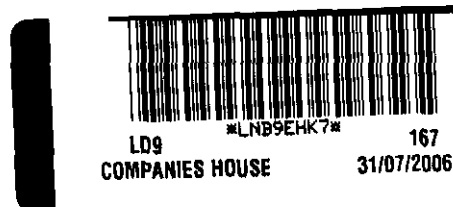


Registered number: 2366623

RWE Thames Water plc

Annual report and financial statements
For the year ended 31 December 2005



Registered Office:
Clearwater Court
Vastern Road
Reading
RG1 8DB

RWE Thames Water plc

Annual report and financial statements for the year ended 31 December 2005

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Directors' report for the year ended 31 December 2005

The Directors present their report and the audited financial statements for the year ended 31 December 2005.

Principal activities

The principal activity of RWE Thames Water plc (Thames Water) is the provision of water and wastewater services to both the domestic and international markets.

Review of business

The results for the year are set out in the consolidated profit and loss account on page 6.

For the year ending 31 December 2005 turnover was £1,656.2m (2004: £1,549.0m). Operating profit from continuing operations, excluding exceptional items was £478.8m for the year (2004: £569.6m). This decrease was substantially due to the reduced share of operating profit attributable to joint ventures and increased general operating costs. Profit on ordinary activities before taxation and exceptional operating costs, was £396.3m for the year (2004: £436.0m).

Capital expenditure of £641.1m (2004: £665.5m) during the year has been particularly targeted towards security of drinking water supplies to customers, leakage reduction, water and wastewater quality programmes and the alleviation of sewerage flooding.

The UK regulated water business, with its stable sales and earnings, continues to be responsible for a large proportion of the earnings of the Group.

Future developments

Following the Group's strategic review in 2004 to focus on the UK region, the Group disposed of a number of international interests, mainly in the Far East, as detailed in note 7. On 23 March 2006, the Group sold its Chilean interests as detailed in note 33. The Group is considering its options for its remaining international interests. As part of this exercise the Group carried out a further review of the carrying value of its investments and impairment charges of £24.1m against goodwill, £4.1m against other intangibles and £27.8m against tangible fixed assets were made.

The Group will continue to seek to develop its business in the UK. This includes bidding for contracts for customer services, operations and maintenance, capital programme management, new connections and sludge disposal contracts.

During the year, the UK regulated water business accepted the Final Determination by the Director General of Water Services for the regulatory price review for the period 2005-09, which has seen us embark upon a record £3.1 billion investment programme (based on 02/03 prices). Prices have needed to rise, but the review demonstrated that this is necessary in order to make essential improvements to the infrastructure on which our customer service relies. The Group and its employees are fully committed to delivering these improvements over the next few years.

2005 was the third driest year for over a century in the Thames Water region of Britain and a period of drought continued into 2006. On 3 April 2006, the UK regulated water business introduced a hosepipe ban and on the 26 June 2006, it applied for a Drought Order for the London area. The impact of this and any other measures that may be required in 2006 is uncertain as at the date of approval of this Report.

Regulated water businesses in the UK are required to meet various performance targets, including those set to reduce leakage. In the year to March 2006, the Group's regulated business failed to meet its leakage target. Following negotiations with the Regulator, Ofwat, the business has given a formal undertaking to achieve specific targets on leakage and to carry out additional work in this area, estimated to cost £150m, in the period to March 2010. This extra investment will not be recoverable from charges to customers.

On 4 November 2005, the ultimate parent company, RWE AG announced its decision to put RWE Thames Water Plc up for sale in order to concentrate on its core businesses of electricity and gas supply.

Directors' report for the year ended 31 December 2005 (Continued)

Financial risk

The Group has a Risk Management Committee which 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 Group is exposed to commodity price risk as a result of its operations. The Group aims to manage its risk by fixing contract prices where possible.

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.

Treasury operations are managed centrally by a specialist team. The operation of the Treasury function is governed by specific policies and procedures that set out specific 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.

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 designed to ensure the Group has sufficient available funds for operations. The current maturity profile of debt is shown in note 20.

Dividends

The total dividend paid in the year of £325.0m compares with a total dividend of £292.4m for the year ended 31 December 2004.

Directors during the year and their interests

The Directors of the Company who served throughout the year, except where stated are:

W J Alexander (resigned 16 November 2005)

W Böttcher

J Forbes (appointed 1 July 2006)

J D Pelczer

H J M Roels

Dr K Sturany

T P Weller (resigned 6 April 2006)

R P Lindackers (appointed 6 December 2005)

None of the Directors has any interest in the shares of RWE Thames Water plc, or its subsidiary companies. In accordance with Statutory Instrument 1985/802 the Directors' interests in shares of the ultimate parent company, RWE AG, have not been disclosed.

During the year under review, none of the Directors had significant contracts with RWE AG, RWE Thames Water plc or any other Group company other than their contracts of service.

Directors' report for the year ended 31 December 2005 (Continued)**Research and development activities**

Expenditure on research and development of £5.3m was made during the year (2004: £5.8m).

The Group's research and development programme is a balanced portfolio of projects to address short, medium and long-term technical needs across the range of water cycle activities managed by the business. The portfolio of research and development projects engaged in during the year delivered solutions for current business needs and prepared the Group for future scenarios.

Donations for charitable and political purposes

During the year donations of £0.2m (2004: £0.2m) were made to registered charities including donations to WaterAid. Employees' charitable donations through payroll have also continued to increase.

There were no donations for political purposes.

Employees

For an organisation such as Thames Water, employees are critical. We recognise the need to invest in their ongoing development and to provide relevant training and career opportunities with appropriate pay and benefits.

Thames Water is committed to fulfilling its obligations in accordance with the Disability Discrimination Act 1995. We believe diversity is important for the growth and success of our company.

Our recruitment principles, our approach to diversity and our disability policy are there 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.

Formal consultation with employees in the UK happens through a partnership agreement. We work closely with our Trade Union colleagues and employees to heighten awareness of partnership principles and we champion a co-operative and collaborative approach to problem solving. We are committed to sharing information with employees on key business issues and our communications framework is subject to continual review and development. We have in operation a variety of communication channels, including an employee magazine, team briefings and regular e-mail updates, together with the team building conferences and events.

In April 2005, to encourage employee participation in the performance of the RWE AG group, the ultimate parent company, RWE Thames Water Plc, launched a Share Incentive Plan (SIP) giving UK employees the opportunity to purchase shares in RWE AG out of pre-tax pay. The Company supported the SIP by matching employee purchases on the basis of one additional share for every four purchased by the employee out of the first £30 of each month's contribution.

Policy on payment of suppliers

The Group supports a number of initiatives to promote a prompt payment culture, including those proposed in the UK by the Construction Round Table and the CBI. The Group's policy is to ensure that all payments to suppliers, service providers and contractors are made on the basis of mutually agreed terms and conditions. The average amount due to trade creditors during the year to 31 December 2005 represented 64 days (2004: 68 days) purchases received from those creditors.

Directors' report for the year ended 31 December 2005 (Continued)

Statement of Directors' responsibilities

Company law requires the Directors to prepare financial statements for each financial period that give a true and fair view of the state of affairs of the Company and the Group and of the results of the Group for that period. In preparing those financial statements, the Directors are required to:

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

The Directors confirm that the financial statements comply with the above requirements with the exception of the changes arising on adoption of new accounting standards in the year as explained on page 10 under note 1.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and the Group and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for ensuring that arrangements are in place for the maintenance and integrity of the Thames Water website, subject to the legal notice declared thereon.

Legislation in the UK concerning the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Auditors

A resolution to reappoint PricewaterhouseCoopers LLP as auditors to the Company will be proposed at the Annual General Meeting.

Approved by the Board on 27 July 2006



J D Pelczer
Director

Independent auditors' report to the members of RWE Thames Water plc

We have audited the Group and parent company financial statements (the "financial statements") of RWE Thames Water plc for the year ended 31 December 2005 which comprise the Group Profit and Loss Account, the Group and Company Balance Sheets, the Group Cash Flow Statement, the Statement of Group Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors

The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the *Statement of Directors' Responsibilities*.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report, and consider whether it is consistent with the audited financial statements. This other information comprises only the Directors' Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

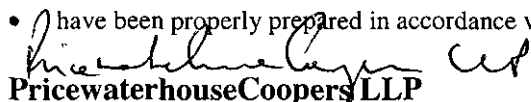
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements:

- give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Group's and the parent Company's affairs as at 31 December 2005 and of the Group's loss and cash flows for the year then ended; and
- have been properly prepared in accordance with the Companies Act 1985.


PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Reading

27 July 2006

Consolidated profit and loss account for the year ended 31 December 2005

	Note	2005 £m	2005 £m	Restated 2004 £m	Restated 2004 £m
Turnover (including share of joint ventures)					
- continuing operations		1,916.4		1,782.1	
- discontinued operations		102.5		96.1	
			2,018.9		1,878.2
Less: share of turnover of joint ventures					
- continuing operations		(345.5)		(304.9)	
- discontinued operations		(17.2)		(24.3)	
			(362.7)		(329.2)
Group turnover	2		1,656.2		1,549.0
Operating costs (including exceptional impairment costs of £56.0m (2004: £140.0m))	3		(1,210.0)		(1,164.6)
Other operating income – continuing operations	6		5.6		8.8
- continuing operations		424.4		361.7	
- discontinued operations		27.4		31.5	
Group operating profit			451.8		393.2
Share of operating profit in:					
- Joint ventures – continuing operations			18.3		43.6
- Joint ventures – discontinued operations			3.5		5.1
- Associates – continuing operations			3.1		1.3
- Associates – discontinued operations			1.0		1.3
Total operating profit: group and share of joint venture and associates			477.7		444.5
Profit on sale of fixed assets			10.2		6.2
Profit/(loss) on disposal of businesses	7		54.6		(2.2)
Net interest payable					
- Group		(184.5)		(174.4)	
- share in joint ventures		(0.7)		(18.0)	
- share in associates		(0.9)		(1.6)	
	8		(186.1)		(194.0)
Other finance income	26		6.9		18.5
Profit on ordinary activities before taxation	2		363.3		273.0
Taxation on profit on ordinary activities	9		(137.6)		(122.7)
Profit on ordinary activities after taxation			225.7		150.3
Equity minority interests			(14.7)		(17.3)
Profit for the financial year			211.0		133.0
Dividends	11		(325.0)		(292.4)
Retained (loss) for the financial year	23		(114.0)		(159.4)

