

Registered number 5819262 (England & Wales)

**Kemble Water Holdings Limited**  
Annual report and financial statements  
For the year ended 31 March 2012



# **Kemble Water Holdings Limited**

## **Annual report and financial statements for the year ended 31 March 2012**

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# **Kemble Water Holdings Limited**

## **Introduction**

Kemble Water Holdings Limited (the "Company") is the ultimate parent company of the Kemble Water Holdings Group (the "Group"). The Group's principal activity is the regulated supply of water and sewerage services through its wholly owned subsidiary, Thames Water Utilities Limited ("TWUL" or "Thames Water"). The Company acts as the holding company for the Group and does not carry out any activities beyond this role.

The Group's performance is therefore dependent upon the performance of TWUL, which in turn is largely dependent upon the regulated business. This report makes reference to the performance of TWUL in order to provide appropriate explanations as to the performance of the Group. The key financial performance indicators of both the Group and TWUL are presented in the Directors' report on page 7.

The Group's management structure separates the management of the Group from the directors of the Company. The Company's directors are all non-executives, whilst the executive team of TWUL work on behalf of the Group, in addition to their responsibilities to TWUL.

## **Directors and advisors at 31 March 2012**

### **Directors**

Sir Peter Mason KBE  
E Beckley  
C R Deacon  
Dr P Dyer  
S R Eaves  
Y Shi  
L Webb  
G I W Parsons  
D J Shah OBE  
M S W Stanley  
R E Verrion

### **Registered auditor**

KPMG Audit Plc  
Chartered Accountants  
15 Canada Square  
London  
E14 5GL

### **Company Secretary and registered office**

J E Hanson  
Clearwater Court  
Vastern Road  
Reading  
Berkshire  
RG1 8DB

# **Kemble Water Holdings Limited**

## **Chairman's statement**

Satisfactory operational and financial performance have again been features of the last year for the Group. It has also been a period of significant and ongoing challenges, to which the Group continues to respond robustly.

Two consecutive dry winters forced the introduction of a temporary use ban across much of southern and eastern England, and the Thames Valley was no exception.

This was not a measure Thames Water took lightly, but one that was unfortunately necessary in order to minimise the likelihood of more severe restrictions at a later stage, if the drought continued.

Against this background, it is all the more satisfying that Thames Water has achieved its leakage target for the sixth successive year, and by a significant margin.

This has been just one aspect of the prudent management of water resources, which has included the use of Thames Water's desalination plant in east London, in response to the drought, to supplement water resources.

The wise use of water is particularly important at a time when Thames Water faces its second major challenge: the staging of the 2012 Olympic and Paralympic games ("the London 2012 games") in London.

The provision of water and sewerage services will clearly play a vital part in the successful staging of the London 2012 games. Thames Water has also been planning carefully to mitigate the inevitable disruption to streetworks activity.

The capital will clearly be the centre of attention this summer. It is also the focus for two huge engineering schemes, which are a major centre of activity for Thames Water, the Lee Tunnel and the Thames Tunnel.

I am pleased to report that, after some years of discussion and planning, work is finally under way to significantly reduce overflows of sewage into London's major rivers.

Although frequently overshadowed by discussions of the Thames Tunnel, the Lee Tunnel will be the largest and deepest tunnel beneath the capital. The tunnel boring machine has started excavating and is due to emerge in Abbey Mills, east London in late 2013.

Thames Water also made good progress on the planning of the Thames Tunnel with Government support. February saw the completion of the second phase of planning consultation on this huge project, which will involve 24 major construction sites across the city.

The Government recognised the Thames Tunnel's importance by including the project in the Chancellor's National Infrastructure Plan and subsequently safeguarded certain key sites.

Elsewhere in London, another major wastewater scheme began to take shape at Deephams Sewerage Treatment Works ("STW"), in Edmonton, where a major upgrade is needed to meet new environmental standards set by the Environment Agency ("EA").

The year ended 31 March 2012 was the second year of the current five-year investment period ("AMP5"). It naturally saw Thames Water accelerating much of the work that began in 2010/11 and is starting to record some significant achievements.

Work is nearing completion, for example, on the first of a series of major improvement projects at our five biggest STW, to improve both their capacity and the quality of treated effluent they discharge to the tidal Thames.

I am pleased to say that our 350 STW once again continued their record of 100% compliance with the strict standards set by the EA.

One area of concern was a rise in the number of serious pollution cases, which senior management is working hard to address.

# **Kemble Water Holdings Limited**

## **Chairman's statement (continued)**

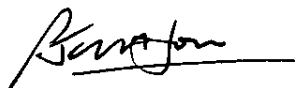
Another significant challenge is the area of customer satisfaction. The way Thames Water handles queries and complaints is rated poorly when compared with the rest of the sector, and this remains an area where it is striving to improve.

On the drinking water side of the business, Thames Water again reported excellent performance. For the calendar year ended 31 December 2011, 99.98% of samples taken at customers' taps complied with stringent national and European standards. This was a slight improvement on the year before, and saw Thames Water maintain supplies that are among the best quality in the UK.

The continuing high performance across the business was, of course, made possible by good management. This is being further enhanced by a major development programme, for which the Thames Water last December received the Staff Development Award at the Utility Industry Achievement Awards. To date, more than 700 managers have completed the programme.

During the year Luis Abreira, Rosamund Blomfield-Smith and Antonio Santos resigned as directors. I would like to thank them all for their valuable contributions. We also welcomed Simon Eaves, Yaping Shi and Lincoln Webb, as new directors bringing with them extensive experience.

I would like to note my thanks to staff across Kemble Water Holding Group for their achievements during 2011/12.



**Sir Peter Mason KBE**

Chairman

7 June 2012

# **Kemble Water Holdings Limited**

## **Directors' report**

### **Introduction**

Unless otherwise stated, all current year data included in this review is for the year ended 31 March 2012 ("2012")

Kemble Water Holdings Limited and its subsidiaries form the Kemble Water Holdings group of companies

### **Nature of business**

The principal activity in the Group is the regulated supply of water and sewerage services by its wholly owned subsidiary, TWUL. The Company's principal activity is to act as the holding company for the Group

### **Background**

TWUL is the largest supplier of water and provider of sewerage services in the UK, based on the number of customers served. It is one of 10 companies currently holding appointments as water and sewerage undertakers in England and Wales, with a further 11 companies holding appointments as water only undertakers

In total, the area served by Thames Water occupies approximately 13,331 km<sup>2</sup> and encompasses more than 9% of the area of England and Wales. This includes London and extends as far as Cirencester in the west, Dartford in the east, Banbury in the north and Haslemere in the south. This area has a population of about 14m people, which represents nearly a quarter of the total population of England and Wales. In approximate terms, Thames Water supplies 3.6m properties (just over 8.8m people) with water, and collects sewage from 5.1m properties (about 14m people), representing 97% of households in its sewerage region

The Annual Performance Report 2011/12, which incorporates the Corporate Responsibility Report, does not form part of this report. It provides further information regarding Thames Water's regulatory and operational performance and will be available on the Thames Water website [www.thameswater.co.uk/cps](http://www.thameswater.co.uk/cps) from 15 July 2012

# Kemble Water Holdings Limited

## Directors' report (continued)

During the last year, Thames Water continued its satisfactory performance against its targets

### Highlights

- Delivering over £1bn of investment in the year, bringing the total for the first two years of AMP5 to over £2bn, in line with Thames Water's capital programme to deliver £4.9bn of investment during this AMP period
- Delivering all of Thames Water's key regulatory outputs, ensuring that the condition of its assets is maintained
- Thames Water reduced leakage to 637 Mld a reduction of 28 Mld (4.2%) compared to 665 Mld in the prior period and beat its target for the year by 36 Mld
- Thames Water's drinking water quality improved slightly to 99.98% (2011: 99.97%)
- Thames Water achieved 100% sewage treatment compliance against strict standards set by the EA
- In November 2011, Thames Water opened its Old Ford water recycling plant on the edge of the Olympic Park in East London, which will supplement the supply of water for the London 2012 games
- Greenhouse gas emissions were 16% lower than two decades ago, despite Thames Water serving 3m more customers and meeting higher standards in many areas of operation
- In addition, 14% of the Group's electricity was generated from renewable energy from burning methane gas from sewage at 22 of its larger STW. The Group also installed solar power arrays at 3 of its main sites and 28 smaller sites. The Group is now one of the largest solar power generators in the UK
- Thames Water was awarded the Utility Industry Achievement Award for staff development in the year
- Thames Water's Transforming Thames programme is delivering its Work, Asset Management and Information ("WAMI") programme, a new contract that covers all metering services and introduced new working patterns and associated terms and conditions for staff
- The Group introduced changes to the Thames Water Pension scheme whereby the defined benefit provision from 1 May 2011 is now based on a Career Average Revalued Earnings ("CARE") basis and no longer on a Final Salary basis
- Thames Water successfully adopted approximately 40,000 km of privately owned sewers and lateral drains on 1 October 2011

# Kemble Water Holdings Limited

## Directors' report (continued)

### Lowlights

- It is with deep regret that the Group has to report the death of two contractors who suffered fatal injuries in two separate incidents. The health and safety of both the Group's, and its contractors' employees continues to be the Group's number one priority.
- The Service Incentive Mechanism ("SIM") score, a measure of customer satisfaction, has deteriorated to 62.61 (2011: 65.20).
- The number of pollution incidents from the Group's sewerage system increased in comparison to last year, with 75 more incidents recorded per 1,000 km. This gave a total of 268 pollution incidents, 20 of which were considered to be serious. An incident in the River Crane resulted in the death of fish along approximately a 12km stretch of the river. Thames Water responded as quickly as it could to clean up the river and has made a voluntary commitment to an ongoing programme of restoration, to be delivered through the Crane Valley Partnership. Spillages from the Group's sewer network are unacceptable and the Group is working harder to try to avoid them.
- In response to the River Crane incident Thames Water has already improved many aspects of its business processes. Key to the ongoing performance improvement is the creation of an Event Learning role to learn from each incident so that Thames Water can work to avoid similar events in the future.
- The bad debt charge has increased to £70.6m (2011: £38.4m) as a result of collection difficulties and customers' ability to pay as a result of the economic recession.



# Kemble Water Holdings Limited

## Directors' report (continued)

### Financial results

#### Financial Key Performance Indicators (KPIs)

Performance Measure	The Group			Thames Water Utilities Limited		
	Year to 31 March 2012 £m	Year to 31 March 2011 £m	% Change	Year to 31 March 2012 £m	Year to 31 March 2011 £m	% Change
Turnover	1,700.2	1,641.9	3.6	1,694.9	1,623.1	4.4
Operating expenditure <sup>1</sup>	(681.9)	(647.9)	(5.2)	(675.4)	(629.6)	(7.3)
Operating profit <sup>2</sup>	576.7	535.0	7.8	643.9	600.2	7.3
Underlying (loss)/profit before tax <sup>3</sup>	(47.0)	(105.6)	55.5	182.2	208.5	(12.6)
Net interest payable (see note 2)	(587.2)	(650.0)	9.7	(425.6)	(402.6)	(5.7)
Total capital expenditure (see note 13) <sup>4</sup>	1,063.8	1,006.6	5.7	1,063.8	1,006.6	5.7

#### Turnover

Turnover for the year was £58.3m (3.6%) higher than the prior year at £1,700.2m (2011: £1,641.9m), reflecting real increases in price ("K"), as agreed with Ofwat, together with increases linked to the Retail Price Index ("RPI")

#### Operating expenditure

Operating expenditure, excluding exceptional item, see note 3 page 50, for the year has increased by £34.0m (5.2%) to £681.9m (2011: £647.9m) compared to the prior year. This increase is as a result of inflationary pressures with average RPI of 4.8%, increased provisioning for bad debts caused by the economic climate and higher than inflationary power price increases, partly offset by a network contract claim settlement (relating to operating expenditure) and continued operational efficiencies.

#### Operating profit

Operating profit has risen by 7.8% to £576.7m (2011: £535.0m). Underlying operating profit, which excludes the exceptional pension curtailment gain of £40.0m in 2012, increased 0.3% to £536.7m (2011: £535.0m).

#### Net interest payable

Net interest payable decreased to £587.2m (2011: £650m). The charge in 2011 was increased by costs of £91m from exiting swap arrangements incurred when re-financing the Group's subordinated debt in Kemble Water Finance Limited.

<sup>1</sup> Operating expenditure: operating costs, excluding exceptional item of £40.0m (2011: £nil) relating to a pension curtailment gain, amortisation, depreciation and the Infrastructure Renewals Charge ("IRC"), see note 3 to the financial statements.

<sup>2</sup> Operating profit is turnover less operating costs.

<sup>3</sup> Underlying (loss)/profit before tax: profit before tax excluding exceptional item (2012: £40.0m (pre-tax), 2011: £nil).

<sup>4</sup> Total capital expenditure: total expenditure on tangible fixed assets net of contributions received, see note 9 to the financial statements.

# **Kemble Water Holdings Limited**

## **Directors' report (continued)**

### **Financial results (continued)**

#### **Capital expenditure**

2011/12 has been a successful year for the delivery of capital investment by the Group, for the second year of AMP5, with over £1bn invested in delivering all of its capital regulatory outputs, whilst delivering efficiencies of over £80 0m against its five year business plan. The Group is on track to deliver the Group's required investment programme of nearly £5bn over this regulatory period.

#### **Treasury policy**

The Group's treasury operations are managed centrally by a small specialist team, which operates with the delegated authority of, and under policies approved by, the Board of Directors. The treasury function does not act as a profit centre and does not undertake any speculative trading activity. The key objectives of the funding strategy are defined by the regulatory regime within which TWUL operates and are intended to ensure that it meets all funding related requirements under the terms of its Licence. This includes maintaining cash reserves and access to undrawn committed bank facilities sufficient to fund at least 12 months net cash flow (as discussed on page 30 - Group dividend policy - extends this to a 15 month period) and to maintain an investment grade credit rating (see "Debt financing" section below) as set out in Condition F of the Licence.

A key objective of treasury policy is to ensure compliance with financial covenants, including interest cover and gearing ratios, maintain liquidity and a balanced debt maturity profile, and ensure that at least 85% of the interest cost within the Securitisation Group, (being Thames Water Utilities Holdings Limited, TWUL, Thames Water Utilities Finance Limited, Thames Water Utilities Cayman Finance Holdings Limited and Thames Water Utilities Cayman Finance Limited) is based on either fixed or RPI-linked interest rates.

#### **Financial risk management**

TWUL's Executive Team receives regular reports from all areas of the business to enable prompt identification of financial and other risks so that appropriate actions can be taken.

The operation of the treasury function is governed by policies and procedures, which set out guidelines for the management of interest rate risk and foreign exchange risk and the use of financial instruments. Treasury policy and procedures are incorporated within the financial control procedures of the Group.

The Group's operations expose it to a variety of financial risks that include the effects of changes in debt market prices, price risk, liquidity risk, interest rate risk and exchange rate risk.

Derivative financial instruments, including cross currency swaps, interest rate swaps and forward currency contracts are employed to manage the interest rate and currency risk arising from the primary financial instruments used to finance the Group's activities. Matching of assets and liabilities in foreign currencies is also applied wherever practicable. The Group actively maintains a broad portfolio of debt, diversified by source and maturity and designed to ensure the Group has sufficient available funds for operations.

The Group is exposed to commodity price risk, especially energy price risk, as a result of its operations. The Group aims to manage its risk by fixing contract prices where possible.

# **Kemble Water Holdings Limited**

## **Director's report (continued)**

### **Financial results (continued)**

#### **Financing**

The Group had committed facilities in place with a syndicate of relationship banks to the value of £1,625m, of which £350m was drawn at 31 March 2012. In addition, due to pre-funding activity undertaken in the final quarter of the year, the Group had £736.4m of cash and current asset investments at 31 March 2012, consisting of cash at bank, short-term deposits with highly rated banks or triple A rated money market funds. This balance, together with undrawn facilities, will provide the Group with the necessary liquidity to fund the operation of the business for at least the next fifteen months. The balance also includes £29.1m of ring-fenced cash and short term investments held in the Group's captive insurance company, Isis Insurance Company Limited, which has been excluded in assessing the liquidity position of the Group.

#### **Debt financing**

Debt financing is raised by the Group, through the Group's wholly owned subsidiaries, Thames Water Utilities Cayman Finance Limited, Kemble Water Finance Limited and Thames Water (Kemble) Finance Plc. Previously, debt had been raised through Thames Water Utilities Finance Limited, another wholly owned subsidiary.

Moody's Investor Service ("Moody's") rates subordinated debt (debt held outside of the securitisation group) at B1 and Fitch rate this debt at BB-. Moody's rate the Class A debt as issued by Thames Water Utilities Cayman Finance Limited, A- long term with stable outlook. Moody's also issues a Corporate Family Rating for the Securitisation Group of companies, which stands at Baa1, reflecting the ability to issue Class B debt beyond 31 March 2011. Standard and Poor's Rating Services ("Standard and Poor's") rates Class A debt as issued by Thames Water Utilities Cayman Finance Limited at A- with a stable outlook. Standard and Poor's are currently undertaking their annual rating review process. Accordingly, TWUL maintains an investment grade issuer credit rating in accordance with the requirements of its Licence.

#### **Capital structure**

Key features of the Group's capital structure are as follows:

- The Group maintains debt at various levels within the capital structure. During 2011 £835m variable rate loans held by Kemble Water Structure Limited were refinanced by £350m of new variable rate bank facilities and a £400m 8-year fixed rate bond at the level of Kemble Water Finance Limited and its financing subsidiary Thames Water (Kemble) Finance Plc respectively. In addition a £75m undrawn 5-year revolving credit facility was arranged at Kemble Water Finance Limited.
- All other debt issued by the Group is documented pursuant to a Common Terms Agreement as part of the Whole Business Securitisation entered into in August 2007. The Group companies within the Whole Business Securitisation ("the Securitisation Group") include Thames Water Utilities Holdings Limited and all of its wholly owned subsidiaries, including Thames Water Utilities Limited.
- Net debt issued by the Group: the ratio of net debt to Regulated Capital Value ("RCV") within the Group is limited to 92.5%.
- Net debt issued by the Securitisation Group: Two classes of debt exist within the Securitisation Group, ("Class A") debt is the most senior debt obligation of the Group and the ratio of Class A net indebtedness to RCV is limited to 75%. Alongside this class of debt the Securitisation Group is able to issue subordinated ("Class B") debt. The ratio of Class A and Class B net indebtedness combined ("Senior net indebtedness") to RCV is limited to 85%.
- Each Obligor within the Securitisation Group has entered into the Security Trust and Inter-creditor Deed ("STID") with the Security Trustee pursuant to which Thames Water Utilities Holdings Limited guarantees the obligations of each other Obligor under the finance documents and the Group and its wholly owned subsidiaries guarantee the obligations of each other under the finance documents, in each case to the Security Trustee. Following an event of default, the documents provide for an automatic 18 month standstill of the claims of the creditors that have entered into the STID.

# Kemble Water Holdings Limited

## Director's report (continued)

### Insurance

The Group maintains a comprehensive insurance programme, renewed annually. This includes cover for a range of insurance classes including Public Liability, Property, Employers Liability, Construction, Motor, and Directors & Officer liability cover.

The insurance coverage has been reviewed and approved by an independent insurance adviser retained to ensure that the Group's insurances,

- are consistent with Good Industry Practice,
- have regard to the risk being covered,
- address the interests of the Group.

### Covenant compliance

Under the terms of its finance documents, the Group is required to comply with various covenants such as interest cover and net debt to RCV. These covenants are measured and submitted to lenders semi-annually and involve both actual data and forecasts. Key financial covenants are shown below.

