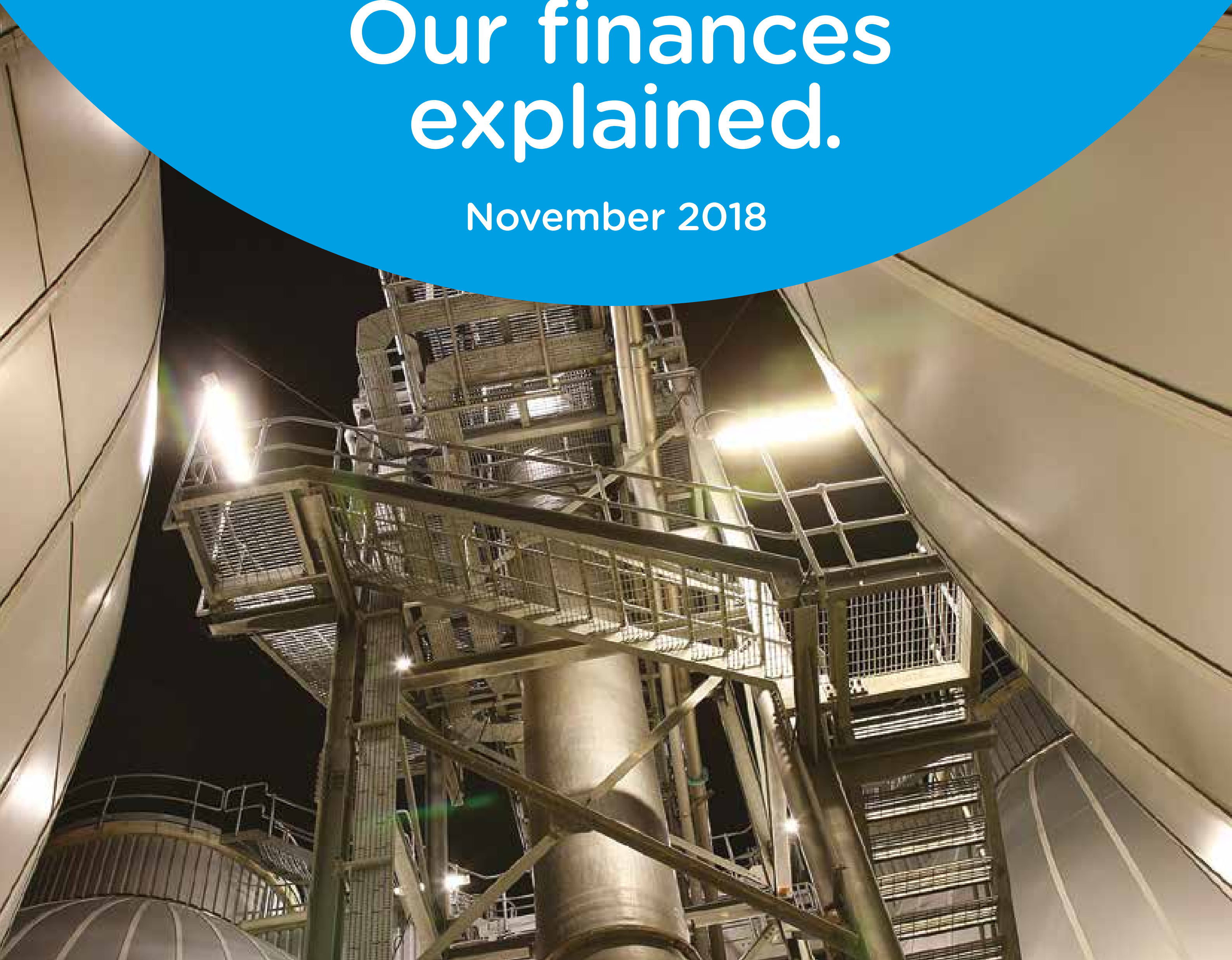
Our finances explained.

November 2018



Sustainable finances

Thames Water has become a very different company over the last two years. With a new independent Chairman, new CEO, new investors and 60% of us being new to the executive team, we've been making fundamental changes to realign the business with the wants and preferences of our customers.

With a major review of our governance, restructures of our business and supply chain partnerships and the development of a revised strategy, we're setting a new direction. To improve our performance where we've not been delivering our customer promises, we've committed an extra £560 million* of investment for this regulatory period, over and above our original plan. Solid and sustainable financing is crucial as we invest to ensure the future provision of our essential services, while keeping bills affordable. We've been investing over £1 billion a year, on average, for the last 13 years in our business, and our average current combined household bills, at £383 (2018/19) , are the second lowest in England and Wales.

Every day, 365 days a year, we provide 2.7 billion litres of one of life's essential ingredients - high quality drinking water - to nearly 10 million people, and treat 15 million customers' wastewater before safely returning it to the natural environment. With London and the Thames Valley in our catchment, our essential services are also vital to the smooth running of the UK economy. Our customers rely on us to spend the money from their bills wisely and this is a responsibility we take very seriously.

As part of our new approach to the management of the business, increasing openness and transparency has become a key characteristic in the way we operate. Over the last year we've made great progress in the process to close our Cayman Islands subsidiaries. Although providing no tax benefit, they no longer serve their original purpose and we're on track to close these entities by the end of the current financial year. Bonds can now be issued by our UK incorporated Plc. We're also disposing of our insurance company in Guernsey.

We're committed to being open about the way we operate our business, and I'm pleased Sir Tony Redmond, Regional Chair of the Consumer Council for Water for London and the South East, agreed to ask me some of the big questions on behalf of customers for our Annual Report and Annual Performance Report 2017/18. You can find the interview on pages 59 and 60 of the report at thameswater.co.uk/annualresults.

Resilience and diversity in our funding portfolio are important drivers in ensuring our financial stability over the longer term. During 2017/18 we successfully placed our first Green bond and our first Canadian bond. The Green Bond was a £705 million US Private Placement (USPP), which allowed us to raise long dated funds with an average maturity of around ten years, at historically low interest rates. With so much of our activity focused on delivering environmental protection, it makes absolute sense for us to be an 'early adopter' of this type of debt issuance in the UK.

Given the nature of our business, we know our finances, including corporation tax position, can appear complex. This, our fifth Our finances explained, goes even further to explain our finances in a simple way to increase transparency.

Brandon Rennet

Chief Financial Officer

* in 12/13 prices

"We've been making fundamental changes to realign the business with the wants and preferences of our customers."

What we do

How our water cycle works

How we generate revenue

In a monopoly sector like the water industry it's our economic regulator, Ofwat, which provides an alternative to competition, driving performance and delivery, and sets limits on the prices we can charge.

Re-investing for the long-term

For the last 13 years we've been investing, on average, more than £1 billion a year in our network. Our 2017/18 profits, after taking into account distributions made to service group debt obligations and working capital requirements, are being reinvested into the business.

