%	174.1	68.5	68.5
Interest receivable on intercompany loans	–	0.18%	0.39%	–	7.8	7.8
Net dividend	4.00%	1.39%	3.05%	174.1	60.7	60.7

Accounting policies

The regulatory accounts have been prepared in accordance with IFRS and the accounting policies detailed on pages 142–148, except for the areas required to differ by Ofwat as detailed in the RAGs. These areas with differing regulatory treatment, such as revenue recognition, capitalisation of interest and grants and contributions, are discussed further below.

Accounting policies for historical cost and current cost accounts

Basis of preparation

In accordance with Condition F of the Instrument of Appointment, these regulatory accounts set out on pages 183–233 have been prepared in order to show separately, in respect of the appointed business, non-appointed business and total business, an income statement, a statement of comprehensive income, a statement of financial position, and a statement of cash flows on the going concern basis, under the historical cost convention, as modified by the revaluation of certain financial assets and liabilities at fair value.

The policies applied in these regulatory accounts are based on IFRS, IAS and IFRIC interpretations issued and effective and ratified by the European Union as at 27 June 2018, the date that the Board of Directors approved the statements, except for:

- revenue recognition (IAS 18);
- grants and contributions (IFRIC 18); and
- capitalisation of borrowing costs (IAS 23).

These exceptions result from compliance with RAGs 3.10 and 4.07 and any subsequent information notices published by Ofwat relating to the year ended 31 March 2018.

Price control segments

The regulatory accounts have been prepared in accordance with RAG 2.07 for classification of costs across the price controls.

On 1 April 2015 the Company completed the internal reorganisation of its business to the structure in place during the reporting year 2017/18, representing individual operating companies ("OpCo") supported by a shared central corporate services unit, aligned with the regulatory environment in which the Company operates and Ofwat's price controls, which are as follows:

Retail Household:	provides certain customer-facing activities including billing and revenue collection for household customers;
Retail Non-Household:	provides a small number of customer-facing activities for non-household customers (see below);
Water:	responsible for all aspects of raw water abstraction and treatment as well as the distribution of high quality drinking water to household and non-household customers. From 1 April 2017, this business segment is also responsible for billing and cash collection of wholesale market charges to licensed non-household retailers for both water and wastewater, including amounts relating to the construction of the Thames Tideway Tunnel that is shown separately in the financial statements;
Wastewater:	responsible for all aspects of wastewater collection, treatment and safe disposal; and
Thames Tideway Tunnel:	responsible for the construction of interface works to the Thames Tideway Tunnel.

Subsequent to this, in April 2018, we undertook a further reorganisation as detailed on page 26. For regulatory reporting purposes, we will continue to report by price control as required by Ofwat.

Transfer of non-household retail customers to Castle Water

On 1 April 2017, the Company transferred its non-household customers to Castle Water Limited, and ceased to act as a retailer for non-household customers, however the Company continues to recognise wholesale revenue from these customers via retailers. The responsibility for billing and revenue collection from retailers lies with Wholesale Market Services, who sit within our water OpCo.

The Company no longer has a licence to operate in the retail non-household market however, there are a small number of non-household activities which continue to be allocated to the retail non-household price control in accordance with RAG 2.07. These amounts relate to activities which are performed by developer services.

Basis of attribution and allocation

Financial information within the Company's finance system (SAP) is recorded by expenditure type within specific cost centres. Where possible, costs are attributed at the lowest level within the cost centre hierarchy i.e. the relevant process level appropriate to the type of cost and accounting separation unit. However, certain costs are recorded at a higher level in the cost centre hierarchy where they do not specifically relate to a process or if the cost is a support related cost.

For the reporting year 2017/18 the cost centre hierarchy represents the management reporting and responsibility framework of the business, based on the OpCo structure that existed during the year.

In 2015 Thames Water implemented Anaplan, a cloud based business modelling and planning application as a tool with which to produce the operating expenditure component of our APR. SAP remains the primary financial accounting and management tool used by the business and is the source of the data used in Anaplan.

Methodology

The Company has produced an Accounting Methodology statement in respect of total expenditure. This separate statement has been published and is available on the our website at www.thameswater.co.uk/annualresults.

This methodology statement details the assumptions used in the allocation of costs into the relevant price control and upstream service units in accordance with RAG 4.07, and also includes a summary of the fixed asset allocation to price control. Where possible, capital expenditure and associated depreciation are directly attributed to one of the price controls. Where this is not possible, as an asset is used by more than one of the price controls, the capital expenditure and depreciation are reported in the price control where the service of principal use occurs with a recharge being made to the other price controls reflecting the proportion of the asset used by them.

Revenue recognition

For regulatory reporting purposes, Ofwat require a deviation from IAS 18 whereby revenue for amounts billed and deemed uncollectable in the current year are recognised within operating costs in the APR. The difference between the amount recorded as revenue in the statutory accounts and the amount recorded as revenue in the regulatory accounts was £24.8 million for the year ended 31 March 2018.

The differences between the statutory accounts and the regulatory accounts can be summarised as follows (Table 1A):

Appointed revenue	£m
Statutory revenue	2,044.9
Bad debt reclassified to opex	28.7
Reclassification of sludge cake sales to opex	(0.8)
Reclassification of grants & contributions to other income	(1.4)
Non-appointed income	(51.3)
Appointed revenue	**2,020.1**

Charging policy

Water and sewerage charges fall into the following three categories:

1) charges which are payable in full;

2) charges which are payable in part; and

3) not chargeable (void properties).

The circumstances in which each of the above applies are set out below. All of the charges covered in parts 1 and 2 are included in revenue.

1) Charges payable in full

Charges are payable in full in the following circumstances:

a) Occupied and furnished

Water (and sewerage) charges are payable in full from the date of connection or change of customer on all properties which are recorded as occupied and furnished.

b) Unoccupied and furnished

Water (and sewerage) charges are payable in full on unoccupied, furnished premises. These include properties:

- left with bedding, a desk or other furniture;
- used for multiple occupation with shared facilities;
- used as holiday, student, hostel or other accommodation; and
- used for short-term occupation or letting where the occupation or term of tenancy is less than 6 months.

Exceptions to this, where water (and sewerage) charges are not payable, include where the customer is:

- in a care home;
- in long-term hospitalisation;
- in prison;
- overseas long-term; or
- in the event of the death of the customer.

c) Unoccupied and unfurnished

Water (and sewerage) charges are payable in full on unoccupied, unfurnished premises where water is being consumed. This includes:

- premises where renovation, redecoration or building work is being undertaken; or
- premises being used as storage.

2) Charges payable in part

The following charges are payable only in certain circumstances:

a) Metered standing charges

Charges are payable on unoccupied, metered properties which are still connected.

b) Surface water charges

Charges are payable on unmeasured properties which are temporarily disconnected.

c) Sewerage unmeasured tariff

Charges are payable on unmeasured, occupied properties where the water supply is disconnected but sewerage is still provided.

d) Surface water and highway drainage

Charges are payable on furnished properties where the water supply is disconnected.

3) Not chargeable
Properties which are unoccupied, unfurnished and disconnected are not chargeable for water and sewerage, therefore no billing is raised and no turnover recognised in respect of these properties.

Occupied properties policy

An occupier is any person who owns a premises or who has agreed with the Company to pay water and sewerage services in respect of the premises. No bills are raised in the name of the "occupier", other than in the circumstances outlined in the 'Unoccupied properties policy' section below. The property management process is followed to identify whether the property is occupied or not.

The property management process consists of the following:

- physical inspections;
- mailings;
- customer contacts;
- meter reading for metered properties;
- land registry checks; and
- credit reference agency data.

Unoccupied properties policy

A property is deemed to be unoccupied when the Company has completed the property management process and not identified the property as occupied. To be classified as unoccupied a property must meet at least one of the following criteria:

- a new property has been connected but is empty and unfurnished;
- the Company has been informed that the customer has left the property;
- it is unfurnished and not expected to be reoccupied immediately;
- it has been disconnected following a customer request;
- the identity of the customer is unknown; or
- the Company has been informed that the customer is in a care home, in long-term hospitalisation, in prison or overseas long-term.

The Company only raises bills in the name of the "occupier" when it has evidence that an unmeasured property is occupied but cannot confirm the name of the occupier. When the Company identifies the occupants the bill is cancelled and re-billed in the customer's name. If the Company has not identified an occupant within 6 months the bill is cancelled and the property is classified as empty.

The Company has a process for dealing with empty properties. When a property is classified as empty, a defined process is followed to verify when the property becomes occupied and/or obtain the name of the customer in order to initiate billing. The residency confirmation process comprises a number of steps which include using external and internal information for desk-top research to confirm the property status (occupied/empty) and, where possible, to identify the occupier name. The property will only cease to be classified as empty when a named customer is identified and billed. The Company does not recognise income in respect of empty properties.

If the Company has turned off the supply of water at the mains to a property at a customer's request then water supply charges are not payable.

A customer may request the supply to be turned off in instances such as the property is to be demolished or where a house previously converted into flats (and additional supplies made) is to be converted back into a house. If the occupier name is not obtained at this point, the property will remain classified as empty and the residency confirmation process is re-started after one to six months. If these steps confirm that a property appears to be empty then the supply may be turned off.

New properties

All new properties are metered. Charges accrue from the date at which the meter is installed. The developer is billed between the date of connection and first occupancy and this is recognised as turnover. If the developer is no longer responsible for the property and no new occupier has been identified, the property management process referred to above is followed to identify the new occupier. Until the new occupier has been identified the property is treated as unoccupied and is not billed.

Disconnections policy

Premises listed in Schedule 4A of the Water Industry Act 1991 (e.g. any dwelling occupied by a person as his or her only or principal home) cannot be disconnected for non-payment of charges. However, the following provisions do apply in respect of any disconnections:

- if the water supply to any premises is disconnected for any reason, but we continue to provide sewerage services to those premises, the customer will be charged the appropriate Sewerage Unmeasured Tariff unless it can be demonstrated that the premises will be unoccupied for the period that the premises are disconnected, in which case there is no charge. Revenue is recognised for sewerage services up to the point we are aware the property becomes unoccupied.
- if it is found subsequently that the premises were occupied for any period when we were advised that the premises would be unoccupied, the appropriate Sewerage Unmeasured Tariff will then apply to that period, appropriate retrospective bills are raised and revenue recognised at that point.
- in the event that we suspect that a property is occupied but we have no record of the occupier, we take steps to establish the identity of the occupier in order that billing can commence and revenue be recognised. Occupier is defined to include any person who owns premises as set out in the 'Occupied properties policy' above and also any person who has agreed with us to pay water supply and/or sewerage charges in respect of any premises (e.g. a Bulk Meter Agreement).

Retrospective review of household measured income accrual

Appointed revenue for the year ended 31 March 2017 included a household measured income accrual of £115.0 million. The value of billing subsequently made in the year ended 31 March 2018, for actual consumption in the prior year was £114.8 million. This has resulted in a decrease in the current year's revenue due to the over-estimation of the prior year's measured income accrual as detailed below:

Measured accrual at 31 March 2017	£m
Base accrual	113.6
Less billing estimate	–
	113.6
Additional accruals	
New accounts accrual	1.4
Total measured accrual at 31 March 2017	115.0

Subsequent "unwind" of accrual	£m
Subsequent billing: matched & unwound	110.6
Still in base accrual and not unwound	1.6
Additional subsequent billing, including property movements	2.6
Comparative subsequent billing and accrual still carried forward	**114.8**
Net overwind	0.2

Operating profit, Other income and Profit before tax

The differences between statutory and regulatory Operating profit, Other income and Profit before tax can be summarised as follows

Operating Profit:	£m
Statutory operating profit	543.5
Reclassification of grants & contributions to other income	(68.8)
Reclassification of profit on sale of non-household business to other operating income	89.7
Capitalisation of borrowings	3.1
Non-appointed	(39.4)
Other	(4.2)
Regulatory operating profit	**523.9**

(Table 1A):

Other income:	£m
Statutory other income	89.7
Reclassification of grants & contributions to other income	68.8
Reclassification of profit on sale of non-household business to other income	(89.7)
Other	2.5
Regulatory other income	**71.3**

Profit before tax:	£m
Statutory profit before tax	150.8
Non-appointed	(39.7)
Capitalised borrowings net of depreciation	(97.5)
Other	(1.5)
Regulatory profit before tax	**12.1**

Grants and contributions

For the purposes of the regulatory accounts the grants and contributions (G&C) Table 2E on page 204 is prepared on a cash basis. A reconciliation between the cash basis and accounting disclosure can be seen in the Statement of Financial Position disclosures directly below Table 2E.

Property, plant and equipment

The regulatory accounts policy on Property, Plant and Equipment ("PP&E") follows the statutory accounting policies with the exception of borrowing costs. In the statutory accounts, borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of the associated asset. All other borrowing costs are included as finance expenses within the income statement. For regulatory reporting purposes borrowing costs may not be capitalised. The regulatory approach, which differs from IAS 23 results in an additional £100.7 million being recognised in interest expense in the regulatory accounts for 2017/18. This amount has been capitalised in the statutory accounts.

In light of Ofwat's introduction of new competitive markets for water resources and bioresources in AMP7, new requirements were introduced in 2016/17 to split the water and waste price controls in Table 2D (historical cost analysis of tangible fixed assets) between water resources and water network+, and sludge and waste network+, respectively. In the first reporting of this in 2016/17 with the requirement to analyse data in a different way, it was necessary for this allocation to be carried out using a manual process based on the then available level of data granularity.

During the course of this year, we have improved our system capabilities and this has allowed us to undertake a more detailed analysis of the data. This exercise identified the need to restate the opening netbook value positions for the new price controls. In the interest of transparency, the quantum of the restatements are noted in the table below.

For clarity, the restatements have no impact on revenue or bills as the relevant new price controls are not yet in operation, additionally, these restatements have not affected the returns made to Ofwat during the year in respect of draft RCV allocations across the new price controls. We made Ofwat aware that this reallocation would be made in this Annual Performance Report.

We have re-stated our prior year Table 2D, using the new methodology, which can be found on pages 202 and 203. The differences in net book value are summarised below:

	Wholesale					Retail		
	Water Resources £m	Water Network+ £m	Wastewater Network+ £m	Sludge £m	TTT £m	HH* £m	NHH* £m	**Total £m**
NBV								
Previously reported at 31 March 2017	470.5	5,905.8	5,874.4	460.6	1,072.8	34.6	4.7	**13,823.4**
Re-allocation to price control	(277.7)	541.3	(553.8)	310.7	(0.2)	(14.6)	(4.7)	**1.0**
Restated balance at 31 March 2017	**192.8**	**6,447.1**	**5,320.6**	**771.3**	**1,072.6**	**20.0**	**–**	**13,824.4**

Financial instruments and hedging

Regulatory fair value measurement

For statutory reporting the Company measures financial instruments, such as derivatives, at fair value at each financial reporting date. Fair value is the price that would be received in selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value reflects the non-performance risk. There are certain reclassifications for financial instruments, between the statutory accounts and the regulatory accounts per Ofwat guidance; these are shown in the borrowings and financial instruments reconciliations shown on page 186.

Taxation

Tax on the profit or loss for the period comprises current and deferred tax. Tax is recognised in the income statement except to the extent that it relates to items recognised directly within equity, in which case it is recognised within the statement of other comprehensive income.

Current tax

Current tax is the expected tax payable or receivable on the taxable income or loss for the period, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustments to tax payable in respect of previous periods.

Taxable profit differs from the profit on ordinary activities before tax as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other periods. This includes the effect of tax allowances and further excludes items that are never taxable or deductible.

Deferred tax

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax is measured on a non-discounted basis using tax rates enacted or substantively enacted at the balance sheet date and that are expected to apply in the period when the deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised only to the extent that it is probable that sufficient future taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax assets and deferred tax liabilities are offset when there is a legally enforceable right to set off tax assets against 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.

Current tax reconciliation

Tax charged in the income statement

	Statutory £m	Non-appointed £m	Appointed activities £m
UK Corporation tax charge	(4.3)	(2.4)	(1.9)
Deferred tax charge	(12.8)	(0.6)	(12.2)
Tax charge on profit on ordinary activities	(17.1)	(3.0)	(14.1)

The Company is not currently in a tax paying position with HMRC (although it does pay for group relief), primarily due to capital allowances on capital expenditure, tax deductions for borrowing costs and group relief which has arisen on interest expenses in holding companies. The tax charge for the year ended 31 March 2018 is lower (2017: lower) than the standard rate of corporation tax in the UK. The differences between profit on ordinary activities before taxation at the standard tax rate and the current tax charge for the year are set out below.

	Total £m	Non-appointed £m	Appointed activities £m
Profit on ordinary activities before taxation as per statutory accounts	150.8	39.7	111.1
Differences between statutory and regulatory definitions – mainly capitalised interest	(99.0)	–	(99.0)
Profit on ordinary activities before taxation for regulatory purposes	51.8	39.7	12.1
Tax charge at 19%	9.9	7.6	2.3
Effects of:			
Depreciation on assets that do not qualify for relief	4.4	–	4.4
Disallowable expenditure[1]	0.8	–	0.8
Non-taxable income[2]	(4.9)	–	(4.9)
Property disposals[3]	(2.2)	–	(2.2)
Capital allowances for the year in excess of depreciation	9.0	–	9.0
Capitalised borrowing costs allowable for tax	(19.1)	–	(19.1)
Timing differences – financial derivatives[4]	(0.8)	–	(0.8)
Pension cost charge in excess of pension contributions	(0.9)	–	(0.9)
Other short term timing differences	(1.4)	–	(1.4)
Group relief not paid at standard rate[5]	(9.3)	(5.2)	(4.1)
Differences between statutory and regulatory definitions – mainly capitalised interest	18.8	–	18.8
	4.3	2.4	1.9
Adjustments to tax charge in respect of prior periods – group relief	–	–	–
Total current tax charge	4.3	2.4	1.9

1 Disallowable expenditure primarily relates to fines included in operating expenses.
2 Non-taxable income relates to income from new service connections. This income is reflected in the accounts as non-taxable income under IFRS principles; however, such income is ultimately taxed through capital allowances.
3 Tax chargeable on gains arising on property disposals is lower than the accounting profits recognised for these disposals because of additional deductions available for tax purposes.
4 Capitalised borrowing costs are allowable for a full tax deduction in the year.
5 Accounting fair value profits and losses arising on our derivatives are non-taxable and non-deductible respectively, as instead they are taxed as the cash flows arise. Deferred tax is provided on these temporary differences.
6 The Company has decided to utilise tax losses available in its parent company for the year ended 31 March 2018. As a result, the Company has reduced its claims for tax relief on its capital expenditure in the year. The tax relief is deferred to later periods and as a result, a deferred tax credit of £12.2 million is included in the current year deferred tax charge. The Company will pay £4.3 million to its parent Company for the tax losses, which is shown in the income statement as a current year tax charge. The Company is paying for the tax losses at a rate which is lower than the standard rate of corporation tax, which reflects the value of the tax losses to the Company. This results in a reduction of the current tax charge of £9.3 million. Utilising tax losses in this way should ultimately benefit customers through lower tax funding in future regulatory settlements.

