

FULL YEAR RESULTS FOR THE YEAR ENDED 31 MARCH 2017

Industry leading customer satisfaction, innovation and operational performance

- Record SIM scores resulting in upper quartile performance
- Systems Thinking approach delivering industry leading innovation and operational performance
- Sector leading status with Environment Agency and Dow Jones Sustainability Index

Investing for customers

- £804m investment taking total AMP6 investment to £1.6bn over first two years
- Accelerated investment delivering further operational and customer benefits and contributing to a net ODI reward of £6.7m
- Announcing today additional £100m of new investment to improve resilience for customers

Strong financials

- Underlying operating profit up 3% to £622.9m (reported operating profit up 7% to £605.5m)
- Total dividends of 38.87p, up 1.1%, in line with policy
- Robust capital structure and effective pensions hedging

Key financials

Continuing operations	Year ended	
	31 March 2017	31 March 2016
Revenue	£1,704.0m	£1,730.0m
Underlying operating profit ¹	£622.9m	£604.1m
Reported operating profit	£605.5m	£567.9m
Total dividend per ordinary share (pence)	38.87p	38.45p
RCV gearing ²	61%	61%

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 on page 18

² Regulatory capital value or RCV gearing calculated as group net debt/United Utilities Water's shadow RCV (outturn prices)

Steve Mogford, Chief Executive Officer, said:

“We have delivered a strong performance for our customers, shareholders and the environment in this second year of the 2015-20 regulatory period. This performance combined with our confidence in delivering a net outperformance over the regulatory period has enabled us to commit to a further £100m of additional investment in the region. This will support our resilience projects bringing additional customer benefits over the next three years.

“We have achieved our best ever customer satisfaction scores under Ofwat’s Service Incentive Mechanism (SIM) ending the year in an upper quartile position amongst our peers. We introduced a number of innovations enhancing our customer service offering. One of the most successful, Priority Services, provides dedicated support to customers experiencing personal or financial difficulties.

“The acceleration of our investment programme continued delivering the early benefit of operational efficiencies and means we have de-risked a number of our Outcome Delivery Incentive (ODI) measures. This contributed to another net ODI reward and improves our likely cumulative outcome over the five-year period. Our Systems Thinking approach is unparalleled in the sector and is delivering a radically different way of managing our business.

“Our performance in the early part of this regulatory period puts us in an industry leading position and demonstrates that we are well placed to deliver further value for customers, shareholders and the environment. This is supported 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 25 May 2017, 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 961929. A recording of the call will be available for seven days following Thursday 25 May 2017 on +44 (0) 20 7031 4064, access code 961929.

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

KEY OPERATIONAL PROGRESS

Customer service, innovation and operational performance remain top priorities, building on the industry leading performance delivered this year.

- **Sustained improvements in customer satisfaction** – achieved our best ever score as measured through Ofwat’s qualitative service incentive mechanism (SIM), with excellent results across the board for billing, water and wastewater services and positioning us as a leading company in the sector. We also achieved a 27 per cent year-on-year reduction in complaints and a 55 per cent reduction in issues not resolved at first contact. Our digital transformation has enhanced our customer experience with further digital propositions based on customer feedback to follow.
- **Effective acceleration and delivery of investment plan** – acceleration of our 2015-20 investment programme continues to deliver early customer service, operational and environmental benefits, enhance resilience and optimise performance under our ODIs. The acceleration of our investment has been achieved with continued highly effective and efficient capital delivery as reflected in our Time: Cost: Quality index (TCQi) score which remains high at over 90%.
- **Innovation through Systems Thinking** – exploiting innovation and our Systems Thinking approach is continuing to transform the way we run our business, and is on track to deliver £100 million of savings in our business plan. We are progressively moving greater capability into our Integrated Control Centre facilitating a more proactive and predictive approach to monitoring our assets and networks. This central control reduces the level of reactive work thereby improving performance and efficiency and helps minimise the customer impact of any incidents.
- **Leading operational and environmental performance** – in July, we attained Industry Leading Company status, as measured through the Environment Agency’s (EA) annual assessment and expect to retain this status when the performance for 2016 is published. On pollution incidents, we have set industry leading standards against this EA measure. We have delivered our best ever performance against the Drinking Water Inspectorate’s (DWI) metrics and expect to compare favourably to our peers when the DWI publish their full report for 2016 in July 2017. This is particularly pleasing given the historical issues we have faced due to the legacy nature of our asset base.
- **Strong environmental, social & governance (ESG) credentials** – we have retained our World Class rating in the Dow Jones Sustainability Index for the ninth consecutive year, a very good achievement in light of the ever evolving standards. In addition, we were winners of the ‘Communicating Integrated Thinking’ award in 2016 and a ‘Credit Award for Excellence in Treating Customer Vulnerability’ in 2017.
- **Delivering shareholder value through regulatory outperformance** – the low cost of debt we have already locked-in places us in a strong position to deliver our target for the 2015-20 period of minimising our cost of debt compared to Ofwat’s industry allowed cost. We are making good progress, implementing initiatives to deliver over £400 million of efficiencies to meet our totex allowance. Operationally, we delivered a good performance on our ODIs in 2016/17 building on the performance in the previous year.
- **Additional investment** – making £100m of anticipated outperformance available for additional investment over the next three years to improve resilience for customers.
- **Non-household retail** – the non-household retail market fully opened on 1 April 2017. Our Water Plus JV with Severn Trent benefitted from first mover advantage and has achieved a net gain through the early switches in the market demonstrating it is well placed to compete as the market evolves.

FINANCIAL OVERVIEW

The group has delivered a strong set of financial results for the year ended 31 March 2017.

- **Revenue** – was down £26 million, at £1,704 million, reflecting the accounting impact of our WaterPlus JV, which completed on 1 June 2016, partly offset by our allowed regulatory revenue changes.
- **Operating profit** – underlying operating profit was up £19 million, at £623 million. This reflects our allowed regulatory revenue changes, a reduction in infrastructure renewals expenditure and lower total costs offset by the accounting impact of our WaterPlus JV. Reported operating profit was £606 million, up £38 million mainly as a result of reduced profit last year due to costs associated with the water quality incident.
- **Capex** – total regulatory capital investment in the year, including £148 million of infrastructure renewals expenditure, was £804 million, in line with company's plans to accelerate the 2015-20 investment programme. As announced today, we will also make an additional £100 million of new investment available over the remainder of the 2015-20 period to improve resilience for customers and taking our five-year regulatory capex programme to c£3.6 billion. In addition, we expect to invest over £100 million in non-regulated projects, subject to acceptable returns. This investment relates primarily to solar power, in which £40 million has been invested in the first two years of the 2015-20 period.
- **Profit before tax** – underlying profit before tax was down £19 million to £389 million, as the increase in underlying operating profit was more than offset by a £36 million increase in the underlying net finance expense. The increase in the underlying net finance expense is mainly due to the impact of higher RPI inflation on our index-linked debt. Reported profit before tax was £442 million, reflecting fair value movements and other adjusting items as outlined in the underlying profit measures table on page 18.
- **Profit after tax** – underlying profit after tax was down by £12 million to £313 million. Reported profit after tax was higher at £434 million, mainly reflecting a deferred tax credit as a result of the UK Government's future planned reduction in the mainstream rate of corporation tax.
- **Capital structure** – the group has a robust capital structure with gearing of 61% as at 31 March 2017 (measured as group net debt to 'shadow' regulatory capital value). Our shadow RCV adjusts for actual spend and was £10.7 billion as at 31 March 2017. This gearing level is comfortably within our target range, of 55% to 65%, supporting a solid investment grade credit rating. United Utilities Water Limited (UW) has long-term credit ratings of A3 from Moody's, on stable outlook, and BBB+ from Standard & Poor's, on positive outlook.
- **Financing headroom** – the group benefits from headroom to cover its projected needs into 2019, 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 25.92 pence per ordinary share (taking the total dividend for 2016/17 to 38.87 pence), an increase of 1.1%, in line with our policy of targeting an annual growth rate of at least RPI inflation through to 2020.

OUTLOOK AND PR19

We are encouraged by our continued strong operational and environmental performance outcomes. Our progress in the first two years of this regulatory period and our robust financial position underpin our confidence that we can deliver our targets for both customers and shareholders and exit the 2015-20 period in a leading position amongst our peers.

We are engaged with customers, Ofwat and other stakeholders ahead of the next regulatory review period which will set our price and service package for the five year period to April 2025. We look forward to the publication of Ofwat's draft methodology for PR19 in July and final methodology in December this year which will represent a further evolution of the framework adopted at PR14.