Covenant	Actual	Trigger	Default
KW Finance Group Debt/RCV	85.2%	92.5%	95.0%
KW Finance PMICR	1.9x	N/A	1.05x
TWUL Senior Debt/RCV	78.3%	85.0%	95.0%
TWUL Senior PMICR	1.4x	1.1x	N/A
TWUL Class A Debt/RCV	68.8%	75.0%	85.0%
TWUL Class A PMICR	1.6x	1.3x	1.1x

The Group was in compliance with all its covenants at 31 March 2012.

The Group has a number of controls in place to ensure compliance with its financial covenants. All the covenants are calculated monthly, including look forward calculations to the end of the AMP period, and reviewed by the TWUL executive, the Group's board and the shareholders. In addition, the regulated nature of the Group's principle business gives a relatively high degree of certainty as to the forecast cash flows of the Group, which is further supported by a rigorous monthly cash flow forecasting process.

The hedging policy under the Whole Business Securitisation requires 85% of debt within the Securitisation Group to be either at a fixed rate of interest, or index linked. This gives the Group a high level of certainty over the cash interest cost.

Finally, the Group assesses the ratio of Senior Net Indebtedness (TWUL Senior Debt/RCV above) to the level of both the stated RCV and the RCV taking into account the Group's best estimates of adjustments that will be made at the beginning of the next AMP period.

These factors give the Group the confidence that it can operate within the financial covenants listed above.

# Kemble Water Holdings Limited

## Director's report (continued)

### Key non-financial performance measures

The table below shows the Group's performance against its key non-financial performance measures, which, with two exceptions were all achieved

Target area	Target 2011/12	Performance 2011/12	Target achieved
<b>Corporate responsibility programme</b>			
Business in the Community Corporate Responsibility Index	Platinum (> 95%)	Platinum (> 95%)	✓
<b>Water</b>			
Drinking water quality compliance	99.98%	99.98%	✓
Security of supply score	100	100	✓
Leakage	673	637	✓
Properties receiving low pressure	34	3	✓
<b>Wastewater</b>			
Sewerage treatment works compliance (LUT)	100%	100%	✓
Properties alleviated from external and internal sewer flooding	-	84*	Target is to achieve 2,488 by 2015
Serious or significant pollution incidents	Zero	20	x
Satisfactory disposal of sewage sludge	100%	100%	✓
<b>Our wider responsibilities</b>			
Renewable energy generation	197 GWh	176 GWh	x
Health and safety – number of accidents per 1,000 employees	5.37	3.12	✓
Employee volunteering – employees volunteering in schools, the community or charities	15%	18%	✓
Sites of Special Scientific Interest (SSSI) in favourable and unfavourable recovering condition	95%	100%	✓
Suppliers, contractors, and service providers' invoices paid according to agreed terms and conditions (+/- 3 day tolerance)	85%	92%	✓

\* Provisional

# Kemble Water Holdings Limited

## Director's report (continued)

### Key performance measures (continued)

Below is a summary of some of the key changes in the business that the Group has used to drive its improvement against targets

#### Water Service and Environmental Performance

- Between 2005 and 2012, the Group has reduced leakage by 26%. A number of measures have helped to achieve this reduction, replacing old pipes including Victorian mains, trunk main replacement, and water pressure management as well as Thames Water's new Trunk Minder system as mentioned below. Thames Water has now met the annual leakage targets agreed with Ofwat for the last six years.
- Thames Water's new Trunk Minder system was introduced to identify a hidden underground leak as soon as it forms, allowing Thames Water to schedule a repair before a leak has time to wash away the ground around the trunk main and cause a major leak.
- The Group's drinking water quality performance remains high at 99.98% compliance, an improvement on the prior year. Whilst Thames Water aims to achieve 100% compliance, many of the failures recorded at customers' taps are caused by the condition or maintenance of customers' pipework and fittings. To that extent, 100% compliance is not within the control of the Thames Water. However, the Group will continue to strive to achieve this aim.
- Water efficiency has been a focus of Thames Water in its campaign to encourage customers to use water wisely. During the last year as a result customers have helped to achieve a daily saving of 6 Mld (2011: 5 Mld).

#### Sewerage Service and Environmental Performance

- During this year, the Group has increased the capacity of some of its STW's to treat wastewater from an additional 61,000 customers. This increase means that Thames Water can deal with new housing development for years to come without having to make further investment or seek delays to the building of these houses.
- Reducing the risk of sewer flooding is of the highest importance to both the Group and its customers. In the year, 45\* properties were affected by sewer flooding for the first time. The number of properties on Thames Water's high risk register was 1,529\*, an increase of three from the previous year. The Group's investment programme resolved the flooding of 60\* properties and Thames Water will continue to offer flooding mitigation measures to alleviate this most distressing experience.
- Thames Water again achieved 100% compliance with the EA standards on treated effluent across all of its 350 treatment works.
- During the year, Thames Water dealt with over 71,050 incidents of sewer blockages including 14,946 across the lengths of private sewers it adopted in October 2011. The Group recognises that this is not the level of performance that it expects to deliver, and is not in line with the Group's plan to reduce the number of these incidents by 2015. The Group aims to improve its performance through the use of new technology such as real time sewer monitors and targeted sewer inspection and maintenance.
- The Group recognises that the environmental damage and public nuisance caused by spillages from its sewer network is unacceptable and works hard to prevent them. The EA categorises pollution incidents on a scale from one (the most serious) to four (no significant environmental impact). In the period, there were 20 incidents that were categorised as Category 1 or 2 by the EA. Clearly, this level is unacceptable and Thames Water is working hard to improve its performance.

\*Provisional

# **Kemble Water Holdings Limited**

## **Director's report (continued)**

### **Key performance measures (continued)**

#### **Security of Supply**

- The Group has maintained 100% Security of Supply to all its customers

#### **Customer Service**

- Along with other water companies, the Group provides information to Ofwat on the number of complaints it receives, and how well they have been handled. The Group also proactively carries out customer satisfaction surveys to gauge where it is performing well and to give the Group an insight into the areas where its customers think that it can do better. Generally, customers were more satisfied with the Group's service than the previous year.
- The Group's Customer Assistance Fund provides support for customers who genuinely cannot pay their bills. During the year the fund made donations totalling £1.8m (2011: £1.9m). In addition £0.3m was provided for exceptional hardship cases and grants for nine specialist advice organisations including Citizens Advice to pay for specialist debt advisors.
- The Group has made improvements to its telephony system to make it easier for customers who would prefer to talk to a customer advisor. The Group has also provided a call back facility for customers who do not want to wait in the line during peak call times.

#### **Health and safety**

The Group continues to have a key focus on health and safety. It has developed its 'one-safety hub', a shared facility enabling the Group and its contractors to share best practice in health and safety. In the current financial year the Group has also reviewed and enhanced its health and safety systems and held further health and safety conferences for the Group's employees and its contractors.

The number of reportable accidents fell to an Accident Incident Rate ("AIR") of 0.33 injuries per 1,000 employees, (2011: 0.50) across the business, a 48% improvement since the start of AMP5.

However, it is with regret that the Group has to report that two employees of its contractors suffered fatal injuries in two separate incidents. The first of these occurred in June 2011 where the contractor was working in an excavation and the Health and Safety Executive are carrying out a full investigation. The second occurred in October 2011, where the contractor was struck by a vehicle when working in a roadway, a driver was charged and convicted of dangerous driving and was sentenced to time in prison.

# Kemble Water Holdings Limited

## Director's report (continued)

### Principal risks and uncertainties

#### Risk overview

The Group's Risk Management process is integrated within the business, and is designed both to identify emerging risks and to minimise the adverse impact of emerging and existing risks. Each business area is responsible for managing its risks and maintaining a risk register. Significant risks are escalated and reviewed by the Executive of TWUL, and the process is overseen by the Audit & Risk Review Committee of TWUL ("ARRC")

The Group is exposed to a number of risks and uncertainties that could have a material impact on its long-term performance. These include:

- **Delivery of the Thames Tunnel** – As an innovative solution to the challenge of reducing sewage discharges into the Thames, the design and construction of the Thames Tunnel presents a number of major technical and logistical challenges. These include the need to secure a number of construction sites in central London, obtaining planning consents via the process for major projects set out in the Planning Act 2008 and managing the inevitable disruption. As well as the many stakeholder issues, a key challenge is to finance the project, and protect the Group's credit rating. The Government has indicated that it will provide support for the exceptional construction risks, but the details of this support and the residual risk to the Group have yet to be resolved.

**Mitigation:** The Group is working closely with the Government to agree the funding model and the appropriate organisational structure to deliver and operate the tunnel.

- **Price Review 14 ("PR14") determination** – All UK water and sewerage companies must justify the operating costs and capital investment needed to deliver service to customers in the five-year period from April 2015. Failure to demonstrate the Group's case to Ofwat's satisfaction may mean that it is unable to invest in asset improvements that the Group believes will benefit its customers in the long term or to finance its business plans.

**Mitigation:** The Group has assembled a dedicated team to oversee the production of the plan, building on experience gained during previous Price Reviews.

- **Managing increased competition in the water industry** - The Water White Paper issued in December 2011 has signalled plans to implement market competition for business customers, while at the same time providing assurances that the sector needs to remain attractive to investors. The extent and timing of changes remain uncertain. The initial impact will largely be for large users, although there will also be opportunities for the provision of wholesale services.

**Mitigation.** The Group is preparing for these changes with a view to taking advantage of the opportunities, and this may require structural change.

- **Employee pension scheme funding** – The Group operates two material defined benefit pension schemes. Whilst the Group has reduced its future exposure by closing the final salary schemes to new entrants, and moving a number of senior employees onto a defined contribution scheme, the Group remains liable for the historic rights earned by past and present employees. Both schemes are currently in deficit on a Gilts valuation basis and, whilst agreed deficit repair plans are in place, there is a risk that actuarial assumptions on investment returns or longevity could change and cause increased employer contributions.

**Mitigation.** The Group will continue to review investment strategy with the trustee in order to ensure that funding risks are understood and managed.



# Kemble Water Holdings Limited

## Directors' report (continued)

### Principal risks and uncertainties (continued)

- **Failure to maintain adequate funding arrangements** – As at 31 March 2012, the Group has adequate cash at bank and current asset investments of £736.4m (2011 £776m) and undrawn committed bank facilities of £1,275m (2011 £1,175m) in place to provide liquidity as required. The Group will need to renew £450m of 364 day committed facilities by August 2012. There remains a risk that credit market conditions will deteriorate against the backdrop of weak economic recovery and falling credit ratings of financial institutions, increasing the cost of raising new debt and refinancing bank facilities. As a regulated utility, the Group does not anticipate a situation where it will be unable to access financing as it would benefit from a flight to quality in poor debt conditions. An increase in the cost of funds may put pressure on key financial covenants (as defined by the Group's capital structure). In addition the impact of a falling RPI rate on the RCV could create further pressure on financial covenant headroom, specifically the ratio of net debt to RCV.

**Mitigation** The Group has an established funding strategy which is reviewed by the Board annually

- **Customer experience measures** – The measure for customer performance is evolving from quantitative to qualitative criteria. All water companies will need to adapt processes in order to optimise performance against these new criteria to be measured against Ofwat's SIM. Failure to deliver the required Customer Service over the remaining years of this regulatory period may lead to a financial penalty in the next regulatory period.

**Mitigation:** The Group is working closely with Ofwat to shape the future reporting requirements, and is reviewing internal processes to improve end-to-end customer service.

- **AMP4 sewer flooding programme** – The Group has responded to an information request from Ofwat issued under section 203 of the "Water Industry Act 1991" concerning the properties claimed as safeguarded from internal sewer flooding by capital schemes completed in 2009/10. The information requested relates to the level of evidence required to support a judgment that a property is likely to have flooded in the past. Ofwat's investigation into whether the Group complied with the relevant guidance continues and is unlikely to conclude its investigations until at least the third quarter of 2012. If Ofwat concludes that the Group has mis-reported its sewer flooding outputs, it may seek to impose sanctions including financial penalties of up to 10% of Group turnover attributable to regulated sewerage services or make a shortfall adjustment at PR14 for sewer flooding outputs which Ofwat determines have not been achieved during the AMP4 period.

**Mitigation:** The Group has provided all the information that has been requested to support the numbers claimed and has met with Ofwat on several occasions to discuss their concerns. The Group awaits the conclusion of Ofwat's investigation.

- **Credit rating** – Regulated water and sewerage utilities benefit from strong investment grade credit ratings based on a large asset base, predictable returns and a stable regulatory environment. This could be adversely affected by Ofwat proposals to amend licence conditions and their further proposals for regulatory reform. The Group's credit rating could also be negatively affected by an agreement on the delivery model for the Thames Tunnel project that exposes TWUL to a level of risk beyond that normally associated with a regulated water and sewerage utility Group, or by the an obligation to deliver a further large capital programme in the next regulatory period (AMP6). A downgrade in credit rating would increase borrowing costs and reduce access to long-term debt markets, putting at risk the ability to meet financial covenants. This would therefore increase the likelihood of tripping a "trigger event" under the terms of the whole business securitisation, an event that would lead to a distribution lock up.

**Mitigation:** The Group is working to ensure our Price Review preparations, Thames Tunnel plans and other significant business changes take account of the impact on the credit rating. In addition, the Group is seeking specialist external advice on protecting its credit rating.

# Kemble Water Holdings Limited

## Directors' report (continued)

### Principal risks and uncertainties (continued)

**Drought** – The Thames catchment area has experienced the driest two-year period in recorded history, leading to a temporary use ban to conserve remaining water supplies. Heavy rain during April has alleviated the immediate crisis, but ground water levels remain very low and a further dry winter may cause a further drought in 2013

**Mitigation:** The Group is managing the drought as a top-priority operational event. It has mobilised a team that draws on experience across the business. This team is headed by a member of the TWUL executive

- **London 2012 games** – London will host the Olympic and Paralympic Games from 27 July 2012. Any operational interruption would cause significant disruption and, with the media present, damage the Group's reputation

**Mitigation:** The Group has worked continuously with the London Organising Committee of the Olympic Games ("LOCOG"), to provide the agreed infrastructure and ensure we are ready operationally. Operational and communications plans are in place

- **Failure to meet regulatory targets** – The Group is required to meet targets set by Ofwat, the EA, the Drinking Water Inspectorate and other regulators. In order to achieve this, the Group must continue to deliver cost and efficiency savings in line with a challenging Final Determination, while maintaining and improving operational performance and the standard of customer service

**Mitigation:** Performance against regulatory measures is the subject of regular management review. The new reporting mechanism allows the Group to further align internal and external performance indicators

- **The effects of climate change and long-term changes in weather patterns** – As the Group continues to supply an increasing population, the effects of climate change could adversely affect its ability to maintain its Security of Supply Index (SoSI) requirements

**Mitigation:** The Group has been working on measures to reduce demand, mounting a widespread awareness campaigns and providing free water saving devices, as well as making provision for new sources of potable water and improving the integrity of its network. Together with other water companies and regulators, the Group is actively participating in work to identify the wider water resources needs across South East England

- **Future changes in laws or regulations** – The Group is not funded by Ofwat for changes in obligations that would affect the whole economy. Consequently the Group may, for example, have to meet the obligations resulting from changes in environmental legislation without recourse to Ofwat

**Mitigation:** Changes that are specific to, or are more material for, the water industry may be funded by Ofwat as a relevant change of circumstance. The Group engages actively with regulators where a change is likely, to ensure the implications are understood, and monitors the impact of recent changes to ensure it can demonstrate the case for additional funding where it is justified

- **Failure of a major asset** – A failure at one of the Group's major assets could significantly impact the safety of its workforce and the public, as well as interrupting supply to customers and breaching environmental and regulatory targets. The impact would be both financial and reputational

**Mitigation.** The Group has a specific compliance process to manage each of the identified risks

# Kemble Water Holdings Limited

## Directors' report (continued)

### Principal risks and uncertainties (continued)

- **Impact of low inflation or deflation** – In return for their capital investment in assets, regulated water companies earn a return on their RCV, which is adjusted by the RPI. In times of low inflation or deflation, the return on this investment will decrease relative to the cost of funding, reducing cash flow and shareholder value.

**Mitigation.** In order to protect the Group from these impacts, around half of the Group's debt is indexed to RPI, either directly in the underlying debt instrument, or by the use of RPI swaps.

- **Servicing of subordinated debt** – In order to service the Group's subordinated debt, Kemble Water Finance Limited looks primarily to cash flows from the Securitisation Group. Without the availability of cash flows, Kemble Water Finance Limited would be unable to service the subordinated debt without additional contribution from shareholders and so would breach the covenants it has undertaken.

**Mitigation:** The Group's treasury department actively manages the availability of cash within the Group both in total and the specific requirements of individual entities. In addition, the Group forecasts cash flows and borrowing requirements rigorously to ensure that there is sufficient cash available to meet the Group's debts as they fall due. However, should TWUL not be in a position to upstream cash flow, due to insufficient liquidity, covenant headroom or distributable reserves, Kemble Water Finance Limited would need to seek additional financial support from shareholders to avoid covenant default.

# **Kemble Water Holdings Limited**

## **Directors' report (continued)**

### **Transforming Thames**

The Transforming Thames programme has continued, with the focus on improving customer service, improving our health and safety performance, enhancing our data and the way it is used to make business decisions and driving operational efficiency

Key efficiency projects have moved to the delivery phase. This includes the WAMI programme, which began phased deployment in November 2011. This programme is implementing a fully integrated work and asset management approach across the business, off a SAP platform, to drive a more effective and efficient process for customers. Rollout to circa 4,000 users will continue through 2012. The benefits from this project include better data capture at source enabling better business decisions, improved customer diagnostics enabling first time resolution and more efficient work planning enabling better productivity in the field. Overall, this will enable an improved customer experience.

New working patterns and associated terms and conditions have been negotiated for all field-based operatives, allowing the Group to meet customer demand and map resources to those demand patterns. These new working patterns were implemented on 1 April 2012.

The Customer Service improvement programme has been developed based around the principle of 10 key aspirational promises for customers. This when delivered will enable the Group's performance to be successfully measured by SIM.

All managers in the field continue to be supported by Change Managers, who are experienced in the sustainable delivery of business change. They provide coaching support to teams, ensuring that the transformation programme is understood, employees are fully engaged in the process and that the appropriate measures are developed to track progress and success.

Following extensive consultation with employees and with the agreement of the pension fund trustees the Group has changed certain provisions in respect of the Thames Water Pension Scheme ("TWPS") for both existing and new employees.

The defined benefit scheme is now closed to new entrants. From 1 April 2011 new employees of the Group are offered participation in the Defined Contribution Stakeholder Pension Scheme ("DCSPS") managed through Standard Life. All senior managers have now moved to this scheme.

For existing members of the TWPS, certain provisions have changed that affect future benefits to its members. Principally, the defined benefit provision from 1 May 2011 is based on a CARE basis and no longer on a Final Salary basis.

The Group has demonstrated continuing improvement in both operational and financial performance, whilst implementing the transformation programme. This provides a strong platform for the future and confidence that the required improvements in Customer Service can also be delivered.

### **Looking further ahead**

It is over 20 years since the water industry was privatised. Since then much has changed - costs of service are lower, performance is better and the industry has delivered significant quality improvements. However, with Thames Water continuing to face challenges, including climate change, population growth and new quality improvements, to name a few, the industry and the Group must ensure they can meet the challenges they face including the immediate challenges faced by below average rainfall resulting in the driest two years since records began.

A key to this is how the sector is regulated going forward to ensure it is fit for purpose to meet these challenges.

There is increasing clarity. In November 2011 Ofwat published early proposals for their 2014 Price Review, in December 2011 Government published its long awaited Water White Paper and moved to expand the existing business retail market. During 2012 we expect Ofwat to further refine its approach to PR14 and Government to publish a draft water bill, primarily focused on enabling a retail market for all business customers.

