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PRIVATE & CONFIDENTIAL

THAMES WATER

Annual Report

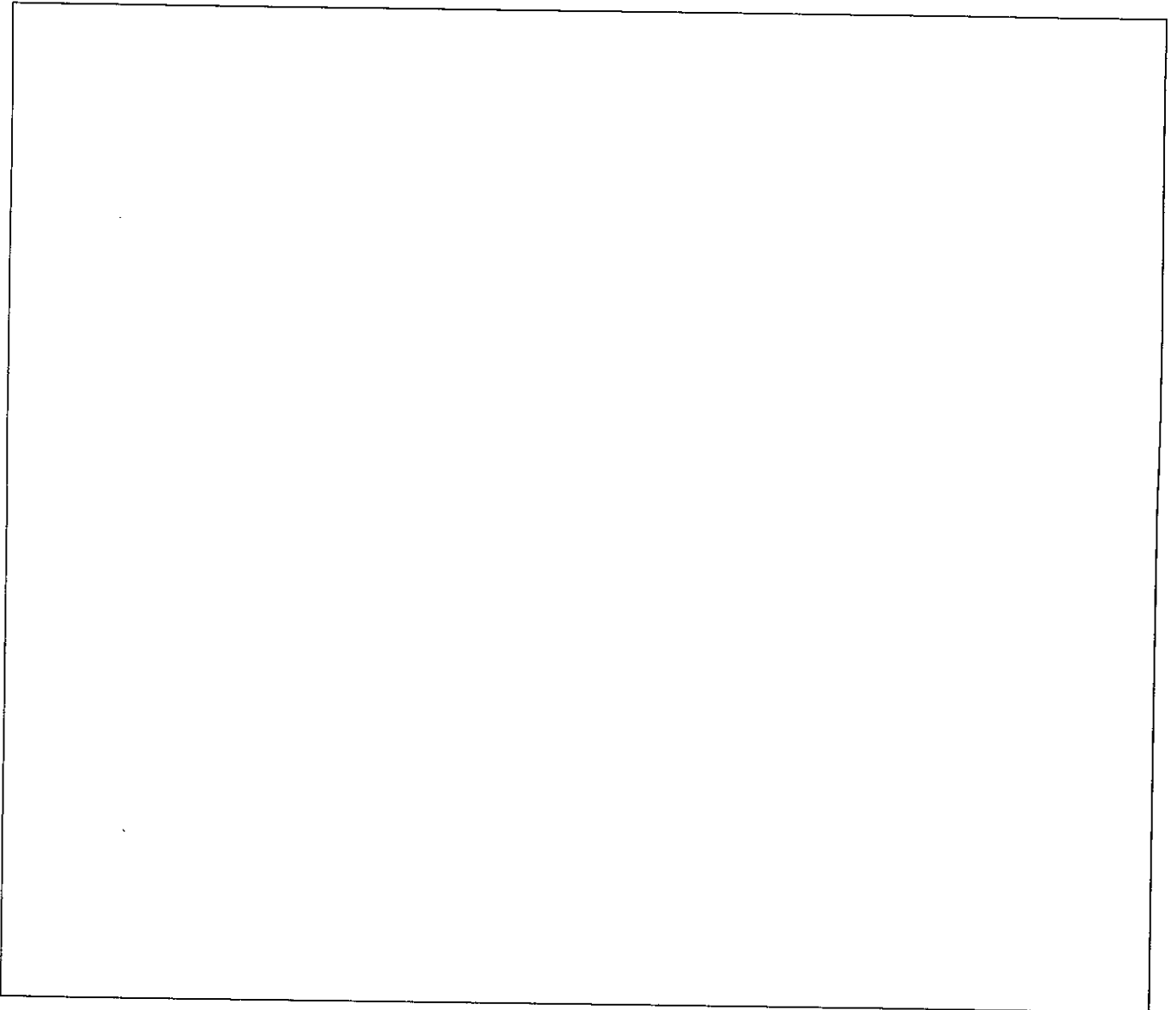


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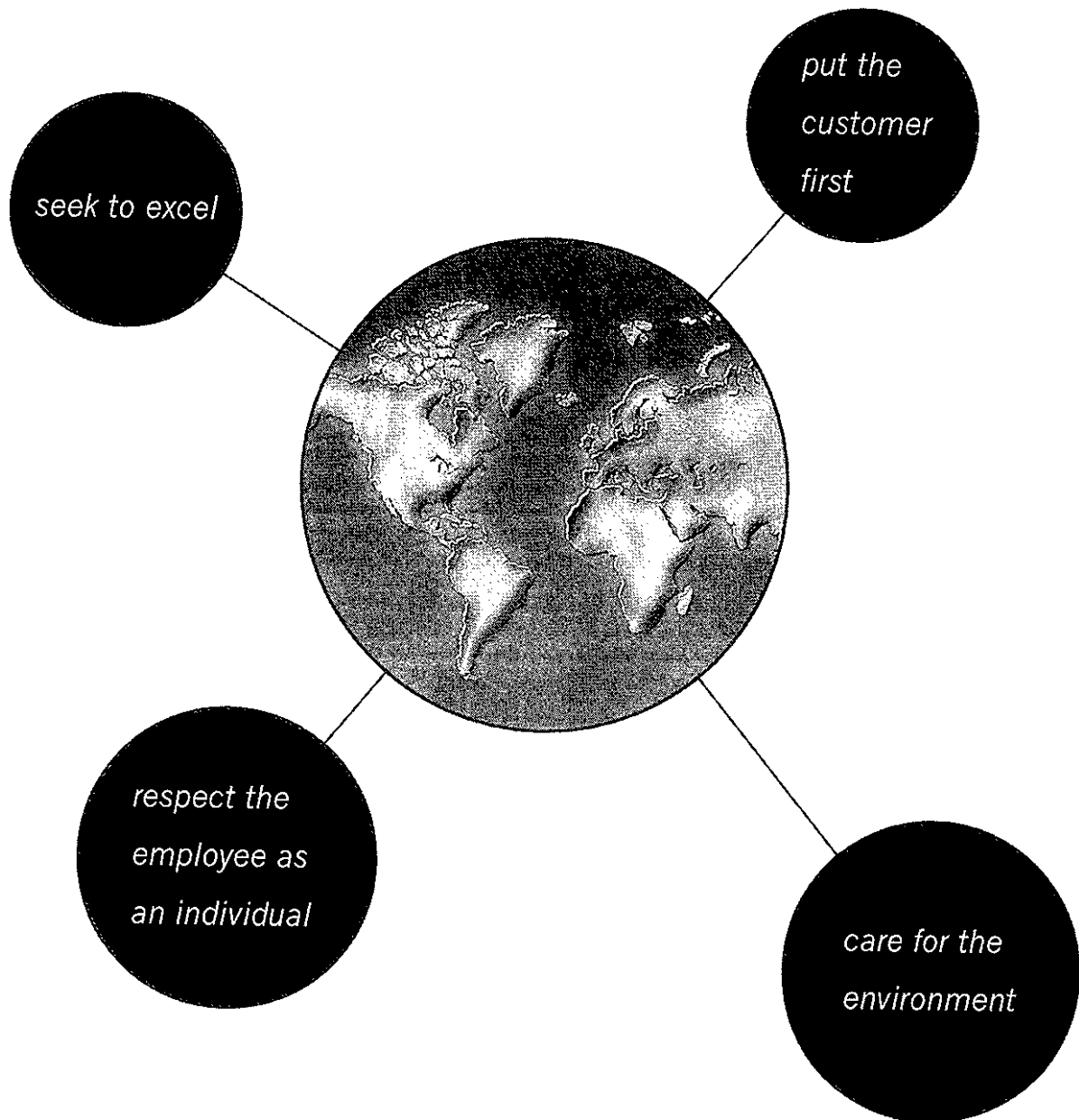


Annual Report and Accounts 1998



Thames Water is the largest water and wastewater services company in the UK, serving 11.9 million domestic and commercial customers in London and the Thames Valley. Around the world, the International, Products and Services divisions provide a wide range of services to over five million customers.

Our drive for success and shareholder value is guided by the same four principles wherever we do business:

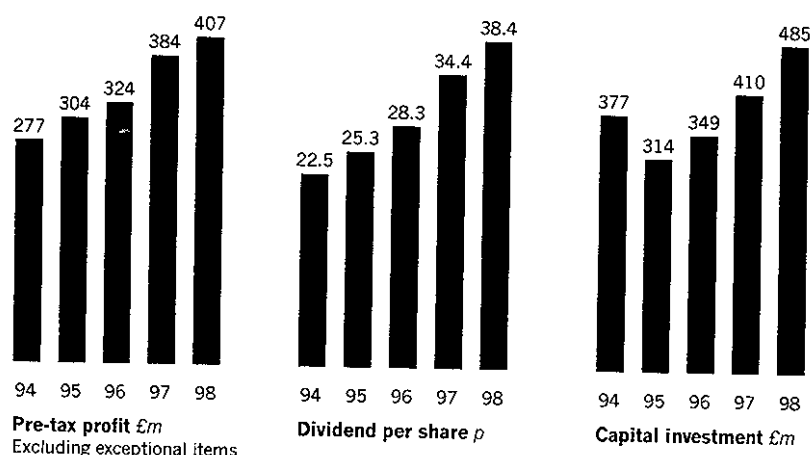


Front cover: Trafalgar Square, London

Back cover: Leak detection work, Albert Bridge, London

Highlights

Year ended 31 March	1998 Excluding exceptional items	1998 Including exceptional items	1997 Excluding bond premium	1997 Including bond premium
Pre-tax profit	£406.9m	£418.6m	£384.0m	£371.8m
Post-tax profit	£344.7m	£125.7m	£330.9m	£320.4m
Earnings per ordinary share	90.7p	33.1p	85.5p	82.8p
Dividend per ordinary share	38.4p	38.4p	34.4p	34.4p



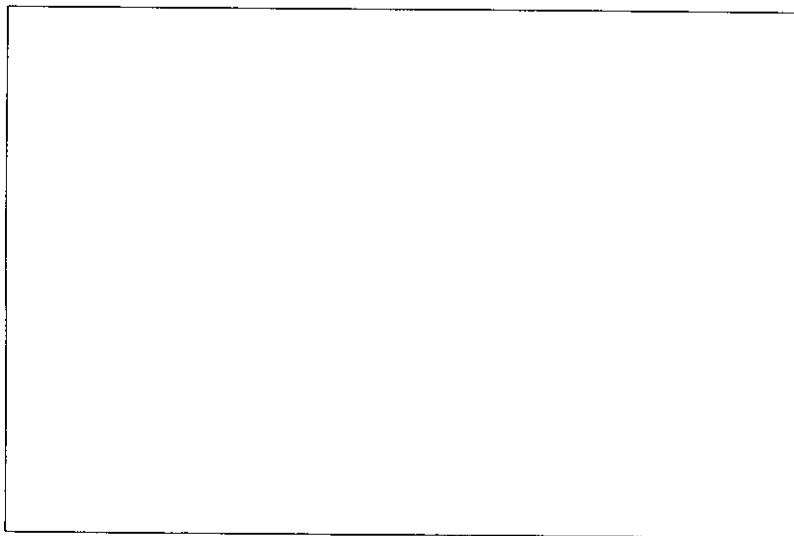
- Highest ever quality and service standards achieved in the Utility business
- No water restrictions imposed last summer for the seventh consecutive year
- Leakage reduction ahead of Ofwat target
- Record Utility capital investment
- Additional £100m discretionary investment
- Exceptional windfall tax of £231m levied.

