Our performance 2015/16

Full year results for the year ended 31 March 2016

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

(1) Underlying profit measures have been provided to give a more representative view of business performance and are defined in the underlying profit measure tables on page 44.
(2) Regulatory capital value or RCV gearing calculated as group net debt/United Utilities Water's RCV (outturn prices).
(3) Time; Cost; Quality index (TCQi), which is an internal measure of the overall effectiveness of delivery of the capital investment programme (shown below).

Strong operational and environmental performance

- Accelerated investment to deliver early operational benefit; £799 million invested in 2015/16 and TCQi(3) at 90 per cent
- £2.5 million net reward achieved for 2015/16 on outcome delivery incentives
- Benefitting from 'systems thinking' operational approach and improved resilience of network
- Retained Dow Jones Sustainability Index 'World Class' rating and sector leading status

Further improvements in customer satisfaction

- Service incentive mechanism score improved compared with last year
- Customers continue to rate us very highly on wastewater services

Implementing efficiency plans to eliminate totex gap

- Business plan initiatives in place to meet totex allowance
- Good progress achieved in first year of the five-year regulatory period

'Water Plus' business retail JV with Severn Trent approved by the CMA

- First mover advantage and economies of scale, ahead of full market opening in 2017

Good financials

- Underlying operating profit down 9 per cent at £604 million, as expected
- Lower underlying net finance expense: benefit of lower cost fixed debt and lower RPI inflation
- Robust capital structure with RCV gearing at 61 per cent, comfortably within our target range of 55 per cent to 65 per cent
- Final dividend of 25.64 pence per share (total for the year 38.45 pence), an increase of 2 per cent in line with policy

Operational performance

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

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

Best service to customers

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

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

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

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

Leading North West service provider – we are consistently ranked third out of 10 leading organisations in the North West, through an independent brand tracker survey which is undertaken quarterly. This covers key attributes such as 'reputation', 'trustworthy' and 'customer service'. We are behind only Marks and Spencer and John Lewis, and ahead of seven other major organisations covering utilities, telecoms, media and banking services.

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

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

Ofwat KPIs – our strong overall operational performance is reflected in Ofwat's latest (2014/15) key performance indicators report, which was published in September. The balance of ratings for United Utilities across the 14 assessment measures represents a joint first position, in respect of the 10 water and sewerage companies. We are pleased that our good performance has been recognised, although we remain strongly focused on improving further.

Business retail: 'Water Plus' joint venture with Severn Trent approved by the CMA – we have been building our capability to ensure we are in a strong position as the competitive business retail market evolves and our 'Water Plus' JV with Severn Trent reinforces this position and gives us first mover advantage ahead of full market opening in 2017. 'Water Plus' combines the complementary skills of both companies to deliver an attractive proposition for customers and will create synergies to provide an efficient and cost-effective operation focused on improved customer service and growth. Before the JV, United Utilities was already very active in this expanding market. After attaining a Scottish water supply licence in 2012, we quickly grew to be one of the most successful new entrants in Scotland and we have continued our expansion and have now won approximately 300 customers, covering around 3,500 sites. Overall, our business retail operation has achieved a net increase in annualised revenue of £18 million. We will continue to bid for business at attractive margins and are not solely focusing on growing market share. We also continue to offer and develop our range of value-added services, such as leak detection and water efficiency advice.

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Lancashire water quality incident

In early August 2015, traces of the parasite cryptosporidium were found in drinking water supplies at Franklaw water treatment works, near Preston, which supplies over 300,000 households across Lancashire including Preston, Blackpool and Chorley. To protect public health, we issued a 'boil water advice' to customers, advising they boil their tap water, prior to drinking it, as a precautionary measure.

To eliminate the cryptosporidium, we installed ultraviolet (UV) treatment units at critical points on our network. An asset installation of this size and complexity would normally take several months to complete; however, through working around the clock, we completed the installation in just four weeks. This enabled us to lift the boil water advice in stages with the final one lifted on 6 September 2015.

Clearly, having the boil water advice in place for such a prolonged period caused considerable inconvenience for our customers and we made every effort to keep them fully informed during the incident via leaflets, television interviews, press, social media and our website. We provided bottled water for those customers who needed it most and were unable to boil their water safely. Compensation payments followed quickly to all those customers and businesses affected. Throughout the incident, we maintained regular engagement with key bodies such as Public Health England and local authorities, seeking their advice, input and agreement to our proposed course of action.

