

SOUTHERN WATER SERVICES LIMITED

**DIRECTORS' REPORT
AND ACCOUNTS FOR THE YEAR ENDED
31 MARCH 2004**

Registered No. 2366670



SOUTHERN WATER SERVICES LIMITED

**Directors' Report and Accounts for the year
ended 31 March 2004**

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REPORT OF THE DIRECTORS

The directors present their report and the audited Accounts for the year ended 31 March 2004.

RESULTS AND DIVIDEND

The profit after taxation for the financial year amounted to £58.4 million (2003: £63.6 million). The directors recommend a final dividend of £60.71 per ordinary share (2003: £nil) which together with an interim dividend totalling £956.40 per ordinary share (2003: £1,214.29) gives a total dividend of £1,017.11 per ordinary share for the year (2003: £1,214.29). The Company also paid preference dividends amounting to £9.5m (2003: £nil) with class A1 shareholders receiving £4.2m and class B shareholders £5.3m. Class A2 shareholders did not receive a dividend as the Company did not meet the outperformance requirements outlined in note 19. The aggregate dividends on the ordinary and preference shares amount to £66.5m (2003: £68.0m). In September 2004 class A1 shareholders will be paid a dividend of £3.0m, class A2 £nil and class B £3.8m. Class A2 shareholders are not expected to be paid a dividend in 2004/05. The retained loss for the year of £8.1 million (2003: £4.4 million) has been transferred to reserves.

PRINCIPAL ACTIVITIES AND REVIEW OF THE BUSINESS

The principal activities of the company are the provision of water supply and wastewater services in the south-east of England.

Turnover in 2003/04 increased by 4.3% to £455.1m (2002/03 £436.5m) resulting from an increase in charges and new growth. Cost of sales increased by 9.3% in 2003/04 to £252.2m (2002/03 £230.7m). Administration expenses increased by 12.0% to £29.9m (2002/03 £26.7m). The increases in cost of sales and administrative expenses result from the effects of inflation together with increases in depreciation and bad debts and costs arising from newly commissioned schemes and new regulatory obligations offset by operating efficiencies.

The company has undertaken a major refinancing project in the year.

RESEARCH AND DEVELOPMENT

The improvement of existing services and processes, together with the identification and development of new technology and solutions, are important aspects of the company's strategy to enhance the quality of service to customers and improve methods of working. Research and development expenditure for the year amounted to £1.7 million (2003: £1.8 million).

SOUTHERN WATER SERVICES LIMITED

DIRECTORS AND THEIR INTERESTS

The directors who held office at 31 March 2004 were as follows:

Martin Baggs
Barrie Delacour
Stuart Derwent
Anthony Fegan
John Harris
David Stainthorpe

Robert Thian (Chairman, appointed 13 May 2003)
Howard Goodbourn (appointed 29 March 2004)
David Golden (appointed 1 November 2003)
Jean Claude Banon (appointed 7 May 2003)
Rory Cullinan (appointed 7 May 2003)
Francois Darley (appointed 7 May 2003)
Paul de Rosen (appointed 24 February 2004)

Cyril Roger-Lacan (appointed 7 May 2003, resigned 24 February 2004)
Eric Hutchinson (resigned 30 May 2003)
Anthony Nelson (resigned 7 May 2003)
Prof Christopher Chapman (resigned 18 November 2003)

None of the directors who held office at the end of the financial year had any disclosable interests in the shares of the company.

DIRECTORS' RESPONSIBILITIES

Company law requires the directors to prepare accounts for each financial period which give a true and fair view of the state of affairs of the company as at the end of the financial period and of the profit or loss of the company for that period. In preparing those accounts, 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 accounts.
- prepare the accounts on a going concern basis unless it is inappropriate to presume that the group will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the accounts comply with the Companies Act 1985. The directors are responsible for the maintenance and integrity of the website. Uncertainty regarding legal requirements is compounded as information published on the internet is accessible in many countries with different legal requirements relating to the preparation and dissemination of financial statements. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

SOUTHERN WATER SERVICES LIMITED

EMPLOYEES

The company has developed its communications processes with its employees to ensure greater understanding of and involvement in the business. This has been achieved through the "Waterline" staff magazine, produced to complement "Southern Water News", and by staff briefings.

The Southern Water Learning business is now firmly established with programmes for school leavers and the long-term unemployed to work alongside and learn from our employees. The Open Learning facilities at all the main company locations reinforce the commitment of the company to providing learning opportunities.

The Company has, during the last 12 months, set up a consultation process with local, functional and a company-wide forum, with representatives being voted onto the forum by their teams, irrespective of whether they are Trade Union representatives. The objective in setting up the new process is to ensure that all areas of the Company are adequately represented for consultation purposes.

Equal opportunity

Southern Water Services Limited policy is to promote equality of opportunity in recruitment, employment continuity, training and career development. The policy is designed to ensure that equal opportunity in these areas extends as far as practicable to people with disabilities. The company is a member of the Employers' Forum on Disability, which supports the efforts to meet the needs of the disabled for employment and access to the company and its buildings.

Health and safety

Every employee receives a copy of the corporate policy statement on health and safety. There are regular meetings of employee representatives and managers to consider all aspects of health and safety, and there is a health and safety management review group which ensures that there is an adequate system for meeting the company's responsibilities for health and safety to its staff, customers and members of the public.

Southern Water Services Limited has its own internal occupational health service, including the provision of physiotherapy. These services are being developed to meet the needs of the business and our employees at work. These services are continuously being reviewed and developed to meet the changing needs of the business and our employees at work.

SOUTHERN WATER SERVICES LIMITED

CREDITOR PAYMENT POLICY AND PRACTICE

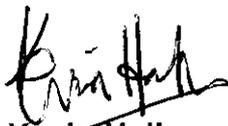
The company's current policy and practice concerning the payment of its trade creditors is to follow the Better Payment Practice Code to which it is a signatory. Copies of the Code may be obtained from the Department of Trade and Industry or from the website www.payontime.co.uk.