United Utilities has been actively engaged in the development of this approach, contributing across the full range of working groups and providing detailed proposals in key areas - such as the development of access pricing arrangements for water resources which will result in better outcomes for customers and the approach to allocating RCV across more disaggregated price controls. We support Ofwat in developing a progressive framework of regulation in the sector whilst also recognising the importance of key pillars of the historic approach such as maintaining protection of historic regulatory capital values.

We believe that our strong track record of operational performance and service delivery, leading environmental performance, innovative approaches to customer service and recognised strengths in transparency and reporting should provide a strong underpin for our business plan. We believe we are also the first - and so far only - UK water company to issue CPI linked debt instruments in anticipation of the transition of price controls away from the RPI measure of inflation.

Before finalising our business plan, it is anticipated that we will make a number of additional submissions reflecting company specific factors. These will include our approach to RCV allocations for bioresources and water resources (in September 2017 and January 2018 respectively), where Ofwat will consider company led proposals for the appropriate split. We also expect to provide early evidence on company specific factors affecting our wholesale and household retail operations in the North West ahead of business plan submission, subject to confirmation of this approach in Ofwat's methodology. Submission of the main business plan is expected to be in September 2018.

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.

Our operational performance is presented under each of these themes.

Best service to customers

Customer service – sitting at the core of everything we do, our strong focus on customer service has helped us deliver substantial improvements in recent years, becoming the most improved company in the 2010-15 period with a reduction of around 75% in the overall number of customer complaints.

This year we re-energised our approach and have seen another upturn in customer satisfaction. In 2016/17 we delivered our best ever scores under Ofwat's qualitative Service Incentive Mechanism (SIM) measure, placing us above the industry average for the full year, and ending the year as a leading company in the sector. Customer complaints in 2016/17 were considerably lower than last year with a 27% year on year reduction and a 55% reduction in the circumstance where an issue is not resolved at first contact.

We introduced a number of innovations over the year, setting new benchmarks for the sector. One of the most successful, Priority Services, provides more targeted support for customers experiencing short or long-term personal or financial difficulties in their lives, with tailored assistance for customers. Since its launch in May 2016, we have seen more than 11,000 customers register for this service, supplementing the wide range of initiatives we already offer customers struggling to pay, in order to help them return to regular payment.

Our new customer website was designed to improve accessibility and ease of use following extensive research and customer engagement, includes web chat services across extended hours, and is mobile-enabled to accommodate customers' increasing use of mobile devices to access day-to-day online services. Additionally, we have recently launched the first fully interactive and real-time customer App in the sector.

Improving customer service will continue to be a key area of focus, and our new management team has identified a range of 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, trustworthiness 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 benefit from our robust water supply and demand balance, along with high levels of water supply reliability. Our overall water quality continues to be good, and although our water quality service index has slightly deteriorated from a very good performance in the prior year, it remains above our historical average and we have plans in place to deliver improved performance going forwards. We have consistently delivered a reliable water service, although we experienced some water no-supply incidents in 2016/17. Whilst this is disappointing, our Systems Thinking approach is helping us to respond to these events and avoid them in future.

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.

Key performance indicators:

- **Outcome delivery incentives (ODIs)** – we have 19 wholesale financial ODIs and, as outlined last year, the risk is skewed to the downside with ten attracting a penalty only.

Whilst a number of our ODI measures are susceptible to one-off events and, on the whole, our ODI targets get tougher each year, our performance in the first two years of this regulatory period has now delivered a cumulative net reward of £9.2million, exceeding our initial expectations. This gives us confidence to narrow our target range for the cumulative net ODI outcome over the 2015-20 period to between plus £30 million and minus £50 million.

In 2016/17 we have achieved another net reward of £6.7 million, exceeding our initial expectations and demonstrating the effectiveness of our planned acceleration of capital expenditure in this regulatory period, alongside our Systems Thinking and innovative approach to the way we operate.

We were particularly pleased this year with the significant improvements made against our leakage targets and have continued to perform well against private sewers and pollution incidents. Our sewer flooding ODI remains challenging as the target becomes increasingly tougher as we progress through this regulatory period. This meant that we received a small penalty this year despite having improved our overall performance compared with the prior year. Our main areas of reward came through our good performance in the areas of leakage, private sewers and pollution, with our main penalty being on reliable water service and water quality service.

- **Service incentive mechanism (SIM)** – last year we stated our target was to move towards the upper quartile in the medium-term, and we are particularly pleased with the progress we have made this year, which saw us ending the year as a leading company in our peer group.

Qualitative: Ofwat has undertaken the four surveys for 2016/17 and United Utilities has improved its score to 4.42 points, compared with 4.27 points in 2015/16, putting us in joint 6th position for the year out of the 18 water companies, and joint 3rd position out of the 10 companies providing both water and wastewater services. We ended the year with our highest ever score of 4.56 in wave 4, which placed us in equal 3rd position in this wave, and 2nd position out of those providing both water and wastewater services. In particular, customers scored us highly for our billing and wastewater services.

Quantitative: the quantitative assessment measures customer contacts and performance is assessed on both an absolute and relative basis. Whilst relative performance can only be assessed in full following the end of each full financial year when the other companies publish their respective results, on absolute performance for 2016/17, our score of 77 points represents a marked improvement on our 2015/16 score of 95 points, and of the 13 companies who share data on quantitative scores, for the full year, this placed us in 4th position out of the 13 and 1st of the 8 water and wastewater companies in this data share.

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. In addition to the electricity we generate from bioresources, we are developing other renewable energy facilities. This is primarily in the area of solar, where we have invested £45 million in the first two years of the 2015-20 period and contributing towards our expected investment of over £100 million across the five-year period.

We have also substantially locked in our power commodity costs across 2015-20, providing greater cost certainty for the regulatory period.

Proactive network management – through our Systems Thinking approach we are more proactive in the management of our assets and networks. We aim to improve our predictive modelling and forecasting through better use of sensors in our network and better analysis of other data, such as weather forecasting, to enable us to address more asset and network problems before they affect customers, thereby reducing the level of reactive work and improving our performance and 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 £5 million contribution in 2016/17. 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.

Reflecting our ongoing focus on bad debt through our new customer facing management team and the penetration of our affordability schemes, our household bad debt expense has reduced to 2.5% of regulated revenue from 3.0% last year.

Pensions – United Utilities has taken progressive steps to de-risk its pension provision. The group had an IFRS retirement benefit surplus of £248 million as at 31 March 2017, compared with a surplus of £275 million as at 31 March 2016. Further details of the group's pension provision are provided in the pensions section on page 16.

Ongoing formal consultations continue regarding proposed changes to the group's pension schemes.

Capital delivery and regulatory commitments – we are strongly focussed on delivering our commitments efficiently and on time, and have a robust commercial capital delivery framework in place. Across the 2015-20 regulatory period, we are working with a single engineering partner and four design and construction partners to deliver our regulatory capital investment programme of c£3.6 billion. We are involving our partners much earlier in project definition and packaging projects by type, geography and timing in order to deliver efficiencies. Projects are allocated on an incentive or competitive basis leading to our partners presenting a range of solutions, innovations and pricing.

We have continued the planned acceleration of our 2015-20 investment programme in order to improve services for customers and deliver early operational and environmental benefits. Regulatory capital investment in 2016/17, including £148 million of infrastructure renewals expenditure, was £804 million, in line with our expectations. This, combined with £799 million invested in 2015/16, brings our total spend to around £1.6 billion of our planned £3.6 billion capital investment across the 2015-20 period.

We are also driving more effective and efficient delivery of our capital programme and applying a tougher measurement mechanism to our Time: Cost: Quality index (TCQi) score for this regulatory period. Despite this tougher approach, our TCQi score remains high at 93% which represents a very good performance, improving from what was already a good performance at 90% in 2015/16.

Key performance indicators:

- **Financing outperformance** – The low cost of debt we have already locked-in places United Utilities in a strong position to deliver our target for the 2015-20 period of minimising our cost of debt compared to Ofwat's industry allowed cost.
- **Total expenditure (totex) performance** – although our totex allowance for the 2015-2020 period is challenging, 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 two years has been good and we remain on track to meet the five-year target.

- **Domestic retail cost to serve** – 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 and despite the challenging target, we have delivered a good performance in 2016/17 outperforming this year’s revenue allowance by around £14 million.

