

CHAIRMAN'S LETTER TO SHAREHOLDERS



SIR JOHN PARKER, CHAIRMAN

DEAR SHAREHOLDER

In my first corporate governance report on behalf of the Board, I am pleased to confirm that it was evident to me on my appointment that the three essential pillars of a successful board were in evidence in the Pennon boardroom, namely having strong financial control, sound administration and good governance. I place great importance on all these facets but maintaining good governance is central to the successful management of every board and to the creation of shareholder value as set out in our business model on pages 10 and 11.

I am committed to ensuring that Pennon Group continues to operate to the highest standards of corporate governance and in my first few months as Chairman I have reviewed in consultation with the Non-executive Directors the Board governance structure. The result is a more streamlined structure as described in this report on page 62 whilst ensuring that the water business remains ring-fenced in accordance with Ofwat regulatory requirements.

The annual report is the principal method of reporting to our shareholders on the Board's governance policies and the practical application of the principles of good corporate governance set out in the UK Corporate Governance Code (the UK Code). The UK Code is published on the Financial Reporting Council (FRC) website, www.frc.org.uk. In accordance with the FRC's requirements, we have reported against the latest version of the Code, which is effective for reporting periods commencing on or after 1 October 2014.

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ROLE OF THE BOARD AND ITS EFFECTIVENESS

My primary role as Chairman is to provide leadership to the Board and to provide the right environment to enable the Directors and the Board as a whole to perform effectively to promote the success of the Company for the benefit of its shareholders. In doing so we take account of the interests of our customers, employees, suppliers, the communities in which we operate and other interested stakeholders including Ofwat, the Drinking Water Inspectorate, the UK environment agencies and other regulatory bodies in the UK.

I believe our revised Board structure reinforces the good governance that was in place before I became Chairman and will enable us to continue to operate effectively and cohesively as a Board. It is my responsibility each year to lead a detailed performance evaluation of the Board and each of the Committees. The aim is to identify further areas for improvement and ensure that our knowledge, skills and processes remain relevant as the Group's businesses develop and grow. Further details of the review, which was facilitated by an external governance consultancy, are set out later in this report.

The revised Board structure also assists in ensuring that all Board members continue to have appropriate up-to-date knowledge and understanding of our businesses as we pursue our refreshed strategy described in the strategic report.

SHAREHOLDER ENGAGEMENT

We maintain appropriate and regular dialogue with our shareholders to ensure that there is a good understanding of our rationale for our strategy and our performance actions. It also allows shareholders to provide feedback on the matters they consider to be important and any issues which require addressing.

We have a comprehensive investor relations programme. During the year some 85 meetings and conference calls were held and Pennon attended six City conferences and salesforce briefings hosted by investment banks. This engagement covered both current and prospective shareholders, the majority of which are institutional, with the remainder being a selection of large private client investment managers.

Over the year we also held a series of analyst and investor briefings focused on particular industry themes and key areas of our business. These included a Viridor Waste Market Briefing, a South West Water Briefing on delivering and outperforming the K6 business plan and an analyst and investor day in Manchester, including site visits to Viridor's Runcorn Energy Recovery Facility and Longley Lane Materials Recycling Facility. In addition to these events, Pennon held its inaugural Capital Markets Event in February, focusing on recent Board and management changes and Group strategy.

The Chief Financial Officer continues to report to the Board regularly on major shareholders' views about the Group, and every six months the Company's brokers present to the Board on equity market developments and shareholder perceptions. This ensures that the Board is fully briefed on the views and aspirations of shareholders.

I will actively encourage the participation of our shareholders at our AGMs and will welcome questions on any business issues affecting the Group. As usual, at our 2016 AGM on 1 July all our Directors intend to be present together with a number of other senior executives of our businesses to meet with shareholders to further explain the developments in the Group.

COMPLIANCE WITH THE UK CORPORATE GOVERNANCE CODE AND OTHER REQUIREMENTS

I am pleased to report that throughout the year the Company complied with the provisions and applied the main principles set out in the UK Code with no exceptions to report.

My introduction to this corporate governance report and the following sections are made in compliance with the UK Code, Financial Conduct Authority (FCA) Listing Rule 9.8.6 and FCA Disclosure and Transparency Rules 7.1 and 7.2 and cover the work of our Board and its Committees, our internal control systems and procedures including risk management, our corporate governance statements relating to share capital and control, our confirmation of the Company as a going concern and Directors' responsibility statements. Finally, in accordance with reporting requirements, on page 101 the Board confirms to shareholders that the Annual Report and Accounts taken as a whole is fair, balanced and understandable and provides the information necessary to assess the Company's performance, business model and strategy.

Sir John Parker
Chairman
Pennon Group Plc
24 May 2016