United Utilities Group PLC
26 May 2016

FULL YEAR RESULTS FOR THE YEAR ENDED 31 MARCH 2016

Continuing operations	Year ended	
	31 March 2016	31 March 2015
Revenue	£1,730.0m	£1,720.2m
Underlying operating profit[1]	£604.1m	£664.3m
Operating profit	£567.9m	£653.3m
Total dividend per ordinary share (pence)	38.45p	37.70p
RCV gearing[2]	61%	59%

[1] Underlying profit measures have been provided to give a more representative view of business performance and are defined in the underlying profit measure tables
[2] Regulatory capital value or RCV gearing calculated as group net debt/United Utilities Water's RCV (outturn prices)
[3] Time: Cost: Quality index (TCQi), which is an internal measure of the overall effectiveness of delivery of the capital investment programme

- **Strong operational and environmental performance**
  - accelerated investment to deliver early operational benefit; £799m invested in 2015/16 and TCQi[3] at 90%
  - £2.5m net reward achieved for 2015/16 on outcome delivery incentives
  - benefitting from 'systems thinking' operational approach and improved resilience of network
  - retained Dow Jones Sustainability Index 'World Class' rating and sector leading status
- **Further improvements in customer satisfaction**
  - service incentive mechanism score improved compared with last year
  - customers continue to rate us very highly on wastewater services
- **Implementing efficiency plans to eliminate totex gap**
  - business plan initiatives in place to meet totex allowance
  - good progress achieved in first year of the five-year regulatory period
- **'Water Plus' Business Retail JV with Severn Trent approved by the CMA**
  - first mover advantage and economies of scale, ahead of full market opening in 2017
- **Good financials**
  - underlying operating profit down 9% at £604m, as expected
  - lower underlying net finance expense: benefit of lower cost fixed debt and lower RPI inflation
  - robust capital structure with RCV gearing at 61%, comfortably within our target range of 55% to 65%
  - final dividend of 25.64 pence per share (total for the year 38.45p), an increase of 2% in line with policy

Steve Mogford, Chief Executive Officer, said:

"We are encouraged to see further improvement in customer satisfaction, particularly in light of the unprecedented flooding events. We placed customers at the heart of our response and we benefitted from our recently opened integrated control centre and improved network resilience.

"We accelerated our investment programme to deliver early operational benefit and exceeded our expectations by achieving a small reward across our outcome delivery incentives, against a tough set of targets. In addition, we have now identified and are implementing a range of efficiency initiatives to meet our total expenditure allowance. We plan to invest over £100 million across the 2015-20 period in renewable energy projects.

"We received CMA approval for our joint venture with Severn Trent to merge our business retail operations, providing us with first mover advantage and economies of scale ahead of full market opening in 2017. The joint venture, named Water Plus, combines the complementary skills of both companies to deliver a fresh, competitive operation providing a very attractive retail proposition for business customers.

"Our progress over this first year of the new regulatory period shows we are well placed to deliver further value for customers, shareholders and the environment, underpinned by a robust capital structure and good credit ratings."

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A presentation to investors and analysts starts at 9.00am on Thursday 26 May 2016, at the Auditorium, Deutsche Bank, Winchester House, 1 Great Winchester Street, London, EC2N 2DB. The presentation can be accessed via a live listen in conference call facility by dialling: +44 (0) 20 7162 0025, access code 958722. A recording of the call will be available for seven days following Thursday 26 May 2016 on +44 (0) 20 7031 4064, access code 958722.

This results announcement and the associated presentation will be available on the day at: http://corporate.unitedutilities.com/investors.aspx

KEY OPERATIONAL PROGRESS

We have made significant progress over recent years and improving operational performance, customer service and environmental improvement will remain top priorities as we move through the 2015-20 regulatory period. Despite the water quality incident we experienced last summer and the operational challenges we faced following the unprecedented flooding events which occurred in December, we have still seen an improvement in customer satisfaction and operational performance.

- **Strong operational performance** – we have delivered significant improvements over recent years and in 2014/15 we again achieved first quartile operational performance, as measured through Ofwat key performance indicators (KPIs) and the Environment Agency's (EA) assessment. Although we cannot assess our relative performance for 2015/16 until the other water companies' metrics are published, we have made further operational improvements this year in a number of areas, including pollution incidents, and overall have achieved a small net reward for 2015/16 on our outcome delivery incentives (ODIs). Furthermore, our 'systems thinking' approach, which integrates the use of our assets, leverages data intelligence and employs technology and new work processes, is supporting our drive for further improvement.

- **Significant improvements in customer service** – we have significantly improved the customer experience over recent years and this was recognised in Ofwat's final determination, in December 2014. Our service incentive mechanism (SIM) performance substantially improved and we averted the risk of a possible c£80 million revenue penalty, benefitting our financials for the 2015-20 period. Supporting this SIM improvement was a total reduction in customer complaints of approximately 75% across the 2010-15 period. Adjusting for the water quality incident, domestic customer complaints are lower than last year and both our qualitative and quantitative SIM scores for 2015/16 have also improved slightly on last year, despite the water quality incident.
- **Effective delivery and acceleration of investment plan** – we have made a good start to the 2015-20 investment programme and we are accelerating the five-year programme to maintain and improve services for customers and deliver further environmental benefits. We continue to drive more effective and efficient delivery of our capital programme and this is reflected in our Time: Cost: Quality index (TCQi) score which remains high, at 90%, despite a tougher measurement mechanism being applied for this regulatory period.
- **Leakage target** – we have consistently met or outperformed our regulatory leakage target and performance in 2015/16 keeps us on track to meet our 2015-20 targets, as set by Ofwat.
- **Regulatory outperformance –** the low cost of debt we have already locked-in places UU in a strong position to deliver our target for the 2015-20 period of beating Ofwat's industry allowed cost of debt. In addition, we have identified and are implementing initiatives to deliver over £400 million of savings to meet our totex allowance. Operationally, we have made good progress this year and achieved a small reward on our ODIs and have substantially mitigated the downside risk associated with our future ODIs, which become progressively tougher as we move through the 2015-20 regulatory period. We have outperformed our regulatory revenue allowance for domestic retail in 2015/16.
- **Strong corporate responsibility credentials –** we retained a 'World Class' rating in the Dow Jones Sustainability Index for the eighth consecutive year, again achieving industry leading performance status in the multi-utility/water sector. In addition, at the PwC 2015 Building Public Trust Awards, UU was selected as joint winner for 'Excellence in reporting in the FTSE 100'.
- **Business Retail: 'Water Plus' JV with Severn Trent approved by the CMA** – we have been building our capability to ensure we are in a strong position as the competitive business retail market evolves and our 'Water Plus' JV with Severn Trent reinforces this position and gives us first mover advantage ahead of full market opening in 2017. 'Water Plus' combines the complementary skills of both companies to deliver an attractive proposition for customers and will create synergies to provide an efficient and cost-effective operation focussed on improved customer service and growth. Before the JV, UU was already very active in this expanding market. After attaining a Scottish water supply licence in 2012, we quickly grew to be one of the most successful new entrants in Scotland and we

have continued our expansion and have now won approximately 300 customers, covering around 3,500 sites. Overall, our business retail operation has achieved a net increase in annualised revenue of £18 million. We will continue to bid for business at attractive margins and are not solely focusing on growing market share. We also continue to offer and develop our range of value-added services, such as leak detection and water efficiency advice.

FINANCIAL OVERVIEW

The group has delivered a good set of financial results for the year ended 31 March 2016.

- **Revenue –** was up £10 million at £1,730 million, despite new regulated price controls. This is because we have benefitted this year from higher than assumed volumes, along with an increase in non-regulated sales, and last year was impacted by the £21 million special discount we applied to customer bills.
- **Underlying operating profit –** lower by £60 million, at £604 million, as expected, reflecting the new regulated price controls, an increase in infrastructure renewals expenditure as we accelerate the investment programme to deliver early operational benefit, along with increases in depreciation and other costs, partly offset by a reduction in bad debts, power and regulatory fees.
- **Capex –** total regulatory capital investment in the year, including £169 million of infrastructure renewals expenditure, was £799 million, in line with company’s plans to accelerate the 2015-20 investment programme. In addition to our c£3.5 billion five-year regulatory capex programme, we expect to invest over £100 million in non-regulated projects, principally relating to solar power, of which £32 million was invested in 2015/16.
- **Underlying profit before tax –** down by £39 million to £408 million, as the £60 million fall in underlying operating profit was partly offset by a £21 million reduction in underlying net finance expense. This is mainly due to the impact of lower RPI inflation on the group’s index-linked debt and a lower cost of debt locked-in on the group’s nominal debt.
- **Underlying profit after tax –** down by £29 million to £325 million, as the decrease in underlying profit before tax was partly offset by a decrease in underlying tax due on lower profits.
- **Capital structure –** the group has a robust capital structure with gearing (measured as group net debt to regulatory capital value) of 61% as at 31 March 2016. This gearing level is comfortably within our target range, of 55% to 65%, supporting a solid investment grade credit rating. United Utilities Water Limited (UUW) has long-term credit ratings of A3 from Moody’s, with a stable outlook, and BBB+ from Standard & Poor’s, with a positive outlook.
- **Financing headroom –** the group now benefits from headroom to cover its projected needs into 2018, enhanced by the recent raising of new finance. This headroom provides good flexibility in terms of when and how further debt finance is raised to help refinance maturing debt and support the delivery of our regulatory capital investment programme.
- **Dividend –** the board has proposed a final dividend of 25.64 pence per ordinary share (taking the total dividend for 2015/16 to 38.45 pence), an increase of 2.0%, in line with our policy of targeting an annual growth rate of at least RPI inflation through to 2020.

OUTLOOK

We are confident that we can build on our strong operational and environmental performance and improve further as we progress through this new regulatory period, supported by our ‘systems thinking’ approach to operating the business. We are accelerating our 2015-20 capex programme and substantial investment in our assets will continue, driving benefits for our customers and the environment. Our progress over the first year of this new regulatory period underpins our confidence in delivering our targets. For shareholders, we are targeting dividend growth of at least RPI inflation each year through to 2020, all underpinned by a robust capital structure.

OPERATIONAL PERFORMANCE

United Utilities aims to deliver long-term shareholder value by providing:

- The best service to customers
- At the lowest sustainable cost
- In a responsible manner

Best service to customers

Customer service – our continuing strong focus on dealing effectively with customer enquiries has helped us deliver substantial improvements in our performance over recent years and this was recognised by Ofwat in the final determination, with UU averting a possible revenue penalty for the 2015-20 period. This is also reflected in a reduction of approximately 75% in the overall number of customer complaints received over the 2010-15 period, which has also contributed to improvements in opex efficiency.

