

Registered Number: 2366894

WESTERN POWER DISTRIBUTION (SOUTH WEST) plc

ANNUAL REPORT AND FINANCIAL STATEMENTS

For the year ended 31 March 2018



Western Power Distribution (South West) plc

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Strategic report

For the year ended 31 March 2018

The directors present their annual report and the audited financial statements of Western Power Distribution (South West) plc (the "Company" or "WPD South West"), company number 2366894, for the year ended 31 March 2018.

Business model

What we do

WPD South West is an electricity Distribution Network Operator ("DNO") and distributes electricity to approximately 1.6 million end users over an area of 14,400 square kilometres in the South West of England. What we do is simple and comprises four key tasks:

- we operate our network assets effectively to 'keep the lights on';
- we maintain our assets so that they are in a condition to remain reliable;
- we fix our assets if they get damaged or if they are faulty;
- we upgrade the existing networks or build new ones to provide additional electricity supplies or capacity to our customers.

The 1.6 million end users are registered with licensed electricity suppliers, who in turn pay WPD South West for distributing electricity across its network. Our charges are regulated and make up around 16% of a domestic customer's bill.

WPD South West's network comprises approximately 27,831 km of overhead lines, 22,694 km of underground cable and 52,626 transformers. During 2017/18, the maximum demand recorded was 2,707 megawatts (2016/17: 2,653 megawatts).

Group structure

Western Power Distribution plc is the parent of a group ("WPD Group" or "WPD") whose principal activity is undertaken by WPD South West, Western Power Distribution (South Wales) plc ("WPD South Wales"), Western Power Distribution (East Midlands) plc ("WPD East Midlands") and Western Power Distribution (West Midlands) plc ("WPD West Midlands"). Where appropriate the four DNOs share engineering control and other systems.

Regulation

WPD South West is a monopoly regulated by the Gas and Electricity Markets Authority (known as "Ofgem"). The regulatory framework is based on a recently updated approach for sustainable network regulation, known as the "RIIO" model where Revenues=Incentives+Innovation+Outputs. From 1 April 2015 Ofgem set an eight year electricity price control review, known as ED1. Under the RIIO model there is a much greater emphasis on companies playing a full role in developing a more sustainable energy sector and delivering value for money network services for customers. A key feature of the RIIO model is that the setting of outputs that network companies are expected to deliver is much more extensive with the outputs embedded within an overall Business Plan which acts as a "contract" between the distribution network companies and their customers. For ED1 Ofgem set WPD's allowance for the cost of equity at 6.4 per cent, which contributes to a weighted average cost of capital ("WACC") allowance of 3.68 per cent for 2017/18.

The operations are regulated under the distribution licence which sets the outputs that WPD needs to deliver for its customers and the associated revenues it is allowed to generate for the eight-year period from 1 April 2015 to 31 March 2023.

In addition to the base level of revenue which WPD South West is allowed to earn, there are incentives to innovate, to achieve customer services outputs relating to customer satisfaction, complaints handling, stakeholder engagement, connections and supply interruptions, and network output measures, which may result in revenue penalties or rewards.

Strategic report (continued)

For the year ended 31 March 2018

Business model (continued)

Regulation (continued)

WPD submitted an outputs based Business Plan for the RII0-ED1 period 2015-2023, which was accepted by Ofgem as “well justified” and could therefore “fast-track” all four WPD licensed areas, ahead of the other five licensed distributor groups. WPD’s modified licences took effect from 1 April 2015.

Business objectives

WPD’s business objectives are simple. They are:

- to minimise the safety risks associated with WPD’s distribution network;
- to improve the reliability of electricity supplies and to make the distribution network more resilient;
- to reduce WPD’s impact on the environment and to facilitate low carbon technology;
- to consistently deliver outstanding customer service;
- to meet the needs of vulnerable customers;
- to engage with our stakeholders;
- to be efficient, effective and innovative in everything we do;
- to make a return for the shareholder.

In summary the main objective of the business is to deliver frontier levels of performance at an efficient level of cost.

Long term strategy

WPD’s long term strategy is to deliver our business objectives through an efficient and scalable organisational structure that can evolve to accommodate the challenges of the future.

Efficient organisational structure

The current flat organisational structure with locally based teams of in-sourced labour has been the foundation of WPD’s success. It gives responsibility to front line staff to deliver work programmes and the absence of multiple layers of management minimises costs.

There are no plans to change this successful business model.

One of the big advantages of the geographical team structure is scalability. More staff can be added to an individual team where increases in future work cluster together or additional teams can be created where there are more widespread increases in workload. These changes can be achieved quickly.

Self-sufficiency

WPD’s resourcing strategy is to use in-sourced labour. This ensures that knowledge is retained, allows greater flexibility to redeploy staff where needed and builds a strong culture with staff motivated to deliver business objectives.

The development of in-house apprentice schemes, training facilities, technical knowledge, operational capability and bespoke systems increases the self-sufficiency. This allows the business to respond quickly to new requirements and obligations and have better control over succession planning.

Investment in technology and innovation

Developing better ways of doing things is encouraged throughout the business. Innovative ideas are captured, tested and rolled-out into the business on a regular basis.

Strategic report (continued)

For the year ended 31 March 2018

Long term strategy (continued)

Investment in technology and innovation (continued)

Innovation is core to our business strategy. We published an updated Innovation Strategy on working smarter and more cost effectively. We look for innovative developments across five broad areas:

- Network performance and efficiency – searching out better processes, equipment and technology that ensure we continue to be efficient;
- Low carbon networks – supporting future electricity demand and generation requirements;
- Smart grids and meters – developing new techniques and utilising enhanced data to help develop more dynamic network control;
- Environment – reducing our business impact on the environment;
- Customer service – developing smarter ways of delivering better customer service.

Technology can provide benefits of improved performance or efficiency. The deployment of technologies is carried out in a way to ensure that compatibility is maintained. This applies equally to IT equipment, communications infrastructure and the roll out of new innovative network management techniques. This keeps costs low as fewer interfaces are required.

Understanding the long term needs of the network

Network monitoring, independent information sources and modelling techniques are used to predict investment requirements into the long term.

Asset replacement forecasts show that in the future more investment will be required to replace an ageing cable population. Monitoring of fault rates and analysis of causes will enable targeted investment programmes to be established. An example of practice where this already exists is in the replacement of Consac cables that were installed in the 1970s but have since been found to have a greater than average fault rate.

In July 2017, as part of its Industrial Strategy, the Department for Business, Energy and Industrial Strategy ("BEIS") published its Smart Systems and Flexibility Plan jointly with Ofgem. New technology is changing the way we generate, distribute and consume energy, and information and communication technology will transform local energy networks from passive systems to more active smarter networks. We are working to accommodate substantial increases in low carbon technologies by providing nationally-adopted innovative solutions that enable generators to connect to our network more quickly and at reduced cost. Alongside this we are exploring the flexibility available from both power generation and demand as we develop as a Distribution System Operator ("DSO"). In July 2017 we issued a consultation on our proposed DSO Strategy. Through implementation of our DSO Transition Programme, we plan to build on our Future Networks Programme and invest £125 million up to 2023 to ensure that our network, and our business, has the capacity to deliver all the emerging system requirements our customers have, both now and in the future.

Doing more than the legal minimum

As a minimum the activities carried out aim to comply with licence obligations and the Electricity Act. Where identified as being in line with our business objectives, additional activities will be carried out to provide better service or provide additional network capacity.

This approach ensures that any incremental investment above legal requirement is made to bring about clearly identified benefits to our customers, stakeholders and our business.

Strategic report (continued)

For the year ended 31 March 2018

Long term strategy (continued)

Completing work programmes

WPD does not delay work programmes. Whilst short term savings would provide a financial benefit under the regulatory efficiency incentive ("IQI"), such action is not commensurate with providing a longer term reliable network for customers. Unless objectives change, work programmes are completed.

Adapting the network for climate change

We engage with the BEIS and the industry to identify common climate change impacts and set about implementing changes to ensure that our networks remain reliable into the long term future.

We have used available projected climate data to assess risks resulting from three priority areas - increased lightning activity, flooding and the impact of temperature rise on overhead lines.

Lightning activity is predicted to increase across the whole WPD area. The effects are being mitigated by adding lightning protection devices to the network.

Site specific flood risk assessments are used to identify the most prudent flood prevention method to adopt to protect equipment. Mitigation measures include protection of individual items, protection of buildings, protection of the site as a whole or in extreme cases site relocation.

Predicted increases in ambient temperature not only mean that thermal expansion will affect overhead line clearances but also thermal loading limits will be reached more quickly. As a result, we have introduced new overhead design requirements to increase ground clearance and have prepared new conductor ratings for overhead lines.

Stakeholder engagement

WPD regularly engages with stakeholders to ensure that our business objectives and strategy are in line with their needs and so that we can learn from our customers first hand. True improvements in customer service and business delivery come from understanding the areas where we can do better.

We use a range of engagement methods, including:

- stakeholder workshops;
- customer panel meetings;
- focus groups with domestic customers;
- 'willingness to pay stated preference' interviews with domestic and business customers;
- connections and distributed generation surgeries;
- distributed generation customer interviews.

Following stakeholder workshops we publish reports detailing all of the feedback received, as well as a WPD response outlining the conclusions we have reached and how this will impact on our plans.

Business review

The focus for the business during the year has been to continue to concentrate on the key five goals of safety, network performance, customer service, environment and business efficiency.

Strategic report (continued)

For the year ended 31 March 2018

Business review (continued)

Key performance indicators ("KPIs")

| | 2017/18 | 2016/17 | 2015/16 |
|--|---------|---------|---------|
| Non-Financial | | | |
| Safety: | | | |
| Lost time accidents | 0 | 2 | 4 |
| Non lost time accidents | 17 | 20 | 26 |
| Network reliability: | | | |
| Customer minutes lost | 35.7 | 39.7 | 37.5 |
| Customer interruptions (per 100 customers) | 56.1 | 52.5 | 51.4 |
| Financial | | | |
| Total expenditure* | £386.0m | £380.1m | £353.3m |
| Debt to Regulatory Asset Value ("RAV") ** | 64.1% | 62.6% | 65.2% |
| Interest cover*** | 5.7 | 7.2 | 6.3 |

* Operating expenses plus capital expenditure (not including customer contributions) on both tangible and intangible assets.

** RAV is a regulatory concept to represent assets with a long term life. The regulated income in any year includes a return on RAV and amortisation of RAV as determined by Ofgem during a rate review. The percentage for the prior year has been restated to reflect the nominal value of RAV.

*** Interest cover is calculated as profit before interest, taxation, depreciation and amortisation divided by interest payable.

The following table details the figures used in the Debt to Regulatory Asset Value:

| | 2017/18 | 2016/17 |
|--|-----------|---------|
| | £m | £m |
| Cash at bank and in hand | 93.6 | 21.6 |
| Less restricted cash | (4.4) | (8.8) |
| Bank loans and overdrafts | (25.3) | (105.4) |
| Long term borrowings | (1,002.5) | (743.9) |
| Letters of credit | (3.8) | (3.8) |
| Amounts owed to other WPD undertakings | (65.2) | (76.0) |
| Net | (1,007.6) | (916.3) |
| RAV* | 1,571.4 | 1,464.9 |
| Debt to RAV | 64.1% | 62.6% |

*It is not possible to perform a reconciliation between RAV and IFRS measures as RAV is a regulatory measure. The differences between IFRS and regulatory rules have built up over many years and cannot be reconciled.

Each of the five key goals are discussed in more detail in the following sections.

Safety

The safety of our staff, customers and members of the public continues to be a core value at the heart of all our business operations. Maintaining a practical and pragmatic safety culture from the "top down" remains an imperative. WPD staff continue to play an active role in many national committees and steering groups which concentrate on the future safety and training policies across the industry.

Strategic report (continued)

For the year ended 31 March 2018

Business review (continued)

Safety (continued)

There were no members of staff involved in lost time accidents in the WPD South West Network Services Area in 2017/18 compared with two in 2016/17. The number of staff involved in non-lost time accidents was 17 in 2017/18 compared with 20 in 2016/17. The total number of accidents to staff across WPD as a whole decreased from 62 in 2016/17 to 58 in 2017/18.

During 2017/18 the Safety Team actively supported WPD Team Managers and Distribution Managers with their safety responsibilities and provided assistance to enable them to maintain a clear focus on safety. The Safety Team also continued to provide support to all other areas of the business but with particular focus on the following areas of work:

- Continued roll-out of a bespoke safety training programme to technical staff across all Network Service areas of the business to promote heightened awareness of risk assessment and safety management related issues.
- Development and introduction of a new computer based process to assist with the required checks and allow Examining Officers and Issuing Officers to create and approve authorisation certificates electronically.
- Developed further engagement with organisations that work with WPD to achieve safety, with a new programme of Safety Conferences for contractors to encourage sharing of best practice with regard to safe methods of working and to promote the industry Powering Improvement initiative.
- Work continued to extend and improve WPD applications on the iPad to assist staff with the provision of additional information and to provide enhancements to the electronic risk assessment facility.
- Support of the national joint initiative between the Energy Networks Association ("ENA"), Health & Safety Executive and Trades Union bodies under the title of 'Powering Improvement' with the 2017 theme being 'Asset Management' in particular by co-ordinating a number of presentations to discuss relevant scenarios and to avoid the loss of corporate memory.
- A targeted public safety leaflet campaign, to provide information about keeping safe in proximity to WPD assets, to over 120,000 wayleave grantors and organisations that operate mobile plant such as lorry loaders and cranes within WPD regions.

During the Autumn of 2017 the Safety Team provided a package of presentations to support managers throughout WPD as part of the '2017 WPD Safety Week' programme, to update staff on the company's health and safety statistics and provisions to cater for mental health issues, to raise awareness of the precautions required where work has to be carried out on live electrical apparatus, how to avoid a slip, trip, or fall which is the most frequently reported type of accident within the business, and safe driving techniques.

In May 2017 an internal audit confirmed that the combined Safety Management Systems conform to OHSAS 18001:2007 as issued by the British Assessment Bureau.

Network performance

Performance of the distribution network is measured in two key ways:

Security - the number of supply interruptions recorded per 100 connected customers ("CI"); and

Availability - the number of customer minutes lost per connected customer ("CML").

All licensees who operate a distribution system are required to report annually to Ofgem on their performance in maintaining system Security and Availability. The Quality of Service incentive scheme, also known as the Information and Incentives Scheme ("IIS") which was introduced by Ofgem in April 2002, financially incentivises all licensees including WPD with respect to both the Security and Availability of supply delivered to customers. In addition Ofgem incentivises the quality of telephone response customers receive when they contact the licensee. This is assessed by a customer survey carried out on a monthly basis.

Strategic report (continued)

For the year ended 31 March 2018

Business review (continued)

Network performance (continued)

Network performance reported to Ofgem for the year was as follows:

| | <u>Total</u> | <u>Target of</u> |
|---|--------------|------------------|
| Minutes lost per customer 2017/18 | 42.8 | |
| Excluded events | (7.1) | |
| IIS Performance 2017/18 | 35.7 | 43.5 |
| | | |
| IIS Performance 2016/17 | 39.7 | 43.6 |
| | | |
| Interruptions per 100 customers 2017/18 | 62.0 | |
| Excluded events | (5.9) | |
| IIS Performance 2017/18 | 56.1 | 58.5 |
| | | |
| IIS Performance 2016/17 | 52.5 | 58.9 |

The figures above cover all reportable interruptions longer than three minutes in duration occurring on the WPD South West network including those caused by bad weather and other faults together with 50% of CI and CML due to pre-arranged shutdowns for maintenance and construction. The 11kV network is the principal driver of customer minutes lost, with faults on overhead lines being the major contributor. In addition to the performance reported under IIS above, 85.61% of customers off supply in the South West as the result of a high voltage ("HV") fault were restored within one hour of the fault occurring.

Under the IIS scheme, performance is targeted at an underlying level of improvement. DNOs are thus permitted to claim an adjustment for events during the year which they believe were exceptional and had a significant impact on the total reported performance. An exceptional event can either be caused by a large number of weather related faults or be due to a one-off event which is outside the DNO's control. In either case, the event must meet prescribed thresholds in terms of the numbers of faults experienced or, for a one-off event, in terms of either the number of customers affected or the duration of the incident. If an event meets these prescribed thresholds, the DNO must notify Ofgem who will conduct an audit to determine the impact of the event. As part of the audit process the DNO must demonstrate that it mitigated against the impact of the event to the best of its ability before Ofgem will exclude the CI and CML incurred. WPD South West reported three exceptional events to Ofgem during the year.