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Chairman's statement

Thames Water has delivered a strong performance this year. Our core business, which provides water services to customers in London and the Thames Valley, performed well in a demanding operational climate. Our non-regulated businesses, including our portfolio of international operating contracts, substantially increased profit before tax by 51%.



The financial results are good. Overall profit before tax and exceptional items increased from £384m to £407m. As a result of the one-off windfall tax of £231m, profit after tax was £126m (1997: £320m).

Earnings per share before exceptional items rose from 85.5p to 90.7p. After exceptional items and the windfall tax, earnings per share declined from 82.8p to 33.1p. The robust underlying performance has led the Board to recommend a final dividend of 25.9p, giving a 11.6% increase in the total dividend for 1997/98 to 38.4p.

The Utility business maintained unrestricted supplies to customers during the most prolonged drought for 230 years. We are grateful to our customers for their excellent response to our calls to use water wisely.

We have also taken firm management action to maximise the use of our resources and to bring down the amounts lost through leakage. We are currently ahead of Ofwat's demanding target and leakage

in London is now the lowest it has been since reliable measurement began.

Drinking water quality and the standards reached by our wastewater treatment works are the best they have ever been, and among the best in the water industry. Our bills to customers continue to be the lowest in England and Wales and our environmental standards are high.

I very much appreciate the hard work and dedication of our employees. Their commitment to the delivery of high quality customer service was recognised by our winning a number of external awards during the year.

Investment in our Utility business reached its highest ever level of £471m this year. In addition, in June 1998, we announced additional discretionary investment of £100m over the next two years, which

*Sir Robert Clarke,
Chairman, at the
Executive Management
Centre, Reading*

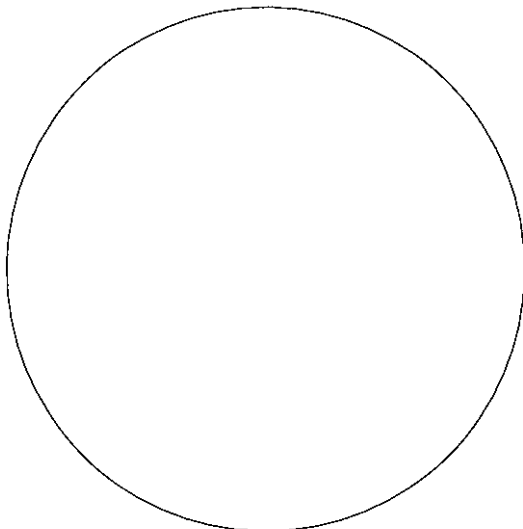
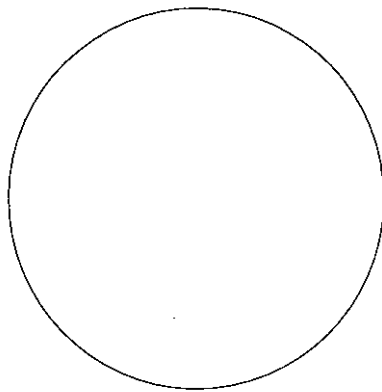
will be used to continue the drive to improve the quality of our service even further.

Our water service operations around the world continue to grow. During the year, we started supplying water to over four million new customers in China and Indonesia.

Our Products, Services, Property and Insurance businesses turned in a strong performance during the year.

The Board has continued to review the Group's financial position and likely future financial needs. In particular, the Board has considered the appropriate balance of equity and debt finance in the Group's

We provide watersports facilities at many of our reservoirs and are continuously looking at ways to improve access to the water for local organisations



London Zoo water garden is sponsored by Thames Water

capital structure, and has concluded that it would now be appropriate to increase the Group's borrowings by approximately £300m, with a corresponding return of capital to shareholders. This will reduce the Group's future overall cost of capital.

David Clementi left the Board last autumn, on taking up his appointment as Deputy Governor of the Bank of England. I paid tribute to his contribution to the Company in our Interim Report. At Christmas, we bade farewell to Bill Harper, our Strategy Director, after 35 years of outstanding service to both Thames Water and the wider water industry.

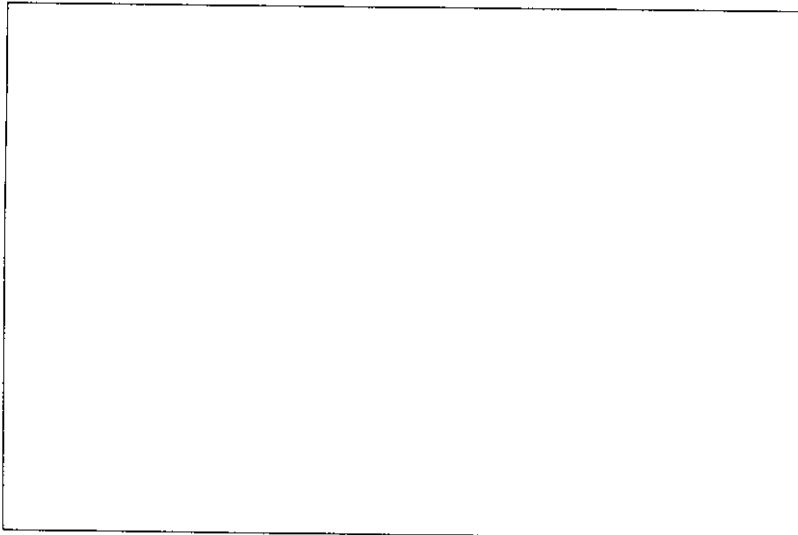
We have made two strong additions to the Board. In March, Lesley Knox, Deputy Chairman of British Linen Bank, joined as a non-Executive Director. At the same time, David Badcock, our Company Secretary and Legal Director, became an Executive Director.

This year's Shareholder Open Days on 13 and 14 September will be held at the Coppermills Advanced Water Treatment Works in Walthamstow, where we have invested £48m to improve the treatment standards of the water we supply to north and east London. I do hope you will join us there.

Thames Water has made excellent progress in the last 12 months. Our competitive cost base and commitment to high quality, good value service allow us to face the future with confidence. In our discussions with Ofwat, we look for a Price Review which serves the needs of all our key stakeholders, delivering value for customers and shareholders, while enabling us to further improve the quality of our operations and continue to protect the environment.

Sir Robert Clarke, Chairman

Chief Executive's review



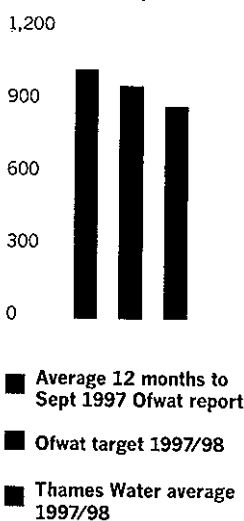
*Bill Alexander,
Chief Executive,
at Holland Park
Ring Main site*

customers' homes to our mains network. This has made a cost-effective contribution to our overall leakage reduction strategy. In total, we have completed over 14,000 repairs during the year.

Utility operations

Turnover of the regulated Utility business increased by 4% to £1,037m. Operating profits showed an increase of 7% to £441m. Operating costs, excluding depreciation and infrastructure renewals, increased by less than 1%, well below the rate of inflation, whilst, at the same time, we introduced a range of new services.

Leakage reduction
Million litres per day



*We have beaten
the 1997/98 target
set by Ofwat by
a good margin*

Leakage Progress

Reducing leakage continues to be a high priority for the Company. We have made excellent progress and are already well on the way to meeting the 1998/99 target set by Ofwat. This has been achieved by the hard work and commitment of over 800 of our people across the Group, who are currently detecting and repairing over 1,200 leaks each month.

New technology has also played its part. We are using a new radar system to pinpoint leaks quickly and to minimise disruption to traffic caused by repairs to our water mains.

During the year, we responded to the Government's request to extend our services, introducing free repairs of significant leaks on pipes connecting domestic

The Environment

Above average rainfall in June 1997 heralded a welcome end to the driest 30-month period in recent history. Since then, we have experienced above average rainfall and have replenished our surface water reservoirs. Our underground reserves will take longer to recover, but are higher than they were this time last year. As we go into this summer, we are confident we will continue to maintain unrestricted supplies to our customers, as we have done for the last seven years.

We believe that metering is the fairest way for most of our customers to pay for water and our research shows much support for this view. Our policy to meter high non-essential water users, such as sprinkler and swimming pool owners, provides a financial incentive for water conservation and helps to defer the development of new water resources.

In February 1998, we welcomed the Government's decision, following a public inquiry, to support our licence to abstract water from underground sources close to the River Kennet near Axford, in Wiltshire. However, we do understand the concerns of local residents about the Kennet and are working closely with the Environment Agency to develop a comprehensive river management plan.

The Company has made great strides over the past year. The Utility business delivered its best ever performance in priority areas such as leakage, drinking water quality, wastewater treatment standards and customer service.

We recently received a Heritage Award from the London Borough of Bexley for the design of our incinerator at Crossness, east London

Investment for the Future

In 1997/98, we invested a record £471m – some 17% higher than last year – on improving, expanding and replacing our water and wastewater assets, bringing our total investment to £3bn since privatisation.

We have again outperformed the service targets agreed with our regulators and customers have benefited from the additional discretionary investment we have made to further improve services.

Our £165m sludge incineration facilities at Beckton and Crossness wastewater treatment works in east London will be in full service well before the deadline of December 1998, when disposal in the North Sea will cease. We were pleased to welcome the House of Commons' Environment Sub-Committee to Beckton in December 1997 to see the incinerators during the early stages of commissioning.