The value we create for our stakeholders

60p

Customers (and suppliers)

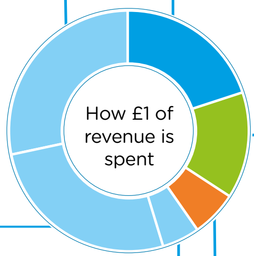
28p – Operational expenditure
As well as supplying world-class drinking water to our customers every day, and removing wastewater, we're spending money to improve our service to customers. Our customers currently benefit from the second lowest combined bill in England and Wales (2018/19).

26p – Investment in our infrastructure.
We're generating value for customers and future generations by investing heavily in our business to ensure a resilient network for many years to come.

1p of this is passed to Tideway, the independent company responsible for the construction of the Thames Tideway Tunnel.

5p – Energy to power operations
Combining wind and solar power with electricity generated from sewage, we generated 293 GWh of energy in 2017/18, more than one fifth of our total requirements and equivalent to £30 million a year in energy costs. It also reduced our greenhouse gas emissions by 112.6 $kTCO_2e$.

1p net profit which is reinvested



20p
Lenders
By borrowing money at efficient rates, we're able to continue investing heavily in our infrastructure while keeping customer bills as low as we can.

14p
Our people
Our people include customer service agents, engineers, water scientists and archeologists to deliver for our customers and the environment.

6p
Government
We paid £192 million in business rates, PAYE and national insurance contributions in 2017/18, which help fund those vital public services we all rely on. We incurred £138 million directly and collected £54 million on behalf of our employees. We have not paid any corporation tax, primarily due to tax deductions for our interest payments and because of heavy investment in our network, for which we receive tax relief under the Government's "capital allowances" regime.

Shareholders
Our shareholders have agreed not to receive dividends until 2020, so the money can be reinvested in the business to secure a better future.

What we spent our money on in 2017/18

1 Net investment in our network

£1,144 million*

This is the money we use to renew and improve our network and infrastructure. We've invested over £1 billion, on average, every year for the last 13 years. We're on track to invest over £5 billion during this regulatory period (2015-2020).

2 Day-to-day operational expenses

£954 million*

This is the money we use to operate and maintain our network, pay our employees, cover our energy costs and pay our technology bills. With a vast network of 140,000km of pipes and 448 treatment works, this money is used to help us ensure our business runs efficiently and we provide the best for our customers.

3 Net financing costs and dividends

£309 million*

We borrow money from banks and other lenders, such as pension funds and insurance companies, to help fund investment in our network. We keep customer bills low by borrowing debt on as favourable terms as possible and by spreading the repayment costs over a longer period. We also pay a dividend to our holding companies, in order for them to fund their debt obligations and working capital requirements, and to external shareholders as a return on their investment (see structure chart on page 27). We did not pay any dividends to external shareholders in 2017/18 and will not pay any during the rest of this regulatory period, while we focus on improving performance for our customers.

*numbers based on cash flow

Some key expenses

Pensions

We currently run three pension schemes to support our employees during retirement – two defined benefit schemes and one defined contribution scheme. The assets of our defined benefit schemes, which support our ability to pay pensions, are held completely separately from those of any Thames Water group companies. Both the value of these assets and our pension obligations – the amount we need to pay retired employees – are affected by interest rate fluctuations and other external market factors. Like many large companies, changes in market factors have led to our obligations being larger than the value of our assets, so we currently have a net pension deficit on one of our defined benefit schemes. Our deficit at March 2018 was £300.8 million. Every three years, our defined benefit schemes are valued by an independent actuary and these valuations are updated annually.

For 2017/18, we paid £46.1 million into our defined benefit pension schemes, which included both regular contributions and payments to reduce the deficit. This is part of our recovery plan to sustainably reduce our pension deficit to zero by 2027, which was agreed with the scheme trustees as part of the last triennial valuation. We also contributed £8.1 million to the defined contribution scheme, which currently serves 55% of our employees.

Power

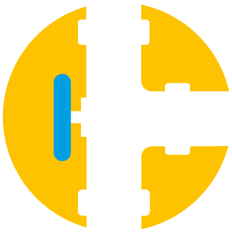
It costs over £108 million a year to power our business making it one of our largest operational costs. In 2017/18 we self-generated one fifth of our energy needs, equivalent to £30 million a year in energy costs, and we're committed to increasing this. Alongside this, we're also doing what we can to drive energy efficiency across the business. We generated 286GWh of electricity from sewage in 2017/18, our best ever performance and enough to power the equivalent of 86,000 homes a year. We're also using more solar power, including from the floating solar panel array on our QE2 reservoir.

For 2017/18, we paid £46.1 million into our defined benefit pension schemes

Investing in the future

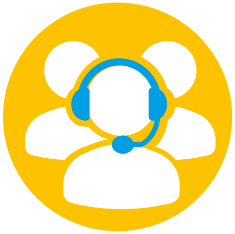
Some of our investments include:

1 Investing over £250 million on a major upgrade of Deephams sewage treatment works to accommodate population growth and reduce odour



2 £1.4 billion buying land and connecting our network to the landmark Thames Tideway Tunnel

3 Additional £97 million to improve our largest water pipes



4 £150 million in a new billing and service platform (Project Spring)


Thames Water
PRO

Our bills

Offering value for money

We provide water and wastewater services for an average of just over £1 per day per household. Our average combined bills remain the second lowest in England and Wales, at £383 per year (2018/19). We keep our bills low through a combination of factors including:

- **Efficient operations and investment**
  Operating our network efficiently drives down unnecessary costs.
- **Low-cost financing**
  We borrow money in competitive markets to minimise our cost of debt.
- **Investment allowances**
  Together with other factors, the Government's capital allowances scheme enables us to keep our corporation tax bills lower than they would otherwise be (further detail on pages 20-22).

Helping our customers

We have a socially and geographically diverse customer base and we need to ensure we cater to their individual needs as well as those collectively as a group. We recognise that our region has some of the most deprived areas in the country and we're committed to helping those who need extra support.

We offer a range of options to help our customers in financially vulnerable circumstances. In 2017/18 we helped over 56,000 households via our two social tariffs - Watersure and Watersure plus - up 48% on the previous year. As part of our plan for 2020-2025 we plan to increase this number to 200,000.

We run a customer assistance fund to support customers with their water debt, with the fund benefiting 7,500 customers in 2017/18. We also offer a range of payment plan options, free meter fits and water efficiency devices to help our customers.

We understand that customers in water debt may also have wider financial issues, so we also help customers with basic living costs outside our services, through a dedicated trust fund. The fund was set up in 2009 and is an independent charity. We contributed over £650,000 to the fund in 2017/18.

"Our average combined bills remain the second lowest in England and Wales, at £383 per year (2018/19)."

Setting our bills

Making our bills affordable, while setting them at a level that enables us to meet our commitments, is something we need to get right. We consult with our customers at length about what they value most from Thames Water and what they are willing to pay for. We are also challenged independently by representative bodies such as our Customer Challenge Group (CCG). We continually evaluate what we need to do to maintain and improve our services to customers and undertake research to understand the future impact of things like climate change and population growth on our network.