# **Kemble Water Holdings Limited**

## **Director's report (continued)**

### **Looking further ahead (continued)**

Looking further ahead, the Group will need to be flexible and ready for any change to the regulatory environment. However, through this period of change there are some constant underlying requirements. The Group will need to ensure that

- High performance is maintained and it capitalises on opportunities for further improvements
- It delivers what customers want at the right price, in the right place and at the right time
- It offers value for money at an affordable price
- Thames Water's Customer Service improves

A key challenge in this process will be the delivery of the proposed Thames Tunnel. The Group is working closely with all stakeholders to ensure this is delivered by the most appropriate means possible.

The Group is always looking ahead to understand the future environment and ensuring that it takes the right actions today to protect the future.

### **Strategic direction statement**

In 2007 the Group published a Strategic Direction Statement, setting out priorities for the next 25 years. As part of its strategic business planning, the Group is working to review and update its long term plans, building on the wants and needs of customers and challenges as diverse as future population growth and climate change.

### **Water resources and drought**

In August 2009, Department for Environment, Food and Rural Affairs ("Defra") called for a public inquiry into Thames Water's draft 25 year Water Resources Management Plan. The Inquiry completed in August 2010 and the Inspector's report recommended additional work in a number of areas including the assessment of long-term solutions for supply security.

Defra issued instructions to Thames Water to complete the plan in line with the Inspector's report and advice from the EA. This has now been completed and Thames Water has consulted further on the plan. No significant issues have been raised and The Secretary of State is now considering the Final Plan and will make a decision in 2012, following advice from the EA.

Following the driest two years since records began, the Group, along with six other companies in the south east of England, gave notice to customers on 12 March 2012 of a temporary water use ban. From 5 April 2012, it was prohibited to draw water through a hosepipe or similar equipment, or fill or maintain a domestic swimming pool, paddling pool or ornamental fountain. The Group will continue to closely monitor the situation over the coming months and further drought management measures may be required to secure supply. The impact of a third successive dry winter cannot be discounted and should this arise it will have an impact on the Group's management of its water resources.

The Government's Water White Paper drew attention to the future threats to the security of water supplies. As part of a response to this threat they propose to reform the abstraction regime and anticipate a new regime in place by no earlier than 2020. In the medium term they are encouraging Ofwat and the EA to consider incentives for companies to better manage their abstraction in a sustainable manner.

# **Kemble Water Holdings Limited**

## **Directors' report (continued)**

### **Looking further ahead (continued)**

#### **Transfer of private sewers**

On 1 July 2011, the "Water Industry (Schemes for Adoptions of Private Sewers 2011)" came into force, whereby all privately owned sewers and lateral drains built before 1 July 2011 and connected to an existing public sewer became the responsibility of sewerage undertakers

As a result, approximately 40,000 kilometres of privately owned sewers and lateral drains were transferred on 1 October 2011 to the Group, an increase of 60% in the sewer network for which the Group is now responsible

A second transfer scheme for those privately owned sewers built after 1 July 2011 was originally scheduled for April 2012, but has been postponed with a new date to be agreed. Private pumping stations connected to the transferred pipework will transfer between 1 October 2011 and 1 October 2016. The Group is currently drawing up its programme for progressive adoption over this five year period

At PR09, Ofwat did not fund companies for the costs of the private sewers or pumping stations transfer. Instead, the Group will be examining the case for submitting an Interim Determination of K ("IDoK") application to Ofwat before September 2013 to enable it to recover the additional costs incurred

#### **Business Retail Competition**

Currently only 30,000 of approximately 1.2m business customers in England and Wales have a choice of retail supplier. In Scotland all business customers have had a choice since 2008. The Government's 2011 Water White Paper proposed to introduce a draft bill in 2012 to bring about choice in England for all business customers. However, there is currently no timetable for this change

The Paper ruled out mandatory legal separation of companies' retail functions and the expansion of retail competition to households. However, companies will be expected to demonstrate arms length dealing with their retail arms and Ofwat have powers to enforce non-discrimination including powers to refer companies to the Competition Commission for structural remedies

#### **Affordability and Recession**

The Group currently has the second lowest combined bill out of the Water and Sewerage Companies ("WaSCs"). However, the Group also has the highest proportion of income deprived households. In the last ten years industry bad debt levels have risen by 10% per annum, which may be illustrative of a rise in affordability issues and recession. In addition specific future bill increases for projects such as the Thames Tunnel will have an impact on customers' ability to pay. Ensuring that the Group invests only where it has its customers support will be necessary to keep bills as low as possible

# **Kemble Water Holdings Limited**

## **Directors' report (continued)**

### **Relationships and resources**

#### **Employees**

This financial year has been challenging, with the largest ever five year capital investment programme being in its second year, continued transformation of the Group's business processes and the challenge of a potential drought combined with preparation for the London 2012 games. The Group's employees have continued to demonstrate high commitment and increased engagement levels throughout the year, supported by the "Passionate About People" strategy.

This strategy was updated in 2011 in line with business requirements to give an increased focus on supporting the organisational change and transformation across the Group, alongside getting the best out of its people by giving them the right support and development. The implementation of the Group's 'Passionate About People' approach continues to engender a positive working environment, which focuses on performance, contribution and values diversity and inclusion.

Overall staff turnover in the current year was 7.95%, reducing from 9.58% in the previous year.

The Group's sickness rate during the year was 2.53% (2011: 2.75%). The Group has an attendance management policy in place with the overall aim of reducing and managing sickness absence and, in particular, long term sickness.

The Group is committed to effective talent management and runs regular Talking Talent reviews to assess performance and potential across the Group. These reviews support effective learning and development interventions and focus on ensuring the Group has the future talent to deliver its business strategy. The Group continues to invest in its core leadership development programmes, future talent pipeline programmes (including apprentices and graduates) and to develop the technical and business skills of its employees.

During this year, the following key people initiatives have been delivered to support the business strategy,

- development and negotiation of working patterns, terms and conditions changes to ensure they are modern, meet the needs of the customer and the business and are in line with the market,
- development of an approach to career paths to ensure that technical roles are identified, have a clear path through the organisation and are appropriately awarded,
- recruitment routes to market and career pages developed to drive employer brand ensuring that the Group is an employer of choice,
- implementation of procedure changes for legislative updates including agency workers regulations, abolition of the normal retirement age and new paternity rights,
- support for occupational health to improve management of long term absence and to develop a strategy to deal with stress,
- the continued focus on employee engagement across the Group, resulting in a year on year increase in employee engagement, as measured through its annual employee survey,
- new intakes to Thames Water's Graduate, Apprentice and Bursary future talent pipeline programmes,
- continued roll out of the Group's core "Foundation, Advanced and Strategic Leadership development" programmes,
- Continued Performance and Development reviews for all employees linked to the annual pay review,
- people plans for all areas of the business.

The Group is committed to the training and development of all of its employees who undertook 14,301 (2011: 12,355) formal training days in 2012. These figures exclude WAMI training, sponsorship for further and higher education, roadshows, conferences, NVQ coaching & assessment and Manager briefings.

# **Kemble Water Holdings Limited**

## **Director's report (continued)**

### **Relationships and resources (continued)**

#### **Stakeholders**

The continuation of work to determine the route and sites for the Thames Tunnel was once again the focus of much of the Group's work with stakeholders. In addition to the second round of public consultation on the project, the Group continued to attend community and residents' groups and public meetings, as well as arranging briefings with local authorities, Members of Parliament and other stakeholders. The Group also arranged interim customer consultation activities in advance of the second phase, where new sites had emerged since the first phase of public consultation.

The Group has continued to host the Thames Tunnel Forum, held approximately quarterly, to brief stakeholders on progress and seek their views on its proposals. This successful format is now also being used for the proposed Deephams STW upgrade in north east London. Thames Water also contributed to the Thames Tunnel Commission established by a group of London Councils for the purpose of reviewing the alternatives to the Group's proposals for the Thames Tunnel.

In addition to one to one briefing with MPs on issues of local interest, the Group hosted a series of roundtable discussions with Parliamentarians and London Assembly Members, to outline its plans on strategic issues and seek their feedback on the Group's approach. Topics discussed included market reforms in the water industry and the management of water resources.

The Group hosted several visits for customers and stakeholders to its sites during the course of the year, providing opportunities for them to see the Group's work first hand, and to mark significant project milestones. These included hosting a visit for Defra's water quality department at the historic Abbey Mills pumping station in November and an event to celebrate the lowering of the Lee Tunnel Boring Machine in December.

The Group was also pleased to host two visits for Secretary of State for the Environment, Caroline Spelman MP. The first involved a review of innovations the Group has developed and a tour of the Lee Tunnel site and desalination plant at the Group's Beckton site, while the second event was hosted to mark the opening of the Old Ford Water Treatment Works, constructed to provide recycled sewage for irrigation and toilet flushing on the Olympic Park.

The Group played an active role in Parliamentary inquiries, submitting written evidence to the Environment, Food and Rural Affairs ("EFRA") Select Committee's examination of the Government's water white paper, *Water for Life*, and giving oral evidence to a House of Lords EU Sub Committee inquiry into European water legislation. During the year representatives from the Group gave evidence to an EFRA committee on the Wastewater National Policy statement.

The last year has seen Thames Water play an increasingly active role in bringing together regulators and stakeholders to jointly develop approaches to challenges such as urban drainage and water resources. The Group hosted a seminar and workshop in December to examine with stakeholders how to increase the uptake of sustainable drainage systems, and have in March held the Group's inaugural quarterly Water Resource Forum, sharing a platform with Defra, Ofwat and the EA.

During 2012, the Group has also sought to influence public policy through its presence at seminars and conferences. A speech was delivered by a representative of TWUL on water scarcity at October's *Water 2011* conference, while presentations by Thames Water on water resources and industry reform were made at the *Future of Utilities* event held in March 2012.

At a regional and local Government level, Thames Water continued to strengthen ties with the authorities it serves. At a pan-London level, the Group worked closely with the Greater London Authority ("GLA"), London Assembly and the Mayor on a variety of issues. This has included working with the Mayor on his streetworks Code of Conduct, and liaising with the Assembly's Environment Committee, hosting a visit for members to the Group's Beckton site and contributing to the Committee's work to determine priorities for 2013. The Group has also been an active member of the GLA's London Waterways' Commission established to oversee the navigable waterways in London.



# **Kemble Water Holdings Limited**

## **Director's report (continued)**

### **Relationships and resources (continued)**

#### **Stakeholders (continued)**

At a local level, the Group worked closely with many of the 100 local authorities it serves across the region, seeking to ensure the Group's operational activities and investment projects were delivered with the minimum of disruption. The Group attended several formal Scrutiny and Public Meetings, giving evidence at meetings and responding to questions and feedback from councillors, officers and the public.

The Group has delivered a number of stakeholder training sessions for its directors and senior managers to ensure that there is a consistency of approach to external engagement.

#### **Public consultations and research**

The focus on public consultations work has again increased this year. Thames Water has a number of major projects either underway or proposed, which has led to its highest level of public consultation activity to date. The Group recognises that these major projects have an adverse impact on a large number of its stakeholders and customers and endeavours to ensure the Group's plans reflect their views where it is possible to do so.

The Group's approach to consultation includes independently-facilitated stakeholder workshops, individual discussions with MPs and other stakeholders, surveys, focus groups and independently-hosted online consultations.

Thames Water has committed to early, proactive and transparent consultation on the Thames Tunnel. Consultation activities have followed best practice principles and have been carried out in accordance with the Government Code of Practice and recognised best practice guidance.

The second phase of consultation on the proposed Thames Tunnel ran for 14 weeks from November 2011 to February 2012, and involved a greater level of detail than 2011's first phase. Thames Water's report on the responses we received to that consultation was published in the middle of May. The Group is taking account of the responses in the preparation of Thames Water's planning submission in respect of the project.

Other consultations this year included a consultation on Thames Water's revised Water Resources Management Plan 2009, which ran from December 2011 to January 2012. A programme of engagement with regulators and stakeholders for the Water Resources Management Plan 2014 is now well underway. Following research into customers' expectations during drought periods, the Group held a public consultation on its draft Drought Plan, from December 2011 to February 2012.

The Group are proposing a major upgrade to its Deephams STW, which serves about 900,000 people in north east London, to significantly improve the quality of the treated wastewater returned to the Salmon's Brook, a tributary to the River Lee. During 2011, a quarterly Stakeholder Forum was established to bring together key stakeholders to share information about the project and answer their questions and concerns, and to seek feedback on the Group's proposals.

A first phase of public consultation is planned for summer 2012 to examine the choice of preferred site and treatment technologies for the STW upgrade, as well as the other options that have been considered. A second phase of public consultation is planned in 2013.

The Group has also held deliberative workshops and focus groups with customers, at which it has provided background information on its work, in order to deepen their understanding of the business and help them to give more informed views. The topics covered have included the Group's approach to the Price Review 2014, drought, water efficiency, bill design, communications materials on the Thames Tunnel project, the transfer of private sewers to water companies, research with business customers and customer strategy and brand and reputation research.

# **Kemble Water Holdings Limited**

## **Directors' report (continued)**

### **Relationships and resources (continued)**

#### **Public consultations and research (continued)**

The Group's continuing commitment to customer engagement will help it understand the wants and needs of its customers and ensure it has (as far as possible) developed the Group plans in accordance with their wishes. However, the Group's need to understand, and test, customers' views is growing all the time and is engaging customers more in some of the strategic decisions the Group faces, in addition to seeking their views on elements of the Group's investment programme. With this in mind, the Group has regularly used its 2,000-strong customer panel to help us better understand its customers' needs and preferences.

The Group is a corporate member of the Consultation Institute and follows Cabinet Office best practice guidelines for consultation, aiming to make the process as open and transparent as possible.

#### **Involving customers in price setting**

A great deal of change has occurred this year following the publication in August 2011 of Ofwat's customer engagement policy statement, *Involving customers in price setting*. This document sets out Ofwat's approach to customer engagement in the price setting process ahead of the 2014 Price Review, and underlines the importance of customer support in determining the acceptability of companies' business plans. Specifically, it details a "three-tiered approach" to enable customers to engage in different ways and to influence the service they receive and the price they pay.

- "Direct, local engagement" to take account of customer views on local priorities and issues that could have a significant impact on the service customers receive
- Establishment of the Thames Water "customer challenge group" to consider evidence of direct customer engagement, and to ensure that Thames Water's plans reflect a balanced understanding of customer views
- Creation of a "customer advisory panel" by Ofwat to inform sector-wide assumptions such as the cost of capital, and provisions for pensions and energy

The Group took full account of the direction and guidance within Ofwat's policy statement in developing its programme of customer engagement activities to inform our strategy and business plan. The first phase of this programme began in September 2011 with a qualitative study of domestic and business customers to understand the relative priorities they placed on different elements of their service. This study was used to inform the development of a quantitative survey in November 2011, which explored the relative values customers placed on improvements or deteriorations to levels of service they currently receive.

Further phases of research and engagement are ongoing and being planned for 2012 and 2013, and will be scrutinised by the newly formed Customer Challenge Group (see below) ahead of their implementation, to inform the development of our long term strategy and business plan.

Thames Water established its Customer Challenge Group ("CCG") – in line with Ofwat's policy statement – and the CCG met for the first time in February 2012 and will meet monthly throughout the period leading to the 2014 price review. The CCG has an independent Chair and Vice Chair, and its members include industry regulators, domestic and business customer representatives and other key stakeholders. The role of the CCG is to challenge Thames Water as it develops its customer engagement and research plans, and on Thames Water's interpretation of customers' views and how these have been reflected in its strategy and business plan. The CCG will provide a report to Ofwat alongside Thames Water's business plan on its customer and stakeholder engagement process, and the content of its strategy and business plan.

# **Kemble Water Holdings Limited**

## **Directors' report (continued)**

### **Relationships and resources (continued)**

#### **Streetworks**

The Group played an active role in developing new approaches to managing the impact of streetworks, responding to consultations on Lane Rental Regulations and Guidance published by the Department for Transport, and Transport for London's Lane Rental Scheme consultation. The Group also participated in workshops facilitated by the Department for Transport and Transport for London to develop proposed Lane Rental schemes.

The Group sought to communicate its approach to streetworks with key stakeholders. Prior to the start of winter, during which the need to carry out leak repairs was at its greatest, highways authorities were approached to ensure a collaborative approach to tackling leakage and minimising disruption.

The drought has increased the need to ensure leaks are tackled quickly and efficiently, and highways authorities have been asked to provide, and have helpfully provided, support for the Group's work in this area.

#### **Key suppliers and contractors**

In 2012 the Group spent in excess of £1.1bn net on construction, goods and services with a range of suppliers and contractors (2011 in excess of £1.4bn). Approximately 23 key suppliers (2011: 31) were engaged with a spend greater than £10m each. The Group's policy is to establish trading arrangements, which are made following an open non-discriminatory, competitive bidding process. Procurement processes reflect the Group's corporate responsibility commitments and, where applicable, comply with the requirements of the Utilities Contracts Regulations 2006 (as amended).

#### **Research and development**

The Group's research and development programme consists of a portfolio of projects designed to address technical needs across the range of water cycle activities. Research and development deliver innovative technical solutions through a research programme aligned with business needs to address challenges for AMP5 and also provide specialist technical support to the business. Expenditure on research and development totalled £3.9m for the year (2011: £3.4m).

#### **Intellectual property**

The Group protects intellectual property of material concern to the business as appropriate, including the filing of patents where necessary.

#### **Energy efficiency and renewable energy**

The Group is committed to reducing its contribution to the causes of climate change and its voluntary target is to achieve by 2015 a challenging 20% reduction in greenhouse gas ("GHG") emissions (compared to 1990 levels) for scope 1 and scope 2 emissions<sup>1</sup>.

The Group's total GHG emissions (Scope 1, 2 and 3) reported for 2012 were 746,000 tonnes (2011: 780,436 tonnes) of carbon emissions ("CO<sub>2</sub>e"). The Group's approach to reporting GHG emissions is consistent with the Department of Energy and Climate Change ("Decc"), Defra guidance and Ofwat reporting requirements. During the year, the Group's reported emissions decreased, largely due to a reduction in imported electricity consumption. Coupled to this was a reduction in the emission factor ("EF") for grid electricity. This followed a change in the methodology that Defra used to calculate the EF which now accounts for imported electricity into the UK.

Last year the Group consumed 1,171 Gigawatt hours ("GWh") of electricity, of which 166 GWh was renewable electricity generated at the Group's operational sites - around 14% of the Group's total electricity use. The Group also produced 85 GWh of heat energy which displaced the need to consume natural gas. This generation of renewable electricity and heat helped reduce the Group's overall GHG emissions.

# Kemble Water Holdings Limited

## Directors' report (continued)

### Energy efficiency and renewable energy (continue)

The Group continues to work hard to understand and reduce its carbon footprint. During 2012 it has

- increased renewable energy generation capacity by 10.9 MW including 6 MW of biogas engines at Riverside STW, and 4.9 MW of photovoltaics (solar power) at 31 sites
- increased metering of its gas and electricity use (covering 100 per cent and 99.6 per cent of use respectively) so that the Group can measure more accurately its energy consumption
- started a programme to save 8 GWh in energy use by making air blowers (used in the sewage treatment process) more efficient
- prioritised the Group's pump efficiency programme on raw water pumps in light of drought conditions. These are pumps that take river water to supply its storage reservoir
- introduced an energy and carbon engagement programme for employees working at the Group's head office. Metering on each floor of the building allows detailed energy monitoring
- installed a dryer at Slough STW, which dries the sewage sludge to produce a granular material that can be used as a renewable fuel
- installed new lighting and motion sensors at 6 operational sites

Looking to the future, there are a number of significant challenges facing the business in terms of reducing the Group's GHG emissions. The Group's activities are very closely linked to the weather. For example, adverse conditions require the need to pump more water, and drought conditions force the use of water treatment by desalination. Both of these scenarios are electricity intensive – with the consequence of increased GHG emissions. Additional upward pressures on energy consumption and GHG emissions that the Group cannot control include new obligations (including the adoption of private sewers and the construction of the Tideway Tunnels) and population growth.