At our new award-winning sewage pumping station at Abbey Mills, innovative engineering design enabled us to reduce the overall cost of the project by around £8m. This is one of the many savings being used partly to fund extra improvements for customers.

We offer free meter installations to all our domestic customers

We have continued our campaign to promote water efficiency to customers with our highly-publicised 'Hippo' campaign, our offer of water audits and the provision of information and advice on how to use water wisely.

The Environmental Review Committee's report of environmental performance is shown on page 21.



Utility service improvements

	1997/98	1990
Drinking water quality compliance	99.8%	95%
Wastewater quality compliance	99.9%	84%
Supply interruptions compliance	99.7%	94%
Avoidance of water use restrictions	100%	22%

Customer Service Achievements

We are continuously seeking ways in which we can improve and extend the services we offer to our customers. Over the past year:

- we have set up a 24-hour centre in Reading to enable us to significantly improve our service response to customers
- over three million households received a customer report outlining our work to improve services and to protect the environment
- we were awarded first place in two categories in the Utility Week Achievement Awards.

Year 2000

In 1995, we set up a project team to look at what effect the Year 2000 date change might have on our computer systems and operations. We have made good progress and are on track to meet the deadline.

The estimated cost of modifications to our computer hardware and software is £11m, most of which is expected to be capitalised as it is part of system enhancements. Expenditure of £2.2m was incurred during the year.

Research and Development

In our research programme, we are working on innovative approaches to quality improvements, with a particular focus on water efficiency and achieving a more reliable performance from our

infrastructure. Longer term goals are to determine and manage the potential impact of climate change and to develop new concepts of sustainability in provision of water and wastewater services for the next millennium.

Competition in the Water Industry

In February 1998, we announced that, subject to the granting by Ofwat of an inset appointment, we had won the first major Private Finance Initiative with the Ministry of Defence. This is for the provision of water and sewerage services to the Tidworth Garrison in the Wessex Water and Southern Water areas. The contract will run for at least 20 years and will provide high standards of service for the 11,000 customers in the Tidworth area.

Regulatory Review

We are looking to the next Price Review in 1999 to produce a balanced package which will set a framework for the Company to deliver benefits to shareholders, customers and the environment. We welcomed confirmation from Ofwat that regulatory stability will be preserved in the lead-up to the Review and that incentive principles should be retained in the longer term. This will allow us to continue to share the benefits of efficiency improvements through additional discretionary investment. Our most recent market research indicates that our customers continue to support this approach.

During the year, we have continued to grow our successful residential development business and have now started to expand into the commercial market.

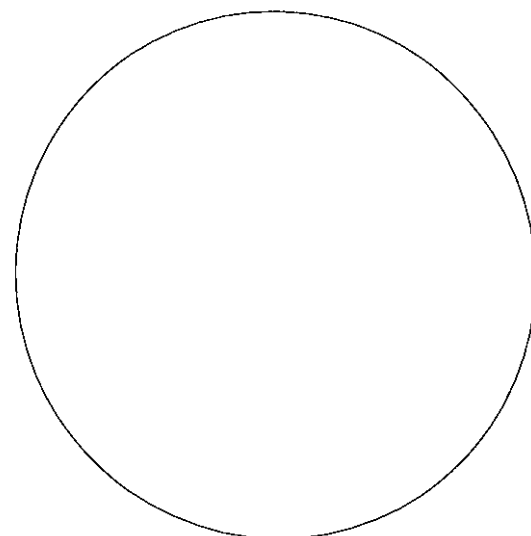
Property

Our Property division has significantly increased its contribution to the Company's financial performance this year, with an operating profit of £15.9m on turnover of £31m.

A significant factor in this success is the strategy for partnerships with leading property development companies. At Barn Elms, in partnership with Berkeley Homes and The Wildfowl & Wetlands Trust, we are converting a former water treatment works and reservoir complex into a wildfowl centre and prestigious housing development. The partnership has been applauded for producing such an asset for the community and London.

Our award-winning property development at Barn Elms creates a striking skyline across the River Thames in London

St James' Homes, our joint venture company with the Berkeley Group, is now in its second year of operation. Sites under development include the former water treatment filter beds at Hampton, where houses and apartments are being built around a new green and cricket ground for the local community. In north



New recreational facilities have been created as part of the property development scheme at our former water treatment works at Surbiton, Surrey

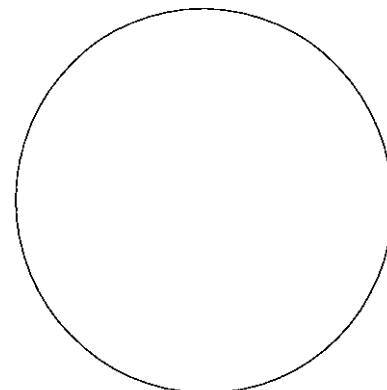
London, the former Thames Water laboratory, a Grade II listed building, is being sympathetically converted for residential use to preserve the special historic qualities of the building.

Innova Park in Enfield is an example of development opportunities which use redundant land released from the Utility business, as part of our ongoing development programme. It is a 100-acre site, formerly used for Utility operations. The first phase of this Business and Science Park development is underway, following site clearance, and keen interest is already being shown by potential occupants.

Insurance

Isis, our captive insurance company, returned an operating profit of £11.1m, including net investment income of £9m. It had some £70m of investments at 31 March 1998, valued individually at the lower of cost or market value.

Our International business continues to provide further opportunities for growth, with new projects being explored and developed.



International

Our strategy to focus on concession contracts has continued with increasing success. Turnover for 1997/98 was £189m, up 10%, and operating profit increased to £6.0m.

Our portfolio of international contracts are progressing well. We are currently working in Australia, China, Malaysia, Indonesia, Puerto Rico, Thailand and Turkey. Details of key events in three of our projects follow.

Izmit, Turkey

At the end of 1997, we won a major award in recognition of the significant export opportunities our water supply contract in Izmit, Turkey, has provided for over 80 British companies. This is our largest project and involves working in conjunction with two Turkish construction companies to build a

water supply system to serve 1.2 million people in a fast-developing area near Istanbul. Once construction work is completed in 1999, Thames Water will manage the new system for a 15-year period.

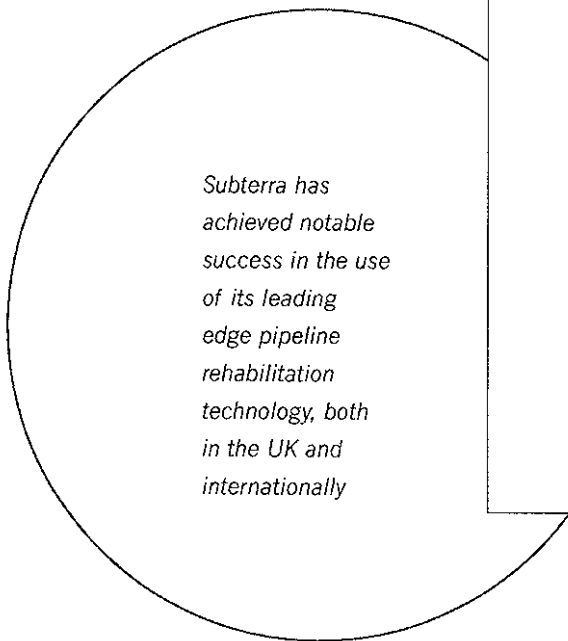
Our project in Turkey is three months ahead of schedule

Shanghai, China

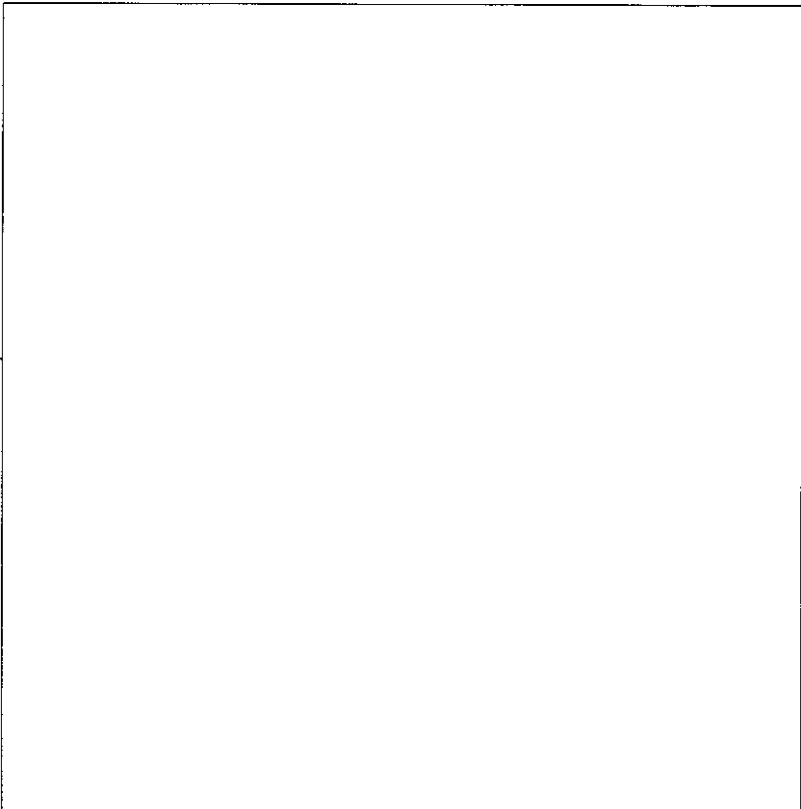
This project is being carried out in conjunction with Bovis who are currently completing a new 400 million litres per day water treatment works. Thames Water will then manage and operate the facilities under a 20-year contract. Water from the first phase of the works was supplied to customers in October 1997, on schedule, and construction work for phase two is ahead of programme.

Jakarta, Indonesia

Earlier in the year, we won a 25-year concession for the operation of water supply services to over five million people in the eastern half of Jakarta. Although our operations were temporarily put on hold following the recent political unrest in Indonesia, at the time of writing, we had resumed operational and administrative control of water services.



Subterra has achieved notable success in the use of its leading edge pipeline rehabilitation technology, both in the UK and internationally



Services

This division has made an operating profit of £6.4m on turnover of £186m.