Price reviews

In a monopoly sector like the water industry it's our economic regulator, Ofwat, which provides an alternative to competition and sets limits on the prices we can charge. Every five years we develop our plans and bills for the next five year regulatory period, based on our extensive planning and customer research, and agree this with Ofwat. This is a very rigorous process, known as a price review. We submitted our proposed plan for 2020-2025 on 3 September 2018 and expect feedback from Ofwat during 2019. Our plan will see average bills remain flat in real-terms. You can find our full business plan at **thameswater.co.uk**

Thames Tideway Tunnel

To minimise the costs and remove risk for our customers, we ran a comprehensive and competitive process to identify the best company to build the Thames Tideway Tunnel. In August 2015, an independent company, Bazalgette Tunnel Limited (BTL), secured a licence from Ofwat as a separate regulated utility business to deliver the landmark construction project, which will divert millions of tonnes of sewage away from the River Thames.

As a result of this robust process, the impact on customers' wastewater bills will be significantly lower than was originally anticipated – initial estimations of an average increase of up to £80 a year were reduced to a maximum of £25. Approximately £13 was included in the 2017/18 bill and £16 is already included in the 2018/19 bill. As we collect the cash, we pass it on to BTL for the construction of the tunnel. No cash is retained by us and therefore we present amounts relating to BTL separately in our financial statements.

We submitted our proposed plan for 2020-2025 in September 2018

Rewards and penalties

We work closely with our customers to set performance commitments for each regulatory period, designed to deliver what is most important to our customers in the most cost effective way. For some of these commitments we are able to earn financial rewards if we perform above expectations, but we can also incur penalties for underperformance.

For 2017/18 we incurred penalties of £35.3 million and earned rewards of £1.3 million. £13.1 million of the total penalty was for leakage and forms part of the £120 million being returned to customers from 2019/2020 - all customers will benefit from reductions on their bills until 2025.

Drinking water compliance

Target: 100.00%

Performance in 17/18: 99.96%

P

Condition of our below ground water network (includes supply interruptions of more than 12 hours)

Target: Stable

Performance in 17/18: Marginal

Penalty: £4.7 million

P

Condition of our above ground water network

Target: Stable

Performance in 17/18: Stable

On target

P

Security of supply index

Target: 100

Performance in 17/18: 97

Penalty: £6.8 million

P

Condition of our below ground wastewater network

Target: Stable

Performance in 17/18: Stable

On target

P

Condition of our above ground wastewater network

Target: Stable

Performance in 17/18: Stable

On target

P

Sewer flooding other causes

Target: 1,085

Performance in 17/18: 1,062

Reward: £1.3 million

PR

Leakage

Target: 620 Ml/D

Performance in 17/18: 695 Ml/D

Penalty: £13.1 million

PR

Supply interruptions lasting more than four hours

Target: 0.13

Performance in 17/18: 0.21

Penalty: £10.7 million

PR

Reduction in the number of properties affected by odour

Target: 793
Performance in 17/18: 1,980
Reward: £46,000

PR

Sewage treatment works discharge compliance

Target: 100%
Performance in 17/18: 99.43%

P

Pollution incidents

Target: 340
Performance in 17/18: 292
On target

PR

Deephams sewage treatment works upgrade and Thames Tideway Tunnel connecting works

Performance in 17/18: Deephams sewage treatment works upgrade: Delivered

Thames Tideway Tunnel connecting works: On target

P

Site security compliance (and with notes) - two performance commitments

End of AMP target.

P

Sustainable urban drainage.

End of AMP target.

PR

Implement new online account management

Target: Limited online
Performance in 17/18: Limited online
On target

P

Properties flooding from rainfall including Counters Creek

End of AMP target.

PR

Water efficiency

End of AMP target.

P

Customer Service - service incentive mechanism score

Ofwat metric: 80.1
Calculated over the AMP

Performance in 17/18: 78.4

PR

Compliance with environmental regulations - two performance commitments

End of AMP target.

P

Resilience of sites to future extreme weather events - water and wastewater

End of AMP target.

P PR

Reduce the amount of phosphorus entering rivers

End of AMP target.

PR

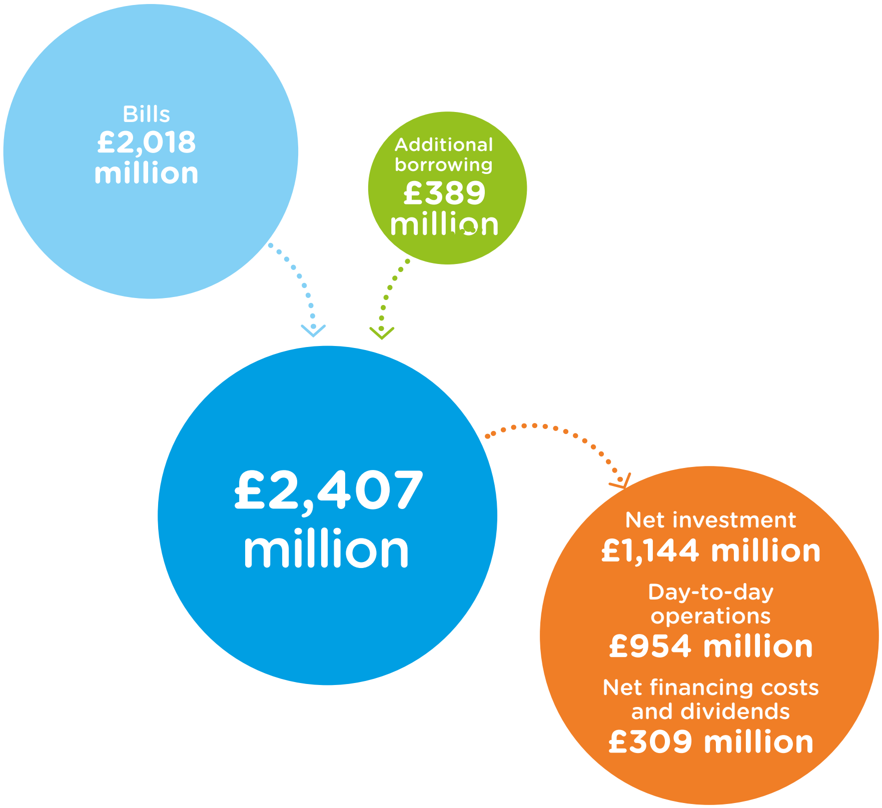
P Can incur penalty

PR Can incur penalty or reward

Bridging the gap

For every £1 we collect from bills, we need an additional 19 pence (2017/18) to help fund our spending (page 6).

To bridge this gap and avoid significant fluctuations to bills, we borrow money at attractive rates. By spreading the cost of our investment and managing our debt over a number of years we also ensure the generations that will benefit from the improvements are those who will be helping to pay for it – this makes our bills fairer and more sustainable.