The company's policy and practice is to settle terms of payment when agreeing the terms of the transaction, to include the terms in contracts and to pay in accordance with its contractual and legal obligations. The company's creditor days at 31 March 2004 were 44 days (2003: 52 days).

AUDITORS

The auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office and a resolution that they be reappointed will be proposed at the annual general meeting.

Approved by the Board of Directors and signed on behalf of the Board.



Kevin Hall
Secretary
2 July 2004

SOUTHERN WATER SERVICES LIMITED

PROFIT AND LOSS ACCOUNT

For the year ended 31 March 2004

	Notes	2004 £m	2003 £m
Turnover	1,2,3	455.1	436.5
Cost of sales	3	(252.2)	(230.7)
		<hr/>	<hr/>
Gross profit		202.9	205.8
Administrative expenses	3	(29.9)	(26.7)
Other operating income	3	1.6	1.5
		<hr/>	<hr/>
Operating profit and profit on ordinary activities before interest and taxation	5	174.6	180.6
Profit on disposal of fixed assets		3.8	8.8
Net interest and similar charges – Normal	7	(93.4)	(76.3)
– Exceptional	4,7	-	(14.0)
Total net interest and similar charges		(93.4)	(90.3)
		<hr/>	<hr/>
Profit on ordinary activities before taxation	5	85.0	99.1
Tax on profit on ordinary activities	8	(26.6)	(35.5)
		<hr/>	<hr/>
Profit on ordinary activities after taxation	20	58.4	63.6
Dividends	9,20	(66.5)	(68.0)
		<hr/>	<hr/>
Retained (loss) for the financial year	20	(8.1)	(4.4)

The above results relate entirely to continuing operations. The company has no recognised gains and losses other than those included in the loss above and therefore no separate statement of total recognised gains and losses has been presented.

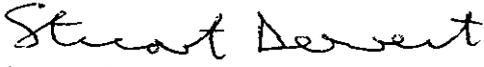
The Notes on pages 8 to 30 form part of these Accounts.

SOUTHERN WATER SERVICES LIMITED

BALANCE SHEET
As at 31 March 2004

	Notes	2004 £m	2003 £m
Fixed assets			
Tangible assets	10	2,711.5	2,631.9
Investments	11	29.2	-
		<u>2,740.7</u>	<u>2,631.9</u>
Current assets			
Stocks	12	1.4	1.8
Debtors: amounts falling due within one year	13	104.7	97.8
Debtors: amounts falling due after one year	14	816.6	-
Cash and deposits		96.6	-
		<u>1,019.3</u>	<u>99.6</u>
Creditors: amounts falling due within one year	15	<u>(225.2)</u>	<u>(1,516.5)</u>
Net current assets/(liabilities)		794.1	(1,416.9)
Total assets less current liabilities		<u>3,534.8</u>	<u>1,215.0</u>
Creditors: amounts falling due after more than one year	16	(2,062.4)	-
Provision for liabilities and charges	17	(375.9)	(372.2)
Grants and contributions	18	(42.5)	(40.7)
Net assets		<u>1,054.0</u>	<u>802.1</u>
Capital and reserves			
Called up share capital	19	0.4	0.1
Share premium	20	306.0	46.3
Profit and loss account	20	747.6	755.7
Total equity shareholder's funds		<u>1,054.0</u>	<u>802.1</u>

The Accounts on pages 5 to 30 were approved by the Board on 2 July 2004 and signed on its behalf by:


Stuart Derwent
Managing Director

SOUTHERN WATER SERVICES LIMITED

CASH FLOW STATEMENT

for the year ended 31 March 2004

	Notes	2004 £m	2003 £m
Net cash inflow from operating activities	21	249.8	327.2
Returns on investments and servicing of finance			
Issue costs of new loans		(53.7)	-
Interest paid		(134.8)	(116.2)
Interest received		43.5	-
Non – equity dividends		(9.5)	-
Net cash outflow from returns on investments and servicing of finance		(154.5)	(116.2)
Taxation		(29.5)	(18.6)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(221.0)	(203.7)
Receipt of grants and contributions		10.3	15.8
Disposal of fixed assets		2.2	8.8
Net cash outflow for capital expenditure and financial investment		(208.5)	(179.1)
Acquisitions			
Acquisition of Southern Water Services (Finance) Limited (formerly First Aqua (JVCo) Limited)		(29.2)	-
Equity dividends paid		(53.6)	(68.0)
Net cash outflow before financing		(225.5)	(54.7)
Financing			
Increase in borrowings		2,133.5	1,210.6
Repayment of borrowings		(1,210.6)	(1,148.1)
Issue of long-term loan		(816.6)	-
Proceeds from share issues		260.0	-
Net cash inflow from financing		366.3	62.5
Increase in net cash		140.8	7.8
Reconciliation to net debt			
Net debt at beginning of year		(1,257.3)	(1202.6)
Increase in net cash		140.8	7.8
Movements in borrowings		(922.9)	(62.5)
Non cash items		(8.7)	-
Net debt at end of year		(2,048.1)	(1,257.3)

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

1 Accounting policies

Basis of accounting

The Accounts have been prepared under the historical cost convention and in accordance with applicable accounting standards and, subject to the treatment of infrastructure grants and contributions described below, with the requirements of the Companies Act 1985.

Basis of preparation

The Accounts contain information about Southern Water Services Limited as an individual company and do not contain consolidated financial information as the parent of subsidiary companies. The company is exempt under section 228 of the Companies Act 1985 from the requirement to prepare consolidated accounts as it and its subsidiary undertaking are included by full consolidation in the consolidated Accounts of the holding company, Southern Water Capital Limited.

Turnover

Turnover represents the income receivable (excluding value added tax) in the ordinary course of the business for goods and services provided and, in respect of unbilled charges, includes an accrual for measured and unmeasured income.