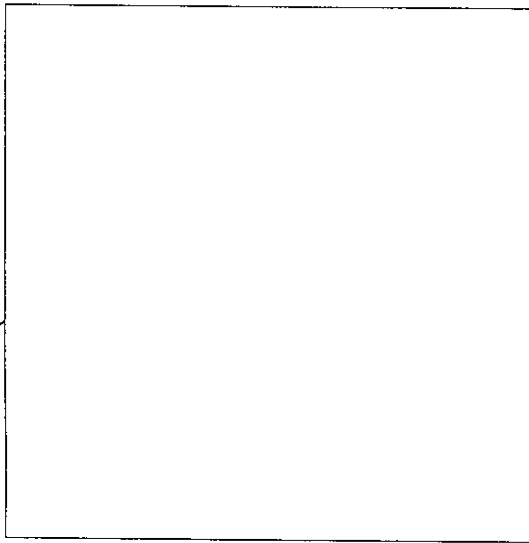
Thames Waste Management has performed well and has significant development prospects in the immediate future. All the necessary clearances have been obtained for a new minerals and landfill site in south London. The company also won a 1.8 megawatt contract for the sale of electricity from the landfill gas power generation plant at Chertsey.

Total Pipeline Solutions provides a new approach for Thames Water Services, using partnering contracts to enable clients to deliver improved service at lower costs. Through an alliance with Tilbury Douglas Construction, the company recently won a contract to service another water company's combined sewer overflow programme. The contract value is in excess

of £80m over four years, and represents a major opportunity in the overall development of the Services division.

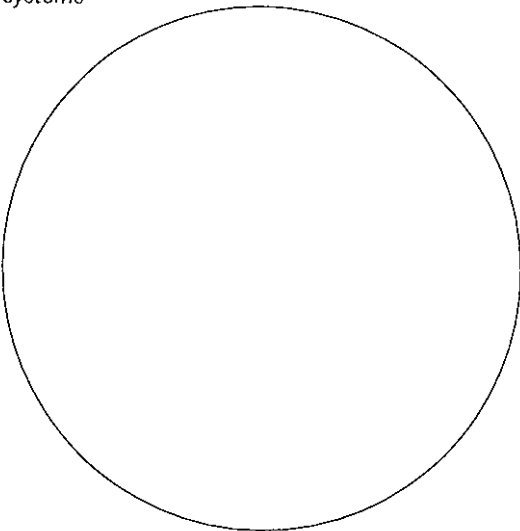
A major success this year for Brophy Grounds Maintenance was the award of the first Scottish contract for a 2,200 square mile area around Perth and Kinross. In addition, this division received three National Landscape Awards for work on the Royal Parks in London and in Falmouth, Cornwall.

Thames Water Services won two Gold Awards from the Corporation of London, demonstrating that the Company continues to set the highest standards for utility work on the streets of London.



T M Products has developed a pioneering device which provides a simple method of connecting pipes of different materials. The 'Grippa' has been selected as one of the Design Council's 'Millennium Products', an initiative launched by Tony Blair to promote innovation, creativity and design

The Portacel product range provides the latest technology in water disinfection systems



Products

In 1997/98, the Products division increased its operating profit by 24% to £5.6m, on turnover of £81m.

This division comprises a portfolio of companies which supply a growing range of water and wastewater products, mainly to municipal markets in the UK and abroad:

- Ashbrook Corporation and FB Leopold Company, both based in the USA, and Simon Hartley, in the UK, supply water and wastewater equipment such as valves and sludge presses
- PCI Membrane Systems specialises in municipal and industrial membrane filtration products
- T M Products supplies pipeline products and water treatment and disinfection equipment to UK water companies as well as overseas.

All these companies have improved their competitive position and are becoming favoured suppliers to many UK and US companies.

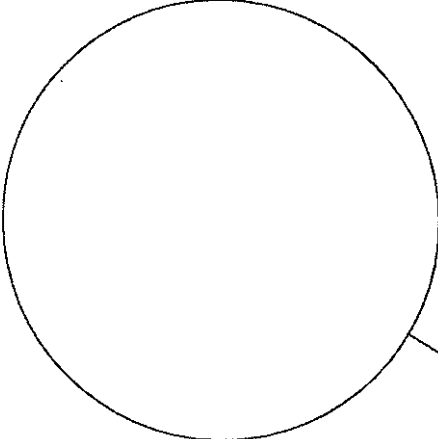
I very much appreciate the hard work and dedication of our employees who have embraced many changes in the year. I also welcome the new employees who have joined the Company.

I am confident that our unrelenting commitment to service and efficiency will enable all of our companies to continue to grow in the future.

Bill Alexander, Chief Executive

Thames Water in the community

In Thames Water, we are committed to supporting the communities in which we operate, both in the UK and overseas, through our involvement in social, educational and environmental activities.

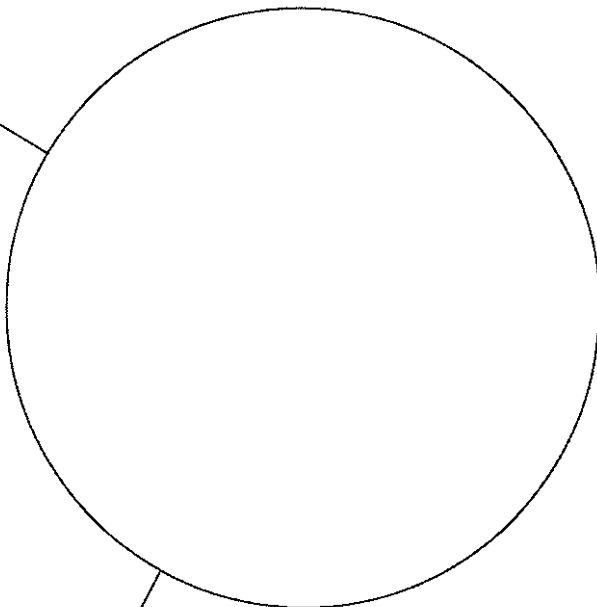


Working with local groups, we have carried out improvements at many of our reservoirs to provide bird watching facilities, including access for the disabled

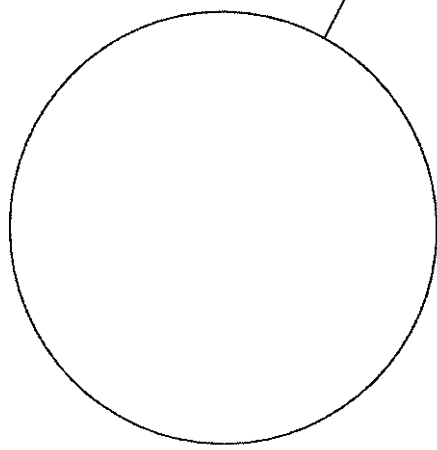
Community partners work with our employees to link operational activities with our customers by organising, supporting and participating in a range of projects which benefit the communities we serve.

Organisations within our area are encouraged to apply for sponsorship for their own projects and, over the past year, we were pleased to support 145 different initiatives. We also provide funds to match those raised by our employees for local charities.

We actively support our local schools with fund raising events, direct employee involvement in projects, and the provision of educational material in support of the National Curriculum. Our 'A' level geography resource pack was highly commended by the Geographical Association who described it as an 'innovative learning resource'.

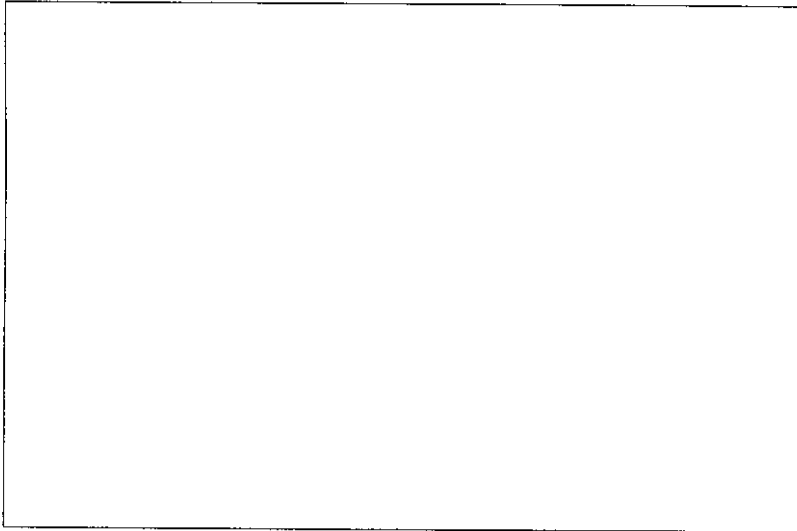


We continue to develop footpaths and cycleways on our land. The Greenway is a seven kilometre path that runs along our Northern Outfall Sewer embankment in east London

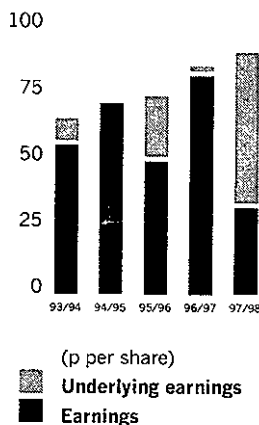


Silver and Pearls is a play, specially created by Thames Water, which helps primary schoolchildren learn about water conservation. A Silver and Pearls awards ceremony recently took place at the National Gallery in London, where we are sponsoring a 'water in art' education pack

Financial review



David Luffrum,
Finance and
Planning Director



Financial Results

Turnover of £1,389m was 8% greater than the previous year. Group operating profit increased by 9% to £481m. The operating margin of 34.6% was 0.4% higher than the 34.2% in 1997.

Profit before tax and exceptional items of £407m was £23m greater than in 1997. It is pleasing to record the non-regulated trading subsidiaries contributed profit before tax of £41m compared to £27m in 1997.

£20m of the exceptional provision made in 1996 has been released to the profit and loss account. The balance of £12m has been carried forward to cover possible residual issues which should be settled in the current year. A provision of £8m has been made in 1998 to cover the exceptional costs of the redevelopment of the Group's head office in Reading. This is predominantly a loss on the disposal of fixed assets.

The tax charge of £62m includes UK corporation tax (£59m) and overseas tax of £2m. The effective rate of tax was 15% which takes account of the availability of capital allowances from the extensive capital investment programme. The full rate of corporation tax is unlikely to apply until well after the Year 2000. The Government introduced an exceptional windfall

tax on the privatised utilities; Thames Water's share amounted to £231m.

Underlying earnings per share grew by 6% to 90.7p. Earnings per share after exceptional charges and the windfall tax reduced by 60%.

Shareholder Returns

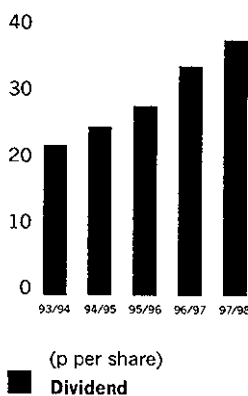
On average, there were 379.9m shares in issue during the year. This was a reduction of 2% over the previous year because of the full year effect of the 1996 share buy-back, marginally offset by the issue of approximately one million shares under the employee share participation schemes.