We have continued to develop our systems and processes to deliver the experience our customers seek when they need to contact us, including multi-channel contact centre technology. We have placed a strong emphasis on striving for first time resolution of customer enquiries, keeping customers informed of progress until resolution. This has been underpinned by investment in our people in terms of better training and improved systems. We have also enhanced our customer feedback process to help us respond to customers' evolving needs and continually improve.

Adjusting for the water quality incident, domestic customer complaints in 2015/16 were lower than last year. Ofwat has amended its SIM methodology for the 2015-20 period, based on domestic retail only and with more emphasis on qualitative performance. This revised methodology is based on a different data set and, as we have highlighted previously, quarterly results may well produce wider fluctuations compared with the last regulatory period. Our SIM scores for 2015/16 have also improved slightly on last year, as outlined in the KPIs section below, despite the operational incidents we experienced in the year.

Improving customer service will continue to be a key area of management focus and we see opportunities to deliver further benefits for our customers.

Leading North West service provider – we are consistently ranked third out of ten leading organisations in the North West, through an independent brand tracker survey which is undertaken quarterly. This covers key attributes such as 'reputation', 'trustworthy' and 'customer service'. We are behind only Marks & Spencer and John Lewis, and ahead of seven other major organisations covering utilities, telecoms, media and banking services.

Robust water supply – our customers continue to benefit from our robust water supply and demand balance, along with high levels of water supply reliability. We continue to supply a high level of water quality, with an improvement in our water quality index ODI, despite the incident last August, although we did separately incur compensation and other associated costs of around £25 million. We have consistently delivered high quality water and believe this incident was a one-off event for us. We have consistently delivered a reliable water service, although we experienced some water no-supply incidents in 2015/16. Whilst this is disappointing, we have improved internal processes and systems detection capability to help reduce the risk of these incidents occurring in the future. We will also benefit from our integrated control centre, enabling us to take corrective action before the customer is impacted.

Reducing sewer flooding – we have continued to invest heavily in schemes designed to reduce the risk of flooding of our customers' homes, including incidence based targeting on areas more likely to experience flooding and defect identification through CCTV sewer surveys. Our plan for the 2015-20 period includes a target of reducing sewer flooding incidents by over 40%, in line with customers' affordability preferences, and we have made a good start. Our wastewater network will continue to benefit from significant investment going forward, as we aim to help mitigate changing weather patterns likely to result from climate change.

Ofwat KPIs – our strong overall operational performance is reflected in Ofwat's latest (2014/15) key performance indicators report, which was published in September. The balance of ratings for UU across the fourteen assessment measures represents a joint first position, in respect of the ten water and sewerage companies. We are pleased that our good performance has been recognised, although remain strongly focussed on improving further.

Key performance indicators:

- **Outcome delivery incentives (ODIs) –** as outlined at our full year results in May 2015, ODIs, which are a new feature of the 2015-20 regulatory period, will form an important KPI composite to monitor the operational performance of our wholesale business. This replaces the previous serviceability KPI which is incorporated within the ODI measures. There are 19 wholesale financial ODIs and the risk is skewed to the downside, with ten attracting a penalty only. We will report each year on our performance and provide a net reward or penalty position across the range of our wholesale ODIs.

  The impact of the water quality incident has not had a material impact on our ODIs, but we have already incurred £25 million of associated costs, as outlined previously. Our sewer flooding ODI is particularly challenging, although there are a number of other areas where we have made a good start, such as private sewers and pollution incidents. Overall, we are encouraged to have achieved a net reward of £2.5 million. We have benefitted from our proactive management approach and the planned acceleration of our investment programme. Our main areas of reward came through our good performance in the areas of private sewers and pollution, with our main penalty being on reliable water service where we experienced some no-supply events in the year.

  Whilst this overall outcome was better than our initial expectations, the ODI targets get tougher as we move through the five-year regulatory period. Therefore, we need to make further improvements to avoid penalties and this will be very challenging for us. Nonetheless, our progress this year gives us the confidence to improve our target to reflect a cumulative net ODI outcome over the 2015-20 period of between plus £30 million and minus £70 million.

- **Service incentive mechanism (SIM) –** UU was the most improved company on SIM during the 2010-15 regulatory period, although we recognise that there is still more to do. Our target is to move towards the upper quartile in the medium-term.

  Qualitative: Ofwat has now undertaken the four surveys for 2015/16 and UU has improved its score to 4.27 points, compared with 4.24 points in 2014/15, despite the water quality incident and the unprecedented flooding events. In particular, customers scored us highly for our wastewater service. For 2015/16, UU was in 12th position out of the 18 water companies.

  Quantitative: the quantitative assessment measures customer contacts and performance is assessed on both an absolute and relative basis. Relative performance can only be assessed following the end of each full financial year when the other companies publish their respective results. On absolute performance for 2015/16, our score of 95 points represents a slight improvement on the previous year when we scored 99 points.

- **Business customer retail growth –** Ofwat introduced a separate price control for business retail for the 2015-20 period and, with the expansion of competition, we have included a new KPI measuring the impact of customer gains and losses. Our business retail operation has now achieved a net increase in annualised revenue of £18 million. This represents a steady increase from £15 million in 2014/15 and £10 million in 2013/14. However, due to the joint venture between UU and Severn Trent, which has now received CMA approval, we are not setting targets as we are re-assessing the appropriateness of this KPI for future reporting.

Lowest sustainable cost

Power and chemicals – our asset optimisation programme continues to provide the benefits of increased and more effective use of operational site management to optimise power and chemical use and the development of more combined heat and power assets to generate renewable energy. Supplementing the electricity we generate from sludge, we are developing other renewable energy facilities, principally in the area of solar, where we expect to invest over £100 million across the 2015-20 period of which £32 million was invested in 2015/16. We have also substantially locked in our power commodity costs across 2015-20, providing greater cost certainty for the regulatory period.

Proactive network management – as part of our 'systems thinking' approach to the way we run our business, we are being more proactive in the management of our assets and networks. We aim to improve our modelling and forecasting to enable us to address more asset and network problems before they affect customers, thereby reducing the level of reactive work and improving efficiency.

Debt collection – our region suffers from high levels of income deprivation and we offer wide-ranging schemes to help customers struggling to pay, including our trust fund into which we paid a £6 million contribution in 2015/16. Notwithstanding our industry-leading debt management processes, deprivation remains the principal driver of our higher than average bad debt and cost to serve and we expect this to continue to be a challenging area for us.

In 2015/16, we have reduced bad debt expense to 2.3% of regulated revenue from 3.1% last year. This reflects our ongoing strong focus on managing bad debts, along with a reduction in certain charges, related to our review last year of operational debt processes and bad debt provisions, which were not expected to continue at the same level.

Pensions – UU has taken progressive steps to de-risk its pension provision. The group had an IFRS retirement benefit surplus of £275 million as at 31 March 2016, an increase in surplus from £79 million as at 31 March 2015. Further details of the group's pension provision are provided in the pensions section.

Capital delivery and regulatory commitments – the business is strongly focussed on delivering its commitments efficiently and on time and has a robust commercial capital delivery framework in place. To improve efficiency further, we implemented new contracting arrangements for the 2015-20 regulatory period to help deliver our regulatory capital investment programme of over £3.5 billion. We re-tendered our engineering and construction partners and selected a single engineering partner and four new design and construction partners. We are involving our partners much earlier in project definition and packaging projects by type, geography and timing to deliver efficiencies. Projects will be allocated to partners on an incentive basis or competed between the partners and, where appropriate, third parties. Our partners have come forward with a range of solutions, innovations and pricing and early results are encouraging.

We also continue to drive more effective and efficient delivery of our capital programme and, for this regulatory period, we are applying a tougher measurement mechanism to our Time: Cost: Quality index (TCQi) score. This includes extending coverage to relevant non-regulatory commitments, measuring cost in terms of totex (previously capex only) and giving a greater weighting in the cost element to our biggest capital projects. This has resulted in a recalibration of the index. Despite this tougher approach, our TCQi score remains high at 90% which represents a very good performance above our internal target of 84% for the first year of this regulatory period.

We have made a good start to the 2015-20 investment programme and, as planned, are accelerating the five-year programme to maintain and improve services for customers and deliver early operational and environmental benefits. Regulatory capital investment in 2015/16, including £169 million of infrastructure renewals expenditure, was £799 million, in line with our expectations.

Key performance indicators:

- **Financing outperformance –** The low cost of debt we have already locked-in places UU in a strong position to deliver our target for the 2015-20 period of beating Ofwat's industry allowed cost of debt.

- **Total expenditure (totex) outperformance –** our KPIs have evolved to reflect the move by Ofwat to a totex price control, with totex outperformance for our wholesale business now replacing the previous separate opex outperformance and capex outperformance measures. We exceeded our 2010-15 outperformance targets for both opex and capex. Although our totex allowance is tough, we are implementing a range of initiatives and are confident of meeting our target of delivering our promises to customers within the cumulative 2015-20 wholesale totex final determination allowance. Progress in the first year has been good and we are on track to meet the five-year target.

- **Domestic retail cost to serve –** with the retail household price control now being separated for the 2015-20 period, we are introducing a new KPI to measure our costs in this area. Overall, it will be very challenging to meet the regulatory assumptions for domestic retail costs. This is primarily due to Ofwat's price review methodology at PR14 which made no allowance for inflation in the domestic retail business and, in our view, made insufficient allowance for dual service (water and wastewater) companies. The regulatory assumptions for domestic retail costs become progressively tougher as we move through the 2015-20 period. Our target is to minimise our costs compared with Ofwat's revenue allowance. We have delivered a good performance in 2015/16 and outperformed this year's revenue allowance by around £10 million.

<u>Responsible manner</u>

Acting responsibly is fundamental to the manner in which we undertake our business and the group has for many years included corporate responsibility factors in its strategic decision making. Our environmental and sustainability performance across a broad front has received external recognition. Earlier in the 2015/16 financial year, UU retained its 'World Class' rating in the Dow Jones Sustainability Index for the eighth consecutive year, again achieving industry leading performance status in the multi-utility/water sector. Retaining 'World Class' status for this length of time is a significant achievement, particularly as the assessment standards continue to increase and evolve. In addition, at the PwC 2015 Building Public Trust Awards, UU was selected as joint winner for 'Excellence in reporting in the FTSE 100'.

Leakage – strong, year round, operational focus on leakage, alongside our network resilience improvements and the implementation of a range of initiatives, such as active pressure management, enabled us to again meet our leakage target in 2015/16.

Environmental performance – this is a high priority for UU and we were again an upper quartile company in the Environment Agency's latest performance metrics, as described in the KPIs section below.