Subject to Ofgem confirmation, our IIS CML of 35.7 customer minutes lost is within our target of 43.5. Our IIS CI of 56.1 interruptions per 100 customers for the year is within of our target of 58.5. The CML outperformance relative to the RIIO-ED1 targets set by Ofgem is particularly gratifying as the new targets are particularly tough for a DNO whose operational performance during this period is acknowledged by Ofgem as being a frontier performer.

Customer service

We are committed to providing excellent customer service at all times and strongly believe that customer satisfaction is the key to the future success of the business. When dealing with customers our policy is to get it right "first time, every time". On the occasions when we fail to meet this standard, staff are encouraged to take personal responsibility for customer issues, to follow the problem through to the end and to adopt our golden rule - "treat customers the way that we would like to be treated".

Strategic report (continued)

For the year ended 31 March 2018

Business review (continued)

Customer service (continued)

If customers are not happy with our efforts to resolve their complaint, they are able to ask The Energy Ombudsman ("Ombudsman") to review the matter. WPD South West and WPD South Wales have completed a ninth year of the statutory Energy Ombudsman Scheme with zero customer complaints upheld. WPD West Midlands and WPD East Midlands achieved a sixth year of the statutory Energy Ombudsman Scheme with zero customer complaints upheld.

During the year WPD South West recorded 38 failures against Ofgem's national Customer Guarantee Service Standards for network performance. The Company recorded zero failures for the year relating to connections performance.

Stakeholder Engagement Incentive

WPD has maintained its position as the top performing DNO group in the Stakeholder Engagement Incentive Award Scheme (which is a key element of Ofgem's Broad Measure of Customer Satisfaction), held since its introduction in 2011/12. Most recently for the year 2016/17, WPD was again rated in first place with a score of 8.53 out of 10. This is worth £6.17m (16/17 prices) and will be applied to 2018/19 revenues across the four DNOs. WPD entered three written submissions, hosted a one day audit of the Consumer Vulnerability part of the submission, this was then followed by a question and answer session with an Ofgem-appointed judging panel of experts.

Broad Measure of Customer Satisfaction

As part of Ofgem's Broad Measure of Customer Satisfaction Incentive, a research agency undertakes a monthly satisfaction survey of DNO customers who contact their DNO to report loss of supply, have been notified of a planned interruption, have a general enquiry, or request a new connection (quoted and completed). This incentive has continued into the RIIO-ED1 period scored across the six performance areas. For WPD's four licence areas around 22,000 customers are surveyed per year. For the regulatory year 2017/18, WPD has been rated the number one DNO for customer satisfaction for the seventh consecutive year with an overall satisfaction rating of 8.93 out of ten.

Ofgem also compares the speed of response that a DNO call centre provides and WPD is consistently identified as the top performer with an average speed of response below 1.65 seconds.

National Customer Service Excellence Standard

WPD's excellent customer service is demonstrated by its continued accreditation to the national Customer Service Excellence Standard ("CSE").

WPD has held the charter mark of best practice since 1992 - the only energy company in the UK to do so. The CSE assessor visits a number of locations across WPD every year. WPD undergoes a stringent external assessment of our engagement activities every year. The CSE standard seeks to ensure we are providing services that are efficient, effective, equitable and have the customer at the heart of everything we do. There is a strong focus on the quality of our engagement methods and in particular the steps we take to develop customer insight, understand users' experiences, robustly capture their feedback and measure satisfaction. The standard assesses WPD's delivery, timeliness, information, professionalism and staff attitudes.

WPD is assessed against 57 elements and has full compliance against every one. As an established holder of the charter mark, WPD is assessed as part of a three year rolling programme, where one third of the standards are reviewed annually. There are four potential outcomes ranging from 'non-compliance' to 'compliance plus' (the highest level possible, indicating best practice across all sectors).

Strategic report (continued)

For the year ended 31 March 2018

Business review (continued)

Customer service (continued)

National Customer Service Excellence Standard (continued)

WPD was reassessed in March 2018. WPD was successfully reaccredited, and demonstrated that improvements continue to be made with compliance plus ratings for a record 43 elements, with zero partial or non-compliances. The assessor concluded that “the culture of WPD continues to be highly customer-focused with a strong emphasis on team working and the use of customer insight to improve service delivery. There is strong leadership and appropriate policies and procedures to support staff in delivering consistently high levels of performance”.

British Standard for Inclusive Service Provision

In 2014, WPD became the first company in the UK to be externally assessed by the British Standards Institute as fully compliant with the BS18477:2010 British Standard for inclusive service provision. Following a full system audit in December 2017, we retained full compliance with this standard for a fifth year. BS18477 was recommended by Ofgem as part of its Vulnerable Customer Strategy review discussions. The assessment adds considerable endorsement to WPD’s social obligations programme and the services we offer to our Priority Service Register customers. WPD was assessed during a two day audit to review the accessibility of our services, literature and website, as well as WPD’s social obligations programme and vulnerable customer strategy, all associated systems and processes, Contact Centre operations and the new connections process. WPD was assessed as fully compliant in over 36 audit elements.

In December 2017 the auditor reported that “WPD is achieving positive outcomes for its customers through expanding its PSR referral networks, implementing new innovative fuel poverty projects and using partners in the health and education sectors to target 'hard to reach' customers.”

Customer Panel and Stakeholder Workshops

The WPD Customer Panel was introduced in 2011. The panel meets four times a year and members, who represent a wide range of customers and other key stakeholder groups, help us keep up to speed with the issues affecting our customers. Members include representatives from Citizen’s Advice, the British Red Cross, Major Energy Users Council, local parish councils, B&Q, University of Nottingham, Energy Saving Trust, Severn Trent Water and National Grid. Through the Panel, we proactively seek honest and challenging customer views about the way we operate and our future plans. It plays an important role in helping WPD develop its strategic priorities. The Panel is attended by WPD’s Chief Executive and other directors, demonstrating the commitment at every level to proactively engage with customers.

Since 2010 WPD has held a number of stakeholder workshops and over 5,000 people, across a range of organisations, have been engaged to help us build and review our Business Plan - the vast majority face-to-face. Now that WPD’s Business Plan has been agreed, WPD has maintained its relationship with stakeholders and shifted the focus on to delivery and also identifying long-term strategic priorities that may change the way networks operate in the future.

In January 2018 WPD hosted annual stakeholder workshops in Birmingham, Derby, Cheltenham, Newport, Bristol and Plymouth. The six events were attended by 270 stakeholders from a range of different backgrounds including domestic, business, local authorities, developers/connections, environmental, energy/utility, regulatory/government and voluntary sectors. WPD has subsequently identified 13 key improvement actions that WPD will be taking in order to address the stakeholder feedback received.

Strategic report (continued)

For the year ended 31 March 2018

Business review (continued)

Customer service (continued)

Deaf Awareness Chartermark

WPD holds the Action on Hearing Loss (formerly RNID) 'Louder Than Words' charter mark accreditation which assesses and endorses the accessibility of WPD's services for deaf and hard of hearing people. We have held the accreditation for seven and nine years respectively for WPD South Wales/WPD South West and WPD East Midlands/WPD West Midlands. We are the first DNO in the UK to have launched the "InterpreterNow" service. This enables deaf customers to contact us in British Sign Language ("BSL") via an online interpreter by downloading a free app. In addition, we now provide a series of customer information videos in BSL.

Environment

WPD is committed to conducting its business as a responsible steward of the environment. WPD plans new routes so as to minimise, as far as economically possible, their impact on the environment.

Every member of staff is made aware of WPD's environmental commitment to abide by environmental laws, regulations and corporate environmental policies, and their responsibilities for reporting any concerns on potential environmental compliance issues so that appropriate action can be taken.

Following a successful surveillance audit in March 2018, WPD maintained certification to ISO55001. This international standard for Asset Management is the successor to PAS55, against which WPD held continuous accreditation since 2006. Whilst asset management specifications, both PAS55 and ISO55001 encompass risk management, setting of and adherence to policies and procedures, and thus has relevance to control of environmental risk.

Fluid filled cables

The design of very high voltage underground cables has evolved over many years and our new cables all use a solid plastic like insulation. Old designs of 33kV and higher voltage cables used an insulating oil in ducts inside the cable. Whilst these cables are normally very reliable, in the event of a fault, or commonly damage by third parties digging the street, this oil may leak out, sometimes many hundreds of litres. In common with other DNOs, WPD works to an operating code agreed with the Environment Agency, and assesses both the condition and the environmental risk posed by the fluid filled cables which WPD owns. The losses from the WPD Group's fluid filled cables can vary from year to year dependent on the number of small leaks at disparate locations rather than high volume single events, often caused by third parties.

Fluid losses (litres) **WPD Group**

| | |
|---------|--------|
| 2017/18 | 33,227 |
| 2016/17 | 17,251 |
| 2015/16 | 19,580 |
| 2014/15 | 25,131 |
| 2013/14 | 16,061 |

The use of Perfluorocarbon Trace ("PFT") technology within WPD reduces the effect on the total annual fluid losses. WPD continues to provide the Environment Agency with a monthly leak report as required under the joint agreement between the Environment Agency and ENA Fluid Filled Cables Group.

Strategic report (continued)

For the year ended 31 March 2018

Business review (continued)

Environment (continued)

SF6 gas

Sulphur hexafluoride (SF6) is a man-made gas which has had widespread use such as in double glazing, tennis balls and training shoes as well as a number of industrial applications including high voltage switchgear. Unfortunately it is also a strong greenhouse gas, with a global warming potential 22,800 times greater than carbon dioxide (CO2).

WPD carefully monitors its SF6 equipment and employs the external ENA Engineering Recommendation S38 methodology for the reporting of SF6 banks, emissions and recoveries. That ENA document, initially drafted by WPD, employs approaches set out by The Intergovernmental Panel on Climate Change ("IPCC"), set up by the World Meteorological Organisation and the United Nations Environmental Programme.

The losses from SF6 equipment in WPD South West and WPD South Wales during 2017/18 amounted to 225kg, representing less than 1% of its bank.

WPD has been listed in the Fluorinated Greenhouse Gas Regulations 2015 (amended) as a Recognised Certification and Evaluation Body (HV Switchgear) under Regulation 33, and has now certified relevant WPD staff.

Electric and magnetic fields ("EMFs")

The question of whether electric and magnetic fields are linked in any way to ill health is a long standing one which has no conclusive answer. WPD is committed to providing members of the public and its employees with full and up to date information on the issue. We believe that the decision on what constitutes a safe level of exposure should be made by the UK Government, advised by the Health Protection Agency.

WPD complies with the public exposure recommendations contained within the 1989 ICNIRP (International Commission on Non-ionising Radiation Protection) Guidelines on Extremely Low Frequency Electromagnetic Fields and with the occupational exposure requirements specified within the Control of Electromagnetic Fields of Work Regulations 2016.

In addition WPD follows the ENA Engineering Recommendation G92/1, Guidelines for best practice in relation to Electric and Magnetic Fields (EMFs) in the Design and Management of Low Voltage Distribution Network and the DECC (now BEIS) Code of Practice on the Optimal Phasing of High Voltage Double Circuit Power.

General

In May 2017 all four of our licensed areas gained certification to the new ISO14001:2015 environmental management standard with no major non-conformances being raised. One six monthly surveillance audit was undertaken in December 2017 and again no major non-conformances were raised.

As with any large organisation working at the heart of the community, WPD wants to support these communities in ways that will enhance the landscape for people and wildlife too. Supporting environmental activities at a grass-roots level enables the community to make meaningful changes which are sustainable and provides an instant impact. In our experience, local groups, charities and schools are willing to take on small scale community projects but lack the financial input for tools and resources to make it happen.

Working in partnership with various regional Wildlife Trusts, The Conservation Trust and Groundwork Wales has enabled school children to experience hands-on nature projects, develop orchards in schools and understand the positive benefits of conserving our natural habitats for the future.

Strategic report (continued)

For the year ended 31 March 2018

Business review (continued)

Environment (continued)

Certain environmental issues are discussed in the Corporate and Social Responsibility section. There is always the risk that changes in legislation relating to environmental and other matters, including those imposed on the UK by the European Union, could result in considerable costs being incurred by the Company with no guarantee that Ofgem would allow them to be recovered through regulated income.

Business efficiency

Profit before tax decreased by £33.8m compared to the previous year. Operating profit at £226.1m was £19.3m lower, with turnover down by £7.8m and operating expenses up by £11.5m. Turnover in the year was impacted by the decrease in tariffs and the timing of the recovery of regulated income.

Total expenditure ('totex') increased by £5.9m. The capital work programme has continued to increase in line with the business plan. Totex is a key feature in the business plan submission to Ofgem as part of the price review process as it underpins the allowed revenue set; thus actual performance against the business plan is subject to close scrutiny as we are incentivised to stay within the business plan.

Total net assets at 31 March 2018 were £895.1m, an increase of £41.8m on the previous year. Tangible fixed assets increased by £183.6m reflecting the fact that capital expenditure exceeds the historical cost depreciation charge.

The pension liability increased from £64.0m to £100.6m as no employer contributions were made during the year (all were prepaid in March 2017) and a remeasurement loss was incurred.

Debt to RAV

Asset cover (total net debt to RAV) is part of the rolling credit facility covenants for several of the WPD companies and is used as a key internal measure. As part of the regulatory process, Ofgem determines what it considers an appropriate debt/equity split to optimise the cost of capital and to ensure that the volume of debt in relation to RAV does not threaten the liquidity of the licensee.

Interest cover

The ratio of earnings before interest, tax, depreciation and amortisation (EBITDA) to interest payable is part of the rolling credit facility covenants for several of the WPD companies. It is also used as a key internal measure of the financial health of the DNOs. This shows that the Company is generating more than enough profits to cover the interest payments.

Capital investment

Gross capital investment on tangible fixed assets (before customers' contributions) during the year was £239.5m (2017: £251.3m) across the WPD South West region and included the replacement of overhead lines and switchgear together with the introduction of new technology.

Strategic report (continued)

For the year ended 31 March 2018

Business review (continued)

Capital investment (continued)

A number of significant projects were undertaken during the year including:

- *Isles of Scilly*

A boat dragging its anchor caused catastrophic damage to the submarine cable feeding the Isles of Scilly off the Cornish coast. 2.5km of damaged cable was recovered from the sea bed at a depth of 70m. 5km was then re-laid along an alternative route. A specialist cable repair vessel, which normally takes 30 days to arrange and mobilise, was contracted and mobilised within 10 days. The repair, which would normally take 105 days, was completed in 36. The submarine cable joint was the first of its kind as the joint was too big to fit in the frame that would safely lower it to the sea bed. So the frame was adapted into a 'joint development device' by WPD staff and was completed during the installation on site. Since the repair 64 tonnes of gravel has been laid to provide extra protection with three five-tonne concrete mattresses to be added in the summer.

- *First 33kV Battery Storage site*

Further developing the generation portfolio, the South West connected its first EHV Battery Storage site in July 17. Using WPD owned land adjacent to Lockleaze 132kV substation near Bristol, Aura Power Ltd have installed a 20MW Lithium Ion Battery Storage Facility which will be used by National Grid for frequency response. In just under six months from first meeting with Aura Power, WPD Projects staff planned and completed the installation.

- *ESQCR risks completion*

Electricity Safety, Quality and Continuity Regulations 2002 specify requirements for clearance to objects and ground. With agreement with the Health and Safety Executive, the South West was tasked with completing all outstanding clearance risks to buildings and structures by 31st March 2018. This has been completed ahead of time.

Future developments

See page 2 for details of our long term strategy.

RIO-ED1

All four WPD DNOs were fast-tracked by Ofgem in respect of RIO-ED1, the only DNOs selected for this process. Fast tracking affords several benefits, including the ability to collect additional revenue equivalent to 2.5% of total annual expenditures (approximately £25m per year across WPD), greater revenue certainty and a higher level of cost saving retention.