However, there are responses that the Group can influence, including energy efficiency, effective energy procurement and the generation of renewable energy. The Group therefore needs constantly to innovate in the management of its energy consumption and GHG emission to ensure they are kept as low as possible. However, changes in Government policy such as the Carbon Reduction Commitment becoming a tax rather than an incentivised cap and trade scheme, and proposed changes to the Feed-in Tariff Scheme have made effective planning and delivery much more difficult.

<sup>1</sup> Scope 1 emissions are those direct emissions associated with the operation of the business. Scope 2 emissions are the indirect emissions associated with the consumption of grid electricity. However, this is reliant on the Government redefining grid emissions.

# **Kemble Water Holdings Limited**

## **Directors' report (continued)**

### **Social and community**

#### **Corporate Responsibility**

The Group is committed to engaging positively with the communities it serves and to minimise the impact of its activities. The Group is pleased to report that it has been awarded 'Platinum' ranking in the Business in the Community Corporate Responsibility Index, having undergone a rigorous reporting process across the Group's Corporate Responsibility and sustainability working practices.

#### **Community Investment**

The Group's updated strategy was approved by the Board and a brief version is available to view on the website <http://www.thameswater.co.uk/cps/rde/xchg/corp/hs.xsl/8276.htm>. The strategy encompasses feedback from customer research and stakeholders in that the core themes for activities include environment and wildlife improvements, education, access to sites and charitable giving. Volunteering opportunities are available with each theme. The Group also signed up to support Love Where You Live, a Keep Britain Tidy initiative looking after the local environment.

#### **Open Days**

A programme of Open Days on the Group's sites was delivered with events for visitors at Slough, Swindon and Maple Lodge STW and Coppermills water treatment works. The Group also took part in London Open House where eight of its heritage sites were opened to the public. Around 1,600 customers and visitors took part in these events which included tours conducted by more than 100 Thames Water volunteer staff.

#### **Community Initiatives**

The Creekside Education centre based on the Thames foreshore in Deptford was opened in May 2011 and has seen 3,735 students, community members and volunteers come and learn about both tidal ecology and key water messages.

The Group has committed to its adoption of Fobney Island, the Fobney Wetland Park along the River Kennet on the edge of Reading, Berkshire. The aim of the project was to provide £200,000 of financial support, technical expertise and employee volunteers. To date the work has created seasonal wetland areas to reconnect the five hectares of floodplain on the island with the River Kennet. In March 2012 a rare Little Ringed Plover was spotted on the new wetland.

Another five students at the University of East London who are benefiting from the TWUL's Engineering Bursary completed their summer placements. The first two students who have been supported since 2009 are due to graduate this year.

The Group has started a new project – Sustainable Urban Drainage for schools – to install ten new urban wetlands in school grounds. The aim of the project is to educate students and the wider community on sustainable drainage and ecology, working with project partners the EA and Wildfowl and Wetlands Trust. The focus of the project will be Pymmes Brook, a tributary of the Lee running through Enfield, Barnet and Haringey.

Working in partnership with the National Trust, the Group provided funding and technical expertise for the newly opened Living Green Centre within Morden Hall Park. The contribution was to provide key water efficiency messages and assist with the development of London's first Archimedes Screw on the weir, which will generate electricity for the Centre.

# **Kemble Water Holdings Limited**

## **Directors' report (continued)**

### **Social and community (continued)**

#### **Education**

The Group's education facilities for school visits continue to take shape with the modular classrooms delivered to Didcot STW and Slough STW in January and February 2012 respectively. The classroom at Hogsmill STW has been completed and the site tour route at Rye Meads STW has been agreed. The first school visits to these new facilities are expected to take place in September 2012.

The Group continued to support the skills agenda by delivering talks and activities based around engineering, including two Network Challenge events in the London Boroughs of Hounslow and Southwark, and careers fairs across the region to educate young people about roles in the water industry.

Working with the London Tideway Tunnels Team, the Group signed up staff volunteers to deliver talks and promote a competition to 1,100 pupils at Newham primary schools to name the Lee Tunnel Boring Machine, which was lowered at the Lee Tunnel site at Beckton in December. Local schoolboy Ryan Waters, from Maryland Primary School in Newham, won the competition to name the boring machine with his name "Busy Lizzie".

Volunteer speakers from the Group continue to promote key messages around the water cycle, saving water and the responsible disposal of waste – promoting Bin It Don't Block It – through the popular Community Speaker Programme. During the last year 58 talks were given across the Group's region reaching a total audience of 6,258. The programme was boosted in March with the Drought Speaker Programme, tackling the current drought situation. More than 90 employee volunteers came forward to deliver presentations and hand out leaflets to schools and community groups focusing on the drought.

#### **Employee engagement**

The Group aims to provide a positive environment where its people are actively engaged and understand their role in the business so they can maximise their contribution.

To measure this, the Group runs an annual employee engagement survey, which gives staff the chance to confidentially provide their honest views on what it is like to work for Thames Water, their team and their manager. Called the Q12 survey, it is run by Gallup and is now in its sixth year.

The Group has seen a year-on-year improvement in employee engagement. This improvement comes against a backdrop of continued organisational change.

The Group intends to enhance the survey in June 2012 to measure staff's views on our customer service, leadership and health and safety.

Over the past year the percentage of staff who volunteered to help community projects was 18%, an increase of 50% on the previous year. The Group entitles each member of staff to two days volunteering leave per year, under its Time to Give scheme, to encourage participation in community, education and fundraising events.

The Group continues to work in partnership with local and regional organisations to promote environmental and community volunteering. Key events in the annual calendar include River Thames clean-ups, working with Thames 21, and the Thames Water-sponsored Reading RESCUE to tidy riverside and urban spaces in and around the town.

In addition, employee volunteers took part in team build projects to improve community spaces. Activities included coppicing and woodland management with Wiltshire Wildlife Trust, painting school halls and improving gardens and grounds at local charity and community organisations.

# **Kemble Water Holdings Limited**

## **Directors' report (continued)**

### **Social and community (continued)**

#### **Charitable donations**

Over the year the Group donated a total of £1,019,340 (2011 £723,576) to good causes through both the Charities Committee and direct donations, including the Group's principal charity WaterAid. Over £700,000 of this amount is a continuation of the shareholders' commitment through the Company's Ten for Ten initiative made in 2009.

The Thames Water Charities Committee met quarterly to consider applications from external charitable organisations seeking funding and authorises matched funding for employee fundraising. In 2012 the Committee donated £79,401 to 21 charities via grants which supported our criteria of either 'water and the environment' or 'water and health'. An example of applications received is one from the Ahoy Centre to donate towards the purchase of two second hand Thames Cutter boats for use by local children and disabled rowers on the Thames in Deptford.

The Group's employees raised £99,718 (2011 £76,805) for various charities throughout the year which the Charities Committee matched funded with £89,401 (2011 £59,376).

Employees also participated in Group-promoted charity events to raise funds and awareness for local and national charities. A highlight was the support for Sport Relief in March where 149 staff took calls at the Group's offices in Reading and Swindon.

More than 100 guests attended the Group's annual Service of Remembrance at Ashford Common Water Treatment Works. An additional service was held at Mogden STW which included the rededication of the site's memorial garden. Charitable donations were made to the Royal British Legion and SSAFA (Soldiers, Sailors, Airmen and Families Association).

#### **WaterAid**

The Group also continues to support its principal charity, WaterAid ([www.wateraid.org](http://www.wateraid.org)) which celebrated its 30th birthday in 2011. Employees at all levels are involved through a variety of activities from fundraising to speaking to schools and community groups about the charity.

At a senior level, the Thames Water WaterAid Steering Committee, which sets fundraising targets and strategy each year, met regularly to review progress and recognise achievements. The Group is also pleased to report that in addition to the charitable donations listed above, over £600,000 was raised through corporate sponsorship for 2012, beating the fundraising target of £500,000 through corporate sponsorship for 2012. Half of this funding is for Thames 4 Bangladesh, a four year campaign aimed at helping four of the country's towns with improving their access to clean water and improving sanitation.

### **Principal activities and likely future developments**

The principal activity of the Group is the provision of water and wastewater services.

The Group's registered number is 5819262 (England and Wales).

### **Results and dividends**

The profit and loss account on page 36 gives the Group's financial results for the year.

The Group paid interim dividends totalling £165.1m during the year (2011 £115.1m).

The Group's dividend policy is

- To pay a progressive dividend commensurate with the long-term returns and business performance, after considering the business' current and expected regulatory and financial performance, regulatory restrictions, management of economic risks and debt covenants.

# Kemble Water Holdings Limited

## Directors' report (continued)

### Results and dividends (continued)

Directors, in assessing the dividend to be paid (to a maximum of statutory distributable reserves), are required to ensure that

- Sufficient liquidity is maintained to enable the business to meet its financial obligations for 15 months
- Post-dividend financial ratios remain within their agreed limits at both the balance sheet date and on a forward-looking basis

The Board does not recommend a final dividend (2011 £nil) However, the Board has proposed a further interim dividend (see note 10, page 55)

### Directors

The directors who held office during the year ended 31 March 2012 and to the date of signing were

Director	Appointments	Resignations
Sir Peter Mason KBE		
L Abraira	04 August 2011	19 January 2012
E Beckley		21 November 2011
R Blomfield-Smith		
C R Deacon		
Dr P Dyer		
S R Eaves	20 January 2012	
R Gadsby		08 July 2011
G I W Parsons		
A F C DeP Santos		04 August 2011
D J Shah		
Y Shi	19 January 2012	
M S W Stanley		
L Webb	21 November 2011	
R E Verrion		

During the year under review, none of the directors had significant contracts with the Company or any other body corporate within the Group, other than their contracts of service, except as disclosed in note 31 to the accounts

The following directors have formally appointed alternate directors to represent them when they are unavailable

director			alternate director		
Name	Appointment	Resignation	Name	Appointment	Resignation
E Beckley			G I W Parsons		
R Blomfield-Smith		21 November 2011	K Boesenberg		21 November 2011
C R Deacon			R D Israel		12 December 2011
			R Evenden	12 December 2011	
A F C DeP Santos		04 August 2011	M C Guerreiro		04 August 2011
L Webb	21 November 2011		C Pham	21 November 2011	
S R Eaves	20 January 2012		Marcus Hill	20 January 2012	
G Parsons			E Beckley	11 November 2011	
Y Shi	19 January 2012		F Sheng	29 February 2012	
D J Shah			L Webb		21 November 2011
			K Roseke	31 January 2012	
R Verrion			S Kolenc		



# **Kemble Water Holdings Limited**

## **Directors' report (continued)**

### **Employee involvement**

The TWUL Chief Executive Officer ("CEO") and Executive team hold quarterly management briefings with managers to provide the opportunity to discuss performance and how the business can continue to move forward. Internal publications ("Management toolkit" and "The Source") provide ongoing support for the changes and transformation happening across the Group. This is in addition to the further improvement of the Group's corporate and local communication channels that deliver regular communication, information and updates to employees. Corporate channels include Group-wide Team Talk briefings, a weekly e-brief containing a message from the TWUL CEO, the Thames Water internal portal web pages and specific priority news updates and managers' key information.

Formal consultation with employees is undertaken in partnership with the recognised Trade Unions. Consultation with management level employees typically takes place on an individual basis, except in the case of changes that affect whole areas of the business. In these circumstances, consultation takes place on a Group-wide basis with employee representatives being elected for the relevant area.

All staff are involved in both the Group's employee engagement programme ("Q12") and annual Performance and Development Review ("PDR") process.

Each year the Group encourages all employees to participate in its annual employee engagement survey. In June 2011, the date of the last survey, 70% of the Group's employees participated and employee engagement improved again year on year. This programme also involves circa 100 volunteer employee engagement champions from around Thames Water who support making the Group a great place to work. It allows all employees to give their opinions and enables managers and teams to take action on key issues identified.

Corporate and Business Unit objectives are agreed by the Executive Team, communicated and cascaded through the Group and included in the annual PDR for all employees. In addition, relevant department and team objectives are cascaded and inform employees' personal objectives which, in turn, are agreed with each employee's manager and reviewed regularly. This process is intended to ensure that all employees are aligned to Group objectives and to ensure that all employees understand where they are adding value.

### **Employment of disabled persons**

The Group is committed to fulfilling its obligations in accordance with the Disability Discrimination Act 1995. The Group has policies and procedures in place that aim to ensure that both job applicants and employees with disabilities have equality of opportunity, are treated fairly and have a safe and practical workplace, free from discrimination, bullying, harassment or victimisation.

Through disability and attendance management policies, support and training is provided for employees who become disabled during the course of their employment so that they continue to work in a position appropriate to their experience and abilities.

### **Policy and practice on payment of creditors**

The Group's policy is to pay all suppliers, contractors and service providers according to pre-agreed terms. During the year under review, the average amount due to trade creditors represented 60 days (2011: 63 days) of purchases received from these creditors.

### **Market value of land and buildings**

The directors have considered the market value of the Group's land and buildings and are satisfied that their market value is not less than their net book value.

# Kemble Water Holdings Limited

## Directors' report (continued)

### Political and charitable donations and expenditure

No political donations were made by the Group (2011 £nil)

The Group made charitable donations totalling £1,019,340 (2011 £723,576) Details of these charitable donations are

- £743,759 (2011 £316,807) to Ten for Ten projects, of which £512,121 went to various educational and recreational projects and £231,638 to the Thames Water Trust Fund for income deprived families
- £118,680 (2011 £106,000) to the Charities Aid Foundation
- £61,129 (2011 £58,021) to TWUL's principal charity, WaterAid
- £60,000 (2011 £60,000) to Thames 21, a range of charities which assist in cleaning rivers and streams within the Thames Valley
- £35,772 (2011 £182,748) of other donations

In addition, fund raising activities by employees and contractors raised £99,718, to which the Group added matching funds of £89,401 (included in the donations above)

### Going concern

The directors believe, after due and careful enquiry, that the Group has sufficient resources for its present requirements and therefore consider it appropriate to adopt the going concern basis in preparing the 2012 financial statements Further information is set out in note 1 'Basis of preparation' on page 40

### Disclosure of information to the auditor

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Group's auditor is unaware, and each director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the Group's auditor is aware of that information

### Directors' indemnities

The Group has made qualifying third party indemnity provisions for the benefit of its directors and for the benefit of other persons who are directors of associated companies and these remain in force at the date of this report

### Auditor

Pursuant to Section 487 of the Companies Act 2006, the auditor will be deemed to be reappointed and KPMG Audit Plc will therefore continue in office

Approved by the Board of Directors on 7 June 2012 and signed on its behalf by



**J Hanson**  
Company Secretary  
Clearwater Court  
Vastern Road  
Reading RG1 8DB

# **Kemble Water Holdings Limited**

## **Statement of directors' responsibilities in respect of the annual report and the financial statements**

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 they have elected to prepare the Group and parent company financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice)

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 Group and parent company and of their profit or loss for that period

In preparing each of the Group and parent company financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgments and 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,
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities

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



## **Independent auditor's report to the Members of Kemble Water Holdings Limited**

We have audited the financial statements of Kemble Water Holdings Limited for the year ended 31 March 2012 set out on pages 36 to 81. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

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.

### **Respective responsibilities of directors and auditor**

As explained more fully in the Directors' Responsibilities Statement set out on page 33, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

### **Scope of the audit of the financial statements**

A description of the scope of an audit of financial statements is provided on the APB's website at [www.frc.org.uk/apb/scope/private.cfm](http://www.frc.org.uk/apb/scope/private.cfm)

### **Opinion on financial statements**

In our opinion the financial statements

- give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 March 2012 and of the Group's loss for the year then ended,
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice, and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### **Opinion on other matters prescribed by the Companies Act 2006**

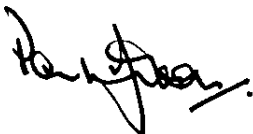
In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

## Independent auditor's report to the Members of Kemble Water Holdings Limited (continued)

### Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us, or
- the parent company financial statements are not in agreement with the accounting records or returns, or
- certain disclosures of directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit



**Paul Johnson (Senior Statutory Auditor)**  
**for and on behalf of KPMG Audit Plc, Statutory Auditor**  
Chartered Accountants  
15 Canada Square  
London  
E14 5GL

7 June 2012

# Kemble Water Holdings Limited

## Consolidated profit and loss account

	Note	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Turnover	2	1,700.2	1,641.9
Operating costs before exceptional items		(1,163.5)	(1,106.9)
Exceptional item – pension curtailment gain	3, 5	40.0	-
Operating costs	3	(1,123.5)	(1,106.9)
<b>Group operating profit</b>		<b>576.7</b>	<b>535.0</b>
Share of operating profit in joint ventures		-	0.4
<b>Total operating profit: Group and share of joint venture and associates</b>		<b>576.7</b>	<b>535.4</b>
Profit on sale of fixed assets	6	3.5	9.0
Profit before interest and taxation		<b>580.2</b>	<b>544.4</b>
- Interest receivable and similar income	7	47.5	6.1
- Interest payable and similar charges	8	(634.7)	(656.1)
<b>Loss on ordinary activities before taxation</b>		<b>(7.0)</b>	<b>(105.6)</b>
Taxation (charge)/credit on loss on ordinary activities	9	(6.1)	24.4
<b>Loss for the year</b>	<b>23</b>	<b>(13.1)</b>	<b>(81.2)</b>

There is no difference between the loss on ordinary activities before taxation and the loss for the year stated above, and their historical cost equivalents

All amounts relate to continuing operations

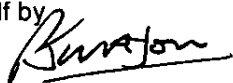
# Kemble Water Holdings Limited

## Balance sheets

	Note	Group		Company	
		31 March 2012 £m	31 March 2011 (represented) £m	31 March 2012 £m	31 March 2011 £m
<b>Fixed assets</b>					
Intangible assets	12	1,557.3	1,582.1	-	-
Tangible assets	13	10,685.0	10,063.6	-	-
Investment in joint ventures					
Share of gross assets		3.6	3.6	-	-
Share of gross liabilities		(3.6)	(3.6)	-	-
Other fixed asset investments	14	0.1	0.1	1.0	1.0
		<b>12,242.4</b>	<b>11,645.8</b>	<b>1.0</b>	<b>1.0</b>
<b>Current assets</b>					
Stocks	15	10.4	8.8	-	-
Debtors	16	582.1	644.9	3,205.0	3,011.8
Investments	17	682.8	802.5	-	-
Cash at bank and in hand		53.6	41.8	-	-
		<b>1,328.9</b>	<b>1,498.0</b>	<b>3,205.0</b>	<b>3,011.8</b>
Creditors amounts falling due within one year	18	(1,557.9)	(1,117.0)	(537.5)	(444.4)
<b>Net current (liabilities)/assets</b>		<b>(229.0)</b>	<b>381.0</b>	<b>2,667.5</b>	<b>2,567.4</b>
<b>Total assets less current liabilities</b>		<b>12,013.4</b>	<b>12,026.8</b>	<b>2,668.5</b>	<b>2,568.4</b>
Creditors amounts falling due after more than one year	19	(9,351.0)	(9,161.7)	-	-
Provisions for liabilities and charges	21	(1,047.3)	(1,023.0)	-	-
<b>Net assets excluding pension liability</b>	27	<b>1,615.1</b>	<b>1,842.1</b>	<b>2,668.5</b>	<b>2,568.4</b>
Pension assets, net of deferred tax	1(t)	29.6	28.0		
Pension liabilities, net of deferred tax	1(t)	(144.5)	(119.4)		
Net pension liability	27	(114.9)	(91.4)	-	-
<b>Net assets including pension liability</b>		<b>1,500.2</b>	<b>1,750.7</b>	<b>2,668.5</b>	<b>2,568.4</b>
<b>Capital and reserves</b>					
Called up share capital	22	1,991.6	1,991.6	1,991.6	1,991.6
Profit and loss account	23	(491.4)	(240.9)	676.9	576.8
<b>Total shareholders' funds</b>		<b>1,500.2</b>	<b>1,750.7</b>	<b>2,668.5</b>	<b>2,568.4</b>