At the time of writing, we await the Drinking Water Inspectorate's (DWI) report into this water quality incident. This will set out its view of the cause of the incident and what measures the Inspectorate considers the company should undertake in response, as well as any action it intends to take.

However, we have not waited for the publication of the DWI report before taking action. We have installed permanent UV treatment at Franklaw so that all flow leaving the site is treated with UV. The scale and nature of the incident tested our processes and procedures for vulnerable customers and, applying lessons learned, in May 2016 we launched a new service proposition called 'Priority Services'. This provides an enhanced, holistic service to customers who have needs categorised as: physical, mental health, financial, language and life events.

Pictured: One of the UV rigs arrives at Warbreck in Blackpool. We installed UV rigs at critical points on our network to eliminate cryptosporidium.

Key performance indicators:

Outcome delivery incentives (ODIs) – as outlined at our full year results in May 2015, ODIs, which are a new feature of the 2015–20 regulatory period, will form an important KPI composite to monitor the operational performance of our wholesale business. This replaces the previous serviceability KPI which is incorporated within the ODI measures. There are 19 wholesale financial ODIs and the risk is skewed to the downside, with 10 attracting a penalty only. We will report each year on our performance and provide a net reward or penalty position across the range of our wholesale ODIs.

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

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

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

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

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

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

Our performance 2015/16

Lowest sustainable cost

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

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

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

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

Pensions – United Utilities has taken progressive steps to de-risk its pension provision. The group had an IFRS retirement benefit surplus of £275 million as at 31 March 2016, an increase in surplus from £79 million as at 31 March 2015. Further details of the group's pension provision are provided in the pensions section on page 43.

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

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

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

Pictured: One of the concrete access shafts constructed as part of a major £6.5 million sewer project in Manchester city centre. A section of the Mancunian Way carriageway collapsed in August 2015 after heavy rainfall caused a sink-hole to open up on the busy Manchester road, damaging the brick-built Victorian sewer located underneath. The concrete shafts were constructed to allow tunnelling machinery access to build the replacement sewer underneath the carriageway.

Business Insight

Flooding and resilience

In December 2015, the UK was battered by a succession of storms known as Desmond, Eva and Frank. These storms were particularly severe in the North West causing widespread flooding in Cumbria, Lancashire and Greater Manchester.

Our services were also badly affected. Following storm Desmond, water supplies to Keswick were interrupted when its treatment works was inundated with flood water (pictured below) and several large wastewater treatment works were heavily flooded and operations impacted severely. A key route linking north and south Cumbria – the A591 – was badly damaged where it runs on our catchment land alongside Thirlmere reservoir.

Work continues to repair the flood damage and improve asset protection should similar events reoccur. To date, the floods have cost the company around £19.5 million restoring operations, repairing plant and machinery and writing off assets. For example, at Kendal both primary and secondary treatment was lost and the outfall returning treated water to the river was washed away. Initial repair work is now largely complete and, where we can, we have replaced damaged assets in a way to be more resilient to future flooding.

We have been keeping all interested groups updated on our progress, providing support for local recovery groups such as those repairing the damage to the A591. Local managers are actively reviewing the resilience of their assets, assessing risks and compiling actions for mitigation, such as reviewing procedures when amber flood warnings are given.

Alongside this immediate response, we are working with key stakeholders to improve resilience to future flooding risk. We are members of the Cumbrian Flood Partnership that, amongst other things, is considering what flood defence improvements may be needed such as upstream catchment actions to reduce the intensity of water flows at peak times. In addition, we are engaging with the Government's National Flood Resilience Review which will assess how the country can be better protected from future flooding and increasingly extreme weather events.

We are also closely examining our own plans on resilience. We are building upon AMP5 flooding assessments to understand better the consequences of failure from extreme or coinciding events, including environmental and financial impacts, and developing solutions to mitigate risk from extreme events.

Our performance 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 beating Ofwat's industry allowed cost of debt.

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

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

Pictured: Engineers at our Davyhulme wastewater treatment works in Manchester have taken delivery of a fleet of electric vehicles which run on power generated by the plant itself in an effort to cut carbon emissions at the works – one of the biggest sewage plants in the UK.