Carbon footprint – we are committed to reducing our carbon footprint and increasing our generation of renewable energy. In 2015/16, our carbon footprint totalled 454,857 tonnes of carbon dioxide equivalent, which is a 22% reduction over the last 10 years. Our renewable energy production in 2015/16 was 138 GWh, representing 17% of our electricity consumption in the year. This represents good progress over the last few years, up from 13% in 2012/13. We are already implementing plans to significantly increase self-generation over the next few years, with a target of around 35% of our electricity consumption by 2020, subject to there being sufficient projects with acceptable returns.

Employees – we continue to work hard to engage all of our employees in the transformation of the group's performance. Although employee engagement has fallen slightly from last year, at 75% this continues to demonstrate that our employees have a strong capability to adapt. We remain focussed on maintaining high levels of employee engagement.

We have been successful in attracting and retaining people and have continued to expand our apprentice and graduate programmes for 2015/16. We now have a total of 54 graduates and 93 apprentices across the business. Our investment in recruiting graduates and apprentices is already benefitting the company, with 49 of them now having secured permanent roles across our business.

As part of our health and safety improvement programme, we have implemented a number of initiatives which helped reduce further the employee accident frequency rate to 0.104 accidents per 100,000 hours for 2015/16, compared with a rate of 0.112 in 2014/15, 0.137 in 2013/14 and 0.188 in the previous year, although we recognise that we still have more to do. Health and safety will continue to be a significant area of focus, as we strive for continuous improvement.

Communities – we continue to support partnerships, both financially and in terms of employee time through volunteering, with other organisations across the North West. We recently set up Catchment Wise, our new approach to tackling water quality issues in lakes, rivers and coastal waters across the North West, and our 'Beachcare' employee volunteering scheme helps to keep our region's beaches tidy. We continue to support local communities, through contributions and schemes such as providing debt advisory services and our Community Fund, offering grants to local groups impacted by our capital investment programme.

Key performance indicators:

- **Leakage** – Although leakage is included within our outcome delivery incentives, we intend to continue publishing our leakage position separately, with it being an important measure from a corporate responsibility perspective. We delivered a good performance in 2015/16 and have again met our regulatory leakage target of 463 megalitres per day.

- **Environmental performance** – On the Environment Agency's latest assessment (2014/15 report), which covers a broad range of operational metrics, UU is again an upper quartile company. Based on our performance across the range of metrics, this indicates we were in joint 2nd position among the ten water and sewerage companies and aligns with our medium-term goal of being a first quartile company on a consistent basis.

- **Corporate responsibility** – UU has a strong focus on operating in a responsible manner and is the only UK water company to have a 'World Class' rating as measured by the Dow Jones Sustainability Index. In 2015/16, UU retained its 'World Class' rating for the eighth consecutive year and aims to retain this rating again this year.

'Systems thinking' operational approach

Underpinning our improving operational performance is our drive toward 'systems thinking' based on four key themes:

- improving the reliability of our assets with the objective of reducing unplanned, and therefore costly, service interruptions;
- improved use of data at local asset level and centrally for performance optimisation;
- adopting a systems approach to our regional water system and wastewater drainage areas to optimise cost and service performance; and
- resource allocation to production teams with full accountability for asset and system performance.

We are investing in this regulatory period in our new wholesale operating model and are progressively rolling out of this radically different capability. Our production line model is well established and last April we opened our new integrated control centre or ICC. This is increasingly becoming a central hub for planning and control of our operations and proved to be a tremendous asset during our handling of the major incidents we had to address last year.

Our new telemetry backbone has been successfully installed across our estate with only a small number of sites to complete. This provides the ‘data highway’ between our sites and the ICC, enabling enhanced monitoring and intervention.

We have full regional production planning up and running for both water production and sludge processing, supported by more enhanced decision-making systems capability at site level.

We are in the final stages of testing of our new maintenance system, providing more effective tasking of field engineering. We have also improved asset availability.

And, we are also using more sensors in our network and better analysing other data, such as weather forecasting, to help reduce costs and improve operational performance and, importantly, prevent issues before they impact the customer.

This is all supported by our digital strategy in which we have already seen our IT systems overhauled and for which data and its exploitation becomes central to our thinking.

Our ‘systems thinking’ approach is expected to deliver benefits of over £100 million across the 2015-20 regulatory period, which were already built into our business plan assumptions.

FINANCIAL PERFORMANCE

Revenue

UU has delivered a good set of financial results for the year ended 31 March 2016. Revenue was up £10 million at £1,730 million despite the new regulated price controls, as we benefitted from higher than expected volumes, non-regulated sales were up and because last year was impacted by the £21 million special discount we applied to customer bills.

Operating profit

Underlying operating profit at £604 million was £60 million lower than last year, as expected. This reflects the new regulated price controls, an expected increase in depreciation and other costs, partly offset by a reduction in bad debts, power and regulatory fees. In line with our planned acceleration, there was also a £21 million increase in infrastructure renewals expenditure this year.

Reported operating profit decreased by £85 million, to £568 million, reflecting the fall in underlying operating profit, along with an increase in adjusting items. Adjusting items for 2015/16 included compensation and operating costs, totalling £25 million, in relation to the water quality incident in summer 2015. Additionally, there was an £11 million charge relating to market reform restructuring costs incurred preparing the business for open competition in the business retail market.

Also in adjusting items was a net credit of £1 million in relation to the unprecedented flooding incidents which occurred in December 2015. We incurred an £11 million impairment charge on our property, plant and equipment plus £1 million on infrastructure renewals expenditure and £7 million of other operating costs. However, these costs were more than offset by insurance proceeds recognised of £20 million.

Investment income and finance expense

The underlying net finance expense of £201 million was £21 million lower than the last year, mainly due to a lower cost of debt locked-in on the group's nominal debt and the impact of lower RPI inflation on the portion of the group's index-linked debt with an eight month lag. Interest on non index-linked debt of £112 million was £13 million lower than last year, due to the lower rates locked in on our interest rate swaps from 2015, compared with our 2010-15 swaps. The indexation of the principal on our index-linked debt amounted to a net charge in the income statement of £38 million, compared with a net charge of £47 million last year. As at 31 March 2016, the group had approximately £3.4 billion of index-linked debt at an average real rate of 1.5%.

The lower cost of nominal debt along with the lower RPI inflation charge compared with last year, contributed to the group's average underlying interest rate of 3.4% being lower than the rate of 4.0% for the year ended 31 March 2015.

Reported net finance expense of £219 million was significantly lower than the £317 million expense in 2014/15. This £98 million decrease principally reflects a change in the fair value gains and losses on debt and derivative instruments, from a £105 million loss in 2014/15 to a £26 million loss in 2015/16. The fair value losses in both years were largely due to a decrease in medium-term interest rates, which impact our derivatives hedging interest rates. The fair value loss in 2014/15 was greater than that in 2015/16, as the decrease in medium-term interest rates was larger in 2014/15. The group uses these swaps to fix interest rates on a substantial proportion of its debt to better match the financing cash flows allowed by the regulator at each price review. The group has fixed the substantial majority of its non index-linked debt for the 2015-20 financial period.

Profit before tax

Underlying profit before tax was £408 million, £39 million lower than last year, due to the £60 million decrease in underlying operating profit, partly offset by the £21 million decrease in underlying net finance expense. This underlying measure adjusts for the impact of the costs associated with the flooding and water quality incidents and retail business market reform, as outlined in the operating profit section above, and other items such as fair value movements in respect of debt and derivative instruments, as outlined in the underlying profit measures table. Reported profit before tax increased by £12 million to £354 million, as the increase due to the aforementioned fair value movements was largely offset by a reduction in reported operating profit.

Tax

In 2015/16, we paid corporation tax of £53 million, which represents an effective cash tax rate on underlying profits of 13%, 7% lower than the headline rate of corporation tax of 20%. Consistent with prior years, the key reconciling item to the headline rate was allowable tax deductions on net capital investment. We have expressed the effective cash tax rate in terms of underlying profits as this measure excludes net fair value movements on debt and derivative instruments and thereby enables a medium term cash tax rate forecast. We would expect the average cash tax rate on underlying profits through to the end of the current regulatory period in March 2020 to be around 15%. The key risk to sustaining this rate is any unexpected changes in tax legislation or practice and, as necessary, we would actively engage with the relevant authorities in order to manage this risk.

The current tax charge was £53 million in 2015/16, compared with £57 million in the previous year. In addition, there were current tax credits of £9 million in 2015/16 and £10 million in 2014/15, both following agreement with the UK tax authorities of prior years' tax matters.

For 2015/16, the group recognised a deferred tax charge of £19 million, compared with a charge of £14m for 2014/15. In addition, in 2015/16 the group recognised a deferred tax charge of £6 million relating to prior years' tax matters, compared with a charge of £9 million in 2014/15. In 2015/16, the group also recognised a deferred tax credit of £112 million relating to the enacted reduction in the headline rate of corporation tax to 18% from 1 April 2020.

The total tax credit for 2015/16 was £44 million as compared to a total tax charge of £70 million for 2014/15, the main difference being the current year deferred tax credit of £112 million relating to changes in tax rates. For both periods, the total underlying tax effective rate was in line with the headline rate (currently at 20%) and subject to any legislative or tax practice changes, we would expect this to continue for the medium term.

In addition to corporation tax, the group pays and bears further annual economic contributions, typically of around £130-140 million per annum, in the form of business rates, employer's national insurance contributions, environmental taxes and other regulatory service fees such as water abstraction charges.

Profit after tax

Underlying profit after tax of £325 million was £29 million lower than last year, principally reflecting the £39 million decrease in underlying profit before tax partly offset by lower underlying tax on lower profits. Reported profit after tax was higher at £398 million, compared with £271 million in the previous year, as the reduction in underlying profit was more than offset by the £112 million deferred tax credit in 2015/16 associated with the enactment of the reductions in corporation tax plus the £78 million movement in fair value on debt and derivative instruments between the two periods.

Earnings per share

Underlying earnings per share decreased from 51.9 pence to 47.7 pence. This underlying measure is derived from underlying profit after tax. Basic earnings per share increased from 39.8 pence to 58.3 pence, for the same reasons that increased profit after tax.

Dividend per share

The board has proposed a final dividend of 25.64 pence per ordinary share in respect of the year ended 31 March 2016. Taken together with the interim dividend of 12.81 pence per ordinary share, paid in February, this produces a total dividend per ordinary share for 2015/16 of 38.45 pence. This is an increase of 2.0%, compared with the dividend relating to last year, in line with the group's dividend policy of targeting a growth rate of at least RPI inflation each year through to 2020. The inflationary increase of 2.0% is based on the RPI element included within the allowed regulated revenue increase for the 2015/16 financial year (i.e. the movement in RPI between November 2013 and November 2014).