The notes on pages 40 to 81 form an integral part of these financial statements

The financial statements on pages 36 to 81 were approved by the Board of directors on 7 June 2012 and signed on its behalf by



**Sir Peter Mason KBE**  
Chairman

Kemble Water Holdings Limited, registered number 5819262

# Kemble Water Holdings Limited

## Consolidated cash flow statement

<b>Cash flow statement</b>	Note	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
<b>Net cash inflow from operating activities</b>	28(a)	<b>964.1</b>	936 7
<b>Returns on investments and servicing of finance</b>	28(b)	<b>(387.8)</b>	(367 2)
<b>Taxation</b>		<b>70.4</b>	(1 5)
<b>Net cash outflow for capital expenditure and financial investment</b>	28(c)	<b>(1,117.4)</b>	(846 9)
<b>Equity dividends paid to shareholders</b>	10	<b>(165.1)</b>	(115 1)
<b>Net cash outflow before management of liquid resources and financing</b>		<b>(635.8)</b>	(439 3)
Net cash inflow/(outflow) from management of liquid resources	28(d)	<b>119.7</b>	(136 5)
<b>Net cash outflow before financing</b>		<b>(516.1)</b>	(575 8)
<b>Financing</b>			
Cash inflow from increase in debt and lease financing	28(d)	<b>527.9</b>	569 1
<b>Increase/(decrease) in net cash</b>	28(d)	<b>11.8</b>	(6 7)
<b>Reconciliation of net cash flow to movement in net debt</b>			
<b>Increase/(decrease) in net cash</b>		<b>11.8</b>	(6 7)
Cash inflow from increase in debt and lease financing			
- loans due within one year		<b>(462.4)</b>	387 9
- loans due after more than one year		<b>(73.4)</b>	(965 4)
- capital repayment of finance leases		<b>7.9</b>	8 4
Cash (outflow)/inflow from increase in liquid resources		<b>(119.7)</b>	136 5
<b>Increase in net debt resulting from cash flows</b>		<b>(635.8)</b>	(439 3)
Other non-cash movements			
- RPI uplift on index-linked bond and debt issue cost amortisation		<b>(192.3)</b>	(211 2)
- other non-cash movement		<b>(0.1)</b>	-
- fair value amortisation on loans at acquisition		<b>10.1</b>	10 7
<b>Increase in net debt</b>		<b>(818 1)</b>	(639 8)
Opening net debt		<b>(8,143.9)</b>	(7,504 1)
<b>Closing net debt</b>		<b>(8,962 0)</b>	(8,143 9)



# Kemble Water Holdings Limited

## Statement of Group total recognised gains and losses

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Group loss for the financial year	(13.1)	(81.2)
Exchange adjustments	-	2.6
Actuarial loss on pension scheme (see note 27)	(93.6)	(1.6)
Deferred tax relief relating to actuarial deficit on pension schemes	21.3	(3.2)
<b>Total recognised losses relating to the year</b>	<b>(85.4)</b>	<b>(83.4)</b>

No items relating to joint ventures went through the statement of total recognised gains and losses

## Reconciliation of movements in shareholders' funds

	Group		Company	
	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m*
(Loss)/profit for the financial year	(13.1)	(81.2)	265.2	374.5
Exchange adjustments	-	2.6	-	-
Actuarial loss on pension scheme (see note 27)	(93.6)	(1.6)	-	-
Deferred tax relating to actuarial deficit on pension scheme	21.3	(3.2)	-	-
Dividend (see note 10)	(165.1)	(115.1)	(165.1)	(115.1)
<b>Net change in shareholders' funds</b>	<b>(250.5)</b>	<b>(198.5)</b>	<b>100.1</b>	<b>259.4</b>
Opening shareholders' funds	1,750.7	1,949.2	2,568.4	2,309.0
<b>Closing shareholders' funds</b>	<b>1,500.2</b>	<b>1,750.7</b>	<b>2,668.5</b>	<b>2,568.4</b>

\* The profit of Kemble Water Holdings Limited for the year ended 31 March 2011 includes the release of an impairment provision of £116.6m which was provided in the prior year

# **Kemble Water Holdings Limited**

## **Notes to the financial statements for the year ended 31 March**

### **1 Principal accounting policies**

The following accounting policies have been applied consistently in dealing with items which the Group considered material in relation to the financial statements, except as noted below

#### **Basis of preparation**

The financial statements are prepared in accordance with the historical cost convention and with applicable accounting standards in the UK and, except for the treatment of certain capital contributions, with the Companies Act 2006. An explanation of this departure from the requirements of the Act is given in accounting policy (e) below

#### **Going concern**

The Group's business activities, together with the factors likely to affect its future development, performance and position, are set out in the Directors' report on pages 4 to 32. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described in the Directors' report

Day to day working capital requirements are funded by the business. During the year £657.1m, net of bond issuance costs, of new debt were secured and there is no current requirement to raise additional finance to meet future project obligations. There are also cash and current asset investment balances of £736.4m and committed facilities with a group of banks of £1,625m, of which £350m was drawn at 31 March 2012, and the remainder are only likely to be used on rare occasions. Of the £1,625m, £450m 364 day facilities are due for renewal by August 2012. The current economic conditions create uncertainty particularly over (a) the level of revenue earned from regulatory activities, (b) the increased occurrence of bad debts, and (c) the availability of bank finance in the foreseeable future. The Group's forecasts and projections, taking account of reasonably possible changes in trading performance, show that the Group should be able to operate within the level of its current facilities for 15 months. However, the Group meets its capital programme requirements by raising new debt

The directors believe, after due and careful enquiry, that the Group and the Company has sufficient resources for its present requirements and, therefore, consider it appropriate to adopt the going concern basis in preparing the 2012 financial statements

#### **Changes to accounting policies**

The same accounting policies used for the year ended 31 March 2011 have been applied in these financial statements

#### **Changes in accounting estimates**

During the year the Group modified the way in which it calculates its provision for bad debts and extended the calculation to cover accrued (unbilled) income. The calculation also uses a number of estimates and assumptions that were updated in line with the collections that the Group is achieving in the current economic climate

As a result the Group's bad debt charge in the year has increased to £70.6m (2011: £38.4m)

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### Summary of significant accounting policies

The principal accounting policies adopted in the preparation of the financial statements are set out below

#### (a) Basis of consolidation

The Group financial statements consolidate the financial statements of the Group and entities controlled by the Group (its subsidiaries), made up to 31 March 2012, and incorporate the results of its share of joint ventures using equity accounting

The results of subsidiaries disposed of during the year are included in the consolidated profit and loss account from the effective date of disposal. Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used under the relevant local GAAP into line with those used by the Group

#### (b) Subsidiaries

Control is achieved where the Group has the power to govern the financial and operating policies, generally accompanied by a shareholding of more than one half of the voting rights, of an investee entity so as to obtain benefits from its activities

All intra-group transactions, balances, income and expenses are eliminated on consolidation

#### (c) Revenue recognition

Revenue represents the fair value of the income receivable in the ordinary course of business for goods and services provided and are recognised in accordance with FRS 5 'Reporting the Substance of Transactions'. No adjustment is made to reduce revenue by an estimated bad debt charge to reflect the fair value as this is not deemed material. Where relevant, revenue includes an estimate of the sales value of water supplied and waste water charges to customers between the date of the last meter reading and the period end, exclusive of value added tax. The estimated usage is based upon historical data, judgement and assumptions, actual results could differ from these estimates, which would result in operating revenues being adjusted in the period for which the revision to the estimates is determined. For customers who do not have a meter, the receivable billed is dependent upon the rateable value of the property, as assessed by an independent rating officer.

Additional charges added to a customer's account as a result of debt recovery activity, such as court costs or solicitors fees, are recognised as favourable operating costs when payment is received in both the statutory and regulatory accounts. The Group currently does not have any charges on income, any outstanding revenue is recovered in the normal course of business. All water and sewerage charges billed to customers are recognised as income at the time they are billed and apportioned over the period to which they relate. For consumption by measured customers which has not yet been billed an accrual is estimated.

Where there is a change of customer in an unmeasured property but the Group cannot confirm the name, a bill is raised in the name of "The Occupier". The Group does not raise billing in the name of the Occupier for metered accounts. However, an unmeasured bill in the name of The Occupier will be cancelled and rebilled once the Group has confirmation of the customer's name. If confirmation is not received the bill is cancelled and the property is classified as empty.

Where a property is classified as empty, an empty property process is followed to verify when the property becomes occupied and/or obtain the name of the customer. The status is established with the customer at point of contact, if the property is not chargeable after 10 weeks the unfurnished/unoccupied state is confirmed visually.

# **Kemble Water Holdings Limited**

## **Notes to the financial statements for the year ended 31 March (continued)**

### **1 Principal accounting policies (continued)**

#### **(c) Revenue recognition (continued)**

The empty property process comprises a number of steps. If these steps confirm that a property appears to be empty then the supply may be turned off. The property will only cease to be classified as empty when a named customer is identified and billed. The Group does not recognise income in respect of empty properties. If the Group has turned off the supply of water at the mains to a property at a customer's request then water supply charges are not payable. A customer may request the supply to be turned off in instances such as the property is to be demolished or where a house previously converted into flats (and additional supplies made) to be converted back into a house.

With regard to new properties, an estimate is made of the sales value of water supplied and waste water charges to customers between the date of connection and the period end is made.

The Group recognises all revenue at the time of delivery. Should the Group consider that the criteria for revenue recognition are not met for a transaction, revenue recognition would be delayed until such time as the transaction becomes fully earned. Payments received in advance of delivery are recorded as deferred revenue.

Property revenue is recognised on completion of the sale.

#### **(d) Intangible assets**

##### **Goodwill**

Purchased goodwill arising on acquisition, being the excess of the purchase price over the fair value of the net assets of a subsidiary, is capitalised and amortised to nil using the straight line method over its estimated useful economic life, of 40 years. Impairment tests on the carrying value are undertaken on an annual basis as the goodwill is amortised over a period greater than 20 years. These tests involve a comparison of the book value with the higher of the net realisable value and the value in use. A life longer than 20 years is deemed appropriate because the goodwill relates primarily to the regulated business of providing water and wastewater services, which is expected to generate stable revenues and there are significant barriers to entry to this business.

Profit or loss on disposal of a previously acquired subsidiary, joint venture or associated undertaking is determined after including the attributable amount of purchased goodwill.

##### **Other intangible assets**

Other intangible assets are measured initially at cost and are amortised on a straight-line basis over their estimated useful lives. Their carrying amount is reduced by any provision for impairment where necessary.

Intangible assets currently comprise of licences and concessions. These assets are being amortised over their remaining useful lives of 8 years.

#### **(e) Tangible fixed assets**

Tangible fixed assets comprise infrastructure assets (mains, sewers and pumped raw water storage reservoirs and sludge pipelines), and other assets (including land, buildings, properties, over ground plant and equipment).

Directly attributable costs are capitalised within fixed assets. These costs include employee costs and other internal costs that are incremental to the business due to the scale and nature of the capital implementation programme of the Group. Interest costs are not capitalised.

##### **Infrastructure assets**

Infrastructure assets comprise a network of systems. In the UK water regulated business, all expenditure on infrastructure assets is capitalised at cost and not depreciated, whilst the planned element incurred in maintaining the operating capability of the network in accordance with defined service standards is expensed as depreciation.

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 1 Principal accounting policies (continued)

#### (e) Tangible fixed assets (continued)

##### Capital contributions

Capital contributions received in respect of infrastructure assets have been deducted from the cost of fixed assets. This is not in accordance with Schedule 1 to the Companies Act 2006 that requires fixed assets to be stated at their purchase price without deduction of contributions, which are accordingly accounted for as deferred income. This departure from the requirement of the Act is, in the opinion of the directors, necessary for the financial statements to give a true and fair view because infrastructure assets do not have a determinable finite life.

Where material, contributions received towards the cost of other assets are accounted for as deferred income and released to the profit and loss account over the estimated economic lives of the assets.

##### Other assets

All other assets, comprising plant and equipment and land and buildings, are stated at cost less accumulated depreciation.

Cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably.

Freehold land is not depreciated and assets in the course of construction are not depreciated until they are commissioned. Other assets are depreciated by writing off their cost less their estimated residual value by equal instalments over their estimated useful lives down to nil, based on management's judgement and experience, which are principally as follows:

Buildings	15 – 60 yrs
Operational structures	30 – 100 yrs
Other	5 – 40 yrs
Fixtures, fittings, vehicles and computers	3 – 7 yrs
Fixed and mobile plant	3 – 40 yrs

Depreciation methods, residual values and useful lives are re-assessed annually and, if necessary, changes are accounted for prospectively.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the profit and loss account.

##### Impairment of tangible and intangible assets excluding goodwill

Intangible assets and tangible fixed assets are assessed for impairment whenever there is an indication of such. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

The recoverable amount is the higher of fair value less costs to sell, and value in use. Value in use represents the net present value of expected future cash flows discounted on a pre-tax basis using a rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 1 Principal accounting policies (continued)

#### (e) Tangible fixed assets (continued)

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. Impairment of non-current assets is recognised in the profit and loss account within operating costs.

Where an impairment loss subsequently reverses, it is recognised in the profit and loss account and the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but not so as to exceed the carrying amount that would have been determined had no impairment loss been recognised in prior years.

#### (f) Stocks

Stock and work in progress are stated at the lower of cost and net realisable value. Cost comprises direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using the weighted average method. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

#### (g) Pre-contract costs

Pre-contract costs are expensed as incurred, except where it is virtually certain that the contract will be awarded, in which case they are recognised as an asset and written off to the profit and loss account over the life of the contract.

#### (h) Taxation

The tax expense represents the sum of current tax and deferred tax.

##### *Current taxation*

Current tax, including UK corporation tax and foreign tax, is based on the taxable profit for the year and is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted at the balance sheet date. Taxable profit differs from the profit on ordinary activities before tax as reported in the profit and loss account because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

##### *Deferred taxation*

Deferred tax is recognised, without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, except as otherwise required by FRS 19 "Deferred Taxation".

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits against which to recover carried forward tax losses and from which the future reversal of underlying timing differences can be deducted.

Deferred taxation is measured at the average tax rates that are expected to apply in the years in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted by the balance sheet date.

Deferred tax is charged or credited in the profit and loss account except when it relates to items charged or credited to equity, in which case the deferred tax is also dealt with via the Statement of total recognised gains and losses.

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 1 Principal accounting policies (continued)

#### (i) Leased assets

Leases are classified according to the substance of the transaction. A lease that transfers substantially all the risks and rewards of ownership to the lessee is classified as a finance lease. All other leases are classified as operating leases.

#### Finance leases

Finance leases are capitalised in the balance sheet at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease.

The corresponding liability is shown as a finance lease obligation to the lessor. Leasing repayments comprise both a capital and a finance element. The finance element is written off to the profit and loss account so as to produce an approximately constant periodic rate of charge on the outstanding obligation. Such assets are depreciated over the shorter of their estimated useful lives and the period of the lease to the first break clause.

#### Operating leases

Operating lease rentals are charged to the profit and loss account on a straight-line basis over the period of the lease.

#### (j) Pension and other post retirement benefits

The Group operates two large defined benefit pension schemes. The Group accounts for these schemes in accordance with FRS 17 "Retirement Benefits". These schemes are independently administered funds, for the substantial majority of the Group's employees. Actuarial valuations are carried out as determined by the pension scheme trustees using the projected unit credit method for both pension schemes at intervals of not more than three years, the rates of contribution payable and the pension cost being determined on the advice of the actuaries, having regard to the results of these valuations. The Group believes that the assumptions utilised in recording obligations under the two schemes are reasonable based on prior experience, market conditions and the advice of scheme actuaries. However, actual results may differ from such assumptions. For any intervening reporting period, the actuaries review the continuing appropriateness of the contribution rates (a complete actuarial valuation is performed every three years). Defined benefit assets are measured at fair value while liabilities are measured at present value (which approximates to fair value).

The difference between the assets and liabilities of the schemes are recognised as a surplus (to the extent that the surplus is recoverable) or obligation in the balance sheet.

The cost of providing pension benefits to employees is included in the profit and loss account within the cost of employee benefits. The difference between the expected return on scheme assets and interest on scheme liabilities are included within other finance income/expense in the profit and loss account.

Actuarial gains and losses are recognised outside the profit and loss account in retained earnings and are presented in the Statement of total recognised gains and losses.

In addition to the defined benefit schemes, the Group operates a Defined Contribution Stakeholder Pension Scheme ("DCSPS"), managed through Standard Life Assurance Limited ("Standard Life"). From 1 April 2011 the DCSPS is the only scheme to which new entrants to the Group will be eligible. The Thames Water Extended Leadership Team of executives have also joined this scheme from 1 April 2011 and are no longer active members of a defined benefit arrangement.

The Group also operates two closed defined contribution pension schemes. The Group has no further payment obligations for these schemes. However, defined funds for individuals are held within these schemes.

# **Kemble Water Holdings Limited**

## **Notes to the financial statements for the year ended 31 March (continued)**

### **1 Principal accounting policies (continued)**

#### **(k) Foreign currencies**

Transactions in foreign currencies are recorded using the rate of exchange current on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the rate of exchange current at the balance sheet date. Gains and losses arising on retranslation are included in the profit and loss account. The foreign exchange loss shown in reserves is as a result of revaluation of certain balance sheet accounts.

On consolidation, the balance sheets of overseas subsidiaries and joint ventures (none of which has the currency of a hyper inflationary economy) are translated into sterling at exchange rates applicable at the balance sheet date. The profit and loss accounts are translated into sterling using the average rate unless exchange rates fluctuate significantly in which case the exchange rate at the date the transaction occurred is used. Exchange differences resulting from the translation of such balance sheets at rates ruling at the beginning and end of the year, together with the differences between profit and loss accounts translated at average rates and rates ruling at the year end, are dealt with as movements on the profit and loss reserve as shown in the Statement of total recognised gains and losses.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing exchange rate. Foreign currency borrowings are recorded at the hedged rate at the balance sheet date.

#### **(l) Cash and cash equivalents**

Cash comprises cash at bank and in hand, deposits, and other short-term highly liquid investments which are readily convertible on initial investment into known amounts of cash at any time without penalty or if a maturity or period of notice of not more than 24 hours or one working day has been agreed.

#### **(m) Financial liabilities and equity**

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities. Equity instruments issued by the Group are recorded at the proceeds received, net of direct issue costs.

#### **(n) Borrowings**

Interest bearing bank loans and overdrafts are recorded as the proceeds received net of direct issue costs. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an amortised cost basis to the profit and loss account using the effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled in the year in which they arise.

#### **(o) Financial instruments and derivatives**

Interest rate swap agreements and financial futures are used to manage interest rate exposure. While the Group enters into currency swaps to manage its exposure to fluctuations in exchange rates, the Group does not use derivative financial instruments for speculative purposes.