Measured income arises from customers who have meters fitted at their premises. Therefore amounts billed are based on actual water consumption. Unmeasured income bills are based on the rateable value of properties. The income accrual is an estimation of the amount of mains water and wastewater charges unbilled at the year end. The accrual is estimated using a defined methodology based upon weighted average tariffs and historical billing and consumption information.

Bad debts

The bad debt provision is calculated by applying recovery rates to an aged debt profile to ensure that the age of debt not covered by the provision is an accurate reflection of the recoverability of debt.

Research and development

Expenditure on research and development is charged to the profit and loss account as it is incurred.

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

1 Accounting policies (continued)

Tangible fixed assets

- i) Infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls) comprise a network of systems.

Expenditure on infrastructure assets relating to increases in capacity or enhancement of the network and on maintaining the operating capability of the network in accordance with defined standards of service, is treated as an addition to fixed assets and is stated at cost after deducting grants and contributions. Staff costs represent those costs directly related to the construction of a specific infrastructure asset and are capitalised as part of infrastructure assets on the basis of the amount of time spent by individuals on capital projects.

The depreciation charge for infrastructure assets is the estimated level of annualised expenditure required to maintain the operating capability of the network and is based on the asset management plan determined by the water industry regulator as part of the price regulation process. The asset management plan is developed from historical experience combined with a rolling programme of reviews of the condition of the infrastructure assets.

- ii) Other assets (including overground assets, plant and equipment) are stated at cost less accumulated depreciation. Other assets are depreciated on the *straight-line method over their estimated operating lives which are principally as follows:*

	<u>Years</u>
Buildings	10 - 60
Operational structures	15 - 80
Fixed plant	10 - 40
Vehicles, computers and mobile plant	3 - 10

Operational structures are assets used for wastewater and water treatment purposes. These include water tanks and similar assets.

- iii) Freehold land is not depreciated.

Assets in the course of construction are not depreciated until they are commissioned. Commissioning is deemed to occur when a new works is officially taken over from the contractor following completion of performance and take-over tests.

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

1 Accounting policies (continued)

Grants and contributions

Capital grants and customer contributions in respect of additions to non-infrastructure fixed assets are treated as deferred income and released to the profit and loss account over the estimated operational lives of the related assets in accordance with the provisions of the Companies Act.

Grants and Capital contributions received relating to infrastructure assets have been deducted from the cost of fixed assets as permitted by Statement of Standard Accounting Practice (SSAP) 4. This is not in accordance with Schedule 4 of the Companies Act 1985 which requires fixed assets to be stated at their purchase price or production cost. The Act does not permit the deduction of contributions, hence these would have been accounted for as deferred income.

This departure from the requirements of the Act is, in the opinion of the directors, necessary for the Accounts to give a true and fair view because infrastructure assets do not have determinable finite lives. Accordingly related capital contributions would not be recognised in the profit and loss account. The effect of this treatment on tangible fixed assets is disclosed in note 10.

Revenue grants and contributions are credited to the profit and loss account in the year to which they relate.

Leased assets

Fixed assets leased to the company under finance leases are capitalised and depreciated in line with the company's depreciation policy. The interest element of finance lease repayments is charged to the profit and loss account in proportion to the balance of the capital repayments outstanding.

Rentals payable under operating leases are charged to profit and loss account as incurred.

Stocks

Stocks are valued at the lower of cost and net realisable value.

Taxation

Deferred taxation is provided on all timing differences that have originated but not reversed by the balance sheet date, calculated at the rate at which it is expected the tax will arise in accordance with FRS 19 "Deferred Tax". Deferred taxation balances are not discounted.

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

1 Accounting policies (continued)

Pensions

Southern Water Services Limited operates pension schemes which cover the majority of the employees. A valuation of the defined benefits pension schemes is normally conducted by an independent actuary every three years. In accordance with Statement of Standard Accounting Practice (SSAP) 24, the regular cost of providing pensions and related benefits and any variations from regular cost arising from the actuarial valuations are charged to the profit and loss account over the expected remaining service lives of current employees following consultations with the actuary. Any difference between the charge to the profit and loss account and the actual contributions paid to the pension schemes is included as an asset or liability in the balance sheet.

Provisions

A provision is recognised when there is a present obligation, whether legal or constructive, as a result of a past event for which it is probable that a transfer of economic benefits will be required to settle the obligation and a reliable estimate can be made of the obligation.

2 Segmental Analysis

The directors believe that the whole of Southern Water Services Limited's activities constitute a single class of business. The company's turnover is generated wholly from within the UK.

3 Classification of turnover and revenue costs

Turnover represents the income receivable for providing water supply and wastewater services and is generated wholly in the United Kingdom.

Cost of sales reflects the direct costs of providing water supply and wastewater services. Administrative expenses comprise the indirect costs of the business. Other operating income relates to rents receivable.

4 Exceptional Items

During the year ended 31 March 2003, a net exceptional finance cost of £14.0m was incurred with respect to the early redemption of the £100m bonds issued by Southern Water Services Finance plc and charged to Southern Water Services Limited.

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

5 Profit on ordinary activities before taxation

	2004	2003
Profit on ordinary activities before taxation is stated after charging/(crediting):	£m	£m
Staff costs (note 6a)	51.7	45.5
Depreciation on		
- owned assets	108.1	92.9
- assets held under finance leases	0.4	0.4
	<u>108.5</u>	<u>93.3</u>
Rentals under operating leases	4.9	4.9
Research and development expenditure	1.7	1.8
Release of grants and contributions (note 18)	(1.9)	(1.9)
Auditors' remuneration for audit work	0.2	0.1
Auditors' remuneration for non-audit services to the company	0.1	0.1
<p>Auditors' remuneration of £1.4m has been capitalised as part of the debt issue costs, in accordance with FRS 4, which have been offset against the loans (notes 15 and 16)</p>		

6 Employee information

	2004	2003
	£m	£m
(a) Employee costs (including directors' emoluments):		
Wages and salaries	52.7	50.4
Social security costs	4.3	3.6
Pension costs	10.7	8.0
	<u>67.7</u>	<u>62.0</u>
Total employee costs	67.7	62.0
Less: charged as capital expenditure	<u>(16.0)</u>	<u>(16.5)</u>
Charged to the profit and loss account	<u>51.7</u>	<u>45.5</u>

Employee costs that are charged as capital expenditure are those directly related to the construction or acquisition of assets.