In June 2015 Ofgem published a consultation proposing a new form of accounts which will apply to the network operators ("NWOs") that are regulated under the RIO framework. The proposed RIO accounts will replace Regulatory accounts. The aim is to improve transparency and make it easier for stakeholders to interpret the regulatory position and performance of the NWOs. Ofgem continues to work with NWOs, External Auditors and stakeholders to develop the RIO Accounts including the Regulatory Financial Reporting Standard ("RFRS"), which set out the rules and procedures by which the accounts should be prepared.

In March 2018 WPD published "RIO accounts" for the 2016/17 year on a voluntary basis and is seeking stakeholder comments and feedback on the format and content of the report to help shape future editions. The aim of the RIO accounts is to reflect regulatory performance, based on the RIO framework. As a result, there are differences between RIO accounts and statutory accounts.

Strategic report (continued)

For the year ended 31 March 2018

Future developments (continued)

RIIO-ED1 (continued)

We hope that by sending out a proposal of what the RIIO Accounts can look like this will help ongoing discussions and development of a set of accounts which is useful for a range of stakeholders. It is Ofgem's current intention that 2018/19 will be the first year of RIIO accounts for all energy network companies.

Future Networks – Research, Innovation and Low Carbon Networks

As part of the previous distribution price control period (known as DPCR5), Ofgem introduced the Low Carbon Network Fund ("LCNF"). It was set up to encourage DNOs to test new technology and commercial arrangements to support the UK's low carbon transition and climate change objectives.

The RIIO ED1 innovation mechanisms came into force in 2015, introducing the Network Innovation Allowance ("NIA") and Network Innovation Competition ("NIC"). NIC has similar focus to LCNF in testing technology and commercial arrangements to support the UK's low carbon transition. NIA has a broader remit encouraging technical and commercial innovation to support all DNO activities.

LCNF projects awarded during DPCR5 continue to be delivered during RIIO-ED1. Project delivery and reporting are set out in special licence conditions and in Ofgem's LCNF, NIA and NIC governance documents.

WPD secured funding for six LCNF Tier 2 flagship projects:

- Network Templates, was completed during 2013 with significant new learning which led to technical policy changes facilitating lower energy bills for customers.
- The Lincolnshire Low Carbon Hub was completed in February 2015 and resulted in "alternative connection" arrangements being implemented for generation customers.
- Project FALCON completed in October 2015; this project gave WPD a more detailed understanding of the application of various engineering techniques, an evolving roadmap about data requirements and a number of follow on projects that build on the learning from the project. In particular this project led to the development of WPD's "Flexible Power" demand side response proposition (www.flexiblepower.co.uk).
- The SoLa Bristol project was completed in April 2016 and provided learning linking customer profiles, time of use tariffs and charging/discharging regimes that will inform regulation and tariff changes moving forward.
- FlexDGrid – This project concluded in June 2017 and developed a much greater understanding of Network Fault Levels. Through enhanced modelling and ground breaking measurement equipment it has assisted the city of Birmingham with the implementation of CHP (combined heat and power).

Strategic report (continued)

For the year ended 31 March 2018

Future Networks – Research, Innovation and Low Carbon Networks (continued)

The remaining LCNF project is continuing to make good progress with valuable learning emerging as WPD trials new solutions:

- Network Equilibrium – This project is investigating the issues associated with further demand and generation integration on rural networks through a better understanding of voltage profiles and power flows. Through optimising voltage profiles at a system level and balancing power flows through the innovative use of power electronics, the existing network capacity can be fully utilised allowing an increased level of distributed generation and demand to connect to the existing network more quickly and cost effectively.

WPD has secured funding under the NIC for two projects:

- Open LV – This project is led, following a tender for project partners, by EA Technology Limited. It is developing a substation intelligence platform which can make network data available to communities and academic institutions. It will also host a number of localised and autonomous Smart Grid applications, freeing capacity on local networks for low carbon technology new connections.
- Energy Forecasting and Flexibility System (EFFS) – This project is being delivered in conjunction with related projects within SSE Energy Networks (Transition) and SP Energy Networks (FUSION). Our work involves the development of a simple, repeatable and transparent methodology to forecast Demand Side Response (DSR) requirements to maintain current levels of supply security. The methodology and algorithms will be demonstrated in a prototype system to be developed by project partner AMT Sybex.

WPD completed 10 projects under the DPCR5's Tier 1 mechanism. Under the RIIO-ED1 arrangements, WPD has registered 30 projects under NIA covering a broad range of topics.

Further details of innovation activities can be found at www.westernpowerinnovation.co.uk.

Principal risks and uncertainties

The Company views the following risk categories as those that are the most significant in relation to WPD.

Regulatory risk

A substantial part of the Company's revenue is regulated and is subject to a review every eight years. The current price control, RIIO-ED1, commenced 1 April 2015 and continues to 31 March 2023.

Under the review, Ofgem assesses the revenue and capital expenditure plans of the Company and determines what it considers an efficient level of that expenditure. Ofgem also considers the required cost of capital sufficient to encourage the required investment in the network, and determines customer service targets.

WPD's management invests considerable resources in the review process and has been proactive in working with Ofgem to establish better measures of cost recording to inform future reviews.

If the Company feels that, as a result of a review it would financially be unable to continue to operate and to meet its obligations under the licence, then it has the right to refer the matter to the UK Competition and Markets Authority for a determination.

The Company's regulated income and also the RAV are to some extent linked to movements in the RPI. Reductions in the RPI would adversely impact revenues and the debt/RAV ratio.

Strategic report (continued)

For the year ended 31 March 2018

Principal risks and uncertainties (continued)

Mid-period review

A mid-period review ("MPR") of outputs is a mechanism included in the RIIO price controls to help manage uncertainty. Any potential MPR would cover material changes to outputs that can be justified by clear changes in government policy and the introduction of new outputs that are required to meet the needs of customers and other network users. Ofgem has made it clear that an MPR is not an opportunity to re-open the price controls or alter incentive mechanisms, other than as required to accommodate changes to outputs. Ofgem has also ruled out making retrospective adjustments as part of MPR. In February 2017, Ofgem published its final decision on the MPR for National Grid electricity transmission and gas distribution, the results of which took effect in April 2018. There was no MPR for gas distribution or for the Scottish Transmission companies.

In July 2017 Ofgem issued a call for evidence on a potential MPR for electricity distribution, followed by a full consultation in December 2017 on options including no MPR, a focused increase in scope or a significant increase in scope. Ofgem published the decision in April 2018 that it would not progress the MPR.

RIIO2 Framework

In July 2017 Ofgem launched the RIIO2 process for establishing the key principles for the RIIO2 Framework across transmission and distribution, followed by a series of industry workshops. Ofgem issued a RIIO2 Framework Consultation in March 2018. This included topics such as the length of the ED2 price control period, the cost of equity and a more prescriptive structure for stakeholder engagement. The consultation closed on 2 May 2018 and Ofgem expects the decision to be published on 30 July 2018.

Network disruption

Disruption to the network could impact profitability both directly through the timing of recovery relating to lower units delivered on which income is charged, and also through the system of penalties and rewards that Ofgem has in place relating to customer service levels (discussed under 'Network performance' above).

There are economic restrictions on the level of capital expenditure that can be incurred to make the network totally reliable. A certain level of risk must be accepted and this is recognised by Ofgem in its regulatory review. However, the Company believes that its network is robust. It targets capital expenditure on schemes which are assessed to have the greatest improvement in customer service levels. It also spends considerable sums on routine maintenance, including tree cutting to keep trees away from lines both for safety reasons and as trees have been proven to be a major cause of network interruptions. The Company has met Ofgem's targets for customer service.

Reliance on suppliers

WPD relies on a limited number of suppliers for cable laying and tree cutting services, and for the supply of cables, plant and machinery. However WPD considers that there are sufficient alternative suppliers such that, should an existing supplier be unable to continue to make supplies, then there will be no significant long-term impact on WPD's ability to operate the network.

Most of the electricity which enters WPD's network is carried on the national grid and enters WPD's network at a limited number of grid supply points. WPD is dependent on the national grid. However, this is also an activity regulated by Ofgem and thus the risk of a major failure is considered very remote.

Environment

Certain environmental issues are discussed in the Corporate and Social Responsibility section. There is always the risk that changes in legislation relating to environmental and other matters, including those imposed on the UK by the European Union, could result in considerable costs being incurred by the Company with no guarantee that Ofgem would allow them to be recovered through regulated income.

Strategic report (continued)

For the year ended 31 March 2018

Principal risks and uncertainties (continued)

Interest rate risk

The Company has had both short-term and long-term external debt during the year, at floating and fixed rates of interest, respectively. An element of the long-term debt is index linked which creates a natural hedge against the Company's regulated income, which is also index linked.

Credit rate risk

WPD South West, WPD South Wales, WPD East Midlands and WPD West Midlands are required by their distribution licences to maintain investment grade ratings, which they have done. All four have the following long-term corporate credit ratings: Moody's Baa1 and Standard & Poor's A-.

Cash deposits are made with third parties with a high credit rating (not below a long-term rating of A/A2/A and a short-term rating of A1/P1/F1 by Standard & Poor's, Moody's and Fitch, respectively) and within strict limits imposed by the appropriate Board.

Exchange rate risk

The Company is exposed to exchange risks on its \$53m investment in debt issued by Western Power Distribution plc.

Creditworthiness of customers

Most of WPD's income is for the delivery of electricity to end-users and thus its customers are the suppliers to those end-users. It is a requirement that all licensed electricity distributors and suppliers become parties to the Distribution Connection and Use of System Agreement. This agreement sets out how creditworthiness will be determined and, as a result, whether the supplier needs to provide collateral. The risk of a significant bad debt is thus considered low.

Pensions

Most employees are members of a defined benefit pension scheme, which also has a considerable number of members who are either retired or have deferred benefits. There are risks associated with the financial performance of the assets within the scheme and with the estimate of the liabilities of the scheme including longevity of members. Currently, ongoing service costs and a proportion of the deficit costs are recoverable through regulated income.

In March 2010 WPD South West and WPD South Wales announced that, with very limited exceptions, its defined benefit pension plan would be closed to new members. A defined contribution scheme is being offered to new employees instead. As time elapses, this will reduce WPD's exposure associated with defined benefit pension plans.

UK membership of European Union ("EU")

In March 2017, the United Kingdom government formally notified the EU of its intent to withdraw from the EU, thereby commencing negotiations on the terms of the withdrawal. There remains significant uncertainty as to the ultimate outcome of the withdrawal negotiations and the related impact on the U.K. economy.

Cyber security

WPD adopts a fundamentally unique stance towards reducing the cyber security risk to the extent that, in addition to considerable resources spent on "defence in depth" cyber security controls, WPD does not permit direct connection between WPD's corporate network and the internet, nor direct cloud based services accessed from WPD's corporate network, nor bring your own device. It therefore considers that the risk of major disruption to its systems or to the electricity network is very low.

Strategic report (continued)

For the year ended 31 March 2018

Insurance arrangements

WPD has a wholly-owned captive insurance company, Aztec Insurance Limited ("Aztec"), based in Guernsey. Depending on the nature of the risk, WPD South West carries all or an element of the risk itself ("self insured") or it underwrites insurance with a combination of Aztec and external insurers. Insurance arrangements are reviewed in detail annually.

Insurance arrangements for the year ended 31 March 2018 relating to WPD's key risks were as follows:

- the distribution network is self insured;
- offices and depots including their contents and stock are self insured up to £500,000 for each claim and externally insured above that, subject to a maximum of £50.0m;
- combined liability covers employer's liability, public and product liability, and professional indemnity. The first £10,000 of each claim is self insured, Aztec covers the next part of the claim up to £1.0m per claim and £5.0m in total; claims exceeding these limits are externally insured subject to certain limits;
- on motor related claims, damage to own vehicles is self insured if not recoverable from a third party, as is the first £5,000 of each third party claim. Aztec covers the next part of the claim up to £1.0m for any claim and £2.4m in aggregate; claims exceeding these limits are externally insured subject to certain limits;
- claims relating to death or injury to employees whilst on WPD business or travelling on business are externally insured subject to various limits;
- external insurance is also in place (subject to limits) for loss of money, securities or property through dishonest acts by employees and for wrongful acts by pension scheme trustees;
- insurance in respect of directors and officers is maintained by WPD's US parent, PPL Corporation;
- external insurance is also in place (subject to limits) for cyber liability (costs for security/privacy breaches, defence costs in relation to regulatory breaches and other breaches) and is maintained by WPD's US parent, PPL Corporation.

Internal control environment

PPL Corporation has an audit committee that has oversight of the internal control environment across all PPL entities. The WPD Internal Audit Team completes a programme of internal audit work that provides independent assurance on internal controls. The WPD Internal Audit Team reports to both the PPL Audit Committee and the Western Power Distribution plc Board. The Western Power Distribution plc Board has responsibility for internal controls across WPD entities.

PPL's Audit Committee reviews and monitors the independence of the external auditor. The responsibility to monitor the financial reporting process and statutory audit of these financial statements is assumed by the Western Power Distribution plc Board. This Board comprises executive and non-executive directors who are employees of WPD's parent, PPL Corporation. The Board of WPD South West also includes independent directors.

The directors of the Western Power Distribution plc Board have exercised their responsibility for internal controls by establishing a system of internal controls designed to manage rather than eliminate the risk of failure to achieve business objectives. In pursuing these objectives, internal control can only provide reasonable and not absolute assurance against material misstatement or loss.

There are many cultural features in WPD that contribute directly to the success of the Company and the results that it has achieved. These include:

- good definition and communication of short-term business objectives and targets;
- commitment to achievement of objectives and targets;
- speedy decision-making;

Strategic report (continued)

For the year ended 31 March 2018

Internal control environment (continued)

- business environment that empowers managers;
- an uncomplicated management structure that aids the flow of information both ways through the organisation.

In order for this success to occur, the control environment is one which empowers those with direct responsibility to take decisions within a clearly defined control framework. The control mechanisms have to be sufficient to limit risk but appropriate to the Company's ability to react quickly and effectively to events, therefore enabling the Company to deliver results over a sustained period of time.

It is important to have a clearly defined structure of control expectations. The controls start at director level and make it clear to everyone concerned how the business should be conducted (policy) and how far each person can go in conducting that business (authority levels). This information is communicated effectively to all levels of staff.

As WPD is owned by a US publicly quoted company, it is subject to the requirements of the US Sarbanes-Oxley Act of 2002 (the "Act"). There are two main components of the Act, SOX302 and SOX404.

Under Section 302 of this Act, senior managers affirm quarterly that disclosure controls are operating effectively and that all material information is disclosed in the financial reports.

Section 404 is an annual process which includes management's assessment of internal controls over financial reporting. WPD complies with these requirements via a two stage approach.

Firstly, Company level controls which are pervasive across the Company are documented and tested. The controls cover the COSO elements of effective internal control and the 17 principles set out in the COSO 2013 integrated framework. These encompass:

- control environment
- risk assessment
- information and communication
- control activities
- monitoring.

Secondly, all the major financial processes have been documented with specific detail on the controls in place. This includes the Information Technology environment which supports the financial processes. Management monitor these controls on an ongoing basis. In addition, the controls are reviewed and tested by the Internal Audit department and any issues identified are communicated back to management and the process owners to enable improvement to the controls.

Annually, WPD's compliance with the Act is also reviewed in detail by WPD's external auditor. Good controls together with appropriate documentation must be maintained, and this is subject to testing by both internal and external auditors on an annual basis. Since inception of the Act, no control failures have been identified which merited public disclosure.

Strategic report (continued)

For the year ended 31 March 2018

Corporate and social responsibility

Social and community issues

In the year to March 2018, we assisted 318 separate charitable and non-charitable organisations as part of a commitment of over £265,000 – the three themes of education, safety and the environment continuing to form the bedrock of our community support.

While maintaining these core themes, we continue to tailor our support to align, where appropriate, with the feedback from our stakeholder engagement and the opinion research from our customer awareness activity.

In particular, we have continued to promote WPD's Priority Service Register at a range of events and roadshows, and we are also continuing to develop initiatives as part of our land safety and educational safety activity.