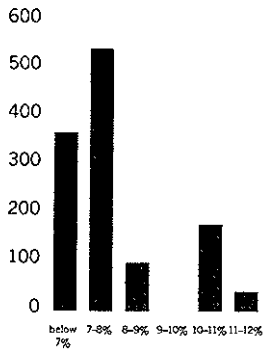
An increase in the dividend per share of 11.6% is proposed, reflecting the Board's commitment to continue its policy of real dividend growth. Full year dividends were covered 2.4 times by underlying earnings.

Before exceptional items, the return on shareholders' funds was 15.2% compared to 14.9% in 1997.

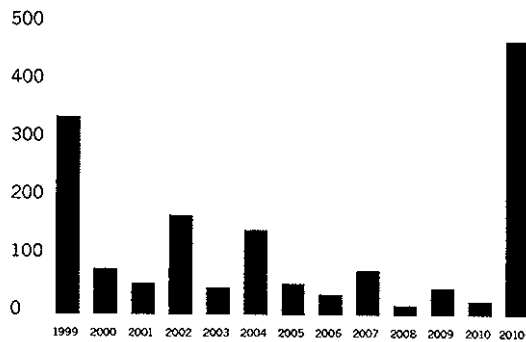
Capital Assets

Total investment in fixed assets during the year was £485m, of which £471m was in the Utility company. Total non-utility investment of £28m included equity investments of £14m in joint venture companies overseas.

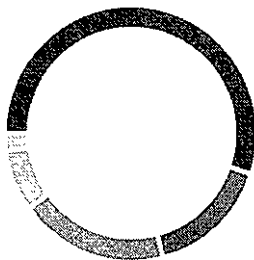




Gross debt interest rate profile £m

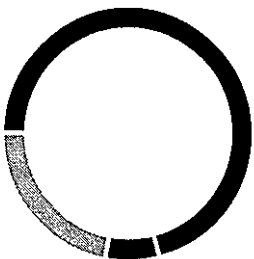


Gross debt maturity profile £m



Net cash used for

- Capital investments 55%
- Dividends 16%
- Tax 19%
- Interest 8%
- Equity investments 2%



Net cash received from

- Operating cash flow 71%
- Capital receipts 7%
- Borrowing 22%

Funding and Treasury Policy

The funding policy of the Group is to maintain a broad portfolio of debt, diversified by source and maturity. The current maturity profile of gross debt of £1,260m at 31 March 1998 is shown in the chart above.

Net debt increased by £195m to £1,085m, largely as a result of the first payment of the windfall tax (£115m) and financing for the Utility's capital investment programme. Gearing was 51% at the year end, compared with 41% at 31 March 1997.

Capital investment of £3bn has been made since privatisation. This is expected to continue at a high level at least until the end of the decade. In addition, the second instalment of the windfall tax (£116m) becomes due in December 1998.

Shareholders at the AGM are being asked to agree a resolution enabling the substitution of debt for equity capital of £300m. The latter will reduce the Group's cost of capital and enhance earnings per share.

Group treasury operations are managed centrally by a small specialist team. The objective is to ensure the availability of a timely flow of funds at a cost which reflects the credit worthiness of the Group. Treasury is managed as a cost centre, not a profit centre. Formal

statements of treasury policies and procedures are in place, which are established and monitored by the Board.

A framework of credit criteria to ensure acceptable counter-party risk across a broad range of financial transactions is regularly reviewed and adjusted from time to time.

The Group's approach to treasury management is to protect profits against risks arising from adverse movements in interest rates and currency exposures. Matching of assets and liabilities is carried out wherever practicable. Swap instruments, forward rate contracts and options in specific circumstances are used to hedge interest rate and currency risks. No material open positions are taken.

A ratio of 60% fixed rate to 40% floating rate is used as a guide in making decisions on borrowings. The percentage of floating rate debt at the year end was 32%. A proportion (14%) of floating rate debt is protected by interest rate collars.

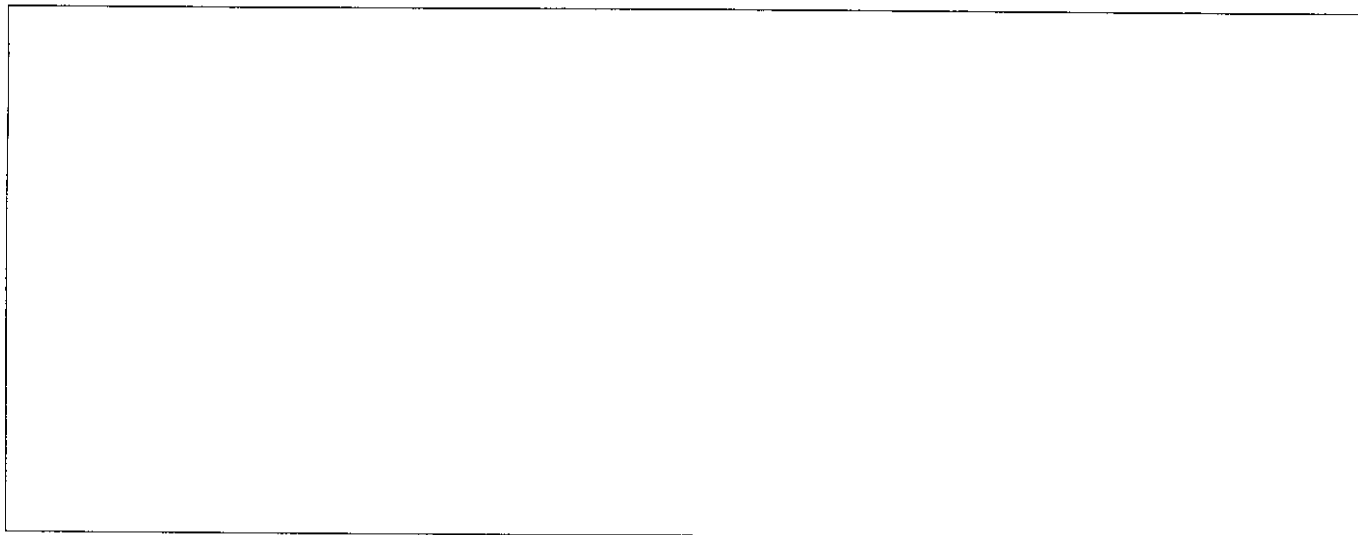
Interest costs mainly reflect the timing and life of debt raised. The weighted average interest rate of 7.6% in 1998 shows a marginal increase of 0.1%, compared to 7.5% in 1997, reflecting the firming of short-term interest rates during the second half of the year. Interest in the year was covered 6.5 times by earnings.

Going Concern

The finances of the Company are sound and the balance sheet remains strong. The Directors believe that the Group has adequate resources to continue its operational existence for the foreseeable future. For this reason, we continue to adopt the going concern basis in preparing the accounts.

David Luffrum, Finance and Planning Director

Board members



From left to right:

Roger Carr

Bill Alexander

David Badcock

Lesley Knox

Sir Robert Clarke

Sir Christopher Leaver

Tony Hobson

David Luffrum

Key to current Committee membership

- *Audit*
- *Remuneration*
- *Charities*
- *Environmental Review*
- *Nomination*
- *Share Dealing*

Executive Directors

Sir Robert Clarke (69) *Chairman* ●●

Appointed to the Board of Thames Water Authority in July 1988 and became Chairman of Thames Water Plc on 1 April 1994. From April 1996, Sir Robert has been full-time Executive Chairman. Chairman of Share Dealing and Nomination Committees.

Bill Alexander (51)

Appointed to the Board of Thames Water Plc in April 1994 and became Chief Executive in October 1997.

A Chartered Engineer, he joined Thames Water as Engineering Director in 1989 and was appointed Managing Director of Thames Water Utilities Limited in February 1992. Amongst his responsibilities was the construction of the Thames Water Ring Main.

David Luffrum (53) ●

Finance and Planning Director, was appointed to the Board of Thames Water Authority in March 1989.

He joined Thames Water Authority in 1974 and previously held financial posts in the Thames Conservancy. He became Finance Director of Thames Water Authority in 1987.

David Badcock (53) ●●

Joined Thames Water Authority as Secretary in 1986, and was appointed Secretary and Legal Director, Thames Water Utilities Limited in 1989. He became Secretary and Legal Director to Thames Water Plc in October 1995 and was appointed to the Board of Thames Water Plc in March 1998.

Non-Executive Directors

Sir Christopher Leaver GBE (60) ●●●●

Vice Chairman

Appointed to the Board of Thames Water Authority in 1983. He was Chairman of Thames Water Plc from May 1993 to March 1994. Chairman of Remuneration and Charities Committees and a member of the Audit Committee for part of the year under review. He is a Director of Pathfinder Properties Plc and Drayhawk Limited.

Roger Carr (51) ●●●

Appointed to the Board of Thames Water Plc in November 1994. He is Chief Executive of Williams PLC, a Director of Bass Plc, Newmond Plc and Landau Forte College, and a member of the CBI Economic Affairs Committee.

Tony Hobson (50) ●●●

Appointed to the Board of Thames Water Plc in November 1994. He is Group Director (Finance) of Legal & General Group Plc. Chairman of the Audit Committee.

Lesley Knox (44) ●●●

Appointed to the Board of Thames Water Plc in March 1998. She is Deputy Chairman of British Linen Bank and formerly Group Director of Kleinwort Benson Group Plc. She is also a non-Executive Director of Bank of Scotland, Scottish Provident and Dawson International Plc.

Directors' report

The Directors present their ninth Annual Report together with the audited accounts for the year ended 31 March 1998.

Principal Activities

The main activities of Thames Water Plc and its subsidiaries (the Group) are:

- water supply services, involving the abstraction of water, its treatment and distribution to customers' premises
- sewerage services, involving the collection, treatment and disposal of sewage from customers' premises, together with the conveyance and treatment of surface water
- international water and wastewater process design and operational and management contracts
- the development and manufacture of products for the treatment of water and wastewater
- waste management and environmental services
- other trading activities including insurance and property development.

A list of the principal subsidiary undertakings appears on pages 46 and 47. Details of the progress made and information relating to the various activities of the Group during the year and plans for the future are given in the Chief Executive's review on pages 4 to 10.

Profits and Dividends

The Group profit for the year attributable to shareholders was £125.7m. A review of the year's performance is included in the financial review on pages 12 and 13.

The Directors recommend payment of a final dividend of 25.9p per share, making a total for the year of 38.4p amounting to £146m.