The new electric 'Polaris' vehicles are replacements for five diesel vans, helping to save around five tonnes of carbon a year. Each vehicle charges up at its own docking station at Davyhulme's award-winning sludge recycling plant.

Davyhulme wastewater treatment works is our biggest plant and will be energy neutral by 2018, thanks to the electricity generated on-site from the biogas produced by the sludge digestion process.

The biogas is used in five combined heat and power engines to generate renewable electricity – up to 80GWh per year. The electricity is retained on-site and used to power the entire Davyhulme wastewater treatment works process. The amount of renewable energy being generated by the process has helped United Utilities to reduce its overall carbon footprint by 22 per cent since 2005/06.

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 2015/16 financial year, we retained our 'World Class' rating in the Dow Jones Sustainability Index for the eighth consecutive year, again achieving industry leading performance status in the multi-utility/water sector. Retaining 'World Class' status for this length of time is a significant achievement, particularly as the assessment standards continue to increase and evolve. In addition, at the PwC 2015 Building Public Trust Awards, United Utilities was selected as joint winner for 'Excellence in reporting in the FTSE 100'.

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

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

Carbon footprint – we are committed to reducing our carbon footprint and increasing our generation of renewable energy. In 2015/16, our carbon footprint totalled 454,857 tonnes of carbon dioxide equivalent, which is a 22 per cent reduction over the last 10 years (see pages 103 and 104, or visit corporate.unitedutilities.com/cr-environment). Our renewable energy production in 2015/16 was 138 GWh, representing 17 per cent of our electricity consumption in the year. This represents good progress over the last few years, up from c13 per cent in 2012/13. We are already implementing plans to significantly increase self-generation over the next few years, with a target of around 35 per cent of our electricity consumption by 2020, subject to there being sufficient projects with acceptable returns.

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

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

Business Insight

Floating solar array

We have a programme for rolling out solar installations across our sites using our extensive roof areas and redundant land for solar farms. During 2015/16 we completed the installation of what is now one of Europe's largest floating solar array systems on Godley reservoir, just outside Manchester, pictured right. While floating solar has been deployed elsewhere around the world, most notably in Japan, it is a relatively new technology in the UK. The installation at Godley consists of around 12,000 panels, covering 45,000 square metres which is equivalent to the size of six football pitches. This should contribute to keeping our future energy costs down and benefit water bills – good news for both shareholders and customers.

Overall, we plan to invest over £100 million across the 2015–20 regulatory period in our non-regulated energy business, mainly in solar facilities. Subject to good projected returns, we are aiming to double our energy self-generation to around 35 per cent by 2020.

Our performance 2015/16

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

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

Key performance indicators:

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

Environmental performance – On the Environment Agency's latest assessment (2014/15 report), which covers a broad range of operational metrics, United Utilities is again an upper quartile company. Based on our performance across the range of metrics, this indicates we were in joint second position among the 10 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 2015/16, we retained our 'World Class' rating for the eighth consecutive year and aim to retain this rating again this year.

Business Insight

Royal opening of Liverpool wastewater treatment works

Twenty-five years after opening the original wastewater treatment works in Sandon Dock, Liverpool, Her Royal Highness the Princess Royal this year returned to the city to open the £200 million extension to the works, built in the adjacent Wellington Dock.

Funded in part by the European Investment Bank, this new investment is a significant milestone in the clean-up of the River Mersey. An additional treatment stage was needed over and above what the original site was providing, to meet the growing needs of the city.

In the mid-1980s the River Mersey had reached an all-time low and was famously known as one of the dirtiest in Europe. But when Sandon Dock was officially opened in 1991 all that changed. Since then the city's waterfront has flourished and many aquatic species have returned to the river including octopus, salmon, grey seals, large cod and even dolphins and porpoises, evidence that the clean-up of the river is working.

The site's new Sequencing Batch Reactor (SBR) treatment facility will clean 11,000 litres of wastewater a second, serving some 600,000 people, before returning it to the Mersey. This is the first multi-storey SBR plant and largest in the UK. By stacking in this way, it fits within the limited footprint available at Wellington Dock, minimises the environmental impact on the surrounding area and minimises the impact on the adjacent world heritage site.

We are proud that our investment to date has made an important contribution to the renaissance of the Liverpool waterfront and this new plant is our next step.