Highlights for the year include:

- Over 3,200 separate educational safety sessions reached over 81,000 schoolchildren against our target of 50,000. These included school visits, crucial crew and lifeskills initiatives.
- Education sponsorships included bursary support for underprivileged students in South Wales involved with Duke of Edinburgh Awards, a British Heart Foundation initiative to provide CPR kits in Bristol schools, sponsorship of the Welsh Business Awards young entrepreneur, the children's safety initiative Countrytastic at the Malvern Show and partnership at three major agricultural shows (Royal Welsh, Bath & West and Malvern) with Techniquest the educational science centre for children.
- Organised the successful re-awarding of the Action on Hearing Loss ("AOHL") Charter Mark for a further 12 months – the seventh consecutive year. It recognises service excellence for those who are hard of hearing or deaf.
- Singled out for praise by AOHL in its national case study 'Working for Change' which highlights service and accessibility excellence. Also won the service excellence award from AOHL Cymru.
- Partnered Wildlife Trusts in Bath and Gloucester. In Bath, a project involving three schools and local people helped to restore the landscape to support pollinators. In Gloucester, the long-term unemployed were taught a range of woodland skills – from coppicing to making tools and benches – in a project that has now been extended to include school students who struggle with mainstream education.
- Worked with Spectacle Theatre to promote PSR in West Wales through street-theatre events, where 'live adverts' were performed by the theatre to promote WPD and the Priority Services Register. As a result, we added 90 new customers to the PSR and the initiative has also been shortlisted for an Arts, Business and Brand Identity Award at the Arts and Business Cymru Awards 2018.
- Continued our winter warmth campaign with Age Cymru to distribute thermometers to the over 65s in South Wales.
- Supported three major agricultural shows (Bath & West, Malvern, Royal Welsh) promoting farm safety messages, the 105 single emergency number and our Priority Service Register. They attracted thousands of visitors. WPD's exhibition was voted best commercial stand at the Three Counties Show, Malvern for the third year running.
- Supported one Welsh language initiative – the Urdd (Welsh Youth Eisteddfod).

Strategic report (continued)

For the year ended 31 March 2018

Corporate and social responsibility (continued)

Customer awareness survey

WPD's commitment to promoting customer awareness pre-dates any of the current regulatory or government pressures on distribution businesses to sharpen their focus on stakeholder engagement.

WPD began this process in a meaningful way in 2010 with the launch of the Power for Life initiative which is designed to raise awareness of the business and to better understand and respond to customer opinion and priorities. The 2017 campaign was WPD's eighth.

This annual customer awareness campaign Power for Life was held during September/October 2017 in the lead up to the winter season. Power for Life makes contact with every customer using direct mail to homes and businesses, as well as a four-week television and radio campaign, press releases and social media.

While reinforcing who we are, what we do, and how well we do it, it also provides information and advice, and explains how we can be contacted in an emergency. Following on from the 2016 campaign, it also encouraged customers to respond so that we could ensure we had their most up-to-date contact details. Some 4,036 customers responded.

Customer opinion research is taken pre and post-campaign. An independent agency undertakes face-to-face feedback with a random sample of 2,000 people across the wider WPD territory. This is designed to test customer awareness of WPD as well as the effectiveness of the campaign in raising the Company's profile and getting across key messages. Analysis indicates that the latest pre-campaign research showed a 2% improvement in customer awareness of WPD on the previous year (58% compared with 56% in 2016).

The post-campaign results indicated that 64% of customers were aware of Western Power Distribution. Here is an excerpt from this year's independent market research survey:

“Awareness of WPD reached its highest ever for the pre-stage survey. Whilst not due to this year's campaign, this may be due to a delayed effect of previous campaigns. This research has demonstrated that awareness of WPD has increased following the campaign, a positive outcome, considering it was very high before the campaign. Furthermore, through analysis of the recall and non-recall groups in the post-campaign research it was possible to isolate the 'campaign effect'. This demonstrated a significantly higher level of awareness of WPD amongst those who had been exposed to the campaign compared to those who had not been exposed.”
(Future Focus Research, 2017)

What is very encouraging is not only the effectiveness seen from the campaign, but actually that our pre-campaign figures in 2017 continue to rise year-on-year. This illustrates that our campaign and ongoing communications work is creating a longstanding effect in making WPD more well known to customers.

Strategic report (continued)

For the year ended 31 March 2018

Environmental matters

See the Environment section on page 10.

Greenhouse gas emissions

Our greenhouse gas reporting year is to 31 March. Emissions for the Company were from:

| | tCO ₂ e | | tCO ₂ e per employee | |
|--|--------------------|---------------|---------------------------------|--------------|
| | 2018 | 2017 | 2018 | 2017 |
| Scope 1 (direct emissions) | | | | |
| Operational transport | 5,786 | 5,737 | 3.75 | 3.74 |
| SF6 gas (see page 10-11) | 2,765 | 1,446 | 1.79 | 0.94 |
| Fuel combustion (diesel) | 2,170 | 1,268 | 1.41 | 0.83 |
| Buildings | 19 | 19 | 0.01 | 0.01 |
| | 10,740 | 8,470 | 6.96 | 5.52 |
| Scope 2 (energy indirect emissions) | | | | |
| Buildings electricity | 2,227 | 3,030 | 1.44 | 1.98 |
| Substation electricity | 2,368 | 2,775 | 1.53 | 1.81 |
| Surf Telecoms Limited (affiliate company) | 272 | 325 | 0.18 | 0.21 |
| | 4,867 | 6,130 | 3.15 | 4.00 |
| Total scope 1 & 2 | 15,607 | 14,600 | 10.11 | 9.52 |
| Scope 3 (other indirect emissions) | | | | |
| Business transport | 885 | 828 | 0.57 | 0.54 |
| Total scope 1, 2 & 3 | 16,492 | 15,428 | 10.68 | 10.06 |

tCO₂e = tonnes of carbon dioxide equivalent

The Company's chosen intensity measurement is tonnes of carbon dioxide equivalent per employee.

The methodology used to calculate our emissions is based on the current guidance provided from BEIS and the Department for Environment, Food and Rural Affairs ("DEFRA") Green House Gas Reporting Requirements and the UK Government conversion factors for 2017/18 Company Reporting.

Employees

The average number of employees during the year was 1,544 (2017: 1,534). These exclude a proportion of WPD South West staff who work in part for other WPD DNOs, and include a proportion of other WPD DNO staff who work in part for WPD South West.

WPD is committed to equality of opportunity in employment and this is reflected in its equal opportunities policy and employment practices. Employees are selected, treated, and promoted according to their abilities and merits and to the requirements of the job. Applications for employment by people with disabilities are fully considered, and in the event of members of staff becoming disabled, every effort is made to ensure that their employment with WPD continues by way of making adjustments to their role and/or working environment or through retraining arranged as appropriate. It is the policy of WPD that the training, career development and promotion of disabled persons should, as far as possible, be identical to that of other employees.

Strategic report (continued)

For the year ended 31 March 2018

Corporate and social responsibility (continued)

Employees (continued)

WPD places considerable value on the involvement of its employees in its affairs. Staff are kept informed of WPD's aims, objectives, performance and plans, and their effect on them as employees through monthly business updates, regular team briefings and other meetings, as well as through WPD's in-house journal. Formal meetings are held regularly between senior managers and representatives of staff and their unions to discuss matters of common interest. A series of road show presentations by the directors each year ensures that all staff are aware of, and can contribute to, WPD's corporate goals.

Gender Pay Gap Report

As with all other UK employers with at least 250 employees, WPD reported on their gender pay gap which was published recently.

WPD's mean hourly gender pay gap was calculated at 9.0%; the median at 10.5% which is 7.6% below the national gender gap and 17.6% below its industry gender pay gap. Therefore, in relative terms, WPD's gender pay gap is positioned positively compared to its UK wide industry segment.

WPD places great emphasis on our diversity and inclusion programmes to attract, retain and progress female employees within the business. It is important for us to continually review our gender pay gap and diversity information and be aware of factors that may impact people related decisions. We have an established Equality and Diversity policy demonstrating the equal treatment of all existing and future employees.

Human rights issues

WPD is dedicated to conducting its business with honesty, integrity and fairness. It is committed to the highest ethical standards. In support of these principles, it is the Company's policy to observe all domestic and applicable foreign laws and regulations.

In addition to conserving the human rights of its employees, WPD also considers those in relation to customers. Two specific customer groups whose needs are targeted by the Company are vulnerable customers and those in fuel poverty.

Vulnerable customers

WPD is required to hold a Priority Services Register ("PSR") that records details about vulnerable customers so that additional support can be provided when the customer contacts WPD or when their supply is interrupted. Bespoke services are provided by understanding the special needs of the customers.

WPD has established a dedicated team of people to proactively contact vulnerable customers and check the detail held about them. This is a process that will be repeated every two years to ensure that the register remains up to date. WPD is also developing processes to share data with other service centred organisations that hold information about vulnerable customers, in line with data protection requirements. In the year to March 2018, WPD contacted 955,664 customers and successfully updated 34% of their records.

Links have been established with many organisations such as the British Red Cross to improve the understanding of the needs of vulnerable customers. These partners work with WPD to improve the services that are provided and we will continue to work with them.

Help is provided for vulnerable customers during power cuts and where possible advice is provided to enable them to be prepared should a power cut occur.

Strategic report (continued)

For the year ended 31 March 2018

Corporate and social responsibility (continued)

Human rights issues (continued)

Project Inspire

Working with the charity and think tank Sustainability First, WPD sponsored 'Project Inspire' alongside Ofgem, the Department for Business Energy & Industrial Strategy (BEIS) and energy suppliers. The aim was to identify how businesses are using innovative technology to meet the current and future needs of vulnerable customers. Over 100 global organisations took part, with best practice highlighted across energy, water and financial institutions. WPD won a silver and two gold awards for our proactive PSR cleansing, vulnerability horizon scan and use of two-way text messaging respectively.

Fuel poverty and energy affordability

Some customers on low incomes cannot afford to use electricity to effectively heat their properties. There is growing concern that customers will suffer as economic growth remains uncertain and austerity measures affect fuel poor customers further. Whilst WPD does not have a direct obligation to provide energy efficiency advice/support, in 2013 we introduced a social obligations strategy that is updated and reviewed by our Chief Executive annually, and includes actions WPD will take to address fuel poverty by helping customers to access information and key support. In recent years we have worked with expert partners such as the Centre for Sustainable Energy, the charity National Energy Action and with the Energy Saving Trust to provide information for our customers on the causes of and solutions for fuel poverty.

WPD has been working with the Coventry Citizens' Advice Bureau ("CAB") since 2014 to deliver an innovative fuel poverty referral scheme called 'Power Up'. The project helps customers by offering income and energy efficiency advice, such as benefits and tariffs advice and energy saving schemes. The service offers free, independent, confidential and impartial advice. The project works by partner organisations such as CAB taking referrals directly from WPD (following calls proactively made to vulnerable customers as part of WPD's update of the Priority Services Register).

Building on this successful model we have replicated this project and now have four 'Power Up' referral schemes – one in each of our regions working with CAB in the Midlands, Energy Saving Trust in South Wales and the Centre for Sustainable Energy in the South West. Every customer contacted as part of WPD's PSR data cleanse is given the opportunity to be referred to a partner organisation, such as Citizens' Advice and the Centre for Sustainable Energy, for support. Based on feedback from our Customer Panel customers are offered free, independent, confidential and impartial advice on:

1. Income maximisation (e.g. benefits and debt advice)
2. Tariff switching assistance
3. Energy efficiency measures (e.g. access to local insulation schemes)
4. Boiler replacements
5. Behavioural changes (e.g. efficient use of heating systems)
6. Health & wellbeing measures

In 2017/18, these projects supported over 15,000 fuel poor customers across WPD, leading to total annual savings of over £5.3m for these customers.

In 2017 we launched a fifth referral scheme 'Power Up Health' with our partner Air Liquide, aimed specifically at oxygen dependent customers. This is being trialled in the South West, where Air Liquide supports over 9,000 customers. In the first three months we delivered total annual savings of over £25,000 through this scheme.

Strategic report (continued)

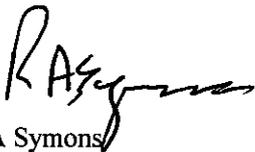
For the year ended 31 March 2018

Human rights issues (continued)

Fuel poverty and energy affordability (continued)

We also support four Affordable Warmth schemes (one per licence area) which deliver the same six fuel poverty interventions, but they do not receive referrals from WPD. Instead we have formed partnerships with existing, fuel poverty outreach programmes who via their existing front-line services seek to identify hard-to-reach customers not already known to WPD.

By Order of the Board



RA Symons
Chief Executive Officer

19 July 2018

Western Power Distribution (South West) plc

Avonbank
Feeder Road
Bristol
BS2 0TB

Directors' report

For the year ended 31 March 2018

Registered company number

The Company's registered number is 2366894.

Ownership

WPD South West is an indirect, wholly-owned subsidiary of Western Power Distribution plc which is owned by PPL Corporation, an electricity utility of Allentown, Pennsylvania, US.

There were no transactions between WPD South West and the ultimate owner other than the settlement of the value of shares issued to the Company's executive directors as part of their remuneration.

Results, dividends and share issue

The profit for the financial year 2018 is £147.7m (2017: £181.9m).

The Company also reports other comprehensive losses, which were posted directly to capital and reserves, of £11.0m (2017: £39.1m loss). This primarily relates to the defined benefit pension plan remeasurement, net of tax.

In 2018, dividends of £94.9m were paid by the Company (2017: £24.4m).

No share capital was issued by the Company in the year (2017: £75.0m).

Political donations and expenditure

WPD is a politically neutral organisation and, during the year, made no political donations.

Financial risk management objectives and policies

WPD does not undertake transactions in financial derivative instruments for speculative purposes. All debt in WPD South West is denominated in sterling and therefore there is no currency risk exposure relating to debt.

The Company holds a \$53.0m investment of US dollar denominated debt issued by another WPD Group company. Any foreign exchange movements are reflected in the profit and loss account. There is no exposure for the WPD Group as a whole.

For further details of risks in relation to treasury operations, see the "principal risks and uncertainties" section of the Strategic report.

Liquidity and going concern

On a day-to-day basis, WPD South West provides liquidity to the whole of WPD with balances with other group companies being settled periodically. It has borrowing arrangements in place with a range of third parties with high credit ratings. At 31 March 2018, WPD South West had committed borrowing facilities available in respect of which all conditions precedent had been met at that date of £245.0m maturing in July 2021, of which none was drawn. In addition, it had uncommitted facilities of £110.0m of which £15.0m can only be used for the issue of letters of credit; at 31 March 2018 no borrowings had been drawn and letters of credit of £3.8m were issued.

In addition, at 31 March 2018 the WPD Group's parent, Western Power Distribution plc, had a £210.0m committed borrowing facility that expires in January 2023 of which all conditions precedent had been met at that date; at 31 March 2018, it had drawn £141.4m against these facilities and thus had £68.6m undrawn. Furthermore WPD West Midlands and WPD East Midlands together had committed borrowing facilities of £600.0m, of which WPD East Midlands had £130.0m drawn as at 31 March 2018 and WPD West Midlands had £19.0m drawn.

The four WPD DNOs also have access to an uncommitted facility from which any DNO can draw but which in aggregate cannot exceed £20m. No borrowings had been drawn against this facility as at 31 March 2018.

Director's report (continued)

For the year ended 31 March 2018

Financial risk management objectives and policies (continued)

Liquidity and going concern (continued)

At 31 March 2018, WPD South West had £1,027.8m (2017: £849.4m) of external debt outstanding of which £25.3m (2017: £105.4m) was due within one year. The Company has net current liabilities of £17.2m (2017: £191.5m) of which £nil (2017: £80.0m) is represented by short term borrowings, £25.3m (2017: £25.4m) by bank loans and overdrafts and £66.6m (2017: £76.0m) by amounts due to companies within the WPD group. The Company had cash and short term deposits of £93.6m (2017: £21.6m). The Company's net current liabilities will be settled with a combination of cash flows from operating activities and use of existing facilities.

After consideration, the directors of the Company have concluded that the Company has sufficient resources available to enable it to continue in existence for the foreseeable future and at least for a period of 12 months from the date of signing the accounts and have therefore continued to adopt the going concern basis in preparing the financial statements. This consideration included an assessment of the net current liabilities, the availability of facilities as set out above, the relatively stable and regulated nature of the business, the forecast long term business plan, and the anticipated ability of the Company to be able to raise additional long term debt in the future.