Our borrowings

Borrowings

We borrow money through a combination of loans from banks and institutions as well as corporate bonds. Our corporate bonds are typical debt 'instruments' that feature in many UK companies. They are sold to third party investors such as pension fund managers and insurance companies and, like any other loan, we pay interest on these bonds. Most of our bonds are publicly listed on major stock exchanges such as the London Stock Exchange and Irish Stock Exchange. Whilst the majority of our funding requirement is in Sterling, we monitor investor demand in other currencies to optimise our average cost of funding.

Our credit rating

The responsible way in which we operate our finances ensures we maintain a strong (investment grade) credit rating, as assigned by external ratings agencies Moody's and Standard & Poor's (S&P). The ongoing assessment of Thames Water by these two agencies provides an independent view of our performance and future outlook. The majority of our debt is rated A3 by Moody's and BBB+ by S&P, allowing us to continue to raise funding at competitive rates which, in turn, allows us to keep costs down for customers.

Interest on our debt

The water industry is considered a low risk investment, making it particularly attractive for pension funds and other similar financial institutions who seek long-term, steady returns. We maintain conservative long-dated debt maturities (currently with an average tenor of approximately 17 years) to minimise refinancing risks. The average interest rate we incurred over the last year was 5.58% and we paid net interest of £224 million on our debt.

Managing financial risk

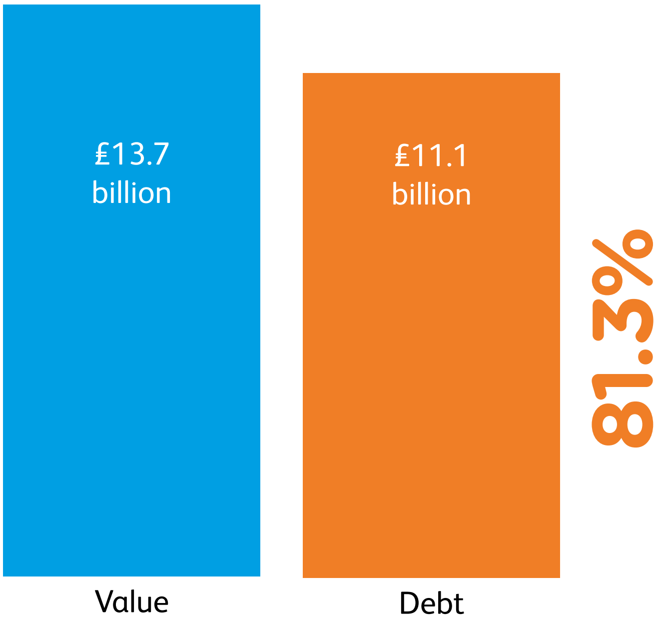
As with any company, our normal business activities expose us to a variety of financial risks, including changes to inflation and interest rates. By borrowing money from different sources, on different interest payment bases and for varying lengths of time, we are able to proactively manage and spread these risks, reducing them to an acceptable level. As a regulated water company, our bills are linked to movements in inflation, which increases or decreases the amount of money we have available to pay for the interest on our debt. For that reason we have also linked around half of our debt to inflation. Most of the remaining debt is borrowed at fixed rates of interest, sometimes for many years, which helps provide certainty and maintains stable borrowing charges relative to changes in revenue.

Our gearing

We are financed by a combination of debt from our lenders and shareholder equity retained in the company. After deducting cash and other cash-like assets, the amount we have borrowed from lenders is referred to as our net debt. Our financial gearing is calculated as the ratio between our net debt and our regulatory capital value ("RCV"), which represents the value of a company's assets as agreed with Ofwat. This relationship – also known as the 'gearing ratio' – shows the extent to which our operations are funded by our debt investors, rather than by shareholders. At 31 March 2018 our net debt (covenant basis) was £11.1 billion and our RCV was £13.7 billion, meaning our gearing ratio was 81.3%.

$$81.3\%\ \text{Gearing} = \frac{\text{£11.1 billion net debt}}{\text{£13.7 billion value (debt and equity)}}$$

You could consider this similar to funding the purchase of a house with a mortgage, where the loan-to-value ratio is the value of debt (mortgage) relative to the value of the house.



As part of our plan for 2020 to 2025 we aim to reduce our gearing by

5% to 76.2%

in March 2025.

Our taxes explained

Tax transparency is a cornerstone in building trust with our customers and other stakeholders.

In 2017/18 we paid over £192 million in business rates, PAYE and national insurance contributions, which helped fund the vital public services we all rely on. We incurred £138 million directly (excluding environmental taxes), mainly through business rates, and collected and paid £54 million on behalf of our employees.

We manage our taxes appropriately and efficiently within both the letter and the spirit of tax legislation, for the benefit of our customers, shareholders and the environment. Due to the size of our company and the amount we're investing, our taxes can appear complex. We've produced a separate document - Our Tax Strategy, which explains our tax policies, and these are also outlined opposite. 'Our tax strategy' can be found at: **corporate.thameswater.co.uk/About-us/Our-investors.**

The Corporate Criminal Offence of the Failure to Prevent the Facilitation of Tax Evasion

The Government introduced new rules from 30 September 2017, requiring companies to have procedures in place to prevent the facilitation of tax evasion. We take this responsibility very seriously and this is reflected in our policies which include:

- Ensuring that we have prevention procedures in place, including obtaining assurances from suppliers, training our staff, providing a whistle-blowing hotline, and reviewing our processes regularly;
- Applying a zero tolerance attitude towards the facilitation of tax evasion and reporting any instances to the authorities, and;
- Not using suppliers who are unable to provide assurance that they have prevention procedures.

Our tax strategy

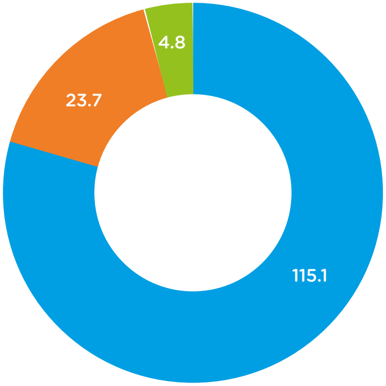
Our tax strategy is straightforward and is underpinned by five key policies to ensure we're a responsible business. It applies to all our Group entities. Our policies are:

1. We comply with all tax legislation requirements at all times, both within the letter and spirit of the law
2. We do not use tax avoidance schemes or aggressive tax planning
3. We engage fully and transparently with HMRC and other Government bodies, and seek to resolve disputes in a co-operative manner
4. We adopt a conservative approach to tax risk management and apply a strong tax governance framework
5. We accept only a low level of risk in relation to taxation

In 2016, HMRC classified us as 'low risk' for the first time.

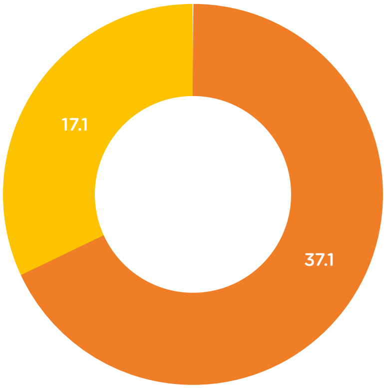
We worked hard to achieve this coveted status, and the tax policies published above ensure that our behaviour is consistent with, and contributes towards us maintaining, this status.