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

6 Employee information(continued)

	2004	2003
	No.	No.
(b) Average number of persons employed		
Operations	1,177	1,163
Project Delivery	66	65
Customer Services	516	470
Corporate Centre	336	317
	2,095	2,015

Prior year numbers have been restated in order to be consistent with the current year's disclosures. The total numbers have not changed.

7 Net interest and similar charges

	2004	2003
	£m	£m
Interest payable on bank loans and overdraft	(0.7)	(1.2)
Interest payable on other loans	(126.2)	(75.1)
Indexation	(8.7)	
Amortisation of issue costs	(1.7)	-
Exceptional cost arising due to early redemption of £100m bond by subsidiary (note 4)	-	(14.0)
Total interest payable	(137.3)	(90.3)
Interest receivable from Southern Water Services Group Limited	39.4	-
Other interest receivable	4.5	-
Net interest charge	(93.4)	(90.3)

For the years ended 31 March 2003 and 31 March 2004, the company paid interest of £75.1m and £126.2m respectively to Group companies.

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

8 Tax on profit on ordinary activities

	2004 £m	2003 £m
Current tax:		
UK corporation tax on profits of the year at 30% (2003: 30%)	19.4	18.5
Adjustment in respect of prior years	3.3	-
	22.7	18.5
Deferred tax:		
Origination and reversal of timing differences	6.6	11.9
Adjustment in respect of prior years	(2.7)	5.1
Total deferred tax	3.9	17.0
 Total tax on profit on ordinary activities	26.6	35.5

The rate of current tax charge on profit on ordinary activities varied from the standard rate of corporation tax due to the following factors:

	2004 £m	2003 £m
Profit on ordinary activities before tax	85.0	99.1
Current tax:		
UK corporation tax rate at 30% (2003: 30%) on profit for the period	25.5	29.7
Adjustments in respect of prior years	3.3	-
Other differences	0.7	(0.6)
Utilisation of capital losses	(1.2)	-
Permanent differences	1.0	1.3
Tax charge on ordinary activities	29.3	30.4
Effect of deferred tax	(6.6)	(11.9)
Current tax charge for period	22.7	18.5

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

9 Dividends per share

	2004 £ per ordinary share	2003 £ per ordinary share	2004 £m	2003 £m
Ordinary Shares				
Interim dividend –23 April	267.86	-	15.0	-
Interim dividend –23 July	196.43	482.14	11.0	27.0
Interim dividend –30 Sept	134.93	-	7.6	-
Interim dividend –23 Oct	-	364.29	-	20.4
Interim dividend –31 Dec	182.56	-	10.2	-
Interim dividend –23 Jan	-	367.86	-	20.6
Interim dividend –31 Mar	174.62	-	9.8	-
Total interim dividend	<u>956.40</u>	1,214.29	<u>53.6</u>	68.0
Final dividend	60.71	-	3.4	-
Total ordinary dividend	<u>1,017.11</u>	1,214.29	<u>57.0</u>	68.0
Preference shares				
Class A				
Interim dividend – 30 Sept	7.78	-	1.2	-
Interim dividend – 31 Mar	20.00	-	3.0	-
Class B				
Interim dividend – 30 Sept	13.61	-	1.5	-
Interim dividend – 31 Mar	35.00	-	3.8	-
Total preference dividend	<u>76.39</u>	-	<u>9.5</u>	-
Total dividends	<u>1,093.50</u>	1,214.29	<u>66.5</u>	68.0

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

10 Fixed assets and capital commitments

(a) Tangible assets

	Freehold land & buildings	Plant & Machinery	Infra- structure assets	Assets in the course of const- ruction	Other	Total
	£m	£m	£m	£m	£m	£m
Cost:						
At 1 April 2003	816.8	839.4	1,202.6	310.6	281.0	3,450.4
Additions	41.3	73.3	54.7	-	25.4	194.7
Transfers	32.6	24.5	12.5	(67.1)	(2.5)	-
Grants & contributions	-	-	(6.6)	-	-	(6.6)
Disposals	(0.7)	(0.9)	(1.2)	-	(10.9)	(13.7)
At 31 March 2004	890.0	936.3	1262.0	243.5	293.0	3,624.8
Depreciation:						
At 1 April 2003	186.3	228.4	252.4	-	151.4	818.5
Charge for the year	23.0	35.8	26.7	-	23.0	108.5
Disposals	(0.7)	(0.9)	(1.2)	-	(10.9)	(13.7)
At 31 March 2004	208.6	263.3	277.9	-	163.5	913.3
Net book value:						
At 31 March 2004	681.4	673.0	984.1	243.5	129.5	2,711.5
At 31 March 2003	630.5	611.0	950.2	310.6	129.6	2,631.9

Of the additions to infrastructure assets, the amount spent on infrastructure renewals during the years ended 31 March 2003 and 31 March 2004 was £41.0m and £32.0m, respectively. Of the grants and contributions set against infrastructure assets during the years ended 31 March 2003 and 31 March 2004, £8.9m and £3.9m respectively, relates to infrastructure renewals.

For the years ended 31 March 2003 and 31 March 2004, the net book value of infrastructure assets is stated after deducting grants and contributions since privatisation of £125.7m and £132.3m, respectively.

Freehold land is stated at a cost of £40.8m and £42.3m at 31 March 2003 and 31 March 2004, respectively, and is not depreciated.

Other assets relate primarily to computer equipment and meter reading devices. Motor vehicles have also been included in this category as at 31 March 2004. The opening balances of cost and depreciation have therefore been increased from £280.3m and £150.7m to £281.0m and £151.4m respectively.