Dividend policy

The WPD Group is structured such that a proportion of the WPD Group's debt is issued by Group companies other than WPD South West, WPD South Wales, WPD East Midlands and WPD West Midlands. Interest payments on this debt, together with other items, are funded primarily through dividend payments from WPD South Wales, WPD South West, WPD East Midlands and WPD West Midlands.

Strategic report

The following information required in the Directors' report has been included in the Strategic report:

- an indication of future developments in the business - see page 2;
- an indication of activities of the Company in the field of research and development - see page 14;
- a statement on the policy for disabled employees - see page 22;
- employee policies - see pages 22-23;
- greenhouse gas (carbon) emissions - see page 22.

Directors and their interests

The directors who served during the year and up to the date of signing the financial statements, unless otherwise stated, were as follows:

| | <u>Appointed</u> |
|--|------------------|
| RA Symons, Chief Executive | 23 October 1997 |
| DCS Oosthuizen, Finance Director (resigned 31 March 2018) | 1 June 1999 |
| P Swift, Operations Director | 1 July 2013 |
| IR Williams, Resources and External Affairs Director (resigned 31 March 2018) | 9 March 2015 |
| IR Williams, Finance Director | 1 April 2018 |
| AJ Sleightholm, Resources and External Affairs Director | 1 April 2018 |
| WH Spence, non-executive director and Chairman, President and Chief Executive Officer PPL Corporation (resigned 31 July 2017) | 16 July 2015 |
| ME Fletcher, non-executive independent director | 31 October 2011 |
| CR Watts, non-executive independent director (deceased 3 July 2017) | 1 April 2014 |
| AJ Cardew, non-executive independent director | 23 March 2017 |

Director's report (continued)

For the year ended 31 March 2018

Directors and their interests (continued)

During and at the end of the financial year, no director was interested in any contract of significance in relation to the Company's business other than service contracts. Insurance in respect of directors and officers is maintained by the WPD Group's ultimate parent, PPL Corporation. The insurance is third party qualifying insurance and is subject to the conditions set out in the Companies Acts and remains in force at the date of signing the Directors' report.

Subsequent events

There have been no significant events since the balance sheet date that require disclosure.

Regulatory financial statements

As a condition of its Electricity Distribution Licence, the Company is required to prepare and publish separate financial statements for its distribution business for each year ending 31 March. The Company will publish information on its website and this information will also be available from the Company's registered office as shown below.

Statement of disclosure to independent auditor

So far as each person who was a director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware. Having made enquiries of fellow directors and the Company's auditor, each director has taken all the steps that he/she is obliged to take as a director in order to make himself/herself aware of any relevant audit information and to establish that the auditor is aware of that information.

Independent auditor

Deloitte LLP have expressed their willingness to continue in office and a resolution proposing their re-appointment will be put before the Annual General Meeting.

By Order of the Board



RA Symons
Chief Executive Officer
19 July 2018

Western Power Distribution (South West) plc

Avonbank
Feeder Road
Bristol BS2 0TB

Directors' responsibilities statement

The directors are responsible for preparing the Annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom accounting standards and applicable law), including Financial Reporting Standard ("FRS") 101 "Reduced Disclosure Framework". Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that year. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Independent auditor's report to the members of Western Power Distribution (South West) plc

Report on the audit of the financial statements

Opinion

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 March 2018 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including Financial Reporting Standard 101 "Reduced Disclosed Framework"; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements of Western Power Distribution (South West) plc which comprise:

- the profit and loss account;
- the statement of comprehensive income;
- the statement of changes in equity;
- the balance sheet;
- the statement of cash flows; and
- the related notes 1 to 26.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 101 "Reduced Disclosure Framework" (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs(UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the Company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Summary of our audit approach

Key audit matters

The key audit matters that we identified in the current year were:

- Capitalisation of overheads; and
- Uncertain tax positions.

Materiality

The materiality that we used in the current year was £8.8m which was determined on the basis of 5% of profit before tax.

Scoping

Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.

Independent auditor's report to the members of Western Power Distribution (South West) plc (continued)

Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where:

- the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of these matters.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

- **Capitalisation of overheads**

Key audit matter description

Amounts capitalised as network assets include indirect costs associated with the engineering department and an element of corporate overhead costs. The costs are capitalised based on management's assessment of the costs incurred that are directly attributable to the capital work performed.

A key audit matter has been identified in respect of the key assumptions. There are two key judgements in relation to the capitalisation of engineering indirect costs and corporate overheads:

1. the nature of costs included within each cost classification; and
2. the appropriate percentage of costs to capitalise.

Due to the management judgements in assessing the value to be capitalised, we have determined that there was a potential for fraud through possible manipulation.

Total engineering indirect costs and corporate overheads are £104.9m in the year (2017: £92.5m), of which £69.6m (2017: £66.3m) has been capitalised to fixed assets.

Refer to note 2 'significant accounting policies' and note 12 'tangible fixed assets' in the financial statements for further discussion of the policy and judgements in capitalisation of overheads.

How the scope of our audit responded to the key audit matter

We have performed the following procedures around this key audit matter:

- Evaluated the design and implementation of the key controls related to the classification of overheads as capitalisation expenditure and appropriate percentage of costs to capitalise.
- Evaluated the appropriateness of the accounting treatment for capitalising overheads by reference to the requirements of IAS 16 Property, Plant and Equipment.

We have tested an audit sample of costs capitalised. We have tested the percentage of costs capitalised through testing the inputs into management's assessment of the capitalisation rate and have tested the allocation of the individual cost categories capitalised on a line by line basis.

Independent auditor's report to the members of Western Power Distribution (South West) plc (continued)

Key audit matters - Capitalisation of overheads (continued)

Key observations

The results of our procedures were satisfactory. On the basis of these procedures we conclude that the capital expenditure recorded is appropriate.

● **Uncertain tax positions**

Key audit matter description

Management uses its judgement in applying the Corporate Interest Restriction Rules introduced with the Finance Act in 2017 to determine the value of interest which can be deducted in arriving at taxable profit. This is a key audit matter due to the significance of the judgement.

Refer to note 2 'significant accounting policies' and note 8 'taxation' in the financial statements for further discussion of the policy and judgements in respect of taxation.

How the scope of our audit responded to the key audit matter

We have performed the following procedures around this key audit matter:

- Evaluated the design and implementation of key controls related to the key tax judgements.

In conjunction with our taxation audit specialist, we have assessed the assumptions and judgements used by management in determining the interest deductible in arriving at taxable profit is reasonable.

Key observations

From the work performed we are satisfied that the assumptions made are reasonable.

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Materiality: £8.8m

Basis for determining materiality: 5% of the profit before tax

Rationale for the benchmark applied: Profit before tax is determined to be the key metric of the users of the financial statements

We agreed with the Board of Directors that we would report all audit differences in excess of £442,400 as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Board of Directors on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Our audit was scoped by obtaining an understanding of the entity and its environment, including internal control, and assessing the risks of material misstatement. Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.

Independent auditor's report to the members of Western Power Distribution (South West) plc (continued)

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Use of our report

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Independent auditor's report

to the members of Western Power Distribution (South West) plc (continued)

Report on other legal and regulatory requirements

Opinions on other matter prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic report and Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic report and the Directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified any material misstatement in the Strategic report or the Directors' report.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report in respect of the following matters if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made.

We have nothing to report in respect of these matters.

Other matters

Auditor tenure

Following the recommendation of the Board of Directors, we were appointed by the shareholders on 16 June 2017 to audit the financial statements for the year ending 31 March 2017 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is two years, covering years ending 31 March 2017 to 31 March 2018.

**Independent auditor's report
to the members of Western Power Distribution (South West) plc (continued)**

Other matters (continued)

Consistency of the audit report with the additional report to the Board of Directors

Our audit opinion is consistent with the additional report to those charged with governance we are required to provide in accordance with ISAs (UK).

Delyth Jones

Delyth Jones, Senior Statutory Auditor
for and on behalf of Deloitte LLP
Statutory Auditor
Bristol, United Kingdom
24 July 2018

Profit and loss account

For the year ended 31 March 2018

| | Note | 2018 £m | 2017 £m |
|---|------|----------------|------------|
| Turnover | 4 | 364.4 | 372.2 |
| Operating expenses | 5 | (138.3) | (126.8) |
| Operating profit | 6 | 226.1 | 245.4 |
| (Expense)/Income from fixed asset investments | | (4.9) | 5.6 |
| Profit on sale of fixed assets | | 0.2 | 0.5 |
| Profit before interest and taxation | | 221.4 | 251.5 |
| Interest receivable and similar income | 7 | 3.3 | 3.3 |
| Interest payable and similar charges | 7 | (45.8) | (40.4) |
| Net interest expense relating to pensions and other post-retirement benefits | 21 | (2.0) | (3.7) |
| Profit before taxation | | 176.9 | 210.7 |
| Tax on profit | 8 | (29.2) | (28.8) |
| Profit for the financial year | | 147.7 | 181.9 |

All activities relate to continuing operations.

The accompanying notes are an integral part of these financial statements.

Statement of comprehensive income

For the year ended 31 March 2018

| | Note | 2018 £m | 2017 £m |
|--|------|---------------|------------|
| Profit for the year | | 147.7 | 181.9 |
| Other comprehensive gain/(loss): | | | |
| <i>Other comprehensive income/(loss) to be reclassified to profit or loss in subsequent periods:</i> | | | |
| Gains arising on cash flow hedges during the year | | 1.3 | - |
| Reclassification adjustments for gains on cash flow hedges included in profit or loss (interest payable) | | (0.1) | (0.1) |
| Income tax effect | | (0.2) | - |
| | | 1.0 | (0.1) |
| <i>Other comprehensive loss not to be reclassified to profit or loss in subsequent periods:</i> | | | |
| Re-measurement losses on defined benefit pension plan | 21 | (14.8) | (48.8) |
| Income tax effect | | 2.8 | 9.8 |
| | | (12.0) | (39.0) |
| Other comprehensive loss for the year, net of tax | | (11.0) | (39.1) |
| Total comprehensive income for the year, net of tax, attributable to equity holders of the parent | | 136.7 | 142.8 |

Statement of changes in equity

For the year ended 31 March 2018

| | Note | Share capital £m | Share premium account £m | Capital redemption reserve £m | Hedging reserve £m | Profit and loss account £m | Total equity £m |
|--|------|---------------------|--------------------------------|-------------------------------------|--------------------------|-------------------------------------|-----------------------|
| At 1 April 2016 | | 363.2 | 4.1 | 6.2 | 1.0 | 285.4 | 659.9 |
| Profit for the year | | - | - | - | - | 181.9 | 181.9 |
| Other comprehensive loss | | - | - | - | (0.1) | (39.0) | (39.1) |
| Total comprehensive income for the year | | - | - | - | (0.1) | 142.9 | 142.8 |
| Issue of equity shares | | 75.0 | - | - | - | - | 75.0 |
| Equity dividends paid | 9 | - | - | - | - | (24.4) | (24.4) |
| At 31 March 2017 | | 438.2 | 4.1 | 6.2 | 0.9 | 403.9 | 853.3 |
| Profit for the year | | - | - | - | - | 147.7 | 147.7 |
| Other comprehensive gain/(loss) | | - | - | - | 1.0 | (12.0) | (11.0) |
| Total comprehensive income for the year | | - | - | - | 1.0 | 135.7 | 136.7 |
| Equity dividends paid | 9 | - | - | - | - | (94.9) | (94.9) |
| At 31 March 2018 | | 438.2 | 4.1 | 6.2 | 1.9 | 444.7 | 895.1 |

Balance sheet

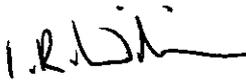
As at 31 March 2018

| | Note | 2018 £m | 2017 £m |
|--|------|----------------|----------------|
| Non-current assets | | | |
| Tangible fixed assets | 12 | 2,582.6 | 2,399.0 |
| Intangible assets | 13 | 14.0 | 7.3 |
| Investments | 14 | 37.8 | 42.4 |
| | | 2,634.4 | 2,448.7 |
| Current assets | | | |
| Stocks | 15 | 8.4 | 8.0 |
| Debtors | 16 | 104.8 | 86.4 |
| Cash at bank and in hand | 17 | 93.6 | 21.6 |
| | | 206.8 | 116.0 |
| Creditors | | | |
| Amounts falling due within one year | 18 | (224.0) | (307.5) |
| | | (17.2) | (191.5) |
| Net current liabilities | | | |
| | | (17.2) | (191.5) |
| Total assets less current liabilities | | | |
| | | 2,617.2 | 2,257.2 |
| Creditors | | | |
| Amounts falling due after more than one year | 18 | (1,504.1) | (1,217.8) |
| Provisions for liabilities | | | |
| Deferred tax | 20 | (109.0) | (108.9) |
| Other | 19 | (8.4) | (13.2) |
| Pension liability | | | |
| | 21 | (100.6) | (64.0) |
| Net assets | | | |
| | | 895.1 | 853.3 |
| Capital and reserves | | | |
| Called-up share capital | 22 | 438.2 | 438.2 |
| Share premium account | 23 | 4.1 | 4.1 |
| Capital redemption reserve | 23 | 6.2 | 6.2 |
| Hedging reserve | 23 | 1.9 | 0.9 |
| Profit and loss account | 23 | 444.7 | 403.9 |
| Equity shareholders' funds | | | |
| | | 895.1 | 853.3 |

The accompanying notes are an integral part of these financial statements.

The financial statements of the Company (registered number 2366894) on pages 36 to 66 were approved by the Board of Directors on 19 July 2018 and were signed on its behalf by:


RA Symons
Chief Executive


IR Williams
Finance Director

Statement of cash flows

For the year ended 31 March 2018

| | Note | 2018 £m | 2017 £m |
|---|------|----------------|----------------|
| Operating activities | | | |
| Profit for the year | | 147.7 | 181.9 |
| Adjustments to reconcile profit for the year to net cash flow from operating activities: | | | |
| Tax expense | | 29.2 | 28.8 |
| Interest payable | | 47.8 | 44.1 |
| Interest receivable | | (3.3) | (3.3) |
| Depreciation of tangible fixed assets | 6 | 46.3 | 43.9 |
| Amortisation of customer contributions | | (8.7) | (7.9) |
| Amortisation of intangible assets | | 1.5 | 2.5 |
| Gain on disposal of tangible fixed assets | | (0.2) | (0.5) |
| Foreign exchange loss/(gain) on fixed asset investment | | 4.6 | (5.6) |
| Difference between pension contributions paid and amounts recognised in the profit and loss account | | 19.8 | (130.6) |
| (Increase)/decrease in provisions | | (4.8) | 3.3 |
| Working capital adjustments: | | | |
| Increase in inventories | | (0.4) | (1.0) |
| Increase in trade and other receivables | | (23.4) | (13.5) |
| (Decrease)/increase in trade and other payables | | (9.2) | 9.3 |
| Interest paid | | (30.1) | (32.6) |
| Interest received | | 3.3 | 3.3 |
| Income taxes paid | | (11.0) | (16.2) |
| Net cash from operating activities | | 209.1 | 105.9 |
| Investing activities | | | |
| Purchase of tangible fixed assets | | (227.3) | (239.4) |
| Customers' contributions received | | 35.7 | 35.1 |
| Proceeds from sale of tangible fixed assets | | 0.5 | 0.8 |
| Transfers from Group | | (0.4) | - |
| Purchase of intangible assets | | (8.2) | (2.0) |
| Net cash used in investing activities | | (199.7) | (205.5) |
| Financing activities | | | |
| Net proceeds from issue of share capital | | - | 75.0 |
| Net (decrease)/increase in short-term borrowings | | (80.0) | 45.0 |
| Proceeds from long-term borrowings | | 246.3 | - |
| Movement in balances with Group undertakings | | (8.7) | (8.4) |
| Dividends or equivalent distributions paid | | (94.9) | (24.4) |
| Net cash from financing activities | | 62.7 | 87.2 |
| Net increase/(decrease) in cash at bank and in hand | | 72.1 | (12.4) |
| Cash at bank and in hand at beginning of year | 17 | (3.8) | 8.6 |
| Cash at bank and in hand at end of year | 17 | 68.3 | (3.8) |

Notes to the financial statements

For the year ended 31 March 2018

1. Authorisation of financial statements and statement of compliance with FRS 101

The financial statements of Western Power Distribution (South West) plc ("the Company") for the year ended 31 March 2018 were authorised for issue by the Board of Directors on 19 July 2018 and the balance sheet was signed on the Board's behalf by RA Symons and IR Williams. The Company is a public limited company, limited by shares and incorporated and registered in England and Wales.