The Group currently does not apply FRS 26 "Financial Instruments Recognition and Measurement", and accordingly the disclosure requirements of FRS 29 "Financial Instruments Disclosures" are not applicable. Therefore, the presentation requirements of FRS 25 "Financial Instruments Presentation" have been applied. However, certain voluntary disclosures have been prepared to aid understanding and ensure comparability with prior year.

Foreign currency and interest rate swaps are all in hedging relationships and are accounted for on an amortised cost basis. Swaps are included within the appropriate caption in notes 19 and 120.



# **Kemble Water Holdings Limited**

## **Notes to the financial statements for the year ended 31 March (continued)**

### **1 Principal accounting policies (continued)**

#### **(p) Accruals and deferred income**

Grants and contributions receivable in respect of depreciating fixed assets are treated as deferred income, which is credited to the profit and loss account over the estimated economic lives of the related assets

#### **(q) Research and development**

Research expenditure is written off to the profit and loss account in the year in which it is incurred

#### **(r) Provisions**

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Insurance provisions are recognised or released by assessing their adequacy using current estimates of future cash flows under insurance contracts

#### **(s) Dividends**

Dividends unpaid at the balance sheet date are only recognised as a liability at that date to the extent that they are appropriately authorised and are no longer at the discretion of the Group. Unpaid dividends that do not meet these criteria are disclosed in the notes to the financial statements

Dividend income is recognised when there is a legal right to receive

#### **(t) Re-presentation of prior year Group balance sheet**

The Group balance sheet as at 31 March 2011 has been re-presented to show the net pension liability split into pension assets, net of deferred tax and pension liabilities, net of deferred tax (see note 27). There is no change to the net-pension liability and the Group's net assets including pension liability are unchanged. There is no change to the Company's balance sheet

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 2 Segmental analysis

The segments by class of business are

**TWUL.** This incorporates the business activities of TWUL and its apportionment of fair value and goodwill derived from the purchase by Kemble Water Limited

**Other** All other activities of the Group including provision of engineering, utility network and asset and facilities management services, land and property development and those activities carried out in managing the Group, including insurance services provided by the captive insurer to the Group and financing arrangements in the holding companies. These balances also include intercompany eliminations and consolidation adjustments

No geographic segmental analysis is necessary as all material activity and net assets are within the UK

#### Profit and loss account by class of business\*

	Year ended 31 March 2012			Year ended 31 March 2011		
	TWUL £m	Other £m	Total £m	TWUL £m	Other £m	Total £m
<b>Turnover</b>	<b>1,694.9</b>	<b>5.3</b>	<b>1,700.2</b>	1,623.1	18.8	1,641.9
Operating profit/(loss)	643.9	(67.2)	576.7	600.2	(65.2)	535.0
Add share of joint ventures	-	-	-	-	0.4	0.4
<b>Operating profit/(loss)</b>	<b>643.9</b>	<b>(67.2)</b>	<b>576.7</b>	600.2	(64.8)	535.4
<b>Profit on sale of fixed assets</b>	<b>3.9</b>	<b>(0.4)</b>	<b>3.5</b>	10.9	(1.9)	9.0
<b>Net interest payable</b>	<b>(425.6)</b>	<b>(161.6)*</b>	<b>(587.2)</b>	(402.6)	(247.4)*	(650.0)
<b>Taxation</b>	<b>25.0</b>	<b>(31.1)</b>	<b>(6.1)</b>	16.7	7.7	24.4
<b>Profit/(loss) after tax</b>	<b>247.2</b>	<b>(260.3)</b>	<b>(13.1)</b>	225.2	(306.4)	(81.2)

\* Interest payable relates to the funding required for the acquisition of the regulated group

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 2 Segmental analysis (continued)

#### Balance sheet by class of business:

	31 March 2012			31 March 2011		
	TWUL £m	Other £m	Total £m	TWUL £m	Other £m	Total £m
<b>Fixed assets</b>						
Intangible assets	1,556.3	1.0	1,557.3	1,581.1	1.0	1,582.1
Tangible assets	10,685.0	0.0	10,685.0	10,058.6	5.0	10,063.6
Investment in joint ventures						
Share of gross assets	-	3.6	3.6	-	3.6	3.6
Share of gross liabilities	-	(3.6)	(3.6)	-	(3.6)	(3.6)
Other fixed asset investments	-	0.1	0.1	-	0.1	0.1
	<b>12,241.3</b>	<b>1.1</b>	<b>12,242.4</b>	11,639.7	6.1	11,645.8
<b>Current assets</b>						
Stocks	9.6	0.8	10.4	8.2	0.6	8.8
Debtors amounts falling due within one year	647.9	(65.8)	582.1	621.9	23.0	644.9
Debtors amounts falling due after one year (inter group loan)	2,015.0	(2,015.0)	-	1,865.0	(1,865.0)	-
Current asset investments	619.4	63.4	682.8	775.8	26.7	802.5
Cash at bank and in hand	2.7	50.9	53.6	3.6	38.2	41.8
	<b>3,294.6</b>	<b>(1,965.7)</b>	<b>1,328.9</b>	3,274.5	(1,776.5)	1,498.0
Creditors amounts falling due within one year	(1,460.4)	(97.5)	(1,557.9)	(1,016.3)	(100.7)	(1,117.0)
<b>Net current assets/(liabilities)</b>	<b>1,834.2</b>	<b>(2,063.2)</b>	<b>(229.0)</b>	2,258.2	(1,877.2)	381.0
<b>Total assets/(liabilities) less current assets/(liabilities)</b>	<b>14,075.5</b>	<b>(2,062.1)</b>	<b>12,013.4</b>	13,897.9	(1,871.1)	12,026.8
Creditors amounts falling due after more than one year	(8,050.2)	(1,300.8)	(9,351.0)	(7,748.7)	(1,413.0)	(9,161.7)
Provisions for liabilities and charges	(1,052.6)	5.3	(1,047.3)	(1,054.3)	31.3	(1,023.0)
<b>Net assets/(liabilities) excluding pension (liabilities)/assets</b>	<b>4,972.7</b>	<b>(3,357.6)</b>	<b>1,615.1</b>	5,094.9	(3,252.8)	1,842.1
Net pension (liabilities)/assets	(119.2)	4.3	(114.9)	(94.6)	3.2	(91.4)
<b>Net assets/(liabilities) including pension (liabilities)/assets</b>	<b>4,853.5</b>	<b>(3,353.3)</b>	<b>1,500.2</b>	5,000.3	(3,249.6)	1,750.7

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 2 Segmental analysis (continued)

The TWUL net assets above include the net book values of goodwill of £1,556.3m (2011 £1,581.1m), fair value adjustments to tangible assets of £1,911.2m (2011 £1,932.7m) and financial instruments included in creditors falling due after more than one year of £463.3m (2011 £267.6m). The other business has a goodwill apportionment of £nil (2011 £nil).

### 3 Group operating costs

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Staff costs before exceptional item (note 5)	201.9	210.7
Exceptional item – pension curtailment gain	(40.0)	-
Staff costs	161.9	210.7
Materials and consumables	156.2	135.9
Other operating charges (net)	470.1	441.4
Amortisation of goodwill and intangibles	44.4	44.4
Depreciation		
- owned assets	298.1	272.6
- infrastructure assets renewal charge	129.5	132.4
- assets held under finance leases	9.6	9.6
Rentals under operating leases		
- hire of plant and machinery	10.0	9.3
- other	5.7	5.4
Research and development	3.9	3.4
Auditor's remuneration	2.7	0.8
Foreign currency losses	(0.1)	0.9
	<b>1,292.0</b>	<b>1,266.8</b>
Own work capitalised (staff and other costs)	<b>(168.5)</b>	<b>(159.9)</b>
	<b>1,123.5</b>	<b>1,106.9</b>

#### Pensions curtailment gain – exceptional item

As described on page 18 of the directors' report, the Group made a number of changes to its pension schemes during the year. The main impact of the resultant changes in accounting estimates relating to pension schemes is the recognition of a curtailment gain of £40.0m, relating to the switch to a CARE basis for the calculation of future benefits. The curtailment gain has been disclosed as an exceptional item on the face of the Group profit and loss account as the directors consider that it is both material to understanding the underlying performance of the Group and one-off in nature. The effective tax charge on this exceptional item is £9.6m based on the UK tax rate of 24%. This exceptional item had a £nil cash flow impact.

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 3 Operating costs (continued)

Reconciliation of operating costs to operating expenditure (KPI)

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Operating costs	1,123.5	1,106.9
Exceptional item	40.0	-
Operating costs excluding exceptional item	1,163.5	1,106.9
Less		
Depreciation	(307.7)	(282.2)
Infrastructure assets renewals charge	(129.5)	(132.4)
Amortisation	(44.4)	(44.4)
Operating expenditure	681.9	647.9

Included in operating costs is auditor's remuneration in respect of the following

Further analysis of auditor's remuneration	Year ended 31 March 2012 £'000	Year ended 31 March 2011 £'000
<b>Fees payable to current auditor:</b>		
Amounts receivable by the auditor and their associates in respect of		
Audit of these financial statements	33	30
Audit of financial statements of subsidiaries pursuant to legislation	340	320
Assurance services	71	163
Other services relating to taxation	25	18
Services relating to information technology	118	-
All other services	2,148	284
	<b>2,735</b>	<b>816</b>

Fees for all other services above include £1.9m in respect of advice on the Thames Tunnel. These costs have been capitalised as part of the design phase of the project. The contract was awarded to KPMG following a competitive tendering process in line with the Group's procurement processes.

No other fees were payable to KPMG Audit Plc in respect of this year or the prior year.

### 4 Information regarding directors

Aggregate directors' emoluments:	Year ended 31 March 2012 £'000	Year ended 31 March 2011 £'000
Salary	735	320

#### Highest paid director.

Total emoluments of the highest paid director of the Company, in respect of their work done for the Group during the year, were £300,000 (2011: £275,000). None of the directors accrued any pension during either 2012 or 2011, or had any accrued pension under the Group's defined benefit scheme.

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 4 Information regarding directors (continued)

During the year, an indirect subsidiary of the Company made a payment of £62,000 (2011 £40,000) to C R Deacon, a director, for consultancy services and a payment of £16,000 (2011 £nil) to R Blomfield-Smith, for consultancy services, which commenced following her resignation as a Director

### 5 Staff numbers and costs

The aggregate payroll costs were as follows.

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
- Wages and salaries	168.2	170.3
- Social security costs	15.9	13.7
- Pension costs defined benefit scheme	16.9	25.1
- Pension costs defined contribution scheme	1.4	0.3
- Severance costs	1.3	3.1
	203.7	212.5
Employment costs included within research and development	(1.8)	(1.8)
Net staff costs before exceptional item	201.9	210.7
Exceptional item pension curtailment gain	(40.0)	-
Net staff costs	161.9	210.7

The average number of persons employed by the Group (including directors) during the year, analysed by category, was as follows

	Year ended 31 March 2012 Number	Year ended 31 March 2011 Number
Operations	4,239	4,578
Support	323	335
	4,562	4,913

### 6 Profit on sale of fixed assets

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Profit on disposal of fixed assets	3.5	9.0
Taxation charge attributable, included in the current tax credit for the period	1.6	1.2

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 7 Interest receivable and similar income

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Interest income		
- Net interest income from swaps	23.7	-
- Other interest income	23.8	6.1
	<b>47.5</b>	<b>6.1</b>

Amounts receivable on swaps relate to interest rate swaps taken out to hedge rates on external borrowings. Refer to note 20. The net interest receivable on swaps in 2012 (2011: Net interest payable on swaps (Note 8)) was the aggregate effect of all swaps held in the Group.

### 8 Interest payable and similar charges

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Interest expense		
- Bank loans and overdrafts	(2.3)	(6.2)
- All other loans	(613.5)	(543.8)
- Net interest expense on swaps	-	(82.8)
Finance charges payable in respect of finance leases	(6.8)	(5.6)
Amortisation of fees and discounts	(9.7)	(12.8)
Net pension finance expense (see note 27)	(2.4)	(4.3)
Other finance charges	-	(0.6)
Interest payable and similar charges	<b>(634.7)</b>	<b>(656.1)</b>

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 9 Taxation on loss on ordinary activities

Analysis of (charge)/credit in year	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
UK corporation tax - amounts payable in respect of corporation tax for the year	(0.3)	(0.8)
Adjustments in respect of previous years	14.9	14.1
<b>Total current tax credit</b>	<b>14.6</b>	<b>13.3</b>
<b>Deferred tax</b>		
Origination and reversal of timing differences	(45.9)	(51.6)
Adjustment in respect of previous years	(33.1)	(1.4)
Current year restatement due to tax rate change to 24% (2011 change to 26%)	75.4	69.5
Pension cost charge lower than pension cost relief	(17.1)	(5.4)
<b>Total deferred tax (charge)/credit</b>	<b>(20.7)</b>	<b>11.1</b>
<b>Tax (charge)/credit on loss on ordinary activities</b>	<b>(6.1)</b>	<b>24.4</b>

#### Factors affecting tax (charge)/credit for year

The current tax credit for the year is higher than (2011 lower than) the standard rate of corporation tax in the UK of 26% (2011 28%). The differences are explained below

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
(Loss) on ordinary activities before taxation	(7.0)	(105.6)
(Loss) on ordinary activities multiplied by standard rate of corporation tax in the UK of 26% (2011 28%)	1.8	29.6
<b>Effects of</b>		
Capital allowances in excess of depreciation and other timing differences	45.9	51.6
Tax losses unable to be used	(44.1)	(67.2)
Disallowable expenditure and other permanent differences	(21.0)	(20.2)
Net pension cost charge lower than pension cost relief	17.1	5.4
Adjustments to tax charge in respect of previous years	14.9	14.1
<b>Current tax credit for the year</b>	<b>14.6</b>	<b>13.3</b>

The tax charge attributable to the profit on sale of fixed assets is £1.6m (2011 £1.2m)

Of the deferred tax charge for the year ended 31 March 2012 of £20.7m (2011 £11.1m credit), a deferred tax charge for the year ended 31 March 2012 of £3.5m (2011 £16.5m credit) is shown as a movement within note 21 provisions for liabilities and charges, and a deferred tax charge for the year ended 31 March 2012 of £17.2m (2011 £5.4m charge) is shown within note 27 (Pension schemes). Deferred tax not recognised in respect of tax losses is £131.6m (2011 £89.2m)



# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 9 Taxation on loss on ordinary activities (continued)

#### Factors affecting the tax charge for the year

The 2012 Budget on 21 March 2012 announced that the UK corporation tax rate will reduce to 22% by 2014. A reduction in the rate from 26% to 25% (effective from 1 April 2012) was substantially enacted on 5 July 2011, and a further reduction to 24% (effective from 1 April 2012) was substantively enacted on 26 March 2012. The financial statements for the year reflect these changes, a credit of £75.4m was taken to the profit and loss account and a charge of £3.0m was taken to reserves.

On 23 March 2011, the Chancellor announced the reduction in the main rate of UK corporation tax to 26% with effect from 1 April 2011. This change became substantively enacted on 29 March 2011 and therefore the effect of the rate reduction created a reduction in the deferred tax liability for the prior period of £69.5m, which has been included in the figures above.

The overall effect of the reductions from 24% to 22%, if these are applied to the deferred tax balance at 31 March 2012, would be to further reduce the deferred tax liability by approximately £75.5m.

### 10 Dividends

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Second interim dividend in respect of prior financial year 4.14p (2011 2.89p) per £1 ordinary share	82.5	57.5
First interim dividend in respect of the current financial year 4.15p (2011 2.89p) per £1 ordinary share	82.6	57.6
	<b>165.1</b>	115.1

On 7 June 2012 the directors approved a second interim dividend of £74.5m (3.7p per ordinary share) in respect of the year ended 31 March 2012.

### 11 Profit of holding company

Retained profit for the year of £265.2m (2011 profit £374.5m) before distributions has been dealt with in the accounts of Kemble Water Holdings Limited. A separate profit and loss account for the Company has not been presented as permitted by Section 408 of the Companies Act 2006.

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 12 Intangible assets

	Goodwill £m	Group Other intangible assets £m	Total £m
<b>Cost</b>			
At the beginning of the year	1,773.4	0.4	1,773.8
Acquisition	19.6	-	19.6
Reclassification	(0.1)	1.1	1.0
<b>At the end of the year</b>	<b>1,792.9</b>	<b>1.5</b>	<b>1,794.4</b>
<b>Amortisation</b>			
At the beginning of the year	(192.2)	0.5	(191.7)
Charge for the year	(44.3)	(0.1)	(44.4)
Reclassification	0.1	(1.1)	(1.0)
<b>At the end of the year</b>	<b>(236.4)</b>	<b>(0.7)</b>	<b>(237.1)</b>
<b>Net book value</b>			
<b>At the end of the year</b>	<b>1,556.5</b>	<b>0.8</b>	<b>1,557.3</b>
At the beginning of the year	1,581.2	0.9	1,582.1

The Group has provided for additional consideration of £19.5m for the acquisition of the regulated group resulting from a review of pre-acquisition liabilities. The additional goodwill arising on acquisition, being the excess of the purchase price over the fair value of the net assets of a subsidiary, has been capitalised and will be amortised to nil using the straight line method over its estimated useful economic life, of 40 years.

Other intangible assets include concessions, licences and similar rights and assets.

The Company has no intangible assets (2011: £nil).

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 13 Tangible fixed assets

	Group				
	Plant and equipment £m	Land and buildings £m	Infra- structure assets £m	Assets in course of construction £m	Total £m
<b>Cost</b>					
At the beginning of the year	3,452.2	2,224.7	4,861.0	1,188.7	11,726.6
Additions	-	-	-	1,095.9	1,095.9
Transfers between items	375.9	74.6	318.7	(769.2)	-
Disposals	(24.6)	-	(0.4)	-	(25.0)
<b>At the end of the year</b>	<b>3,803.5</b>	<b>2,299.3</b>	<b>5,179.3</b>	<b>1,515.4</b>	<b>12,797.5</b>
<b>Capital contributions</b>					
At the beginning of the year	-	-	(141.0)	-	(141.0)
Additions	-	-	(32.1)	-	(32.1)
<b>At the end of the year</b>	<b>-</b>	<b>-</b>	<b>(173.1)</b>	<b>-</b>	<b>(173.1)</b>
<b>Depreciation</b>					
At the beginning of the year	(744.5)	(275.0)	(502.5)	-	(1,522.0)
Provided during the year	(259.7)	(48.0)	(129.5)	-	(437.2)
Disposals	19.8	-	-	-	19.8
<b>At the end of the year</b>	<b>(984.4)</b>	<b>(323.0)</b>	<b>(632.0)</b>	<b>-</b>	<b>(1,939.4)</b>
<b>Net book value</b>					
<b>At the end of the year</b>	<b>2,819.1</b>	<b>1,976.3</b>	<b>4,374.2</b>	<b>1,515.4</b>	<b>10,685.0</b>
At the beginning of the year	2,707.7	1,949.7	4,217.5	1,188.7	10,063.6

Depreciation has not been charged on freehold land stated in the financial statements at cost of £120.3m (2011 £117.1m)

On 1 October 2011 the Group adopted 40,000km of private sewers. The private sewers have zero cost, depreciation and net book value as no cost was paid by the Group on adoption.