Reconciliation to total current tax charge allowed in price limits

	Appointed activities £m
Current tax charge allowed in price limits	–
Charge in respect of group relief for the year	1.9
Charge in respect of group relief for prior years	–
Tax charge on profit on ordinary activities	1.9

The tax charge arises in respect of group relief payable on profits of the appointed business, which arise because the Company has reduced its claims for tax relief on its capital expenditure in the year, as explained in footnote 5 above. Amounts are payable to the Company's parent company.

2A. Segmental income statement

For the year ended 31 March 2018

The following table provides further information of our appointed business split by the price control units defined by Ofwat.

	Retail		Water			Waste				
	HH* £m	NHH* £m	Water Resources £m	Water network+ £m	**Water total £m**	Waste-water network+ £m	Sludge £m	**Waste-water total £m**	TTT £m	**Total £m**
Revenue – price control	168.3	(0.9)		842.0	842.0	935.4		935.4	54.4	1,999.2
Revenue – non price control	–	–		15.5	15.5	5.4		5.4	–	20.9
Operating expenditure	(168.5)	(6.1)	(62.2)	(408.4)	(470.6)	(364.0)	(66.2)	(430.2)	–	(1,075.4)
Depreciation – tangible fixed assets	(2.3)	–	(4.2)	(264.2)	(268.4)	(178.0)	(46.3)	(224.3)	(0.7)	(495.7)
Amortisation – intangible fixed assets	(1.0)	–	(0.2)	(13.4)	(13.6)	(10.2)	(2.8)	(13.0)	–	(27.6)
Other operating income	0.1	88.8	0.1	0.6	0.7	12.6	0.3	12.9	–	102.5
Operating (Loss)/ profit before recharges	(3.4)	81.8			105.6			286.2	53.7	523.9
Recharges from other segments	–	–	–	–	–	(3.6)	(0.9)	(4.5)	–	(4.5)
Recharges to other segments	–	–	0.3	4.2	4.5	–	–	–	–	4.5
Operating (Loss)/ profit	(3.4)	81.8			110.1			281.7	53.7	523.9
Surface water drainage rebates										1.4

* HH = Household, NHH = Non-household

The non-household price control shows a profit of £81.8 million primarily due to the profit made on the sale of the non-household business on 1 April 2017 of £89.7 million.

2B. Totex analysis – wholesale water & wastewater

For the year ended 31 March 2018

This table shows the breakdown of the wholesale totex expenditure from table 2A into the price control units required to be reported on by Ofwat.

	Water Resources £m	Water Network+ £m	Wastewater Network+ £m	Sludge £m	TTT £m	**Total £m**
Operating expenditure						
Power	13.4	41.2	64.6	(13.8)	–	105.4
Income treated as negative expenditure	(0.1)	(0.1)	(0.1)	(10.4)	–	(10.7)
Service charges/discharge consents	13.1	–	5.3	0.1	–	18.5
Bulk supply/Bulk discharge	2.6	0.1	2.4	0.1	–	5.2
Other operating expenditure						
Renewals expensed in year (Infrastructure)	–	63.1	69.0	–	–	132.1
Renewals expensed in year (Non-Infrastructure)	–	–	–	–	–	–
Other operating expenditure excluding renewals	27.4	228.0	190.3	80.3	–	526.0
Local authority and Cumulo rates	3.5	72.4	28.5	9.9	–	114.3
Total operating expenditure excluding third party services	59.9	404.7	360.0	66.2	–	890.8
Third party services	2.3	3.7	4.0	–	–	10.0
Total operating expenditure	62.2	408.4	364.0	66.2	–	900.8
Capital expenditure						
Maintaining the long term capability of the assets – infra	6.3	139.3	70.8	–	–	216.4
Maintaining the long term capability of the assets – non-infra	15.5	170.2	149.3	87.5	(0.1)	422.4
Other capital expenditure – infra	2.0	65.2	29.8	–	36.4	133.4
Other capital expenditure – non-infra	(1.4)	67.3	140.9	(1.5)	2.4	207.7
Infrastructure network reinforcement	–	8.3	7.3	–	–	15.6
Total gross capital expenditure (excluding third party)	22.4	450.3	398.1	86.0	38.7	995.5
Third party services	–	–	–	–	–	–
Total gross capital expenditure	22.4	450.3	398.1	86.0	38.7	995.5
Grants and contributions	–	58.4	35.5	–	–	93.9
Totex	84.6	800.3	726.6	152.2	38.7	1,802.4
Cash expenditure						
Pension deficit recovery payments	1.0	9.4	7.2	2.3	–	19.9
Other cash items	–	–	–	–	–	–
Totex including cash items	85.6	809.7	733.8	154.5	38.7	1,822.3

2C. Operating cost analysis – retail

For the year ended 31 March 2018

Table 2C breaks down the retail operating costs included in table 2A into the cost categories set out in the RAGs.

	Household £m	Non-household £m	**Total £m**
Operating expenditure			
Customer services	65.1	0.6	**65.7**
Debt management	12.5	–	**12.5**
Doubtful debts	52.0	4.6	**56.6**
Meter reading	8.7	–	**8.7**
Services to developers	–	0.7	**0.7**
Other operating expenditure	30.2	0.2	**30.4**
Total operating expenditure excluding third party services	168.5	6.1	**174.6**
Third party services operating expenditure	–	–	**–**
Total operating expenditure	168.5	6.1	**174.6**
Depreciation – tangible fixed assets	2.3	–	**2.3**
Amortisation – intangible fixed assets	1.0	–	**1.0**
Total operating costs	**171.8**	**6.1**	**177.9**
Debt written off	65.8	2.2	**68.0**

Total operating costs for retail household are £171.8 million in 2017/18; this is £17.9 million higher than the cost to serve as allowed in the FD of £153.9 million. During 2017/18 the household retail price control has seen the following increases in costs:

- Customer services costs have increased as a result of increased network enquiries due to unprecedented weather events during March 2018 as well as increased investment in customer service improvements;
- Bad debt charge has increased due to higher write offs for debt of our waste-only customers; and,
- Increased depreciation of tangible fixed assets year on year due to 2017/18 being the first full year of depreciation for assets commissioned in March 2017.

Following our decision in July 2016 to exit from the competitive non-household retail market from the date of market opening (1 April 2017), the company entered an agreement to transfer ownership of its non-household customers to Castle Water from the date of market opening. The Company continues to incur certain operational costs related to the non-household market as disclosed in table 2C above. These costs have been disclosed within the non-household price control in accordance with Ofwat guidance and relate to the following:

- developer services for the provision of information and administration for new connections;
- costs relating to bad debts for non-household receivables at 31 March 2017;
- investigatory visits/first visit to the customer where the cause of the investigation is not a network issue; and,
- general and support expenditure in relation to the above activities.

2D. Historic cost analysis of tangible fixed assets – wholesale water, wholesale waste & retail
As at 31 March 2018

	Wholesale					Retail		
	Water Resources £m	Water Network+ £m	Wastewater Network+ £m	Sludge £m	TTT £m	HH* £m	NHH* £m	**Total £m**
Cost								
At 1 April 2017	261.3	8,721.3	7,334.2	1,332.3	1,074.6	79.4	–	18,803.1
Disposals	–	(8.7)	(4.8)	–	–	–	–	(13.5)
Additions	22.0	444.2	384.8	82.6	38.7	5.5	–	977.8
Adjustments[1]	(0.2)	(6.1)	(3.3)	(0.9)	–	–	–	(10.5)
Assets adopted at nil cost	–	7.8	14.3	–	–	–	–	22.1
At 31 March 2018	**283.1**	**9,158.5**	**7,725.2**	**1,414.0**	**1,113.3**	**84.9**	**–**	**19,779.0**
Depreciation								
At 1 April 2017	(68.5)	(2,274.2)	(2,013.6)	(561.0)	(2.0)	(59.4)	–	(4,978.7)
Disposals	–	4.5	4.0	0.1	–	–	–	8.6
Adjustments	–	–	–	–	–	–	–	–
Charge for year	(4.2)	(264.2)	(178.0)	(46.3)	(0.7)	(2.3)	–	(495.7)
At 31 March 2018	**(72.7)**	**(2,533.9)**	**(2,187.6)**	**(607.2)**	**(2.7)**	**(61.7)**	**–**	**(5,465.8)**
Net book value at 31 March 2018	**210.4**	**6,624.6**	**5,537.6**	**806.8**	**1,110.6**	**23.2**	**–**	**14,313.2**
Net book value at 1 April 2017	**192.8**	**6,447.1**	**5,320.6**	**771.3**	**1,072.6**	**20.0**	**–**	**13,824.4**
Depreciation charge for the year								
Principal services	(4.2)	(264.2)	(178.0)	(46.3)	(0.7)	(2.3)	–	(495.7)
Third party services	–	–	–	–	–	–	–	–
Total	**(4.2)**	**(264.2)**	**(178.0)**	**(46.3)**	**(0.7)**	**(2.3)**	**–**	**(495.7)**

* HH = Household, NHH = Non-household

1 Adjustments to cost primarily relate to IFRS write offs of residual balances.

The net book value includes £2,437.7 million in respect of assets in the course of construction. Intangible assets have not been included in this fixed asset disclosure. The opening gross book value of intangibles under IFRS at the beginning of the year was £268.5 million, with additions of £61.8 million. Amortisation of £128 million brought forward and a charge in the year of £27.5 million. The result is a closing net book value for the year ended 31 March 2018 of £168.6 million. This balance is reflected in table 1C 'Intangible Assets'.

In light of Ofwat's introduction of new competitive markets for water resources and bioresources in AMP7, new requirements were introduced in 2016/17 to split the water and waste price controls in Table 2D (historical cost analysis of tangible fixed assets) between water resources and water network+, and sludge and waste network+, respectively. In the first reporting of this in 2016/17 with the requirement to analyse data in a different way, it was necessary for this allocation to be carried out using a manual process based on the then available level of data granularity.

During the course of this year, we have improved our system capabilities and this has allowed us to undertake a more detailed analysis of the data. This exercise identified the need to restate the opening netbook value positions for the new price controls. In the interest of transparency, the quantum of the restatements are noted in the table below.

For clarity, the restatements have no impact on revenue or bills as the relevant new price controls are not yet in operation, additionally, these restatements have not affected the returns made to Ofwat during the year in respect of draft RCV allocations across the new price controls. We made Ofwat aware that this reallocation would be made in this Annual Performance Report.

The 2016/17 table has been restated as follows:

Historic cost analysis of tangible fixed assets – wholesale water, wholesale waste & retail

Restated as at 31 March 2017

	Wholesale					Retail		
	Water Resources £m	Water Network+ £m	Wastewater Network+ £m	Sludge £m	TTT £m	HH* £m	NHH* £m	**Total £m**
Cost								
At 1 April 2016	234.3	8,299.0	6,937.8	1,229.5	992.8	75.0	–	17,768.4
Disposals	–	(5.2)	(2.3)	–	–	–	–	(7.5)
Additions	27.0	420.7	350.0	102.8	81.8	4.4	–	986.7
Adjustments	–	–	–	–	–	–	–	–
Assets adopted at nil cost	–	6.8	48.7	–	–	–	–	55.5
At 31 March 2017	**261.3**	**8,721.3**	**7,334.2**	**1,332.3**	**1,074.6**	**79.4**	**–**	**18,803.1**
Depreciation								
At 1 April 2016	(63.9)	(2,030.2)	(1,835.7)	(509.6)	(1.3)	(58.7)	–	(4,499.4)
Disposals	–	3.0	2.1	–	–	–	–	5.1
Adjustments	–	–	–	–	–	–	–	–
Charge for year	(4.6)	(247.0)	(180.0)	(51.4)	(0.7)	(0.7)	–	(484.4)
At 31 March 2017	**(68.5)**	**(2,274.2)**	**(2,013.6)**	**(561.0)**	**(2.0)**	**(59.4)**	**–**	**(4,978.7)**
Net book value at 31 March 2017	**192.8**	**6,447.1**	**5,320.6**	**771.3**	**1,072.6**	**20.0**	**–**	**13,824.4**
Net book value at 1 April 2016	**170.5**	**6,268.8**	**5,102.1**	**719.9**	**991.5**	**16.3**	**–**	**13,269.1**
Depreciation charge for the year								
Principal services	(4.6)	(247.0)	(180.0)	(51.4)	(0.7)	(0.7)	–	(484.4)
Third party services	–	–	–	–	–	–	–	–
Total	**(4.6)**	**(247.0)**	**(180.0)**	**(51.4)**	**(0.7)**	**(0.7)**	**–**	**(484.4)**

The net book value does not agree to the prior year by £1 million in total. This is due to a number of assets being reclassified from the non-appointed business to the appointed business following the detailed review of the fixed asset register. We have reconciled the previously published net book value to the re-stated table below.

	Wholesale					Retail		
	Water Resources £m	Water Network+ £m	Wastewater Network+ £m	Sludge £m	TTT £m	HH* £m	NHH* £m	**Total £m**
Net book value:								
Previously reported at 31 March 2017	470.5	5,905.8	5,874.4	460.6	1,072.8	34.6	4.7	13,823.4
Re-allocation to price control	(277.7)	541.3	(553.8)	310.7	(0.2)	(14.6)	(4.7)	1.0
Restated balance at 31 March 2017	**192.8**	**6,447.1**	**5,320.6**	**771.3**	**1,072.6**	**20.0**	**–**	**13,824.4**

* HH = household, NHH = non household.

2E. Analysis of capital contributions and land sales – wholesale

For the year ended 31 March 2018

Table 2E shows information about capital contributions made by customers to the cost of assets we construct along with any income received by the sale of land.

	Fully recognised in income statement £m	Capitalised and amortised (in income statement) £m	Fully netted off capex £m	Total £m
Grants and contributions – water				
Connection charges (s45)	22.7	–	–	22.7
Infrastructure charge receipts (s146)	–	14.9	–	14.9
Requisitioned mains (s43, s55 & s56)	5.4	–	–	5.4
Other contributions (price control)	0.4	4.2	–	4.6
Diversions (s185)	4.7	–	–	4.7
Other Contributions (non-price control)	5.5	0.6	–	6.1
Total	38.7	19.7	–	58.4
Value of adopted assets		7.9		7.9
Grants and contributions – wastewater				
Infrastructure charge receipts (s146)	–	20.6	–	20.6
Requisitioned sewers (s100)	3.6	–	–	3.6
Other contributions (price control)	0.9	3.1	–	4.0
Diversions (s185)	1.6	–	–	1.6
Other Contributions (non-price control)	5.3	0.4	–	5.7
Total	11.4	24.1	–	35.5
Value of adopted assets		14.6		14.6
Grants and contributions – TTT				
Infrastructure charge receipts (s146)	–	–	–	–
Requisitioned sewers (s100)	–	–	–	–
Other contributions (price control)	–	–	–	–
Diversions (s185)	–	–	–	–
Other Contributions (non-price control)	–	–	–	–
Total	–	–	–	–
Value of adopted assets		–		–

	Water £m	Wastewater £m	TTT £m	Total £m
Movements in capitalised grants & contributions				
At 1 April 2017	139.4	186.8	–	326.2
Capitalised in year	19.7	24.1	–	43.8
Amortisation (in income statement)	(6.9)	(9.5)	–	(16.4)
At 31 March 2018	152.2	201.4	–	353.6
Land sales				
Proceeds from disposals of protected land	2.8	11.2	–	14.0

2F. Household – revenue by customer type

For the year ended 31 March 2018

This table shows an analysis of household retail revenues and customer numbers by customer type.

	Wholesale charges revenue A £m	Retail revenue B £m	**Total revenue C £m**	Number of customers D 000s	**Average household retail revenue per customer E=B/D £**
Unmeasured water only customer*	6.4	0.4	6.8	25.7	16.7
Unmeasured wastewater customer only	145.1	17.5	162.6	866.5	20.2
Unmeasured water & wastewater customer	740.7	73.2	813.9	2,091.8	35.0
Measured water only customer**	5.7	0.5	6.2	22.0	20.5
Measured wastewater only customer	147.6	26.1	173.7	1,067.3	24.4
Measured water & wastewater customer	384.6	50.6	435.2	1,336.3	37.8
Total	1,430.1	168.3	1,598.4	5,409.6	31.1

Note: Number of customers relates specifically to the number of properties that are charged at a specific tariff band rate. Average household retail revenue per customer (column E) is calculated by dividing retail revenue from column B by the number of customers in column D.

* There are 25,662 customers in this tariff band with retail revenue of £428,976, resulting in an average retail revenue per customer of £16.7.

** There are 22,046 customers in this tariff band with retail revenue of £451,381, resulting in an average retail revenue per customer of £20.5.

2G. Non-household water – revenue by tariff type

For the year ended 31 March 2018

Table 2G shows an analysis of non-household water revenues and customer numbers by customer type.