The final dividend is expected to be paid on 1 August 2016 to shareholders on the register at the close of business on 24 June 2016. The ex-dividend date is 23 June 2016.

In light of the Financial Reporting Lab's recent report entitled 'Disclosure of dividends – policy and practice' which provided best practice guidance, we have enhanced our dividend policy disclosure as outlined below.

- ***Dividend policy*** – a growth rate target of at least RPI inflation each year through to 2020.

- ***Policy period*** – the dividend policy aligns with the five-year regulatory period which runs from 1 April 2015 to 31 March 2020.

- ***Policy approval process*** – the dividend policy was considered and approved by the UU Group PLC Board in January 2015, as part of a comprehensive review of the 2015-20 regulatory final determination in the context of a detailed business planning process, with due regard for the group's financial metrics, credit ratings and long-term financial stability, and is reviewed at least annually.

- ***Distributable reserves*** – as at 31 March 2016, the company had distributable reserves of £3,205 million. The total external dividends relating to the 2015/16 financial year amounted to £262 million. The company distributable reserves support over 12 times this annual dividend.

- ***Financing headroom*** – supporting the group's cash flow, UU adopts a funding/liquidity headroom policy of having available resources to cover the next 15-24 months of projected cash outflows.

- ***Cash flows from subsidiaries*** – the directors consider that the group's principal operating subsidiary, United Utilities Water Limited, has sufficient resources to pay dividends to United Utilities Group PLC for the duration of the current dividend policy period to support the external payment of dividends to shareholders.

- ***Financial stability*** – the water industry has invested significant capital since privatisation in 1989 to improve services for customers and provide environmental benefits, a large part of which is driven by legislation. Water companies have typically raised borrowings to help fund the capital investment programme. Part of total expenditure is additive to the regulatory capital value, or RCV, on which water companies earn a return allowed by the economic regulator, Ofwat. RCV gearing is useful in assessing a company's financial stability in the UK water industry and is one of the key credit metrics that the credit rating agencies focus on. UU has had a relatively stable RCV gearing level over the last five years, always comfortably within its target range of 55% to 65%, supporting a solid A3 credit rating with Moody's. RCV gearing at 31 March 2016 was 61% and the movement in net debt is outlined in the cash flow section.

- ***Dividend sustainability*** – in approving the policy, the Board is satisfied that across the current regulatory period, the projected dividend is adequately covered by underlying profit after tax. Separately, the executive directors' long-term remuneration plan is directly linked to a measure of sustainable dividends. Whilst specific targets are not disclosed in advance, for commercial sensitivity reasons, there is a major focus on the creation of strong earnings that ensure the sustainability of dividends.

- ***Viability statement* –** the dividend policy is underpinned by the group's long-term viability statement (contained within the group's annual report and financial statements). Assurance supporting this statement is provided by the review of: the group's key financial measures; the key credit financial metrics; the group's liquidity position; and the contingent liabilities of the group.

- ***Annual dividend approval process* –** the group places significant emphasis on strong corporate governance, and before declaring interim and proposing final dividends, the UU Group Board undertakes a comprehensive assessment of the group's key financial metrics.

- ***Risks to policy sustainability***
  <u>2015-20</u>
  - the policy is considered by the Board to be robust to reasonable changes in assumptions, such as inflation, opex, capex and interest rates.
  - extreme economic, regulatory, political or operational events, which could lead to a significant deterioration in the group's financial metrics during the policy period, may present risks to policy sustainability.

  <u>2020-25</u>
  - a dividend policy for the post 2020 period will be formulated when the outcome of the next regulatory price review is known.

Cash flow

Net cash generated from continuing operating activities for the year ended 31 March 2016 was £686 million, compared with £707 million in the previous year. This reduction mainly reflects lower profit partly offset by an improvement in working capital cashflows and, to a lesser extent, lower corporation tax paid. The group's net capital expenditure was £682 million, principally in the regulated water and wastewater investment programmes. This excludes infrastructure renewals expenditure which is treated as an operating cost under IFRS.

Net debt including derivatives at 31 March 2016 was £6,261 million, compared with £5,924 million at 31 March 2015. This increase reflects regulatory capital expenditure and payments of dividends, interest and tax, partly offset by operating cash flows.

Fair value of debt

The group's gross borrowings at 31 March 2016 had a carrying value of £6,978 million. The fair value of these borrowings was £7,461 million. This £483 million difference principally reflects the significant fall in real interest rates, compared with the rates at the time we raised our index-linked debt. This difference has decreased from £705 million at 31 March 2015 due primarily to an increase in credit spreads.

Debt financing and interest rate management

Gearing (measured as group net debt divided by UUW's regulatory capital value) was 61% at 31 March 2016, an increase of 2% compared with the position at 31 March 2015, remaining comfortably within our target range of 55% to 65%.

UUW has long-term credit ratings of A3/BBB+ and United Utilities PLC has long-term credit ratings of Baa1/BBB- from Moody's Investors Service (Moody's) and Standard & Poor's (S&P) Ratings Services respectively. The split rating reflects differing methodologies used by the credit rating agencies. Moody's has the group's ratings on a stable outlook, whereas S&P has the group's ratings on a positive outlook.

The group has access to the international debt capital markets through its €7 billion euro medium-term note programme (EMTN). The EMTN programme does not represent a funding commitment, with funding dependent on the successful issue of the notes.

Cash and short-term deposits at 31 March 2016 amounted to £214 million. Over 2015-20 we have financing requirements totalling around £2.5 billion to cover refinancing and incremental debt, supporting our 2015-20 investment programme and we have now already raised around £1.4 billion of this requirement (including the most recent £250 million loan with the European Investment Bank (EIB), signed in April 2016). In December 2013, UUW agreed a new £500 million term loan facility with the EIB and we drew down the final £150 million on this facility during the first half of 2015/16, all on a floating rate basis. In March 2015, UUW signed a new £250 million index-linked term loan facility with the EIB. This is an amortising facility with an average loan life of 10 years and a final maturity of 18 years from draw down and as at 31 March 2016 we had drawn down £175 million on this facility. In March 2015, UUW arranged a £100 million, 10-year index-linked loan with an existing relationship bank.

In April 2015, UUW's financing subsidiary, United Utilities Water Finance PLC (UUWF), issued two index-linked notes totalling £60 million, consisting of a £25 million, 10-year maturity and a £35 million, 15-year maturity. UUWF also issued a €52 million note (swapped to floating sterling) with a 12-year maturity. All these notes were issued via private placement off our EMTN programme.

In the second half of 2015/16, UUW arranged two £100 million loans with existing relationship banks; a 7-year floating rate loan, drawn down in December 2015 and a 10-year index-linked loan, drawn down in March 2016. UUWF issued a €30 million private placement note (swapped to floating sterling), with a 15-year maturity, off our EMTN programme in October 2015. In addition, the group agreed £50 million of new 5-year committed bank facilities.

In April 2016, UUW signed a £250 million index-linked term loan facility with the EIB to support the delivery of UUW's AMP6 investment programme. This is an amortising facility with an average loan life of 10 years and a final maturity of 18 years from draw down and is the first tranche of an anticipated £500m funding package for AMP6 from the EIB, with the second tranche expected to be made available for signature later in the AMP. In May 2016, UU PLC signed a new 7-year revolving credit facility with an existing relationship bank. Following the signing of these facilities, the group now has headroom to cover its projected financing needs through until mid-2018.

Long-term borrowings are structured or hedged to match assets and earnings, which are largely in sterling, indexed to UK retail price inflation and subject to regulatory price reviews every five years.

Long-term sterling inflation index-linked debt provides a natural hedge to assets and earnings. At 31 March 2016, approximately 55% of the group's net debt was in index-linked form, representing around 34% of UUW's regulatory capital value, with an average real interest rate of 1.5%. The long-term nature of this funding also provides a good match to the company's long-life infrastructure assets and is a key contributor to the group's average term debt maturity profile, which is around 20 years.

Where nominal debt is raised in a currency other than sterling and/or with a fixed interest rate, the debt is generally swapped to create a floating rate sterling liability for the term of the debt. To manage exposure to medium-term interest rates, the group fixes underlying interest costs on nominal debt out to ten years on a reducing balance basis. This is supplemented by fixing substantially all remaining floating rate exposure across the forthcoming regulatory period around the time of the price control determination.

In line with this, the group has fixed interest costs for substantially all of its floating rate exposure over the 2015-20 period, locking in an average annual interest rate of around 3.7% (inclusive of credit spreads). For 2015/16, the rate was slightly higher, as we transitioned between the two regulatory periods.

Liquidity

Short-term liquidity requirements are met from the group's normal operating cash flow and its short-term bank deposits and supported by committed but undrawn credit facilities. The group's €7 billion euro medium-term note programme provides further support.

Available headroom at 31 March 2016 was £269 million based on cash, short-term deposits, committed bank facilities, along with the undrawn portion of the EIB term loan facilities (signed at that time), net of short-term debt as well as committed facilities and term debt falling due within 12 months.

UU believes that it operates a prudent approach to managing banking counterparty risk. Counterparty risk, in relation to both cash deposits and derivatives, is controlled through the use of counterparty credit limits. UU's cash is held in the form of short-term money market deposits with prime commercial banks.

UU operates a bilateral, rather than a syndicated, approach to its core relationship banking facilities. This approach spreads maturities more evenly over a longer time period, thereby reducing refinancing risk and providing the benefit of several renewal points rather than a large single refinancing requirement.

Pensions

As at 31 March 2016, the group had an IAS 19 net pension surplus of £275 million, compared with a net pension surplus of £79 million at 31 March 2015. This £196 million favourable movement mainly reflects the impact of a significant increase in credit spreads, reducing the IAS19 pension liability, partially offset by an increase in inflation assumptions. In contrast, the scheme specific funding basis does not suffer from volatility due to inflation and credit spread movements as it uses a fixed inflation assumption via the inflation funding mechanism and a prudent, fixed credit spread assumption. Therefore, the recent inflation and credit spread movements have not had a material impact on the deficit calculated on a scheme specific funding basis or the level of deficit repair contributions.

Further detail on pensions is provided in note 10 ("Retirement benefit surplus") of these condensed consolidated financial statements.