Financial performance

Revenue

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

Operating profit

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

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

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

Investment income and finance expense

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

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

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

Profit before tax

Underlying profit before tax was £408 million, £39 million lower than last year, due to the £60 million decrease in underlying operating profit, partly offset by the £21 million decrease in underlying net finance expense. This underlying measure adjusts for the impact of the costs associated with the flooding and water quality incidents and retail business market reform, as outlined in the operating profit section above, and other items such as fair value movements in respect of debt and derivative instruments, as outlined in the underlying profit measures table on page 44. Reported profit before tax increased by £12 million to £354 million, as the increase due to the aforementioned fair value movements was largely offset by a reduction in reported operating profit.

Tax

Consistent with our wider business objectives, we are committed to acting in a responsible manner in relation to our tax affairs. Full details of our tax policies and objectives are set out on page 102.

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

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

Our performance 2015/16

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

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

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

Profit after tax

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

Earnings per share

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

Dividend per share

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

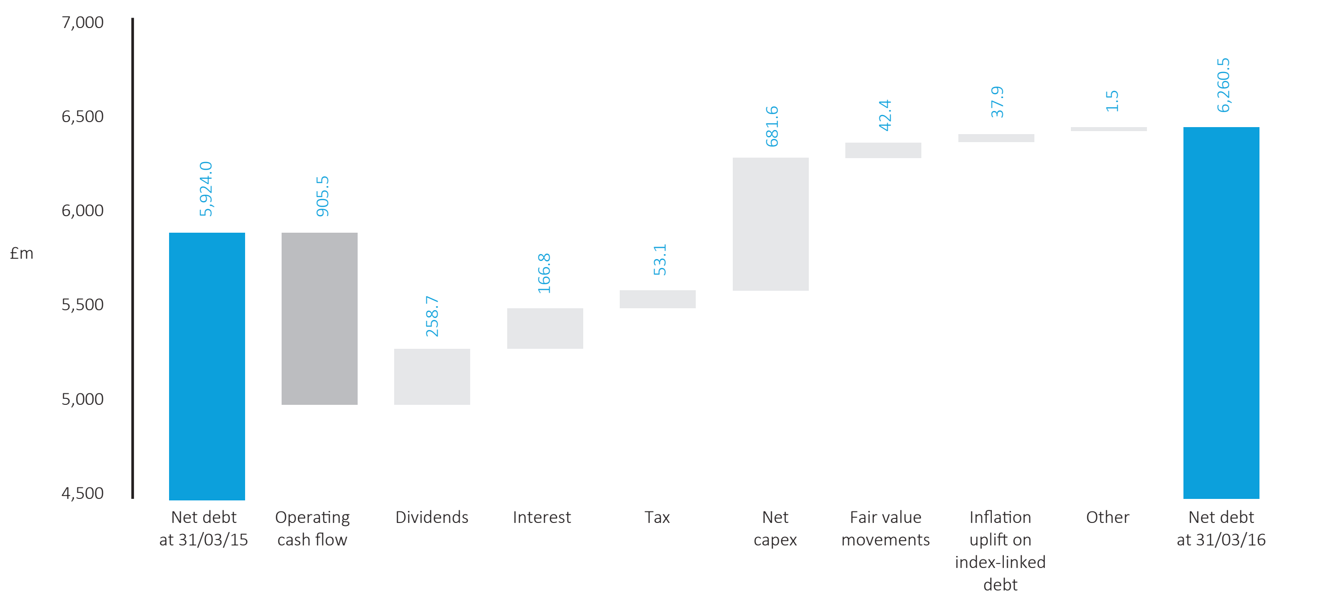
The final dividend is expected to be paid on 1 August 2016 to shareholders on the register at the close of business on 24 June 2016. The ex dividend date is 23 June 2016.

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

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

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

Summary of net debt movement



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

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

Financing headroom – supporting the group's cash flow, 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 per cent to 65 per cent, supporting a solid A3 credit rating with Moody's. RCV gearing at 31 March 2016 was 61 per cent and the movement in net debt is shown on the previous page.

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 (page 71). Assurance supporting this statement is provided by the review of: the group's key financial measures; the key credit financial metrics; the group's liquidity position; and the contingent liabilities of the group.

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

Risks to 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 post 2020 period will be formulated when the outcome of the next regulatory price review is known.