	Wholesale charges revenue A £m	Retail revenue B £m	**Total revenue C £m**	Number of connections D 000s	Average NHH retail revenue per connection E £
Default tariffs					
TB 1: Water – metered – 0-500m^3	28.8	(0.4)	28.4	110.1	
TB 2: Water – metered – 500-1000m^3	13.9	(0.1)	13.8	15.3	
TB 3: Water – metered – 1000-5000m^3	52.5	(0.2)	52.3	18.7	
TB 4: Water – metered – 5000-20000m^3	46.2	(0.1)	46.1	4.1	
TB 5: Water – metered – 20000-50000m^3	23.4	–	23.4	0.7	
TB 6: Water – metered – 50000-250000m^3	26.8	–	26.8	0.4	
TB 7: Water – metered – over 250000m^3	8.4	–	8.4	0.1	
TB 22: Water – business assessed – 0-500m^3	6.3	0.6	6.9	22.5	
TB 23: Water – business assessed – 500-1000m^3	1.7	0.1	1.8	1.0	
TB 24: Water – business assessed – 1000-5000m^3	3.0	0.1	3.1	0.6	
TB 25: Water – business assessed – 5000-20000m^3	0.7	–	0.7	–	
TB 30: Water Unmetered	2.3	–	2.3	8.3	
Total default tariffs	214.0	–	214.0	181.8	
Non-default tariffs					
Total non-default tariffs	–	–	–	–	
Total	214.0	–	214.0	181.8	

	Number of customers 000s	Average NHH retail revenue per customer £
Revenue per customer		
Total	181.8	–

Note: Number of connections relates specifically to the number of properties that are charged at a specific tariff band rate.

Following our decision in July 2016 to exit from the competitive non-household retail market from the date of market opening (1 April 2017), the company entered an agreement to transfer ownership of its non-household customers to Castle Water from the date of market opening. The Company continues to recognise wholesale revenue from these customers.

During the year ended 31 March 2017, the company recognised sales in respect of non-household customers who had not been billed before year end of £89 million. The value of billing confirmed by Castle Water in relation to consumption in the prior year was £79.6 million, resulting in a decrease of £9.7 million in revenue for the year ended 31 March 2018, due to a net over-estimation of the prior year's measured income accrual. We have shown this decrease in the retail revenue columns of tables 2G and 2H for clarity for the year ended 31 March 2018. No retail revenue for non-household customers has been earned for the year ended 31 March 2018, following the Company's exit from that market on the first day of the financial year.

Please note: we have not completed the average retail revenue per connection columns of tables 2G and 2H because the company did not earn non household retail revenue in 2017/18; the retail revenue columns only reflect the movement of the measured income accrual.

2H. Non-household wastewater – revenue by tariff type

For the year ended 31 March 2018

Table 2H shows an analysis of non-household wastewater revenues and customer numbers by customer type.

	Wholesale charges revenue A £m	Retail revenue B £m	**Total revenue C £m**	Number of connections D 000s	Average NHH retail revenue per connection E £
Default tariffs					
TB 8: Meter volume band 0-500m³	30.3	(1.4)	28.9	152.4	
TB 9 : Meter volume band 500-1000m³	11.5	(0.1)	11.4	17.7	
TB 10: Meter volume band 1000-5000m³	45.7	(0.2)	45.5	26.5	
TB 11: Meter volume band 5000-20,000m³	34.5	–	34.5	4.7	
TB 12: Meter volume band 20,000-50,000m³	15.4	–	15.4	0.7	
TB 13: Meter volume band 50,000-250,000m²	17.3	–	17.3	0.4	
TB 14: Meter volume band above 250,000m³	5.0	–	5.0	0.1	
TB 15: Trade effluent – metered – 0-500m³	0.7	–	0.7	0.9	
TB 16: Trade effluent – metered – 500m³-1000m³	0.1	–	0.1	0.4	
TB 17: Trade effluent – metered – 1000m³-5000m³	1.2	–	1.2	1.1	
TB 18: Trade effluent – metered – 5000m³-20000m³	2.1	–	2.1	0.4	
TB 19: Trade effluent – metered – 20000m³-50000m³	3.3	–	3.3	0.2	
TB 20: Trade effluent – metered – 50000m³-250000m³	4.0	–	4.0	–	
TB 21: Trade effluent – metered – over 250000m³	0.7	–	0.7	–	
TB 26 : Wastewater – business assessed – 0-500m³	5.8	0.7	6.5	25.5	
TB 27: Wastewater – business assessed – 500-1000m³	1.1	–	1.1	1.0	
TB28: Wastewater – business assessed – 1000-5000m³	1.9	0.1	2.0	0.6	
TB 29: Wastewater – business assessed – 5000-20000m³	0.4	–	0.4	–	
TB 31: Wastewater Unmetered	6.7	–	6.7	21.3	
Total default tariffs	187.7	(0.9)	186.8	253.9	
Non-default tariffs					
Total non-default tariffs	–	–	–	–	–
Total	187.7	(0.9)	186.8	253.9	–
				Number of customers 000s	Average NHH retail revenue per customer £
Revenue per customer					
Total				253.9	

Note: Number of connections relates specifically to the number of properties that are charged at a specific tariff band rate.

Following our decision in July 2016 to exit from the competitive non-household retail market from the date of market opening (1 April 2017), the company entered an agreement to transfer ownership of its non-household customers to Castle Water from the date of market opening. The Company continues to recognise wholesale revenue from these customers.

During the year ended 31 March 2017, the company recognised sales in respect of non-household customers who had not been billed before year end of £89 million. The value of billing confirmed by Castle Water in relation to consumption in the prior year was £79.6 million, resulting in a decrease of £9.7 million in revenue for the year ended 31 March 2018, due to a net over-estimation of the prior year's measured income accrual. We have shown this decrease in the retail revenue columns of tables 2G and 2H for clarity for the year ended 31 March 2018. No retail revenue for non-household customers has been earned for the year ended 31 March 2018, following the Company's exit from that market on the first day of the financial year.

Please note: we have not completed the average retail revenue per connection columns of tables 2G and 2H because the company did not earn non household retail revenue in 2017/18; the retail revenue columns only reflect the movement of the measured income accrual.

21. Revenue analysis and wholesale control reconciliation

For the year ended 31 March 2018

This table shows the retail price control difference between the actual revenue recovered and the revenue assumed at the final determination.

	Household £m	Non-household £m	Total £m
Wholesale charge – water			
Unmeasured	420.2	14.0	434.2
Measured	207.8	200.0	407.8
Third party revenue	–	–	–
Wholesale charge – wastewater			
Unmeasured	446.3	15.4	461.7
Measured	312.1	161.6	473.7
Third party revenue	–	–	–
Wholesale Total (exc. TTT)	1,386.4	391.0	1,777.4
Wholesale charge – TTT			
Unmeasured	25.7	0.5	26.2
Measured	18.0	10.2	28.2
Third party revenue	–	–	–
Wholesale Total (inc. TTT)	1,430.1	401.7	1,831.8
Retail revenue			
Unmeasured	91.2	1.6	92.8
Measured	77.1	(2.5)	74.6
Other third party revenue	–	–	–
Retail Total	168.3	(0.9)	167.4
Third party revenue – non-price control			
Bulk supplies – water			3.6
Bulk supplies – waste			1.5
Other third party revenue			15.6
Principal services – non-price control			
Other appointed revenue			0.2
Total appointee revenue			2,020.1

	Water £m	Wastewater £m	TTT £m	Total £m
Wholesale revenue governed by price control	842.0	935.4	54.4	1,831.8
Grants and contributions[1]	47.5	28.2	–	75.7
Total revenue governed by wholesale price control	889.5	963.6	54.4	1,907.5
Amount assumed in wholesale determination	884.1	993.4	54.7	1,932.2
Adjustment for in-period ODI revenue	–	–	–	–
Adjustment for WRFIM	(1.1)	(26.4)	(0.2)	(27.7)
Total assumed revenue	883.0	967.0	54.5	1,904.5
Difference	6.5	(3.4)	(0.1)	3.0

1 Relevant capital contributions as defined in FD

Comparison of allowed and actual revenue – Wholesale control

Total wholesale revenue governed by the wholesale price control for 2017/18 of £1,907.5 million is £3.0 million (0.2%) higher than the amount allowed in the Final Determination (FD).

Wholesale Water

Wholesale water revenue was £6.5 million (0.8%) higher than the FD, driven by:

- higher than forecast capital contributions from connection and infrastructure charge revenue; and
- core tariff revenue lower than forecast due to lower property numbers as well as data cleanse activities which reduced revenue as identified through a deep dive into the transfer of our non-household customer base following our exit from the non-household Retail market.

Wholesale Wastewater

Wholesale wastewater revenue (including the Company's delivered element of the Thames Tideway Tunnel) was £3.4 million (0.4%) lower than the FD, driven by:

- higher than forecast capital contributions from connection and infrastructure charge revenue; and
- core tariff revenue lower than forecast due to lower property numbers as well as data cleanse activities which reduced revenue as identified through a deep dive into the transfer of our non-household customer base following our exit from the non-household Retail market.

The variance between actual revenue and allowed revenue in the wholesale water and wastewater price controls will be adjusted through the Wholesale Revenue Forecasting Incentive Mechanism (WRFIM) when 2019/20 wholesale prices are set. The additional revenue recovered, driven by capital contributions, will be returned to customers in 2019/20 tariffs.

2J. Infrastructure network reinforcement cost

For the year ended 31 March 2018

Table 2J presents the infrastructure reinforcement costs, as included in totex in tables 4D and 4E (pages 217 and 218 respectively), by type of system or facility.

	Network reinforcement capex £m	On site/site specific capex (memo only) £m	**Total £m**
Wholesale water network+ (treated water distribution)			
Distribution and trunk mains	8.3	–	8.3
Pumping and storage facilities	–	–	–
Other	–	–	–
Total	8.3	–	8.3
Wholesale wastewater network+ (sewage collection)			
Foul and combined systems	3.6	–	3.6
Surface water only systems	2.9	–	2.9
Pumping and storage facilities	0.8	–	0.8
Other	–	–	–
Total	7.3	–	7.3

Performance summary

3A. Outcome performance table

For the year ended 31 March 2018

Performance commitment	Units description	2015/16 performance level actual	2016/17 performance level actual	2017/18 performance level – actual	2017/18 CPL (for PCs with annual targets)	AMP CPL (for PCs with AMP end targets)	2017/18 CPL met?	2017/18 notional reward or penalty accrued	2017/18 notional reward or penalty accrued £m (4 DPs)	Total AMP6 reward or penalty 31 March 2020 forecast	Total AMP6 reward or penalty 31 March 2020 forecast £m (4 DPs)
WA1: Improve handling of written complaints by increasing 1st time resolution – water	% written complaints resolved 1st time	91	96	96	95	N/A	Yes				
WA2: Number of written complaints per 10,000 connected properties – water	No. written complaints/ 10,000 properties	8.84	9.12	12.39	8.58	N/A	No				
WA3: Customer satisfaction surveys (internal CSAT monitor) – water	TW internal Customer satisfaction score (mean score out of 5)	4.44	4.50	4.42	4.50	N/A	No				
WA4: Reduced water consumption from issuing water efficiency devices to customers	Ml/d reduced water consumption (cumulative)	–	–	20.22	N/A	15.45	–				
WA5: Provide a free repair service for customers with a customer side leak outside of the property	Number against target above annual baseline no.	1,404	2,089	4,834	1,410	N/A	Yes				
WB1: Asset health water infrastructure	Asset health indicator	Marginal	Marginal	Marginal	Stable	N/A	No	Underperformance penalty	(4.6750)	Underperformance penalty	(23.3750)
WB2: Asset health water non-infrastructure	Asset health indicator	Stable	Stable	Stable	Stable	N/A	Yes				
WB3: Compliance with drinking water quality standards (MZC) – Ofwat/ DWI KPI	Mean zonal compliance (%)	99.96	99.96	99.96	100	N/A	No	Penalty deadband		Penalty deadband	
WB4: Properties experiencing chronic low pressure (DG2)	No. of properties with low pressure (DG2) at the end of the reporting year	0	5	206	34	N/A	No				
WB5: Average hours lost supply per property served, due to interruptions > 4 hours	Hours lost supply per property served	0.12	0.12	0.21	0.13	N/A	No	Underperformance penalty	(10.6700)	Underperformance penalty	(4.4200)
WB6: Security of Supply Index – Ofwat KPI	Security of Supply Index (SOSI)	100	99	97	100	N/A	No	Underperformance penalty	(6.7950)	Underperformance penalty	(9.0600)
WB7: Compliance with SEMD advice notes (with or without derogation)	% compliance with SEMD advice notes	–	–	21	N/A	100	–				
WB8: Ml/d of sites made resilient to future extreme rainfall events	Ml/d of WTWs made resilient	–	–	4	N/A	1,015	–			Outperformance	
WC1: Greenhouse gas emissions from water operations	$ktCO_2e$	275.9*	151.4*	46.2	201	N/A	Yes				
WC2: Leakage	Megalitres per day (Ml/d) (annual average)	642	677	695	620	N/A	No	Underperformance penalty	(13.0500)	Underperformance penalty	(48.6000)

3A. Outcome performance table continued

Performance commitment	Units description	2015/16 performance level actual	2016/17 performance level actual	2017/18 performance level – actual	2017/18 CPL (for PCs with annual targets)	AMP CPL (for PCs with AMP end targets)	2017/18 CPL met?	2017/18 notional reward or penalty accrued	2017/18 notional reward or penalty accrued £m (4 DPs)	Total AMP6 reward or penalty 31 March 2020 forecast	Total AMP6 reward or penalty 31 March 2020 forecast £m (4 DPs)
WC3: Abstraction Incentive Mechanism (AIM)	Refer to Table 3C	–	0	(1,676.29)	0	N/A	Yes				
WC4: We will educate our existing and future customers	No. of children directly engaged	17,491	20,898	21,341	17,000	N/A	Yes				
WC5: Deliver 100% of agreed measures to meet new environmental regulations	% of agreed schemes completed	–	–	–	N/A	100	–				
WD1: Energy imported less energy exported	GWh (gigawatt-hours)	496	491	510	472	N/A	No				
SA1: Improve handling of written complaints by increasing first time resolution – wastewater	% written complaints resolved 1st time	87	93	94	95	N/A	No				
SA2: Number of written complaints per 10,000 connected properties – wastewater	No. written complaints/ 10,000 properties	6.46	6.21	4.39	6.70	N/A	Yes				
SA3: Customer satisfaction surveys (internal CSAT monitor) – wastewater	TW internal Customer satisfaction score (mean score out of 5)	4.50	4.57	4.55	4.65	N/A	No				
SB1: Asset health wastewater non-infrastructure	Asset health indicator	Stable	Stable	Stable	Stable	N/A	Yes				
SB2: Asset health wastewater infrastructure	Asset health indicator	Stable	Stable	Stable	Stable	N/A	Yes				
SB3: Properties protected from flooding due to rainfall (including Counters Creek project)	No. properties protected from flooding due to rainfall	–	–	40	N/A	2127	–				See page 37
SB4: Number of internal flooding incidents, excluding those due to overloaded sewers (SFOC)	No. of internal sewer flooding (other causes) incidents	1,410	1,214	1,062	1,085	N/A	Yes	Outperformance reward	1.2650	Underperformance penalty	(5.9350)
SB5: Contributing area disconnected from combined sewers by retrofitting sustainable drainage	No. of hectares (cumulative)	–	–	0	N/A	20	–				
SB6: Compliance with SEMD advice notes (with or without derogation)	% compliance with SEMD advice notes	–	–	26	N/A	100	–				
SB7: Population equivalent of sites made resilient to future extreme rainfall events	Population equivalent (cumulative)	–	–	537,700	N/A	1,700,000	–				
SB8: Lee Tunnel including Shaft G	Scheme delivery	Scheme delivered	Scheme delivered 2015/16	Scheme delivered 2015/16	N/A	N/A	N/A				
SB9: Deephams Wastewater Treatment Works	Scheme delivery	–	Scheme delivered	Scheme delivered 2016/17	N/A	N/A	N/A				
SC1: Greenhouse gas emissions from wastewater operations	$ktCO_2e$	468.5	346.7	231.7	315	N/A	Yes				

Performance commitment	Units description	2015/16 performance level actual	2016/17 performance level actual	2017/18 performance level – actual	2017/18 CPL (for PCs with annual targets)	AMP CPL (for PCs with AMP end targets)	2017/18 CPL met?	2017/18 notional reward or penalty accrued	2017/18 notional reward or penalty accrued £m (4 DPs)	Total AMP6 reward or penalty 31 March 2020 forecast	Total AMP6 reward or penalty 31 March 2020 forecast £m (4 DPs)
SC2: Total category 1–3 pollution incidents from sewage related premises	No. of pollution incidents (cats 1, 2 and 3)	232	315	292	340	N/A	Yes	Reward deadband		Reward deadband	
SC3: Sewage treatment works discharge compliance	% WwTW discharge compliance	99.13	98.28	99.43	100	N/A	No	Penalty deadband		Underperformance penalty	(2.3070)
SC4: Water bodies improved or protected from deterioration as a result of Thames Water's activities	No. of water bodies improved or protected by catchment management	–	–	0	N/A	13	–				
SC5: Satisfactory sludge disposal compliance	% satisfactory sludge disposal compliance	100	100	100	100	N/A	Yes				
SC6: We will educate our existing and future customers	No. of children directly engaged	17,491	20,898	21,341	17,000	N/A	Yes				
SC7: Modelled reduction in properties affected by odour	No. of properties (modelled cumulative reduction)	–	1,305	1,980	1,771	N/A	Yes	Outperformance reward	0.0460	Outperformance reward	0.2578
SC8: Deliver 100% of agreed measures to meet new environmental regulations	% of agreed schemes completed	–	–	–	N/A	100	–				
SC9: Reduce the amount of phosphorus entering rivers to help improve aquatic plant and wildlife	Kilograms of phosphorus removed per day	–	–	0	N/A	59	–				
SD1: Energy imported less energy exported	GWh (gigawatt-hours)	533	477	431	329	N/A	No				
T1A: Successful procurement of the Infrastructure Provider (IP)	Infrastructure Provider (IP) procurement	Scheme delivered	Scheme delivered 2015/16	Scheme delivered 2015/16	N/A	N/A	N/A				
T1B: Thames Water will fulfil its land related commitments in line with the TTT programme requirements	Land related commitments	13	13	13	Acquire land access rights in line with programme in the development consent order and programme timetable to be agreed with Ofwat	N/A	Yes				
T1C: Completion of category 2 and 3 construction works and timely availability of sites to the IP	No. of sites (cumulative)	9	19	21	23	N/A	Yes				
T2: Thames Water will engage effectively with the IP, and other stakeholders, both in terms of integration and assurance	Effective engagement with IP and stakeholders	–	Effective engagement	Effective engagement	Effective engagement	N/A	Yes				
T3: Thames Water will engage with its customers to build understanding of the TTT project. Thames Water will liaise with the IP on its surveys of local communities impacted by construction**	Engagement to build TTT understanding	Yes	No	No	Improving trend	N/A	No				

3A. Outcome performance table continued

Performance commitment	Units description	2015/16 performance level actual	2016/17 performance level actual	2017/18 performance level – actual	2017/18 CPL (for PCs with annual targets)	AMP CPL (for PCs with AMP end targets)	2017/18 CPL met?	2017/18 notional reward or penalty accrued	2017/18 notional reward or penalty accrued £m (4 DPs)	Total AMP6 reward or penalty 31 March 2020 forecast	Total AMP6 reward or penalty 31 March 2020 forecast £m (4 DPs)
RA1: Minimise the number of written complaints received from customers (relating to charging and billing)	No. written complaints/ 10,000 properties	14	19	17	18	N/A	Yes				
RA2: Improve handling of written complaints by increasing first time resolution – charging and billing	% written complaints resolved 1st time	92	94	95	95	N/A	Yes				
RA3: Improve customer satisfaction of retail customers – charging and billing service	TW internal Customer satisfaction score (mean score out of 5)	4.61	4.63	4.66	4.45	N/A	Yes				
RA4: Improve customer satisfaction of retail customers – operations contact centre	TW internal Customer satisfaction score (mean score out of 5)	4.27	4.46	4.43	4.57	N/A	No				
RA5: Increase the number of bills based on actual meter reads (in cycle)	% bills based on actual meter reads	91	97	96	96	N/A	Yes				
RA6: Service incentive mechanism (SIM)	Service incentive mechanism (SIM) score	76.8	77.3	78.4	80.1	N/A	–				
RB1: Implement new online account management for customers supported by web-chat	Delivery status	Limited online	Limited online	New online self serve channel	New online self serve channel	N/A	Yes				
RC1: Increase the number of customers on payment plans (excluding Thames Tideway Tunnel)	% of customers on DD payment plans	54	55	58	54	N/A	Yes				
RC2: Increase cash collection rates (excluding Thames Tideway Tunnel)	% of cash collected from billing in the year	88.2	87,9	89.2	89.7	N/A	No				

* 2015/16 and 2016/17 performance for WC1 has been restated in 2017/18. See page 33.