The Company meets the definition of a qualifying entity under FRS 100 "Application of Financial Reporting Requirements".

2. Significant accounting policies

Basis of preparation

These financial statements were prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework ("FRS 101") and in accordance with applicable accounting standards.

As permitted by FRS 101, the Company has taken advantage of the disclosure exemptions available under that standard in relation to financial instruments, capital management, presentation of comparative information in respect of certain assets, standards not yet effective, related party transactions and share based payments.

Where required, equivalent disclosures are given in the group accounts of Western Power Distribution plc. The group accounts of Western Power Distribution plc are available to the public and can be obtained as set out in note 26.

The financial statements have been prepared on the historical cost basis. Historical cost is generally based on the fair value of the consideration given in exchange for goods and services.

The Company's financial statements are presented in Sterling and all values are rounded to the nearest hundred thousand pounds except when otherwise indicated.

The principal accounting policies adopted are set out below.

Going concern

The directors have prepared the financial statements on a going concern basis as they have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. This is discussed further under 'Financial risk management objectives and policies' within the Directors' report.

Group financial statements

Group financial statements have not been prepared as the Company has taken advantage of the relief under s400 of the Companies Act 2006. The results of the Company are consolidated in the financial statements of Western Power Distribution plc. These financial statements therefore present information about the Company and not the Western Power Distribution (South West) plc Group.

Turnover

Turnover is recognised to the extent that it is probable that economic benefits will flow to the Company and that the turnover can be reliably measured. Turnover comprises primarily use of energy system income. Turnover includes an assessment of the volume of unbilled energy distributed to customers between the date of the last meter reading and the year end. Remaining sales relate to the invoice value of other goods and services provided which also relate to the electricity network.

Notes to the financial statements

For the year ended 31 March 2018

2. Significant accounting policies (continued)

Turnover (continued)

Where turnover received or receivable exceeds the maximum amount permitted by regulatory agreement and adjustments will be made to future prices to reflect this over-recovery, no liability is recognised as such an adjustment to future prices relates to the provision of future services. Similarly no asset is recognised where a regulatory agreement permits adjustments to be made to future prices in respect of an under-recovery.

Contributions

Contributions receivable in respect of tangible fixed assets are treated as deferred income, which is credited to the profit and loss account over the estimated weighted life of the related assets of 69 years.

Finance costs

Finance expenses comprise interest payable on borrowings, accretion relating to inflation on index linked debt, the release of discount on provisions, and interest on pension scheme liabilities. Interest charges are recognised in the profit and loss account as they accrue, on an effective rate basis.

Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

WPD South West as a lessee

Leases where the lessor retains a significant portion of the risks and benefits of ownership of the assets are classified as operating leases and rentals payable are charged to the profit and loss account on a straight line basis over the lease term.

WPD South West as a lessor

Assets leased out under operating leases are include in tangible fixed assets and depreciated over the estimated useful lives. Rental income, including the effect of lease incentives, is recognised on a straight line basis over the term of the lease.

Tangible fixed assets

Tangible fixed assets are stated at cost less accumulated depreciation and impairments. Borrowing costs directly attributable to assets under construction and which meet the recognition criteria in International Accounting Standard ("IAS") 23 are capitalised as part of the cost of that asset.

Expenditure on electricity infrastructure assets relating to increases in capacity or enhancements of the network including qualifying replacement expenditure are treated as additions. Other costs incurred in maintaining the operating capability of the network in accordance with defined standards of service are expensed in the year in which the expenditure is incurred.

Cost comprises the aggregate amount paid and the fair value of any other consideration given to acquire the asset and includes costs directly attributable to making the asset capable of operating as intended. Employee costs incurred in implementing capital schemes are capitalised within infrastructure assets together with the cost of materials and an appropriate proportion of production overheads.

Contributions received towards the cost of tangible fixed assets which include low carbon network funding are included in trade and other payables as deferred income and credited on a straight-line basis to the profit and loss account over the estimated economic useful lives of the assets to which they relate.

Notes to the financial statements

For the year ended 31 March 2018

2. Significant accounting policies (continued)

Tangible fixed assets (continued)

Depreciation is provided on all tangible fixed assets, other than land, on a straight-line basis over its expected useful life as follows:

| | <u>Years</u> |
|---|--------------|
| Distribution network assets: | |
| Overhead lines and poles | 65 |
| Underground cables | 85 |
| Plant and machinery (transformers and switchgear) | 55 |
| Meters | 3 |
| Other (towers and substation buildings) | Up to 80 |
| Buildings - freehold | Up to 60 |
| Buildings - long leasehold | Up to 60 |
| Fixtures and equipment | Up to 20 |
| Vehicles and mobile plant | Up to 10 |

The carrying values of tangible fixed assets are reviewed for impairment if events or changes in circumstances indicate the carrying value may not be recoverable, and are written down immediately to their recoverable amount. Useful lives and residual values are reviewed annually and where adjustments are required these are made prospectively. An item of tangible fixed assets is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the derecognition of the asset is included in the profit and loss account in the period of derecognition.

Intangible assets

Costs directly associated with the development of computer software for internal use are capitalised where technical feasibility can be demonstrated, the Company is satisfied that future economic benefits will flow to the Company and the cost can be separately identified and reliably measured. Software is measured initially at cost and amortised on a straight-line basis over its estimated useful life. Carrying amount is reduced by any provision for impairment where necessary. The estimated useful life assigned to computer software is up to five years.

Stocks

Stocks are stated at the lower of cost and net realisable value. Cost is determined using the weighted average method and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. It excludes borrowing costs.

Taxation

Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities, based on tax rates and laws that are enacted or substantively enacted by the balance sheet date.

Deferred income tax is recognised on all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements, with the following exceptions:

- where the temporary difference arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss;
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future; and

Notes to the financial statements

For the year ended 31 March 2018

2. Significant accounting policies (continued)

Taxation (continued)

- deferred income tax assets are recognised only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, carried forward tax credits or tax losses can be utilised.

Deferred income tax assets and liabilities are measured on an undiscounted basis at the tax rates that are expected to apply when the related asset is realised or liability is settled, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date. Deferred income tax assets and liabilities are offset only if a legally enforceable right exists to set off current tax assets against current tax liabilities, the deferred income taxes relate to the same taxation authority and that authority permits the Company to make a single net payment.

Income tax is charged or credited to other comprehensive income if it relates to items that are charged or credited to other comprehensive income. Similarly, income tax is charged or credited directly to equity if it relates to items that are credited or charged directly to equity. Otherwise income tax is recognised in the profit and loss account.

Pension benefits

The Company participates in one defined benefit pension plan, which is a section of the industry-wide Electricity Supply Pension Scheme ('ESPS'). The ESPS scheme is, with very limited exception, closed to new members. A defined contribution plan is offered to new employees.

The ESPS is a group defined benefit pension plan that shares risks between entities under common control. Under FRS 101, the scheme has been accounted for as a defined benefit scheme by the Company as it has legal responsibility for the plan which it holds jointly with WPD South Wales. The net defined benefit cost and net deficit of the plan have been allocated to WPD South West and WPD South Wales in accordance with pensionable salaries.

The cost of providing benefits under the defined benefit plan is determined using the projected unit credit method, which attributes entitlement to benefits to the current period (to determine current service cost) and to the current and prior periods (to determine the present value of defined benefit obligation) and is based on actuarial advice. Past service costs, resulting from either a plan amendment or a curtailment (a reduction in future obligations as a result of a material reduction in the plan membership), are recognised immediately when amendments or curtailments occur. The current service cost (including administration costs) is allocated to the profit and loss account or capital expenditure as appropriate.

Net interest expense related to pension benefits represents the net change in the present value of plan obligations and the value of plan assets resulting from the passage of time, and is determined by applying the discount rate to the present value of the benefit obligation at the start of the year and to the fair value of plan assets at the start of the year, taking into account expected changes in the obligation or plan assets during the year. Net interest expense relating to pension benefits is recognised in the profit and loss account.

Remeasurement of the net defined benefit liability or asset, comprising actuarial gains or losses, and the return on plan assets (excluding amounts included in net interest described above) are recognised within other comprehensive income in the period in which they occur.

Notes to the financial statements

For the year ended 31 March 2018

2. Significant accounting policies (continued)

Pension benefits (continued)

The defined benefit pension plan surplus or deficit in the balance sheet comprises the total of the present value of the defined benefit obligation (using a discount rate based on high quality corporate bonds), less the fair value of plan assets out of which the obligations are to be settled directly. Fair value is based on the market price information and in the case of quoted securities is the published bid price.

Contributions to defined contribution schemes are recognised in the profit and loss account or capital expenditure as appropriate in the year in which they become payable.

Share-based payments

The cost of cash-settled transactions is measured at fair value using an appropriate option pricing model. Fair value is established at each balance sheet date from grant date until the awards are settled. During the vesting period a liability is recognised representing the product of the fair value of the award and the portion of the vesting period expired as at the balance sheet date. From the end of the vesting period until settlement, the liability represents the full fair value of the award as at the balance sheet date. Changes in the carrying amount of the liability are recognised in profit or loss for the year.

Provisions

Provisions are recognised when the Company has a legal or constructive obligation as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. If the effect is material, expected future cash flows are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability.

Dividend distribution

Dividend distribution to the Company's shareholder is recognised as a liability in the financial statements in the year in which the dividends are approved by the Company's directors.

Financial assets

Financial assets are classified as loans and receivables; financial assets at fair value through profit or loss; derivatives designated as hedging instruments in an effective hedge; held-to-maturity financial assets; or as available-for-sale financial assets, as appropriate. The Company's financial assets include cash at bank and in hand, trade receivables, other receivables, loans and other investments. The Company determines the classification of its financial assets at initial recognition. Financial assets are recognised initially at fair value, normally being the transaction price plus, in the case of financial assets not at fair value through profit or loss, directly attributable transaction costs.

The subsequent measurement of financial assets depends on their classification as follows:

Loans and receivables

Loans and receivables are carried at amortised cost using the effective interest method. Trade and other debtors are recognised and carried at the lower of their original invoiced amount and recoverable amount. Provision for impairment is made through the profit and loss account when there is objective evidence that the Company will not be able to recover balances in full. Balances are written off when the probability of recovery is assessed as being remote.

Cash equivalents are short-term highly liquid investments that are readily convertible to known amounts of cash, are subject to insignificant risk of changes in value and have a maturity of three months or less from the date of acquisition.

Notes to the financial statements

For the year ended 31 March 2018

2. Significant accounting policies (continued)

Financial assets (continued)

Held to maturity investments

Held to maturity financial assets are measured at amortised cost using the effective interest method, less any impairment.

Financial liabilities

Financial liabilities are classified as financial liabilities at fair value through profit or loss; derivatives designated as hedging instruments in an effective hedge; or as financial liabilities measured at amortised cost, as appropriate. The Company's financial liabilities include trade and other payables, accruals and interest bearing loans and borrowings. The Company determines the classification of its financial liabilities at initial recognition.

The measurement of financial liabilities depends on their classification, as follows:

Financial liabilities measured at amortised cost

All financial liabilities are initially recognised at fair value. For interest-bearing loans and borrowings this is the fair value of the proceeds received net of directly attributable issue costs.

After initial recognition, interest bearing loans are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs and any discount or premium on settlement. Gains and losses arising on the repurchase, settlement or cancellation of liabilities are recognised respectively in interest and other income and finance costs.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of an asset that necessarily take a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of the respective assets. All other borrowing costs are expensed in the period in which they occur. Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds.

3. Critical accounting judgements and key sources of estimation uncertainty

In the application of the Company's accounting policies, which are described in note 2, the directors are required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

Critical judgements in applying the Company's accounting policies

The following is the critical judgement, apart from those involving estimations (which are dealt with separately below), that the directors have made in the process of applying the Company's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Notes to the financial statements

For the year ended 31 March 2018

3. Critical accounting judgements and key sources of estimation uncertainty (continued)

Capitalisation of overheads

Indirect costs are initially charged to the profit and loss account. A proportion is then capitalised based on an assessment of the allocation of direct costs between operating activities and those which are capitalised as they provide long term benefit.

Key sources of estimation uncertainty

The key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting period that may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

Pension obligations

The Company has a commitment, mainly through the ESPS, to pay pension benefits. The cost of these benefits and the present value of the Company's pension liabilities depend on such factors as the life expectancy of the members, the salary progression of current employees, the return that the pension fund assets will generate in the time before they are used to fund the pension payments and the discount rate at which the future pension payments are discounted. Based on advice from external actuaries, the Company uses estimates for all these factors in determining the pension costs and liabilities incorporated in the financial statements. The assumptions reflect historical experience and management's judgement regarding future expectations. Refer to note 21 for sensitivity information.

4. Segmental reporting

Substantially all of the Company's turnover and profit before tax are derived from the delivery of electricity across its distribution network in the United Kingdom and related activities.

Revenue from its five largest customers amounted to £102.6m, £63.4m, £45.9m, £40.8m and £40.1m (2017: £114.5m, £69.9m, £48.6m, £44.1m and £42.8m).

Other sources of revenue are not material and so are not shown separately.

5. Operating expenses

The directors consider that the nature of the business is such that the analysis of expenses shown below is more informative than that set out in the formats specified by the Companies Act 2006.

| | 2018 | 2017 |
|--|--------------|-------|
| | £m | £m |
| Employee benefit expense (note 10) | 32.5 | 28.5 |
| Depreciation | 46.3 | 43.9 |
| Amortisation of intangible assets | 1.5 | 2.5 |
| Amortisation of customer contributions | (8.7) | (8.2) |
| Property taxes | 19.1 | 15.9 |
| Other operating charges | 47.6 | 44.2 |
| | 138.3 | 126.8 |

Notes to the financial statements

For the year ended 31 March 2018

6. Operating profit

| | 2018 £m | 2017 £m |
|---|------------|------------|
| Operating profit is stated after charging/(crediting): | | |
| Depreciation* | 46.3 | 43.9 |
| Amortisation of intangible assets | 1.5 | 2.5 |
| Operating lease rentals: | | |
| Plant, machinery and equipment | 1.2 | 1.5 |
| Land and buildings | 2.2 | 2.2 |
| Amortisation of customer contributions | (8.7) | (8.2) |
| Research and development expenditure ** | 0.1 | 0.1 |
| Auditors' remuneration: | | |
| Fees payable to the Company's auditor for the audit of the Company's annual accounts | 0.2 | 0.2 |
| Non audit fee | - | - |

* Depreciation is stated net of depreciation capitalised of £9.7m (2017: £10.3m) in respect of equipment consumed during the construction of the electricity network.

** Research and development costs above exclude expenditure on Low Carbon Network and Network Innovation Allowance projects which is capitalised together with associated funding received.

7. Net interest expense

| | 2018 £m | 2017 £m |
|---|--------------|--------------|
| Interest receivable | | |
| Interest on loans to other WPD undertakings | (3.0) | (3.1) |
| Other | (0.3) | (0.2) |
| Total interest receivable | (3.3) | (3.3) |
| Interest payable | | |
| Interest payable on bank loans and overdrafts | 0.6 | 0.9 |
| Interest payable on loans from other WPD undertakings | 0.3 | 0.4 |
| Interest payable on other loans | 45.5 | 39.6 |
| Less: interest capitalised | (0.6) | (0.5) |
| Total interest payable | 45.8 | 40.4 |
| Net interest expense | 42.5 | 37.1 |

Interest in 2018 was capitalised at a rate of 2.2% (2017: 3.0%), based on the yield on the Company's borrowings.