Underlying profit

In considering the underlying results for the period, the directors have adjusted for the items outlined in the table below to provide a more representative view of business performance. Reported operating profit and profit before tax from continuing operations are reconciled to underlying operating profit, underlying profit before tax and underlying profit after tax (non-GAAP measures) as follows:

Operating profit	**Year ended 31 March 2016 £m**	**Year ended 31 March 2015 £m**
Operating profit per published results	**567.9**	**653.3**
Water quality incident	24.8	-
Flooding incidents (net of insurance proceeds recognised)	(0.6)	-
Business retail market reform[1]	11.1	-
Restructuring costs	0.9	11.0
Underlying operating profit	**604.1**	**664.3**

Net finance expense	**£m**	**£m**
Finance expense	(224.4)	(317.8)
Investment income	5.0	1.0
Net finance expense per published results	**(219.4)**	**(316.8)**
Adjustments:		
Net fair value losses on debt and derivative instruments	26.3	104.7
Interest on swaps and debt under fair value option	16.5	4.0
Net pension interest (income)/expense	(3.1)	7.0
Capitalised borrowing costs	(21.3)	(20.9)
Underlying net finance expense	**(201.0)**	**(222.0)**

Profit before tax	**£m**	**£m**
Share of profits of joint ventures	**5.0**	**5.1**
Profit before tax per published results	**353.5**	**341.6**
Adjustments:		
Water quality incident	24.8	-
Flooding incidents (net of insurance proceeds recognised)	(0.6)	-
Business retail market reform[1]	11.1	-
Restructuring costs	0.9	11.0
Net fair value losses on debt and derivative instruments	26.3	104.7
Interest on swaps and debt under fair value option	16.5	4.0
Net pension interest (income)/expense	(3.1)	7.0
Capitalised borrowing costs	(21.3)	(20.9)
Underlying profit before tax	**408.1**	**447.4**

Profit after tax	**£m**	**£m**
Underlying profit before tax	**408.1**	**447.4**
Reported tax credit/(charge)	44.0	(70.4)
Deferred tax credit – change in tax rate	(112.5)	-
Agreement of prior years' UK tax matters	(3.4)	(0.7)
Tax in respect of adjustments to underlying profit before tax	(10.9)	(22.2)
Underlying profit after tax	**325.3**	**354.1**

Earnings per share	**£m**	**£m**
Profit after tax per published results (a)	397.5	271.2
Underlying profit after tax (b)	325.3	354.1
Weighted average number of shares in issue, in millions (c)	681.9m	681.9m
Earnings per share per published results, in pence (a/c)	58.3p	39.8p
Underlying earnings per share, in pence (b/c)	**47.7p**	**51.9p**

[1] Relates to market reform restructuring costs incurred preparing the business for open competition in the business retail market

Underlying operating profit reconciliation

The table below provides a reconciliation between group underlying operating profit and United Utilities Water Limited (UUW) historical cost regulatory underlying operating profit (non-GAAP measures) as follows:

Continuing operations
Underlying operating profit

	Year ended 31 March 2016 £m
Group underlying operating profit	**604.1**
Underlying operating loss not relating to UUW	7.2
UUW statutory underlying operating profit	**611.3**
Revenue recognition	(0.2)
Capitalised borrowing costs	2.8
Other differences (including non-appointed business)	(8.3)
UUW regulatory underlying operating profit	**605.6**

PRINCIPAL RISKS AND UNCERTAINTIES

As a business our strategy is to deliver value by providing the best service to customers, at the lowest sustainable cost and in a responsible manner. In doing so the group is exposed to a range of internal and external risks of varying types which can impact upon these objectives. We therefore maintain a risk management framework to continually identify, assess and manage risks.

All parts of the group use the same risk management framework ensuring consistency of approach and supporting risk management and monitoring. The framework includes: an embedded governance and reporting process; an assessment and management process which is aligned to ISO 31000: 2009; and a central database, tools and guidance to further support consistency, embedment and continuous improvement.

Leaders within the group's individual business areas and functions are responsible for the assessment and management of risk including the identification and escalation of new/emerging circumstances and the monitoring and reporting on risk and control effectiveness. All event types (strategic, financial, operational, compliance and hazard) are considered in the context of their potential impact on the delivery of our business objectives. The assessment is based on the likelihood of an event occurring and the financial and reputational impact should the event occur. The assessment takes into account a gross position (without controls or assuming that all controls fail), a current position benefiting from existing controls and a targeted position where further mitigation is required to meet objectives or obligations.

The resulting risk profile is reported to the group board twice a year. The report covers four areas: the ten highest ranked risks (based on likelihood x impact); a further five risks included due to the potential severity of their impact; risks that fall outside these categories but are included due to potential reputational impact or new/emerging circumstances; and a summary of all of the event-based risks within the profile relative to ten principal risks (see below) that could seriously affect the performance, future prospects or reputation of the business.

This approach is in line with the principles of the UK Corporate Governance Code and involves reporting to the group board for each full and half year statutory accounting period allowing the board to:
• determine the nature and extent of the principal risks it is willing to take in achieving its strategic objectives;
• oversee the management of those risks and provide challenge to executive management where appropriate;
• express an informed opinion on the long term viability of the company; and
• monitor risk management and internal control systems and review their effectiveness.

Our risk profile currently consists of around 200 event-based risks. By their nature, these will include all combinations of high to low likelihood and high to low impact. Heat maps are typically used in various managerial and group reports either as a method to collectively evaluate the extent of multiple risks within a certain profile or to evaluate the effectiveness of mitigation for a single risk relative to the initial gross position.

Key features and developments

Regulatory, operational, compliance and delivery risks remain key features of the group's risk profile. The introduction of outcome delivery incentives by Ofwat after PR14 creates a regime of potential penalties and rewards based on meeting targets for the delivery of operational and capital programmes. In the context of customer service and operational performance, the Lancashire water quality incident in the summer of 2015 reinforced the requirement to consistently deliver clean, safe drinking water and to further mitigate risks to a continuous service through implementing greater resilience in the asset base.

Market Reform and the introduction of non-household retail competition in April 2017 requires significant preparation so that the group's retail and wholesale functions are in a position to compete successfully while continuing to operate compliantly and in accordance with the 'level playing field'.

Looking further ahead, the expected introduction of competition in sludge and water resource activities and the further promotion of the existing inset regime and the UK Government's consideration (announced November 2015) of legislation to enable household retail activities to become competitive at some future date all place risk on the group. Climate change is also recognised as one of the sector's biggest challenges with significant and permanent implications on the water cycle and the long-term sustainability of the water and wastewater service including: water abstraction; supply and treatment capability; drainage and sewer capacity; and wastewater treatment and discharge efficiency and effectiveness.

Principal risks

The principal risks (aggregated clusters of event-based risks), reflect the categories of risks that define business activity or contributing factors where value can be lost or gained and could have a material impact on the business model, future performance, solvency or liquidity of the group. In each case the magnitude of the potential effect is highlighted together with the extent of management/mitigation. To ensure relevance with the current environment, issues or areas of uncertainty associated with each principal risk are also illustrated.

1. Regulatory Environment and Framework Risk

The potential change in the regulatory environment and/or frameworks either through political or regulatory events may increase costs of administration, reduce income and margin and lead to greater variability of returns.

To manage and mitigate this risk we engage in relevant government and regulatory consultations which may affect policy and regulation in the sectors where we operate. We also consult with customers to understand their requirements and proactively consider all the opportunities and threats associated with any potential change, exploiting opportunities and mitigating risks where appropriate.

Current key risks, issues or areas of uncertainty include: market reform including non-household and upstream competition and, further ahead, household competition; and a possible change from using the retail prices index to the consumer prices index for regulatory indexation.

2. Corporate governance and legal compliance risk

The failure to meet all legal and regulatory obligations and responsibilities (principally relating to the regulated business, but also including non-regulated activity/commitment) can result in additional workload, financial penalties, additional capital/operating expenditure (from enforcement orders or legal defence) and compensation following litigation. In more remote but extreme circumstances, penalties of up to 10 per cent of relevant turnover and ultimately revocation of our licence or the appointment of a special administrator are possible.

Management and mitigation of this risk includes the continual monitoring of legislative and regulatory developments. Risk-based training of employees is undertaken and we participate in consultations to influence legislative and regulatory developments. Funding for any material additional compliance costs in the regulated business is sought as part of the price determination process. The group also robustly defends litigation where appropriate and seeks to minimise its exposure by establishing provisions and seeking recovery wherever possible.

Current key risks, issues or areas of uncertainty include: competition law and regulatory compliance whilst preparing for and operating within a changing competitive market; current material litigation (see below); and new higher fine levels for environmental offences.

3. Water Service risk

The inability to provide a secure and resilient supply of clean safe drinking water due to operational performance problems or service or asset failures can lead to additional operating or capital expenditure and/or increased regulatory scrutiny and regulatory penalties. In more extreme situations the group could also be fined for breaches of statutory obligations, be subject to enforcement action, be held liable to third parties and sustain reputational damage.

4. Wastewater service risk

The inability to remove, treat and return wastewater to the environment in an effective, resilient and compliant manner due to operational performance problems or service or asset failures can lead to additional operating or capital expenditure and/or increased regulatory scrutiny and regulatory penalties. In more extreme situations the group could also be fined for breaches of statutory obligations, be subject to enforcement action, be held liable to third parties and sustain reputational damage.

Management and mitigation for both Water and Wastewater Service risk is provided through core business processes, including forecasting, quality assurance procedures, risk assessments and rigorous sampling/testing regimes. Ongoing system and network integration improves service provision and measures of success have been developed to monitor performance. Following the Lancashire water quality incident in 2015 we are further enhancing our approach to operational risk and resilience.

Current key risks, issues or areas of uncertainty include: population growth; climate change; meeting infrastructure investment requirements; expected change to the abstraction licensing regime; Catchment management; and raw water quality.

5. Security Risk (Cyber or Physical)

The inability to protect people, information and assets from malicious or accidental activity which could impact the provision of vital services and/or harm people or commercial business.

Physical and technological security measures combined with strong governance and inspection regimes aim to protect infrastructure, assets and operational capability. Recent initiatives include awareness training across the business relating to seven key areas of security and the implementation of a security governance model to oversee all aspects of security and security strategy. Ongoing system and network integration improves operational resilience and we maintain robust incident response, business continuity and disaster recovery procedures. We also maintain insurance cover for loss and liability and the licence of the regulated business also contains a 'shipwreck' clause that, if applicable, may offer a degree of recourse to Ofwat/customers in the event of a catastrophic incident.

Current key risks, issues or areas of uncertainty include: cybercrime; terrorism; and other criminality relating to assets or operations

6. Resource Risk (Human, technological and physical)

The inability to support/deliver effective and efficient business activity can impact the ability to make appropriate decisions and ultimately meet targets. This can also affect the ability to recruit and retain knowledge/expertise or to recover effectively following an incident. In remote but extreme circumstances there is also the potential for higher levels of regulatory scrutiny, financial penalties, reputational damage and missed commercial opportunities.