** We conduct regular customer surveys to inform our measurement for performance commitment T3, taking account of awareness and understanding of the Thames Tideway Tunnel project among our household and non-household customers.

Our committed performance level is an improving trend. We have recently reviewed our methodology for assessing and reporting our performance, in consultation with the Customer Challenge Group, and have adopted a new approach. Applying the improved methodology retrospectively changes the RAG rating for 2016/17 to red from amber. The rating for 2015/16 remains green.

	Baseline (2014/15)	AMP6 Year 1 (2015/16)	AMP6 Year 2 (2016/17)	AMP6 Year 3 (2017/18)
% of household customers aware of Thames Tideway Tunnel	42	43	36	40
% of household customers who understand what the Thames Tideway Tunnel is	35	35	31	36
% of non-household customers aware of Thames Tideway Tunnel	No data available	36	36	37
% of non-household customers who understand what the Thames Tideway Tunnel is	No data available	28	27	26

3B. Sub-measure performance table

For the year ended 31 March 2018

PC/ sub-measure ID	PC/sub-measure	Unit	2016–17 performance level – actual	**2017–18 performance level – actual**	**2017–18 CPL* met?**
00	**WB1: Asset health water infrastructure**	category	Marginal	**Marginal**	**No**
01	Total bursts	nr	8,326	**8,546**	**Yes**
02	Unplanned interruptions to customer >12 hours (DG3)	nr	6,051	**23,457**	**No**
03	Iron mean zonal non-compliance	%	0.09	**0.07**	**Yes**
04	Inadequate pressure (DG2)	nr	5	**206**	**No**
05	Planned network rehabilitation (kilometres)	nr	103.28	**142.75**	**–**
06	Customer complaints discolouration white water (nr per 1,000 population)	nr	0.17	**0.17**	**Yes**
00	**WB2: Asset health water non-infrastructure**	category	Stable	**Stable**	**Yes**
01	Disinfection index (DWI)	%	99.99	**99.96**	**No**
02	Reservoir integrity index	%	0.00	**0.00**	**Yes**
03	DWQ compliance measures – turbidity (number of sites)	nr	0	**1**	**Yes**
04	Process control index	%	100.00	**100.00**	**Yes**
05	DWQ compliance measures – enforcement actions	nr	0	**0**	**Yes**
06	Water quality complaints for chlorine (nr per 1,000 population)	nr	0.060	**0.050**	**Yes**
07	Water quality complaints for hardness (nr per 1,000 population)	nr	0.010	**0.010**	**Yes**
00	**SB1: Asset health wastewater non-infrastructure**	category	Stable	**Stable**	**Yes**
01	Unconsented pollution incidents (cat 1, 2 and 3) STWs, storm tanks, pumping stations and other	nr	34	**22**	**Yes**
02	Sewage treatment works discharges failing numeric consents %	%	1.72	**0.57**	**No**
03	Total population equivalent served by sewage treatment works failing look-up table consents	%	0.00	**0.00**	**Yes**
00	**SB2: Asset health wastewater infrastructure**	category	Stable	**Stable**	**Yes**
01	Number of sewer collapses	nr	632	**321**	**Yes**
02	Number of sewer blockages	nr	80,747	**77,402**	**Yes**
03	Pollution incidents (cat 1–3)	nr	243	**241**	**No**
04	Properties internally flooded	nr	1,106	**969**	**Yes**

* CPL = Committed performance level.

3C. AIM table

For the year ended 31 March 2018

Abstraction sites	2017/18 AIM performance Ml	2017/18 normalised AIM performance Ml	Cumulative AIM performance 2017/18 Ml	Cumulative normalised AIM performance 2017/18 Ml	Contextual information relating to AIM performance
RIVER LEE AT NEW GAUGE PUMPING STATION (London WRZ)	(871.3)	(0.22)	(871.3)	(0.22)	River flows went below the AIM trigger flow during 2017/18 and despite water resource pressure and water quality challenges we were able to reduce abstraction and comply with AIM.
PANGBOURNE (Kennet Valley WRZ)	(494.9)	(0.17)	(494.9)	(0.17)	River flows went below the AIM trigger flow during 2017/18 and despite the water resource situation we were able to reduce abstraction and comply with AIM.
AXFORD PUMPING STATION (SWOX WRZ)	(164.4)	(0.09)	(164.4)	(0.09)	River flows went below the AIM trigger flow for a significant period during 2017/18, despite burst issues on a strategic main in the area we were able to reduce abstraction and comply with AIM.
PANN MILL PUMPING STATION (Slough/Wycombe/ Aylesbury WRZ)	(96.0)	(0.08)	(96.0)	(0.08)	River flows went below the AIM trigger flow during 2017/18 and despite water quality pressures we were able to reduce abstraction and comply with AIM.
NORTH ORPINGTON PS (London WRZ)	(49.8)	(0.54)	(49.8)	(0.54)	River flows went below the AIM trigger flow during 2017/18 for a short period, we were able to reduce abstraction and comply with AIM.
Total	**(1,676.4)**	**(1.10)**	**(1,676.4)**	**(1.10)**	

Prolonged low rainfall during 2017 lead to low flows across our supply area, which resulted in our AIM triggers being crossed at all our sites. However, despite some significant supply challenges during the summer of 2017, the availability of alternative sources of water in each case meant we were able to comply with AIM at all of our sites and therefore comply overall with AIM for 2017/18.

3D. SIM table
For the year ended 31 March 2018

Line description	Units	Score
Qualitative performance		
1st survey score	score	4.16
2nd survey score	score	4.25
3rd survey score	score	4.14
4th survey score	score	4.13
Qualitative SIM score (out of 75)	score	59.45
Quantitative performance		
Quantitative composite score	score	120.52
Quantitative SIM score (out of 25)	calc	18.97
SIM score		
Total annual SIM score (out of 100)	calc	78.4

4A. Non-financial information

For the year ended 31 March 2018

This table shows information with regards to the water consumption, vacant households and wholesale water and wastewater volumes.

	Unmeasured	Measured
Retail – household		
Number of void households ('000s)	105.7	83.4
Per capita consumption (excluding supply pipe leakage) l/h/d	157.5	123.3

	Water	Wastewater
Wholesale		
Volume (Ml/d)		
Bulk supply export	93.6	10.8
Bulk supply import	0.4	4.5
Distribution input	2,680.9	

4B. Wholesale totex analysis

For the year ended 31 March 2018

Table 4B shows the totex expenditure in out-turn prices for wholesale operations, split by the price controls as required by Ofwat. The information shows the totex expenditure for 2017/18 as well as cumulatively for the AMP.

	Current year			Cumulative		
	Water £m	Wastewater £m	TTT £m	Water £m	Wastewater £m	TTT £m
Actual totex	895.3	888.3	38.7	2,441.0	2,714.8	244.0
Less: Items excluded from the menu						
Third party costs	6.0	4.0	–	19.5	12.5	–
Pension deficit recovery costs	10.4	9.5	–	29.8	27.2	–
Other 'rule book' adjustments[1]	–	0.4	(2.0)	–	22.6	55.9
Total costs excluded from the menu	16.4	13.9	(2.0)	49.3	62.3	55.9
Add: Transition expenditure						
Transition expenditure	–	–	–	26.1	54.6	–
Adjusted actual totex	878.9	874.4	40.7	2,417.8	2,707.1	188.1
Adjusted actual totex – base year prices	782.2	778.2	36.2	2,217.8	2,489.4	174.3
Allowed totex based on final menu choice – base year prices	687.9	792.5	54.4	1,984.1	2,428.7	274.2
Cumulative over/(under)spend	94.3	(14.3)	(18.2)	233.7	60.7	(99.9)

As part of the price review process for AMP6, Ofwat proposed a 'totex sharing mechanism' for water companies, under which approximately half of any cumulative totex under or overspend compared to the Ofwat allowance, would be shared with customers, through adjustments to their bills after 2020.

Table 4B shows our actual totex for 2017/18 alongside our cumulative totex for the AMP to date; a number of adjustments are made to these figures to allow us to compare our spend against the allowance in each year per the Final Determination ("FD") for the 5 year period 2015 – 2020.

The adjustments to totex include:

- 'Items excluded from the menu' – these are expenses that we have incurred that were not included in the FD. Examples of these items include third party costs (such as the cost of providing bulk supplies), pension deficit recovery costs and other 'rule book' adjustments such as fines. In the TTT price control, we also adjust for purchases of land required to develop the TTT, that are subject to a '100:0' sharing rate with customers; these costs are excluded from totex in table 4B above, in line with Ofwat guidance because customers receive the full benefit of any increase in land values when they are sold at a future date.
- Transition expenditure – these are any costs incurred in the period 2010 – 2015 that deliver performance in 2015 – 2020 (no adjustment in 2017/18).
- Adjustment to base year prices – the FD defines totex in 2012/13 prices, so to compare against the FD, we adjust for inflation to a consistent price base.

In 2017/18, we have amended the cumulative total of items excluded from the menu to correct for items previously omitted and to reflect more accurate interpretation of RAG guidance. The impact of these revisions is an increase to items excluded from the menu of £7.4 million for Water third party costs and £1.2 million for Waste third party costs. We also corrected cumulative other 'rule book' adjustments in the TTT price control by £28.4 million in respect of land costs subject to the 100:0 sharing rate.

1 In 2017/18, we have recognised a £2.0 million credit in against the TTT price control in relation to costs subject to a 100:0 sharing rate. This consists of land costs totalling £2.0 million which have been offset by rental income (also subject to the 100:0 sharing rate) of £4 million.

4B. Wholesale totex analysis continued

Our performance against the FD has been analysed for each price control below:

Water:
In 2017/18, our totex for water of £782.2 million in base year prices (2012/13) was £94.3 million higher than the FD allowance of £687.9 million. This additional spend particularly reflects increased expenditure to improve our leakage and resilience. The main items that make up the overspend include the following:

- Increased costs related to the infrastructure alliance and challenges around leakage reduction;
- Increased spend on trunk mains replacement work;
- Increased spend in the leakage recovery plan aimed at bringing our leakage performance back on target by 2020, after we missed our leakage targets in 2016/17 and 2017/18;
- Water supply overspend driven by leakage, particularly due to unprecedented weather patterns in March 2018;
- Increase in cumulo rates costs following revaluation by the Valuation Office; and,
- Increased group and support costs relating to insurance, consultancy and IT costs.

Cumulatively, our totex for water of £2,217.8m is £233.7m over what we were allowed in the FD. Of this overspend, we have acknowledged that c. £90million incurred to date was related to inefficient leakage costs. Under the totex sharing mechanism, approximately £46million of these costs would have been shared with customers through adjustments to their bills in AMP7; however we do not think this is reasonable, and our shareholders have committed to fully bear this cost.

Waste:
In 2017/18, our totex for waste of £778.2 million in base year prices (2012/13) was broadly in line with our FD allowance (£792.5 million).

Cumulatively, our totex for waste of £2,489.4 million is £60.7 million over what we were allowed in the FD, particularly reflecting increased maintenance spend across our sites and network, to improve our resilience.

TTT:
In 2017/18, our totex for TTT of £36.2 million in base year prices (2012/13) was £18.2 million lower than the FD allowance of £54.4 million and cumulatively, our totex for TTT of £174.3 million is £99.9 million under the totex allowance. This is primarily due to savings to date in the Development and Delivery phases of the project.

4C. Impact of AMP performance to date on RCV

For the year ended 31 March 2018

Table 4C shows the projected adjustments to the Regulatory Capital Value that are expected at the next price review.

	Water	Wastewater	TTT	Total
Cumulative totex over/(under) spend so far in the price control period	233.7	60.7	(99.9)	194.5
Customer share of cumulative totex over/(under) spend	149.1	42.2	(60.2)	131.1
RCV element of customer share of cumulative totex over/(underspend)	123.8	39.9	(123.9)	39.8
Adjustment for ODI rewards or penalties	–	–	–	–
RCV determined at FD at 31 March	5,682.7	6,664.8	1,357.3	13,704.8
Projected 'shadow' RCV	**5,806.5**	**6,704.7**	**1,233.4**	**13,744.6**

Note: the ODI rewards and penalties incurred until 31 March 2018 will have an impact on revenue in the next price review, rather than an RCV adjustment, so are not included in the table above. Further information over our performance can be seen in Table 3A on pages 209 – 212.

The RCV element of the totex over/(underspend) is a calculated value which reflects the difference between allowed and actual totex, multiplied by the average AMP6 slow money percentage. For TTT, this includes any over/(underspend) on land, which passes 100% to customers, through an RCV adjustment.

4D. Totex analysis – wholesale water

For the year ended 31 March 2018

Table 4D provides information about the different activities undertaken as part of delivering upstream services with a breakdown of the total expenditure for carrying out the supply of water.

	Water resources		Network+				
	Abstraction licences £m	Raw water abstraction £m	Raw water transport £m	Raw water storage £m	Water treatment £m	Treated water distribution £m	Total £m
Operating expenditure							
Power	–	13.4	0.3	–	9.5	31.4	54.6
Income treated as negative expenditure	–	(0.1)	–	–	(0.1)	–	(0.2)
Abstraction charges	13.1	–	–	–	–	–	13.1
Bulk supply	–	2.6	–	–	–	0.1	2.7
Other operating expenditure							
Renewals expensed in year (Infrastructure)	–	–	–	–	–	63.1	63.1
Renewals expensed in year (Non-Infrastructure)	–	–	–	–	–	–	–
Other operating expenditure excluding renewals	0.9	26.5	1.7	–	62.5	163.8	255.4
Local authority and Cumulo rates	–	3.5	6.3	–	5.7	60.4	75.9
Total operating expenditure excluding third party services	**14.0**	**45.9**	**8.3**	**–**	**77.6**	**318.8**	**464.6**
Third party services	–	2.3	–	–	–	3.7	6.0
Total operating expenditure	**14.0**	**48.2**	**8.3**	**–**	**77.6**	**322.5**	**470.6**
Capital expenditure							
Maintaining the long term capability of the assets – infra	–	6.3	4.7	–	–	134.6	145.6
Maintaining the long term capability of the assets – non-infra	–	15.5	1.6	–	76.2	92.4	185.7
Other capital expenditure – infra	–	2.0	0.3	–	–	64.9	67.2
Other capital expenditure – non-infra	–	(1.4)	–	–	7.6	59.7	65.9
Infrastructure network reinforcement	–	–	0.1	–	–	8.2	8.3
Total gross capital expenditure (excluding third party)	**–**	**22.4**	**6.7**	**–**	**83.8**	**359.8**	**472.7**
Third party services	–	–	–	–	–	–	–
Total gross capital expenditure	**–**	**22.4**	**6.7**	**–**	**83.8**	**359.8**	**472.7**
Grants and contributions	–	–	–	–	–	58.4	58.4
Totex	**14.0**	**70.6**	**15.0**	**–**	**161.4**	**623.9**	**884.9**
Cash expenditure							
Pension deficit recovery payment	–	1.0	0.1	–	3.0	6.3	10.4
Other cash items	–	–	–	–	–	–	–
Totex including cash items	**14.0**	**71.6**	**15.1**	**–**	**164.4**	**630.2**	**895.3**

	Water resources		Network+			
Unit cost information (operating expenditure)	Abstraction licences	Raw water abstraction	Raw water transport	Raw water storage	Water treatment	Treated water distribution
	Licensed volume available	Volume abstracted	Volume transported	Average volume stored	Distribution input volume	Distribution input volume
Volume (Ml)	1,546,857.1	1,066,331.0	88,575.7	–	988,299.2	978,520.5
Unit cost (£/Ml)	9.0	45.2	93.7	–	78.6	329.5
Population ('000s)	10,012.8	10,012.8	10,012.8	10,012.8	10,012.8	10,012.8
Unit cost (£/population)	1.4	4.8	0.8	–	7.8	32.2

4E. Totex analysis – wholesale wastewater

For the year ended 31 March 2018

Table 4E provides information about the different activities undertaken as part of delivering upstream services with a breakdown of the total expenditure for carrying out the supply of sewerage services.