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

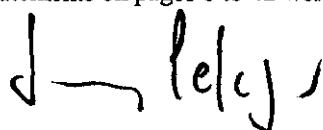
Balance sheets at 31 December 2005

	Note	Group		Company	
		2005 £m	Restated 2004 £m	2005 £m	Restated 2004 £m
Fixed assets					
Intangible assets	12	69.7	83.3	-	-
Tangible assets	13	6,107.8	5,806.2	0.4	0.8
Investments in joint ventures:					
- share of gross assets		687.9	709.2		
- share of gross liabilities		(610.7)	(634.2)		
		77.2	75.0	27.1	35.2
Investments in associates		3.1	(3.8)	-	-
Investments in subsidiary undertakings		-	-	1,518.8	2,108.5
Fixed asset investments	14	80.3	71.2	1,545.9	2,143.7
		6,257.8	5,960.7	1,546.3	2,144.5
Current assets					
Stocks and work in progress	15	34.2	31.5	-	-
Debtors	16	796.4	720.4	105.1	133.0
Investments	17	11.7	82.7	-	-
Cash at bank and in hand		72.5	67.7	17.9	2.2
		914.8	902.3	123.0	135.2
Creditors: amounts falling due within one year	18	(1,686.7)	(1,968.0)	(826.0)	(1,200.1)
Net current liabilities		(771.9)	(1,065.7)	(703.0)	(1,064.9)
Total assets less current liabilities		5,485.9	4,895.0	843.3	1,079.6
Creditors: amounts falling due after more than one year	19	(2,900.8)	(2,193.0)	-	-
Provisions for liabilities and charges	21	(990.3)	(980.0)	(116.5)	(95.0)
Net assets excluding pension asset/liability		1,594.8	1,722.0	726.8	984.6
Pension asset	26	36.8	16.2	-	-
Pension liability	26	(88.7)	(89.6)	-	-
Net assets including pension asset/liability		1,542.9	1,648.6	-	-
Capital and reserves					
Called up share capital	22/23	81.8	81.8	81.8	81.8
Share premium	23	104.5	104.5	104.5	104.5
Capital redemption reserve	23	320.8	320.8	320.8	320.8
Profit and loss	23	853.8	980.4	219.7	477.5
Equity shareholder's funds		1,360.9	1,487.5	726.8	984.6
Equity minority interest		182.0	161.1	-	-
Capital employed		1,542.9	1,648.6	726.8	984.6

The notes on pages 10 to 42 form part of these accounts.

The financial statements on pages 6 to 42 were approved by the Board of Directors on 27 July 2006 and signed on its behalf by

J D Pelczer
Director



Consolidated cash flow statement for the year ended 31 December 2005

	Note	2005 £m	2004 £m
Net cash inflow from operating activities	27	814.6	790.8
Dividends received from joint ventures		7.1	2.3
Returns on investments and servicing of finance	28	(189.5)	(170.9)
Taxation		(78.5)	(41.4)
Capital expenditure and financial investment	29	(558.0)	(580.4)
<i>Acquisitions and disposals</i>			
Proceeds from disposals of business combinations		73.4	25.4
Purchase of minority interest		(11.2)	-
Purchase of fixed asset investments	14	(11.1)	(9.0)
Equity dividends paid to shareholder	11	(325.0)	(292.4)
Net cash (outflow) before management of liquid resources and financing		(278.2)	(275.6)
Management of liquid resources	30	71.0	0.4
Financing			
Cash inflow from increase in debt and lease financing	30	210.0	158.3
Increase/(decrease) in net cash		2.8	(116.9)

Reconciliation of net cash flow to movement in net debt for the year ended 31 December 2005

	2005 £m	2004 £m
Increase/(decrease) in net cash	2.8	(116.9)
<i>Cash (inflow)/outflow from (increase)/decrease in debt and lease financing:</i>		
- loans due within one year	455.1	(330.4)
- loans due after more than one year	(673.2)	165.5
- capital repayment of finance leases	8.1	6.6
Cash (inflow)/outflow from liquid resources	(71.0)	(0.4)
(Increase) in net debt resulting from cash flows	(278.2)	(275.6)
<i>Other non-cash movements:</i>		
- foreign exchange translation differences	(29.1)	58.6
- RPI uplift on index-linked bond	-	(4.9)
(Increase) in net debt	(307.3)	(221.9)
Net debt at 1 January	(3,126.1)	(2,904.2)
Net debt at 31 December	(3,433.4)	(3,126.1)

**Statement of group total recognised gains and losses
for the year ended 31 December 2005**

	2005 £m	Restated 2004 £m
Group profit for the financial year	211.0	133.0
Foreign exchange adjustments offset in reserves	(37.0)	3.0
Actuarial gain on pension scheme	34.9	(80.2)
Deferred tax relating to actuarial gain/(loss)	(10.5)	24.1
Total recognised gains and losses relating to the year	198.4	79.9
Prior year adjustment – FRS 17	(73.9)	(32.2)
– FRS 21	25.0	92.4
Total gains and losses recognised since last annual report	149.5	140.1

**Reconciliation of movements in group shareholder's funds
for the year ended 31 December 2005**

	2005 £m	Restated 2004 £m
Group profit for the financial year	211.0	133.0
Dividends	(325.0)	(292.4)
	(114.0)	(159.4)
Foreign exchange adjustments offset in reserves	(37.0)	3.0
Actuarial gain on pension scheme	34.9	(80.2)
Deferred tax relating to actuarial gain/(loss)	(10.5)	24.1
Net change in shareholders' funds	(126.6)	(212.5)
Opening shareholders' funds as previously reported	1,536.4	1,639.8
Restatement - FRS 17	(73.9)	(32.2)
Restatement – FRS 21	25.0	92.4
Shareholders' funds as at 1 January restated	1,487.5	1,700.0
Shareholders' funds as at 31 December	1,360.9	1,487.5

Notes to the financial statements for the year ended 31 December 2005**1 Accounting policies**

The financial statements have been prepared on the going concern basis and 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 1985. An explanation of this departure from the requirements of the Act is given below. A summary of the more important Group accounting policies is set out below.

Changes in accounting policies and presentation of financial information

In accordance with the requirements of FRS 18, the directors have reviewed the Company's accounting policies to ensure that they remain the most appropriate to its particular circumstances for the purpose of giving a true and fair view.

The same accounting policies used for the year ended 31 December 2004 have been applied with the following exceptions:

FRS 17 Retirement Benefits

From 1 January 2005, the Company has adopted the full requirements of FRS 17 'Retirement Benefits' in the financial statements. The adoption of this new standard represents a change in accounting policy and the comparative figures have been restated accordingly.

The effect of the change in accounting policy to adopt FRS 17 was to decrease the brought forward profit and loss reserves by £73.9m (2004: £32.2m), to increase the profit for the period by £12.1m (2004: £17.6m) and to recognise a £24.4m actuarial gain in the year (2004: £56.1m actuarial loss) directly in reserves.

FRS 21 Events after the Balance Sheet Date

From 1 January 2005, the Company has adopted the full requirements of FRS 21 'Events after the Balance Sheet Date' in the financial statements. The adoption of this new standard represents a change in accounting policy and the comparative figures have been restated accordingly.

In accordance with FRS 21, dividends declared after the balance sheet date are no longer recognised as a liability at the balance sheet date and are now recorded in the financial statements on a cash paid basis.

The effect of the change in accounting policy to adopt FRS 21 was to increase the brought forward profit and loss reserves by £25m (2004: £92.4m) and to increase the retained profit for the period by £50m (2004 decrease by £67.4m).

Infrastructure renewals expenditure

From 1 April 2005, certain expenditure in respect of leakage previously classified as infrastructure renewals expenditure per FRS 15, is now classified as 'other operating costs'. The impact of this change is to increase 'other operating costs' and to reduce both fixed asset additions and the infrastructure depreciation charge by the same amount.

The effect of this change in accounting policy was to increase other operating costs by £47.4m (2004: £47.7m) and reduce fixed asset additions and the infrastructure depreciation charge by £47.4m (2004: £47.7m).

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and all of its subsidiaries, associated undertakings and joint ventures. The results of undertakings acquired or disposed of during the year are included in the consolidated profit and loss account from the date of their acquisition or up to the date of their disposal. Where the financial statements of undertakings are drawn up to a year end different from that of the parent company, appropriate adjustments are made to the Group financial statements to reflect any significant transactions in the intervening period. Intra-group sales and profits are eliminated on consolidation.

The Group's relationships are defined as follows:

- Subsidiary: the Group controls the financial and operating policies of the undertaking
- Joint venture: the Group holds a long-term interest and shares control under a contractual agreement
- Associate: the Group has a participating interest and exercises significant influence

Notes to the financial statements for the year ended 31 December 2005

1 Accounting policies (continued)

Turnover which excludes value added tax or equivalent sales tax, trade discounts and sales between group companies, represents the income receivable in the ordinary course of business for goods and services provided and, in respect of contract work in progress, the value of work carried out.

Intangible assets comprise fees on concession contracts. These assets are being amortised over their remaining useful lives of between 14 and 40 years.

Tangible fixed assets comprise infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs and sludge pipelines); and other assets (including properties, over ground plant and equipment). The carrying value of tangible fixed assets is reviewed for impairment if circumstances dictate that they may not be recoverable.

Infrastructure assets comprise a network of systems. In the UK water regulated business, all expenditure on infrastructure assets is capitalised at cost, whilst the planned element incurred in maintaining the operating capability of the network in accordance with defined service standards is expensed as depreciation.

Other assets are included at cost less accumulated depreciation. Freehold and long leasehold land is not depreciated. Assets in the course of construction are not depreciated until they are commissioned. Other assets are depreciated evenly over their estimated economic lives, which are principally as follows:

Buildings:

- | | |
|--|-------------|
| • Operational structures | 40-80 years |
| • Other | 20-60 years |
| • Fixed and mobile plant | 20-40 years |
| • Vehicles, computers, fixtures and fittings | 3-10 years |

Capital contributions received in respect of infrastructure assets have been deducted from the cost of fixed assets. This is not in accordance with Schedule 4 to the Companies Act 1985 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 finite life. Accordingly, related capital contributions would not be recognised in the profit and loss account. The effect of this departure on the value of tangible fixed assets is disclosed in note 13.

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.

Leased assets

Where assets are financed by leasing arrangements which substantially transfer all the risks and rewards of ownership of an asset to the lessee (finance leases), the assets are treated as if they had been purchased and the corresponding capital cost is shown as an obligation to the lessor. Leasing payments are treated as consisting of a capital element and finance costs, the capital element reducing the obligation to the lessor and the finance charges being written off to the profit and loss account over the period of the lease in relation to the assets' written down values. The assets are depreciated over the shorter of their estimated useful lives and the lease period.

All other leases are regarded as operating leases. Rentals arising under operating leases are expensed on a straight line basis over the life of the lease.

Notes to the financial statements for the year ended 31 December 2005

1 Accounting policies (continued)

Investments

Fixed asset investments

- In the financial statements of the Company, investments held as fixed assets are stated at cost less provisions for impairment in value.
- In the Group financial statements, interests in associated undertakings and joint ventures are accounted for using the equity method of accounting. The consolidated profit and loss account includes the Group's share of the operating results, interest, pre-tax results and attributable taxation of such undertakings for the period. In the consolidated balance sheet, the interests in associated undertakings and joint ventures are shown as the Group's share of the net assets and of goodwill.

Current asset investments are stated at the lower of cost and net realisable value.

Stocks and work in progress, with the exception of long-term contract work in progress, are valued at the lower of cost and net realisable value. Cost includes labour, materials, transport and an element of overheads.

Long-term contracts are included in the profit and loss account by recording turnover and related costs as contract activity progresses. Profit attributable to turnover to date is included where the outcome of the contract can be foreseen with reasonable certainty. Full provision is made for losses on unprofitable contracts.