Employees

During the year, we have involved a large number of employees at all levels in defining the Company's values and behaviours, which complement the four principles. The values are success, responsiveness, professionalism, respect for others, honesty and integrity, and challenge and innovation.

In the Utility business, new constitutional arrangements for the Company Forum and Business Unit Committees, Disciplinary and Grievance Procedures have been put in place. There are employees as Member Trustees for the three major pension schemes operated by the Group.

Thames Water is committed to contributing towards the Government's Welfare to Work initiative (New Deal). Programmes

have already been established for leakage and pipeline activities. Further programmes are planned for later in the year.

Employees had another opportunity to join or extend their interest in the Company Sharesave Scheme. Awards were made to the Executive Directors and other members of the Executive Management Team under the Long-Term Restricted Share Plan, approved by Shareholders in July 1996 (see page 20). An appropriation of shares was made to employees under the Thames Water Profit Sharing Scheme in respect of the year ended 31 March 1997. It is intended that a further appropriation will be made in respect of the year ended 31 March 1998.

Direct communication with employees was continued through the Company newspaper, conferences and team briefings.

Health and Safety

It is the policy throughout the Group to ensure that health and safety standards appropriate to local circumstances are maintained at a high level in order to protect both our employees and members of the public. All managers and employees have responsibility for implementing this policy under the guidance of the Health and Safety Manager and his team.

Employment of the Disabled

The Group recognises its responsibility for the employment, training, career development and promotion of disabled persons. Every effort is made to continue to employ those who become disabled while working for the Group.

Capital

During the year, 660,676 ordinary shares were issued to holders on the exercise of their options under the Company's Sharesave Scheme.

Options for 393,660 ordinary shares were exercised during the year under the Company's Executive Share Option Scheme. Under the Company's Profit Sharing Scheme for employees, 108,049 ordinary shares were issued.

Directors

The names of the present Directors of the Company are shown on page 14. All the Directors served on the Board throughout the financial year, except Lesley Knox and myself, who were both appointed on 1 March 1998. John Thomson and John Worlidge retired on 29 July 1997 at the Annual General Meeting. David Clementi and Bill Harper stood down from the Board on 31 August and 31 December 1997 respectively.

In accordance with Article 105, Roger Carr and Tony Hobson will retire at the forthcoming Annual General Meeting and, being eligible, will offer themselves for re-election.

In accordance with Article 87 of the Company's Articles of Association, Lesley Knox and I will retire at the forthcoming Annual General Meeting and offer ourselves for re-election.

None of the non-Executive Directors have service contracts with the Company. My service contract is subject to termination by one year's notice.

Directors' Interests in Shares

The beneficial interests of Directors and their families in shares in the Company at the beginning and end of the year are shown in the tables on pages 20 and 34 for Executive Directors and non-Executive Directors respectively. No Director had any non-beneficial interest in the shares of the Company. The only changes in the Directors' registered interests in the shares of the Company during the period from 1 April 1998 to 19 June 1998 were Lesley Knox who acquired 308 shares on 1 April 1998, and Sir Robert Clarke who acquired 578 shares on 12 June 1998. None of the Directors had any beneficial interests in the shares of any subsidiary company.

Significant Contracts

During the period under review, there were no significant contracts between the Company and any of the Directors, other than service contracts with the Executive Directors.

Substantial Shareholdings

At 19 June 1998, the Directors had been advised of notifiable interests in the issued ordinary share capital of [6.87%] by Franklin Resources, Inc and its affiliates, [3.37%] by the Capital Group Companies, Inc, [3.40%] by FINAXA S.A., AXA S.A. and their subsidiaries, and [3.0%] by the Standard Life Group.

The Directors consider that the close company provisions of the Income and Corporation Taxes Act 1988 do not apply to the Company. There has been no change in this respect since the end of the financial year.

Research and Development

The Group is committed to a programme of research and development activities. Page 6 of the Chief Executive's review highlights the main areas where research activity is undertaken.

Environment

The Directors continue to regard care for the environment as one of the fundamental guiding principles of Thames Water. The

Environmental Review Committee, whose report is on page 21, has continued its work of reviewing the Group's environmental strategy, performance and reporting systems.

Policy on Payment of Suppliers

Thames Water actively supports a number of initiatives to promote a prompt payment culture, including those proposed by the Construction Round Table and the CBI. The implementation of these principles in the Company's arrangements with its suppliers is managed by its procurement subsidiary CONNECT 2020, whilst arrangements with its contractors are managed through the Engineering Department. All payments to suppliers, service providers and contractors are made on the basis of mutually agreed terms and conditions which are established in advance of purchases.

The amount due to trade creditors at 31 March 1998 represented 39 days' purchases received from those creditors.

Political and Charitable Donations

Charitable donations amounting to £121,000 were made during the year. No donations were made for any political purposes during the year.

Auditors

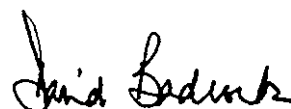
A Resolution to reappoint Coopers & Lybrand as the Company's Auditors and to authorise the Directors to determine their remuneration will be proposed at the Annual General Meeting on 28 July 1998.

Special Business

In addition to the Ordinary Business to be transacted at the 1998 Annual General Meeting, three items of Special Business will be proposed. Further details of these items, together with explanatory notes, will be found in the circular accompanying this Report and Accounts. They are:

- a Resolution renewing the power granted to Directors in July 1997 to issue equity securities for cash other than pro rata to ordinary shareholders
- a Resolution to implement a return of capital to shareholders
- a Resolution authorising the Company to make market purchases of up to 10% of the Company's issued share capital, if appropriate.

By order of the Board



David Badcock, Company Secretary
19 June 1998



Corporate governance

The Directors are pleased to confirm that, throughout the year, the Company has complied fully with all the provisions of the Cadbury Committee's Code of Best Practice. They have taken note of the final report of the Hampel Committee on Corporate Governance in January 1998 and the proposed changes to the Listing Rules published by the London Stock Exchange in March. They will keep the Group's corporate governance arrangements under review during 1998.

The Report of the Audit Committee on page 22 outlines the Group's system of internal control, for which the Board of Directors has overall responsibility. The Directors' statement on going concern appears on page 13. The Auditors' report on corporate governance matters is set out below.

The Board and Board Committees

At the close of the year under review, the Board comprised the full-time Executive Chairman, Sir Robert Clarke, Sir Christopher Leaver, our Vice Chairman and senior non-Executive Director, three Executive Directors, including Mr W J Alexander as Chief Executive, and three further non-Executive Directors.

The full Board meets monthly and monitors executive management and the performance of the major business units across the Group, in accordance with a predetermined programme. There is a formal schedule of matters reserved for decision by the Board, which

includes overall strategy, business planning, acquisitions and disposals, and approval of major projects. Detailed management information is put to each Board Meeting in a systematic manner to enable Directors to discharge their duties. One-third of all Directors retire from office each year. The Company's Annual General Meeting provides a good opportunity for Directors to report to institutional and private shareholders on its business activities and to answer their questions.

The Chairman and Directors have a full programme of meetings and consultations with institutional shareholders.

The work of the Board is supported by six committees, each of which has formal terms of reference. The reports of the Remuneration, Environmental Review and Audit Committees are shown on pages 18, 21 and 22 respectively.

The Share Dealing Committee considers all applications to deal in shares by Directors and senior employees, to meet the requirements of law and of the London Stock Exchange.

The Charities Committee makes charitable donations from a budget allocated by the Board, considers community support activities and encourages charitable fund raising by employees.

The Nomination Committee makes recommendations to the Board on Board membership and top management succession.

Report of the Auditors to Thames Water Plc on corporate governance matters

In addition to our audit of the financial statements, we have reviewed the Directors' statements on corporate governance matters above and internal financial control on page 22 concerning the Company's compliance with the paragraphs of the Cadbury Code of Best Practice specified for our review by the London Stock Exchange and their adoption of the going concern basis in preparing the financial statements. The objective of our review is to draw attention to non-compliance with Listing Rules 12.43(j) and 12.43(v).

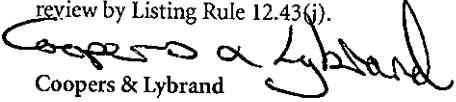
Basis of Opinion

We carried out our review in accordance with guidance issued by the Auditing Practices Board. That guidance does not require us to perform the additional work necessary to, and we do not, express any opinion on the effectiveness of either the Group's system of internal financial control or its corporate governance procedures or on the ability of the Company or Group to continue in operational existence.

Opinion

With respect to the Directors' statements on internal financial control on page 22, and going concern on page 13, in our opinion the Directors have provided the disclosures required by the Listing Rules referred to above and such statements are not inconsistent with the information of which we are aware from our audit work on the financial statements.

Based on enquiry of certain Directors and officers of the Company, and examination of relevant documents, in our opinion the Directors' statement above appropriately reflects the Company's compliance with the other aspects of the Code specified for our review by Listing Rule 12.43(j).


Coopers & Lybrand
Chartered Accountants
London 19 June 1998

Report of the Remuneration Committee

Composition and Role

The Remuneration Committee comprises all the non-Executive Directors of the Board and it met on five occasions during the year ending 31 March 1998. Those who served throughout the year were Sir Christopher Leaver (Chairman), Roger Carr and Tony Hobson. Lesley Knox was appointed with effect from 1 March 1998.

The Committee's central function is to determine the contracts of service and remuneration of the Chairman and the other Executive Directors. The fees payable to non-Executive Directors (see Note 5 to the Accounts on page 34) are determined by the Chairman and other Executive Directors without reference to the Committee.

Compliance

The Committee can confirm that the Company has complied fully with Section A of the Best Practice Provisions (annexed to the Stock Exchange Listing Rules) and further confirms that the Committee has taken into account the provisions of Section B of the Best Practice Provisions in framing its remuneration policy.

Remuneration Policy

The Company's executive remuneration policy seeks to ensure that it can attract and retain high quality Executive Directors who are pivotal to its future success and growth. It recognises the need for the Company to be competitive, both at home and increasingly in the international market. Particular attention is paid to the comparative position of companies in the water sector and the wider utility sector.

Basic Salary

The Committee determined revised salaries for the Chairman and other Executive Directors with effect from the annual pay review on 1 July 1997:

Sir Robert Clarke	£243,636
Mr W J Alexander	£192,500
Mr D J Luffrum	£156,000
Mr W R Harper	£114,500

The increase in salaries (4%) acknowledged the contribution by each Executive Director to the Company's performance in the year and was in line with the average increase for the Company's executive group.

On 24 September 1997, the Company announced the promotion of Mr Alexander as Chief Executive. In the light of his appointment, the Committee, having taken advice on prevailing salary levels, agreed to increase his basic salary to £250,000 from 1 October 1997.