	Network+ Sewage collection			Network+ Sewage treatment		Sludge			
	Foul £m	Surface water drainage £m	Highway drainage £m	Sewage treatment and disposal £m	Imported sludge liquor treatment £m	Sludge transport £m	Sludge treatment £m	Sludge disposal £m	Total £m
Operating expenditure									
Power	6.9	2.2	1.3	54.2	–	–	(13.8)	–	50.8
Income treated as negative expenditure	(0.1)	–	–	–	–	–	(9.6)	(0.8)	(10.5)
Discharge consents	1.2	0.4	0.2	3.5	–	–	0.1	–	5.4
Bulk discharge	–	–	–	2.4	–	–	0.1	–	2.5
Other operating expenditure									
Renewals expensed in year (Infrastructure)	46.0	14.6	8.4	–	–	–	–	–	69.0
Renewals expensed in year (Non-Infrastructure)	–	–	–	–	–	–	–	–	–
Other operating expenditure excluding renewals	56.7	15.6	7.3	109.9	0.8	11.1	50.0	19.2	270.6
Local authority and Cumulo rates	–	–	–	28.5	–	–	9.0	0.9	38.4
Total operating expenditure excluding third party services	**110.7**	**32.8**	**17.2**	**198.5**	**0.8**	**11.1**	**35.8**	**19.3**	**426.2**
Third party services	3.0	0.4	0.1	0.5	–	–	–	–	4.0
Total operating expenditure	**113.7**	**33.2**	**17.3**	**199.0**	**0.8**	**11.1**	**35.8**	**19.3**	**430.2**
Capital expenditure									
Maintaining the long term capability of the assets – infra	70.8	–	–	–	–	–	–	–	70.8
Maintaining the long term capability of the assets – non-infra	28.0	3.5	1.2	115.4	0.2	1.3	78.3	7.7	235.6
Other capital expenditure – infra	31.4	(1.6)	–	–	–	–	–	–	29.8
Other capital expenditure – non-infra	4.3	0.1	0.1	137.4	–	–	(1.3)	–	140.6
Infrastructure network reinforcement	3.8	3.5	–	–	–	–	–	–	7.3
Total gross capital expenditure (excluding third party)	**138.3**	**5.5**	**1.3**	**252.8**	**0.2**	**1.3**	**77.0**	**7.7**	**484.1**
Third party services	–	–	–	–	–	–	–	–	–
Total gross capital expenditure	**138.3**	**5.5**	**1.3**	**252.8**	**0.2**	**1.3**	**77.0**	**7.7**	**484.1**
Grants and contributions	34.8	0.1	–	0.6	–	–	–	–	35.5
Totex	**217.2**	**38.6**	**18.6**	**451.2**	**1.0**	**12.4**	**112.8**	**27.0**	**878.8**
Cash expenditure									
Pension deficit recovery payments	2.5	0.7	0.3	3.7	–	0.2	1.9	0.2	9.5
Other cash items	–	–	–	–	–	–	–	–	–
Totex including cash items	**219.7**	**39.3**	**18.9**	**454.9**	**1.0**	**12.6**	**114.7**	**27.2**	**888.3**

	Network+ Sewage collection			Network+ Sewage treatment		Sludge		
Unit cost information (operating expenditure)	Volume collected Ml	Volume Collected Ml	Volume Collected Ml	BOD Tonnes	BOD Tonnes	Volume transported M3	Dried solid mass treated ttds	Dried solid mass disposed ttds
Volume (Ml)	702,657.7	325,096.8	179,347.8	354,102.6	8,391.8	1,384,487.2	366.2	365.2
Unit cost (£/Ml)	161.8	102.1	96.5	562.4	91.3	8.0	97,853.8	52,715.1
Population ('000s)	15,018.3	15,018.3	15,018.3	15,018.3	15,018.3	15,018.3	15,018.3	15,018.3
Unit cost (£/population)	7.6	2.2	1.2	13.3	0.1	0.7	2.4	1.3

4F. Operating cost analysis – household retail

For the year ended 31 March 2018

This table sets out the operating costs for the household retail business as defined by the Ofwat price control.

	Household unmeasured				Household measured				
	Water only £m	Waste-water only £m	Water and sewerage £m	Total £m	Water only £m	Waste-water only £m	Water and sewerage £m	**Total £m**	**Total £m**
Operating expenditure									
Customer services	0.3	6.7	28.0	35.0	0.3	8.4	21.3	30.0	65.0
Debt management	0.1	1.0	6.1	7.2	0.1	1.3	3.9	5.3	12.5
Doubtful debts	0.2	4.9	24.8	29.9	0.1	6.1	16.0	22.2	52.1
Meter reading	–	–	–	–	0.1	2.0	6.6	8.7	8.7
Other operating expenditure	0.2	4.4	12.2	16.8	0.1	5.5	7.8	13.4	30.2
Total operating expenditure excluding third party services	0.8	17.0	71.1	88.9	0.7	23.3	55.6	79.6	168.5
Third party services operating expenditure	–	–	–	–	–	–	–	–	–
Total operating expenditure	0.8	17.0	71.1	88.9	0.7	23.3	55.6	79.6	168.5
Depreciation – tangible fixed assets									
On assets existing at 31 March 2015	–	–	0.1	0.1	–	–	–	–	0.1
On assets acquired since 1 April 2015	–	–	1.3	1.3	–	–	0.9	0.9	2.2
Amortisation – intangible fixed assets									
On assets existing at 31 March 2015	–	–	–	–	–	–	–	–	–
On assets acquired since 1 April 2015	–	–	0.6	0.6	–	–	0.4	0.4	1.0
Total operating costs excluding third party services	0.8	17.0	73.1	90.9	0.7	23.3	56.9	80.9	171.8
Capital Expenditure	0.3	0.1	23.2	23.6	0.2	0.3	14.8	15.3	38.9

Other operating expenditure includes the net retail expenditure for the following retail activities which are part funded by wholesale.

Household	**Total £m**
Demand-side water efficiency – gross expenditure	7.3
Demand-side water efficiency – expenditure funded by wholesale	(5.4)
Demand-side water efficiency – net retail expenditure	1.9
Customer-side leak repairs – gross expenditure	9.0
Customer-side leak repairs – expenditure funded by wholesale	(8.6)
Customer-side leak repairs – net retail expenditure	0.4

4G. Wholesale current cost financial performance

For the year ended 31 March 2018

Table 4G shows our financial performance in current cost terms.

	Water £m	Wastewater £m	TTT £m	**Total £m**
Revenue	857.5	940.8	54.4	1,852.7
Operating expenditure	(470.6)	(430.2)	–	(900.8)
Capital maintenance charges	(351.4)	(394.0)	(0.7)	(746.1)
Other operating income	0.7	12.9	–	13.6
Current cost operating profit	36.2	129.5	53.7	219.4
Other income	29.6	34.7	7.1	71.4
Interest income	42.7	50.0	10.2	102.9
Interest expense	(261.3)	(306.5)	(62.4)	(630.2)
Other interest expense	(3.7)	(4.4)	(0.9)	(9.0)
Current profit before tax and fair value movements	(156.5)	(96.7)	7.7	(245.5)
Fair value loss on financial instruments	(19.4)	(22.7)	(4.6)	(46.7)
Current profit before tax	(175.9)	(119.4)	3.1	(292.2)

Note: Other income, interest costs and fair value (losses) have been apportioned between Water, Waste and TTT using the RCV split as defined by the Final Determination shown in table 4C.

4H. Financial metrics

For the year ended 31 March 2018

This table shows our key financial metrics: measures of financial performance and financial position, revenue earned, earnings before interest, tax, depreciation and amortisation and an analysis of our borrowings in terms of interest payable and the maturity profile of those borrowings.

	Units	Metric
Financial indicators		
Net debt	£m	11,365.027
Regulated equity	£m	2,339.779
Regulated gearing	%	82.93%
Post tax return on regulated equity	%	2.54%
RORE (return on regulated equity, cumulative)	%	4.86%
Dividend yield	%	1.86%
Retail profit margin – Household	%	(0.22%)
Retail profit margin – Non-household	%	(1.73%)
Credit rating	n/a	Baa1 negative
Return on RCV	%	4.44%
Dividend cover	dec	(0.04)
Funds from operations (FFO)	£m	746.418
Interest cover (cash)	dec	3.23
Adjusted interest cover (cash)	dec	1.66
FFO/Debt	dec	0.07
Effective tax rate	%	3.22%
Free cash flow (RCF)	£m	691.418
RCF/capex	dec	0.65
Revenue and earnings		
Revenue (actual)[1]	£m	1,999.252
EBITDA (actual)[1]	£m	923.756
Borrowings		
Proportion of borrowings which are fixed rate	%	49.53%
Proportion of borrowings which are floating rate	%	0.81%
Proportion of borrowings which are index linked	%	49.65%
Proportion of borrowings due within 1 year or less	%	0.84%
Proportion of borrowings due in more than 1 year but no more than 2 years	%	4.20%
Proportion of borrowings due in more than 2 years but no more than 5 years	%	9.05%
Proportion of borrowings due in more than 5 years but no more than 20 years	%	51.26%
Proportion of borrowings due in more than 20 years	%	34.65%

RORE key drivers	2015/16	2016/17	2017/18	Cumulative RORE (simple arithmetic average)
Base allowed return	5.63%	5.62%	5.61%	5.62%
Totex	(1.05%)	(2.07%)	(1.52%)	(1.54%)
ODIs	(0.25%)	(0.28%)	(0.61%)	(0.38%)
Exiting non-household retail market	0.00%	0.00%	1.17%	0.39%
Financing	(0.26%)	0.61%	1.97%	0.78%
Actual RORE	**4.07%**	**3.88%**	**6.63%**	**4.86%**

We exited the non-household retail market on 1 April 2017. This has affected RORE in 2017/18 as follows:

- Removing the 2017/18 margin on non-household retail, included in the base allowed return (-0.2%)
- Remaining costs incurred in the non-household retail price control (-0.1%)
- Recognising the net proceeds of the sale of the non-household retail business (+1.5%)

We have revised our calculation of RORE in 2015/16 and 2016/17. This reflects the following items:

- Changes in the wholesale totex allocation between menu totex and non-menu totex, as identified in Table 4B (+0.1%)
- Using a more accurate source of interest expense (Table 1A), to more closely align with the guidance around reporting financial flows (+0.5%)
- Removing any differences between expenditure and allowance associated with Counters Creek, as discussed on page 37 (-0.2%)
- Recognising that we bear 100% of the costs associated with the inefficient expenditure around leakage reduction[2] (-0.3%)

In May 2018, Moody's affirmed our Baa1 Corporate Family Rating ("CFR") but placed us on negative outlook (2017: stable outlook). This continues to be a strong investment grade credit rating supporting our ratings of A3 and Baa3 for our Class A and Class B debt respectively. The change to negative outlook reflects a change in assessment of the stability and predictability of the UK water regulatory regime rather than a reflection of our operational performance.

1 Revenue (actual) and EBITDA (actual) relates to price control only and is calculated in line with Ofwat guidance. As the numbers are presented to 3 decimal places, there may be small rounding differences between the numbers stated above and the regulatory accounting tables.

2 As identified in "Notice of Ofwat's proposal to impose a penalty on Thames Water Utilities Limited", Ofwat, June 2018

4I. Financial derivatives

As at 31 March 2018

This table provides an analysis of our portfolio of financial derivatives.

	Nominal value by maturity (net)				Total value		Interest rate (weighted average for the year to 31 March 2018)	
	1 to 2 years £m	2 to 5 years £m	Over 5 years £m	Nominal value (net) £m	Mark to Market £m	Total accretion £m	Payable %	Receivable %
Interest rate swap (sterling)								
Floating to fixed rate	–	1,000.0	1,250.0	2,250.0	199.3	–	3.2	0.6
Floating from fixed rate	–	1,000.0	693.6	1,693.6	22.3	–	0.6	1.0
Floating to index linked	–	–	20.0	20.0	0.9	1.3	5.0	2.9
Floating from index linked	–	–	–	–	–	–	–	–
Fixed to index-linked	–	–	1,123.7	1,123.7	262.0	217.6	5.7	5.2
Fixed from index-linked	–	–	–	–	–	–	–	–
Total	**–**	**2,000.0**	**3,087.3**	**5,087.3**	**484.5**	**218.9**		
Foreign Exchange								
Cross currency swap USD	–	38.7	200.4	239.1	1.4	–	2.3	3.5
Cross currency swap EUR	–	–	–	–	–	–	–	–
Cross currency swap YEN	–	–	153.6	153.6	41.3	–	6.6	3.3
Cross currency swap Other	–	–	–	–	–	–	–	–
Total	**–**	**38.7**	**354.0**	**392.7**	**42.7**	**–**		
Currency interest rate								
Currency interest rate swaps USD	–	–	–	–	–	–	–	–
Currency interest rate swaps EUR	–	–	–	–	–	–	–	–
Currency interest rate swaps YEN	–	–	–	–	–	–	–	–
Currency interest rate swaps Other	–	–	–	–	–	–	–	–
Total	–	–	–	–	–	–		
Forward currency contracts								
Forward currency contracts USD	–	–	–	–	–	–	–	–
Forward currency contracts EUR	–	–	–	–	–	–	–	–
Forward currency contracts YEN	–	–	–	–	–	–	–	–
Cross Forward currency contracts Other	–	–	–	–	–	–	–	–
Total	–	–	–	–	–	–	–	–
Other financial derivatives	–	–	–	–	–	–	–	–
Total financial derivatives	**–**	**2,038.7**	**3,441.3**	**5,480.0**	**527.2**	**218.9**		

Supply of trade

Introduction

RAG 3.10 requires the Company to disclose transactions with both associated companies and the non-appointed business in accordance with the guidance provided in RAG 5.07. Although the appointed business applies IFRS an associated company for the purposes of supply of trade is any company within the Group[1] or a related company as defined by Financial Reporting Standard 102 as required by RAG 5.07. The following disclosures comply with RAG 3.10.

During the year there were no single contracts in excess of 0.5% (£10.1 million) of the Company's appointed revenue with any subsidiary of the Kemble Group of companies or related companies.

The Company has also chosen to voluntarily disclose all transactions with companies for which there is a common Director. The Directors of the Company and their connection to other Group companies is shown on the Directors' interest table on page 223.

Services provided by the Company and recharged to associated companies

Associate Company	Company Principal Activity	Service Provided	Turnover of associate during 2017/18 (£'000)	Terms of supply	Value (£'000)
Thames Water Limited	Holding Company	Director costs, Treasury, Insurance, Tax and Financial Control support services	–	No market – costs allocated by time	1,491.6
Thames Water Limited	Holding Company	Non-Executive Director Costs	–	No market – costs allocated by time	157.6
Thames Water Property Services Limited	Property Company	Director costs, Treasury, Insurance, Tax and Financial Control support services	201.4	No market – costs allocated by time	33.8
Kennet Properties Limited	Property Company	Director costs, Treasury, Insurance, Tax and Financial Control support services	10,102.3	No market – costs allocated by time	6.1
Kennet Properties Limited	Property Company	Payroll Costs	10,102.3	No market – costs allocated by time	24.0
Thames Water Commercial Services Limited	Commercial Company	Support Services	65.1	No market – costs allocated by time	402.9
					2,116.0

Services provided to the Company by associated companies

Associate Company	Company Principal Activity	Service Provided	Turnover of associate during 2017/18 (£'000)	Terms of supply	Value (£'000)
Thames Water Property Services Limited	Property Company	Payroll Costs	201.4	No market – actual costs recharged	262.9
Thames Water Property Services Limited	Property Company	Facilities Services	201.4	Negotiated price	37.1
Thames Water Utilities Holdings Limited	Holding Company	Group Tax Relief	–	No market – actual cost	4,300.0
Dunelm Energy Limited	Management Consultancy Company	Administrative Services	Not available – small company exemption	Negotiated	4.5
					4,604.5

1 The Group means the group of companies headed by Kemble Water Holdings Limited, the ultimate parent company.
2 The Kemble Group of companies refers to all those companies included within the Kemble Holdings Limited Group consolidation, of which Thames Water Utilities Limited is a member (see Group Structure on page 110).

Payments to companies with common Directors

Company	Common Director	Service	Terms of supply	Value (£'000)
Arqiva Limited	Mark Braithwaite[2]	Smart Metering	Negotiated	15,894.8
KPMG LLP[1]	Greg Pestrak	Assurance, Consultancy and Audit	Negotiated	1,526.2
Water UK	Steve Robertson	Memberships & Subscriptions	Mandatory Fee	619.9
Cranfield University	Dame Deirdre Hutton	Tuition fees, Training and Conferences	Mandatory Fee	123.4
Cadent Gas Limited	Mark Braithwaite[2]	Gas Main Works	Negotiated	61.7
HS1 Limited	Kenton Bradbury	Abstraction Licence	Mandatory Fee	12.0
The Financial Reporting Council Limited	Nick Land	2017/18 Preparers' Levy	Mandatory Fee	8.4
Southern Gas Networks plc	Guy Lambert & Kenton Bradbury	Gas Main Works	Negotiated	1.8
				18,248.2

In addition to the above, the Company paid Macquarie Infrastructure and Assets (Europe) Limited a sum of £0.7 million for advisory fees that were due for the period prior to their exit (1 April 2017 to 31 May 2017). As at 31 March 2018, there were no Thames Water Utilities Limited Directors who are also Directors of Macquarie Infrastructure and Assets (Europe) Limited, however in the interest of transparency, we are disclosing this payment.

Directorships held in Group Companies

The Company discloses the following information as part of its compliance with RAG 5.07, listing those Directors of the Company who are also directors of the following Group companies during the year ended 31 March 2018 and up to the date of signing this report:

<table>
<tr><th>Director</th><th>Thames Water Utilities Limited</th><th>Thames Water Utilities Holdings Limited</th><th>Thames Water Limited</th><th>Kemble Water Finance Limited</th><th>Kemble Water Eurobond PLC</th><th>Kemble Water Holdings Limited</th><th>Thames Water Commercial Ventures Holdings Limited</th><th>Thames Water Commercial Ventures Finance Limited</th><th>Thames Water Procurement Limited</th></tr>
<tr><td colspan="10">Executive Directors</td></tr>
<tr><td>Nick Fincham</td><td>✓</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Brandon Rennet</td><td>✓</td><td></td><td></td><td></td><td></td><td></td><td>A – 01/04/2017</td><td>A – 01/04/2017</td><td></td></tr>
<tr><td>Steve Robertson</td><td>✓</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td colspan="10">Non-Executive Directors</td></tr>
<tr><td>Kenton Bradbury</td><td colspan="6">A – 31/05/2017</td><td></td><td></td><td></td></tr>
<tr><td>Mark Braithwaite</td><td colspan="6">R – 31/05/2017</td><td></td><td></td><td></td></tr>
<tr><td>Christopher Deacon</td><td>✓</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Nicholas Horler</td><td>R – 19/12/2017</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Guy Lambert</td><td>✓</td><td>✓</td><td>✓</td><td>✓</td><td>✓</td><td>✓</td><td></td><td></td><td></td></tr>
<tr><td>Sir Peter Mason KBE</td><td>R – 25/01/2018</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Greg Pestrak</td><td>A – 15/11/2017</td><td colspan="5">A – 03/10/2017</td><td></td><td></td><td></td></tr>
<tr><td>Dipesh Shah OBE</td><td>R – 02/08/2017</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td colspan="10">Independent Non-Executive Directors</td></tr>
<tr><td>Lorraine Baldry</td><td>✓</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Dame Deirdre Hutton</td><td>✓</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Nicholas Land</td><td>✓</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Ian Marchant</td><td>A – 01/12/2017</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Ian Pearson</td><td>✓</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Edward Richards</td><td>✓</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
</table>

Key: R – resigned A – appointed

Thames Water Utilities Limited conducts its appointed business so as to ensure arm's length trading and avoidance of cross-subsidy in the spirit of Condition F of the Instrument of Appointment.