Long-term contract work in progress is stated at net cost less foreseeable losses and progress payments received and receivable. The amount by which turnover is in excess of payments on account is separately disclosed within debtors as amounts recoverable on contracts. Progress payments received in excess of costs less foreseeable losses are disclosed in creditors. Where foreseeable losses exceed net costs, the excess is disclosed in provisions for liabilities and charges.

Foreign currencies

Transactions in foreign currencies are translated into sterling at the exchange rate ruling at the date of the transaction. Monetary assets and liabilities in foreign currencies are translated into sterling at the rates of exchange ruling at the balance sheet date. The exchange differences arising are included in the profit and loss account in the period in which they arise.

The results of overseas subsidiary undertakings, joint ventures and associates are translated at average rates of exchange for the year. Differences arising from the translation of year-end assets and liabilities at closing rates, together with the restatement of opening balance sheets of overseas subsidiary undertakings at closing rates, are dealt with through reserves together with exchange differences on the translation of foreign currency borrowings funding such investments.

Research and development expenditure is charged to the profit and loss account in the year in which it is incurred.

Taxation

Deferred taxation is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date, where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date.

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 periods 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 taxation is measured on a non-discounted basis.

Provision for insurance liabilities

Provision is made for known and estimated liabilities arising from uninsured claims against the Group and for claims against its wholly owned insurance company, where there is a present obligation that will result in transfer of economic benefits.

Notes to the financial statements for the year ended 31 December 2005

1 Accounting policies (continued)

Goodwill arising on acquisition, being the excess of the purchase price over the fair value of the net assets of subsidiary, joint venture or associated undertakings acquired, is capitalised and amortised using the straight line method over its estimated useful economic life, not exceeding 20 years. Impairment tests on the carrying value are undertaken at the end of the first full financial year following acquisition and in other periods if events or changes in circumstances indicate that the carrying values may not be recoverable. These tests involve a comparison of the book value with the higher of the net realisable value and the value in use.

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.

For accounting periods to 31 March 1997 the accounting policy for goodwill arising on acquisition was to write off against reserves in the year in which it arose.

Derivative financial instruments

Interest rate swaps, cross currency swaps and forward currency contracts are used to manage interest rate profiles and mitigate exchange risks. When matched with primary financial instruments, the net position is measured at the hedge rate and presented *within creditors on the balance sheet. Income, costs, gains, losses and expenses are recognised within net interest payable* in the profit and loss account over the life of the instruments.

Related party disclosures

The company has taken advantage of the exemption under paragraph 3(c) from the provisions of FRS 8 'Related party disclosures', which requires the disclosure of the details of material transactions between the reporting entity and any related parties, on the grounds that it is a wholly owned subsidiary of RWE AG group, a company registered in Germany.

Notes to the financial statements for the year ended 31 December 2005

2 Segmental analysis

The segments by class of business are:

Water and wastewater: Water and wastewater operations

Products and services: Provision of engineering, utility network and asset and facilities management services

Property: Land and property development

Other activities: Those activities carried out in managing the Group, including insurance services provided by the captive insurer to the Group

Turnover

By class of business

	2005			2004		
	Total £m	Inter- segment £m	External £m	Total £m	Inter- segment £m	External £m
Water and wastewater	1,546.4	(8.9)	1,537.5	1,441.2	(9.8)	1,431.4
Products and services	312.2	(37.9)	274.3	241.4	(32.1)	209.3
Property	189.7	-	189.7	242.2	(8.3)	233.9
Other activities	25.4	(8.0)	17.4	20.9	(17.3)	3.6
Group (including share of joint ventures)	2,073.7	(54.8)	2,018.9	1,945.7	(67.5)	1,878.2
Share of joint ventures (included above)			(362.7)			(329.2)
Group			1,656.2			1,549.0

By geographical segment -
origin

	2005			2004		
	Total £m	Inter- segment £m	External £m	Total £m	Inter- segment £m	External £m
UK	1,828.6	(11.7)	1,816.9	1,640.5	(6.8)	1,633.7
Europe	67.1	(6.3)	60.8	88.6	(5.6)	83.0
Americas	90.2	-	90.2	75.8	(0.2)	75.6
Asia Pacific	51.3	(0.3)	51.0	89.3	(3.4)	85.9
Group (including share of joint ventures)	2,037.2	(18.3)	2,018.9	1,894.2	(16.0)	1,878.2
Share of joint ventures (included above)			(362.7)			(329.2)
Group			1,656.2			1,549.0

There is no material difference between the origin and destination of turnover.

Notes to the financial statements for the year ended 31 December 2005

2 Segmental analysis (continued)

Profit on ordinary activities before taxation

By class of business	2005	Restated
	£m	2004 £m
Water and wastewater	237.0	163.1
Products and services	23.7	24.2
Property	64.0	89.5
Other activities	38.6	(3.8)
Group, joint ventures and associates	363.3	273.0

By geographical segment	2005	Restated
	£m	2004 £m
UK	390.1	394.8
Europe	8.5	7.5
Americas	(18.8)	(142.9)
Asia Pacific	(16.5)	13.6
Group, joint ventures and associates	363.3	273.0

Net Assets

By class of business	2005	Restated
	£m	2004 £m
Water and wastewater	4,856.9	4,622.7
Products and services	23.1	39.2
Property	130.7	156.4
Other activities	(34.4)	(43.6)
	4,976.3	4,774.7
Net debt	(3,433.4)	(3,126.1)
Net assets	1,542.9	1,648.6

By geographical segment	2005	Restated
	£m	2004 £m
UK	4,259.5	4,130.3
Europe	248.1	244.4
Americas	443.6	337.5
Asia Pacific	25.1	62.5
	4,976.3	4,774.7
Net debt	(3,433.4)	(3,126.1)
Net assets	1,542.9	1,648.6

Notes to the financial statements for the year ended 31 December 2005

3 Operating costs

	2005	2005	2005	Restated 2004	Restated 2004	Restated 2004
	Continuing operations £m	Discontinued operations £m	Total £m	Continuing operations £m	Discontinued operations £m	Total £m
Staff costs	224.5	10.3	234.8	205.5	10.0	215.5
Materials and consumables	111.1	6.1	117.2	102.4	4.8	107.2
Other operating charges	484.8	19.2	504.0	361.1	14.4	375.5
Amortisation of goodwill and intangibles	1.5	2.8	4.3	9.9	4.5	14.4
Depreciation:						
- owned assets	232.2	13.7	245.9	213.7	9.7	223.4
- infrastructure assets	100.2	-	100.2	87.9	-	87.9
- assets held under finance leases	9.6	-	9.6	9.7	-	9.7
Rentals under operating leases:						
- hire of plant and machinery	5.9	-	5.9	3.1	-	3.1
- other	7.7	-	7.7	8.2	-	8.2
Research and development	5.3	-	5.3	5.8	-	5.8
Auditors' remuneration in respect of audit work and other statutory and regulatory requirements	1.3	-	1.3	1.2	-	1.2
Foreign currency (gains)/losses	(0.2)	-	(0.2)	0.7	-	0.7
	1,183.9	52.1	1,236.0	1,009.2	43.4	1,052.6
Own work capitalised	(59.0)	-	(59.0)	(51.0)	-	(51.0)
	1,124.9	52.1	1,177.0	958.2	43.4	1,001.6
Exceptional costs – impairment of intangibles	4.1	24.1	28.2	-	140.0	140.0
Exceptional costs – impairment of tangibles	27.8	-	27.8	-	-	-
Exceptional costs – other	(23.0)	-	(23.0)	23.0	-	23.0
	1,133.8	76.2	1,210.0	981.2	183.4	1,164.6

Included in auditors' remuneration is £52,000 (2004: £50,000) in respect of audit fees incurred by the Company for the year ended 31 December 2005.

Exceptional costs in 2005 relate to a goodwill impairment charge of £24.1m (2004 £140.0m), an other intangible fixed asset impairment charge of £4.1m (2004 £nil) and a tangible fixed asset impairment charge of £27.8m (2004 £nil) as shown in notes 12 and 13. The reinstatement of a debtor due from a fellow subsidiary company of £23.0m was originally provided for in 2004.

Included in Other operating charges for continuing operations is a charge of £22.3m representing the cumulative effect of accounting errors identified in the consolidation process in prior years. The directors have concluded, in accordance with FRS 3 – Reporting Financial Performance, that the impact of these mis-statements is not of such significance as to require a prior year restatement. The directors confirm that none of the errors identified have involved any financial loss to the Group and that the financial statements of the parent company, together with those of all the Group's individual subsidiaries, are not effected.

Notes to the financial statements for the year ended 31 December 2005

4 Information regarding Directors

	2005 £000	2004 £000
Aggregate emoluments	1,900	2,059
Aggregate emoluments receivable under long-term incentive schemes (granted in the years 2001, 2002 and 2003)	2,757	-
Compensation for lost office	230	506
	4,887	2,565

Retirement benefits are accruing to 3 (2004: 3) Directors under a defined benefit pension scheme.

The Senior Executives within the RWE Group were entitled to receive stock options and stock appreciation rights granted in previous years as part of the RWE Executive Stock Option Plan (applicable for 2001) and the Long Term Incentive Plan (LTIP) (applicable for 2002 and 2003). The total received as part of this long term incentive scheme was £2,757,000. There were no aggregate emoluments receivable under the LTIP in 2004. The amounts per year are as follows:

		Highest paid Director	
		£	£
Executive Stock Option Plan 2001 - 1	Grant date - 15 January 2001	743,487	595,475
Executive Stock Option Plan 2001 - 2	Grant date - 2 August 2001	548,225	439,086
Long term incentive plan - 2002	Grant date - 20 September 2002	311,286	91,204
Long term incentive plan - 2003	Grant date - 1 July 2003	1,153,615	558,339
		2,756,613	1,684,103

Highest paid Director

	2005 £000	2004 £000
Emoluments	749	923
Emoluments receivable under long-term incentive schemes (granted in the years 2001, 2002 and 2003)	1,684	-
Compensation for lost office	230	-
	2,663	923
Accrued pension at end of year – accruing under a defined benefit pension scheme	292	238

The highest paid director during the year was W J Alexander, who left the company on 16 November 2005. His emoluments were enhanced by a long-term incentive plan payment. For the year ended 31 December 2005, the total received as part of this long-term incentive scheme in respect of the years 2001, 2002 and 2003 was £2,757,000, of this, £1,684,103 related to W J Alexander.

The above details of Directors' emoluments do not include the emoluments of R P Lindackers, H J M Roels and Dr K Sturany in respect of their services to the Group. The emoluments of H J M Roels and Dr K Sturany are dealt within the accounts of RWE AG. R P Lindackers is an employee of RWE AG. No emoluments were recharged to the Company in respect of these three directors.

For the period to 1 November 2005, J D Pelczer was remunerated primarily in his capacity as CEO and President of American Water, a fellow subsidiary company of the RWE group, although at the same time he was also Deputy CEO of RWE Thames Water Division. It is not possible to separate out his emoluments in respect of services to the Group from those in respect of services to American Water; therefore no emoluments for that period have been included in the above disclosures. J D Pelczer was remunerated by the Group from 1 November 2005 and therefore his emoluments for that period have been included in the above disclosures.