Management and mitigation of this risk focuses on developing our people with the right skills and knowledge, combined with delivering effective technology to enable and support the business to meet its objectives. Employees are kept informed regarding business strategy and progress through various communication channels. Training and personal development programmes exist for all employees in addition to talent management programmes and apprentice and graduate schemes. We focus on change programmes and innovative ways of working to deliver better, faster and more cost-effective operations.

Current key risks, issues or areas of uncertainty include: delivering required employee engagement; personal development and talent management; technological innovation; and asset management

7. Financial risk

The inability to appropriately finance the business due to capital, credit, market, funding, liquidity or tax-related risk could result in additional financing cost, an adverse impact on the income statement, the economic return on the regulatory capital value (RCV) and our pension schemes with a requirement for the group to make additional contributions and potential reputational damage. In extreme but remote cases adverse market conditions could affect our access to debt capital markets and subsequently available liquidity and credit ratings.

Management and mitigation relates to the following. Refinancing is long-term with staggered maturity dates to minimise the effect of short-term downturns. Counterparty credit, exposure and settlement limits exist to reduce any potential future impacts. These are based on a number of factors, including the credit rating and the size of the asset base of the individual counterparty. The group also employs hedging strategies to stabilise market fluctuation for inflation, interest rates and commodities (notably energy prices). Sensitivity analysis is carried out as part of the business planning process, influencing the various financial limits employed. Continuous monitoring of the markets takes place including movements in credit default swap prices and movements in equity levels.

Current key risks, issues or areas of uncertainty include: stability of financial institutions and the world economy; economic uncertainty; inflation/deflation; financial market conditions; interest rates and funding costs; and Brexit

8. Programme delivery risk

The ineffective or inefficient delivery of capital, operational and change programmes against relevant time, cost or quality measures could result in a failure to secure competitive advantage or operating performance efficiency and cost benefits. There is also the risk of increased delivery costs or a failure to meet our obligations and customer outcomes which, depending on the nature and extent of failure, could result in an impact at future price reviews, regulatory or statutory penalties and negative reputational impact with customers and regulators.

We have a developed and clear view of our investment priorities which are built into our programmes, projects and integrated business and asset plans. We have created better alignment and integration between our capital delivery partners and engineering service provider including alignment with our operating model. Our programme and project management capabilities are well established with strong governance and embedded processes to support delivery, manage risks and achieve business benefits. We utilise a time, cost and quality index (TCQi) as a key performance indicator and enhance our performance through a dedicated programme change office to deliver change in a structured and consistent way. Supply chain management is utilised to deliver end-to-end contract management which includes contract strategy and tendering, category management, security of supply, price and price volatility and financial and operational service level performance.

Current key risks, issues or areas of uncertainty include: supply chain security of supply; delivery of solutions; quality and innovation; new contract delivery partnerships for the 2015–2020 period with a new approach to construction and design; and price volatility.

9. Revenue risk

The inability to maintain revenues and margin due to customer service provision can be caused by financial penalties issued by the regulator through components of the service incentive mechanism for household customers and loss of revenue associated with commercial churn for non-household customers using five megalitres and above per annum. The proposed opening of the market for retail services to all non-household customers in England from 2017 generates both opportunities and risk associated with market share, scale and margin erosion. There is also much uncertainty surrounding the form of upstream reform which is now anticipated to materialise after 2019.

For Domestic Retail there is a transformation plan in place covering a wide range of initiatives and activities to improve customer service, with a number of controls in place to monitor achievement against the plan. Similarly, within Business Retail we look to retain existing and acquire new commercial customers by striving to meet their needs more effectively. We monitor competitor activity and target a reduction in operating costs. Within our wholesale department processes, systems, data and organisational capacity and capability to deal with market participants and the central market operator are being prepared. The new market requirements will require all market participants to treat other participants equally (‘on a level playing field’) whilst maintaining compliance with existing regulations.

Current key risks, issues or areas of uncertainty include: socio-economic deprivation in the North West; welfare reform and the impact on domestic bad debt; competition in the water and wastewater market and competitor positioning; Brexit; proposed new Business Retail joint venture with Severn; Trent; and market Reform and the ability to treat other participants equally.

10. Health, safety and environmental risk

The potential harm to employees, contractors, the public or the environment due to working with and around water, sewage, construction and excavation sites, plant and equipment could result in the group could be fined for breaches of statutory obligations, be held liable to third parties and sustain reputational damage.

Management and mitigation involves the development of a strong health, safety and environmental culture where ‘nothing we do at United Utilities is worth getting hurt for’. This is supported by strong governance and management systems which include policies and procedures which are certified to OHSAS 18001 and ISO 14001.

Current key risks, issues or areas of uncertainty include: excavation, tunnelling and construction work; working with water and wastewater; chemicals; all weather conditions; and driving and vehicle movement.

Material Litigation

There continue to be two ongoing pieces of material litigation worthy of note, as outlined below. However, based on the facts currently known to us and the provisions in our statement of financial position, our directors remain of the opinion that the likelihood of these having a material adverse impact on the group’s financial position is remote.

• In February 2009, United Utilities International Limited (UUIL) was served with notice of a multiparty ‘class action’ in Argentina related to the issuance and payment default of a US$230 million bond by Inversora Eléctrica de Buenos Aires S.A. (IEBA), an Argentine project company set up to purchase one of the Argentine electricity distribution networks which was privatised in 1997. UUIL had a 45 per cent shareholding in IEBA which it sold in 2005. The claim is for a non-quantified amount of unspecified damages and purports to be pursued on behalf of unidentified consumer bondholders in IEBA. UUIL has filed a defence to the action and will vigorously resist the proceedings given the robust defences that UUIL has been advised that it has on procedural and substantive grounds.

• In March 2010, Manchester Ship Canal Company (MSCC) issued proceedings seeking, amongst other relief, damages alleging trespass against United Utilities Water Limited (UUW) in respect of UUW’s discharges of water and treated effluent into the canal. Whilst the matter has not reached a final conclusion, the Supreme Court has found substantively in UUW’s favour on a significant element of the claim and the High Court has upheld UU’s position on the remainder of the proceedings. We await to see whether MSCC pursue a further claim to introduce additional matters for determination.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This financial report contains certain forward-looking statements with respect to the operations, performance and financial condition of the group. By their nature, these statements involve uncertainty since future events and circumstances can cause results and developments to differ materially from those anticipated. The forward-looking statements reflect knowledge and information available at the date of preparation of this financial report and the company undertakes no obligation to update these forward-looking statements. Nothing in this financial report should be construed as a profit forecast.

Certain regulatory performance data contained in this financial report is subject to regulatory audit.

Consolidated income statement

	Year ended 31 March 2016 £m	Year ended 31 March 2015 £m
Revenue	**1,730.0**	1,720.2
Employee benefit expense (note 3)	**(146.9)**	(145.1)
Other operating costs (note 4)	**(485.8)**	(424.3)
Other income	**3.6**	3.3
Depreciation and amortisation expense	**(363.7)**	(352.6)
Infrastructure renewals expenditure	**(169.3)**	(148.2)
Total operating expenses	**(1,162.1)**	(1,066.9)
Operating profit	**567.9**	653.3
Investment income (note 5)	**5.0**	1.0
Finance expense (note 6)	**(224.4)**	(317.8)
Investment income and finance expense	**(219.4)**	(316.8)
Share of profits of joint ventures	**5.0**	5.1
Profit before tax	**353.5**	341.6
Current tax charge	**(44.3)**	(47.1)
Deferred tax charge	**(24.2)**	(23.3)
Deferred tax credit - change in tax rate	**112.5**	-
Tax (note 7)	**44.0**	(70.4)
Profit after tax	**397.5**	271.2

All of the results shown above relate to continuing operations.

Earnings per share (note 8)		
Basic	**58.3p**	39.8p
Diluted	**58.2p**	39.7p
Dividend per ordinary share (note 9)	**38.45p**	37.70p

Consolidated statement of comprehensive income

	Year ended 31 March 2016 £m	Year ended 31 March 2015 £m
Profit after tax	**397.5**	271.2
Other comprehensive income		
Remeasurement gains on defined benefit pension schemes (note 10)	**160.1**	250.5
Tax on items taken directly to equity (note 7)	**(26.5)**	(50.1)
Foreign exchange adjustments	**3.0**	(3.1)
Total comprehensive income	**534.1**	468.5

Consolidated statement of financial position

	31 March 2016 £m	31 March 2015 £m
ASSETS		
Non-current assets		
Property, plant and equipment	**10,031.4**	9,716.3
Intangible assets	**162.4**	144.9
Interests in joint ventures	**35.1**	31.7
Investments	**8.7**	8.6
Trade and other receivables	**2.5**	2.5
Retirement benefit surplus (note 10)	**275.2**	79.2
Derivative financial instruments	**765.5**	681.6
	11,280.8	10,664.8
Current assets		
Inventories	**29.3**	40.5
Trade and other receivables	**367.4**	353.3
Cash and short-term deposits	**213.6**	244.0
Derivative financial instruments	**0.1**	1.0
Assets classified as held for sale (note 11)	**15.6**	-
	626.0	638.8
Total assets	**11,906.8**	11,303.6
LIABILITIES		
Non-current liabilities		
Trade and other payables	**(530.5)**	(480.0)
Borrowings (note 12)	**(6,508.8)**	(6,067.3)
Deferred tax liabilities	**(1,062.0)**	(1,123.8)
Derivative financial instruments	**(255.8)**	(196.6)
	(8,357.1)	(7,867.7)
Current liabilities		
Trade and other payables	**(341.7)**	(381.2)
Borrowings (note 12)	**(469.2)**	(578.1)
Current tax liabilities	**(12.3)**	(21.1)
Provisions	**(15.1)**	(12.5)
Derivative financial instruments	**(5.9)**	(8.6)
	(844.2)	(1,001.5)
Total liabilities	**(9,201.3)**	(8,869.2)
Total net assets	**2,705.5**	2,434.4
EQUITY		
Share capital	**499.8**	499.8
Share premium account	**2.9**	2.9
Cumulative exchange reserve	**(5.7)**	(8.7)
Merger reserve	**329.7**	329.7
Retained earnings	**1,878.8**	1,610.7
Shareholders' equity	**2,705.5**	2,434.4