Our tax position 2017/18



Taxes incurred directly
(£144 million)

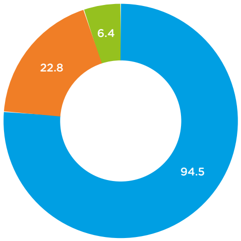
- Business rates
- Employer NICs
- Carbon reduction commitment



Taxes collected
(£54 million)

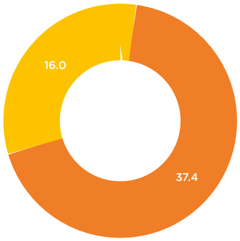
- Employee PAYE
- Employee NICs

2016/17



Taxes incurred directly
(£124 million)

- Business rates
- Employer NICs
- Carbon reduction commitment

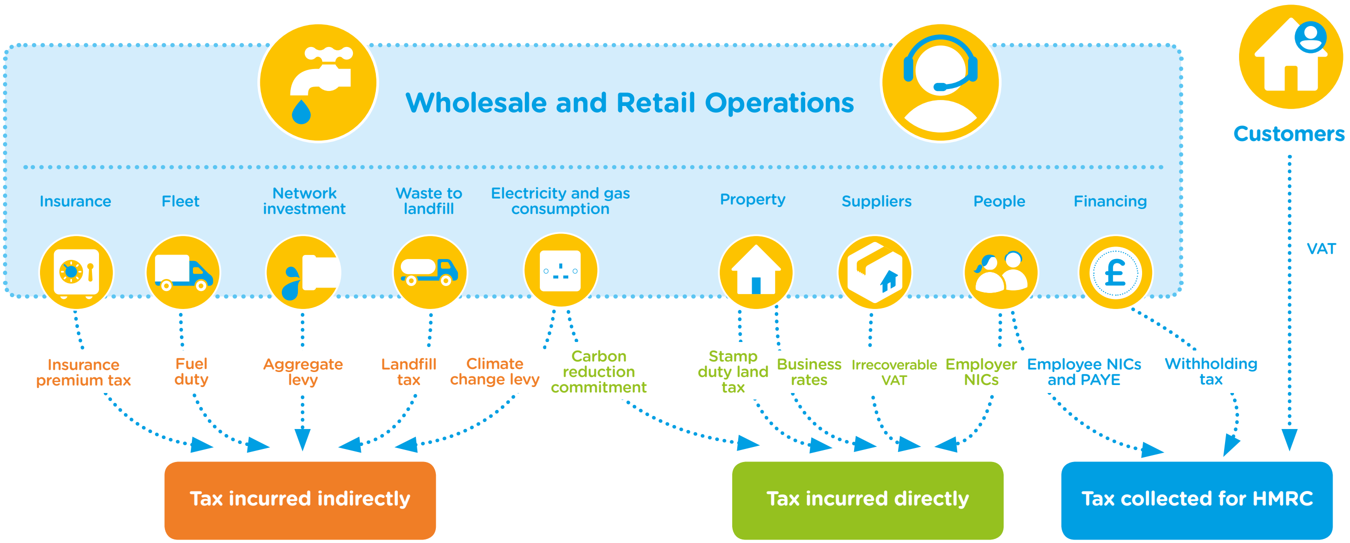


Taxes collected
(£53 million)

- Employee PAYE
- Employee NICs

Our value chain

This illustration shows the areas in our value chain where we incur and collect taxes.



- Taxes incurred indirectly are taxes that represent a cost to us, but are included in the costs our suppliers and contractors charge us. Therefore, we do not pay these directly to the Government, but incur them indirectly as a consequence of our activities;

- Taxes incurred directly are taxes that represent a cost to us, are accounted for in our financial statements, and are paid directly to the UK Government by us;

- Taxes collected by us are tax costs of another party which we collect on their, or the Government's, behalf. These costs do not affect our financial results. As we undertake the commercial activity, it generates the tax which contributes to the economy.

Tax descriptions

- **Insurance Premium Tax** – a tax levied on insurance premiums
- **Fuel Duty** – a duty on petrol, diesel and fuel used in vehicles
- **Aggregate Levy** – a tax on the extraction of rock, gravel and sand
- **Landfill Tax** – a tax on waste disposed of to landfill
- **Climate Change Levy** – a tax on the industrial or commercial use of electricity, gas and solid fuels
- **Carbon Reduction Commitment** – a tax on gas and electricity consumption, calculated by reference to associated carbon dioxide emissions
- **Stamp Duty Land Tax** – a tax on the purchase of land and property
- **Business Rates** – a tax on non-domestic properties we own or occupy
- **VAT** – a tax levied on the sale of goods and services
- **National Insurance (NIC)** – a tax on wages incurred by employers and employees
- **PAYE** – Pay As You Earn income tax incurred by employees on their wages. It is deducted by employers and paid to Her Majesty's Revenue & Customs (HMRC)
- **Withholding tax** – a tax on interest payments on loans

Whilst we incur and collect all of the above, only the largest amounts are shown on page 17.

Our corporation tax

The UK Government has for many years allowed companies to claim tax relief on capital investment in their UK operations - these allowances are a common feature of national tax regimes across the world. At the same time, the UK Government also provides tax relief for interest costs on debt which has been raised to fund investment.

Due to our huge capital investment programme and interest costs on our debt we don't currently pay corporation tax. You can find our draft tax calculation for 2017/18 on page 24. The reduced cost associated with us not paying corporation tax is fully passed on to customers through lower bills, so our customers are the only ones to benefit from us not paying corporation tax.

Interest costs are deductible for tax purposes and are substantial at the moment. The Government's capital allowances regime allows us to delay payment of corporation tax (creating a "deferred tax" liability) until a time when our level of investment is lower. Our deferred tax liability on fixed assets was £1.1 billion at 31 March 2018. If our investment levels were to reduce, our capital allowances claim would also reduce. This would lead to an increase in our taxable profits and we would pay corporation tax. Although tax we pay would be funded through customer bills, any increase in bills to cover our corporation tax charge would be offset by a bill reduction due to lower investment costs. The long life span of our assets would also protect customers from a sudden bill increase, if and when the deferred tax becomes payable.

It is difficult to reliably estimate when we will become corporation tax paying. It depends on a number of factors:

- our profitability, which is influenced by our performance,
- the regulatory return and level of debt;
- our level of capital investment, which gives rise to capital allowances; and
- tax legislation and accounting changes.

We are not expecting to pay any corporation tax in the current, or next, regulatory period, which goes up to 2025.

"The reduced cost associated with us not paying corporation tax is fully passed on to customers through lower bills, so our customers are the only ones to benefit from us not paying corporation tax."

Our 2017/18 draft corporation tax calculation

A company's UK corporation tax liability is based on its accounting profit before tax, as shown in its statutory accounts.