1 Payments to KPMG LLP are disclosed as Greg Pestrak (Non-Executive Director), who was appointed on 3 October 2017, was a Director of KPMG LLP until 16 June 2017.

2 Mark Braithwaite resigned on 31 May 2017, the value included for Arqiva above is for a full year of services.

Borrowings and Loans

All borrowings from the Company's wholly owned subsidiaries are disclosed in Note 19 on pages 161–162.

All loans to the Company's wholly owned subsidiaries are disclosed in Note 14 on page 158.

Transfer of assets by or to the appointee

There were no transfers of assets or liabilities by or to the Company in excess of the materiality limit (2017: £nil).

Guarantees or other forms of security by the appointee

The Company, as part of the Whole Business Securitisation ('WBS') capital structure, guarantees unconditionally and irrevocably all the borrowings and derivatives of Thames Water Utilities Finance Limited and Thames Water Utilities Cayman Finance Limited as listed on page 178 for the year ended 31 March 2018. In November 2017, the Company announced its intention to close its Cayman Island subsidiaries.

Omissions of rights

There were no omissions of rights during the year (2017: none).

Waiver of any consideration, remuneration or other payment by the appointee

There were no waivers of any consideration, remuneration or other payments by the appointee during the year (2017: none).

Dividends paid to associated undertakings

The Company's dividend policy, which was in place during the year, is to pay a progressive dividend commensurate with long-term returns and business performance, after considering the business' current and expected regulatory and financial performance, regulatory restrictions, management of economic risks and debt covenants. For further information on the new dividend policy please see page 129.

During the year, the Company paid interim dividends of £55.0 million (2017: £157.0 million) to its immediate parent company, Thames Water Utilities Holdings Limited. Of these dividend payments, none were made to external shareholders of the Group (2017: £100.0 million). The chart on page 62 shows how the dividends were utilised within the Group.

Our Group structure

Strategic and operational oversight of the Company is led by the Company's Board. The Board's primary responsibility is to promote the long-term success of the Company for the benefit of its customers, employees, shareholders and other stakeholders.

Kemble Water Holdings ("KWH") Limited is considered to be the ultimate parent company. The primary activity of KWH is to act as a holding company in the Group. Approval of certain matters are specifically reserved for the Board of KWH, including approval of the long term business plan, significant investment, material transactions such as major acquisitions and divestment and certain strategic decisions.

The Group structure chart shown on page 110 sets out the ownership of Thames Water Utilities Limited and its subsidiaries.

Directors' certificate under Condition F6A of the Company's Instrument of Appointment

This is to certify that at their meeting on 27 June 2018, the Directors of Thames Water Utilities Limited ("the Appointee") resolved that, in their opinion, for at least the next 12 months:

- the Appointee will have available to it:
  - sufficient financial resources and facilities to enable it to carry out the Regulated Activities (including the investment programme necessary to fulfil the Appointee's obligations under the Licence of Appointment); and
  - management resources and systems of planning and internal control which are sufficient to enable it to carry out those functions as required by sub-paragraph 6A.1.
- all contracts entered into with any associated company include all necessary provisions and requirements concerning the standard of service to be supplied to the Appointee, to ensure that it is able to meet all its obligations as a water and a sewerage undertaker.

In determining whether they can ensure compliance with the requirements of Condition F6A as at 27 June 2018, the Directors consider many areas, the specifics of key areas are outlined in the table below which relate directly to the specified areas noted above requiring the various available resources; financial, management and systems of planning and internal control, including procurement arrangements.

In addition to these areas, in making this determination for the next 12 months, the Directors have also looked in detail at recent investigations and publications by Ofwat that relate to the Company.

Leakage

Ofwat published their 'Notice to impose a penalty on Thames Water' on 7 June 2018 (the 'Ofwat Notice') and in making their determination for the next 12 months the Directors have taken into account the findings and proposed undertakings, many of which have already been actioned. In summary the findings show that the Company:

- has failed to maintain an efficient and economical system of water supply within its area in relation to its management of leakage during AMP6;
- failed to ensure it had adequate management resources and systems of planning and control to manage network leakage during AMP6 consistently with its regulated duties and functions, including section 37 WIA91;

and further that the Company's Board

- underestimated its statutory obligations in relation to leakage in its approach to its reporting obligations under paragraphs 6A.2A and 6A.2B of Condition F of its licence, in both 2016 and 2017;
- failed to devote sufficient management resources to, and impose adequate systems of control over, leakage reduction performance at a Board level;
- did not challenge the lack of reporting on operational matters or impose greater scrutiny or control over the Alliance; and
- should have taken a far more proactive approach to its leakage reduction performance.

The Company and Board have already taken steps to rectify many of the areas, most notably;

- significant changes to the Infrastructure Alliance contract are now complete, with control over all key activities now lying with Thames Water senior managers and not with contractor staff and the changes to the incentive mechanisms for the alliance partners;
- change to the Operational Design of the business to align key processes across the business and ensure that the right focus is being given to key areas of performance including leakage;
- improvements to the reporting of leakage and other performance metrics to the Board and other key stakeholders, ensuring a proactive approach to leakage management and monitoring of leakage performance against targets on a monthly basis; and
- a comprehensive Governance review of the Board and the Committees that report into them, with the changes already made within the Executive management team and the changes being made to the composition of the Board.

These actions, many of which have been completed, are fully consistent with the Proposed Undertakings in the Ofwat Notice.

Freeze/Thaw Review

The Directors have considered Ofwat's 'Out in the cold – water companies' response to the 'Beast from the East' report published on 19 June 2018 following their review of the freeze thaw event of March 2018. Specifically, the Board have considered:

- the Company's general duty under section 27 of the Water Industry Act 1991 to keep under review the way in which the Company carries out its functions; and
- the primary duties to further the consumer objective to protect the interests of consumers and the resilience object to secure the long-term resilience of the Company's water supply and wastewater systems.

Directors' certificate under Condition F6A of the Company's Instrument of Appointment continued

To ensure compliance with the Directors' Certificate under Condition F6A of the Company's Instrument of Appointment the Directors have also taken into account the specific requirements of the Condition and all of the proposed undertakings. In particular, the main areas that have been considered are:

Availability of financial resources and facilities	▸ the Company's Final Determination for the 2015–2020 regulatory period; ▸ the Company's available cash resources and borrowing facilities, which include significant, undrawn bank facilities and take into account: • the availability of funds to cover the additional £97 million investment that the Appointee committed to following the trunk mains burst incidents in 2016; • the availability of funds to cover the additional spend committed in order to deliver the Appointee's leakage recovery plan and meet its Performance Commitment in 2019/20 in line with the Proposed Undertakings; • the reduction in revenue as a result of the commitment to reduce customer bills to reflect the ODI penalties in line with the undertakings; and • the availability of funds to cover additional resource to enable the Company to deliver its obligations. ▸ the Company's projected net cash flow for the remainder of this regulatory period; ▸ the Company's investment grade ratings, as shown on page 61 of this report; ▸ the Company's compliance with its financial covenants as disclosed on page 62 of this report; ▸ the preparation of the Company's statutory accounts on a going concern basis as disclosed on page 142 of this report; and ▸ the Company's long-term viability as disclosed on pages 79–82 of this report.
Management resources	▸ the Company's People Strategy and People Plans which ensure that the Appointee has access to personnel which will enable it to deliver its regulatory obligations, operational and customer performance, strategic goals and meet its performance commitments. In particular: • the Company's recent changes to both the Executive Team and Board; • the Company's recent reorganisation and changes to its operating model; • the Company's plans to ensure sufficient management control, including the acknowledgement of additional Executive time required and bringing additional capabilities back into the business following a redesign of our Infrastructure Alliance contract; • the Company's engagement with employees in the development of our Company vision for people, customers and assets; • the Company's succession planning strategy; • the Company's training and development programme for all employees enabling its people to gain skills appropriate to their roles; • the Company's recruitment strategy allowing selection of high calibre candidates; and • the Company's recognition and reward programme to enable it to attract and retain employees with appropriate skills and experience, including redefining its incentive arrangements.
Systems of planning and internal control	▸ the implementation of recommendations following the recent governance review of the Company's Board and the committees that report into them; ▸ the Company's formal risk management process, which reviews, monitors and reports on the risks and mitigating controls; ▸ the implementation of recommendations following Ofwat's review of the freeze thaw event of March 2018 to enable significant improvements to the preparation and response to similar events in the future; ▸ the Company's principal risks and uncertainties as disclosed on pages 72–78 of this report; ▸ the Company's performance in respect of its Performance Commitments as disclosed in table 3A on pages 209–212 of this report. In respect of operational performance, additional consideration has been given to: • Leakage performance: the impact of missing the target for the year and the forecast of missing the target in 2018/19, including the remedial action that has been taken and is planned and how this is monitored and reported on an ongoing basis in line with the Proposed Undertakings; • Asset health – infrastructure: the impact of the trunk mains bursts, specifically their effect on supply interruptions and subsequent impact on our water infrastructure asset health measure, and remedial action that is being taken and is planned and how this is monitored on an ongoing basis; • Security of Supply: the impact of missing the target for the year; and • Pollutions: the impact of any pollution incidents and the remedial action that has been taken and is planned and how this is being monitored on an ongoing basis. ▸ the Company's procurement arrangements, whereby all trading arrangements, including those with associates, must be appropriate for the appointee to meet its regulatory requirements, including the recent restructuring of our Infrastructure Alliance and Technology and Transformation Alliance contracts.

Other key Undertakings	Additionally, we have committed to: ▸ Providing customers with regular updates on our leakage performance. This will be done via: • monthly performance updates on our website, which will provide the ability for customers to leave feedback; and • through monthly updates to the CCG and direct engagement with customers. ▸ Providing the Board with regular updates on leakage, including updates on customer engagement and feedback. ▸ No Executive or senior management incentives will be paid for leakage performance below its Performance Commitment. The Transformation Incentive (see page 119), which includes leakage performance at Performance Commitment level or better for 2019/20, will defer all payments until July 2020. ▸ Further developing our response plan to events; including the nature and timing of communications. ▸ Improving the information we hold on customer in vulnerable circumstances. ▸ Publish an externally assured action plan by 28 September 2018 setting out how the Company is addressing the issues identified in Ofwat's review of the freeze thaw event. ▸ Undertaking additional assurance activities and responding to recommendations (see Data Assurance Summary www.thameswater.co.uk/annualresults). ▸ The ARRC will formally revisit compliance with this condition on a quarterly basis and report to the Board.

Taking all of the above into account, the Directors have resolved that, in their opinion, the Company will have available to it, for at least the next 12 months sufficient resources to enable it to carry out and meet its regulatory obligations, as set out in the Company's Instrument of Appointment.

Steve Robertson
Executive Director

Brandon Rennet
Executive Director

Nick Fincham
Executive Director

Nick Land
Independent Non-Executive Director

Ian Marchant
Chairman

Kenton Bradbury
Non-Executive Director

For, and on behalf of, the Board of Thames Water Utilities Limited

27 June 2018

Risk and compliance statement 2017/18

Purpose and Scope of Our Risk and Compliance Statement

The purpose of our Risk and Compliance Statement is to set out for our customers and stakeholders, including our regulators, the processes we have in place to demonstrate our compliance with relevant statutory, licence and regulatory obligations ("obligations").

The obligations, for which Ofwat is the relevant enforcement authority and against which we assess our compliance include:

- our Instrument of Appointment ("Licence");
- the Water Industry Act 1991;
- key pieces of legislation for which Ofwat is the relevant enforcement authority; including the Competition Act 1998; and
- environmental and corporate legislation which impacts on our activities.

We have set out in this statement and earlier in this report, our performance against performance commitments and legal requirements. We have also identified the risks that we are facing and the steps we are taking to mitigate those risks.

The Statements

The Thames Water Utilities Limited Board ("Board") considers that we have:

1. a thorough understanding of our obligations;
2. taken steps to understand and meet our customers' expectations;
3. sufficient processes and systems of internal control to enable us to deliver our services to customers and meet our obligations;
4. appropriate systems and processes to enable us to identify, manage and review our material risks; and
5. met all of our material obligations, subject to any departures from this statement as set out in section 5 below.

1. Understanding our obligations

Our approach to achieving compliance with our obligations is based on having a clear understanding of the statutory, licence and regulatory obligations that are relevant to a Water and Sewerage Undertaker.

Our obligations are primarily set out in the Water Industry Act 1991, and our Licence as at 27 June 2018.

In recognition of the performance issues that have arisen during the year, we are doing more to strengthen, and provide better visibility of our framework for ensuring compliance with our obligations. As part of our programme of continuous improvement, during 2017/18 we carried out a risk assessment and mapped impacts and accountabilities for obligations assessed as having a high-impact to our business, customers and stakeholders, to our Company processes and policies. We also formalised ownership of these obligations at senior management level within our business. We are now in the process of performing a more detailed review of the adequacy of our processes and documenting key controls to ensure that we are absolutely transparent about our arrangements for meeting our obligations.

As the regulatory and legislative environment changes our internal processes will enable us to maintain awareness and map these changes to our existing practices and develop relevant policy guidance to ensure we comply.

In order to meet our obligations we have established processes, systems of internal control and governance as set out in section 3 below. Additionally, we have engaged an external assurance provider to independently review the information contained in our combined Annual Report and Annual Performance Report ("AR") and confirm compliance with our reporting obligations to Ofwat.

A summary of our key reporting obligations/ accounting disclosures is set out in the table below, further details of which can be found in this report:

Obligation source	Obligation description	AR page ref.
Licence condition F6 as at 27 June 2018	Confirmation that trade with associates is at arm's length	Supply of trade disclosure – pages 222–224
Licence condition F6A as at 27 June 2018	Confirmation that we have sufficient financial and management resources and systems of planning and internal controls for the next 12 months	F6A Certificate – pages 225–227
Licence condition F6A as at 27 June 2018	Confirmation that the Company has contracts with any associate company with necessary provisions and requirements concerning the standard of service to be supplied to ensure compliance with Company's obligations as a water and sewerage undertaker	F6A Certificate – pages 225–227
Licence condition F6A.6 as at 27 June 2018	Maintaining investment grade credit rating	F6A Certificate – pages 225–227
Licence condition K as at 27 June 2018	Confirmation that there are sufficient rights and assets available to enable a special administrator to run the business	Page 182
Water Industry Act 1991 (section 35A)	Publication of a statement explaining the links between Directors' pay and standards of performance we achieve (Remuneration Committee Report)	Remuneration Committee Report – pages 112–128
Companies (Audit, Investigations and Community Enterprise) Act 2004	Confirmation that we have made our auditors aware of all relevant information	Directors' Report – pages 129–132
Licence condition F6 (line 1A) as at 27 June 2018	Report on dividend policy	Directors' Report – pages 129–132

2. Meeting our customers' expectations

We have taken steps to understand our customers' expectations

We understand that we provide an essential service to each and every one of our customers. We are in a privileged position and understand that we cannot be complacent. Our customers quite rightly expect exceptional customer service and we are continuing to invest in this area to ensure we meet their expectations.

In 2016/17, we began a two year journey to deliver our Customer Experience Programme with the intention of delivering common capabilities across our whole business – covering wholesale and retail. As we are now one year into our journey, we are able to provide an update of progress and how we have made significant strides forward.

Following on from the work that we started in 2016/17, we have created new journey dashboards to mirror the key reasons for customers contacting us and these now provide a line of sight and measurement of the end-to-end customer journeys. We are becoming much smarter with the data available to us whether this is based upon our performance, from customers or operational data. Through understanding and analysing this, we are able to turn raw data into valuable information which in turn gives us the insight to take the right action.

For customers who experience a wastewater service issue (blockage, flooding or nuisance issue), we have introduced changes through two improvement phases; with a first phase focussed on simplifying our initial attendance promises and proactively managing these promises through new and better management of our work scheduling, meaning we can resolve more issues first time. Our second phase (currently being rolled out) is focussed on improving the service we provide customers whose issue cannot be resolved at the first visit. For these customers, we have introduced proactive telephone and SMS contact to ensure they remain informed of progress towards resolving their issue and changed how our planning teams operate to provide our teams with greater ownership of a customer's issue through to resolution. These changes are expected to complete by the end of June 2018.

For customers who experience a water service issue (visible leak, no water, low pressure, nuisance issue), we have launched a similar change programme in which our immediate focus is improving the likelihood of completing any necessary repair work at the first visit. This is complemented by changes to the way in which we keep our customers informed so that customers can expect a consistent service whether they experience an issue with their wastewater or water service.

We have undertaken a pilot of one of our core journeys, customers moving home, which has enabled our front line staff to take more ownership and ability to resolve matters at the point the customer contacts us.

Our new customer journey model allow us to review and continuously improve the experience for our customers through capturing the direct touchpoints (such as calling us) or indirect touchpoints (such as turning on a tap or paying a bill) and documenting the way in which our customers feel. As our customer journey model matures we will pilot the governance around it to make sure we are considering what each end to end journey means to our customers and how it can shape improvements going forward. To support this, we have introduced new predictive analytics which enable us to understand the likely future impacts of events or our actions and this is helping us make more informed decisions.