Directors' interests

None of the Directors has any interest in the shares of RWE Thames Water plc, or its subsidiary companies. During the year under review none of the Directors had significant contracts with RWE AG, RWE Thames Water plc or any other Group company other than their contracts of service.

Transactions with Directors and Officers

There were no other transactions or arrangements which are required to be disclosed under the provision of the Companies Act 1985, nor were there any related party transactions with the Directors or connected persons.

Consolidated profit and loss account for the year ended 31 December 2005

	Note	2005 £m	2005 £m	Restated 2004 £m	Restated 2004 £m
Turnover (including share of joint ventures)					
- continuing operations		1,916.4		1,782.1	
- discontinued operations		102.5		96.1	
			2,018.9		1,878.2
Less: share of turnover of joint ventures					
- continuing operations		(345.5)		(304.9)	
- discontinued operations		(17.2)		(24.3)	
			(362.7)		(329.2)
Group turnover	2		1,656.2		1,549.0
Operating costs (including exceptional impairment costs of £56.0m (2004: £140.0m))	3		(1,210.0)		(1,164.6)
Other operating income – continuing operations	6		5.6		8.8
- continuing operations		424.4		361.7	
- discontinued operations		27.4		31.5	
Group operating profit			451.8		393.2
Share of operating profit in:					
- Joint ventures – continuing operations			18.3		43.6
- Joint ventures – discontinued operations			3.5		5.1
- Associates – continuing operations			3.1		1.3
- Associates – discontinued operations			1.0		1.3
Total operating profit: group and share of joint venture and associates			477.7		444.5
Profit on sale of fixed assets			10.2		6.2
Profit/(loss) on disposal of businesses	7		54.6		(2.2)
Net interest payable					
- Group		(184.5)		(174.4)	
- share in joint ventures		(0.7)		(18.0)	
- share in associates		(0.9)		(1.6)	
	8		(186.1)		(194.0)
Other finance income	26		6.9		18.5
Profit on ordinary activities before taxation	2		363.3		273.0
Taxation on profit on ordinary activities	9		(137.6)		(122.7)
Profit on ordinary activities after taxation			225.7		150.3
Equity minority interests			(14.7)		(17.3)
Profit for the financial year			211.0		133.0
Dividends	11		(325.0)		(292.4)
Retained (loss) for the financial year	23		(114.0)		(159.4)

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

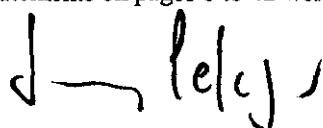
Balance sheets at 31 December 2005

	Note	Group		Company	
		2005 £m	Restated 2004 £m	2005 £m	Restated 2004 £m
Fixed assets					
Intangible assets	12	69.7	83.3	-	-
Tangible assets	13	6,107.8	5,806.2	0.4	0.8
Investments in joint ventures:					
- share of gross assets		687.9	709.2		
- share of gross liabilities		(610.7)	(634.2)		
		77.2	75.0	27.1	35.2
Investments in associates		3.1	(3.8)	-	-
Investments in subsidiary undertakings		-	-	1,518.8	2,108.5
Fixed asset investments	14	80.3	71.2	1,545.9	2,143.7
		6,257.8	5,960.7	1,546.3	2,144.5
Current assets					
Stocks and work in progress	15	34.2	31.5	-	-
Debtors	16	796.4	720.4	105.1	133.0
Investments	17	11.7	82.7	-	-
Cash at bank and in hand		72.5	67.7	17.9	2.2
		914.8	902.3	123.0	135.2
Creditors: amounts falling due within one year	18	(1,686.7)	(1,968.0)	(826.0)	(1,200.1)
Net current liabilities		(771.9)	(1,065.7)	(703.0)	(1,064.9)
Total assets less current liabilities		5,485.9	4,895.0	843.3	1,079.6
Creditors: amounts falling due after more than one year	19	(2,900.8)	(2,193.0)	-	-
Provisions for liabilities and charges	21	(990.3)	(980.0)	(116.5)	(95.0)
Net assets excluding pension asset/liability		1,594.8	1,722.0	726.8	984.6
Pension asset	26	36.8	16.2	-	-
Pension liability	26	(88.7)	(89.6)	-	-
Net assets including pension asset/liability		1,542.9	1,648.6	-	-
Capital and reserves					
Called up share capital	22/23	81.8	81.8	81.8	81.8
Share premium	23	104.5	104.5	104.5	104.5
Capital redemption reserve	23	320.8	320.8	320.8	320.8
Profit and loss	23	853.8	980.4	219.7	477.5
Equity shareholder's funds		1,360.9	1,487.5	726.8	984.6
Equity minority interest		182.0	161.1	-	-
Capital employed		1,542.9	1,648.6	726.8	984.6

The notes on pages 10 to 42 form part of these accounts.

The financial statements on pages 6 to 42 were approved by the Board of Directors on 27 July 2006 and signed on its behalf by

J D Pelczer
Director



Consolidated cash flow statement for the year ended 31 December 2005

	Note	2005 £m	2004 £m
Net cash inflow from operating activities	27	814.6	790.8
Dividends received from joint ventures		7.1	2.3
Returns on investments and servicing of finance	28	(189.5)	(170.9)
Taxation		(78.5)	(41.4)
Capital expenditure and financial investment	29	(558.0)	(580.4)
<i>Acquisitions and disposals</i>			
Proceeds from disposals of business combinations		73.4	25.4
Purchase of minority interest		(11.2)	-
Purchase of fixed asset investments	14	(11.1)	(9.0)
Equity dividends paid to shareholder	11	(325.0)	(292.4)
Net cash (outflow) before management of liquid resources and financing		(278.2)	(275.6)
Management of liquid resources	30	71.0	0.4
Financing			
Cash inflow from increase in debt and lease financing	30	210.0	158.3
Increase/(decrease) in net cash		2.8	(116.9)

Reconciliation of net cash flow to movement in net debt for the year ended 31 December 2005

	2005 £m	2004 £m
Increase/(decrease) in net cash	2.8	(116.9)
Cash (inflow)/outflow from (increase)/decrease in debt and lease financing:		
- loans due within one year	455.1	(330.4)
- loans due after more than one year	(673.2)	165.5
- capital repayment of finance leases	8.1	6.6
Cash (inflow)/outflow from liquid resources	(71.0)	(0.4)
(Increase) in net debt resulting from cash flows	(278.2)	(275.6)
Other non-cash movements:		
- foreign exchange translation differences	(29.1)	58.6
- RPI uplift on index-linked bond	-	(4.9)
(Increase) in net debt	(307.3)	(221.9)
Net debt at 1 January	(3,126.1)	(2,904.2)
Net debt at 31 December	(3,433.4)	(3,126.1)

**Statement of group total recognised gains and losses
for the year ended 31 December 2005**

	2005 £m	Restated 2004 £m
Group profit for the financial year	211.0	133.0
Foreign exchange adjustments offset in reserves	(37.0)	3.0
Actuarial gain on pension scheme	34.9	(80.2)
Deferred tax relating to actuarial gain/(loss)	(10.5)	24.1
Total recognised gains and losses relating to the year	198.4	79.9
Prior year adjustment – FRS 17	(73.9)	(32.2)
– FRS 21	25.0	92.4
Total gains and losses recognised since last annual report	149.5	140.1

**Reconciliation of movements in group shareholder's funds
for the year ended 31 December 2005**

	2005 £m	Restated 2004 £m
Group profit for the financial year	211.0	133.0
Dividends	(325.0)	(292.4)
	(114.0)	(159.4)
Foreign exchange adjustments offset in reserves	(37.0)	3.0
Actuarial gain on pension scheme	34.9	(80.2)
Deferred tax relating to actuarial gain/(loss)	(10.5)	24.1
Net change in shareholders' funds	(126.6)	(212.5)
Opening shareholders' funds as previously reported	1,536.4	1,639.8
Restatement - FRS 17	(73.9)	(32.2)
Restatement – FRS 21	25.0	92.4
Shareholders' funds as at 1 January restated	1,487.5	1,700.0
Shareholders' funds as at 31 December	1,360.9	1,487.5

Notes to the financial statements for the year ended 31 December 2005

2 Segmental analysis

The segments by class of business are:

Water and wastewater: Water and wastewater operations

Products and services: Provision of engineering, utility network and asset and facilities management services

Property: Land and property development

Other activities: Those activities carried out in managing the Group, including insurance services provided by the captive insurer to the Group

Turnover

By class of business

	2005			2004		
	Total £m	Inter- segment £m	External £m	Total £m	Inter- segment £m	External £m
Water and wastewater	1,546.4	(8.9)	1,537.5	1,441.2	(9.8)	1,431.4
Products and services	312.2	(37.9)	274.3	241.4	(32.1)	209.3
Property	189.7	-	189.7	242.2	(8.3)	233.9
Other activities	25.4	(8.0)	17.4	20.9	(17.3)	3.6
Group (including share of joint ventures)	2,073.7	(54.8)	2,018.9	1,945.7	(67.5)	1,878.2
Share of joint ventures (included above)			(362.7)			(329.2)
Group			1,656.2			1,549.0

By geographical segment -
origin

	2005			2004		
	Total £m	Inter- segment £m	External £m	Total £m	Inter- segment £m	External £m
UK	1,828.6	(11.7)	1,816.9	1,640.5	(6.8)	1,633.7
Europe	67.1	(6.3)	60.8	88.6	(5.6)	83.0
Americas	90.2	-	90.2	75.8	(0.2)	75.6
Asia Pacific	51.3	(0.3)	51.0	89.3	(3.4)	85.9
Group (including share of joint ventures)	2,037.2	(18.3)	2,018.9	1,894.2	(16.0)	1,878.2
Share of joint ventures (included above)			(362.7)			(329.2)
Group			1,656.2			1,549.0

There is no material difference between the origin and destination of turnover.

Notes to the financial statements for the year ended 31 December 2005

3 Operating costs

	2005	2005	2005	Restated 2004	Restated 2004	Restated 2004
	Continuing operations £m	Discontinued operations £m	Total £m	Continuing operations £m	Discontinued operations £m	Total £m
Staff costs	224.5	10.3	234.8	205.5	10.0	215.5
Materials and consumables	111.1	6.1	117.2	102.4	4.8	107.2
Other operating charges	484.8	19.2	504.0	361.1	14.4	375.5
Amortisation of goodwill and intangibles	1.5	2.8	4.3	9.9	4.5	14.4
Depreciation:						
- owned assets	232.2	13.7	245.9	213.7	9.7	223.4
- infrastructure assets	100.2	-	100.2	87.9	-	87.9
- assets held under finance leases	9.6	-	9.6	9.7	-	9.7
Rentals under operating leases:						
- hire of plant and machinery	5.9	-	5.9	3.1	-	3.1
- other	7.7	-	7.7	8.2	-	8.2
Research and development	5.3	-	5.3	5.8	-	5.8
Auditors' remuneration in respect of audit work and other statutory and regulatory requirements	1.3	-	1.3	1.2	-	1.2
Foreign currency (gains)/losses	(0.2)	-	(0.2)	0.7	-	0.7
	1,183.9	52.1	1,236.0	1,009.2	43.4	1,052.6
Own work capitalised	(59.0)	-	(59.0)	(51.0)	-	(51.0)
	1,124.9	52.1	1,177.0	958.2	43.4	1,001.6
Exceptional costs – impairment of intangibles	4.1	24.1	28.2	-	140.0	140.0
Exceptional costs – impairment of tangibles	27.8	-	27.8	-	-	-
Exceptional costs – other	(23.0)	-	(23.0)	23.0	-	23.0
	1,133.8	76.2	1,210.0	981.2	183.4	1,164.6

Included in auditors' remuneration is £52,000 (2004: £50,000) in respect of audit fees incurred by the Company for the year ended 31 December 2005.