Tax adjustments must be made to that accounting profit, and the resulting "taxable profits" are multiplied by the corporation tax rate (19% in 2017/18, due to fall to 17% by 2020).

Tax deductions

1. **Capital allowances** – companies can claim a deduction for investment in critical infrastructure
2. **Interest costs on debt** – some costs are not recognised in the income statement
3. **Group relief** – tax losses generated from interest expenses in our holding companies can be transferred under "group relief" rules. Broadly speaking, these rules ensure that corporation tax is paid on the profits of the whole group
4. **Pension contributions** – some contributions are not recognised in the income statement. This encourages pension savings
5. **New service connections to our network** – this income is taxed by reducing capital allowances instead
6. **Property disposals** – additional tax deductions are available when property is sold

Added back

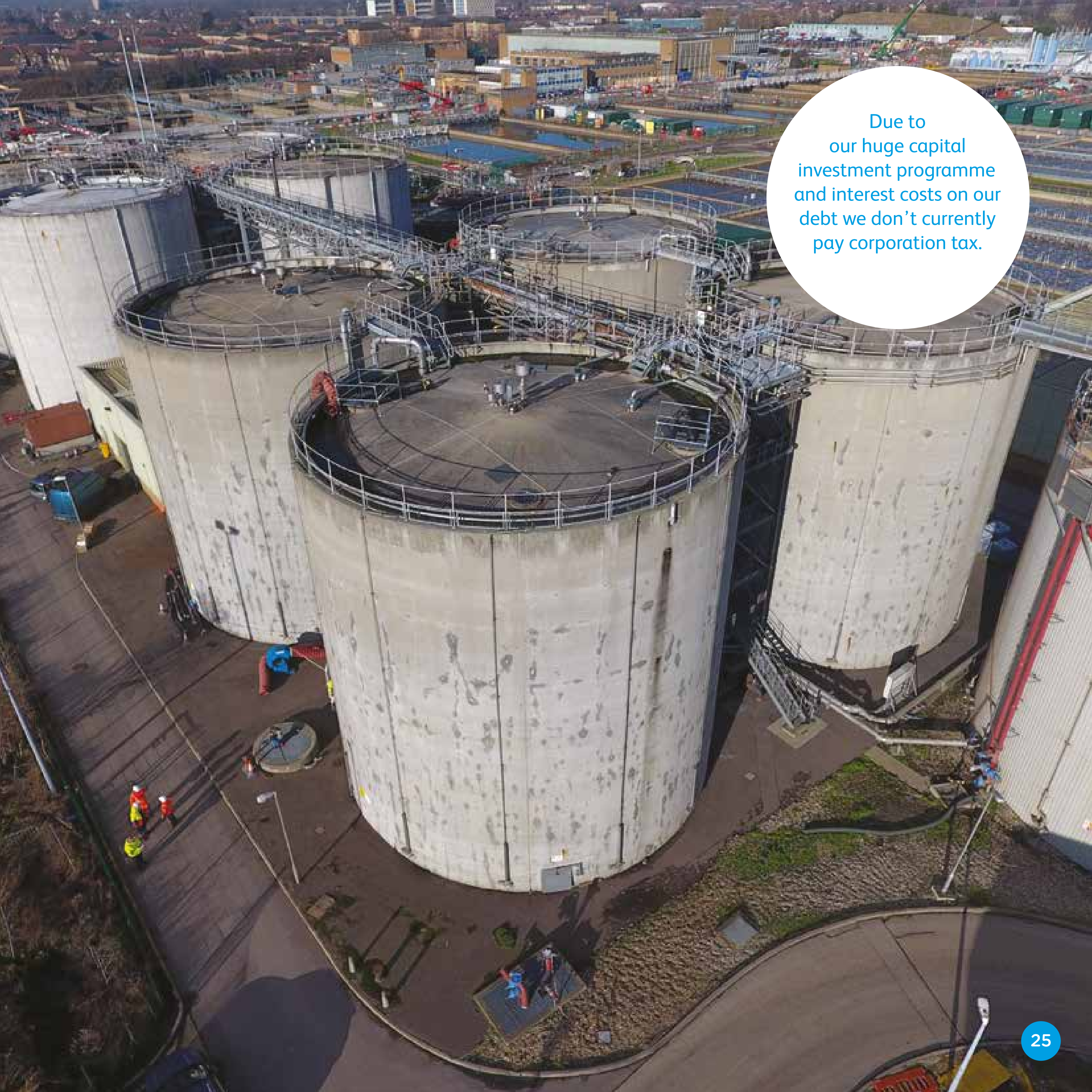
7. **Depreciation** – of infrastructure as capital allowances are deducted instead. In the early years, the depreciation costs are generally lower than capital allowances, which defers our tax
8. **Derivatives** – which are taxed based on their cash flows rather than accounting profits or losses
9. **Disallowable costs** – i.e. fines

Our draft corporation tax computation 2017/18

	£m
Profit before tax per statutory accounts	151
Deduct:	
1 Capital allowances	(473)
2 Interest costs on debt	(101)
3 Group relief	(72)
4 Pension contributions	(20)
5 New service connections to our network	(23)
6 Property disposals	(8)
Add back:	
7 Depreciation of infrastructure	546
8 Fair value losses on derivatives	(4)
9 Disallowable costs (e.g. fines)	4
Taxable profits	Nil

Already included in profit before tax: Interest costs on debt of £427m, which are deductible for tax purposes

"Our largest deductions are for capital allowances and interest".



Due to our huge capital investment programme and interest costs on our debt we don't currently pay corporation tax.

Country by country reporting

Our operations

All of the Group's operational activities are located in the UK. Historically we have traded in overseas countries, and as a result have legacy entities incorporated in Thailand, Brazil, Singapore and Puerto Rico. There are no trading activities in these overseas entities, and we are in the process of closing them down. However, this process can take some time and in the meantime they continue to comply with the relevant administrative requirements incurring a low level of administrative costs.

We have an insurance company incorporated in Guernsey which manages historic insurance claims, and a finance company and holding company incorporated in the Cayman Islands, which are now in the process of being closed down. It is important to note that any profits generated by these entities are, and always have been, fully subject to tax in the UK.

Guernsey

Our captive insurance company manages legacy insurance claims against the Group for historic policies written up to 2008 (no new insurance contracts have been written since then and it is in a "run-off" phase). Although the company pays no tax in Guernsey and is not tax resident in the UK, any profits arising in the company are fully taxable in the UK under UK Controlled Foreign Company rules. As part of our commitment to simplify our structure and support transparency we will dispose of this subsidiary in 2019.

An abbreviated version of the information that we expect to disclose to HMRC for the purposes of Country by Country Reporting in relation to 2017/18 is provided below.