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

10 Fixed assets and capital commitments (continued)

Assets held under finance leases are capitalised and included in plant and machinery:

	2004	2003
	£m	£m
Cost	11.7	11.7
Aggregate depreciation	(7.5)	(7.1)
Net book amount	<u>4.2</u>	<u>4.6</u>

(b) Capital commitments

	2004	2003
	£m	£m
In respect of contracts placed	<u>105.7</u>	<u>151.3</u>

11 Fixed asset investments

	2004	2003
	£m	£m
Shares in group undertakings		
At 1 April	-	-
Additions in year	29.2	-
At 31 March	<u>29.2</u>	<u>-</u>

Southern Water Services Limited acquired on 23 July 2003 all the issued shares of Southern Water Services (Finance) Limited, a company incorporated in the Cayman Islands. The principal activity of the company is to raise debt finance.

Southern Water Services Limited sold its holding of 49,999 shares in Southern Water Services Finance plc to Southern Water Limited on 23 July 2003. There was no profit or loss on the sale.

12 Stocks

	2004	2003
	£m	£m
Raw materials	1.2	1.2
Work in progress	0.2	0.6
	<u>1.4</u>	<u>1.8</u>

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

13 Debtors: amounts falling due within one year

	2004	2003
	£m	£m
Trade debtors	59.0	56.2
Unbilled income	35.9	34.8
Amounts owed by group undertakings	1.9	-
Prepayments	2.0	0.1
Other debtors	5.9	6.7
	104.7	97.8

14 Debtors: amounts falling due after one year

	2004	2003
	£m	£m
Loan to Southern Water Services Group Limited (formerly First Aqua Limited)	816.6	-

The loan to Southern Water Services Group Limited (formerly First Aqua Limited) is secured on the assets held under the Southern Water Services Group Security agreement and repayable on 31 July 2052 with interest payable at 7%.

15 Creditors: amounts falling due within one year

	2004	2003
	£m	£m
Bank overdraft	2.5	46.7
Trade creditors	18.9	21.6
Loans from group undertakings (see below)	30.3	1,210.6
Capital creditors and capital accruals	90.0	116.4
Amounts owed to group undertakings	3.8	52.6
Corporation tax	7.3	7.3
Other taxation and social security	1.5	1.4
Other accruals and deferred revenue	70.0	59.9
Debt issue costs (note 16)	(2.5)	-
Dividend payable	3.4	-
	225.2	1,516.5

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

15 Creditors: amounts falling due within one year (Continued)

In 2003 the loans from the parent company and group undertakings were unsecured and repayable on demand with varying interest rates between 5-7%. The loan from Southern Water Services (Finance) Limited (formerly First Aqua (JVCo) Limited) is unsecured, interest free, and shall be repayable in whole or part upon demand at any time, provided that:

- (a) on the date of such demand, no class A debt is outstanding, no class B debt is outstanding and no mezzanine debt is outstanding; or
- (b) with the consent of the security trustee

An analysis is shown below:

	2004 £m	2003 £m
Loan from parent company	-	495.6
Loan from intermediate holding company	-	594.4
Loan from Southern Water Services (Finance) Limited (formerly First Aqua (JVCo) Limited)	<u>30.3</u>	<u>120.6</u>
	<u>30.3</u>	<u>1,210.6</u>

The prior year amount of £120.6m has been reclassified from 'loan from intermediate company' to 'loan from Southern Water Services (Finance) Limited (formerly First Aqua (JVCo) Limited)' in order to be consistent with the current year's disclosure. The total numbers have not changed.

16 Creditors: amounts falling due after more than one year

	2004 £m	2003 £m
Loans and other borrowings:		
Loan from Southern Water Services (Finance) Limited (formerly First Aqua(JVCo) Limited)	2,111.9	-
Debt issue costs	<u>(49.5)</u>	<u>-</u>
	<u>2,062.4</u>	<u>-</u>
	2004 £m	2003 £m
Repayments fall due as follows:		
Between one to two years	-	-
Between two and five years	300.0	-
After five years not by instalments	1,811.9	-
After five years by instalments	-	-
	<u>2,111.9</u>	<u>-</u>

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

16 Creditors: amounts falling due after more than one year (continued)

As part of the Southern Water Group refinancing on 23rd July 2003 Southern Water Services (Finance) Limited (formerly First Aqua (JVCo) Limited) raised new debt in the financial markets and on-lent the borrowings to Southern Water Services Limited.

Under the loan agreement between Southern Water Services Limited and Southern Water Services (Finance) Limited (formerly First Aqua (JVCo) Limited), Southern Water Services (Finance) Limited (formerly First Aqua (JVCo) Limited) on-lends an amount equal to each bond or other debt raised at the same interest rate plus 0.01%. Therefore each individual back to back inter company loan has been separately disclosed.

An analysis of the loans is shown below: -

	2004	2003
Loans	£m	£m
Class A £350m 6.202% fixed rate 2029	350.0	-
Class A £150m 3.716% index linked 2034	152.6	-
Class A £35m 3.716% index linked 2034	35.6	-
Class A £300m 6.185% fixed rate 2007	300.0	-
Class A £350m 6.650% fixed rate 2026	350.0	-
Class A £150m 3.826% index linked 2023	152.9	-
Class A £120m 6.935% fixed rate 2013 (note (i) below)	120.0	-
Class B £250m 7.879% fixed rate 2038 (note (ii) below)	250.0	-
Artesian £165m 4.086% index linked 2033	167.6	-
Senior mezzanine £127.2m 11.97% fixed rate 2038	127.2	-
Junior mezzanine £106m 16.01% fixed rate 2038 (note (iii) below)	106.0	-
Debt issue costs	(49.5)	-
	2,062.4	-

These loans are guaranteed and secured pursuant to a guarantee and security agreement (the Security Agreement). The agreement is over the entire property, assets, rights and undertaking of each of Southern Water Services Limited, Southern Water Services (Finance) Limited (formerly First Aqua (JVCo) Limited) Southern Water Services Holdings Limited, and Southern Water Services Group Holdings Limited. In the case of Southern Water Services Limited, this is to the extent permitted by the Water Industry Act 1991 and Licence.