Exceptional costs in 2005 relate to a goodwill impairment charge of £24.1m (2004 £140.0m), an other intangible fixed asset impairment charge of £4.1m (2004 £nil) and a tangible fixed asset impairment charge of £27.8m (2004 £nil) as shown in notes 12 and 13. The reinstatement of a debtor due from a fellow subsidiary company of £23.0m was originally provided for in 2004.

Included in Other operating charges for continuing operations is a charge of £22.3m representing the cumulative effect of accounting errors identified in the consolidation process in prior years. The directors have concluded, in accordance with FRS 3 – Reporting Financial Performance, that the impact of these mis-statements is not of such significance as to require a prior year restatement. The directors confirm that none of the errors identified have involved any financial loss to the Group and that the financial statements of the parent company, together with those of all the Group's individual subsidiaries, are not effected.

Notes to the financial statements for the year ended 31 December 2005

4 Information regarding Directors

	2005 £000	2004 £000
Aggregate emoluments	1,900	2,059
Aggregate emoluments receivable under long-term incentive schemes (granted in the years 2001, 2002 and 2003)	2,757	-
Compensation for lost office	230	506
	4,887	2,565

Retirement benefits are accruing to 3 (2004: 3) Directors under a defined benefit pension scheme.

The Senior Executives within the RWE Group were entitled to receive stock options and stock appreciation rights granted in previous years as part of the RWE Executive Stock Option Plan (applicable for 2001) and the Long Term Incentive Plan (LTIP) (applicable for 2002 and 2003). The total received as part of this long term incentive scheme was £2,757,000. There were no aggregate emoluments receivable under the LTIP in 2004. The amounts per year are as follows:

		Highest paid Director	
		£	£
Executive Stock Option Plan 2001 - 1	Grant date - 15 January 2001	743,487	595,475
Executive Stock Option Plan 2001 - 2	Grant date - 2 August 2001	548,225	439,086
Long term incentive plan - 2002	Grant date - 20 September 2002	311,286	91,204
Long term incentive plan - 2003	Grant date - 1 July 2003	1,153,615	558,339
		2,756,613	1,684,103

Highest paid Director

	2005 £000	2004 £000
Emoluments	749	923
Emoluments receivable under long-term incentive schemes (granted in the years 2001, 2002 and 2003)	1,684	-
Compensation for lost office	230	-
	2,663	923
Accrued pension at end of year – accruing under a defined benefit pension scheme	292	238

The highest paid director during the year was W J Alexander, who left the company on 16 November 2005. His emoluments were enhanced by a long-term incentive plan payment. For the year ended 31 December 2005, the total received as part of this long-term incentive scheme in respect of the years 2001, 2002 and 2003 was £2,757,000, of this, £1,684,103 related to W J Alexander.

The above details of Directors' emoluments do not include the emoluments of R P Lindackers, H J M Roels and Dr K Sturany in respect of their services to the Group. The emoluments of H J M Roels and Dr K Sturany are dealt within the accounts of RWE AG. R P Lindackers is an employee of RWE AG. No emoluments were recharged to the Company in respect of these three directors.

For the period to 1 November 2005, J D Pelczer was remunerated primarily in his capacity as CEO and President of American Water, a fellow subsidiary company of the RWE group, although at the same time he was also Deputy CEO of RWE Thames Water Division. It is not possible to separate out his emoluments in respect of services to the Group from those in respect of services to American Water; therefore no emoluments for that period have been included in the above disclosures. J D Pelczer was remunerated by the Group from 1 November 2005 and therefore his emoluments for that period have been included in the above disclosures.

Directors' interests

None of the Directors has any interest in the shares of RWE Thames Water plc, or its subsidiary companies. During the year under review none of the Directors had significant contracts with RWE AG, RWE Thames Water plc or any other Group company other than their contracts of service.

Transactions with Directors and Officers

There were no other transactions or arrangements which are required to be disclosed under the provision of the Companies Act 1985, nor were there any related party transactions with the Directors or connected persons.

Notes to the financial statements for the year ended 31 December 2005

5 Employees

Employment costs	2005 £m	Restated 2004 £m
Group employment costs including Executive Directors' remuneration:		
- Wages and salaries	195.8	181.7
- Social security costs	16.1	15.6
- Other pension costs (note 26)	25.8	21.4
	237.7	218.7
Employment costs included within research and development	(2.9)	(3.2)
Net employment costs	234.8	215.5

Employee numbers

	2005 No.	2004 No.
Average monthly number of persons employed by the Group including Executive Directors:		
Water and wastewater	7,581	7,853
Products and services	919	826
Property	75	83
	8,575	8,762

6 Other operating income

	2005 £m	2004 £m
Investment income	4.1	5.7
Other income	1.5	3.1
	5.6	8.8

Notes to the financial statements for the year ended 31 December 2005

7 Profit/(loss) on disposal of businesses

	2005 £m	2004 £m
Profit/(loss) on disposal of businesses during the period	54.6	(2.2)

The major disposals in the year were:

On 19th June 2005 the Group sold its interests in its joint ventures, United Water International Pty Limited and United Water Services Pty Limited for consideration of £11.1m. Net assets disposed of, after provisions for disposal, were £3.9m, giving a profit on disposal of £7.2m

On 2nd August 2005, the Group sold its interests in its Thai operating entities including Thai Tap Water Supply Company Limited, Pathum Thani Company Limited and Pathum Thani Water Operations Company Limited for a total consideration of £55.2m. Net assets disposed of, after provisions for disposal, were £10.5m, giving a profit on disposal of £44.7m.

8 Net interest payable

	2005 £m	2004 £m
Bank loans, overdrafts and other loans:		
- Repayable within five years otherwise than by instalments	62.7	61.0
- Repayable within five years by instalments	43.7	51.7
- Not wholly repayable within five years	95.4	84.4
Finance charges in respect of finance leases	11.9	11.1
Other finance charges	-	0.6
Interest payable and similar charges	213.7	208.8
Interest receivable	(27.6)	(14.8)
	186.1	194.0

Included within bank loans, overdrafts and other loans repayable within five years otherwise than by instalments is £50.8m (2004: £44.1m) of interest paid to RWE group companies.

Notes to the financial statements for the year ended 31 December 2005

9 Taxation on profit on ordinary activities

Analysis of charge in year

	2005 £m	2004 £m
UK corporation tax - amounts payable in respect of corporation tax for the period	85.1	45.8
UK corporation tax - adjustments in respect of previous periods	(4.6)	(19.4)
Overseas corporation taxes	11.0	17.8
Share of associates and joint venture tax	7.8	10.4
Total current tax	99.3	54.6
Deferred tax - origination and reversal of timing differences	37.1	49.2
Deferred tax - adjustments in respect of previous periods	2.5	15.7
Deferred tax – pension cost charge in excess of pension cost relief	(1.3)	3.2
Total deferred tax	38.3	68.1
Taxation on profit on ordinary activities	137.6	122.7

Factors affecting tax charge for period

The current tax charge for the period is lower (2004: lower) than the standard rate of corporation tax in the UK of 30% (2004: 30%). The differences are explained below:

	2005 £m	2004 £m
Profit on ordinary activities before taxation	363.3	273.0
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30% (2004: 30%)	109.0	81.9
Effects of:		
Capital allowances in excess of depreciation	(22.2)	(47.9)
Other timing differences	(1.8)	(1.3)
Amortisation of goodwill	-	3.4
Disallowable expenditure and other permanent differences	21.2	50.4
International corporate tax rate differentials and other items	(3.6)	(9.3)
Net pension cost in excess of pension contribution	1.3	(3.2)
Adjustments in respect of previous periods	(4.6)	(19.4)
Current tax charge for the year	99.3	54.6

Notes to the financial statements for the year ended 31 December 2005**10 Profits of holding company**

Of the profit, before dividends, of the Group for the financial year, a profit of £67.2m (2004: loss of £264.6m) has been dealt with in the accounts of RWE Thames Water plc. A separate profit and loss account for the Company has not been presented as permitted by Section 230 of the Companies Act 1985.

11 Dividends

	2005 £m	Restated 2004 £m
Equity		
Interims paid – 91.35p (2004: 82.19p) per 23p share	325.0	292.4
	325.0	292.4

All shares in issue are equity shares.

In addition to the above, the directors have declared a 6th interim dividend in respect of the financial year ending 31 December 2005 of £75.0m (21p per ordinary share) (2004: £25.0m (7p per ordinary share)). Total dividends payable in respect of the year ended 31 December 2005 of £375.0m compare with total dividends of £225.0m payable in respect of the year ended 31 December 2004.

Notes to the financial statements for the year ended 31 December 2005

12 Intangible assets

	Group		
	Goodwill £m	Other intangible assets £m	Total £m
Cost			
At 1 January 2005	223.9	63.4	287.3
Additions	-	2.1	2.1
Disposals	-	(1.0)	(1.0)
Foreign exchange adjustments	53.9	9.5	63.4
At 31 December 2005	277.8	74.0	351.8
Aggregate amortisation			
At 1 January 2005	179.2	24.8	204.0
Charge for the year	2.9	1.4	4.3
Impairment charge	24.1	4.1	28.2
Disposals	-	-	-
Foreign exchange adjustments	43.7	1.9	45.6
At 31 December 2005	249.9	32.2	282.1
Net book value			
At 31 December 2005	27.9	41.8	69.7
At 31 December 2004	44.7	38.6	83.3

As a result of a review in the year of the carrying value of the Group's investments, a Goodwill impairment charge of £24.1m (2004: £140.0m) and an other intangible impairment charge of £4.1m (2004: £nil) were made.

Goodwill is capitalised on new acquisitions made after 31 March 1997. Goodwill arising on acquisitions made prior to 31 March 1997 was written off directly to reserves.

The Company had £nil intangible assets (2004: £nil).