Since our website was refreshed in 2016/17 we have been carrying out essential 'fix the basics' to ensure our digital platforms remain stable. We created a new Digital team that is set up to optimise our key journeys, and we have set up the capability for us to deliver continuous optimisation for these journeys. Our roadmap allows us to protect our key journeys and ensure any change affecting those journeys is delivered and has an optimisation path after launch. Over the past year, we have gained a high degree of insight. We will now be able to execute at pace and learn what works best for our customers on a continuous basis, rather than project by project.

A new Social Media platform was delivered which means we can manage Twitter and Facebook conversations in a more insightful way. Not only can we improve how we prioritise responses better but the wealth of data we can analyse adds to the great insight the digital platforms can provide to the rest of the business – all in real-time. Our Social Media team now work 24/7 and are able to promptly respond to customers through this channel.

During the year we delivered a smarter way of handling major incidents which can cause so much disruption to our customers. A new dedicated incident management team is in place which can quickly mobilise at any time during the day or night and respond to the needs of our customers alongside our field force. We have introduced a dedicated team of customer representatives who visit our customers within one hour when things go wrong and sensitively handle their individual requirements. We have committed to provide customers with quick and proactive updates across our interactive voice recognition, website and Social Media channels during events, with regular updates. This has already seen us halve the number of customers who felt the need to contact us to find out what is happening. The success of this was reflected when the team were shortlisted for the customer care award at the UK Customer Satisfaction Awards 2018. Finally, we have taken on board the feedback of our customers and we are introducing a new policy for compensating them for the inconvenience that these types of incidents can cause.

As we formulate our customer services plan for the future, we will recognise the diversity of our customer base across our region and make sure that the services and tariffs that we develop are reflective of the demographics of our customers.

We are piloting a service to "warm transfer" customers needing holistic debt advice to Stepchange, a debt advice charity. The pilot is progressing and we plan to roll this out to all our front line teams within our Revenue Contact Centre as we roll out wider training to identify and make referrals for vulnerability services.

Our analysis indicates that there are around 290,000 customers who may qualify for a social tariff with over 80% of these currently not receiving it. Through campaigns and collaboration with a variety of utilities, local authorities, local cultural groups and local advice associations we are working to increase awareness of these tariffs. This includes a working group with the overlapping Water Only Companies with the aspiration of harmonising the qualifying criteria for our social tariffs. Another example is training the Wandsworth Age UK team on the referral pathways for support in Thames Water and utilities in general.

We have also provided Smarter Home Visits to approximately 70,000 households during the year. This is a water efficiency installation and advice service for households, and helps identify water and energy bill savings for all and will help those customers who are struggling to pay. This includes a benefits maximisation referral which has identified £272,000 of unclaimed benefits for customers. To develop this programme we have collaborated with a local housing association to deliver an additional 3,500 bespoke energy and water saving visits. Smarter Home Visits are also used to distribute a joint leaflet to promote priority services registers for both Thames Water and UK Power Networks (UKPN). Following the successful trials across London, we have extended this initiative to also include the Scottish and Southern Energy Network (SSEN) in our Thames Valley region.

During the year we began to notify customers in six local authorities that the billing arrangements for water services were changing. We signposted our financial support services (WaterSure and WaterSure Plus) and priority services and as a result an additional 5,000 customers now receive help from these tariffs. Several London Boroughs held customer stalls or roadshows during the year to provide community support and we have worked with them to increase customer awareness of our services and tariffs. We recognise that there is more to do to improve our engagement with customers, particularly in areas where we have fallen short of expectations. Our recent reorganisation, in April 2018, has been designed to ensure that our organisation reflects the way our customers see us and that our customers are at the heart of our decision making.

3. Our systems of internal control

We have established processes and systems of internal control that enable us to meet our obligations.

Our approach to meeting and demonstrating compliance with our obligations is based on having defined processes, systems of internal control and sound governance arrangements in place.

The key features of our systems of internal control and governance arrangements are:

- a governance model whereby our Board has ultimate responsibility for risk and control. The Board has oversight through its various committees, who have delegated responsibility for certain matters of risk and control, in line with best practice. As part of our continuous improvement process, we have reviewed our Board governance and how decision making is delegated through our organisation as well as making these arrangements more transparent to our customers and stakeholders;
- a defined operational and organisational structure, detailing key accountabilities and responsibilities;
- a risk management process that reports on the Company's risk profile, identifies risks to the delivery of our strategic business objectives, assesses the impact of these risks should they materialise, and the likelihood of this happening. Risks are prioritised, according to our defined risk scoring criteria, allowing for the most significant risks to be monitored quarterly by Senior and Executive Management, our Audit, Risk and Reporting Committee (ARRC) and our Board. These reviews form the basis for our annual principal risks and uncertainties disclosure;
- a framework of corporate policies, supported by operating standards and procedures, and authorisation and approval guidelines that provide the necessary guidance to our employees and business partners as to how they should operate and conduct themselves when acting on behalf of the Company;
- comprehensive business planning and financial reporting procedures, including the preparation of detailed annual operational budgets for the year ahead and projections for subsequent years;
- an annual Controls Self-Assessment process that has evolved during the year, and which requires senior management to report on the maturity and effectiveness of the key internal controls in operation within their business area, identify opportunities for improvement and to implement remedial action where required. A holistic view of the outcomes of this process provides a targeted programme for improvement of our internal control environment;
- an annual internal audit programme that independently reviews the design and effectiveness of key controls that help mitigate risks to the delivery of our strategic business objectives, and reviews the effectiveness of the risk management process;
- reporting to the ARRC on the assurance arrangements for the reporting of regulatory information as required by Ofwat under its Company Monitoring Framework;
- Board and committee review of reports produced by internal and external auditors, as well as assurance/compliance teams within the business; and
- our ARRC also receives assurance from our independent external advisors (KPMG) on regulatory reporting matters. Our advisors review our data and controls to enable us to have confidence in the accuracy and completeness of the data we prepare and publish. This also forms the basis of our declarations of compliance.

We use the "three lines of defence" model, as set out in the section on our principal risks and uncertainties (pages 72–78), to provide assurance on our risk management arrangements, and systems of internal control:

- First line – management is responsible for the application of our risk management framework and for the operational effectiveness of internal controls;
- Second line – our risk function and compliance teams are responsible for supporting the business on, and providing oversight of, the identification, assessment, monitoring and reporting of risk and mitigation strategies; and
- Third line – our internal audit function provides independent and objective assurance on the risk management framework and the effectiveness of the systems of internal control.

In drafting this statement we have taken into account the results of ongoing monitoring of financial, operational and compliance controls, undertaken by first, second and third lines of defence, including the outcomes from our risk management process. Additionally, we have taken into consideration Ofwat's recent reports and Information Notices, including Ofwat's findings in their leakage investigation as published in their '*Notice to impose a penalty on Thames Water*' on 7 June 2018 and their 'Out in the cold – water companies' response to the 'Beast from the East' report on 19 June 2018.

In respect of the freeze thaw event, we have already completed a thorough root cause analysis and will use the insight that delivers to make further improvements. Pleasingly, the Ofwat report confirms that we are already focussing on the right areas.

We recognise that there are areas where we have recently fallen short of expectations and are committed to ensuring these are addressed. As a result we commenced a programme to review and improve our entire risk and controls framework to ensure that our key processes, including our response to major events, have the rigour to meet and exceed our commitments to, and the expectations of, our customers and other stakeholders.

Prescribed status

Due to shortcomings in the reporting of our leakage performance and errors that were identified within some of our financial tables within our 2016/17 Annual Performance Report, our categorisation under Ofwat's Company Monitoring Framework assessment, moved us from 'targeted' status to 'prescribed'. Details of our plans to deliver our leakage recovery plan, as well as the outcome of Ofwat's investigation into our leakage performance, can be found on page 9 of this Report. In response to our information errors in our Annual Performance Report, we have been reviewing and reflecting on the control environment that underpins our publication and provision of information. We have therefore enhanced our external information assurance framework based on our three lines of defence model. These changes have further refined the accountabilities and responsibilities within our business and should increase both customer and Ofwat confidence in our publications and company submissions. For example, we have engaged our employees company-wide to ensure information providers understand the importance of data, and our internal and external reporting obligations. We are continuing to work closely with our assurance partners, our Executive Team and Board on reviewing, verifying and validating our returns.

Leakage investigation

We acknowledge Ofwat's findings from their investigation into our leakage performance and accept the failings identified in our governance processes. The Company and Board have already taken steps to address many areas, such as:

- making significant changes to the Infrastructure Alliance contract, with control over all key activities now lying with the Company's senior managers and not with contractor staff;
- changes to the Operational Design of the business to align key processes across the business and ensure that the right focus is being given to key areas of performance, including leakage,
- improvements to the reporting of leakage and other performance metrics to the Board and other key stakeholders, ensuring a proactive approach to leakage management and monitoring of leakage performance against targets on a monthly basis; and
- undertaking a comprehensive Governance review of the Board and the Committees that report into them, with the changes already made within the Executive management team and the changes being made to the composition of the Board.

Freeze thaw investigation

We welcome Ofwat's findings from their review of the March 2018 freeze thaw event and acknowledge their specific recommendations. In response to these, we will:

- develop our emergency response plans;
- develop our plans regarding the provision, deployment and delivery of alternative water supplies;
- improve the information we hold on customers in vulnerable circumstances;
- develop a comprehensive crisis communications plan for customers, retailers, employees and other stakeholders;
- consider our approach to proactively fixing customer side leakage;
- improve the quality of data to be able to more quickly and accurately predict and identify network issues; and
- update governance processes to ensure they are fit for purpose and function effectively.

Other areas of focus

Our ability to demonstrate awareness of, and compliance with, our policies is relatively immature with reliance placed on annual awareness and training programmes, and local managerial control that are focused primarily on topics deemed to be mandatory for our business. We have commenced an improvement programme that will address recognised and identified shortcomings.

We continue to review our Recruitment Strategy and Recognition & Reward arrangements to ensure we attract high calibre individuals and retain employees with appropriate skills and experience to run our business. Whilst we have confidence in our ability to manage change at a local level, there are opportunities for us to better align our approach to address our corporate priorities. Additionally, we are about to undertake a review of the process and controls that underpin our event management arrangements.

We are developing a Policy Framework and a 'Policy Hub' where all policies will be stored (including governance around updates to them). We plan to roll out a business process, risk & controls system across the business – taking an existing system and driving a consistent use of it across the business.

Additionally, we have dedicated team within the Digital area who are working with the business to significantly improve data quality and data governance across the business.

4. Managing our risks

We have systems and processes in place which allow us to identify, assess, manage and report risk

Our risk management process is developed to align with the Risk Management International Standard, ISO 31000, which aids our compliance with the Financial Reporting Council's UK Corporate Governance Code guidance on risk management. Risks are identified, assessed and managed across all our operations, change programmes, support and corporate functions on a rolling basis and reported to the relevant committee on a regular basis throughout the year. Risks are regularly assessed and prioritised against our defined impact and likelihood criteria. This approach enables us to determine how we will respond to any specific risk and to prioritise and target mitigation actions.

The business and functional teams are supported and challenged in this work by the Risk, Audit & Assurance team, which also co-ordinates and ensures consistent reporting of our risks at business and corporate levels, escalating as appropriate. The risk information reported is considered, reviewed and challenged by relevant oversight committees including the Executive Committee and our Audit, Risk and Reporting Committee. More detailed information on the risk management process and its outputs can be found on pages 64–71.

We are disappointed that we failed to meet the standards that Ofwat expects of us in providing confidence to our customers about our ability to deliver, monitor and report on our performance, which, in combination with some errors in our 2016/17 Annual Performance Report led to us being placed in the "prescribed" category following Ofwat's annual Company Monitoring Framework assessment. We recognise that if commitments are not met, we need to be transparent about the reasons for this, the lessons learned and set out the remedial action being taken. As well as ensuring we have plans to address specific comments raised by Ofwat in their assessment, we published an updated Statement of Risks, Strengths and Weaknesses for 2017/18 based on a detailed assessment of our reporting risks (www.thameswater.co.uk/annualresults), in addition to a statement reporting risks associated with our PR19 plan and related submissions (www.thameswater.co.uk/annualresults).

We underestimated the severity and impact the 'Beast from the East' would have on, not only, our network, but customers' pipes which led to a number of customers being out of supply for up to five days. Following the event in March 2018, we reviewed our original plans and response and have also taken into consideration Ofwat's findings in the report published on 19 June 2018. We will formalise our actions and response to Ofwat's report by 28 September 2018.

5. Delivery of outcomes/Performance against Performance Commitments

We are working hard to deliver the outcomes our customers expect.

For this five year regulatory period, we set ourselves 55 ambitious Performance Commitments. 41 of these Performance Commitments had an annual target for 2017/18. A summary of our performance against each of these Performance Commitments (including the three commitments met during years one and two of the AMP and 11 with an AMP end target) is presented in Table 3A on pages 209–212 of this Report. This Report has been reviewed by our independent assurance providers.

Our performance against our 41 annual Performance Commitments 2017/18 can be summarised as follows:

- 9 red (performance below committed level and outside the acceptable range/deadband)
- 8 amber (performance below committed level, but within an acceptable range/deadband)
- 24 green (performance at, or favourable to the committed level)

A detailed guide to the performance ratings is included in Table 3A on pages 209–212 of this Report.

Commentary around our Performance Commitments, including plans in place to address areas where we have fallen short of our targets, can be found on pages 28 to 37 of this Report.

The following Performance Commitments were rated as red:

- RA4: Improved customer satisfaction of Retail customers (operations contact centre) – see page 32
- WA2: Minimise the number of written complaints received from customers (relating to water services) – see page 31
- WB4: Low pressure performance – see page 11
- WB5: Supply interruptions > 4 hrs (hr/prop) – see page 11
- WB6: Security of Supply Index – see page 29
- WC2: Leakage – see page 9
- WD1: Energy imported – energy exported (GWh) – water – see page 49
- SD1: Energy imported – energy exported (GWh) – waste – see page 49
- T3: Engaging with customers to build understanding of TTT project – see page 35

Board Statement

The Board confirms that, insofar as it is aware, having made reasonable enquiries, the information contained in the Risk and Compliance Statement is materially accurate at the date below.

Steve Robertson
Executive Director

Brandon Rennet
Executive Director

Nick Fincham
Executive Director

Nick Land
Independent Non-Executive Director

Ian Marchant
Chairman

Kenton Bradbury
Non-Executive Director

For, and on behalf of, the Board of Thames Water Utilities Limited

27 June 2018

Data assurance summary

We are committed to providing accurate and transparent reporting on our performance. It is critical to us that our customers are confident that we are monitoring and reporting how well we are delivering our service. Each year we report on how we are performing against the 55 performance commitments we set at the start of this five year regulatory period.

Ofwat, the regulator for the water industry, assesses water companies against the Company Monitoring Framework on an annual basis and places them in a category of assurance. The categories are:

- Self Assured – The Company has demonstrated consistently that customers and other stakeholders can place trust and confidence in the information that it provides;
- Targeted – The Company did not consistently meet the high standards that customers and other stakeholders expect; and
- Prescribed – The company did not instil sufficient confidence about their ability to deliver, monitor and report performance.

Feedback on our 2016/17 reporting identified two areas where we have not met the standards that Ofwat expects of us in providing confidence to our customers about our ability to deliver, monitor and report performance. Therefore we were placed in the 'prescribed' category, the lowest category of assurance following Ofwat's review in November 2017.

We are very disappointed with our performance in these areas and we are committed to ensuring our reporting is transparent and accurate to provide trust and confidence on whether the company is achieving its committed level of performance.

Following our downgrade to the prescribed category, in January 2018 we published our Statement of risks, strengths and weaknesses and assurance plans 2017/18. The purpose of this statement was to support us in providing customers and other stakeholders with information that is easy to understand, provides transparency and helps to build trust and confidence in our performance reporting.

In March 2018, we published our Final assurance plans 2017/18 which explain how we are addressing the risks identified in the Statement of risks, strengths and weaknesses 2017/18.

For further information about the outcomes of our assurance plans, please see our Data assurance summary 2017/18 (www.thameswater.co.uk/annualresults).

Independent auditor's report to the Water Services Regulation Authority (the "WSRA") and the Directors of Thames Water Utilities Limited

Opinion on Annual Performance Report

We have audited the sections/tables within Thames Water Utilities Limited's Regulatory Accounts for the year ended 31 March 2018 ("the Regulatory Accounts") which comprise:

- the regulatory financial reporting tables comprising the income statement (table 1A), the statement of comprehensive income (table 1B), the statement of financial position (table 1C), the statement of cash flows (table 1D) and the net debt analysis (table 1E) and the related notes; and
- the regulatory price review and other segmental reporting tables comprising the segmental income statement (table 2A), the totex analysis for wholesale water and wastewater (table 2B), the operating cost analysis for retail (table 2C), the historical cost analysis of fixed assets for wholesale and retail (table 2D), the analysis of capital contributions and land sales for wholesale (table 2E), the household water revenues by customer type (table 2F), the non-household water revenues by customer type (table 2G), the non-household wastewater revenues by customer type (table 2H), the revenue analysis & wholesale control reconciliation (table 2I), the infrastructure network reinforcement costs (table 2J) and the related notes.

We have not audited the Outcome performance table (tables 3A to 3S) and the additional regulatory information in tables 4A to 4W.

In our opinion, Thames Water Utilities Limited's Regulatory Accounts have been properly prepared in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA (RAG 1.08, RAG 2.07, RAG 3.10, RAG 4.07 and RAG 5.07) and the accounting policies (including the company's published accounting methodology statement(s), as defined in RAG 3.10, appendix 2).

Basis of opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)"), including ISA (UK) 800, and applicable law, except as stated in the section on Auditors' responsibilities for the audit of the Regulatory Accounts below, and having regard to the guidance contained in ICAEW Technical Release Tech 02/16 AAF 'Reporting to Regulators on Regulatory Accounts' issued by the Institute of Chartered Accountants in England & Wales.

Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the Regulatory Accounts section of our report. We have fulfilled our ethical responsibilities under, and are independent of the company in accordance with, UK ethical requirements under the FRC Ethical Standard. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of matter – basis of preparation

We draw attention to the fact that the Regulatory Accounts have been prepared in accordance with Condition F, the Regulatory Accounting Guidelines, the accounting policies (including the company's published accounting methodology statement(s), as defined in RAG 3.10, appendix 2) set out in the statement of accounting policies and under the historical cost convention. The nature, form and content of the Regulatory Accounting statements are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly we make no such assessment.