Country of incorporation	Tax residence	Tax paid (£m)	Revenue (£m)	Profit / (loss) before tax (£m)	Reported current tax (charge)/credit (£m)	Number of employees/ directors	Net assets / (liabilities) (£m)
UK entities	UK	-	2,045.2	82.3	1.3	5,419	1,577.7
Guernsey	Guernsey	-	-	(0.5)	-	4	3.1
Cayman Islands	UK	-	-	69.4	(1.2)	3	(117.3)
Singapore	Singapore[B]	-	-	-	-	2	(0.1)
Puerto Rico	Puerto Rico	-	-	-	(0.1)	2	0.8
Brazil	Brazil	-	-	-	-	-	-
Thailand	Thailand	-	-	(0.1)	-	3	(0.8)
Total as per 2017/18 Group accounts		-	2,045.2	151.1	-	5,426[A]	1,463.4

Note: Figures are to the nearest £0.1m, and based on statutory accounts for the year ended 31 March 2018, except Singapore and Thailand which had a year end of 31 December 2017.
Note A: Some directors of overseas entities are also employees of UK entities.
Note B: This entity also has an Indian branch

Closure of our Cayman Island companies

In 2007 we incorporated a finance company and a holding company in the Cayman Islands.

A finance company raises funding for the group, for example by issuing bonds, and manages treasury aspects such as derivatives. The funds raised by the finance company were lent to Thames Water Utilities Limited, primarily to fund our infrastructure investment programme. The purpose of the Cayman Islands holding company was to hold shares in the finance company.

The use of a Cayman Islands incorporated finance company was solely to address the requirements of UK company law that existed when it was set up in 2007. It was not possible for a UK company to issue public bonds to repay debt provided by investors to help finance its acquisition. These restrictions have now largely been amended or removed.

Although the companies were registered in the Cayman Islands, they were always resident in the UK for tax purposes and were subject to tax in the UK. There was no tax benefit associated with the companies being registered in the Cayman Islands and the companies operated and were managed wholly from our UK office.

Although they provide no tax benefit we recognise the word Cayman complicates perceptions and we're in the process of closing the entities to simplify our structure and improve transparency.

The process to close them is nearly complete, and is outlined below:

1

June / July 2018

- Bondholders and shareholders agreed that our Cayman Islands incorporated entities could be eliminated

2

End of July 2018

- Our existing UK incorporated finance company was recapitalised in preparation of being converted into a PLC

3

End of August 2018

- Conversion to PLC took place
- The assets and liabilities in our Cayman Islands incorporated entities were transferred to UK entities on a tax neutral basis
- Bonds can now be issued by our UK incorporated PLC finance company to continue to fund our infrastructure investment programme

4

End of September 2018

- Cayman Islands entities were put into liquidation

5

By March 2019

- Cayman Islands entities are formally dissolved

Group structure

Our investors have invested equity and debt in the Group. The debt provided by our shareholders of £310 million is listed, which allows interest payments to be paid free from withholding tax under the Government's "quoted Eurobond" rules.

Shareholders

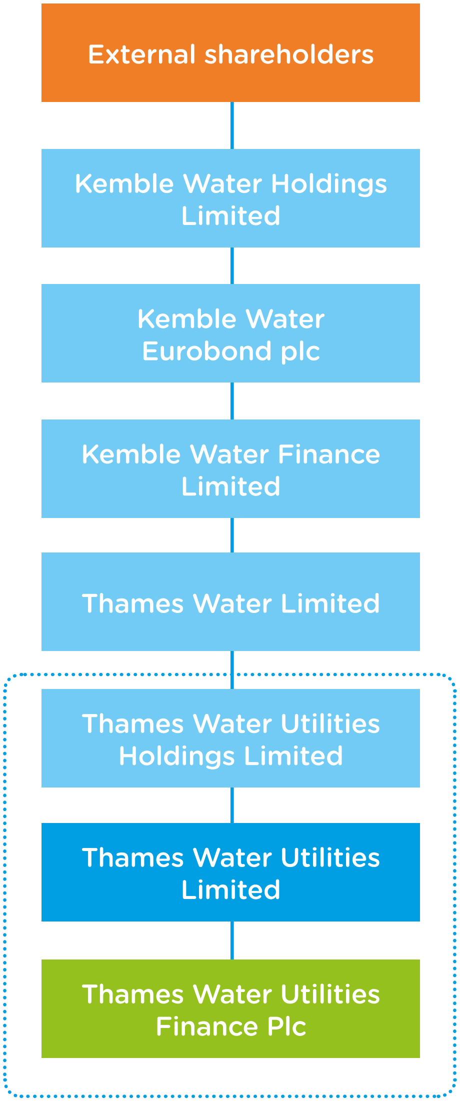
Holding Company

Regulated Water Company

Financing Company

Whole Business Securitisation Group

Establishing a 'whole business securitisation' structure
In 2007 a 'whole business securitisation' debt structure was established to insulate Thames Water's credit worthiness from that of its ultimate shareholders and holding companies. It introduced comprehensive covenant and security arrangements within Thames Water Utilities Limited for secured creditors to ensure the company would be able to secure and maintain a strong investment grade credit rating.



Kemble Water Holdings Limited

This is the ultimate, UK incorporated company of the Group, set up in 2006 for investors to hold shares in the group.

Kemble Water Eurobond plc

This is a UK incorporated company, originally set up to raise debt from shareholders to help buy Thames Water in 2006.

Kemble Water Finance Limited

This is a UK incorporated company, originally set up to raise debt from external lenders to help buy Thames Water in 2006. External lenders require greater security than shareholders so their debt is held in a separate company, which is closer to Thames Water. The company also holds our insurance company.

Thames Water Limited

This is a UK incorporated company, and was at one point listed on the London Stock Exchange. Now it holds pension obligations and other non-regulated companies.

Thames Water Utilities Holdings Limited

This is a UK incorporated company, set up in 2007 for the whole business securitisation (WBS), and provides security to WBS lenders over the shares in TWUL

Thames Water Utilities Limited

This is our regulated operating company which provides water and sewerage services.

Thames Water Utilities Finance Plc

This is a UK incorporated company, which raises debt to fund investment in our water and sewerage network.

Ownership

Thames Water is jointly owned by 10 institutional investors – made up mostly of pension funds and sovereign wealth funds. The two largest investors represent pension funds – one based in Canada and one in the UK. All of our investors take a long-term view of the company's infrastructure, its customers and the natural environment.