Responsible manner

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 2016/17 financial year, United Utilities retained its World Class rating in the Dow Jones Sustainability Index for the ninth 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 Finance for the Future Awards in October 2016, United Utilities won the international Communicating Integrated Thinking award, following on from the PwC 2015 Building Public Trust Awards in which United Utilities was selected as joint winner for Excellence in Reporting in the FTSE 100.

Leakage – we have a 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. This delivered a particularly good performance against our leakage targets in 2016/17, delivering our largest ODI reward in this area.

Environmental performance – this is a high priority for United Utilities and we were encouraged to have been awarded Industry Leading Company status 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. Our carbon footprint has reduced by 22% over the last 10 years. Our renewable energy production in 2016/17 was 149 GWh, representing 18% of our electricity consumption in the year. This represents good progress over the last few years, up from 13% in 2012/13, and we are implementing plans to significantly increase self-generation over the next few years.

Employees – we continue to work hard to engage all of our employees in the transformation of the group’s performance. Employee engagement was high at 89% this year, broadly in line with last year on a normalised basis as we amended the question structure slightly. 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 2016/17. We now have a total of 64 graduates and 119 apprentices across the business. Our investment in recruiting graduates and apprentices is already benefitting the company, with 122 of them now having secured permanent roles across our business.

Over the last year, we have continued our sustained focus on health, safety and wellbeing. In this period we retained our Gold award status with the Royal Society for the Prevention of Accidents as well as the top place ranking on the Dow Jones sustainability index. Following a four day audit, we were also awarded the UK workplace wellbeing charter. Our contractor accident frequency rate is at its lowest ever

at 0.087 accidents per 100,000 hours. For the same period, our employee accident frequency rate has increased to 0.196 accidents per 100,000 hours, compared with a rate of 0.104 in 2015/16. We recognise that we still have more to do, and 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. Our Catchment Wise programme helps to tackle 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 an excellent performance in 2016/17 and have again met our regulatory leakage target of 463 megalitres per day.
- **Environmental performance** – On the Environment Agency's latest annual assessment, published in July 2016, we were awarded Industry Leading Company status across the range of operational metrics. This indicates we were in second position amongst 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** – United Utilities 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 2016/17, United Utilities retained its World Class rating for the ninth consecutive year.

FINANCIAL PERFORMANCE

United Utilities delivered a strong set of financial results for the year ended 31 March 2017.

Revenue

Revenue was down £26 million, at £1,704 million, reflecting the impact of our Water Plus JV, which completed on the 1 June 2016, partly offset by our allowed regulatory revenue changes.

With regard to Ofwat's revenue correction mechanism, relating to the 2014/15 financial year, we have £9.5 million to return to customers. As we have previously indicated, we propose to return the £9.5 million to customers through revenue reductions of c£3 million in 2017/18, c£3 million in 2018/19 and c£3 million in 2019/20 to help aid a smoother bill profile.

Separately, consistent with Ofwat's annual wholesale revenue forecasting incentive mechanism (WRFIM), we will also be reducing 2017/18 revenue by £7 million as actual volumes in 2015/16 were higher than our assumptions increasing revenue by 0.4%.

Operating profit

Underlying operating profit at £623 million was £19 million higher than last year. This reflects our allowed regulatory revenue changes, a reduction in infrastructure renewals expenditure, an improvement in our bad debt charges and a small reduction in the remaining cost base, partly offset by the accounting impact of our Water Plus JV. The JV completed on 1 June 2016 and, from that date, its contribution is no longer included within operating profit and is, instead, included within the share of profits of joint ventures line in the income statement. However, as expected, due to start-up costs, our share of 2016/17 losses of the Water Plus JV was around £2 million.

Reported operating profit increased by £38 million, to £606 million, reflecting the increase in underlying operating profit, along with a reduction in adjusted items. Adjusted items for 2016/17 amounted to £17 million, £10 million of which related to restructuring costs. Adjusted items in the prior year amounted to £36 million, £25 million of which related to the water quality incident in summer 2015.

Investment income and finance expense

The underlying net finance expense of £237 million was £36 million higher than last year, mainly due to the impact of higher RPI inflation on the group's index-linked debt, particularly on the portion of index-linked debt with a three-month lag. Interest on non index-linked debt of £108 million was £4 million lower than last year, due to the lower rates locked in on our interest rate swaps. The indexation of the principal on our index-linked debt amounted to a net charge in the income statement of £81 million, compared with a net charge of £38 million last year. As at 31 March 2017, the group had approximately £3.6 billion of index-linked debt at an average real rate of 1.3%.

The higher RPI inflation charge compared with last year contributed to the group's average underlying interest rate of 3.8% being higher than the rate of 3.4% for the year ended 31 March 2016. The average underlying interest rate represents the underlying net finance expense divided by average debt.

Reported net finance expense of £189 million was lower than the £219 million expense in 2015/16. This £30 million decrease principally reflects a change in the fair value gains and losses on debt and derivative instruments, from a £26 million loss in 2015/16 to a £24 million gain in 2016/17. The fair value gain in the current year is due to the net receipts on swaps and debt under fair value option and gains on our electricity swap portfolio due to an increase in the market price of electricity. Losses in the prior year were largely due to a decrease in medium-term interest rates, which impact our derivatives hedging interest rates. 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 Ofwat at each price review. The group has fixed the substantial majority of its non index-linked debt for the 2015-20 regulatory period.

Profit before tax

Underlying profit before tax was £389 million, £19 million lower than last year, as the £19 million increase in underlying operating profit was more than offset by the £36 million increase in underlying net finance expense. This underlying measure reflects the adjusting items, 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 on page 18.

Reported profit before tax significantly increased by £89 million to £442 million, due in most part to fair value movements and the increase in reported operating profit, as well as a £22 million profit on disposal of the non-household retail business.

Tax

In addition to corporation tax, the group pays and bears further annual economic contributions, typically of around £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.

In 2016/17, we paid corporation tax of £42 million, which represents an effective cash tax rate on underlying profits of 11%, which is 9% 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 capital investment. We have expressed the effective cash tax rate in terms of underlying profits as this measure excludes 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 £54 million in 2016/17, compared with £53 million in the previous year. There were current tax credits of £23 million in 2016/17 and £9 million in 2015/16, following agreement of prior years' tax matters; in addition to UK tax, the current year figure also included the release of a provision in relation to agreed historic overseas tax matters.

For 2016/17, the group recognised a deferred tax charge of £28 million, compared with a charge of £19m for 2015/16. In addition, in 2016/17 the group recognised a deferred tax charge of £7 million relating to prior years' tax matters, compared with a charge of £6 million in 2015/16. In 2016/17, the group also recognised a deferred tax credit of £58 million relating to the enacted reduction in the headline rate of corporation tax from 18% to 17% from 1 April 2020. This compares to a deferred tax credit of £112 million in 2015/16 when the enacted reduction in the headline rate of corporation tax from 1 April 2020 was reduced from 20% to 18%.

The total tax charge for 2016/17 was £9 million as compared to a total tax credit of £44 million for 2015/16, the main difference being the £54 million reduction in the deferred tax credit 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.

Profit after tax

Underlying profit after tax of £313 million was £12 million lower than last year, principally reflecting the £19 million decrease in underlying profit before tax partly offset by lower underlying tax on lower profits. Reported profit after tax was higher at £434 million, compared with £398 million in the previous year, as the £89 million increase in the reported profit before tax was partly offset by the £53 million higher tax charge.

Earnings per share

Underlying earnings per share decreased from 47.7 pence to 46.0 pence. This underlying measure is derived from underlying profit after tax. Basic earnings per share increased from 58.3 pence to 63.6 pence, for the same reasons that increased profit after tax.

Dividend per share

The board has proposed a final dividend of 25.92 pence per ordinary share in respect of the year ended 31 March 2017. Taken together with the interim dividend of 12.95 pence per ordinary share, paid in February, this produces a total dividend per ordinary share for 2016/17 of 38.87 pence. This is an increase of 1.1%, 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 1.1% is based on the RPI element included within the allowed regulated revenue increase for the 2016/17 financial year (i.e. the movement in RPI between November 2014 and November 2015).

The final dividend is expected to be paid on 4 August 2017 to shareholders on the register at the close of business on 23 June 2017. The ex-dividend date is 22 June 2017.