Notes to the financial statements for the year ended 31 December 2005

13 Tangible fixed assets

				Group	Company
	Land and buildings £m	Infra- structure assets £m	Plant and equipment £m	Total £m	Plant and equipment £m
Cost					
At 1 January 2005	2,107.7	3,835.0	3,060.8	9,003.5	2.5
Additions	8.2	377.9	255.0	641.1	-
Disposals	(13.5)	-	(50.4)	(63.9)	-
Foreign exchange adjustments	59.8	3.7	86.0	149.5	-
At 31 December 2005	2,162.2	4,216.6	3,351.4	9,730.2	2.5
Capital contributions					
At 1 January 2005	-	526.1	-	526.1	-
Additions	-	48.7	-	48.7	-
At 31 December 2005	-	574.8	-	574.8	-
Accumulated depreciation					
At 1 January 2005	475.5	982.6	1,213.1	2,671.2	1.7
Provided during the year	13.6	166.2	175.9	355.7	0.4
Impairment charge	-	-	27.8	27.8	-
Disposals	(1.8)	-	(49.8)	(51.6)	-
Foreign exchange adjustments	23.3	-	21.2	44.5	-
At 31 December 2005	510.6	1,148.8	1,388.2	3,047.6	2.1
Net book value					
At 31 December 2005	1,651.6	2,493.0	1,963.2	6,107.8	0.4
At 31 December 2004	1,632.2	2,326.3	1,847.7	5,806.2	0.8

As a result of a review in the year of the carrying value of the Group's investments, a Plant and equipment impairment charge of £27.8m (2004: £nil) was made.

The net book value of land and buildings is analysed as follows:

	2005 £m	2004 £m
Group		
Freehold land and buildings	1,622.4	1,597.7
Leaseholds - over 50 years	15.1	20.1
- under 50 years	14.1	14.4
	1,651.6	1,632.2

No depreciation has been charged on freehold land included at a cost of £30.1m (2004: £30.0m).

Notes to the financial statements for the year ended 31 December 2005

13 Tangible fixed assets (continued)

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

	Cost		Net book value	
	2005 £m	2004 £m	2005 £m	2004 £m
Plant and equipment	272.5	272.6	176.8	186.5

Tangible fixed assets at 31 December 2005 include £722.0m (2004: £860.0m) of assets in the course of construction.

In June 2005 the London Borough of Newham, following a direction from the Mayor of London, formally refused planning permission for the Group's proposed Thames Gateway Water Treatment Plant, employing desalination technology at Beckton in East London. The site is operational land owned by the Group. An appeal has been lodged and a public inquiry began in May 2006. A duplicate application for planning permission has also been submitted. The works carried out to date are a combination of site preparation, for which planning permission is not considered a requirement, a pilot plant constructed on the site to prove the technology, for which planning permission has been granted and some preliminary construction works in readiness for the permanent plant which has been refused planning permission. The works on site have ceased pending the outcome of the appeal with the exception of work required to make the site safe and to fulfill contractual obligations. To 31 December 2005 the Group has spent £64m, of which £15m is in respect of site preparation and the pilot plant. The Group is strongly of the opinion that this plant is an essential element in securing future adequate supplies of water to the population of London, in view of the projected imbalance between supply and demand in a drought year and that the desalination plant is the most appropriate solution for the Group to take at this time. The current position reflects the best estimate of the outcome of the appeal. If it emerges at any stage that the current judgment needs to be revised, then a reappraisal of the amounts capitalised may become necessary.

14 Fixed asset investments

Group

Interests in joint ventures and associated undertakings

	2005 £m	2004 £m
Share of net assets		
At 1 January	71.2	43.7
Additions	11.1	9.0
Share of profit after tax for year	16.6	21.3
Dividends paid to group companies	(7.1)	(2.3)
Disposals	(11.5)	-
Foreign exchange adjustments	-	(0.5)
At 31 December	80.3	71.2

The cost of the Group's interests in associated undertakings and joint ventures at 31 December 2005 amounted to £16.3m (2004: £31.8m). The Group's share of post-acquisition accumulated profits at 31 December 2005 was £60.0m (2004: £39.4m). The associated undertakings and joint ventures are all unlisted.

On 2 August 2005, the Group disposed of its direct interest in Thai Tap Supply Company Limited for cash consideration of £45.6m.

Of the share capital issued in the year £5.9m relates to that of Metronet Rail BCV Limited and £5.2m relates to that of Metronet Rail SSL Limited.

Notes to the financial statements for the year ended 31 December 2005

14 Fixed asset investments (continued)

Company

The Company's fixed asset investments can be analysed as follows:

	Interests in joint ventures £m	Investment in subsidiary under- takings £m	Total £m
At 1 January 2005	35.2	2,108.5	2,143.7
Additions	11.1	238.5	249.6
Repayment of loans	-	(687.7)	(687.7)
Disposals	(20.2)	-	(20.2)
Foreign exchange adjustments	1.0	1.2	2.2
Provisions against investments	-	(141.7)	(141.7)
At 31 December 2005	27.1	1,518.8	1,545.9

The additions in interests in joint ventures arising during the year relate to share capital issued in the year by Metronet Rail BVC Limited and Metronet Rail SSL Limited. The additions in the investments in subsidiary undertakings relate to additional loans made to existing subsidiary undertakings.

The disposal of interests in joint ventures relates to the disposal of Thai Tap Supply Company Limited in the year.

Following the Group's strategic decision to focus on the UK and Europe region in 2004, the Company continued to review the carrying value of its investments in the light of its disposal program. As a result of this review, a provision of £141.7m was made against the carrying value of the Company's investments.

15 Stocks and work in progress

	2005 £m	2004 £m
Group		
Raw materials and consumables	9.1	9.1
Work in progress	4.8	2.7
Finished goods and goods for resale	20.3	19.7
	34.2	31.5

The Company had no stock and work in progress at 31 December 2005 (2004: £nil).

Notes to the financial statements for the year ended 31 December 2005

16 Debtors

	Group		Company	
	2005 £m	Restated 2004 £m	2005 £m	2004 £m
Due within one year:				
Trade debtors	242.2	230.0	-	-
Amounts owed by parent and fellow subsidiary undertakings	150.4	116.4	93.2	113.6
Amounts owed by joint venture undertakings	41.6	87.4	-	15.9
Amounts owed by associated undertakings	-	0.1	-	-
Other debtors	140.1	105.2	11.9	3.5
Prepayments and accrued income	205.8	149.2	-	-
	780.1	688.3	105.1	133.0
Due after more than one year:				
Trade debtors	16.3	15.6	-	-
Other debtors	-	16.5	-	-
	796.4	720.4	105.1	133.0

17 Current asset investments

	Group	
	2005 £m	2004 £m
Fixed term deposits and certificates of deposit	-	2.5
Fixed and floating interest rate securities	1.4	66.7
Treasury funds	10.3	13.5
	11.7	82.7

The Company had no current asset investments as at 31 December 2005 (2004: £nil).

Notes to the financial statements for the year ended 31 December 2005

18 Creditors: amounts falling due within one year

	Group		Company	
	2005 £m	Restated 2004 £m	2005 £m	Restated 2004 £m
Bank loans and overdrafts	241.6	300.2	132.4	127.9
Other loans	18.1	17.7	17.8	17.8
Trade creditors – operating	122.9	48.7	-	-
Trade creditors – capital	161.9	148.8	-	-
Amounts owed to parent and fellow subsidiary undertakings	553.1	939.7	671.6	1,043.0
Obligations under finance leases	9.9	8.1	-	-
Corporation tax	45.7	31.7	-	-
Other taxation and social security	2.2	10.9	-	-
Other creditors	148.7	114.6	0.1	3.2
Accruals and deferred income	382.6	347.6	4.1	8.2
	1,686.7	1,968.0	826.0	1,200.1

19 Creditors: amounts falling due after more than one year

	Group		Company	
	2005 £m	2004 £m	2005 £m	2004 £m
Bank loans	852.0	735.2	-	-
Other loans	776.1	846.2	-	-
Amounts owed to parent and fellow subsidiary undertakings	875.1	225.0	-	-
Obligations under finance leases	215.6	225.5	-	-
Corporation tax	0.7	1.5	-	-
Other creditors	27.2	19.5	-	-
Deferred income	154.1	140.1	-	-
	2,900.8	2,193.0	-	-

Amounts owed to parent and fellow subsidiary undertakings are:

	Group		Company	
	2005 £m	2004 £m	2005 £m	2004 £m
Inter-company loans				
- Within one year	529.3	918.6	481.8	875.3
- After more than one year	875.1	225.0	-	-
	1,404.4	1,143.6	481.8	875.3
Non-loan amounts due within one year	23.8	21.1	189.8	158.9
	1,428.2	1,164.7	671.6	1,034.2

Notes to the financial statements for the year ended 31 December 2005

20 Financial instruments

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.

Financial assets

Interest rate risk profile

	Total at floating rates		Total at fixed rates		No interest		Total book value		For fixed rate assets only Weighted average interest rate		Weighted average period until maturity for which rate is fixed	
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
	£m	£m	£m	£m	£m	£m	£m	£m	%	%	Years	Years
Current asset investment												
- £ Sterling	9.2	74.1	-	-	-	-	9.2	74.1	-	-	-	-
- Other	1.1	8.6	0.7	-	0.7	-	2.5	8.6	3.6	-	-	-
	10.3	82.7	0.7	-	0.7	-	11.7	82.7	3.6	-	-	-
Cash at bank/hand												
- £ Sterling	31.5	31.1	-	-	23.1	0.4	54.6	31.5	-	-	-	-
- \$ US	2.9	3.7	-	-	4.6	14.6	7.5	18.3	-	-	-	-
- Other	4.5	6.0	0.4	-	5.5	11.9	10.4	17.9	17.5	-	0.1	-
	38.9	40.8	0.4	-	33.2	26.9	72.5	67.7	17.5	-	0.1	-
Debtors > 1 year	-	-	-	-	16.3	32.1	16.3	32.1	-	-	-	-
	49.2	123.5	1.1	-	50.2	59.0	100.5	182.5	10.6	-	0.1	-

The Group is not exposed to currency risk on non-sterling current asset investments, as they are held within an overall portfolio managed by external fund managers.

Non-interest bearing assets of £0.7m (2004: £Nil) are held as units in investment and unit trusts and have no maturity period.

LIBID and base rates are the benchmark rates for floating current asset investments and cash at bank respectively.

Notes to the financial statements for the year ended 31 December 2005

20 Financial instruments (continued)

Financial liabilities

Interest rate risk profile

	Total at floating rates		Total at fixed rates		No interest		Total book value		For fixed rate liabilities only Weighted average interest rate		Weighted average period until maturity for which rate is fixed	
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
	£m	£m	£m	£m	£m	£m	£m	£m	%	%	Years	Years
Bank loans and overdraft												
- £ Sterling	239.0	260.4	392.5	291.1	-	-	631.5	551.5	6.6	6.7	3.8	4.5
- \$ US	-	-	103.2	134.7	-	-	103.2	134.7	7.7	7.3	2.8	4.0
- Other	321.9	122.8	37.0	226.4	-	-	358.9	349.2	3.5	6.5	1.4	2.9
	560.9	383.2	532.7	652.2	-	-	1,093.6	1,035.4	6.6	6.8	2.7	3.8
Other loans and finance leases												
- £ Sterling	917.2	1,053.1	1,405.0	1,109.9	-	-	2,322.2	2,163.0	5.8	6.7	15.8	20.7
- \$ US	47.6	43.2	8.8	-	-	-	56.4	43.2	-	-	-	-
- Other	-	0.1	45.5	34.8	-	-	45.5	34.9	0.2	4.0	0.2	4.9
	964.8	1,096.4	1,459.3	1,144.7	-	-	2,424.1	2,241.1	3.1	5.4	8.1	12.8
Creditors > 1 year												
- Other	-	-	-	-	10.1	19.5	10.1	19.5	-	-	-	-
	1,525.7	1,479.6	1,992.0	1,796.9	10.1	19.5	3,527.8	3,296.0	5.2	6.1	5.4	8.3

Other loans include amounts owed to RWE group companies.