The Company has no tangible fixed assets (2011: £nil)

The net book value of land and buildings comprises

	31 March 2012 £m	31 March 2011 £m
<b>Group</b>		
Freehold	1,965.7	1,939.1
Long leasehold - over 50 years	7.8	7.8
Short leasehold - under 50 years	2.8	2.8
	<b>1,976.3</b>	<b>1,949.7</b>

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 13 Tangible fixed assets (continued)

Details of the Group's tangible fixed assets which are held under finance leases are

	Plant and equipment total £m
<b>Cost</b>	
At the beginning and end of the year	272.5
<b>Depreciation</b>	
At the beginning of the year	(146.1)
Charge for the year	(9.6)
<b>At the end of the year</b>	<b>(155.7)</b>
<b>Net book value</b>	
<b>At the end of the year</b>	<b>116.8</b>
At the beginning of the year	126.4

### 14 Fixed asset investments

In accordance with FRS 9, where the carrying value of an individual investment is less than £nil, the negative carrying value has been disclosed in provisions for liabilities and charges within other provisions (note 21)

The associated undertakings and joint ventures are all unlisted

The Company has no (2011 £nil) investments in joint ventures or associates

#### Group

Interests in investments	£m
<b>Cost</b>	
At the beginning and end of the year	0.1
<b>Net book value</b>	
At the beginning and end of the year	0.1

#### Company

	Investment in subsidiary under- taking £m
<b>Cost</b>	
<b>At the beginning and end of the year</b>	<b>1.0</b>

The investment relates to Kemble Water Eurobond Plc

See note 30 for a list of principal subsidiaries

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 15 Stocks

#### Group

	31 March 2012 £m	31 March 2011 £m
Raw materials and consumables	5.8	5.8
Finished goods and goods for resale	4.6	3.0
	<b>10.4</b>	<b>8.8</b>

The Company has no stocks (2011 £nil)

### 16 Debtors

	Group		Company	
	31 March 2012 £m	31 March 2011 £m	31 March 2012 £m	31 March 2011 £m
<b>Due within one year:</b>				
Trade debtors	256.2	273.4	-	-
Amounts owed by Group undertakings	-	-	3,205.0	3,011.8
Corporation tax receivable	-	34.8	-	-
Other debtors	90.1	122.1	-	-
Prepayments and accrued income	235.8	214.6	-	-
	<b>582.1</b>	<b>644.9</b>	<b>3,205.0</b>	<b>3,011.8</b>

#### Company

Amounts owed by Group undertakings is further analysed as follows

	31 March 2012 £m	31 March 2011 £m
Inter-company loans due within one year	1,990.6	1,990.6
Non-loan amounts due within one year	1,214.4	1,021.2
	<b>3,205.0</b>	<b>3,011.8</b>

A loan of £1,990.6m (2011 £1,990.6m) which incurs interest at 18% (2011 18%) is owed by the immediate subsidiary company, Kemble Water Eurobond Plc. All other amounts owed by subsidiary undertakings are unsecured, interest free and repayable on demand.

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 17 Current asset investments

Group	31 March 2012 £m	31 March 2011 £m
Bank deposits	181.4	313.4
Money market funds	501.4	489.1
	<b>682.8</b>	<b>802.5</b>

The Company has no current asset investments (2011 £nil)

Current asset investments consist of short-term bank deposits with highly rated banks and triple A rated money market funds

### 18 Creditors: amounts falling due within one year

	Group		Company	
	31 March 2012 £m	31 March 2011 £m	31 March 2012 £m	31 March 2011 £m
Other loans	470.0	7.6	-	-
Trade creditors – operating expenses	278.6	253.9	-	-
Trade creditors – capital expenditure	243.0	332.3	-	-
Obligations under finance leases	56.5	7.9	-	-
Corporation tax payable	21.0	-	-	100.3
Group relief creditor	-	-	93.1	-
Taxation and social security	5.6	4.8	-	-
Other creditors	120.0	124.5	-	-
Interest creditors	202.3	212.0	-	-
Amounts owed to subsidiary undertakings	-	-	444.4	344.1
Accruals and deferred income	160.9	174.0	-	-
	<b>1,557.9</b>	<b>1,117.0</b>	<b>537.5</b>	<b>444.4</b>

The amounts owed to subsidiary undertakings are interest free and payable on demand

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 19 Creditors: amounts falling due after more than one year

	Group		Company	
	31 March 2012 £m	31 March 2011 £m	31 March 2012 £m	31 March 2011 £m
Secured bank loans	999.6	1,718.8	-	-
Other loans	8,041.6	7,066.8	-	-
Obligations under finance leases	130.7	187.1	-	-
Deferred income	177.1	189.0	-	-
Accruals	2.0	-	-	-
	<b>9,351.0</b>	<b>9,161.7</b>	<b>-</b>	<b>-</b>

Other loans are all secured apart from one loan, £310.4m (2011 £310.4m) For further detail of security see note 29

### 20 Financial instruments

#### Funding and treasury policy

The Group's treasury operations are managed centrally by a small specialist team within the Group reporting directly to the Chief Financial Officer of TWUL. The treasury team manages the financing (including debt, interest costs and foreign exchange) for the Group. Treasury policy is focussed on efficient and effective management of cash and financial resources within the Group.

The Group's funding policy is to maintain a broad portfolio of debt. The debt arranged via Thames Water Utilities Finance Limited, Thames Water Utilities Cayman Finance Limited, Kemble Water Finance Limited and Thames Water (Kemble) Finance Plc is diversified by source and maturity in order to protect profits against risks arising from adverse movements in interest rates and currency exposures.

Derivative financial instruments, including cross currency swaps, interest rate swaps and index-linked swaps, are employed to manage the currency, interest rate and inflation risks arising from the primary financial instruments used to finance the Group's activities.

#### Short-term debtors and creditors

Short-term debtors and creditors have been excluded from the following financial instruments disclosures, other than the currency risk disclosures.

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 20 Financial instruments (continued)

#### Interest rate risk profile at 31 March

After taking into account the Group's interest rate and currency swaps, the interest rate risk profile of the Group's financial liabilities and assets is as follows

#### Group financial assets

	Total at floating rates		Total at book value	
	31 March 2012 £m	31 March 2011 £m	31 March 2012 £m	31 March 2011 £m
Current asset investments	682.8	802.5	682.8	802.5
Cash in bank and in hand	53.6	41.8	53.6	41.8
	<b>736.4</b>	<b>844.3</b>	<b>736.4</b>	<b>844.3</b>

London Inter-Bank Offered Rate ("LIBOR") and Bank of England base rate are the benchmark rates for floating current asset investments and cash at bank respectively

#### Group financial liabilities

	Total at floating rates		Total at fixed rates		Total at RPI linked rates		Total book value	
	31 March 2012 £m	31 March 2011 £m	31 March 2012 £m	31 March 2011 £m	31 March 2012 £m	31 March 2011 £m	31 March 2012 £m	31 March 2011 £m
Bank loans and overdraft								
- £ Sterling	265.0	122.3	217.7	1,173.1	516.9	423.4	999.6	1,718.8
Other loans and finance leases								
- £ Sterling	316.0	323.8	4,648.2	3,475.9	3,734.6	3,469.7	8,698.8	7,269.4
	<b>581.0</b>	<b>446.1</b>	<b>4,865.9</b>	<b>4,649.0</b>	<b>4,251.5</b>	<b>3,893.1</b>	<b>9,698.4</b>	<b>8,988.2</b>



# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 20 Financial instruments (continued)

#### Interest rate risk profile at 31 March (continued)

	Weighted average interest rate for fixed rate and RPI linked debt		Weighted average period until maturity for which rate is fixed for fixed rate and RPI debt	
	Year ended 31 March 2012	Year ended 31 March 2011	31 March 2012	31 March 2011
	%	%	Years	Years
Bank loans and overdraft				
- £ Sterling	5.2	2.8	14.0	14.1
Other loans and finance leases				
- £ Sterling	3.5	2.8	21.1	16.5
All loans	3.7	2.8	20.4	16.4

Liabilities with RPI linked rates have been re-presented as a separate category. Previously these were included within the 'Total at fixed rates' category. The directors consider that this revised presentation is more appropriate in order to reflect the amount of financial liabilities held as RPI linked bonds. Total financial liabilities remain unchanged.

The Company has no interest rate swaps nor cross currency swaps (2011: £nil).

Short term borrowings at floating rates bear interest at rates linked to LIBOR. Fixed rate and RPI linked borrowings of £9,117.4m (2011: £8,542.1m) equate to 94% (2011: 95%) of the total borrowings.

#### Currency risk

The Group is not economically exposed to any significant currency risk after matching foreign currency assets and liabilities and taking the effects of its hedging instruments into consideration.

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 20 Financial instruments (continued)

#### Fair values

Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties, other than in a forced or liquidation sale. The table below sets out a comparison of the book and fair values of the Group's financial instruments.

	Book Value		Fair value	
	31 March 2012 £m	31 March 2011 £m	31 March 2012 £m	31 March 2011 £m
<b>Primary financial instruments held or issued to finance the Group's operations.</b>				
<b>Financial assets:</b>				
Current asset investments	682.8	802.5	682.8	802.5
Cash at bank and in hand	53.6	41.8	53.6	41.8
<b>Total financial assets</b>	<b>736.4</b>	<b>844.3</b>	<b>736.4</b>	<b>844.3</b>
<b>Financial liabilities:</b>				
Bank loans and overdrafts	(999.6)	(1,718.8)	(999.6)	(1,759.3)
Other loans and finance leases	(8,424.1)	(7,121.6)	(8,614.5)	(6,798.9)
Derivative financial instruments held to manage the interest rate and currency profile				
Cross currency swaps and forward foreign currency contracts	(96.3)	(31.1)	(217.5)	(58.8)
Interest rate swaps	0.5	-	(53.9)	(61.7)
Index-linked swaps	(178.9)	(116.7)	(518.0)	(344.8)
<b>Total financial liabilities</b>	<b>(9,698.4)</b>	<b>(8,988.2)</b>	<b>(10,403.5)</b>	<b>(9,023.5)</b>
<b>Net financial liabilities</b>	<b>(8,962.0)</b>	<b>(8,143.9)</b>	<b>(9,667.1)</b>	<b>(8,179.2)</b>

Other loans include bonds, which are publicly traded. Fair values for these have been calculated using the 31 March 2012 quoted prices. Mark-to-market techniques (discounting expected cash flows at prevailing interest and exchange rates) are employed in computing fair values for the remaining fixed rate borrowing and all derivative financial instruments.

The Company has no bank loans, overdrafts, other loans, finance leases or derivatives financial instruments (2011 £nil).

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 20 Financial instruments (continued)

#### Maturities

The maturity profile of the carrying amount of the Group's financial liabilities other than short-term creditors and accruals and creditors more than 1 year, as disclosed on page 61, is as follows

	31 March 2012 £m	31 March 2011 £m
Bank loans and overdrafts		
- Within one year	-	-
- Between one and two years	-	-
- Between two and five years	332.7	835.0
- After more than five years	666.9	883.8
	<b>999.6</b>	<b>1,718.8</b>
Other loans		
- Within one year	470.0	7.6
- Between one and two years	-	470.0
- Between two and five years	735.6	301.5
- after more than five years	7,306.0	6,295.3
	<b>8,511.6</b>	<b>7,074.4</b>
Finance leases		
- Within one year	56.5	7.9
- Between one and two years	28.1	56.5
- Between two and five years	80.1	93.2
- after more than five years	22.5	37.4
	<b>187.2</b>	<b>195.0</b>
<b>Total borrowings</b>	<b>9,698.4</b>	<b>8,988.2</b>

Loans are repayable between 2013 and 2062

The Group's loans wholly repayable after more than five years are

	31 March 2012 £m	31 March 2011 £m
Bank loans	666.9	883.8
Other loans	7,306.0	6,295.3
	<b>7,972.9</b>	<b>7,179.1</b>

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 20 Financial instruments (continued)

Other listed loans include

<u>Other secured loans in order of maturity include</u>	
500m Euro 6 13% Fixed rate bond due 2013	£600m 5 13% Fixed rate bond due 2037
£150m Floating rate bond due 2014	20bn Yen 3 28% Fixed rate bond due 2038
£200m 4 9% Fixed rate bond due 2015	£50m 3 85% Index linked bond due 2040
£200m Floating rate bond due 2016	£500m 5 5% Fixed rate bond due 2041
500m Euro 3 25% Fixed rate bond due 2016	£50m 1 98% Index linked bond due 2042
£400m 7 21% Fixed rate bond due 2018	£55m 2 09% Index linked bond due 2042
£400m 7 75% Fixed rate bond due 2019	£40m 1 97% Index linked bond due 2045
£200m 5 05% Fixed rate bond due 2020	£100m 1 85% Index linked bond due 2047
£225m 6 59% Fixed rate bond due 2021	£200m 1 82% Index linked bond due 2049
£175m 3 38% Index linked bond due 2021	£300m 1 68% Index linked bond due 2053
£550m 5 34% Class B Fixed rate bond due 2025	£300m 1 68% Index linked bond due 2055
£330m 6 75% Fixed rate bond due 2028	£200m 1 77% Index linked bond due 2057
£300m 5 75% Class B Fixed rate bond due 2030	\$156m 3 month US\$ libor + 0 95% Index linked bond due 2060
£200m 6 5% Fixed rate bond due 2032	£350m 1 76% Index linked bond due 2062

#### Group

Loans repayable by instalments after more than five years are	31 March 2012 £m	31 March 2011 £m
Other loans and finance leases	22 5	37 4

The range of interest rates on outstanding bank loans, other loans and finance leases is 0 2% to 11 0% (2011 1 23% to 11 0%) These interest rates are those contracted on the underlying borrowings before taking account of interest rate protection

#### Borrowing facilities

At 31 March 2012 the Group has access to committed credit facilities of £1,625m (2011 £1,175m) of which £350m (2011 £nil) had been drawn at the balance sheet date, through its subsidiary companies Thames Water Utilities Cayman Finance Limited and Kemble Water Finance Limited

The Group has access to funding through its wholly owned subsidiary, Thames Water Utilities Cayman Finance Limited's £10 0bn multi-currency bond programme, of which £4 18bn (2011 £4 03bn) is still outstanding at the balance sheet date

Previously debt has been raised through its wholly owned subsidiary, Thames Water Utilities Finance Limited's £5 0bn debt issuance programme, of which £2 7bn (2011 £2 7bn) remains in issue at the balance sheet date Legacy debt obligations will remain outstanding, but it is not expected that any further debt will be issued by Thames Water Utilities Finance Limited

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 21 Provisions for liabilities and charges

	Deferred tax £m	Insurance liabilities £m	Other provisions £m	Total £m
At 1 April 2011	(903.5)	(50.9)	(68.6)	(1,023.0)
Net charge to profit and loss for the year	(3.5)	(7.4)	(0.6)	(11.5)
Adjustment to acquisition consideration provision	-	-	(19.6)	(19.6)
Released during the year	-	1.5	5.3	6.8
<b>At 31 March 2012</b>	<b>(907.0)</b>	<b>(56.8)</b>	<b>(83.5)</b>	<b>(1,047.3)</b>

The elements of deferred taxation are as follows.

An analysis of amounts provided at current tax rates is as follows

	£m
Accelerated capital allowances	(978.3)
Tax losses carried forward	2.6
Other timing differences	68.7
<b>At the end of the year</b>	<b>(907.0)</b>

**Total deferred tax provision:**

Included in taxation provision above	(907.0)
Deferred tax asset provided on pension deficit (see note 27)	36.2
	<b>(870.8)</b>

There is an unrecognised deferred tax asset in respect of tax losses where the Group does not anticipate taxable profits in the immediate future. The amount of deferred tax asset unrecognised at 24% (2011: 26%) is

	31 March 2012 £m	31 March 2011 £m
Deferred tax asset not recognised in respect of tax losses	131.6	89.2

See note 9 for more information on deferred taxation

#### Insurance liabilities

Insurance liabilities comprise provisions for claims received but not yet settled and anticipated claims not yet reported. These provisions are held by the Group's captive insurance company, Isis Insurance Company Limited, and external providers.

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 21 Provisions for liabilities and charges (continued)

#### Other provisions

Other provisions principally relate to claims against the Group and represent management's best estimate of the value of settlement and costs. It is estimated that claims will be settled in more than one year.

The Company has no provisions (2011: £nil)

### 22 Share capital

	31 March 2012 £m	31 March 2011 £m
<b>Group and Company</b>		
Allotted, called up and fully paid		
1,991,600,000 ordinary shares of £1 each	1,991.6	1,991.6

### 23 Profit and loss account

	Group		Company	
	Year end 31 March 2012 £m	Year end 31 March 2011 £m	Year end 31 March 2012 £m	Year end 31 March 2011 £m
At beginning of year	(240.9)	(42.4)	576.8	317.4
(Loss)/profit for the year	(13.1)	(81.2)	265.2	374.5
Exchange adjustments	-	2.6	-	-
Actuarial loss recognised in the pension schemes	(93.6)	(1.6)	-	-
Deferred tax relating to actuarial deficit on pension schemes	21.3	(3.2)	-	-
Dividends paid	(165.1)	(115.1)	(165.1)	(115.1)
<b>At end of year</b>	<b>(491.4)</b>	<b>(240.9)</b>	<b>676.9</b>	<b>576.8</b>

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 24 Contingencies

There are claims arising in the normal course of business, which are in the process of negotiation. The Group has set aside amounts considered appropriate for all legal and similar claims as per note 21.

#### Contingent liabilities

Following Thames Water's submission of its June Return in June 2010, Ofwat raised concerns about data reported to it in connection with Thames Water's delivery of its AMP4 hydraulic flooding programme including specifically in relation to the use of hydraulic modelling to support the identification of properties for inclusion in the June Return.

Ofwat issued a notice under Section 203 of the Water Industry Act 1991 on 9 June 2011 to formally request additional information. Thames Water's response was made on 29 July 2011, with supplementary responses on 7 October 2011 and 18 November 2011. Thames Water had a meeting with Ofwat on 28 February 2012 to discuss any residual concerns which it may have in more detail.

In May 2012, Ofwat notified Thames Water that it had formally transferred the case to an internal Ofwat casework team through its gateway process to continue with the investigation. Ofwat has indicated that this formal transfer does not prejudice the outcome of the investigation and is a procedural step. Ofwat has further indicated that it is unlikely to conclude its investigations until at least the third quarter of 2012.

If Ofwat concludes that Thames Water has mis-reported its sewer flooding outputs, it may seek to impose sanctions, including financial penalties of up to 10% of TWUL's turnover attributable to regulated sewerage services or make a shortfall adjustment at PR14 for sewer flooding outputs, which Ofwat determines have not been achieved during the AMP4 period.

The Group recognises that Ofwat's ongoing Section 203 investigation may have some financial impact. Any such potential financial impact cannot yet be quantified and, as such, no provision has been made within these accounts.

### 25 Operating leases

At 31 March, the Group was committed to making the following annual payments in respect of non-cancellable operating leases:

	31 March 2012		31 March 2011	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
<b>Leases which expire:</b>				
- Within one year	0.1	0.1	-	-
- In the second to fifth years inclusive	0.6	0.4	0.2	4.6
- Over five years	5.9	1.2	6.2	-
	<b>6.6</b>	<b>1.7</b>	<b>6.4</b>	<b>4.6</b>

The Company has no commitments in respect of non-cancellable operating leases (2011: £nil).

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 26 Capital commitments

	31 March 2012 £m	31 March 2011 £m
<b>Group</b>		
Contracted for but not provided in the financial statements	<b>1,035.5</b>	1,517.2

In addition to these commitments, the Group has long-term capital investment plans to meet performance and asset condition requirements and to provide for new demand and growth. The Company has no capital commitments (2011 £nil)

### 27 Pension schemes

Pension arrangements for the majority of the Group's employees are of the defined benefit type, funded through two main Group pension schemes, TWPS and Thames Water Mirror Image Pension Scheme ("TWMIPS") (see table below for details of each schemes' respective deficit or surplus), covering employees within the Thames Water Group, whose assets are held separately from those of the Group in independently administered funds. The defined benefit arrangements were closed to new employees from 1 April 2011. From this date, new employees have been offered membership of a defined contribution scheme managed through Standard Life, see note 1(j) page 45. Contributions to the scheme are charged to the profit and loss account in the period to which they relate.