In light of the Financial Reporting Lab's report entitled 'Disclosure of dividends – policy and practice' which provided best practice guidance, we enhance 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 United Utilities Group 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 2017, the company had distributable reserves of £3,184 million. The total external dividends relating to the 2016/17 financial year amounted to £265 million. The company distributable reserves support over 12 times this annual dividend.
- **Financing headroom** – supporting the group's cash flow, United Utilities 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. United Utilities 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 for U UW with Moody's. RCV gearing at 31 March 2017 was 61% and the movement in net debt is outlined in the cash flow section below.

- **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; the contingent liabilities of the group; and the key risks of the group together with the associated mitigating actions.
- **Annual dividend approval process** – the group places significant emphasis on strong corporate governance, and before declaring interim and proposing final dividends, the United Utilities Group board undertakes a comprehensive assessment of the group’s key financial metrics.
- **Policy sustainability**
 - 2015-20
 - 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;
 - 2020-25
 - a dividend policy for the 2020-25 period will be formulated after Ofwat announces the outcome of the regulatory price review (currently expected in December 2019).

Cash flow

Net cash generated from continuing operating activities for the year ended 31 March 2017 was £821 million, compared with £686 million in the previous year. This increase mainly reflects a switch between cash generated from operating activities and cash used in investing activities largely due to the accounting treatment of our Water Plus JV. The group’s net capital expenditure was £692 million, principally in the regulated water and wastewater investment programmes. This excludes infrastructure renewals expenditure which is treated as an operating cost under IFRS. Cash flow capex differs from regulatory capex, since regulatory capex is based on capital work done in the period, rather than actual cash spent.

Net debt including derivatives at 31 March 2017 was £6,579 million, compared with £6,261 million at 31 March 2016. This increase reflects accelerated regulatory capital expenditure, payments of dividends, interest and tax, the inflationary uplift on index-linked debt and loans to joint ventures, partly offset by operating cash flows.

Fair value of debt

The group’s gross borrowings at 31 March 2017 had a carrying value of £7,385 million. The fair value of these borrowings was £8,603 million. This £1,218 million difference principally reflects the significant fall in real interest rates, compared with the rates at the time we raised a portion of the group’s index-linked debt. This difference has increased from £483 million at 31 March 2016 due primarily to a decrease in credit spreads.

Debt financing and interest rate management

Gearing, measured as group net debt divided by UUW's shadow (adjusted for actual spend) regulatory capital value, was 61% at 31 March 2017. This is the same gearing as at 31 March 2016 and remains comfortably within our target range of 55% to 65%.

UUW has long-term credit ratings of A3/BBB+ and United Utilities PLC (UU 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 (EMTN) programme. 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 2017 amounted to £248 million. Over 2015-20 we have financing requirements totalling around £2.5 billion to cover refinancing and incremental debt, supporting our five-year investment programme, and we have now raised over £1.7 billion of this requirement.

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. As at 31 March 2017, £75 million had been drawn down. 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 June 2016, UUW's financing subsidiary, United Utilities Water Finance PLC (UUWF), raised c£76 million of term funding, via the issue of €30 million and HKD600 million private placement notes, both with a 15-year maturity, off our EMTN programme. In September 2016, UUWF raised c£53 million of term funding, via the issue of 12-year and 20-year private placement notes, in RPI-linked form, off the group's EMTN programme, at the group's best ever real interest rates. In the second half of 2016/17, UUWF raised a further c£172 million, via the issue of 15-year and 20-year private placement notes, in index-linked form, off our EMTN programme. In response to Ofwat's decision to transition away from RPI inflation linkage, £100 million of this index-linked funding was CPI-linked, these being the first ever CPI-linked notes issued by a UK utility.

In addition, since September 2016, the group has agreed £100 million of new or replacement 5-year committed bank facilities and extended a further £100 million for an initial term of 5-years. The group has headroom to cover its financing needs into 2019.

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 2017, 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 1.3%. 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 3.6% (inclusive of credit spreads).

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 EMTN programme provides further support.

Available headroom at 31 March 2017 was £699 million based on cash, short-term deposits, committed bank facilities and the undrawn portion of the signed EIB term loan facilities, net of short-term debt as well as committed facilities and term debt falling due within 12 months.

United Utilities 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. United Utilities' cash is held in the form of short-term money market deposits with prime commercial banks.

United Utilities 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 2017, the group had an IAS 19 net pension surplus of £248 million, compared with a net pension surplus of £275 million at 31 March 2016. This £28 million reduction mainly reflects the impact of a decrease in credit spreads. 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 a blend of the inflation market hedge and 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 11 ('Retirement benefit surplus') of these condensed consolidated financial statements.

Underlying profit

The underlying profit measures in the table following represent alternative performance measures (APMs) as defined by the European Securities and Markets Authority (ESMA). These measures are linked to the group's financial performance as reported under International Financial Reporting Standards (IFRSs) as adopted by the European Union in the group's consolidated income statement, which can be found on page 25. As such, they represent non-GAAP measures.

These APMs have been presented in order to provide a more representative view of business performance. The group determines adjusted items in the calculation of its underlying measures against a framework which considers significance by reference to profit before tax, in addition to other qualitative factors such as whether the item is deemed to be within the normal course of business, its assessed frequency of reoccurrence and its volatility which is either outside the control of management and/or not representative of current year performance.

Adjusted item	Rationale
Water quality incident	A significant water quality incident occurred in the year ended 31 March 2016, the likes of which management would not expect to occur on a frequent basis. As such, this was not considered part of the normal course of business.
Flooding incidents	Two significant flooding incidents in the year ended 31 March 2016 caused extensive damage to localised parts of our infrastructure, resulting in significant levels of remedial operating expenditure and a large claim under the group's insurance cover. Management's view is that these were significant and infrequent events and, as such, were not part of the normal course of business.
Non-household retail market reform	The group has incurred significant costs since the year ended March 2015 in preparation for the non-household retail market opening to competition in April 2017. This represents a one-off event and as such, is not considered part of the normal course of business.
Restructuring costs	The group has incurred restructuring costs in the past in relation to a number of discrete underlying events which can cause volatility in the reported results. Management adjusts internally for these costs to provide an underlying view of performance which it views as being more representative of the normal course of business and more comparable period to period.
Net fair value losses on debt and derivative instruments	Fair value movements on debt and derivatives can be both very significant and volatile from one period to the next. These movements are determined by macro-economic factors which are outside the control of management and these instruments are purely held for funding and hedging purposes, (not for trading purposes). Taking these factors into account, management believe it is useful to adjust for this to provide a more representative view of performance.
Interest on swaps and debt under fair value option	Net fair value losses on debt and derivative instruments includes interest on swaps and debt under fair value option. In adjusting for the former, it is appropriate to add back interest on swaps and debt under fair value option to provide a view of the group's costs of debt which is better aligned to the return on capital it earns through revenue.
Net pension interest (income)/ expense	This item can be very volatile from one period to the next and it is a direct function of the extent to which the pension scheme is in an accounting deficit or surplus position. Management believe it is useful to adjust for this to provide a more representative view of performance which is better aligned to the return on capital it earns through revenue.
Capitalised borrowing costs	The accounting standards allow for the capitalisation of borrowing costs in the cost of qualifying assets. Management believe it is appropriate to adjust for these significant costs to provide a representative cost of borrowings and current year performance which is better aligned to the return on capital it earns through revenue.
Profit on disposal of business	This relates to the disposal of the group's non-household retail business during the year ended 31 March 2017 which represents a significant one-off event and, as such, is not considered part of the normal course of business.
Deferred tax credit-change in tax rate	The deferred tax impact from changes to the corporation tax rate announced by HMRC represent both significant and volatile impacts which are outside the control of management. Management adjust for this to provide a more representative view of current year performance.
Agreement of prior years' tax matters	The agreement of prior years' tax matters can be significant, volatile and often related to the final settlement of numerous prior year periods. Management adjust for this to provide a more representative view of current year performance.
Tax in respect of adjustments to underlying profit before tax	Management adjust for the tax impacts of the above adjusted items to provide a more representative view of current year performance.