On 20 February 1998, the Committee determined the salary of Mr Badcock (Company Secretary and Legal Director) at £115,000 to reflect the increased responsibilities on his promotion to the Board on 1 March 1998.

Incentive Plans

The Committee's policy is to provide a mixture of short-term and longer-term incentives to align the Executive Directors with the Company's strategic plans and the interests of its shareholders and customers. The performance criteria adopted are intended to be easy to understand and subject to external validation wherever possible. A key feature of the design of the Incentive Plans is that achievement of the targets would represent a significant step change in Company performance.

In addition to basic salary, the Executive Directors participate in short-term (annual) and long-term (four years) Incentive Plans. The Chairman does not participate in either Plan.

The Annual Cash/Share Bonus Plan provides for a maximum award of 30% of basic salary. The targets for the bonus plan are set by the Committee and comprise financial performance criteria which are set above budgeted performance levels and customer service performance measures which are monitored by external agencies. Two-thirds of the bonus is awarded in cash and one-third in conditional rights to shares. The bonus is non-pensionable.

For 1997/98, provisional awards were made to Executive Directors of 22.6% of basic salary. Two-thirds of the award is payable in July 1998 and the remaining one-third will be awarded in conditional rights to shares which will not normally vest until August 2001 (see table on page 20). The awards reflected significant outperformance of both planned profit and customer service targets.

The Long-Term Restricted Share Plan replaced the Executive Share Option Scheme and has operated since 1996. Performance is measured by reference to total shareholder return over a four-year period against a comparator group comprising eight water and sewerage companies. In 1997, the Committee agreed to increase the award in shares from 20% to 25% of basic salary in recognition of the Company's improving financial and operational performance. The Plan provides for a 'ceiling' award of 30% which is at the lower end of Plans adopted by companies in the comparator group.

The Company's underlying financial performance is a key factor for the Committee in deciding whether or not to make a conditional award of shares and, if so, its size. Other factors taken into account at that stage include the Company's physical performance and the progress made in achieving improvements in customer service. Beneficial vesting of the shares is conditional upon comparative performance over the four-year period. Full vesting is achieved should the Company be placed first or second in the comparative ranking. Achievement of third or fourth place would qualify for one-half and one-quarter of the award respectively. The award lapses if the Company is placed fifth or below.

Pensions and other Benefits

The Company's policy is to offer Executive Directors and Senior Executives membership of the Senior Executive Pension Scheme. This scheme provides a 'top up' arrangement for benefits that accrue through membership of the contributory Thames Water Pension Scheme.

The Senior Executive Pension Scheme is a funded, Inland Revenue approved, final salary, occupational pension scheme which, together with the contributory scheme, has the following features applicable to Executive Directors:

- a normal retirement age of 60;
- an accrual rate of 1/30th per year of pensionable service subject to an overall pension at normal retirement age of two-thirds of final pensionable salary;
- life cover of four times pensionable salary;
- pensions payable in the event of ill health; and
- spouse's pension on death.

All of the pension scheme benefits are subject to Inland Revenue limits. Where benefit entitlements are restricted by Inland Revenue rules, then supplementary arrangements are in place. Separate arrangements exist for Mr Alexander and details are shown following this report.

Executive Directors are eligible to participate in the Company's arrangements for executive benefits which include the provision of a fully expensed car, membership of private medical and insurance schemes, a financial advisory service and the reimbursement of business telephone charges.

No changes were made to the structure of other benefits but the value of car benefits was increased in line with the scales issued by the Inland Revenue.

Service Contracts

Sir Robert Clarke's service contract comes to an end on his retirement in March 1999.

Service contracts for the other Executive Directors are subject to one year's notice. This followed a reduction from three years' to two years' notice in 1994 and a further reduction to one year in 1996. In the event of termination without due notice, a payment of compensation will be made representing one year's total remuneration.

Full details of the remuneration, pension arrangements and the interests in shares of the Executive Directors in 1997/98, compared with the previous year's figures, are shown immediately following this report.

Sir Christopher Leaver, Committee Chairman

Executive Directors' Remuneration – year ended 31 March 1998

Executive Director	Salary £000	Annual bonus			1998 Total £000	Salary £000	Annual bonus			1997 Total £000
		Cash £000	Deferred £000	Other benefits £000			Cash £000	Deferred £000	Other benefits £000	
Sir Robert Clarke	241	–	–	14	255	234	–	–	13	247
W J Alexander	219	33	16	9	277	185	33	16	8	242
D Badcock (from 1.3.98)	10	1	1	2	14	–	–	–	–	–
W R Harper (left 31.12.97)**	85	19	–	10	114	108	19	10	10	147
D J Luffrum	170*	23	12	15	220	149	26	13	9	197
Totals	725	76	29	50	880	676	78	39	40	833

* Includes an ex gratia payment of £15,000 (non-pensionable) for additional responsibilities assumed during Mr Alexander's absence.

** Mr Harper received £185,000 by way of compensation for early termination of his contract. This represented one year's salary and benefits (including a pension credit) discounted to reflect the period of notice given.

Pensions

All Executive Directors, except Sir Robert Clarke, are members of the Thames Water Pension Scheme (the 'main' Scheme) and the Senior Executive Pension Scheme. The disclosure below is based upon the accrued benefits method and the amounts shown represent the annual pension accrued within the two schemes and payable on retirement at age 60, based upon each Executive Director's pensionable service to date, current pensionable salary and any benefits transferred in from previous employers.

Executive Director	Age at 31.03.98	Pensionable service at 31.03.98	Executive Directors' contributions in year to 31.03.98 ⁽¹⁾ £000	Increase in accrued pension during the year to 31.03.98 ⁽²⁾ £000	Accumulated total accrued pension at 31.03.98 ⁽³⁾ £000
W J Alexander	51	8 years	6	1	12
D Badcock	53	30 years	3	6	52
D J Luffrum	53	35 years	5	2	90

Notes:

- 1 The pension entitlement shown is that which would be paid annually on retirement, based on pensionable service to 31 March 1998 and the contributions shown are those paid by the Executive Directors under the terms of the main Scheme in the year to 31 March 1998.
- 2 The increase in accrued pension during the year to 31 March 1998 excludes any increase for inflation. Pension increases are pre-funded in line with inflation.

Notes continued:

- 3 Members of the main Scheme have the option to pay Additional Voluntary Contributions; neither the contributions nor the resulting benefits are included in the above table.
- 4 Spouses' pensions following death in retirement are payable equal to 50% of the Executive Directors' pensions before the exercise of any cash option.
- 5 Sir Robert Clarke has an executive pension plan to which a contribution of £18,000 pa is made through a salary sacrifice arrangement. The pension plan assumes a normal retirement age of 70 and the benefits will be those that can be provided from the value of the fund at the time.
- 6 Mr Alexander is entitled to a pension on retirement at age 60 of 58% of his pensionable salary in the last fiscal year prior to retirement less benefits in his previous employer's pension schemes. This commitment will be met by a combination of funded pensions through the main Scheme, the Senior Executive Pension Scheme and an arrangement provided by an annual charge to the profit and loss account. For the year to 31 March 1998, this amounted to £208,000 (1997: £111,000), the increase resulting from Mr Alexander's salary revision following his appointment as Chief Executive on 1 October 1997. The total provision at 31 March 1998 was £413,000.
- 7 Mr Luffrum and Mr Badcock are entitled to a pension on retirement at age 60 of two-thirds of pensionable salary in the last fiscal year prior to retirement. The pension will be funded from the main Scheme and the Senior Executive Pension Scheme.
- 8 Mr Harper drew pension benefits from the main Scheme from 1 January 1998.
- 9 In the year ended 31 March 1998, the Company made an unfunded pension payment of £14,942 (1997: £14,607) to Mr Hoffman, a former Executive Director.

Executive Directors' Interests in Shares

Ordinary Shares and Executive Share Options

Executive Director	Ordinary Shares		1997 Number	1998 Number	Executive Share Options		Date when exercisable	Expiry date
	31.03.97 Number	31.03.98 Number			Notional value £000	Exercise price		
Sir Robert Clarke	6,306	7,088	—	—	—	—	—	—
W J Alexander	14,682	14,722	18,000	18,000	122.9	347p	02.07.94	July 2001
			31,000	31,000	189.7	418p	24.06.95	June 2002
			22,000	22,000	126.9	453p	08.12.97	Dec 2004
D J Luffrum	36,643	36,683	18,000	18,000	103.9	453p	08.12.97	Dec 2004
W R Harper	11,788	—	22,000	—	—	347p	Exercised 06.01.98 (see note 3)	
			11,000	—	—	356p		
			9,000	—	—	453p		
D Badcock	1,896	1,936	10,000	10,000	57.7	453p	08.12.97	Dec 2004
			14,000	14,000	65.8	560p	08.12.98	Dec 2005

Notes:

- 1 Following the adoption of the Long-Term Restricted Share Plan at the 1996 AGM, no further Executive Share Options will be granted to Executive Directors.
- 2 i) No Executive Share Options granted to Executive Directors lapsed during the year.
ii) The notional value of the Executive Share Options is based on the difference between the market price of the Company's shares at the close of business on 12 June 1998 (1030p) and the exercise price. The share price ranged from 657.5p to 972.0p during the year.
- 3 On 6 January 1998, Mr Harper (a former Executive Director) exercised options under the Executive Share Option Scheme on 42,000 shares. The mid-market price on the date of exercise was 895p.
- 4 Under the Thames Water Sharesave Scheme, which is available to Executive Directors and all employees, Sir Robert Clarke had 4,097 options at 31 March 1998 (1997: 4,097). The exercise price of these options is 421p. Mr Luffrum had 2,205 options at 31 March 1998 (1997: 2,205) and the exercise price of these options is 442p. Mr Badcock had 4,637 options at 31 March 1998 (1997: 4,637) and the exercise price of these options is 372p.

Incentive Plans

Long-Term Restricted Share Plan

Executive Director	Date of award	Number of shares (maximum)	Earliest vesting date
W J Alexander	02.08.96	6,941	01.04.2000
	09.07.97	6,525	01.04.2001
D Badcock	09.07.97	1,932	01.04.2001
D J Luffrum	02.08.96	5,628	01.04.2000
	09.07.97	5,288	01.04.2001
W R Harper (left 31.12.97)	02.08.96	See note 1	—

Notes:

- 1 Under the terms of the Long-Term Restricted Share Plan, the Committee exercised their discretion to release from trust a proportion (1,806) of the 4,127 shares awarded to Mr Harper. In exercising their discretion, the Committee had regard to the period that had elapsed and the Company's comparative performance, assessed by total shareholder return, from 1 April 1996 to the date of his leaving. Rights to the remaining 2,321 shares have lapsed.