Contributions to the defined contribution pension scheme in the year were £1.4m (2011 £0.3m)

The service cost of the Group, as included in the profit and loss account, represents the net of the total service cost of the Group schemes and the pension contributions made by the other group companies into the schemes in the financial period.

In addition to the cost of the UK Pension arrangements, the Group operates arrangements under which it augments benefits on retirement. These augmentations are funded by way of additional employer contributions to the schemes. In the year ended 31 March 2012 payments amounted to £1.5m (2011 £2.1m)

The latest full actuarial valuation was undertaken as at 31 December 2010 on behalf of the pension Trustees by Aon Hewitt Limited ("Hewitt") (the independent and professionally qualified consulting actuaries to the schemes). This valuation has been updated at 31 March 2012 by Mercer Limited ("Mercer"), independent and professionally qualified consulting actuaries, using revised assumptions that are consistent with the requirements of FRS 17 and shown in this note to the accounts. The Group has taken advice from Mercer in respect of the funding position of the Group pension schemes.

Following extensive consultation with employees and with the agreement of the pension fund trustees the Group has changed certain provisions in respect of the TWPS for both existing and new employees.

The defined benefit scheme is now closed to new entrants. From 1 April 2011 new employees of the Group will be offered participation in the DCSPS managed through Standard Life.

For existing members of the TWPS, certain provisions have changed that will affect future benefits available to its members. Principally, the defined benefit provision from 1 May 2011 will be based on a CARE basis and no longer on a Final Salary basis.



# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 27 Pension schemes (continued)

Net liability by pension schemes before tax

	31 March 2012 £m	31 March 2011 £m
<i>Thames Water Pension Scheme</i>		
Deficit in scheme	(190.1)	(161.4)
<i>Thames Water Mirror Image Scheme</i>		
Surplus in scheme	73.5	59.6
Impact of irrecoverable surplus	(39.9)	(21.6)
	33.6	38.0
Other schemes	5.4	-
<b>Liability before deferred tax asset</b>	<b>(151.1)</b>	<b>(123.4)</b>

The Group has recognised a surplus in the Thames Water Mirror Image scheme to the extent that it may possibly be able to recover it by paying a reduced rate of contributions in the future. The recognisable surplus has been calculated in accordance with FRS 17 as the present value of the current service cost projected over the future working lifetime of all active members of the scheme, using the assumptions adopted at 31 March 2012.

The assumptions used in the valuation of assets and liabilities of the schemes are the same for both schemes, therefore the following tables are for the combined values for both schemes.

<b>Reconciliation of funded status to balance sheet</b>	31 March 2012 £m	31 March 2011 £m
Fair value of scheme assets	1,551.6	1,414.0
Present value of scheme liabilities	(1,662.8)	(1,515.8)
Deficit in scheme	(110.9)	(101.8)
Impact of irrecoverable surplus	(39.9)	(21.6)
Liability recognised on the balance sheet	(151.1)	(123.4)
Deferred tax asset	36.2	32.0
<b>Net pension liability</b>	<b>(114.9)</b>	<b>(91.4)</b>
Presented in the balance sheet as		
Pension asset, net of deferred tax	29.6	28.0
Pension liability, net of deferred tax	(144.5)	(119.4)

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 27 Pension schemes (continued)

#### Movement in the present value of scheme liabilities

	31 March 2012 £m	31 March 2011 £m
Opening present value of scheme liabilities	1,515.8	1,472.4
Current service cost Thames Water Utilities Limited	16.4	25.4
Current service cost Other Thames Water Group participating companies	0.1	-
Interest cost	80.0	81.4
Contribution by scheme participants	0.2	0.3
Curtailment gain on changes to scheme benefits	(40.0)	-
Actuarial gains on scheme liabilities	154.2	32.1
Actuarial loss from changes in inflation assumptions	-	(37.5)
Net benefit paid out	(65.4)	(60.4)
Termination pension cost	1.5	2.1
<b>Closing present value of scheme liabilities</b>	<b>1,662.8</b>	<b>1,515.8</b>

#### Movement in fair value of scheme assets

	31 March 2012 £m	31 March 2011 £m
Opening fair value of scheme assets	1,414.0	1,327.0
Expected return on scheme assets	77.4	77.3
Actuarial gains on scheme assets	78.9	14.6
Contributions by the employer Thames Water Utilities Limited	44.6	52.2
Contributions by the employer Other Thames Water Group participating companies	0.4	-
Contribution of section 75 debt payment	-	0.9
Contributions by scheme participants	0.2	0.3
Termination pension costs	1.5	2.1
Net benefits paid out	(65.4)	(60.4)
<b>Closing fair value of scheme assets</b>	<b>1,551.6</b>	<b>1,414.0</b>

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 27 Pension schemes (continued)

(Income)/expense recognised in the profit and loss account:

	Year end 31 March 2012 £m	Year end 31 March 2011 £m
Current service cost	16.4	25.2
Exceptional item – pension curtailment gain*	(40.0)	-
Interest cost	80.0	81.5
Expected return on scheme assets	(77.7)	(77.3)
	<b>(21.3)</b>	29.4

\* During the period a curtailment gain of £40.0m arising from changes to certain provisions, in respect of the Thames Water Pension Scheme, which came into effect on 1 May 2011, has been classified as an exceptional item. This gain arose as a result of changes to scheme benefits, which have reduced future liabilities.

The expense is recognised in the following line items in the profit and loss account:

	Year end 31 March 2012 £m	Year end 31 March 2011 £m
Operating costs: staff costs	16.4	25.1
Operating costs: exceptional item	(40.0)	-
Other finance expense	2.3	4.3
<b>Total expense charged in the profit and loss account</b>	<b>(21.3)</b>	29.4

Analysis of amount recognised in the statement of total recognised gains and losses.

	Year end 31 March 2012 £m	Year end 31 March 2011 £m
Actual return less expected return on pension scheme assets	78.4	14.5
Changes in assumptions underlying the present value of scheme liabilities	(153.7)	(32.1)
Changes in inflation assumption – CPI from RPI	-	37.6
Adjustment relating to irrecoverable surplus	(18.3)	(21.6)
<b>Actuarial loss recognised in the statement of total recognised gains and losses</b>	<b>(93.6)</b>	(1.6)
Cumulative amount of gains recognised in the statement of total recognised gains and losses	<b>(295.2)</b>	(201.6)

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 27 Pension schemes (continued)

#### Fair value of scheme assets and return on these assets:

The fair value of the assets held by the pension schemes, the long-term expected rate of return on each class of assets and the average expected long-term rate of return obtained by weighting the individual rates in accordance with the anticipated balance in the schemes' investment portfolio are shown in the following table

	31 March 2012		31 March 2011	
	Long-term expected rate of return	Value £m	Long-term expected rate of return	Value £m
Equities	7.11%	533.0	8.4%	473.2
Bonds	4.63%	32.9	5.5%	101.3
Gilts	1.86-3.11%	785.9	4.15-4.40%	648.0
Property	6.11%	103.3	7.4%	90.6
Other assets	3.11%	96.5	4.4%	100.9
Average expected long-term rate of return/total fair value of assets	4.6%	1,551.6	5.90%	1,414.0

The Group employs a building block approach in determining the long-term rate of return on pension plan assets. Historical markets are studied and assets with higher volatility are assumed to generate higher returns consistent with widely accepted capital market principles. The assumed long-term rate of return on each asset class is set out within this note. The overall expected rate of return on assets is then derived by aggregating the expected return for each asset class over the actual asset allocation for the schemes.

#### The main financial assumptions used for FRS 17 purposes are as follows:

	31 March 2012	31 March 2011
Price inflation – RPI Linked	3.1%	3.5%
Price inflation – CPI Linked	2.4%	3.0%
CARE revaluation (CPI max 2.5%)	2.4%	-
Salary increases – TWPS	-	4.5%
Salary increase – TWMIPS	3.6%	4.0%
Pension increases – RPI Linked	3.1%	3.5%
Pension increases – CPI Linked	2.4%	3.0%
Discount rate for scheme liabilities	4.65%	5.5%

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 27 Pension schemes (continued)

In valuing the liabilities of the pension schemes at 31 March 2012, mortality assumptions have been made as indicated below. These mortality assumptions are based on the recent actual mortality experience of members within the schemes and the assumptions also allow for future improvements to mortality rates.

	<b>31 March 2012</b>	31 March 2011
TWPS members who joined before/after 1 January 1995		
Life expectancy for a male pensioner from age 60	<b>27</b>	26
Life expectancy for a female pensioner from age 60	<b>29</b>	28
Life expectancy from age 60 for a male pensioner currently aged 40	<b>29</b>	28
Life expectancy from age 60 for a female pensioner currently aged 40	<b>31</b>	29
TWMIPS		
Life expectancy for a male pensioner from age 60	<b>26</b>	24
Life expectancy for a female pensioner from age 60	<b>28</b>	26
Life expectancy from age 60 for a male pensioner currently aged 40	<b>28</b>	26
Life expectancy from age 60 for a female pensioner currently aged 40	<b>30</b>	28

### History of fair value of assets, present value of liabilities, surplus in scheme and experience gains and losses

	<b>31 March 2012 £m</b>	31 March 2011 £m	31 March 2010 £m	31 March 2009 £m	31 Dec 2008 £m
Fair value of scheme assets	<b>1,551.6</b>	1,414.0	1,327.0	1,048.8	1,214.8
Present value of scheme liabilities	<b>(1,662.8)</b>	(1,515.9)	(1,472.3)	(1,110.3)	(1,098.9)
<b>(Deficit)/surplus in scheme</b>	<b>(111.2)</b>	(101.9)	(145.3)	(61.5)	115.9

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 27 Pension schemes (continued)

#### Experience adjustments.

	31 March 2012 £m	31 March 2011 £m	31 March 2010 £m	31 March 2009 £m	31 Dec 2008 £m
<b>Experience gains/(losses) on scheme assets:</b>					
Amounts	76.3	13.6	214.1	(250.8)	(102.7)
Percentage of scheme assets	4.9%	5.9%	16.7%	24.1%	8.5%
<b>Experience gains/(losses) on scheme liabilities.</b>					
Amounts	11.1	-	-	(44.4)	(5.4)
Percentage of scheme liabilities	0.7%	-	-	4.0%	0.5%
<b>Total amount recognised in the Statement of total gains and losses:</b>					
Amounts	(93.6)	2.0	(111.9)	(136.4)	3.9
Percentage of present value of scheme liabilities	5.7%	0.1%	7.2%	12.0%	0.4%

The Group expects to contribute approximately £42.3m (2011 £55.5m) to the defined benefit schemes in the next financial year

### 28 Analysis of cash flows

#### 28(a) Net cash inflow from operating activities

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
<b>Reconciliation of operating profits to net cash flow from operating activities</b>		
Group operating profit	576.7	535.4
Depreciation charges	437.2	414.6
Amortisation	44.4	44.4
(Increase)/decrease in stocks	(1.6)	2.5
Decrease/(increase) in debtors	5.7	(13.3)
Decrease in creditors	(11.8)	(0.6)
Deferred income release	(13.8)	(13.6)
Decrease in provisions	(4.2)	(5.6)
Difference between pension charge and cash contributions	(68.5)	(27.1)
<b>Net cash flow from operating activities</b>	<b>964.1</b>	<b>936.7</b>

Depreciation includes maintenance expenditure on infrastructure assets in accordance with FRS 15, Tangible Fixed Assets

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 28 Analysis of cash flows (continued)

#### 28(b) Return on investment and servicing of finance

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Interest received	182.8	112.7
Interest paid	(563.7)	(518.7)
Interest element of finance lease rental payments	(6.9)	(6.5)
	<b>(387.8)</b>	<b>(412.5)</b>

#### 28(c) Capital expenditure and financial investment

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Purchase of tangible fixed assets	(993.6)	(901.5)
Infrastructure renewals expenditure	(176.8)	-
Capital contributions received	44.3	41.0
Investment	-	1.2
Sale of tangible fixed assets	8.7	12.4
	<b>(1,117.4)</b>	<b>(846.9)</b>

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 28 Analysis of cash flows (continued)

#### 28(d) Analysis of net debt

	At 1 April 2011 £m	Cash flow £m	Other non- cash movements £m	At 31 March 2012 £m
Cash at bank and in hand	41.8	11.8	-	53.6
Loans due within one year	(7.6)	(462.4)	-	(470.0)
Loans due after more than one year	(8,785.6)	(73.4)	(182.2)	(9,041.2)
Finance leases due within one year	(7.9)	(48.5)	(0.1)	(56.5)
Finance leases due after more than one year	(187.1)	56.4	-	(130.7)
	(8,988.2)	(527.9)	(182.3)	(9,698.4)
Liquid resources	802.5	(119.7)	-	682.8
<b>Total</b>	<b>(8,143.9)</b>	<b>(635.8)</b>	<b>(182.3)</b>	<b>(8,962.0)</b>

The Group includes its current asset investments (see note 17) as liquid resources

Other non-cash changes mainly comprise the carrying value uplift by RPI, of RPI index-linked loans. This adjustment is in accordance with FRS 4 "Capital instruments", which requires the carrying value of such index-linked loans to be recalculated at each balance sheet date.

### 29 Guarantees

Thames Water Utilities Holdings Limited, Thames Water Utilities Limited and its direct subsidiaries are Obligors under the whole business securitisation entered into in 2007. The Obligors have all entered into a Security Trust and Intercreditor Deed. Under this document each Obligor will guarantee the obligations of each other Obligor with their future cash flows. The guaranteed debt as at 31 March 2012 was £8.5 bn (2011 £7.6 bn).

At 31 March 2012 the Group has secured the overdrafts and loans of certain subsidiaries up to a maximum of £20m (2011 £20m). The Group has also guaranteed facilities for contract bonding on behalf of certain subsidiaries amounting to £0.8m (2011 £0.6m) at 31 March 2012.

The Group has provided security by way of a debenture over its assets in relation to monies owed by the Group under its credit facility agreement with RBS as Facility Agent. This facility amounted to £425m (2011 £835m), the amount outstanding at 31 March 2012 was £350m (2011 £835m). The chargee is RBS as Facility Agent.

The Isis Insurance Company Limited, a wholly owned subsidiary of the Group, has letters of credit in issue totalling £3.9m (2011 £5.1m), and £0.5m (2011 £3.6m) secured under a Security Trust Agreement. Security for these is provided by the Company to the value of £3.9m invested in a fixed term deposit held with Royal Bank of Scotland International Limited and £0.5m held in the Global Treasury Funds.

In addition, there are a number of parent company guarantees in respect of subsidiary company contractual obligations that have been entered into in the normal course of business. No unprovided loss is expected to arise under these arrangements.



# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 30 Group undertakings

At 31 March 2012, the Group held more than 10% of the allotted share capital of the following principal undertakings

	Country of incorporation registration and operation	Class of share capital held	Proportion of shares held directly	Proportion of shares held indirectly	Basis of consolidation	Nature of business
<b>UK</b>						
Kemble Water Eurobond Plc	England & Wales	Ordinary	100%	-	Subsidiary	Investment holding company
Kemble Water Liberty Limited	England & Wales	Ordinary	-	100%	Subsidiary	Investment holding company
Kemble Water Structure Limited	England & Wales	Ordinary	-	100%	Subsidiary	Investment holding company
Kemble Water Finance Limited	England & Wales	Ordinary	-	100%	Subsidiary	Investment holding company
Kemble Water Investments Limited	England & Wales	Ordinary	-	100%	Subsidiary	Investment holding company
Kemble Water Limited	England & Wales	Ordinary	-	100%	Subsidiary	Investment holding company
Thames Water Limited	England & Wales	Ordinary	-	100%	Subsidiary	Holding company
Thames Water Utilities Limited	England & Wales	Ordinary	-	100%	Subsidiary	Water and wastewater services
Thames Water Utilities Finance Limited	England & Wales	Ordinary	-	100%	Subsidiary	Finance Company
Thames Water Utilities Cayman Finance Limited	Cayman Islands	Ordinary	-	100%	Subsidiary	Finance Company
Thames Water (Kemble) Finance Plc	England & Wales	Ordinary	-	100%	Subsidiary	Finance Company
Isis Insurance Company Limited	Guernsey	Ordinary	-	100%	Subsidiary	Insurance
Kennet Properties Limited	England & Wales	Ordinary	-	100%	Subsidiary	Property
Thames Water Investments Limited	England & Wales	Ordinary	-	100%	Subsidiary	Property
Thames Water International Services Limited	England & Wales	Ordinary	-	100%	Subsidiary	Marketing of technical managerial services
Thames Water Property Services Limited	England & Wales	Ordinary	-	100%	Subsidiary	Property
Trans4m Limited (In administration)	England & Wales	Ordinary	-	25%	Investment	Contract management for stations and civil assets

Advantage is taken of section 410 of the Companies Act 2006 and full information will be annexed to the next Annual Return delivered to the Registrar of Companies after the accounts in question have been approved under section 233

# Kemble Water Holdings Limited

## Notes to the financial statements for the year ended 31 March (continued)

### 31 Related parties

During the year, the Group completed the following sales to and purchases from related parties, all of which were undertaken at arm's length commercial prices in the ordinary course of business

Related party	Nature of transaction	Year ended	Year ended	Year ended	Year ended
		31 March 2012	31 March 2012	31 March 2011	31 March 2011
		Value £m	Amount due £m	Value £m	Amount due £m
Macquarie Group Limited	Fees payable for management and other services	4.2	1.0	12.0	8.7

During the year, a subsidiary of the group incurred advisory fee charges of £62,000 (2011 £40,000) for consultancy services provided by C R Deacon, a director

### 32 Immediate and ultimate parent company and controlling party

Kemble Water Holdings Limited is owned by a consortium of investors led by Macquarie European Infrastructure Funds 1 and 2 ("MEIF 1 & 2"), wholesale investment funds which make long-term investments in infrastructure and related businesses located across Europe. The directors do not consider there to be an ultimate parent or controlling party. Kemble Water Holdings Limited is the largest group to consolidate these financial statements.

The Company's other shareholders are international pension funds and institutional investors.

MEIF 1 & 2 invest in businesses which

- Provide an essential service to the community
- Have a strong competitive position
- Generate stable cash flows over the long term

MEIF 1 & 2 aim to deliver sustainable cash yields and moderate capital growth from their diversified portfolios of quality infrastructure investments.

MEIF 1 & 2 are managed by Macquarie Capital Funds (Europe) Limited ("MCFEL"). MCFEL is a wholly owned member of the Macquarie Group, and is authorised and regulated by the Financial Services Authority under the UK Financial Services and Markets Act 2000. MCFEL is resourced by executives of Macquarie Capital Funds.

Copies of the accounts of all of the above companies may be obtained from The Company Secretary's Office, Thames Water Group, Clearwater Court, Vastern Road, Reading, Berkshire, RG1 8DB.

# **Kemble Water Holdings Limited**

## **Notes to the financial statements for the year ended 31 March (continued)**

### **33 Off-balance sheet arrangements**

The Group is party to a number of contractual arrangements for the purposes of the Group's principal activities that are not required to be included on its balance sheet. The principal off-balance sheet arrangements are listed below:

- Operating leases (see note 25)
- Outsourcing contracts

In respect of outsourcing contracts, the Group has entered into various arrangements to outsource the provision of certain back-office and operational functions with third party providers. These outsourced arrangements include IT support, Legal Services, metering services, capital delivery and Customer Service. These arrangements are on commercial terms and no associated penalty or termination clauses will have a material impact on the financial position of the Group.