Operating profit

	Year ended 31 March 2017	Year ended 31 March 2016
	£m	£m

Operating profit per published results	605.5	567.9
Water quality incident	-	24.8
Flooding incidents (net of insurance proceeds recognised)	1.5	(0.6)
Non-household retail market reform	5.8	11.1
Restructuring costs	10.1	0.9
Underlying operating profit	622.9	604.1

Net finance expense

	£m	£m
Finance expense	(202.7)	(224.4)
Investment income	13.7	5.0
Net finance expense per published results	(189.0)	(219.4)
Adjustments:		
Net fair value losses on debt and derivative instruments	(24.3)	26.3
Interest on swaps and debt under fair value option	15.4	16.5
Net pension interest (income)/expense	(10.2)	(3.1)
Capitalised borrowing costs	(29.2)	(21.3)
Underlying net finance expense	(237.3)	(201.0)

Profit before tax

	£m	£m
Share of profits of joint ventures	3.8	5.0
Profit before tax per published results	442.4	353.5
Adjustments:		
Water quality incident	-	24.8
Flooding incidents (net of insurance proceeds recognised)	1.5	(0.6)
Non-household retail market reform ¹	5.8	11.1
Restructuring costs	10.1	0.9
Net fair value (gains)/losses on debt and derivative instruments	(24.3)	26.3
Interest on swaps and debt under fair value option	15.4	16.5
Net pension interest (income)/expense	(10.2)	(3.1)
Capitalised borrowing costs	(29.2)	(21.3)
Profit on disposal of business	(22.1)	-
Underlying profit before tax	389.4	408.1

Profit after tax

	£m	£m
Underlying profit before tax	389.4	408.1
Reported tax (charge)/credit	(8.5)	44.0
Deferred tax credit – change in tax rate	(58.2)	(112.5)
Agreement of prior years' tax matters	(15.5)	(3.4)
Tax in respect of adjustments to underlying profit before tax	6.2	(10.9)
Underlying profit after tax	313.4	325.3

Earnings per share

	£m	£m
Profit after tax per published results (a)	433.9	397.5
Underlying profit after tax (b)	313.4	325.3
Weighted average number of shares in issue, in millions (c)	681.9m	681.9m
Earnings per share per published results, in pence (a/c)	63.6p	58.3p
Underlying earnings per share, in pence (b/c)	46.0p	47.7p

PRINCIPAL RISKS AND UNCERTAINTIES

Our strategy is to create sustainable value by delivering the best service to customers, at the lowest sustainable cost and in a responsible manner. In doing this, the group is exposed to a range of internal and external risks of varying types which can impact upon us and the delivery of our objectives and operations. To understand and manage these risks, we maintain a risk management framework which includes:

- an enterprise-wide approach to risk management;
- a well-established governance and reporting structure;
- a risk assessment and management process which is aligned to ISO 31000:2009; and
- a suite of tools, guidance material and training packages to support consistency of approach.

Business areas and functions are responsible for the identification, analysis, evaluation and management of risk relative to their business environment including new and emerging circumstances. All event types (including regulatory, legal, core operations, service and hazard) are considered for their likelihood of occurrence and both the financial and reputational impact should that event occur. Each assessment takes into account a gross position (assuming no controls or that all controls fail), a current position benefitting from an analysis of the type and effectiveness of existing controls and a targeted position where further mitigation may be required if the current position is evaluated as not meeting our objectives or obligations.

The nature and extent of the risk profile culminating from this structured approach is reported to the group board twice a year, illustrating individual event based risks that underpin ten inherent risk categories that are regarded as the principal risks (see below). From this initial overview, the report then focuses on two categories of risk: i) the most significant group wide business risks and ii) wholesale operational risks. These are represented by the ten highest ranked risks (based on likelihood x 'full life' financial impact) for each of the two categories and a further five risks with potentially very high impact severity in their current state (net of control effectiveness) with reputational impact noted for awareness and management. The report also highlights risks that fall outside these categories but are included due to potential reputational impact or because they are notable new/emerging circumstances.

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 120 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

Our risk profile shows that, for each set of the ten highest ranked risks (one set for each of group wide business risks and wholesale operational risks), the majority fall into the principal risk areas 'Political and regulatory', 'Water service' and 'Wastewater service'. Operationally, the dominance of the penalty element of the outcome delivery incentive mechanism and the effect following changes to the Environmental Sentencing Guidelines are key features of this exposure. Reputationally, our core operations/service provision (notably water service) and health safety and environmental risks have the

highest focus for monitoring and reviewing control effectiveness based on the potential impact should the risk event occur.

We aim for continuous improvement in both our governance and approach to managing risk. Changes this year include the introduction of a core risk team and additional sign-off processes relating to operational risk. We have also developed a programme focused on long term resilience of assets, overseen by the newly formed wholesale resilience board. Associated with this is a focus on asset health and operational hazard risk assessment in advance of and beyond PR19. This should ensure that we fully understand the long-term risk profile of our asset base and improve our capability to deliver the most cost-effective and proportionate risk management response. Other developments include an ongoing transformation programme (with the Drinking Water Inspectorate) to address some areas of concern arising from the Lancashire incident in 2015, system optimisation in wastewater services through a remote monitoring and control transformation project and in domestic retail a customer service improvement plan underpinned by a clear strategy, improved complaints handling, accurate data and cultural change.

The introduction of non-household retail competition required significant preparation. Ensuring we continue to operate compliantly and in accordance with ‘level playing field’ requirements remains a key area of focus.

Whilst most of our operations are in the UK, the potential effects of ‘Brexit’ have been considered, assessed and reported to the group board. Like many companies, a key issue is the level of uncertainty that exists. Our assessment included sources of funds, costs of goods and services, our ability to collect cash in the event of an economic downturn and the effect of any potential inflationary shift over current predictions. This area remains under review.

Looking further ahead, the expected introduction of competition in relation to certain wholesale activities and the possible introduction of competition in the provision of household retail activities at some future date all place risk on the group.

It is also important to acknowledge other potential significant change in environment and societal conditions. Climate change is expected to be one of the sector’s biggest challenges having significant and permanent implications on the water cycle and the long-term sustainability of water and wastewater services including water abstraction, supply and treatment capability, drainage and sewer capacity and wastewater treatment and discharge efficiency and effectiveness.

The principal risks (aggregated clusters of event-based risks), which have been set out below 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 potential effect is highlighted together with the extent of management/mitigation. To ensure relevance with the current environment, issues or areas of uncertainty are also illustrated.

1. Political and regulatory risk

The potential change in the regulatory environment and/or frameworks, either through political or regulatory events, for example following Brexit, 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, the potential for the introduction of household competition; a

possible change from using the Retail Prices Index to the Consumer Prices Index for regulatory indexation; and Brexit.

2. Compliance risk

Reputational, brand and general damage arising from the potential 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.

To manage and mitigate this risk, legislative and regulatory developments are continually monitored. 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; level playing field requirements in relation to non-household retail; current material litigation; and new higher fine levels for environmental offences.

3. and 4. Water and Wastewater Service risks

The potential failure of water or wastewater operational processes or assets due to operational performance problems or service or asset failures can lead to a failure to provide a secure supply of clean, safe drinking water or an inability to remove, treat and return water to the environment. This can cause public health, community and environmental impacts, 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 risks 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: water quality; interruption to supply; structural integrity of major assets; pollution; population growth; climate change; meeting infrastructure investment requirements; and expected change to the abstraction licensing regime.

5. Retail and commercial risk

The potential inability to provide good and fair service to domestic customers and third party retailers. Poor service to customers can result in financial penalties and an impact on regulatory reputation. The opening of the market for retail services to all non-household customers in England in April 2017 has generated both opportunities and risk for the group and its associated business retail function in respect of income, margin and debt. Breaches of legal and regulatory requirements could lead to fines, penalties and reputational damage. Uncertainty remains in respect of potential upstream reform from 2020.

To manage and mitigate this risk, 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 looked to retain existing and acquire new commercial customers by striving to meet their needs more effectively. We monitored

competitor activity and targeted 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 have been delivered. 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; and Market Reform and the ability to treat other participants equally.

6. Financial risk

The potential inability to appropriately finance the business due to the failure of financial counterparties could result in additional financing cost, an adverse impact on the income statement and potential reputational damage. Variability in inflation (as measured by the UK Retail Prices Index) and changes in interest rates, funding costs and other market risks could adversely impact the economic return on the Regulatory Capital Value. Increased pension scheme deficit could lead to a requirement for the group to make additional contributions. In extreme but remote cases adverse market conditions could affect our access to debt capital markets and subsequently available liquidity and credit ratings.

To manage and mitigate this risk, 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; and financial market conditions, interest rates and funding costs.

7. Programme delivery risk

The potential ineffective delivery of capital, operational and change programmes/processes resulting in failure to deliver capital or 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, failure of legal or regulatory obligations and subsequent penalties. This could lead to negative reputational impact with customers and regulators.

To manage and mitigate this risk, 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: security of supply; delivery of solutions; quality and innovation; and new contract delivery partnerships for the 2015-2020 period with a new approach to construction and design.