Notes to the financial statements

For the year ended 31 March 2018

8. Tax

Tax charged to the profit and loss account:

| | 2018 £m | 2017 £m |
|--|-------------|-------------|
| Current tax: | | |
| UK corporation tax on profits for the year | 27.4 | 6.6 |
| Adjustment in respect of prior years | (1.0) | (1.1) |
| Deferred tax (note 20): | | |
| Relating to the origination and reversal of timing differences | 2.9 | 30.9 |
| Impact of tax rate change | (0.1) | (8.2) |
| Adjustment in respect of prior years | - | 0.6 |
| Tax expense in the profit and loss account | 29.2 | 28.8 |

The tax on the Company's profit before tax differs from the theoretical amount that would arise using the standard rate of corporation tax in the UK of 19% (2017: 20%) as follows:

| | 2018 £m | 2017 £m |
|--|-------------|-------------|
| Profit on ordinary activities before tax | 176.9 | 210.7 |
| Profit on ordinary activities before tax multiplied by standard rate of corporation tax in the UK of 19% (2017: 20%) | 33.6 | 42.1 |
| Effects of: | | |
| Expenses not deductible and income not taxable for tax purposes | (0.3) | 0.4 |
| Adjustments to tax charge in respect of prior years | (1.0) | (0.5) |
| Group relief received for free | (2.9) | (5.0) |
| Impact of tax rate change | (0.2) | (8.2) |
| Total tax expense reported in the profit and loss account | 29.2 | 28.8 |

In addition to the amount charged to the profit and loss account, the following amounts relating to tax have been recognised in other comprehensive income.

| | 2018 £m | 2017 £m |
|--|--------------|--------------|
| Deferred tax: | | |
| On cash flow hedges | 0.2 | - |
| On remeasurement loss on defined benefit pension scheme | (2.8) | (9.8) |
| Total tax credit in the statement of other comprehensive income | (2.6) | (9.8) |

Notes to the financial statements

For the year ended 31 March 2018

8. Tax (continued)

Change in corporation tax rate

From 1 April 2017 the standard rate of corporation tax was reduced from 20% to 19%. In addition the Finance Act 2016 reduced the standard rate of corporation tax to 17% from 1 April 2020. This future change has been enacted and the impact included in these financial statements.

9. Dividends

| | 2018 £m | 2017 £m |
|--|------------|------------|
| Dividends on equity shares: | | |
| Interim dividends - 10.8 pence per share (2017: 3.4 pence per share) | 94.9 | 24.4 |

10. Employee benefit expense

Employee benefit expense, including directors' remuneration, was as follows:

| | 2018 £m | 2017 £m |
|--|------------|------------|
| Wages and salaries | 78.2 | 77.8 |
| Social security costs | 9.1 | 9.1 |
| Pension costs | 20.1 | 14.1 |
| | 107.4 | 101.0 |
| Less: amounts capitalised | (74.9) | (72.5) |
| Charged to the profit and loss account | 32.5 | 28.5 |

There are no personnel, other than the directors, who as key management have authority and responsibility for planning, directing and controlling activities, directly or indirectly, of the Company.

The average number of employees during the year was 1,544 (2017: 1,534). All employees work for the network distribution activity. The number of staff and costs shown include a proportion of other WPD DNO staff who work in part for WPD South West, and exclude a proportion of WPD South West staff who work in part for other WPD DNOs.

Notes to the financial statements

For the year ended 31 March 2018

11. Directors' emoluments

The service contracts for the executive directors are with WPD South West. However, the emoluments detail given in this note represents total emoluments of the directors for all services provided to WPD companies as a whole. The total costs below are apportioned between WPD South Wales, WPD South West, WPD West Midlands and WPD East Midlands.

| WPD Group | Highest paid director | | Total | |
|---|-----------------------|--------------|--------------|--------------|
| | 2018 £000 | 2017 £000 | 2018 £000 | 2017 £000 |
| The emoluments of the executive directors comprised: | | | | |
| Base salary (note i) | 607 | 594 | 1,629 | 1,518 |
| Performance dependent bonus (note ii) | 580 | 552 | 1,201 | 1,097 |
| Pension compensation allowance (note iii) | - | - | 345 | 808 |
| Sub-total directors' remuneration | 1,187 | 1,146 | 3,175 | 3,423 |
| Long term incentive plan (note iv) | 691 | 1,245 | 1,250 | 2,509 |
| Fees to the independent non executive directors (notes v, vi) | - | - | 100 | 61 |
| | 1,878 | 2,391 | 4,525 | 5,993 |

(i) Base salary also includes benefits in kind.

(ii) The amount of the annual bonus is based on WPD's financial performance, the reliability of the electricity network, and other factors.

(iii) As a result of changes in tax applicable to UK pensions, the executive directors have resigned as active members of the Electricity Supply Pension Scheme ("ESPS" - note 21). Thus WPD no longer contributes for ongoing service to the ESPS in respect of the executive directors. Instead and subject to their service contract, WPD pays cash compensation to them individually equivalent to the value of WPD's contribution into the ESPS that would have been made had they remained active members (as determined by external actuaries).

(iv) Under a long term incentive plan, the executive directors were granted phantom stock options. The option price is set at the quoted share price of WPD's parent in the US, PPL Corporation, at the date the phantom options were granted. Options outstanding may be exercised during fixed periods and the gain is payable through the payroll. The values above include any payments made to the executive directors in respect of gains in value of phantom options exercised in the year. None of the executive directors was granted new options in either year; no executive directors exercised options (2017: three). In addition, the executive directors receive annually a grant of PPL Corporation shares which cannot generally be accessed for three years; a number of these shares is dependent on the achievement of certain criteria at PPL. The value of the shares granted in the year is shown within this line.

(v) The independent UK non executive directors are entitled to fees as determined by the appropriate Board. No emoluments are paid to US based non-executive directors, who are officers of PPL, in respect of their services as directors to the WPD Group.

(vi) During the year, four executive directors (2017: four) were members of the defined benefit ESPS. At 31 March 2018, the highest paid director had accrued annual pension benefits of £585,456. The benefits shown assume that an option to convert an element of the annual benefits to a lump sum payable on retirement is not exercised.

Notes to the financial statements

For the year ended 31 March 2018

12. Tangible fixed assets

| | Non network land & buildings £m | Distribution network £m | Fixtures & equipment £m | Vehicles & mobile plant £m | Total £m |
|---------------------------|--|-------------------------------|-------------------------------|-------------------------------------|----------------|
| Cost | | | | | |
| At 1 April 2017 | 8.3 | 3,200.2 | 50.7 | 34.6 | 3,293.8 |
| Additions | 2.0 | 225.3 | 8.9 | 3.3 | 239.5 |
| Transfer | 0.4 | - | - | - | 0.4 |
| Disposals and retirements | - | - | (3.7) | (3.0) | (6.7) |
| At 31 March 2018 | 10.7 | 3,425.5 | 55.9 | 34.9 | 3,527.0 |
| Depreciation | | | | | |
| At 1 April 2017 | 1.2 | 855.4 | 22.8 | 15.4 | 894.8 |
| Charge for the year | 0.2 | 43.5 | 9.1 | 3.2 | 56.0 |
| Disposals and retirements | - | - | (3.7) | (2.7) | (6.4) |
| At 31 March 2018 | 1.4 | 898.9 | 28.2 | 15.9 | 944.4 |
| Net book value | | | | | |
| At 31 March 2018 | 9.3 | 2,526.6 | 27.7 | 19.0 | 2,582.6 |
| At 31 March 2017 | 7.1 | 2,344.8 | 27.9 | 19.2 | 2,399.0 |

All non network land and buildings are freehold. The net book value of land and buildings within the distribution network above is £202.0m (2017: £182.1m); these are all freehold.

Included within the Company's fixed assets are assets in the course of construction amounting at 31 March 2018 to £37.3m (2017: £31.5m) and land at a cost of £62.2m (2017: £54.2m).

Included in additions are staff costs of £74.9m (2017: £72.5m).

Notes to the financial statements

For the year ended 31 March 2018

13. Intangible assets

Computer
software
£m

Cost

At 1 April 2017 13.6

Additions 8.2

At 31 March 2018 21.8

Amortisation

At 1 April 2017 6.3

Charge for the year 1.5

At 31 March 2018 7.8

Carrying amount

At 31 March 2018 14.0

At 31 March 2017 7.3

14. Investments

Listed group
debt ⁽¹⁾
£m

Cost

At 1 April 2017 42.4

Exchange adjustments (4.6)

At 31 March 2018 37.8

Provision for impairment

At 1 April 2017 and 31 March 2018 -

Net book value

At 31 March 2018 37.8

At 31 March 2017 42.4

Notes to the financial statements

For the year ended 31 March 2018

14. Investments (continued)

(1) Investment in Group parent debt

Investments in WPD Group debt relate to the Company's held-to-maturity interest in unsecured US dollar denominated bonds of Western Power Distribution plc, maturing in 2028. The exchange loss of £4.9m (2017: £5.6m gain) is recognised in the profit and loss account and recorded within 'income from fixed asset investments'.

The Company has the following wholly owned subsidiary undertakings which are dormant and carried at no value: WPD Share Scheme Trustees Limited, Western Power Pensions Trustee Limited and WPD Limited. The shares are ordinary shares and the registered office is Avonbank, Feeder Road, Bristol BS2 0TB.

15. Stocks

| | 2018 £m | 2017 £m |
|------------------|------------|------------|
| Raw materials | 8.0 | 7.5 |
| Work in progress | 0.4 | 0.5 |
| | 8.4 | 8.0 |

16. Debtors

| | 2018 £m | 2017 £m |
|---|--------------|------------|
| Amounts falling due within one year: | | |
| Trade debtors | 62.1 | 63.3 |
| Amounts owed by other WPD undertakings | 1.3 | 3.4 |
| Other debtors | 20.7 | 4.4 |
| Prepayments and accrued income | 20.2 | 11.9 |
| UK corporation tax | - | 2.9 |
| Amounts falling due after more than one year: | | |
| Prepayments and accrued income | 0.5 | 0.5 |
| | 104.8 | 86.4 |

Amounts owed by other WPD undertakings are unsecured and are repayable on demand.

17. Cash at bank and in hand

| | 2018 £m | 2017 £m |
|--------------------------|-------------|------------|
| Cash at bank | 13.6 | 15.6 |
| Short-term bank deposits | 80.0 | 6.0 |
| Cash at bank and in hand | 93.6 | 21.6 |

Notes to the financial statements

For the year ended 31 March 2018

17. Cash at bank and in hand (continued)

At 31 March 2018, the Company had available £245.0m (2017: £165.0m) of undrawn committed borrowing facilities in respect of which all conditions precedent had been met. All facilities incur commitment fees at market rates. At 31 March 2018, it also had available undrawn uncommitted facilities of £106.2m (2017: £66.2m). The four WPD DNOs also have access to an uncommitted facility from which any DNO can draw but which in aggregate cannot exceed £20m; no borrowings had been drawn against this facility as at 31 March 2018 (2017: £nil). Together WPD East Midlands and WPD West Midlands have a £600.0m committed facility; borrowings of £149.0m had been drawn against these facilities as at 31 March 2018 (2017: £125.0m).

Included in cash and short-term bank deposits are restricted amounts totalling £4.4m (2017: £8.8m) which are not readily available for the general purposes of the Company. The restrictions relate to cash balances that can only be used for Low Carbon Network Fund projects.

For the purposes of the cash flow statement, cash at bank and in hand comprise the following at 31 March:

| | 2018 £m | 2017 £m |
|---------------------------------------|-------------|--------------|
| Cash at bank and in hand (from above) | 93.6 | 21.6 |
| Bank overdrafts (note 18) | (25.3) | (25.4) |
| | 68.3 | (3.8) |

Bank overdrafts comprise principally unpresented cheques at the year end.

18. Creditors

| | 2018 £m | 2017 £m |
|--|--------------|--------------|
| Amounts falling due within one year: | | |
| Bank loans and overdrafts | 25.3 | 25.4 |
| Short-term borrowing | - | 80.0 |
| Payments received on account | 21.2 | 22.6 |
| Trade creditors | 22.3 | 28.7 |
| Amounts owed to other WPD undertakings | 65.2 | 76.0 |
| UK corporation tax | 12.6 | - |
| Other taxation and social security | 12.7 | 14.2 |
| Other creditors | 11.5 | 9.1 |
| Deferred contributions | 8.7 | 8.2 |
| Accruals and deferred income | 44.5 | 43.3 |
| | 224.0 | 307.5 |

Notes to the financial statements

For the year ended 31 March 2018

18. Creditors (continued)

| | 2018 £m | 2017 £m |
|--|----------------|------------|
| Amounts falling due after more than one year: | | |
| Deferred contributions | 501.6 | 473.8 |
| Unsecured borrowings repayable after more than five years: | | |
| £250m 5.875% bonds 2027 | 248.6 | 248.4 |
| £200m 5.75% bonds 2040 | 197.4 | 197.3 |
| £105m 1.541% index linked bonds 2053 | 144.7 | 139.2 |
| £120m 1.541% index linked bonds 2056 | 165.4 | 159.1 |
| £250m 2.375% bonds 2029 | 246.4 | - |
| | 1,504.1 | 1,217.8 |

The bank loans and overdrafts are unsecured. The overdraft is repayable on demand and includes cheques issued but not yet presented. Bank loans are short term. Amounts owed to other WPD undertakings are unsecured and are repayable on demand. Interest on bonds is paid semi-annually or annually.

Unsecured borrowings are stated net of unamortised issue costs of £3.6m (2017: £2.4m). These costs together with the interest expense are allocated to the profit and loss account over the term of the bonds at a constant rate on the carrying amount.

In November 2017, WPD South West entered into a £250m 11.5 year 2.375% bond with a £2.3m discount. The proceeds were used for general corporate purposes.

19. Provisions for liabilities

| | Deferred taxation (note 20) £m | Asset retirement obligations £m | Other £m | Total £m |
|------------------------------------|---|--|-------------|--------------|
| At 1 April 2017 | 108.9 | 9.5 | 3.7 | 122.1 |
| Arising/(released) during the year | 0.1 | (2.4) | (1.3) | (3.6) |
| Utilised during the year | - | (0.2) | (0.9) | (1.1) |
| At 31 March 2018 | 109.0 | 6.9 | 1.5 | 117.4 |

Asset retirement obligations ("ARO") relate to an estimate of the costs of dismantling and removing items of property, plant and equipment at the end of their useful life and are expected to be settled over the next 70 years.

The effect of discounting on AROs is not material and is therefore not shown separately.

Other provisions at 31 March 2018 substantially relate to uninsured losses and an expected settlement of liabilities relating to the Electricity Association Technology Limited ("EATL") of £1.2m relating primarily to a pension deficit relating to that company. The liability in respect of the EATL is being settled over a period of approximately nine years; the directors expect the remaining provisions to be settled within the next two years.

Notes to the financial statements

For the year ended 31 March 2018

20. Deferred tax

The following are the deferred tax liabilities and assets recognised by the Company and movements thereon during the current and prior year:

| | Accelerated capital allowances £m | Retirement benefit obligations £m | Other £m | Total £m |
|---------------------------------------|--|--|--------------|---------------------|
| At 1 April 2016 | 125.6 | (27.8) | (2.4) | 95.4 |
| Charge to the profit and loss account | 6.6 | 25.3 | (0.5) | 31.4 |
| Change in corporation tax rate | (8.4) | - | 0.2 | (8.2) |
| Charge to equity | - | (9.7) | - | (9.7) |
| At 1 April 2017 | 123.8 | (12.2) | (2.7) | 108.9 |
| Charge to the profit and loss account | 6.2 | (4.1) | 0.6 | 2.7 |
| Credit to equity | - | (2.8) | 0.2 | (2.6) |
| At 31 March 2018 | 130.0 | (19.1) | (1.9) | 109.0 |

Certain deferred tax assets and liabilities have been offset. The following is an analysis of the deferred tax balances (after offset) for financial reporting purposes:

| | 2018 £m | 2017 £m |
|--|--------------------|------------|
| Deferred tax liabilities | 130.5 | 124.1 |
| Deferred tax assets | (21.5) | (15.2) |
| Provision for deferred tax at 31 March | 109.0 | 108.9 |

The net deferred tax liability due after more than one year is £123.4m (2017: £111.9m).

Deferred tax assets are recognised for tax loss carry-forwards to the extent that the realisation of the deferred tax benefit through future taxable profits is probable. The Company did not recognise deferred tax assets of £70.4m (2017: £70.6m) in respect of capital losses amounting to £414.2m (2017: £415.1m) that can be carried forward against future taxable chargeable gains as there is no use of these assets for the foreseeable future.