The Group's interest rate and cross currency swaps are £50m (2004: £276m) of floating to fixed interest rate swaps and £43m (2004: £43m) of fixed to floating interest rate swaps. Cross currency swaps hedge currency risk on £425m (2004: £456m) of foreign currency borrowings.

Included in these amounts are £nil (2004: £nil) of floating to fixed interest rate swaps, £16m (2004: £16m) of fixed to floating interest rate swaps, and £45m (2004: £46m) of cross currency swaps for the Company.

Short term borrowings at floating rates bear interest at rates linked to LIBOR.

Fixed rate borrowings of £1,992.0m (2004: £1,796.9m) equate to 57% (2004: 55%) of gross borrowings and 59% (2004: 57%) of net debt.

Currency risk

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

Notes to the financial statements for the year ended 31 December 2005

20 Financial instruments (continued)

Gains and losses on hedges

The table below shows the extent to which the Group has unrecognised gains and losses in respect of hedges at the beginning and end of the year.

	Gains £m	Losses £m	Net £m
Unrecognised gains/(losses) on hedges at start of year	25.7	(16.5)	9.2
Recognised during the year	7.7	(0.4)	7.3
(Losses)/gains arising in the year that were not recognised	(32.8)	1.2	(31.6)
Unrecognised gains/(losses) on hedges at end of year	0.6	(15.7)	(15.1)
of which:			
Gains/(losses) expected to be recognised in the next financial year	0.6	-	0.6
Gains/(losses) expected to be recognised after the next financial year	-	(15.7)	(15.7)

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 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	
	2005 £m	2004 £m	2005 £m	2004 £m
Primary financial instruments held or issued to finance the Group's operations:				
Financial assets:				
Current asset investments	11.7	82.7	11.7	82.7
Cash at bank and in hand	72.5	67.7	72.5	67.7
Debtors > 1 year	16.3	32.1	16.3	32.1
Financial liabilities:				
Bank loans and overdrafts	(1,093.6)	(1,035.4)	(1,127.2)	(1,062.0)
Other loans and finance leases	(2,424.1)	(2,241.1)	(2,692.4)	(2,345.6)
Creditors > 1 year	(10.1)	(19.5)	(10.1)	(19.5)
Derivative financial instruments held to manage the interest rate and currency profile:				
Interest rate swaps, cross currency swaps and forward foreign currency contracts	-	-	(15.1)	9.2
	(3,427.3)	(3,113.5)	(3,744.3)	(3,235.4)

Notes to the financial statements for the year ended 31 December 2005

20 Financial instruments (continued)

Fair values (continued)

Primary financial instruments include bonds, which are traded on a public market. Fair values for these have been calculated using the 31 December 2005 and 31 December 2004 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 borrowings and all derivative financial instruments. Floating rate liabilities have fair values which approximate to book value.

Maturities

The maturity profile of the carrying amount of the Group's financial liabilities other than short-term creditors and accruals and creditors > 1 year, as disclosed on page 28, is as follows:

	Group		Company	
	2005 £m	2004 £m	2005 £m	2004 £m
Bank loans and overdrafts				
- Within one year	241.8	300.2	132.4	127.9
- Between one and two years	109.4	52.5	-	-
- Between two and five years	629.1	428.2	-	-
- After more than five years	113.3	254.5	-	-
	1,093.6	1,035.4	132.4	127.9
Other loans				
- Within one year	547.3	936.3	499.6	893.2
- Between one and two years	-	13.0	-	-
- Between two and five years	266.6	83.0	-	-
- after more than five years	1,384.7	975.2	-	-
	2,198.6	2,007.5	499.6	893.2
Finance leases				
- Within one year	9.9	8.1	-	-
- Between one and two years	11.8	9.8	-	-
- Between two and five years	56.2	44.3	-	-
- after more than five years	147.6	171.4	-	-
	225.5	233.6	-	-
Total borrowings	3,517.7	3,276.5	632.0	1,021.1

The analysis of maturities excludes creditors due after more than one year. Loans are repayable between 2006 and 2032.

Notes to the financial statements for the year ended 31 December 2005

20 Financial instruments (continued)

Loans wholly repayable after more than five years are:

	Group		Company	
	2005 £m	2004 £m	2005 £m	2004 £m
Bank loans	113.2	254.5	-	-
Other loans	1,384.8	975.2	-	-
	1,498.0	1,229.7	-	-

Other loans include:

€156m floating rate loans EURIBOR from RWE AG due 2006
 £361m floating rate loans LIBOR from RWE AG due 2006
 \$29m floating rate loan LIBOR from RWE AG due 2006
 £225m 6.60% loan from RWE Finance BV due 2021
 £250m 4.75% MTN Eurobonds due 2010
 £200m 4.90% MTN Eurobonds due 2015
 £200m 5.05% MTN Eurobonds due 2020
 £330m 6.75% MTN Eurobonds due 2028
 £200m 6.50% MTN Eurobonds due 2032
 £175m EURIBOR MTN Eurobond loan due 2021

Loans repayable by instalments after more than five years are:

	2005 £m	2004 £m
Group		
Bank loans	12.8	-
Other loans and finance leases	176.4	171.4
	189.2	171.4

The range of interest rates on outstanding bank loans are 2.3% to 10.9% (2004: 4.0% to 11.1%). These interest rates are those contracted on the underlying borrowings before taking account of interest rate derivatives.

Borrowing facilities

At 31 December 2005, the Group had a committed borrowing facilities with RWE AG of £150m (2004: £150m). This facility replaced a number of committed facilities with a range of financial institutions which expired during the year.

Expiring:	Group		Company	
	2005 £m	2004 £m	2005 £m	2004 £m
Within one year	150.0	150.0	-	-

The Group also has a US\$4billion (2004: US\$4billion) uncommitted Euro Medium Term Note programme. The programme provides access for Thames Water Utilities Limited (via Thames Water Utilities Finance plc) to the capital markets in a range of currencies and maturities. At 31 December 2005, £1,460.2m of issuance (2004: £807.8m) had been borrowed with a weighted average term of 14.96 years (2004: 22.0 years) at a weighted average rate of 5.49% (2004: 6.10%). These facilities are required for continuing investment within the Group and the Directors consider them sufficient for the Group's requirements.

Notes to the financial statements for the year ended 31 December 2005

21 Provisions for liabilities and charges

Group

	Deferred Tax £m	Insurance Liabilities £m	Other £m	Total £m
At 1 January 2005	892.6	52.2	35.2	980.0
Provided during the year	39.6	3.1	31.3	74.0
Utilised during the year	-	(18.2)	(12.6)	(30.8)
Released during the year	-	-	(36.6)	(36.6)
Foreign exchange adjustments	-	-	3.7	3.7
At 31 December 2005	932.2	37.1	21.0	990.3

Deferred taxation

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

	2005 £m	2004 £m
Accelerated capital allowances	925.0	887.0
Other timing differences	7.2	5.6
	932.2	892.6

Total deferred tax provision:

	Note	2005 £m	2004 £m
Included above		932.2	892.6
Deferred tax provided on pension liability	26	(22.3)	(31.5)
		909.9	861.1

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.

Other provisions

Other provisions primarily relate to liabilities in respect of contracts, third party claims and restructuring and reorganisation.

Notes to the financial statements for the year ended 31 December 2005

21 Provisions for liabilities and charges (continued)

Company

	Other Provisions £m
At 1 January 2005	95.0
Provided during the year	31.9
Utilised during the year	(10.4)
At 31 December 2005	116.5

22 Share capital

	2005 £m	2004 £m
Group and Company		
Authorised:		
976,128,916 ordinary shares of 23p each and 380,367,532 'B' shares of 79p each	525.0	525.0
Allotted, called up and fully paid		
355,770,743 ordinary shares of 23p each	81.8	81.8

23 Share capital and reserves

	Share capital £m	Share pre- mium £m	Capital redemp- -tion reserve £m	Profit and loss reserve £m	2005 Total £m	Restated 2004 Total £m
Group						
At 1 January 2005	81.8	104.5	320.8	1,029.3	1,536.4	1,639.8
Restatement – FRS 17				(73.9)	(73.9)	(32.2)
Restatement – FRS 21				25.0	25.0	92.4
At 1 January 2005 - restated	81.8	104.5	320.8	980.4	1,487.5	1,700.0
(Loss) for the financial year	-	-	-	(114.0)	(114.0)	(159.4)
Foreign exchange adjustments	-	-	-	(37.0)	(37.0)	3.0
Actuarial gain/(loss) on pension scheme	-	-	-	34.9	34.9	(80.2)
Movement on deferred tax relating to pension scheme	-	-	-	(10.5)	(10.5)	24.1
At 31 December 2005	81.8	104.5	320.8	853.8	1,360.9	1,487.5
Net pension liability				51.9	51.9	73.4
Reserves excluding net pension liability	81.8	104.5	320.8	905.7	1,412.8	1,560.9

The cumulative goodwill of £10.5m (2004 £10.5m) relating to acquisitions made prior to 31 March 1997 is included in Group reserves.

Notes to the financial statements for the year ended 31 December 2005

23 Share capital and reserves (continued)

	Share capital £m	Share pre- mium £m	Capital redemp- -tion reserve £m	Profit and loss reserve £m	2005 Total £m	Restated 2004 Total £m
Company						
At 1 January 2005	81.8	104.5	320.8	452.5	959.6	1,356.8
Restatement – FRS 21	-	-	-	25.0	25.0	92.4
At 1 January 2005 - restated	81.8	104.5	320.8	477.5	984.6	1,449.2
(Loss) for the year	-	-	-	(257.8)	(257.8)	(464.6)
At 31 December 2005	81.8	104.5	320.8	219.7	726.8	984.6

24 Operating leases

At 31 December 2005, the Group was committed to making the following annual payments in respect of non-cancellable operating leases:

Group	2005 £m	2004 £m
Land and buildings		
Leases which expire:		
- Within one year	0.2	0.1
- Between one and two years	-	0.3
- Between two and five years	0.8	0.2
- After more than five years	4.3	5.1
	5.3	5.7
Other		
Leases which expire:		
- Within one year	0.3	0.4
- Between one and two years	0.6	0.4
- Between two and five years	0.3	0.1
	1.2	0.9

At 31 December 2005 and 2004 the Company has no commitments to make payments in respect of non-cancellable operating leases.

Notes to the financial statements for the year ended 31 December 2005

25 Capital commitments

	2005 £m	2004 £m
Group		
Contracted for but not provided in the financial statements	156.2	196.9

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.

The Group's share of joint ventures and associated undertakings' capital commitments are not separately disclosed since they are not material to the Group.