Consolidated statement of changes in equity

Year ended 31 March 2016

	Share capital £m	Share premium account £m	Cumulative exchange reserve £m	Merger reserve £m	Retained earnings £m	Total £m
At 1 April 2015	499.8	2.9	(8.7)	329.7	1,610.7	2,434.4
Profit after tax	-	-	-	-	397.5	397.5
Other comprehensive income/(expense)						
Remeasurement gains on defined benefit pension schemes (note 10)	-	-	-	-	160.1	160.1
Tax on items taken directly to equity (note 7)	-	-	-	-	(26.5)	(26.5)
Foreign exchange adjustments	-	-	3.0	-	-	3.0
Total comprehensive income	-	-	3.0	-	531.1	534.1
Dividends (note 9)	-	-	-	-	(258.7)	(258.7)
Equity-settled share-based payments	-	-	-	-	2.3	2.3
Exercise of share options - purchase of shares	-	-	-	-	(6.6)	(6.6)
At 31 March 2016	**499.8**	**2.9**	**(5.7)**	**329.7**	**1,878.8**	**2,705.5**

Year ended 31 March 2015

	Share capital £m	Share premium account £m	Other reserve £m	Cumulative exchange reserve £m	Merger reserve £m	Retained earnings £m	Total £m
At 1 April 2014	499.8	2.9	158.8	(5.6)	329.7	1,230.3	2,215.9
Profit after tax	-	-	-	-	-	271.2	271.2
Other comprehensive (expense)/income							
Remeasurement gains on defined benefit pension schemes (note 10)	-	-	-	-	-	250.5	250.5
Tax on items taken directly to equity (note 7)	-	-	-	-	-	(50.1)	(50.1)
Foreign exchange adjustments	-	-	-	(3.1)	-	-	(3.1)
Total comprehensive (expense)/income	-	-	-	(3.1)	-	471.6	468.5
Dividends (note 9)	-	-	-	-	-	(249.4)	(249.4)
Transfer of other reserve	-	-	(158.8)	-	-	158.8	-
Equity-settled share-based payments	-	-	-	-	-	2.9	2.9
Exercise of share options - purchase of shares	-	-	-	-	-	(3.5)	(3.5)
At 31 March 2015	**499.8**	**2.9**	**-**	**(8.7)**	**329.7**	**1,610.7**	**2,434.4**

Consolidated statement of cash flows

	Year ended 31 March 2016 £m	Year ended 31 March 2015 £m
Operating activities		
Cash generated from operations (note 15)	**905.5**	941.7
Interest paid	**(168.7)**	(175.6)
Interest received and similar income	**1.9**	1.0
Tax paid	**(53.1)**	(61.9)
Tax received	**-**	1.3
Net cash generated from operating activities	**685.6**	706.5
Investing activities		
Purchase of property, plant and equipment	**(634.2)**	(665.7)
Purchase of intangible assets	**(66.1)**	(63.4)
Proceeds from sale of property, plant and equipment	**1.4**	2.0
Grants and contributions received	**17.3**	18.1
Purchase of investments	**-**	(0.8)
Proceeds from investments	**0.2**	-
Dividends received from joint ventures	**4.6**	4.9
Net cash used in investing activities	**(676.8)**	(704.9)
Financing activities		
Proceeds from borrowings	**693.0**	411.2
Repayment of borrowings	**(474.1)**	(19.1)
Dividends paid to equity holders of the company (note 9)	**(258.7)**	(249.4)
Exercise of share options – purchase of shares	**(6.6)**	(3.5)
Net cash (used in)/generated from financing activities	**(46.4)**	139.2
Net (decrease)/increase in cash and cash equivalents	**(37.6)**	140.8
Cash and cash equivalents at beginning of the year	**219.7**	78.9
Cash and cash equivalents at end of the year	**182.1**	219.7

NOTES

1. Basis of preparation and accounting policies

The condensed consolidated financial statements for the year ended 31 March 2016 have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority.

The accounting policies, presentation and methods of computation are consistent with those applied in the audited financial statements of United Utilities Group PLC for the year ended 31 March 2015 and are prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU).

The condensed consolidated financial statements do not include all of the information and disclosures required for full annual financial statements and do not comprise statutory accounts within the meaning of section 434 of the Companies Act 2006, but are derived from the audited financial statements of United Utilities Group PLC for the year ended 31 March 2016, for which the auditors have given an unqualified opinion.

The comparative figures for the year ended 31 March 2015 do not comprise the group's statutory accounts for that financial year. Those accounts have been reported upon by the group's auditor and delivered to the registrar of companies. The report of the auditor was unqualified and did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying their report and did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

Going concern
The directors have a reasonable expectation that the group has adequate resources for a period of at least 12 months from the date of approval of the financial statements and have therefore assessed that the going concern basis of accounting is appropriate in preparing the condensed financial statements and that there are no material uncertainties to disclose. This conclusion is based upon a review of the resources available to the group, taking account of the group's financial projections together with available cash and committed borrowing facilities as well as consideration of the group's capital adequacy, consideration of the primary legal duty of United Utilities Water Limited's economic regulator to ensure that water and wastewater companies can finance their functions, and any material uncertainties. In reaching this conclusion, the board has considered the magnitude of potential impacts resulting from uncertain future events or changes in conditions, the likelihood of their occurrence and the likely effectiveness of mitigating actions that the directors would consider undertaking.

2. Segmental reporting

The board of directors of United Utilities Group PLC (the board) is provided with information on a single segment basis for the purposes of assessing performance and allocating resources. The board reviews revenue, underlying operating profit, operating profit, assets and liabilities, regulatory capital expenditure and regulatory capital value gearing at a consolidated level. In light of this, the group has a single segment for financial reporting purposes and therefore no further detailed segmental information is provided in this note.

3. Employee benefits expense

Included within employee benefits expense were £0.9 million (31 March 2015: £11.0 million) of restructuring costs.

4. Other operating costs

	Year ended 31 March 2016 £m	Re-presented* Year ended 31 March 2015 £m
Hired and contracted services	**107.5**	93.4
Property rates	**86.3**	80.5
Materials	**67.2**	58.5
Power	**65.3**	69.1
Charge for bad and doubtful receivables	**39.2**	52.9
Regulatory fees	**27.9**	29.2
Third party wholesale charges	**15.1**	10.8
Impairment of property, plant and equipment	**11.4**	-
Cost of properties disposal	**10.5**	0.6
Legal and professional expenses	**5.8**	4.8
Loss on disposal of property, plant and equipment	**5.4**	5.1
Operating leases payable	**5.0**	4.4
Impairment of assets classified as held for sale (note 11)	**2.7**	-
Loss on disposal of intangible assets	**-**	0.5
Amortisation of deferred grants and contributions	**(6.9)**	(7.7)
Compensation from insurers	**(20.1)**	-
Other expenses	**63.5**	22.2
	485.8	424.3

* The comparatives have been re-presented to allocate £7.0 million accommodation, £3.4 million movements in other provisions, and £2.1 million research and development to categories which better reflect the underlying nature of these costs. In addition, a separate category for third party wholesale charges has been presented, which were previously within other expenses.

During the year there were £19.5 million (31 March 2015: £nil) of expenses incurred as a result of two significant flooding incidents caused by Storms Desmond and Eva, comprising an £11.4 million impairment of property, plant and equipment, £7.0 million of operating costs and £1.1 million of infrastructure renewals expenditure. Insurance compensation of £20.1 million relating to the flooding incidents has been recognised to the extent that the group considers the recovery to be ‘virtually certain’ at 31 March 2016. The group expects there to be further substantial recovery of the flooding incident costs under its insurance cover in the year ending 31 March 2017, though at this stage it is not practicable to estimate the value of this.

In addition, there were £24.8 million (31 March 2015: £nil) of costs, largely comprising customer compensation payments included within other expenses, incurred in relation to a large water quality incident, and £11.1 million (31 March 2015: £1.1 million) in relation to market reform restructuring costs incurred preparing the business for open competition in the business retail market.

5. Investment income

	Year ended 31 March 2016 £m	Year ended 31 March 2015 £m
Interest receivable	**1.9**	1.0
Net pension interest income (note 10)	**3.1**	-
	5.0	1.0

6. Finance expense

	Year ended 31 March 2016 £m	Year ended 31 March 2015 £m

Interest payable	**198.1**	206.1
Net fair value losses on debt and derivative instruments	**26.3**	104.7
	224.4	310.8
Net pension interest expense (note 10)	**-**	7.0
	224.4	317.8

Interest payable is stated net of £21.3 million (31 March 2015: £20.9 million) borrowing costs capitalised in the cost of qualifying assets within property, plant and equipment and intangible assets during the year. Interest payable includes a £37.9 million (31 March 2015: £46.6 million) non-cash inflation uplift charge in relation to the group's index-linked debt.

Net fair value losses on debt and derivative instruments includes £16.5 million income (31 March 2015: £4.0 million) due to net interest on swaps and debt under fair value option.

7. Tax

During the year ended 31 March 2016, there was a deferred tax credit of £112.5 million (31 March 2015: £nil) reflecting the staged reduction in the headline rate of corporation tax to 18 per cent from 1 April 2020. In the year ending 31 March 2017, there will be a further deferred tax credit currently estimated at around £56.0 million reflecting the further rate reduction from 18 to 17 per cent, from 1 April 2020, recently announced in the 2016 Chancellor's Budget but which is not expected to be substantively enacted until around July 2016.

After adjusting for the above current year deferred tax credit of £112.5 million, the total effective tax charge for the current and prior years was in line with the headline rate of corporation tax, currently 20 per cent (31 March 2015: 21 per cent). The split of the total tax charge between current and deferred tax was due to ongoing timing differences in relation to tax deductions on pension contributions, capital investment and unrealised gains and losses on treasury derivatives.

The tax adjustments taken to equity primarily relate to remeasurement movements on the group's defined benefit pension schemes.

8. Earnings per share

Basic and diluted earnings per share are calculated by dividing profit after tax by the weighted average number of shares in issue during the year. The weighted average number of shares in issue as at 31 March 2016 for the purpose of the basic earnings per share was 681.9 million (31 March 2015: 681.9 million) and for the diluted earnings per share was 683.0 million (31 March 2015: 683.3 million).

9. Dividends

	Year ended 31 March 2016 £m	**Year ended 31 March 2015 £m**
Dividends relating to the year comprise:		
Interim dividend	**87.3**	85.6
Final dividend	**174.8**	171.4
	262.1	257.0
Dividends deducted from shareholders' equity comprise:		
Interim dividend	**87.3**	85.6
Final dividend	**171.4**	163.8
	258.7	249.4

The proposed final dividends for the years ended 31 March 2016 and 31 March 2015 were subject to approval by equity holders of United Utilities Group PLC as at the reporting dates, and hence have not been included as liabilities in the consolidated financial statements as at 31 March 2016 and 31 March 2015 respectively.