Cash flow

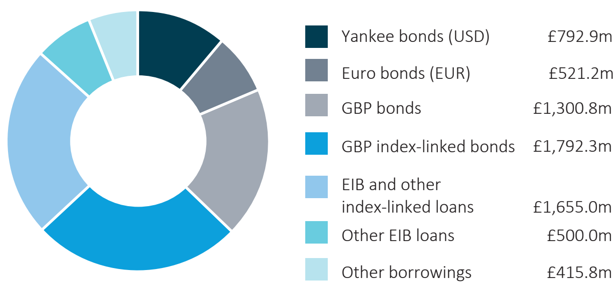
Net cash generated from continuing operating activities for the year ended 31 March 2016 was £686 million, compared with £707 million in the previous year. This reduction mainly reflects lower profit partly offset by an improvement in working capital cash flows and, to a lesser extent, lower corporation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

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

Fair value of debt

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

Gross debt – total carrying value £6,978.0m



Our performance 2015/16

Debt financing and interest rate management

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

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

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

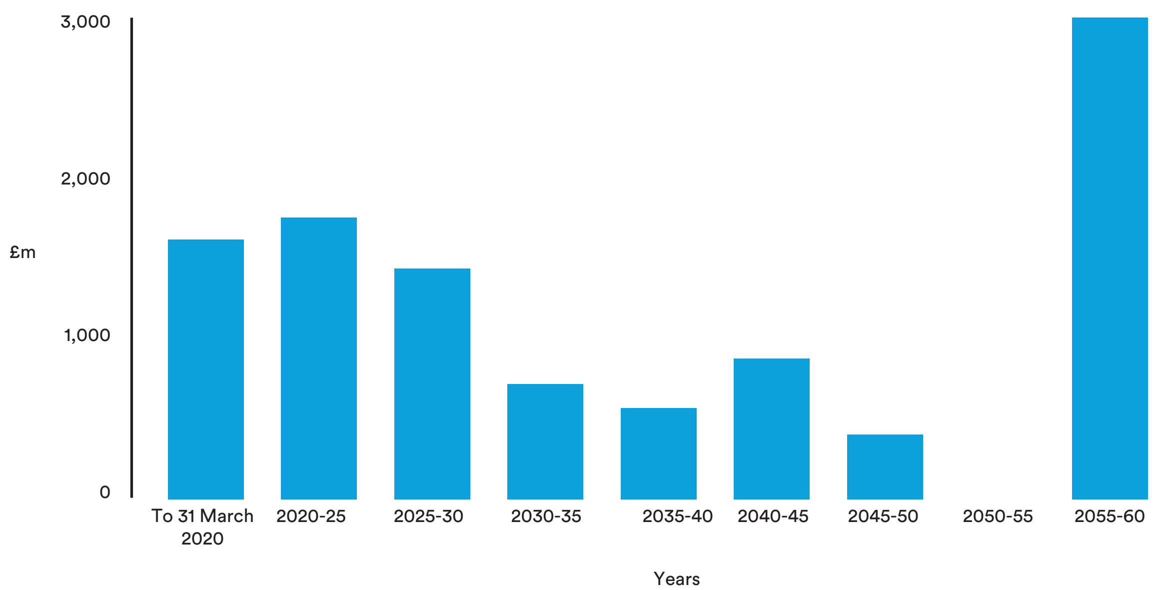
Cash and short-term deposits at 31 March 2016 amounted to £214 million. Over 2015–20 we have financing requirements totalling around £2.5 billion to cover refinancing and incremental debt, supporting our 2015–20 investment programme and we have now already raised around £1.4 billion of this requirement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

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

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

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

Term debt maturity per regulatory period*



* Future repayments of index-linked debt include inflation based on an average annual RPI rate of 3%.

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

Long-term sterling inflation index-linked debt provides a natural hedge to assets and earnings. At 31 March 2016, approximately 55 per cent of the group's net debt was in index-linked form, representing around 34 per cent of UUW's regulatory capital value, with an average real interest rate of 1.5 per cent. 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 10 years on a reducing balance basis. This is supplemented by fixing substantially all remaining floating rate exposure across the forthcoming regulatory period around the time of the price control determination.

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

Liquidity

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

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

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

Further detail on pensions is provided in note 18 ('Retirement benefit surplus') of these consolidated financial statements.

Our performance 2015/16

Underlying profit

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

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

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

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

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

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

(1) Relates to market reform restructuring costs incurred preparing the business for open competition in the business retail market.

Underlying operating profit reconciliation

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

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