

CHAIRMAN'S STATEMENT



SIR JOHN PARKER, CHAIRMAN

DEAR SHAREHOLDER

In my first annual statement to you as Chairman of Pennon Group, I am pleased to report another year of strong performance and solid financial results, which translate directly to shareholder value.

Following my appointment as Chairman in August 2015, I took time to familiarise myself with the Group's operations and the strengths of the business, and concluded that a strong platform exists upon which we can further build to achieve a successful future. It was clear to me that Pennon was ready to move to the next phase; South West Water had embarked on a new five-year regulatory cycle whilst working towards the full integration of Bournemouth Water's business acquired in April 2015, and Viridor was progressing from 'construction' to 'operation', with eight Energy Recovery Facilities (ERFs) operating successfully and the construction of three more progressing well. In addition, I found talented and committed people throughout the organisation, with a very strong executive leadership team in place. The autumn of 2015 was therefore a natural time for reflection in terms of the Group's strategic priorities.

Whilst this strategic review has not given rise to a 'new' Group strategy, it has led to differences of nuance and focus. In particular, we identified that with the maturity of Viridor's business, as it moves away from waste disposal to landfill, greater commonality exists between the Group's businesses. We also recognised that we were able to move towards a more homogeneous risk profile across the two businesses, with Pennon's investment proposition now premised on an increased proportion of contracted long-term, index-linked revenues over a long-lived asset base.

As part of the strategic review, the Board decided to create a new role of Group Chief Executive Officer, a position to which Chris Loughlin (who was Chief Executive of South West Water at the time) was appointed with effect from 1 January 2016. Chris has been tasked with driving forward our strategy, which will involve looking across the business at how we can share best practice, deliver synergies and capitalise on emerging opportunities. Both Viridor and South West Water have a breadth and depth of experience in managing large asset bases and in using engineering excellence, technology and innovation to deliver efficiency and effectiveness. By sharing knowledge across the Group and harnessing our combined skills we can provide even better service to our wide customer base of local authorities, major corporate clients and household customers throughout the UK. By driving integration across the Group we will also be able to extract tangible efficiencies and synergies.

HEALTH AND SAFETY

I have been impressed by the level of commitment of the Board and the senior management teams to the health, safety and wellbeing of our people. As reported last year, tragically there was an incident in June 2015 involving a Viridor vehicle, which resulted in the death of a Viridor employee. The Group continues to work with the authorities in relation to this incident.

Reflecting the Board's desire for a consistent and effective Group-wide approach, we have created a new role of director of Safety, Health, Environment, Quality and Sustainability (SHEQS), and recruitment is underway. The Group has strategic improvement plans in place and continues to invest in programmes and initiatives to further embed the change in culture and attitudes necessary to achieve its target of zero accidents and incidents.

SUSTAINABILITY

Environmental, social and governance (ESG) matters are integral to our strategy and business model. The Sustainability Committee of the Board continues to oversee our performance in maintaining a responsible approach to business operations. The Group's notable achievements include another year of high quality drinking water; benefits to local economies as a direct result of our investment in energy recovery infrastructure, strong performance against new EU bathing water standards, preliminary work on a new water treatment works with cutting edge technology for the Plymouth area, investment in further customer service improvements, further work to reduce the risk of sewer flooding, recognition for our apprenticeship programmes, and acclaimed education programmes and community engagement activities across the Group.

Further information on the Group's approach to sustainability is provided throughout the strategic report and in the Sustainability Committee report for the year on pages 70 to 73.

DIVIDEND

I am pleased to report that the Board is recommending a final dividend per share of 23.12p, representing a 6.0% increase on last year's final dividend. This will result in a total dividend for the year of 33.58p, an increase of 5.6%, which is in line with our dividend policy of year-on-year growth of 4% above RPI inflation to 2019/20 and reflects the Board's confidence in the future financial performance of the Group. We will again be offering a scrip dividend alternative to shareholders in respect of the final dividend for which the timetable is given on page 173.

BUILDING ON A STRONG PLATFORM DELIVERING SUSTAINABLE PROFIT AND DIVIDEND GROWTH



NEW GOVERNANCE FRAMEWORK

On my appointment, I was pleased to see that a strong commitment to the three essential pillars of a successful board – strong financial control, sound administration and good governance – was in evidence in the boardroom. To ensure we are well placed to continue to deliver solid growth and efficiency, I reviewed our Board structures, in consultation with the Non-executive Directors, and identified opportunities for streamlining the Group's governance framework and decision-making processes. Changes were implemented after agreement with Ofwat in respect of South West Water and Bournemouth Water governance arrangements. This involved simplifying the subsidiary board structure to achieve more efficient governance whilst preserving the regulatory ring fence around the water and wastewater business. Further details are provided in the governance report on page 62.

OTHER BOARD DEVELOPMENTS

Ken Harvey, our long-serving and distinguished Chairman of 18 years, retired at last year's AGM. The success of Pennon Group today is in no small measure due to his professional leadership and integrity. Our Senior Independent Director, Gerard Connell, also stepped down at the AGM and we acknowledge the significant contribution he made to our Board during his 12 years of service. We also wish both a happy retirement. I am pleased to report that Gill Rider has been appointed as our new Senior Independent Director.

As reported above, Chris Loughlin was appointed to the new role of Group Chief Executive Officer on 1 January 2016. Prior to that, Chris served as an Executive Director of Pennon Group Plc in his capacity as Chief Executive of South West Water. Stephen Bird was promoted to the position of Managing Director of South West Water with effect from the same date. As at 1 April 2016, Susan Davy's title changed from Group Director of Finance to Chief Financial Officer.

Changes to the governance structure, which were implemented on 1 April 2016, have seen our existing independent Non-executive Directors, Martin Angle, Neil Cooper and Gill Rider, additionally being appointed as non-executive directors of South West Water Limited. I continue to serve as chairman of South West Water, an office to which I was appointed on 31 July 2015. In addition, the Board has been pleased to welcome three non-executive directors of South West Water, Martin Hagen, Steve Johnson and Lord Matthew Taylor, to participate in plenary sessions of the Pennon Group Board and its Committees. Steve Johnson resigned subsequent to the year end due to taking up another appointment.

Ken Woodier, our Group General Counsel and Company Secretary, decided to retire in the year. He has served the Board in a diligent, professional and committed way for some 18 years. We thank him and wish him well in the future. He is succeeded by Helen Barrett-Hague from Alent Plc and we welcome her to Pennon.

DIVERSITY

The Board continues to promote equality and diversity across the Group in all areas, including gender and ethnicity. I am pleased to say we exceeded our target of 25% female representation on the Board by 2015.

We remain committed to ensuring our Board pursues a progressive diversity agenda and you will find further details in our Nomination Committee report on page 74.

MANAGEMENT AND EMPLOYEES

The success of any company is down to the quality of its leadership, not just in the boardroom, but throughout the organisation. The strong and effective leadership we have along with well-trained and skilled personnel, including our award-winning apprenticeship schemes, underpin the success of Pennon Group.

May I take this opportunity to express my thanks and that of our Board to all our employees who make the difference to our performance and to the service we render to our communities every day.

LOOKING TO THE FUTURE

With its refreshed strategy Pennon will continue to capitalise on strategic opportunities, whilst developing our people, protecting the environment, helping the communities in which we operate and enhancing shareholder value. We have built a solid foundation for the future.

Sir John Parker
Chairman
Pennon Group Plc
24 May 2016