Notes to the financial statements

For the year ended 31 March 2018

21. Pension commitments

Electricity Supply Pension Scheme ("ESPS")

The ESPS provides pension and other related defined benefits based on final pensionable pay to employees throughout the electricity supply industry. One segment of the ESPS, the WPD Group Segment, relates to WPD South West and WPD South Wales and most employees of these companies are members of the ESPS. These two companies are liable for the WPD Group Segment and would benefit from any surplus if wound up. The assets are held in a trustee administered fund.

Effective 1 April 2010, the WPD Group segment of the ESPS was closed to new members except in very limited circumstances. Existing members are unaffected. A defined contribution scheme is being offered to new employees.

The liability recognised in the balance sheet in respect of the defined benefit pension plan is the present value of the defined benefit obligation at the end of the reporting period less the fair value of the plan assets. The defined benefit obligation is calculated annually by independent actuaries, Aon Hewitt Limited, using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash flows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits are paid, and that have terms to maturity approximating to the terms of the related pension obligation.

Actuarial gains and losses arising from experience adjustments and changes to actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise.

Past-service costs are recognised immediately in income.

The scheme is a funded, defined benefit, final salary pension plan. The level of benefits provided depends on members' length of service and their salary at their date of leaving the Company. The majority of pensions in payment receive inflationary increases in line with the RPI (Retail Prices Index) inflation. The benefit payments are from trustee-administered funds. The amount of contributions to be paid is decided jointly by the employer and the Trustees of the Scheme. Assets held in trust are governed by UK regulations and practice. The scheme's investment strategy is decided by the Trustees, in consultation with the employer. The Board of Trustees must be composed of representatives of the employer and plan participants in accordance with the scheme's legal documentation.

The net defined benefit cost and net deficit of the plan have been allocated to WPD South West and WPD South Wales in accordance with pensionable salaries, currently 61.7% to WPD South West (2017: 61.3%). The figures below show the proportion allocated to WPD South West.

The amounts recognised in the WPD South West's balance sheet are determined as follows:

| | 2018 | 2017 |
|--|------------------|-----------|
| | £m | £m |
| Present value of obligations | 1,491.0 | 1,487.4 |
| Fair value of scheme assets | (1,390.4) | (1,423.4) |
| Deficit of funded plan and liability recognised in the balance sheet | 100.6 | 64.0 |

Notes to the financial statements

For the year ended 31 March 2018

21. Pension commitments (continued)

Electricity Supply Pension Scheme ("ESPS") (continued)

The regulator, Ofgem, currently allows ongoing service costs and a proportion of the deficit costs to be recovered through regulated income.

Analysis of the amount charged to profit before interest and taxation or to capital expenditure:

| | 2018 | 2017 |
|---|---------------|--------|
| | £m | £m |
| Current service cost | 18.8 | 13.0 |
| Administrative costs | 1.0 | 1.0 |
| Operating charge relating to defined benefit plan | 19.8 | 14.0 |
| Interest income on plan assets | (34.8) | (36.8) |
| Interest on plan liabilities | 36.8 | 40.5 |
| Other finance expense | 2.0 | 3.7 |

The operating charge is allocated to the operating expenses in the profit and loss account or to capital expenditure as appropriate.

Analysis of the amount recognised in other comprehensive income:

| | 2018 | 2017 |
|--|---------------|---------|
| | £m | £m |
| Loss/(gain) on plan assets excluding amounts included in interest income | 11.7 | (202.1) |
| (Gain)/loss from change in financial assumptions | (18.4) | 268.2 |
| Experience losses/(gains) | 16.2 | (13.6) |
| Change in percentage allocation rate | 5.3 | (3.7) |
| Remeasurement loss recognised in other comprehensive income | 14.8 | 48.8 |

Notes to the financial statements

For the year ended 31 March 2018

21. Pension commitments (continued)

Electricity Supply Pension Scheme ("ESPS") (continued)

The movement in the net defined benefit obligation over the accounting period is as follows:

| | Year ended 31 March 2018 | | | Year ended 31 March 2017 | | |
|--|-----------------------------------|---------------------------------|--------------|-----------------------------------|---------------------------------|-------------|
| | Present value of obligation £m | Fair value of plan assets £m | Total £m | Present value of obligation £m | Fair value of plan assets £m | Total £m |
| Liability/(asset) at 1 April | 1,487.4 | (1,423.4) | 64.0 | 1,265.0 | (1,122.9) | 142.1 |
| Current service cost | 18.8 | - | 18.8 | 13.0 | - | 13.0 |
| Administrative cost | 1.0 | - | 1.0 | 1.0 | - | 1.0 |
| Interest expense | 36.8 | (34.8) | 2.0 | 40.5 | (36.8) | 3.7 |
| | 56.6 | (34.8) | 21.8 | 54.5 | (36.8) | 17.7 |
| Remeasurements: | | | | | | |
| Loss/(gain) on plan assets excluding amounts included in interest income | - | 11.7 | 11.7 | - | (202.1) | (202.1) |
| (Gain)/loss from change in financial assumptions | (18.4) | - | (18.4) | 268.2 | - | 268.2 |
| Experience Losses/(gains) | 16.2 | - | 16.2 | (13.6) | - | (13.6) |
| Change in percentage allocation rate | 10.1 | (4.8) | 5.3 | (31.9) | 28.2 | (3.7) |
| | 7.9 | 6.9 | 14.8 | 222.7 | (173.9) | 48.8 |
| Contributions: | | | | | | |
| Employer | - | - | - | - | (144.6) | (144.6) |
| Plan participants | 2.7 | (2.7) | - | 2.7 | (2.7) | - |
| | 2.7 | (2.7) | - | 2.7 | (147.3) | (144.6) |
| Payments from plan: | | | | | | |
| Benefit payments | (62.6) | 62.6 | - | (56.5) | 56.5 | - |
| Administrative costs | (1.0) | 1.0 | - | (1.0) | 1.0 | - |
| | (63.6) | 63.6 | - | (57.5) | 57.5 | - |
| Liability/(asset) at 31 March | 1,491.0 | (1,390.4) | 100.6 | 1,487.4 | (1,423.4) | 64.0 |

Notes to the financial statements

For the year ended 31 March 2018

21. Pension commitments (continued)

Electricity Supply Pension Scheme ("ESPS") (continued)

The significant actuarial assumptions made were as follows:

| | 2018 | 2017 |
|--|--------------|-------|
| RPI inflation | 3.00% | 3.00% |
| CPI inflation | 1.90% | 1.90% |
| Rate of general long-term salary increases | 3.75% | 3.75% |
| RPI-linked pension increases | 2.95% | 2.95% |
| Post-88 GMP pension increases | 1.80% | 1.80% |
| Discount rate for scheme liabilities | 2.58% | 2.51% |

Assumptions relating to future mortality are set based on actuarial advice in accordance with published statistics and experience. These assumptions translate into an average life expectancy in years for a member at age 60:

| | 31 March 2018 | 31 March 2017 |
|--|---|---|
| Mortality table adopted | Based on S2PXA base tables with CMI 2015 core projections and a 1.0% per annum long-term improvement rate | Based on S1PXA base tables with CMI 2011 core projections and a 1.0% per annum long-term improvement rate |
| Life expectancy for a male currently aged 60 | 26.7 | 26.6 |
| Life expectancy for a female currently aged 60 | 28.8 | 28.7 |
| Life expectancy at 60 for a male currently aged 40 | 28.1 | 28.0 |
| Life expectancy at 60 for a female currently aged 40 | 30.4 | 30.3 |

The sensitivity of the defined benefit obligation to changes in the principal assumptions is:

| | Change in assumption % | Impact on defined benefit obligation £m |
|-----------------|---------------------------|--|
| Discount rate | +/-0.50% | +136.4 / -124.2 |
| RPI inflation | +/-0.50% | +130.6 / -119.7 |
| Life expectancy | + 1 year | 69.9 |

Notes to the financial statements

For the year ended 31 March 2018

21. Pension commitments (continued)

Electricity Supply Pension Scheme ("ESPS") (continued)

The above sensitivity analysis on the discount rate is based on a change in that assumption while holding all other assumptions constant. The change in RPI inflation assumption impacts on the salary increases, CPI assumption, revaluation in deferment and pension increase assumptions. When calculating the sensitivity of the defined benefit obligation to significant actuarial assumptions the same method (present value of the defined benefit obligation calculated with the projected unit credit method at the end of the reporting period) has been applied as when calculating the pension liability recognised in the balance sheet.

The WPD Group of the ESPS scheme assets are comprised as follows:

| | 31 March 2018 | | 31 March 2017 | |
|---|----------------|--|----------------|--|
| | Total £m | Of which not quoted in an active market £m | Total £m | Of which not quoted in an active market £m |
| Equities | 278.1 | - | 276.0 | - |
| Absolute return | 485.7 | - | 449.5 | - |
| Government bonds | 488.1 | - | 509.1 | - |
| RAFI and diversified funds (equity funds) | - | - | - | - |
| Corporate bonds | - | - | - | - |
| Property | 101.6 | 101.6 | 95.5 | 95.5 |
| Other | 36.9 | - | 93.3 | - |
| Total | 1,390.4 | 101.6 | 1,423.4 | 95.5 |

There is no self-investment in the scheme.

Through its defined benefit pension plan, the Company is exposed to a number of risks, the most significant of which are detailed below:

| | |
|-----------------------|--|
| Asset volatility | The liabilities are calculated using a discount rate set with reference to corporate bond yields; if assets underperform this yield, this will create a deficit. The scheme holds a significant proportion of growth assets (e.g. equities) which are expected to outperform corporate bonds in the long-term while providing volatility and risk in the short-term. The allocation to growth assets is monitored such that it is suitable with the scheme's long-term objectives. |
| Change in bond yields | A decrease in corporate bond yields will increase the scheme's liabilities, although this will be partially offset by an increase in the value of the scheme's bond holdings. |
| Inflation risk | The majority of the scheme's benefit obligations are linked to inflation, and higher inflation will lead to higher liabilities (although, in most cases, caps on the level of inflationary increases are in place to protect against extreme inflation). The majority of the assets are either unaffected by or loosely correlated with inflation, meaning that an increase in inflation will increase the deficit. |
| Life expectancy | The majority of the scheme's obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the liabilities. |

Notes to the financial statements

For the year ended 31 March 2018

21. Pension commitments (continued)

Electricity Supply Pension Scheme ("ESPS") (continued)

The scheme uses government bonds, corporate bonds and cash as matching assets. The remainder of the assets are used as growth assets.

A contingent liability exists in relation to the equalisation of Guaranteed Minimum Pension ("GMP"). The UK Government intends to implement legislation which could result in an increase in the value of GMP for some categories of member. This would increase the defined benefit obligation of the plan. At this stage, it is not possible to quantify the impact of this change.

The employer has agreed that it will aim to eliminate the scheme actuarial deficit (as assessed on the ongoing funding basis) by 31 March 2026.

The current agreed employer contributions are 31.2% per annum of pensionable salaries in respect of future benefit accrual, expenses (including PPF levies) and death in service benefits, plus an additional £1.4m per annum in respect of expenses. The Company made a £75.0m prepayment to the scheme in respect of deficit recovery and future service contributions on 30 March 2017. Company contributions are expected to recommence from 1 April 2018 with deficit contributions of £53.4m per annum payable from 1 April 2018 to 31 March 2021 and £12.9m per annum payable from 1 April 2021 to 31 March 2026.

Funding levels are monitored on a regular basis and the next triennial valuation is due to be completed as at 31 March 2019.

Current expected total employer contributions to the WPD South West segment of the ESPS for the year ending 31 March 2019 are £69.0m. Note that for the year 1 April 2018 to 31 March 2019 contributions payable have been offset to allow for the overpayment contributions as a result of the lump sum prepayment made on 30 March 2017. The results of the actuarial funding valuation as at 31 March 2019 may give rise to a revised schedule of contributions and as such the quantities in the above may be liable to change.

The weighted average duration of the defined benefit obligation is around 18 years.

Other scheme

WPD also operates a defined contribution scheme. The assets of the scheme are held separately from those of WPD in an independent fund administered by the scheme trustee. The scheme has two sections and the following relates to the WPD Group as a whole:

- (a) a closed section with no active members. All of the active members in this scheme have transferred to the ESPS. At 31 March 2018 there were 204 members with deferred benefits in the scheme (2017: 208) and 3 pensioners (2017: 3). Market value of the assets was £2.2m (2017: £2.2m).
- (b) a new pension arrangement available to all new employees in WPD with effect from 1 April 2010. At 31 March 2018 there were 3,544 members (2017: 3,288). The market value of the assets of the open section of the scheme was £73.9m (2017: £60.3m). Employer contributions to the scheme across WPD amounted to £7.6m in the year (2017: £6.7m).

Notes to the financial statements

For the year ended 31 March 2018

22. Authorised and issued share capital

| | 2018 £ | 2017 £ |
|--|--------------------|-------------|
| Authorised: | | |
| 1,460,000,000 ordinary shares of 50p each | 730,000,000 | 730,000,000 |
| <hr/> | | |
| | 2018 £ | 2017 £ |
| Allotted, called-up and fully paid: | | |
| 876,306,245 ordinary shares of 50p each | 438,153,123 | 438,153,123 |

23. Reserves

| | Share premium account £m | Capital redemption reserve £m | Hedging reserve £m | Profit & loss account £m |
|---|-----------------------------------|--|--------------------------|-----------------------------------|
| At 1 April 2016 | 4.1 | 6.2 | 1.0 | 285.4 |
| Profit for the financial year | - | - | - | 181.9 |
| Net movement on cash flow hedges (net of tax) | - | - | (0.1) | - |
| Dividends paid | - | - | - | (24.4) |
| Actuarial losses on defined benefit pension plan (net of tax) | - | - | - | (39.0) |
| At 31 March 2017 | 4.1 | 6.2 | 0.9 | 403.9 |
| Profit for the financial year | - | - | - | 147.7 |
| Net movement on cash flow hedges (net of tax) | - | - | 1.0 | - |
| Dividends paid | - | - | - | (94.9) |
| Actuarial losses on defined benefit pension plan (net of tax) | - | - | - | (12.0) |
| At 31 March 2018 | 4.1 | 6.2 | 1.9 | 444.7 |

The share premium account arose on the issue of shares under share option schemes and the capital redemption reserve is in respect of the purchase of its own shares by the Company, both prior to 1996.

The hedging reserve includes value received in respect of interest rate derivatives entered into in anticipation of the issue of long-term debt. The interest rate derivatives were settled in prior years and the gain continues to be amortised through the profit and loss account over the term of the debt.

Notes to the financial statements

For the year ended 31 March 2018

24. Contingent liabilities

Legal proceedings

WPD South West is party to various legal claims, actions and complaints. Although WPD South West is unable to predict with certainty whether or not it will ultimately be successful in these legal proceedings or, if not, what the impact might be, the directors currently believe that disposition of these matters will not have a materially adverse effect on WPD South West's financial statements.

25. Commitments

Capital commitments

Capital expenditure contracted for at the balance sheet date but not recognised in the financial statements is as follows:

| | 2018 £m | 2017 £m |
|-----------------------|------------|------------|
| Tangible fixed assets | 21.2 | 13.0 |

Operating lease commitments - WPD South West as lessee

WPD South West leases plant and machinery under non-cancellable operating lease arrangements. The leases have various terms, escalation clauses and renewable rights.

Future minimum rentals payable under non-cancellable operating leases at 31 March are as follows:

| | 2018 £m | 2017 £m |
|--|------------|------------|
| Within one year | 0.1 | 0.1 |
| In the second to fifth years inclusive | 0.2 | 0.2 |
| After five years | - | - |
| | 0.3 | 0.3 |

Notes to the financial statements

For the year ended 31 March 2018

26. Ultimate parent undertaking

The immediate parent undertaking of the Company is WPD Distribution Network Holdings Limited, which is registered in England and Wales.

The smallest group in which the results of the Company are consolidated is headed by Western Power Distribution plc. Copies of these financial statements may be obtained from the Company's registered office as stated below.

The largest group in which the results of the Company are consolidated is that headed by PPL Corporation, incorporated in the United States of America, which is the ultimate parent undertaking and controlling party. Copies of its accounts may be obtained from its registered address at Two North Ninth Street, Allentown, Pennsylvania, PA18101-1179, US.

Registered office:

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Avonbank
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Telephone : 0117 933 2000
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Registered number 2366894