8. Resource Risk

The potential inability to provide appropriate resource (human, system, technological or physical) required to support business activity (including information, operational technology, skill sets, systems and telecommunications) can lead to poor efficiency and effectiveness of business activity, the inability 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.

To manage and mitigate this risk, developing our people with the right skills and knowledge, combined with delivering effective technology are important enablers to 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; asset management.

9. Security risk

The potential inability to protect people, information, infrastructure and non-infrastructure from malicious or accidental activity. Our resources, assets and infrastructure are exposed to various threats (malicious or accidental) which could impact the provision of vital services and/or harm people or commercial businesses. In addition commercial or sensitive information could be lost.

To manage and mitigate this risk, 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: ownership and operation of National Infrastructure and Critical National Infrastructure; cybercrime; and terrorism.

10. Health, safety and environmental risk

The potential for operational or natural hazards to affect employees, contractors, the public or the environment. Working with and around water, sewage, construction and excavation sites, plant and equipment exposes people and the environment to man-made and naturally occurring hazards. This could result in harm to people, wildlife and natural habitats and lead to increased work down-time and additional operational costs, for example environmental clean-up. Depending on the circumstances, the group could be fined heavily for breaches of statutory obligations, be held liable to compensate third parties and sustain severe reputational damage.

To manage and mitigate this risk, we have developed 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: extreme weather conditions; excavation, tunnelling and construction work; working with substances hazardous to human health; working with water and wastewater; and driving and vehicle movement.

Material Litigation

The group robustly defends litigation where appropriate and seeks to minimise its exposure by establishing provisions and seeking recovery wherever possible. Litigation of a material nature is regularly reported to the group board. Two cases of particular note are as follows, 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 (U UW) in respect of 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 U UW's favour on a significant element of the claim and the High Court has upheld U UW's position on the remainder of the proceedings. MSCC have now instigated further heads of claim against U UW in order that they may continue to challenge U UW's rights to discharge water and treated effluent into the canal.

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.

This announcement contains inside information, disclosed in accordance with the Market Abuse Regulation which came into effect on 3 July 2016 and for UK Regulatory purposes the person responsible for making the announcement is Simon Gardiner, Company Secretary.

LEI 2138002IEYQAOC88ZJ59

Classification – Full Year Results

Consolidated income statement

	Year ended 31 March 2017 £m	Year ended 31 March 2016 £m
Revenue	1,704.0	1,730.0
Employee benefit expense (note 3)	(151.9)	(146.9)
Other operating costs (note 4)	(435.1)	(485.8)
Other income	4.2	3.6
Depreciation and amortisation expense	(364.9)	(363.7)
Infrastructure renewals expenditure	(150.8)	(169.3)
Total operating expenses	(1,098.5)	(1,162.1)
Operating profit	605.5	567.9
Investment income (note 5)	13.7	5.0
Finance expense (note 6)	(202.7)	(224.4)
Investment income and finance expense	(189.0)	(219.4)
Profit on disposal of business (note 10)	22.1	-
Share of profits of joint ventures	3.8	5.0
Profit before tax	442.4	353.5
Current tax charge	(31.5)	(44.3)
Deferred tax charge	(35.2)	(24.2)
Deferred tax credit - change in tax rate	58.2	112.5
Tax (note 7)	(8.5)	44.0
Profit after tax	433.9	397.5
All of the results shown above relate to continuing operations.		
Earnings per share (note 8)		
Basic	63.6p	58.3p
Diluted	63.5p	58.2p
Dividend per ordinary share (note 9)	38.87p	38.45p

Consolidated statement of comprehensive income

	Year ended 31 March 2017 £m	Year ended 31 March 2016 £m
Profit after tax	433.9	397.5
Other comprehensive income		
Remeasurement (losses)/gains on defined benefit pension schemes (note 11)	(76.7)	160.1
Tax on items taken directly to equity (note 7)	17.3	(26.5)
Foreign exchange adjustments	3.7	3.0
Total comprehensive income	378.2	534.1

Consolidated statement of financial position

	31 March 2017 £m	31 March 2016 £m
ASSETS		
Non-current assets		
Property, plant and equipment	10,405.5	10,031.4
Intangible assets	187.7	162.4
Interests in joint ventures	75.2	35.1
Investments	9.0	8.7
Trade and other receivables	112.3	2.5
Retirement benefit surplus (note 11)	247.5	275.2
Derivative financial instruments	731.0	765.5
	<u>11,768.2</u>	11,280.8
Current assets		
Inventories	22.4	29.3
Trade and other receivables	303.9	367.4
Current tax asset	7.1	-
Cash and short-term deposits	247.8	213.6
Derivative financial instruments	76.7	0.1
Assets classified as held for sale (note 10)	-	15.6
	<u>657.9</u>	626.0
Total assets	<u>12,426.1</u>	11,906.8
LIABILITIES		
Non-current liabilities		
Trade and other payables	(589.3)	(530.5)
Borrowings (note 12)	(7,058.4)	(6,508.8)
Deferred tax liabilities	(1,031.5)	(1,062.0)
Derivative financial instruments	(235.5)	(255.8)
	<u>(8,914.7)</u>	(8,357.1)
Current liabilities		
Trade and other payables	(323.0)	(341.7)
Borrowings (note 12)	(326.1)	(469.2)
Current tax liabilities	-	(12.3)
Provisions	(26.5)	(15.1)
Derivative financial instruments	(14.2)	(5.9)
	<u>(689.8)</u>	(844.2)
Total liabilities	<u>(9,604.5)</u>	(9,201.3)
Total net assets	<u>2,821.6</u>	2,705.5
EQUITY		
Share capital	499.8	499.8
Share premium account	2.9	2.9
Cumulative exchange reserve	(2.0)	(5.7)
Merger reserve	329.7	329.7
Retained earnings	1,991.2	1,878.8
Shareholders' equity	<u>2,821.6</u>	2,705.5

Consolidated statement of changes in equity

Year ended 31 March 2017

	Share capital £m	Share premium account £m	Cumulative exchange reserve £m	Merger reserve £m	Retained earnings £m	Total £m
At 1 April 2016	499.8	2.9	(5.7)	329.7	1,878.8	2,705.5
Profit after tax	-	-	-	-	433.9	433.9
Other comprehensive income/(expense)						
Remeasurement losses on defined benefit pension schemes (note 11)	-	-	-	-	(76.7)	(76.7)
Tax on items taken directly to equity (note 7)	-	-	-	-	17.3	17.3
Foreign exchange adjustments	-	-	3.7	-	-	3.7
Total comprehensive income	-	-	3.7	-	374.5	378.2
Dividends (note 9)	-	-	-	-	(263.1)	(263.1)
Equity-settled share-based payments	-	-	-	-	3.4	3.4
Exercise of share options - purchase of shares	-	-	-	-	(2.4)	(2.4)
At 31 March 2017	499.8	2.9	(2.0)	329.7	1,991.2	2,821.6

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 11)	-	-	-	-	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

Consolidated statement of cash flows

	Year ended 31 March 2017 £m	Year ended 31 March 2016 £m
Operating activities		
Cash generated from operations (note 15)	1,018.1	905.5
Interest paid	(161.0)	(168.7)
Interest received and similar income	4.9	1.9
Tax paid	(42.4)	(53.1)
Tax received	1.2	-
Net cash generated from operating activities	820.8	685.6
Investing activities		
Purchase of property, plant and equipment	(672.4)	(634.2)
Purchase of intangible assets	(52.4)	(66.1)
Proceeds from sale of property, plant and equipment	4.1	1.4
Grants and contributions received	29.0	17.3
Loans to joint ventures	(109.0)	-
Investment in joint ventures	(13.5)	-
Proceeds from disposal of business (note 10)	3.3	-
Dividends received from joint ventures	5.4	4.6
Proceeds from investments	0.9	0.2
Net cash used in investing activities	(804.6)	(676.8)
Financing activities		
Proceeds from borrowings	736.2	693.0
Repayment of borrowings	(448.7)	(474.1)
Dividends paid to equity holders of the company (note 9)	(263.1)	(258.7)
Exercise of share options – purchase of shares	(2.4)	(6.6)
Net cash (used in)/generated from financing activities	22.0	(46.4)
Net (decrease)/increase in cash and cash equivalents	38.2	(37.6)
Cash and cash equivalents at beginning of the year	182.1	219.7
Cash and cash equivalents at end of the year	220.3	182.1

NOTES

1. Basis of preparation and accounting policies

The condensed consolidated financial statements for the year ended 31 March 2017 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 2016 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 2017, for which the auditors have given an unqualified opinion.