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

16 Creditors: amounts falling due after more than one year (continued)

The following loans were repaid on the 23rd July 2003: -

	£m
Loan from Southern Water Limited (formerly Southern Water plc)	495.6
Loan from Southern Water Services Group Limited (formerly First Aqua Limited)	594.4
Loan from Southern Water Services (Finance) Limited (formerly First Aqua (JVCo) Limited)	120.6

Debt issue costs represent issue fees paid to Southern Water Services (Finance) Limited (formerly First Aqua (JVCo) Limited). These are being amortised over the weighted average life of the loan advances noted above. As at 31 March 2004 debt issue costs amounted to £52.0m of which £2.5 m represents the short-term amount which is disclosed separately in note 15.

Notes:

- (i) The interest rate on the class A6 £120m is fixed at 6.935% until March 2009 when it reverts to LIBOR plus 2.95% with a premium of 0.01%.
- (ii) The interest rate on the class B1 £250m is fixed at 7.879% until March 2014 when it reverts to LIBOR plus a margin to be determined with a premium of 0.01%.
- (iii) The interest rate on the senior mezzanine £125m loan is fixed at 11.97% until March 2022 when it reverts to LIBOR plus 6.25% with a premium of 0.01%. For the remaining senior mezzanine loan of £2.2m the interest rate is LIBOR plus 6.25% with a premium of 0.01%.

17 Provision for liabilities and charges

	2004 £m	2003 £m
(a) Environmental obligations		
At 1 April	3.1	3.1
Utilised in year	<u>(0.2)</u>	<u>-</u>
At 31 March	<u>2.9</u>	<u>3.1</u>
(b) Deferred taxation		
Accelerated capital allowances	383.4	378.0
Other timing differences	<u>(10.4)</u>	<u>(8.9)</u>
Deferred taxation	<u>373.0</u>	<u>369.1</u>
Total	<u><u>375.9</u></u>	<u><u>372.2</u></u>

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

17 Provision for liabilities and charges (continued)

The environmental provision relates to costs for the decommissioning of abandoned sites. No reimbursement is expected. As the period over which the provision will be utilised cannot be determined the provision is not discounted.

Movement in deferred tax provision:	2004	2003
	£m	£m
Deferred tax provided at 1 April	369.1	352.1
Deferred tax charge in Profit and Loss Account	3.9	17.0
Deferred tax provided at 31 March	<u>373.0</u>	<u>369.1</u>

18 Grants and contributions

	£m
At 1 April 2003	40.7
Receivable in year	3.7
Released to profit and loss account	(1.9)
At 31 March 2004	<u>42.5</u>

Grants and Contributions relate to non-infrastructure assets.

19 Share capital

	2004	2003
	£m	£m
Equity shares		
Authorised		
46,050,000 ordinary shares of £1 each	46.1	46.1
Non equity shares		
Preference shares		
150,000 Class A1 shares of £1 each	0.2	-
150,000 Class A2 shares of £0.01 each	0.0	-
110,000 Class B shares of £1 each	0.1	-
	<u>0.1</u>	<u>0.1</u>
Allotted, called up and fully paid		
56,000 ordinary shares of £1 each	0.1	0.1
Non equity shares		
Preference shares issued		
150,000 Class A1 shares of £1 each	0.2	-
150,000 Class A2 shares of £0.01 each	0.0	-
110,000 Class B shares of £1 each	0.1	-
	<u>0.4</u>	<u>0.1</u>

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

19 Share capital

The preference shares which do not carry voting rights, were issued on the 23 July 2003, and are redeemable at their nominal value plus the share premium paid, on 31 March 2038. Class A1 and B shares were issued at £1,000 per share and the amounts received totalled £260.0m for both classes of shares. Class A2 were issued for £0.01 per share and the amount received totalled £1,500. Shareholders are entitled to receive dividends as follows: -

Class A1

- £40 per share

Class A2

- the base value dividend plus an amount for company outperformance. The base value is £nil per share increasing by £15 every five years. (Outperformance is the difference between the company's audited 'profit before interest and taxation' and the targeted 'profit before interest and taxation' as determined by OFWAT in the periodic review).

Class B

- £70 per share

These dividends are payable on the 31 March and 30 September each year. On winding up the preference shareholders rank above ordinary shareholders with the preference shareholders being paid in order of Class A1, Class A2 then Class B.

20 Reconciliation of movement in shareholder's funds

	Called up share capital £m	Share premium £m	Profit and loss account £m	Total £m
At 1 April 2002	0.1	46.3	760.1	806.5
Profit before Dividends paid	-	-	63.6	63.6
Dividends paid	-	-	(68.0)	(68.0)
At 31 March 2003	0.1	46.3	755.7	802.1
At 1 April 2003	0.1	46.3	755.7	802.1
Issue of Preference Shares	0.3	259.7	-	260.0
Profit before Dividends paid	-	-	58.4	58.4
Dividends paid	-	-	(66.5)	(66.5)
At 31 March 2004	0.4	306.0	747.6	1,054.0

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

21 Cash Flow from operating activities

	2004	2003
	£m	£m
Continuing operations		
Operating profit and profit on ordinary activities before interest and taxation	174.6	180.6
Depreciation charge	108.5	93.3
Amortisation of grants and contributions	(1.9)	(1.8)
Decrease in environmental provision	(0.2)	-
Decrease in stocks	0.4	2.3
(Increase) / decrease in debtors	(5.3)	14.0
(Decrease) / increase in creditors	(26.3)	38.8
Total net cash inflow from operating activities	249.8	327.2

22 Pensions

The Company accounted for pension costs during the year under SSAP 24, but has also made the detailed disclosures required under the transitional arrangements under FRS 17. These disclosures show a net FRS 17 deficit (after deferred tax) of £104.5 million (2003 deficit £99.5m). The deficit has arisen mainly as a result of turbulence in the stock market and low interest rates.