The Regulatory Accounts are separate from the statutory financial statements of the Company and has not been prepared under the basis of International Financial Reporting Standards as adopted by the European Union ("IFRSs"). Financial information other than that prepared on the basis of IFRSs does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in statutory financial statements prepared in accordance with the Companies Act 2006.

The Regulatory Accounting Statements on pages 181–208 have been drawn up in accordance with Regulatory Accounting Guidelines with a number of departures from IFRSs. A summary of the effect of these departures from Generally Accepted Accounting Practice in the Company's statutory financial statements is included in the tables within section 1.

The Regulatory Accounts are prepared in accordance with a special purpose framework for the specific purpose as described in the Responsibilities for the Regulatory Accounts and the audit section below. As a result, the Regulatory Accounts may not be suitable for another purpose.

Our opinion is not modified in this respect.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the Regulatory Accounts is not appropriate; or
- the directors have not disclosed in the Regulatory Accounts any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the Regulatory Accounts are authorised for issue.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern.

Our assessment of risks of material misstatement

Reporting on other information

The other information comprises all of the information in the Regulatory Accounts other than the Regulatory Accounting Statements within the Regulatory Accounts and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the Regulatory Accounting Statements does not cover the other information and, accordingly, we do not express an audit opinion or any form of assurance thereon.

In connection with our audit of the Regulatory Accounting Statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the Regulatory Accounting Statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the Regulatory Accounting Statements within the Regulatory Accounts or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement or inconsistency of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

Responsibilities of the Directors for the Regulatory Accounts

As explained more fully in the Statement of Directors' Responsibilities set out on pages 181–182, the directors are responsible for the preparation of the Regulatory Accounts in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the Company's accounting policies (including the Company's published accounting methodology statement(s), as defined in RAG 3.10, appendix 2).

The directors are also responsible for such internal control as they determine is necessary to enable the preparation of the Regulatory Accounts that is free from material misstatement, whether due to fraud or error.

In preparing the Regulatory Accounts, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the Audit of the Regulatory accounting statements within the Regulatory Accounts

Our objectives are to obtain reasonable assurance about whether the Regulatory accounting statements within the Regulatory Accounts are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these Regulatory Accounts.

As part of an audit in accordance with ISAs (UK), we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the company's Regulatory Accounts, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our report. However, future events or conditions may cause the company to cease to continue as a going concern.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during the audit.
- Assess the reasonableness of significant accounting estimates and related disclosures made by the directors.

We have not assessed whether the accounting policies are appropriate to the circumstances of the Company where these are laid down by Condition F. Where Condition F does not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the Regulatory Accounts are consistent with those used in the preparation of the statutory financial statements of the company.

The Company has presented the allocation of operating costs and assets in accordance with the accounting policy for price control segments set out in page 193 and its accounting methodology statement(s) published on the Company's website on 28 June 2018. We are not required to assess whether the methods of cost allocation set out in the Methodology Statement are appropriate to the circumstances of the Company or whether they meet the requirements of the WSRA, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK).

Opinion on other matters prescribed by Condition F

Under the terms of our contract we have assumed responsibility to provide those additional opinions required by Condition F in relation to the accounting records. In our opinion:

- proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F; and
- the Regulatory Accounting Statements are in agreement with the accounting records and returns retained for the purpose of preparing the Regulatory Accounts.

Use of this report

This report is made, on terms that have been agreed, solely to the Company and the WSRA in order to meet the requirements of Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewage undertaker under the Water Industry Act 1991 ("Condition F"). Our audit work has been undertaken so that we might state to the Company and the WSRA those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under Condition F to procure such a report and (b) to facilitate the carrying out by the WSRA of its regulatory functions, 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 WSRA, for our audit work, for this report or for the opinions we have formed.

Our opinion on the Regulatory Accounting Statements within the Regulatory Accounts is separate from our opinion on the statutory financial statements of the Company for the year ended 31 March 2018 on which we reported on 27 June 2018, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our "Statutory audit report") was made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our Statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Robert Brent
For and on behalf of KPMG LLP
Chartered Accountants
15 Canada Square
London
E14 5GL
27 June 2018

Glossary of regulatory terms

Agreed upon procedures – Specific procedures carried out by an assurance provider, which have been agreed with the company.

AMP 6 slow money % – the proportion of allowed total expenditure (totex) that is added to the RCV for each year of the AMP period.

Appointed Business – The appointed business comprises the regulated activities of the Company which are activities necessary in order for the Company to fulfil the function and duties of a water and sewerage undertaker under the Water Industry Act 1991.

Arm's-length trading – Trading in which the Company treats the other party, usually an associate company, on the same basis as an external party.

Asset Management Plan ("AMP") – An 'Asset Management Period' is the five-year period covered by a water company's business plan. These are numbered; with AMP1 referring to the first such planning period after the water industry was privatised – i.e. the period from 1990 to 1995. The current period (2015 – 2020) is known as AMP6, and the period for which we are now starting to plan (2020 – 2025) will be AMP7.

Associate company – Condition A of the Licence defines an associate company to be any group or related company. Condition F of the Licence requires all transactions between the Company and its associated companies to be disclosed subject to specified materiality considerations.

Assurance – Provides confidence and a level of certainty about whether that piece of information or data is correct.

Assurance plans – A plan of the activities we will carry out to provide assurance on the data/information that we publish.

Capital Expenditure ("Capex") – Expenditure to acquire or upgrade physical assets such as property, pipes and treatment works.

C17 – The Water Act 2014 allowed 1.2 million businesses and other non-household customers of providers based mainly or wholly in England to choose their supplier of water and wastewater retail services from April 2017. Retail services include functions like billing and customer services. The new market is open to all non-household customers. Thames Water has chosen to exit this market and has sold its non-household retail business to Castle Water. Thames Water will remain the wholesaler to these customers, who were transferred to Castle water before the market opening on 1 April 2017.

Committed Performance Level ("CPL") – in order to measure our progress against our performance commitments, we agreed committed performance levels with Ofwat for each year of AMP 6. Our committed performance levels are published in our Final Determination.

Company monitoring framework – Ofwat's framework that sets out the way in which companies must provide and assure performance information to their customers and stakeholders.

Cost – The actual cost to the supplier, of the goods, works or services, including a reasonable rate of return on capital employed. Unless the circumstances of the transaction provide a convincing case for the use of an alternative measure, the return on capital should be consistent with the cost of capital/net retail margin as set out in Ofwat's final determination of 12 December 2014 (or any other determination applicable in the 2015–20 period).

Cost allocation – Cost allocation is the means by which all costs are allocated to appointed and non-appointed businesses, price control units, or specific supplies, works and services, ensuring a fair share of overheads, even where costs cannot be directly attributed to specific activities and associated services.

Cost driver – A cost driver is the factor or factors which cause cost to occur. This can be further divided between the driver that causes an activity to occur, and a driver that determines how often it occurs. Costs may vary in relation to the cost driver over the short or longer term, depending on the nature of cost concerned.

Consumer Price Index ("CPI") – The Consumer Prices Index is a measure of economic inflation based on a set series of goods and services set by the Office for National Statistics. This is the headline measure of inflation used in the Government's target for inflation.

Cross-subsidy – Cross-subsidy in this context is monetary aid or contributions from the appointee to the associate, or between price control units, which does not reflect the value of the services received. It also relates to services provided by the appointee to associate companies where there has been an under-recovery of costs incurred by the appointee.

CSAT – Short for 'customer satisfaction', this refers to the qualitative component of the SIM measure.

Customer Challenge Group ("CCG") – Independent group of domestic customer, business customer and environmental representatives to ensure that we continue to be held to account for delivering our commitments and meeting the promises we made to our customers.

Customer side leakage ("CSL") – leakage from customer side pipes.

Customer numbers – To ensure consistency with the way in which price controls have been set for 2015–20, customer numbers when used as a cost allocation metric is equal to 1.0 for single-service (water or wastewater only) customers and 1.3 for dual-service (water and wastewater) customers.

F6A – A statement to confirm that for at least the next 12 months:

- the company will have available to it:
  - sufficient financial resources and facilities to enable it to carry out the Regulated Activities; and
  - management resources and systems of planning and internal control which are sufficient to enable it to carry out those functions
- all contracts entered into with any associated company include all necessary provisions and requirements concerning the standard of service to be supplied to the Appointee, to ensure that it is able to meet all its obligations as a water and a sewerage undertaker.

Final Determination ("FD") – The conclusion of discussions on the scale and content of the asset management plan for the forthcoming five-year AMP period. It is accompanied by a determination of the allowable adjustment to wholesale price limits for the forthcoming AMP.

Full-time equivalents ("FTEs") – For the purposes of cost allocation, FTEs should include all full-time staff, and contractors/temporary staff directly employed. Where there is an existing contractual arrangement in place with an associate or third party for example a third party billing arrangement, FTEs will include all full-time staff, and contractors/temporary staff directly employed by the associate or third party involved in providing that service to the appointee.

Household – These are properties used as single domestic dwellings (normally occupied), receiving water for domestic purposes which are not factories, offices or commercial premises. These include cases where a single aggregate bill is issued to cover separate dwellings having individual standing charges. (In some instances, the standing charge may be zero.) The number of dwellings attracting an individual standing charge and not the number of bills should be counted. Mixed/commercial properties and multiple household properties – for example, blocks of flats having only one standing charge – should be excluded.

Infrastructure and non-infrastructure assets – Infrastructure assets are mainly our below-ground assets, such as pipes, water mains, sewers, dams and reservoirs. Non-infrastructure assets are those mainly found above ground, such as water and sewage treatment works, pumping stations, laboratories and workshops.

Instrument of Appointment – Water companies operating the public water networks hold appointments as water undertakers, and those operating the public wastewater networks hold appointments as sewerage undertakers, for the purposes of the Water Industry Act 1991. They also supply water and wastewater services direct to household and non-household customers who are connected to their networks.

Licence – The Instrument of Appointment dated August 1989 under Section 11 and 14 of the Water Act 1989 (as in effect on 1 August 1989) under which the Secretary of State for the Environment appointed Thames Water Utilities Limited as a water and sewerage undertaker under the Act for the areas described in the Instrument of Appointment, as modified or amended from time to time.

Measured – These are properties where some or all of the charges for supplies are based on measured quantities of volumes.

Modern Equivalent Asset Value (“MEAV”) – The cost of an asset of equivalent productive capability to satisfy the remaining service potential of the asset being valued if the asset would be worth replacing or the recoverable amount if it would not. The gross MEA value is what it would cost to replace an old asset with a technically up to date new asset with the same service capability allowing for any difference both in the quality of output and in operating costs. The net MEA value is the depreciated value taking into account the remaining service potential of an old asset compared with a new asset, and is stated gross of third-party contributions.

Non-appointed business – The non-appointed business activities of the Company are activities for which the Company as a water and sewerage undertaker is not a monopoly supplier (for example, the sale of laboratory services to an external organisation) or involves the optional use of an asset owned by the Company (for example, the use of underground assets for cable television).

Non-household – These are properties receiving water for domestic purposes but which are not occupied as domestic premises, or where domestic dwellings are combined with other properties, or where properties are in multiple occupation but only have one standing charge. In this case, it is the number of bills that should be counted.

Outcome Delivery Incentive (“ODI”) – ODIs is a collective term for the financial incentives – positive and negative – that Ofwat has applied to the delivery of our five-year plan. ‘Rewards’ allow us to charge more over the next five years (in this case, 2020–2025), while ‘penalties’ require us to charge less. Some of these ODIs measure performance in each of the five years of our current plan, while others apply only to the whole five years.

Ofwat – The name used to refer to the Water Services Regulation Authority (WSRA). The WSRA acts as the economic regulator of the water industry.

Operating Expenditure (“Opex”) – Payments for the day-to-day operations of our business, such as operating and maintaining our network and treatment works, paying our staff and our energy bills. This is known as operational expenditure or OPEX.

Performance Commitment (“PC”) – Outcome performance commitments agreed with Ofwat that reflect customers’ views and priorities of service.

Periodic Review (“PR”) – The price determination process undertaken by Ofwat every five years. Each water and sewerage undertaker submits a Business Plan covering the five-year period for which Ofwat will determine cost and revenue allowances.

Price control units – At the 2014 price review Ofwat introduced separate binding price controls. These include wholesale water, wholesale wastewater, retail household, retail non-household and Thames Tideway Tunnel (“TTT”).

Regulatory Accounting Guidelines (“RAG”) – The accounting guidelines for regulatory accounts issued, and amended from time to time, by Ofwat.

Regulatory Capital Value (“RCV”) – The capital base used in setting price limits. The value of the appointed business that earns a return on investment. It represents the initial market value (200-day average), including debt at privatisation, plus subsequent net new capital expenditure including new obligations imposed since 1989. The capital value is calculated using the Ofwat methodology (i.e. after current cost depreciation and infrastructure renewals accrual).

Retail – This term refers to any water company activities that take place once water has passed to the customer’s side of a property boundary. These include billing, payment handling, debt management, meter reading and handling billing related calls.

Retail Price Index (“RPI”) – The RPI is compiled and published monthly by the Office for National Statistics. RPI is an average measure of change in the prices of goods and services bought for the purpose of consumption by the vast majority of households in the United Kingdom.

Service Incentive Mechanism (“SIM”) – The Service Incentive Mechanism was introduced by Ofwat to replace the OPA as a measure of the service customers experience from their water company. It is now in its second year. There are two elements to the SIM:

- A quantitative measure awards penalty points for issues ranging from callers to our customer centre receiving an engaged tone, through to complaints.
- A qualitative measure is calculated via telephone interviews to assess the satisfaction of customers who have contacted us to resolve queries.

Stakeholders – A person, group or organisation that has an interest or a concern in our Company.

Statement of risks, strengths and weaknesses and draft assurance plans – This is an annual document produced following consultation with our customers and stakeholders. It provides information on what we consider to be our key reporting risks and plans for how we will reduce these risks. Following publication of the Statement of risks strengths and weaknesses and draft assurance plans, further consultation is sought from customers and stakeholder before publication of the Final assurance plans.

Thames Tideway Tunnel – The Thames Tideway Tunnel is a landmark construction project which will protect the River Thames from pollution. London’s sewer system is regularly overwhelmed and spills millions of tonnes of sewage into the tidal section of the river every year. The tunnel will tackle the problem of overflows from the capital’s Victorian sewers for at least the next 100 years, and enable the UK to meet European environmental standards. The Company is responsible for planning, enabling and interface works for the project; the revenue and costs associated with this part of the project are shown in the “TTT” price control unit in the regulatory accounting tables. Bazelgette Tunnel Limited (‘BTL’) is an independent company un-related to Thames Water Utilities Limited that was appointed in 2015 to construct the Thames Tideway Tunnel. For the year ending 31 March 2017, The Company has included construction costs of the Thames Tideway Tunnel in its bills to wastewater customers. These amounts are subsequently paid to BTL. The revenue and profit on this arrangement, which is excluded from our key performance indicators, has been disclosed as non-appointed in the regulatory tables. The cash balance included (also shown as non-appointed) reflects amounts collected and not paid over at the balance sheet date.

Third-party contributions – Grants and third-party contributions received in respect of infrastructure assets and any deferred income relating to grants and third-party contributions for non-infrastructure assets.

Total expenditure (“Totex”) – The mechanism, introduced in PR14 (price review 2014) for planning and reporting capital (for example, buying a new car) and operational (repairing your old car) spend. The object is to achieve the optimum combination to deliver the required business plan outcomes. It applies to both water and waste (i.e. our wholesale business) but not to retail.

Unmeasured – These are properties where none of the charges for supplies are based on measured quantities of volumes. These include properties which receive an assessed charge because metering is not possible or economic.

Wholesale – This term covers all water company activities that take place before water passes the customer’s property boundary – resources management, abstraction, treatment, distribution (water and sewer networks), sewage collection, transportation, sewage treatment, sludge disposal and energy from waste.

Working capital – The aggregate of stocks, trade debtors and trade creditors, if material.

Working capital adjustment – The impact of RPI on the real value of working capital to the business.

Regulatory environment

The water and sewerage industry in England and Wales is comprised of over 50 million household and non-household consumers who are served by 32 privately owned companies, of which Thames Water is the largest provider of water and sewerage services.

The industry was privatised in 1989 with companies awarded licences to serve specified geographical areas. This created regional monopolies and in order to inject competition, government regulatory authorities were established. The water industry has evolved making significant improvements in areas including customer service, promoting value for customers, drinking water quality, and environmental conservation.

Whilst considerable progress has been made, there are still a number of key challenges facing the industry including:

- service affordability;
- rising environmental standards;
- increasing customer expectations;
- population growth and lifestyle changes; and
- climate change.

We recognise these challenges and have incorporated them into forming the Company's strategy which is designed to balance the needs of the overall industry against customers' and stakeholders' requirements to generate value from the business.

The water industry has in place a robust regulatory framework created to safeguard consumers' interests and ensure compliance with national and European legislation. Our key regulators are outlined below:

OFWAT

Ofwat (The Water Services Regulatory Authority) is the economic regulator of water and sewerage sector in England and Wales, responsible for protecting customers' interest whilst ensuring water companies finance and conduct their functions effectively.

Consumer Council for Water (CCW)

The CCW is an independent body that represents customers' interests relating to price, service and value for money as well as conducting independent research and investigating customers' complaints relating to water quality.

Department for Environment Food & Rural Affairs (DEFRA)

DEFRA is a UK government department supported by 35 agencies and public bodies responsible for setting policies and regulations on environmental, food and rural issues. DEFRA sets the overall water and sewerage policy framework in England including setting standards and drafting legislation.

Drinking Water Inspectorate (DWI)

The DWI regulates the quality of drinking water quality that we supply and ensures its safety and compliance with Water Quality Regulations. They do this via reviewing the tests that we conduct on our drinking water as well as carrying out inspections on water companies as and when required.

Environmental Agency (EA)

The EA is the principal adviser to the government and main body set up to protect and improve the environment in England and Wales. They work in collaboration with other organisations to reduce flood risk, promote sustainable development and secure environmental and social benefits.

Customer Challenge Group

Customer Challenge Group (CCG)

Our independent CCG, made up of customer representatives and stakeholders, has continued to challenge and advise us on the development of our business plan and how it can better reflect the needs of our customers. They have published an independent report about how we report our performance alongside our APR.

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