Our external shareholders

	% holding
Ontario Municipal Employees Retirement System (OMERS) OMERS is the defined benefit pension plan for 482,000 active, deferred and retired employees of nearly 1,000 municipalities, school boards, libraries, police and fire departments, and other local agencies in communities across Ontario, Canada.	31.777
Universities Superannuation Scheme (USS) Universities Superannuation Scheme was established in 1975 as the principal pension scheme for universities and other higher education institutions in the UK. It has circa 390,000 scheme members across more than 350 institutions and is one of the largest pension schemes in the UK, with total fund assets of over £60 billion (as at March 2017).	10.939
Infinity Infinity Investments S.A is a subsidiary of the Abu Dhabi Investment Authority (ADIA). ADIA manages a global investment portfolio that is diversified across more than two dozen asset classes and sub-categories.	9.900
Wren House Wren House Infrastructure Management Limited, an English limited liability company, was set up in late 2013 as the global direct infrastructure investment vehicle of the Kuwait Investment Authority ("KIA"). The KIA is the sole shareholder of Wren House. Wren House has been assigned responsibility for building partnerships, sourcing and execution of transactions, as well as asset management. Wren House's strategy is targeting the creation of a long-term focused, sustainable infrastructure platform and Wren House seeks to do so through partnership investment models for sizeable transactions where large sums of capital can be deployed.	8.772
bcIMC bcIMC is one of Canada's largest institutional investors within the capital markets. It invests on behalf of public sector clients in British Columbia and its activities help finance the retirement benefits of more than 538,000 plan members, as well as the insurance and benefit funds that cover over 2.3 million workers in British Columbia.	8.706
Hermes (BT Pension Scheme) Hermes GPE is one of Europe's leading independent specialists in global private markets. It manages its investment in Thames Water on behalf of the BT Pension Scheme, which has 300,000 scheme members. Hermes GPE invests in and advises on infrastructure, private equity and credit products on behalf of its clients and is specialised in co-investments, primary fund and secondary investments.	8.699
Cicero Investment Corporation As a sovereign wealth fund, Cicero Investment Corporation is a vehicle to diversify China's foreign exchange holdings and seek maximum returns for its shareholder within acceptable risk tolerance.	8.688
QIC QIC is a global diversified alternative investment firm offering infrastructure, real estate, private equity, liquid strategies, and multi-asset investments. It is one of the largest institutional investment managers in Australia.	5.352
Aquila Aquila GP Inc. is a leading infrastructure management firm and a wholly owned subsidiary of Fiera Infrastructure Inc., a leading investor across all subsectors of the infrastructure asset class.	4.995
PGGM (Stichting Pensioenfonds Zorg en Welzijn) PGGM are a pension fund service provider and manage the pensions for different pension funds, the affiliated employers and their employees.	2.172

Profits and dividends

Profits

Our profit is the revenue we have left after taking into account all of our day-to-day running costs, finance expense and taxes. In 2017/18 our underlying profit after tax was £108.8 million which excludes the money passed over to Bazalgette Tunnel Limited for the Thames Tideway Tunnel.

Dividends

Dividends are used for two purposes:

1 To pay for holding company obligations

Thames Water Utilities Limited is one company within a larger group of companies, known as the Kemble Water Group. Each of the companies within our group serves its own function. Thames Water's dividends are initially paid to its immediate parent company (commonly referred to as a 'holding company'), and then money will flow up through the group, in part to enable the holding companies to pay for their own debt obligations and their own working capital requirements. In 2017/18 £55 million was paid to holding companies and other group companies to service their debt and cover day-to-day cash needs.

2 Shareholder Returns

While we focus on meeting the performance expectations of customers, our investors support the Board's decision not to pay any dividends to external shareholders for the rest of the current regulatory period, so the money they would have received can be reinvested. Our new shareholders will not receive dividends for the first three years of ownership Between 2020 and 2025, we will pay modest dividends of circa £20 million a year.

A fair dividend policy

We recognise the importance of paying dividends in future years to continue attracting the right type of long-term investors who will remain committed to our long-term vision. The Board is also mindful of the privilege of our position as a monopoly provider of essential services and has agreed the parameters of a new and fair dividend policy, with full support of shareholders, which has the following features:

- Payment of a proposed dividend should not impair short-term liquidity or compliance with our covenants
- Payment of a proposed dividend should not impair the longer- term financeability of the company's business
- Assessment of the impact that payment of the dividend may have on all stakeholders including employees, pension members and customers
- Our financial performance, that underpins the opportunity to pay the dividend, is as a result of operational performance that meets the level required of a supplier of essential services
- If a net dividend is declared above Ofwat's 5% dividend yield guidance, applied to Ofwat's notional company, the Board will consider whether the additional returns result from performance (including progress towards de-gearing) that has benefited customers and may therefore be reasonably applied to finance a dividend

When dividends are paid, we will be clear about their level, how they relate to delivery for customers and why they have been awarded.

Executive remuneration

We are committed to ensuring our remuneration framework supports our strategy and our approach is based on key principles:

- Be aligned with customers' needs and the long-term objectives of all stakeholders;
- Drive behaviours that support what our customers want, need and expect;
- Demonstrate a clear link between performance-related pay and excellent operational performance; and
- Seek to offer reasonable and competitive pay and benefits which are simple, transparent and fair.

Our Chief Executive Officer, Steve Robertson, will not take any bonus payments until 2020, as a personal commitment to improving the performance of the business. He will only receive these bonus payments following the end of the regulatory period, if we meet our critical customer and environmental commitments as shown below.

CEO bonus targets

Incentive Element	Measures	Element as % of Total Bonus
Leakage	ML/d	50.0%
Customer	Contactor NPS	12.5%
	Non-Contactor NPS	
Asset Health	Asset Health Measures	12.5%
Environment	Environmental Performance Assessment	12.5%
Shareholder Value	PR19 Outcome	12.5%

Structure of the targets for the 2018/19 'Annual Managers bonus' for executive directors (excluding the CEO).

Bonus Element	Objective	Measures	Element of % of Total Bonus
Customer	New billing and service platform (Project Spring) Customer Advocacy	Programme complete and benefits on track Contactor NPS on track Non-contactor NPS on track	20%
Corporate Challenges	Organisation Design ("OD") Company Monitoring Framework	Deliver successful OD programme Company Monitoring Framework assessment	20%
PR19	PR19 successful	Deliver successful PR19 outcome	20%
Financial	Group EBITDA	Group EBITDA	20%
Personal	Annual personal performance assessment, including delivery of budgets, will determine the percentage applied.		20%

Our investment history

Average yearly investment in 2017/18 prices.

Five years prior to privatisation
£350 million

The water industry was privatised in 1989

1989 - 2001
£629 million

Post-privatisation – rebuilding infrastructure as Thames Water Plc (floated on the London Stock Exchange)

One of the key reasons the industry was privatised was to address the many years of underinvestment in water and wastewater infrastructure during public ownership. During this period, we constructed the Thames Water ring main, and upgraded our major treatment works in London.

2001 - 2006
£716 million*

International expansion as part of RWE

After the German utility company, RWE acquired Thames Water, we accelerated the rate of our international expansion. As part of this, we purchased the US' largest privately owned water company, American Water Works.

2006 - 2017
£1.1 billion

Focusing on the UK as part of the Kemble Group

After the Kemble Group, made up of national and international investors, bought Thames Water in 2006, all of our global interests were sold or closed. This allowed us to focus our attention on the UK.

2017 – present
£1.1 billion

Current ownership

Since 2017, new investors, OMERS, USS and Wren House have, in aggregate, acquired over 51% of Thames Water. The new shareholder base has agreed not to take dividends until at least 2020, as we focus on improving performance for our customers.

*Investment in UK business

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This booklet can be supplied in large print, braille, or audio format upon request.

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