Pension schemes operated

At 1 April 2003 the Company principally operated three schemes. In November 2003 the Company ceased their involvement with the Scottish Power plc pension scheme and transferred the assets to the Southern Water Pension Scheme (SWPS). Details of the schemes are shown below:

1. Southern Water Pension Scheme (SWPS), a funded defined benefit scheme which was closed to new members in 31 December 1998 but re-opened in July 2003. This scheme has nine trustee directors.
2. Southern Water Executive Pension Scheme (SWEPS), which is a funded defined benefit scheme. This scheme has four trustee directors.

Both of the above schemes are operated by Southern Water Services Limited. The assets of the schemes are held separately from those of the company. State Street Bank and Trust Company acts as custodian for the defined benefit schemes and asset management is delegated to external fund managers.

3. Scottish Power plc pension scheme, which is a defined benefit scheme was closed to Southern Water employees in November 2003, when they were transferred back to SWPS. This was administered by Scottish Power plc, however, the Company made contributions on behalf of certain of its employees.

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

22 Pensions (continued)

Members of both remaining schemes receive an annual statement of their accrued benefits.

The latest actuarial valuations of the Southern Water Pension Scheme (SWPS) and Southern Water Services Executive Pension (SWEPS) schemes were carried out as at 31 March 2001 using the projected unit method. The assumptions which have the most significant effect on the results of the valuation are those relating to the rate of return on investments, the rate of future pensionable salary increases and the level of pension increases.

The principal assumptions made by the actuary in the valuation were as follows:

	2001 SWPS % pa	2001 SWEPS % pa
Return on investments	6.2	5.3
Salary growth	4.5	4.5
Pension increases on the excess over guaranteed minimum pensions	2.5	2.5

The assets of the scheme had a market value of £296.0m for the SWPS and £22.0m for the SWEPS at 31 March 2001. This was sufficient to cover 107% and 102% of the benefits of SWPS and SWEPS respectively, that had accrued to members at that date, after allowing for expected future increases in earnings.

The funding level is likely to have deteriorated since the March 2001 actuarial valuation due to adverse stock movements.

Regular pension costs under SSAP 24

1. Pension costs for the SWPS (including costs transferred from the Scottish Power plc scheme) and SWEPS during the year were £10.1m (2003 - £7.1m). The pension cost for the year was greater than the actual contribution paid of £7.4m (2003 - £4.1m) resulting in an accrual in the balance sheet at 31 March 2004 of £5.9m (2003 - £3.2m). The increased cost is in relation to the fund deficits.
2. Pension costs for the employees previously in the Scottish Power plc scheme (now transferred to the SWPS) were £0.6m (2003 - £0.9m). The actual contributions for the year were also £0.6m, resulting in no accruals or prepayments being held on the balance sheet (2003 - £0.9m).

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

22 Pensions (continued)

FRS 17 - disclosures

The Company is following the transitional arrangements under FRS 17 and the required disclosures are made below.

FRS 17 - assumptions, asset, liability and reserves disclosures

Formal actuarial funding valuations of the two principal defined benefit schemes in the UK were carried out at 1 April 2001 and updated to 31 March 2004 by a qualified independent actuary. The following disclosures are combined for the SWPS and SWEPS. The major assumptions used by the actuary are set out in the table below.

	2004	2003	2002
	% pa	% pa	% pa
Price inflation	2.9	2.5	2.8
Rate of increase in salaries (plus an age-related promotional scale)	4.4	4.0	4.3
Rate of increase of pensions in payment	2.9	2.5	2.8
Rate of increase for deferred pensions	2.9	2.5	2.8
Discount rate	5.6	5.6	6.0
Expected return on assets – SWPS	7.3	7.5	7.3
Expected return on assets – SWEPS	5.6	5.6	6.0

The assets and liabilities in the schemes and the expected rates of return at 31 March 2004, 31 March 2003 and 31 March 2002 were:

	Rate of return	Rate of return	Rate of return	Value at	Value at	Value at
	2004	2003	2002	2004	2003	2002
	%	%	%	£m	£m	£m
Equities	8.4%	8.7%	8.0%	192.6	156.4	210.3
Bonds	4.8%	4.7%	5.3%	87.9	78.6	84.2
Cash	3.9%	4.0%	3.8%	4.9	1.9	5.1
Total market value of Plan assets				285.4	236.9	299.6
Total value of Plan liabilities				(434.6)	(379.1)	(338.6)
Accrued deficit in the Plan				(149.2)	(142.2)	(39.0)
Related deferred tax asset				44.7	42.7	11.7
Net pension liability				(104.5)	(99.5)	(27.3)

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

22 Pensions (continued)

FRS 17 - assumptions, asset, liability and reserves disclosures

If FRS 17 had been adopted and therefore the pension liabilities as discussed above were to be recognised, the company's net assets and profit and loss account after taking account of the effect of both pension schemes would have been as follows:

	2004	2003
	£ m	£ m
Shareholder's funds		
As reported (note 20)	1,054.0	802.1
SSAP 24 accrual in relation to SWPS and SWEPS, net of related deferred tax	4.1	2.1
FRS 17 net pension liability as above	(104.5)	(99.5)
As adjusted for FRS 17	<u>953.6</u>	<u>704.7</u>
Profit and loss account		
As reported (note 20)	747.6	755.7
SSAP 24 accrual as above	4.1	2.1
FRS 17 net pension liability as above	(104.5)	(99.5)
As adjusted for FRS 17	<u>647.2</u>	<u>658.3</u>

FRS 17 – profit and loss account disclosures

The following amounts would have been recognised in the profit and loss account for the year to 31 March 2004 under the requirements of FRS17.