26 Post retirement scheme

Pension Schemes

Pension arrangements for the majority of the Group's UK employees are of the defined benefit type. They are funded through pension schemes, whose assets are held separately from Group assets in independently administered funds. In addition, there are un-funded defined benefits provided for Directors and senior employees affected by the cap on earnings, which cannot be provided through approved arrangements. Other overseas arrangements are established in accordance with local custom and practice.

Defined benefit scheme

The disclosures in this note are based on the calculations carried out in connection with the formal actuarial valuation of the main schemes as at 31 December 2004. This valuation has been updated at 31 December 2005 by Hewitt, Bacon and Woodrow (the independent and professionally qualified consulting actuaries to the schemes) using revised assumptions that are consistent with the requirements of FRS 17 and shown in the table below.

The next full actuarial valuation as at 31 December 2007 will be undertaken by Hewitt, Bacon and Woodrow during 2008.

The Group has taken advice from Hewitt, Bacon and Woodrow in respect of the funding position of the Groups pension schemes. With consideration of the funding position of the schemes, the company contribution rate has been increased where necessary in accordance with Hewitt, Bacon and Woodrow recommendations. The Company has agreed contribution rates into the various sections of the pension schemes ranging from 0% to 18.7%. It has been agreed with the trustees that contributions will remain at that level for the next five years.

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

	2005	2004	2003
Price inflation	2.9%	2.9%	2.8%
Salary increases	3.9%	3.9%	3.8%
Pension increases	2.9%	3.0%	2.7-2.9%
Discount rate for scheme liabilities	4.75%	5.25%	5.4%

Notes to the financial statements for the year ended 31 December 2005

26 Post retirement scheme (continued)

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 value of the schemes' liabilities assessed on the assumptions described above are shown in the following table:

	2005		2004		2003	
	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m
Equities	8.0%	525.7	8.0%	445.0	8.3%	789.0
Bonds	4.5%	63.8	4.5 – 5.0%	477.0	5.3%	66.0
Gilts	4.0%	445.1	-	-	-	-
Property	8.0%	118.0	8.0%	87.0	8.3%	52.0
Other assets	4.5%	2.3	4.0%	-	4.3%	10.0
Total market value of assets		1,154.9		1,009.0		917.0
Present value of schemes liabilities		(1,229.1)		(1,113.9)		(952.0)
(Deficit) in the schemes		(74.2)		(104.9)		(35.0)
Related deferred tax asset		22.3		31.5		10.0
Net pension (deficit)		(51.9)		(73.4)		(25.0)

This can be analysed as follows:

	2005 £m	2004 £m
Thames Water Mirror Image Pension Scheme	36.8	16.2
Thames Water Pension Scheme	(88.7)	(89.6)
	(51.9)	(73.4)

Analysis of amount charged to operating profit:

	2005 £m	2004 £m
Current service cost	(25.8)	(21.4)
Total operating charge included in operating profit	(25.8)	(21.4)

Analysis of amount credited to other finance income:

	2005 £m	2004 £m
Expected return on pension scheme assets	65.4	70.1
Interest on pension scheme liabilities	(58.5)	(51.6)
Net finance income included within net interest payable	6.9	18.5

Notes to the financial statements for the year ended 31 December 2005

26 Post retirement scheme (continued)

Analysis of amount recognised in statement of recognised gains and losses:

	2005 £m	2004 £m
Actual return less expected return on pension scheme assets	98.4	37.0
Experience gains and losses arising on the scheme liabilities	24.7	(39.1)
Changes in assumptions underlying the present value of scheme liabilities	(88.2)	(78.1)
Actuarial gain/(loss) recognised in STRGL	34.9	(80.2)

The movement in the deficit during the year to 31 December 2005 was as follows:

	2005 £m	2004 £m
(Deficit) in scheme at start of year	(104.9)	(35.2)
Operating charge	(25.8)	(21.4)
Employer contributions	14.7	13.4
Other finance income	6.9	18.5
Actuarial gain/(loss)	34.9	(80.2)
(Deficit) in scheme at end of year	(74.2)	(104.9)

The details of experience gains and losses for the year to 31 December 2005 are as follows:

	2005 £m	2004 £m	2003 £m
Difference between the expected gains and losses on scheme assets:			
Amount (£m)	98.4	37.0	96.9
Percentage of scheme assets	8.5%	3.7%	10.6%
Experience gains and losses on scheme liabilities:			
Amount (£m)	24.7	(39.1)	4.6
Percentage of the present value of the scheme liabilities	2.0%	3.5%	0.5%
Total amount recognised in statement of total recognised gains and losses:			
Amount (£m)	34.9	(80.2)	28.5
Percentage of the present value of the schemes liabilities	2.8%	7.2%	3.0%

Notes to the financial statements for the year ended 31 December 2005

27 Net cash inflow from operating activities

	2005 £m	2004 £m
Group operating profit (after exceptional operating items)	451.8	393.2
Depreciation and amortisation	360.0	335.4
Impairment of intangibles and tangibles – exceptional	56.0	140.0
Other costs – exceptional	(23.0)	23.0
Decrease/(increase) in stocks	(2.9)	16.8
(Increase)/decrease in debtors	(59.7)	(19.9)
(Decrease)/increase in creditors	130.9	(70.2)
(Decrease)/increase in provisions	13.3	(29.1)
Difference between pension charge & cash contributions	2.9	0.9
Foreign exchange	(114.7)	0.7
	814.6	790.8

Depreciation includes maintenance expenditure on infrastructure assets in accordance with FRS 15.

28 Return on investments and servicing of finance

	2005 £m	2004 £m
Interest received	63.0	14.0
Interest paid	(247.5)	(148.8)
Interest element of finance lease rental payments	(11.9)	(11.1)
Minority interest dividends	-	(25.0)
Other finance income received	6.9	-
	(189.5)	(170.9)

29 Capital expenditure and financial investment

	2005 £m	2004 £m
Purchase of tangible fixed assets	(578.8)	(586.0)
Purchase of intangible fixed assets	(2.1)	(0.4)
Infrastructure renewals expenditure	(49.4)	(68.7)
Capital contributions received	48.7	64.9
Proceeds on sale of tangible fixed assets	22.6	9.5
Proceeds on sale of intangible fixed assets	1.0	0.3
	(558.0)	(580.4)

Notes to the financial statements for the year ended 31 December 2005

30 Analysis of net debt

	At 31 December 2004 £m	Cash flow £m	Exchange movements £m	Other non- cash movements £m	At 31 December 2005 £m
Cash in hand	67.7	4.8	-	-	72.5
Bank overdraft	(130.5)	(2.0)	-	-	(132.5)
Net cash	(62.8)	2.8	-	-	(60.0)
Loans due within one year	(1,106.0)	455.1	(5.5)	-	(656.4)
Loans due after more than one year	(1,806.4)	(673.2)	(23.6)	-	(2,503.2)
Finance leases	(233.6)	8.1	-	-	(225.5)
	(3,146.0)	(210.0)	(29.1)	-	(3,385.1)
Liquid resources	82.7	(71.0)	-	-	11.7
Total	(3,126.1)	(278.2)	(29.1)	-	(3,433.4)

The Group includes as liquid resources term deposits of less than one year, fixed and floating interest rate securities and managed funds. Further details are given in note 17.

Other non-cash movements comprise of the cash held by disposed subsidiaries.

31 Related parties

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

Related party	Status	Nature of transaction	2005		2004	
			Sale value £m	Amount due £m	Sale value £m	Amount due £m
Metronet Rail SSL Limited	Joint Venture	Technical service fee	1.2	0.2	0.7	-
Metronet Rail BCV Limited	Joint Venture	Technical service fee	1.2	0.4	0.3	-
St James Group Limited	Joint Venture	Property	36.5	9.4	27.1	15.3
Stirling Water Seafield Limited	Joint Venture	Products and services	9.9	1.0	5.3	1.0
Scottish Water Solutions Limited	Associate	Technical service fee	3.4	-	-	-
Trans 4 M Limited	Joint venture	Technical service fee	10.4	0.7	-	-
United Water International Pty Limited	Joint Venture	Water and wastewater	-	-	0.5	0.1

The Group made sales to the Izmit Municipality, a related party by virtue of its minority shareholding in Izmit Su As, of £76.8m (2004: £73.3m). These transactions were water and wastewater sales. The amount due at 31 December 2005 was £12.2m (2004: £14.0m).

Notes to the financial statements for the year ended 31 December 2005

32 Guarantees

At 31 December 2005 the Company has guaranteed the overdrafts and loans of certain subsidiaries up to a maximum of £756.9m (2004: £946.8m). The Company has also guaranteed facilities for contract bonding on behalf of certain subsidiaries amounting to £64.8m at 31 December 2005 (2004: £115.7m) and certain RWE group companies amounting to £55.9m (2004: £51.7m). 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.

33 Post balance sheet events

On 23rd March 2006, the Group sold its interests in Aguas Nuevo Sur Maule SA (ESSAM) and Empresas de Servicios Sanitarios del Bio Bio SA (ESSBIO) for cash consideration of £101.8m. Net assets disposed of, after provisions made in the current year, equalled the consideration received.

34 Ultimate parent company and controlling party

The immediate parent company is Thames Water Aqua Holdings GmbH, a 100% subsidiary of the ultimate parent company and controlling party RWE AG, a company incorporated in Germany. Copies of the ultimate parent company's consolidated financial statements may be obtained from RWE Aktiengesellschaft, Opernplatz 1, D-45128 Essen, Germany.

35 Group undertakings

At 31 December 2005, the Group held more than 10% of the allotted share capital of the following principal trading 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
UK:						
Thames Water Utilities Limited	England & Wales	Ordinary	100%		Subsidiary	Water and wastewater services
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
Thames Water Services Limited	England & Wales	Ordinary	100%		Subsidiary	Provision of utility network and facility management services
St James Group Limited	England & Wales	Ordinary	50%		Joint venture	Property
Stirling Water Seafield Limited	Scotland	Ordinary		49%	Joint venture	Waste water treatment services

Notes to the financial statements for the year ended 31 December 2005

35 Group undertakings (continued)

	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
UK cont:						
Trans4m Limited	England & Wales	Ordinary		25%	Joint venture	Contract management for stations and civil assets
Metronet Rail SSL Holdings Limited	England & Wales	Ordinary	20%		Joint venture	Maintenance and upgrade of London Underground
Metronet Rail BCV Holdings Limited	England & Wales	Ordinary	20%		Joint venture	Maintenance and upgrade of London Underground
Europe:						
Izmit Su As	Turkey	Ordinary	55%		Subsidiary	Water operations and maintenance
Americas:						
Aguas Nuevo Sur Maule SA (ANSM)	Chile	Ordinary		100%	Subsidiary	Water operations and maintenance
Thames Water Chile Limitada	Chile	Ordinary		100%	Subsidiary	Management Company
Empresa de Servicios Sanitarios del Bio SA (ESSBIO)	Chile	Ordinary		51%	Subsidiary	Water operations and maintenance

A full list of subsidiary undertakings within the Group will be filed at Companies House with the Company's annual return.