The final dividend of 25.64 pence per ordinary share (2015: 25.14 pence per ordinary share) is expected to be paid on 1 August 2016 to shareholders on the register at the close of business on 24 June 2016. The ex-dividend date for the final dividend is 23 June 2016.

The interim dividend of 12.81 pence per ordinary share (2015: 12.56 pence per ordinary share) was paid on 1 February 2016 to shareholders on the register at the close of business on 18 December 2015.

10. Retirement benefit surplus

The main financial assumptions used by the company's actuary to calculate the defined benefit surplus of the United Utilities Pension Scheme (UUPS) and the United Utilities PLC Group of the Electricity Supply Pension Scheme (ESPS) were as follows:

	Year ended 31 March 2016 %pa	**Year ended 31 March 2015 %pa**
Discount rate	**3.4**	3.1
Pensionable salary growth and pension increases	**3.2**	3.0
Price inflation	**3.2**	3.0

The net pension expense before tax in the income statement in respect of the defined benefit schemes is summarised as follows:

	Year ended 31 March 2016 £m	**Year ended 31 March 2015 £m**
Current service cost	**22.3**	18.1
Curtailments/settlements	**1.1**	5.5
Administrative expenses	**2.7**	2.6
Pension expense charged to operating profit	**26.1**	26.2
Net pension interest (income) (note 5)/expense (note 6)	**(3.1)**	7.0
Net pension expense charged before tax	**23.0**	33.2

The reconciliation of the opening and closing net pension surplus included in the statement of financial position is as follows:

	Year ended 31 March 2016 £m	**Year ended 31 March 2015 £m**
At the start of the year	**79.2**	(177.4)
Expense recognised in the income statement	**(23.0)**	(33.2)
Contributions paid	**58.9**	39.3
Remeasurement gains gross of tax	**160.1**	250.5
At the end of the year	**275.2**	79.2

The closing surplus at each reporting date is analysed as follows:

	31 March 2016 £m	**31 March 2015 £m**
Present value of defined benefit obligations	**(2,970.4)**	(3,054.5)

Fair value of schemes' assets	**3,245.6**	3,133.7
Net retirement benefit surplus	**275.2**	79.2

In the year ended 31 March 2016 the discount rate has increased by 0.3 per cent, which includes a 0.7 per cent increase in credit spreads offset by a decrease in swap yields over the year. The £160.1 million remeasurement gain has largely resulted from the impact of the increase in credit spreads during the year, partially offset by the impact of an increase in inflation. Further details on the approach to managing pension scheme risk are set out in the audited consolidated financial statements of United Utilities Group PLC for the year ended 31 March 2015.

Included within the above is the impact of pension assumption amendments resulting from a review undertaken during the year. To align with market practice the discount rate is now based on an AA 'corporate bond' curve rather than a broader AA 'non-gilt' curve that was previously used. This has resulted in a 0.2% increase in the discount rate during the year and a 0.2% increase in credit spreads. In addition, the allowance for inflation risk premium has been removed from the basis of the inflation rate assumption to better align with the risk management strategy, which has increased the inflation assumption by 0.3%. Finally the mortality assumptions have been revised to increase the long-term annual rate of improvement from 1.5% to 1.75%.

11. Assets classified as held for sale

During the year, the group entered into an agreement which will involve the disposal of its non-household water and wastewater retail business, principally comprising billing and customer service activities, into a new joint venture with Severn Trent PLC. As at 31 March 2016, completion of the disposal was expected within 12 months, subject to clearance from the Competition and Markets Authority (CMA), and so £18.3 million of intangible assets have been classified as held for sale. These assets have subsequently been impaired by £2.7 million during the year to give a carrying value of £15.6 million, which ensures that the assets are valued at fair value less cost to sell in accordance with IFRS 5 'Non-Current Assets Held for Sale and Discontinued Operations'. See note 18 for events occurring after the 31 March 2016.

12. Borrowings

New borrowings raised during the year ended 31 March 2016 were as follows:

- On 23 April 2015 the group issued £25.0 million index-linked notes due April 2025 and £35.0 million index-linked notes due April 2030.
- On 27 April 2015 the group issued EUR 52.0 million fixed interest rate notes due April 2027.
- On 16 June 2015 the group drew down the remaining £150.0 million against its existing £500.0 million term loan facility with the European Investment Bank, at a floating rate of interest. This loan is structured on an amortising basis with final repayment in June 2033.
- On 26 October 2015 the group issued EUR 30.0 million fixed interest rate notes due October 2030.
- On 8 December 2015 the group borrowed £100.0 million from an existing relationship bank, at a floating rate of interest, due October 2022.
- On 17 December 2015 the group drew down £100.0 million, and on 1 February 2016 a further £75.0 million, against its existing £250.0 million term index-linked loan facility with the European Investment Bank. These loans are structured on an amortising basis with final repayments in December 2033 and February 2034 respectively.
- On 23 March 2016 the group borrowed £100.0 million, index-linked, from an existing relationship bank, due March 2026.

The notes included in the list above were issued through private placement under the Euro medium-term note programme.

13. Fair values of financial instruments

The fair value of financial instruments held at fair value and financial instruments for which fair value does not approximate carrying value, are shown in the table below.

	31 March 2016	**31 March 2015**

	Fair value £m	Carrying value £m	Fair value £m	Carrying value £m
Available for sale financial assets				
Investments	**8.7**	**8.7**	8.6	8.6
Financial assets at fair value through profit or loss				
Derivative financial assets - fair value hedge	**583.8**	**583.8**	521.6	521.6
Derivative financial assets - held for trading	**181.8**	**181.8**	161.0	161.0
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities - held for trading	**(261.7)**	**(261.7)**	(205.2)	(205.2)
Financial liabilities designated as fair value through profit or loss	**(338.0)**	**(338.0)**	(333.7)	(333.7)
Financial instruments for which fair value does not approximate carrying value				
Financial liabilities in fair value hedge relationships	**(2,293.0)**	**(2,373.0)**	(2,218.0)	(2,252.1)
Other financial liabilities at amortised cost	**(4,830.1)**	**(4,267.0)**	(4,798.5)	(4,059.6)
	(6,948.5)	**(6,465.4)**	(6,864.2)	(6,159.4)

The increase in credit spreads during the year is the principal reason for the reduction in the difference between the fair value and carrying value of the group's borrowings.

The group has calculated fair values using quoted prices where an active market exists, which has resulted in 'level 1' fair value liability measurements under the IFRS 13 'Fair value measurement' hierarchy of £2,149.5 million (31 March 2015: £2,142.6 million) for financial liabilities in fair value hedge relationships and £1,309.9 million (31 March 2015: £2,530.3 million) for other financial liabilities at amortised cost.

The £1,213.5 million reduction (31 March 2015: £1,493.9 million increase) in 'level 1' fair value liability measurements is largely due to the maturity of a £425.0 million bond during the year and a decrease in the number of observable quoted bond prices at 31 March 2016. In the absence of an appropriate quoted price, the group has applied discounted cash flow valuation models utilising market available data which are classified as 'level 2' valuations. More information in relation to the valuation techniques used by the group and the IFRS 13 hierarchy can be found in the audited financial statements of United Utilities Group PLC for the year ended 31 March 2015.

14. Net debt

	Year ended 31 March 2016 £m	Year ended 31 March 2015 £m
At the start of the year	**5,924.0**	5,515.9
Net capital expenditure	**681.6**	709.0
Dividends (note 9)	**258.7**	249.4
Interest	**166.8**	174.6
Tax	**53.1**	60.6
Fair value movements*	**42.4**	107.2
Inflation uplift on index-linked debt (note 6)	**37.9**	46.6
Other	**1.5**	2.4
Cash generated from operations (note 15)	**(905.5)**	(941.7)
At the end of the year	**6,260.5**	5,924.0

* Fair value movements includes net fair value losses on debt and derivative instruments of £26.3 million (31 March 2015: £104.7 million) less net receipts on swaps and debt under fair value option of £16.1 million (31 March 2015: £2.5 million).

Net debt comprises borrowings, net of cash and short-term deposits and derivatives.

15. Cash generated from operations

	Year ended 31 March 2016	Year ended 31 March 2015

	£m	£m
Operating profit	**567.9**	653.3
Adjustments for:		
Depreciation of property, plant and equipment	**332.5**	323.6
Amortisation of intangible assets	**31.2**	29.0
Impairment of property, plant and equipment	**11.4**	-
Impairment of assets classified as available for sale	**2.7**	-
Loss on disposal of property, plant and equipment	**5.4**	5.1
Loss on disposal of intangible assets	**-**	0.5
Amortisation of deferred grants and contributions	**(6.9)**	(7.7)
Equity-settled share-based payments charge	**2.3**	2.9
Other non-cash movements	**(3.8)**	(1.2)
Changes in working capital:		
Decrease/(increase) in inventories	**11.2**	(0.7)
Increase in trade and other receivables	**(14.1)**	(23.0)
Decrease in trade and other payables	**(4.1)**	(23.2)
Increase/(decrease) in provisions	**2.6**	(3.8)
Pension contributions paid less pension expense charged to operating profit	**(32.8)**	(13.1)
Cash generated from operations	**905.5**	941.7

16. Commitments and contingent liabilities

At 31 March 2016 there were commitments for future capital expenditure contracted but not provided for of £447.3 million (31 March 2015: £396.8 million).

Details of the group’s contingent liabilities are disclosed in the audited financial statements of United Utilities Group PLC for the year ended 31 March 2015. There have been no significant developments relating to contingent liabilities in the year ended 31 March 2016.

17. Related party transactions

There were no material related party transactions during the year ended 31 March 2016, nor were there material receivable or payable balances outstanding as at that date.

18. Events after the reporting period

On 3 May 2016, the CMA approved the joint venture arrangement with Severn Trent PLC (see note 11) and as a result completion is expected to occur in June 2016.

There were no further events arising after the reporting date that required recognition or disclosure in the financial statements for the year ended 31 March 2016.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The responsibility statement below has been prepared in connection with the group's full annual report for the year ended 31 March 2016. Certain parts thereof are not included within this announcement.

Responsibilities Statement

We confirm that to the best of our knowledge:

- the financial statements has been prepared in accordance with IFRS as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole;
- the strategic report includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face; and
- the directors consider the annual report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the group's performance, business model and strategy.

The directors of United Utilities Group PLC at the date of this announcement are listed below:

Dr John McAdam
Steve Mogford
Dr Catherine Bell
Stephen A Carter
Mark Clare
Russ Houlden
Brian May
Sara Weller

This responsibility statement was approved by the board and signed on its behalf by:

………………………..	……………………….
Steve Mogford	Russ Houlden
25 May 2016	25 May 2016
Chief Executive Officer	Chief Financial Officer