The comparative figures for the year ended 31 March 2016 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 condensed consolidated 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 £10.1 million (31 March 2016: £0.9 million) of restructuring costs.

Employee benefits expense is stated net of £4.0 million (31 March 2016: £nil) of costs recharged under transitional service agreements at nil margin to Water Plus, a joint venture established between the group and Severn Trent PLC during the year.

4. Other operating costs

	Year ended 31 March 2017 £m	Year ended 31 March 2016 £m
Hired and contracted services	101.5	107.5
Property rates	91.6	86.3
Power	68.7	65.3
Materials	67.7	67.2
Charge for bad and doubtful receivables	29.9	39.2
Regulatory fees	28.6	27.9
Cost of properties disposed	8.6	10.5
Legal and professional expenses	6.5	5.8
Operating leases payable	4.4	5.0
Loss on disposal of property, plant and equipment	3.3	5.4
Third party wholesale charges	3.0	15.1
Impairment of property, plant and equipment	0.2	11.4
Impairment of assets classified as held for sale	-	2.7
Amortisation of deferred grants and contributions	(6.7)	(6.9)
Compensation from insurers	(12.3)	(20.1)
Other expenses	40.1	63.5
	<u>435.1</u>	<u>485.8</u>

As a result of two significant flooding incidents caused by Storms Desmond and Eva in December 2015, there were £13.8 million (31 March 2016: £19.5 million) of expenses incurred, comprising £11.1 million (31 March 2016: £7.0 million) of operating costs, £2.5 million (31 March 2016: £1.1 million) of infrastructure renewals expenditure, and a £0.2 million (31 March 2016: £11.4 million) impairment of property, plant and equipment. Insurance compensation of £12.3 million (31 March 2016: £20.1 million) relating to the flooding incidents has been recognised and the group expects there to be further recovery of the flooding incident costs under its insurance cover in the year ending 31 March 2018, as further remedial work is undertaken.

In addition, there were £5.8 million (31 March 2016: £11.1 million) of market reform restructuring costs incurred in preparing the business for competition in the non-household retail market and £nil (31 March 2016: £24.8 million) of costs relating to a large water quality incident, largely comprising customer compensation payments included within other expenses.

Total other operating costs are stated net of £14.5 million (31 March 2016: £nil) of costs recharged to Water Plus at nil margin under transitional service agreements.

5. Investment income

	Year ended 31 March 2017 £m	Year ended 31 March 2016 £m
Interest receivable	3.5	1.9
Net pension interest income (note 11)	10.2	3.1
	<u>13.7</u>	<u>5.0</u>

6. Finance expense

	Year ended 31 March 2017 £m	Year ended 31 March 2016 £m
Interest payable	227.0	198.1
Net fair value (gains)/losses on debt and derivative instruments	(24.3)	26.3
	<u>202.7</u>	<u>224.4</u>

Interest payable is stated net of £29.2 million (31 March 2016: £21.3 million) borrowing costs capitalised in the cost of qualifying assets within property, plant and equipment and intangible assets during the year. Interest payable includes an £80.7 million (31 March 2016: £37.9 million), non-cash, inflation uplift charge in relation to the group's index-linked debt.

Net fair value (gains)/losses on debt and derivative instruments includes £15.4 million income (31 March 2016: £16.5 million) due to net interest on swaps and debt under fair value option.

7. Tax

During the year ending 31 March 2017 there was a deferred tax credit of £58.2 million (31 March 2016: £112.5 million) reflecting the substantive enactment of the reduction in the headline rate of corporation tax from 18 per cent to 17 per cent from 1 April 2020 (31 March 2016: 20 per cent to 18 per cent similar headline rate reduction). There was a current tax credit of £22.5 million (31 March 2016: £9.0 million) and a deferred tax charge of £7.0 million (31 March 2016: £5.6 million) relating to agreed matters in relation to prior years, primarily being the release of a provision in relation to agreed historic overseas tax matters. In addition, the current period profit on disposal of the non-household retail business during the current period was non-taxable.

After adjusting for the above tax credits and the non-taxable item, 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 2016: 20 per cent). The split of the total tax charge between current and deferred tax relates 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 2017 for the purpose of the basic earnings per share was 681.9 million (31 March 2016: 681.9 million) and for the diluted earnings per share was 683.0 million (31 March 2016: 683.0 million).

9. Dividends

	Year ended 31 March 2017 £m	Year ended 31 March 2016 £m
Dividends relating to the year comprise:		
Interim dividend	88.3	87.3
Final dividend	176.8	174.8
	<u>265.1</u>	<u>262.1</u>
Dividends deducted from shareholders' equity comprise:		
Interim dividend	88.3	87.3
Final dividend	174.8	171.4
	<u>263.1</u>	<u>258.7</u>

9. Dividends (continued)

The proposed final dividends for the years ended 31 March 2017 and 31 March 2016 were subject to approval by equity holders of United Utilities Group PLC as at the reporting dates, and therefore have not been included as liabilities in the consolidated financial statements as at 31 March 2017 and 31 March 2016 respectively.

The final dividend of 25.92 pence per ordinary share (2016: 25.64 pence per ordinary share) is expected to be paid on 4 August 2017 to shareholders on the register at the close of business on 23 June 2017. The ex-dividend date for the final dividend is 22 June 2017.

The interim dividend of 12.95 pence per ordinary share (2016: 12.81 pence per ordinary share) was paid on 1 February 2017 to shareholders on the register at the close of business on 16 December 2016.

10. Disposal of non-household retail business

On 3 May 2016 the Competition and Markets Authority approved the formation of a joint venture, Water Plus Group Limited, between United Utilities PLC and Severn Trent PLC. On 1 June 2016 the group completed the disposal of its non-household water and wastewater retail business, principally comprising billing and customer service activities, to Water Plus. This resulted in a £22.1 million profit and £3.3 million of cash proceeds on disposal of the business, together with a £15.6 million disposal of assets that had been classified as held for sale. The formation of the joint venture resulted in an increase in interests in joint ventures of £39.1 million, comprising £25.6 million of shares in the joint venture received on disposal of the non-household retail business, and £13.5 million of equity contributed during the year. The group's £2.0 million share of the joint venture's losses for the period was subsequently recognised, which included £5.2 million of initial set up costs not expected to be incurred in future years.

11. 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 2017 %pa	Year ended 31 March 2016 %pa
Discount rate	2.55	3.40
Pensionable salary growth and pension increases	3.40	3.20
Price inflation	3.40	3.20

Mortality in retirement is assumed to be in line with the Continuous Mortality Investigation's (CMI) S2PA (31 March 2016: S1NA) year of birth tables, with scaling factor of 108 per cent for males and 102 per cent for females (31 March 2016: one-year age rating for males in the UUPS only), reflecting actual mortality experience; and CMI 2015 (31 March 2016: CMI 2014) long-term improvement factors, with a long-term annual rate of improvement of 1.75 per cent (31 March 2016: 1.75 per cent).

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 2017 £m	Year ended 31 March 2016 £m
Current service cost	19.7	22.3
Curtailments/settlements	3.1	1.1
Administrative expenses	2.7	2.7
Pension expense charged to operating profit	25.5	26.1
Net pension interest credited to investment income (note 5)	(10.2)	(3.1)
Net pension expense charged before tax	15.3	23.0

11. Retirement benefit surplus (continued)

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

	Year ended 31 March 2017 £m	Year ended 31 March 2016 £m
At the start of the year	275.2	79.2
Expense recognised in the income statement	(15.3)	(23.0)
Contributions paid	64.3	58.9
Remeasurement (losses)/gains gross of tax	(76.7)	160.1
At the end of the year	<u>247.5</u>	<u>275.2</u>

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

	31 March 2017 £m	31 March 2016 £m
Present value of defined benefit obligations	(3,615.5)	(2,970.4)
Fair value of schemes' assets	3,863.0	3,245.6
Net retirement benefit surplus	<u>247.5</u>	<u>275.2</u>

In the year ended 31 March 2017 the discount rate has decreased by 0.85 per cent, which includes a 0.6 per cent decrease in credit spreads and a 0.25 per cent decrease in swap yields over the year. The £76.7 million remeasurement loss has largely resulted from the impact of the decrease in credit spreads during the year, partially offset by growth asset gains, the reduction in swap yields and the favourable impact of changes in mortality during the year. 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 2016.