Analysis of amounts charged to operating profit:

	2004	2003
	£ m	£m
Employer's current service cost	7.2	6.4
Employer's past service costs	0.2	2.0
Total charged to operating profit	<u>7.4</u>	<u>8.4</u>

Analysis of other amounts credited to the profit and loss account:

	2004	2003
	£ m	£m
(Gain) on settlements	(0.2)	-
Net gain credited to profit and loss account	<u>(0.2)</u>	<u>-</u>

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

22 Pensions (continued)

Analysis of the amount charged to other finance income:

	2004	2003
	£ m	£m
Interest on pension scheme liabilities	21.1	20.3
Expected return on pension scheme assets	(17.0)	(21.4)
Net charge/ (credit) to other finance income	4.1	(1.1)
Total P&L charge before tax	11.3	7.3

Analysis of the amounts recognised in STRGL:

	2004	2003
	£ m	£m
Actuarial gain/ (loss) on scheme assets	33.4	(77.6)
Experience loss arising on scheme liabilities	(6.8)	(3.0)
Loss on change of assumptions (financial and demographic)	(27.5)	(19.4)
Total loss recognised in STRGL before		
Adjustment for tax	(0.9)	(100.0)

Analysis of the movement in the schemes' deficits during the year

	2004	2003
	£ m	£m
Deficit in the plan at 1 April 2003	(142.2)	(39.0)
Employers' contributions	7.4	4.1
Employers' current service cost	(7.2)	(6.4)
Employers past service cost	(0.2)	(2.0)
Settlement gain	0.2	-
Acquisitions loss	(2.2)	-
Other finance income	(4.1)	1.1
Actuarial loss	(0.9)	(100.0)
Deficit in the scheme at end of year	(149.2)	(142.2)

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

22 Pensions (continued)

Details of experience gains and losses for the year to 31 March 2004 are as follows:

	2004	2003
a. Actuarial (gain)/loss on scheme assets		
Amount (£m)	(34.0)	77.6
Percentage of the scheme assets	11.9%	32.8%
b. Experience loss on scheme liabilities		
Amount (£m)	6.8	3.0
Percentage of the present value of the scheme liabilities	1.6%	0.8%
c. Total actuarial loss recognised in STRGL		
Amount (£m)	0.3	100.0
Percentage of the present value of the scheme liabilities	0.1%	26.4%

23 Contingent liabilities

	2004 £m	2003 £m
Capital claims	21.9	22.5

Contractors' submit claims to the Company for the estimated final cost of their works. These claims are reviewed by Southern Water, who assess where the liability for the costs rests and the amount that will actually be settled. The expected amount is included within capital creditors and a further sum is identified as a contingent liability, representing a proportion of the difference between the contractors claim and Southern Water's valuation.

24 Financial commitments

	2004 £m	2003 £m
As 31 March 2004, the company had annual commitments under non-cancellable operating lease agreements in respect of vehicles for which the payment extends over a number of years as follows:		
Expiring within one year	1.0	1.6
Expiring between two and five years	2.8	2.0
	3.8	3.6

Operating leases are charged to the Profit and Loss Account over the lease term.

SOUTHERN WATER SERVICES LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

25 Directors' emoluments

	2004	2003
	£000	£000
Aggregate emoluments (including benefits in kind)	<u>1,568</u>	<u>922</u>

Retirement benefits are accruing to five directors under a Southern Water defined benefit scheme.

Details of emoluments and benefits for the highest paid director:

	2004	2003
	£000	£000
Aggregate highest paid director's emoluments and benefits	<u>331</u>	<u>234</u>
Defined benefit scheme: Accrued annual pension at 31 March	<u>99</u>	<u>90</u>

26 Related party transactions

The company has taken an exemption, as allowed by Financial Reporting Standard 8, not to disclose related party transactions with other group companies as the holding company, Southern Water Capital Limited publishes full statutory consolidated Accounts.

Prior to 7 May 2003, an immediate parent undertaking Southern Water Services Group Limited (formerly First Aqua Limited) published full statutory consolidated Accounts.

27 Ultimate holding company

The immediate parent undertaking is SWS Holdings Limited.

Up to 7 May 2003, the ultimate parent undertaking and controlling party was First Aqua Holdings Limited.

At 31 March 2004, the ultimate parent undertaking and controlling party was Southern Water Capital Limited, which prepares consolidated accounts. Copies of Southern Water Capital Limited's consolidated Accounts may be obtained from the Company Secretary of Southern Water Services Limited, at Southern House, Yeoman Road, Worthing, BN13 3NX.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SOUTHERN WATER SERVICES LIMITED

We have audited the accounts which comprise the profit and loss account, the balance sheet, the cash flow statement, and the related notes which have been prepared under the historical cost convention and the accounting policies set out in the accounting policy note.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the directors' report and the accounts in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities.

Our responsibility is to audit the accounts in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. 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 accounts 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 accounts, 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 transactions is not disclosed.

We read the other information contained in the directors' report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounts. The other information comprises only the directors' report.

Basis of audit opinion

We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

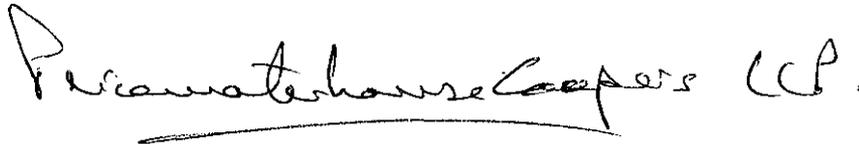
We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the accounts are free from material misstatement, whether caused by fraud or other irregularity or error.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

SOUTHERN WATER SERVICES LIMITED

**INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SOUTHERN
WATER SERVICES LIMITED**

Opinion

In our opinion the accounts give a true and fair view of the state of the company's affairs at 31 March 2004 and of its profit and cash flows for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Handwritten signature of PricewaterhouseCoopers LLP.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors
London,

7 July 2004.