Member data used in arriving at the liability figure included within the overall IAS 19 surplus has been based on the finalised actuarial valuation as at 31 March 2016 for the group's ESPS scheme, and the preliminary results of the actuarial valuation as at 31 March 2016 for the group's UUPS scheme.

12. Borrowings

New borrowings raised during the year ended 31 March 2017 were as follows:

- On 9 June 2016 the group issued EUR 30.0 million fixed interest rate notes due June 2031.
- On 13 June 2016 the group issued HKD 600.0 million fixed interest rate notes due June 2031.
- On 15 June 2016 the group drew down the remaining £75.0 million against its existing £250.0 million term RPI index-linked loan facility signed in March 2015 with the European Investment Bank. This loan is structured on an amortising basis with final repayment in June 2034.
- On 17 June 2016 the group drew down £75.0 million against its new £250.0 million term RPI index-linked loan facility signed in April 2016 with the European Investment Bank. This loan is structured on an amortising basis with final repayment in June 2034.
- On 30 September 2016 the group issued £20.0 million RPI index-linked notes due October 2028 and £26.5 million RPI index-linked notes due September 2036.
- On 9 December 2016 the group issued £38.0 million RPI index-linked notes due December 2031, £20.0 million CPI index-linked notes due December 2031, £29.0 million RPI index-linked notes due December 2036 and £20.0 million CPI index-linked notes due December 2036.
- On 10 February 2017 the group issued £60.0 million CPI index-linked notes due February 2037.

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

13. Fair values of financial instruments

The fair values of financial instruments are shown in the table below.

	31 March 2017		31 March 2016	
	Fair value £m	Carrying value £m	Fair value £m	Carrying value £m
Available for sale financial assets				
Investments	9.0	9.0	8.7	8.7
Financial assets at fair value through profit or loss				
Derivative financial assets - fair value hedge	591.1	591.1	583.8	583.8
Derivative financial assets - held for trading	216.6	216.6	181.8	181.8
Financial liabilities at fair value through profit or loss				
Derivative financial liabilities - held for trading	(249.7)	(249.7)	(261.7)	(261.7)
Financial liabilities designated as fair value through profit or loss	(375.5)	(375.5)	(338.0)	(338.0)
Financial instruments for which fair value does not approximate carrying value				
Financial liabilities in fair value hedge relationships	(2,544.6)	(2,522.4)	(2,293.0)	(2,373.0)
Other financial liabilities at amortised cost	(5,682.8)	(4,486.6)	(4,830.1)	(4,267.0)
	(8,035.9)	(6,817.5)	(6,948.5)	(6,465.4)

A decrease in underlying interest rates on index-linked debt 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 £1,766.1 million (31 March 2016: £2,149.5 million) for financial liabilities in fair value hedge relationships and £937.9 million (31 March 2016: £1,309.9 million) for other financial liabilities at amortised cost.

The £755.4 million reduction (31 March 2016: £1,213.5 million reduction) in 'level 1' fair value liability measurements is largely due to a decrease in the number of observable quoted bond prices in active markets at 31 March 2017. 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 2016.

14. Net debt

	Year ended 31 March 2017 £m	Year ended 31 March 2016 £m
At the start of the year	6,260.5	5,924.0
Net capital expenditure	691.7	681.6
Dividends (note 9)	263.1	258.7
Interest	156.1	166.8
Loans to joint ventures	109.0	-
Inflation uplift on index-linked debt (note 6)	80.7	37.9
Tax	41.2	53.1
Other	4.4	1.5
Fair value movements	(9.9)	42.4
Cash generated from operations (note 15)	(1,018.1)	(905.5)
At the end of the year	6,578.7	6,260.5

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

14. Net debt (continued)

Fair value movements includes net fair value gains on debt and derivative instruments of £24.3 million (31 March 2016: £26.3 million net fair value losses) less net receipts on swaps and debt designated at fair value of £14.4 million (31 March 2016: £16.1 million).

15. Cash generated from operations

	Year ended 31 March 2017 £m	Year ended 31 March 2016 £m
Operating profit	605.5	567.9
Adjustments for:		
Depreciation of property, plant and equipment	336.2	332.5
Amortisation of intangible assets	28.7	31.2
Impairment of property, plant and equipment	0.2	11.4
Impairment of assets classified as available for sale	-	2.7
Loss on disposal of property, plant and equipment	3.3	5.4
Loss on disposal of intangible assets	0.5	-
Amortisation of deferred grants and contributions	(6.7)	(6.9)
Equity-settled share-based payments charge	3.4	2.3
Other non-cash movements	(3.0)	(3.8)
Changes in working capital:		
Decrease in inventories	6.9	11.2
Decrease/(increase) in trade and other receivables	71.1	(14.1)
Decrease in trade and other payables	(0.6)	(4.1)
Increase in provisions	11.4	2.6
Pension contributions paid less pension expense charged to operating profit	(38.8)	(32.8)
Cash generated from operations	1,018.1	905.5

16. Commitments and contingent liabilities

At 31 March 2017 there were commitments for future capital expenditure contracted but not provided for of £336.9 million (31 March 2016: £447.3 million).

Following a review undertaken during the year, the group has determined that the possibility of any outflow in respect of performance guarantees issued is remote and, as such, there are no contingent liabilities to be disclosed in respect of these (31 March 2016: £9.8 million).

A contingent liability exists in relation to the equalisation of Guaranteed Minimum Pension (GMP), which is expected to have a widespread impact for defined benefit pension schemes operating in the UK. At this stage it is not possible to quantify the impact of legislative changes proposed by the UK Government in this area.

17. Related party transactions

The related party trading transactions with the group's joint ventures during the period and amounts outstanding at the period end date were as follows:

	Year ended 31 March 2017 £m	Year ended 31 March 2016 £m
Sales of services	404.3	1.2
Purchases of goods and services	0.7	0.7
Costs recharged at nil margin under transitional service agreements	18.5	-
Interest income and fees recognised on loans to related parties	2.6	-
Amounts owed by related parties	163.5	2.9
Amounts owed to related parties	12.1	-

Sales of services to related parties during the year mainly represent non-household wholesale charges and were on the group's normal trading terms.

At 31 March 2017 amounts owed by joint ventures, as recorded within trade and other receivables in the statement of financial position, were £163.5 million (31 March 2016: £2.9 million), comprising £41.5 million of trade balances, which are unsecured and will be settled in accordance with normal credit terms, and £122.0 million relating to loans. Included within these loans receivable were the following amounts owed by Water Plus:

- £100.0 million outstanding on a £100.0 million revolving credit facility provided by United Utilities Water Limited, which is guaranteed by United Utilities PLC, with a maturity date of 30 September 2019, bearing a floating interest rate of LIBOR plus a credit margin;
- £9.0 million receivable being the fair value of amounts owed in relation to a £12.5 million unsecured loan note held by United Utilities PLC, with a maturity date of 28 March 2027. This is an interest-free shareholder loan with a total amount outstanding at 31 March 2017 of £12.5 million, comprising the £9.0 million receivable held at fair value, and £3.5 million recorded as an equity contribution to Water Plus recognised within interests in joint ventures; and
- £9.7 million outstanding on a £19.6 million unsecured amortising loan note held by United Utilities PLC, with a final maturity date of 30 November 2017, bearing a floating interest rate of LIBOR plus a credit margin. Repayments received on this loan note represent part of the proceeds received on disposal of the group's non-household retail business (see note 10).

A further £3.3 million (31 March 2016: £2.5 million) of non-current receivables was owed by other related parties at 31 March 2017.

No expense or allowance has been recognised for bad and doubtful receivables in respect of the amounts owed by related parties (31 March 2016: £nil).

During the year, United Utilities PLC provided guarantees in support of Water Plus in respect of certain amounts owed to wholesalers. The aggregate limit of these guarantees was £42.5 million, of which £24.0 million related to guarantees to United Utilities Water Limited.

At 31 March 2017, amounts owed to joint ventures were £12.1 million (31 March 2016: £nil). The amounts outstanding are unsecured and will be settled in accordance with normal credit terms (31 March 2016: £nil).

18. Events after the reporting period

There were no events arising after the reporting date that required recognition or disclosure in the financial statements for the year ended 31 March 2017.

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 2017. Certain parts thereof are not included within this announcement.

Responsibilities Statement

We confirm that to the best of our knowledge:

- the financial statements have 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
Stephen A Carter
Mark Clare
Alison Goligher
Russ Houlden
Brian May
Sara Weller

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

.....
Steve Mogford

24 May 2017

Chief Executive Officer

.....
Russ Houlden

24 May 2017

Chief Financial Officer