Annual Cash/Share Bonus Plan

Executive Director	Date of award	Number of shares	Notional value (note 1) £000	Earliest vesting date
W J Alexander	09.07.97	2,237	23.0	09.07.2000
D J Luffrum	09.07.97	1,815	18.7	09.07.2000
W R Harper (left 31.12.97)	09.07.97	1,319	—	Released from trust Jan 1998

Notes:

- 1 The notional value of the shares is based upon the market price of the Company's shares at the close of business on 12 June 1998 (1030p).
- 2 Under the terms of the Annual Cash/Share Bonus Plan, 1,319 shares were released from trust to Mr Harper following the date of his leaving.

Report of the Environmental Review Committee

The Environmental Review Committee, comprising Sir Christopher Leaver, Lesley Knox, John Sexton (Environment Director) and myself, reviews the Company's environmental strategy, performance and reporting systems. Our sixth Environmental Review, setting out fuller details of the Company's performance during the financial year, is now available from the Customer Centre.

This was a year of continued improvement in performance. Once again, the Company was placed in the top quintile of the FTSE-100 companies surveyed in Business in the Environment's index of environmental engagement. It is hoped to further improve performance through initiatives such as the environmental commitment programme launched this year, which seeks to ensure environmental issues are identified and managed in a systematic way across the whole of the Company's operations, including the overseas and non-regulated businesses.

The Company is aware of the importance sustainability must play in guiding the business forward and the opportunity has been taken to set out the key issues of relevance to a water utility. To help understand the complex issues of sustainability, the Company is working with Forum for the Future and the Environment Council.

Water Supply

Despite another dry year, it was pleasing that the Company was able to maintain supplies to customers without imposing restrictions. This was due to both operational improvements and the timely negotiation with the Environment Agency of a more customer and environmentally friendly revised operating agreement for Lower Thames abstractions. The Company's water efficiency campaign continues to raise customer awareness of the importance of conserving this precious resource. The drive to reduce leakage from the Company's pipes continues and, during the year, average leakage was 881 million litres per day (Ml/d) – a reduction of over 119 Ml/d from last year.

Fuelled by exceptionally low groundwater levels and growing public awareness, last year saw an increase in the number of low flow issues. Working with the Environment Agency, the Company assesses the impact of abstractions and looks for practical solutions.

The quality of drinking water improved again this year, with 99.8% of tests meeting regulatory standards – our highest ever achievement.

The Company is looking at the growing problem of rising groundwater under London, with a view to maximising its use as a source of drinking water, where feasible.

Wastewater

Compliance with the Environment Agency's wastewater treatment works effluent discharge consents has reached an all time high with over 99.9% compliance. Additionally, to assist the Environment Agency during the drought conditions, many plants have been operated to a much higher effluent quality than normally required, so as to help mitigate the effects of very low river flows. Finally, a further 17 sites have been upgraded to meet the new quality requirements, as agreed in the 1994 price review, which will result in a more normal river flow regime, when the benefits of these investments will be clearly apparent.

Regrettably, Thames Water was prosecuted four times for causing pollution as a result of equipment failures or blockages. Remedial action has been taken at the sites to ensure that such incidents do not happen again.

Global Warming

Following the signing of the Kyoto Protocol to the UN Framework Convention on Climate Change, emissions of greenhouse gases from industry are gaining closer scrutiny. The Company has undertaken a desktop study to review the emissions of these gases from its processes. The majority of emissions originate from energy used in the pumping of drinking water and wastewater. Details of emissions and the actions to reduce them are provided in the Environmental Review 1998.

Biodiversity and Public Access

Biodiversity is the variety of life on earth. The UK Biodiversity Action Plan identifies threatened species and habitats and sets targets on action to save them, including action plans for wetland protection. 32 projects have been carried out to establish wetlands and enhance sites this year. One example of a wetland created is at Swindon wastewater treatment works, complementing the existing lagoon area. It has been designed to include gravel islands to provide safe nesting areas for the Little Ringed Plover. Further details of this and other schemes can be found in the 1998 Conservation, Access and Recreation Report.

The Company was presented with a Mars and Berkshire Environment Award for the fourth year running, for environmental initiatives such as water conservation and waste minimisation.

Bill Harper, Committee Chairman

Report of the Audit Committee

The Audit Committee's role is to assist the Board in carrying out its responsibilities relating to internal control, external and internal audit, accounting and external reporting. Any non-Executive Board member may attend the Committee's meetings. The membership comprises three non-Executive Directors, including myself as Chairman. Membership of the Committee changed during the year along with the Chairmanship, in line with changes in the non-Executive Directors of the Board.

Each meeting of the Committee had an agenda linked to events in the Company's financial calendar.

In October 1997, we considered the interim results prior to their release. We also reviewed the report by the Company's external auditors (Coopers & Lybrand) on matters arising from their 1997 year-end audit of the accounts, including consideration of management responses to the external auditors' recommendations. The external auditors' planned approach and fee proposal for the audit of the accounts for 1997/98 was also considered and agreed at this meeting. We considered the fees for non-audit services provided by Coopers & Lybrand during the preceding year and concluded that

they were reasonable in relation to the audit fee and did not impair the external auditor's independence.

At the meeting in January 1998, we received a report from management on progress in addressing matters raised in both internal and external audit reports. Plans to optimise the liaison and matching of resources between internal and external audit were considered and will remain a point of focus.

In April 1998, we considered the principal accounting policies to be adopted for the 1997/98 financial accounts. We reviewed a report on the work of the internal audit department for that year and agreed the department's programme for 1998/99. We considered a report detailing the results of the internal control self-certification questionnaires as completed by each business unit.

In May and June, the Committee met on two occasions to review the annual external financial reporting.

Tony Hobson, Committee Chairman

Internal financial control

The Board of Directors has overall responsibility for the framework of internal financial control throughout the Group, which is designed to provide reasonable, but not absolute, assurance against material misstatement or loss. These controls are established in order to safeguard the Group's assets and to maintain proper accounting records so that reliable financial information is provided.

The framework of financial controls is as follows:

- The Group has in place an organisational structure with clearly defined lines of authority and accountability. This is supported by a Corporate Policies and Procedures manual which is reviewed and updated annually. The manual contains, *inter alia*, sections setting out policies and procedures to be followed in business planning, capital expenditure approval, sales tenders, treasury management, insurance and risk management. There are comprehensive policies and procedures in place which cover authorisation, segregation of duties, recording of data and physical security.
- Risk areas are reviewed on a regular basis by executive management and key risks and risk management programmes are reported to the Board.
- The Group operates a comprehensive annual budget and

financial reporting system which compares profits and cash performance with budget on a monthly basis. Revised forecasts for the year are prepared quarterly. At each monthly meeting, the Board reviews the performance of the major business units across the Group.

- The Group has clear policies for the approval and control of expenditure. Capital and revenue expenditure are subject to formal detailed appraisal and review, according to approval levels set by the Board.
- The Group has an established internal audit department which carries out reviews of business and control procedures as part of a broadly based programme of work. This internal audit programme is constructed using risk assessment techniques to develop an appropriate cycle of activity reviews, having regard to the key aspects of the business. The plans and results of internal audit reviews are reviewed by the Audit Committee on a regular basis.
- On behalf of the Board, the Audit Committee reviews the effectiveness of the system of internal financial control. This includes a supervised self-assessment by the business units, through which they are required to confirm compliance with control objectives.

Statement of the Directors' responsibilities

for the preparation of the financial statements

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

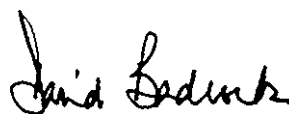
- select suitable accounting policies and then apply them consistently
- make judgements and estimates that are reasonable and prudent
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements
- prepare the financial statements on the 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 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 Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

By Order of the Board



David Badcock, Company Secretary

19 June 1998

Report of the Auditors to the members of Thames Water Plc

We have audited the financial statements on pages 24 to 47.

Respective Responsibilities of Directors and Auditors

As described above, the Company's Directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of Opinion

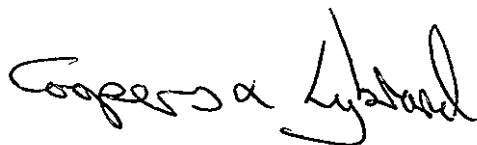
We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in preparation of the financial statements, 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 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 of the state of affairs of the Company and the Group at 31 March 1998 and of the profit, total recognised gains and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.



Coopers & Lybrand

Chartered Accountants and Registered Auditors

London

19 June 1998

Consolidated profit and loss account

Year ending 31 March	Note	1998			1997		
		Continuing operations £m	Discontinued operations £m	Total £m	Continuing operations £m	Discontinued operations £m	Total £m
Turnover							
– Group and share of joint ventures		1,410.3	5.9	1,416.2	1,264.9	33.8	1,298.7
– Share of joint ventures turnover		(27.2)	–	(27.2)	(11.3)	–	(11.3)
– Group turnover	3	1,383.1	5.9	1,389.0	1,253.6	33.8	1,287.4
Operating costs	4	(916.5)	(14.8)	(931.3)	(824.8)	(41.8)	(866.6)
Other operating income	6	10.8	3.3	14.1	11.6	–	11.6
Utilisation of discontinued business provision	2	–	5.5	5.5	–	7.6	7.6
Group operating profit		477.4	(0.1)	477.3	440.4	(0.4)	440.0
Share of operating profit in joint ventures		3.3	–	3.3	0.7	–	0.7
Operating profit		480.7	(0.1)	480.6	441.1	(0.4)	440.7
Non-operating exceptional items:							
– Reading office redevelopment	2	(8.3)	–	(8.3)	–	–	–
– Loss on sale/closure of discontinued operations	2	–	(0.7)	(0.7)	–	(51.0)	(51.0)
– Release/utilisation of discontinued business provision	2	–	20.7	20.7	–	51.0	51.0
Profit on ordinary activities before interest and taxation							
	3	472.4	19.9	492.3	441.1	(0.4)	440.7
Interest	7			(73.7)			(56.7)
Non-recurring premium on the repurchase of Convertible Bonds				–			(12.2)
Profit on ordinary activities before taxation	3			418.6			371.8
Taxation on profit on ordinary activities	8			(62.2)			(51.4)
Windfall tax	9			(230.7)			–
Profit for the financial year	24			125.7			320.4
Dividends on equity shares	12/24			(146.2)			(132.0)
(Deficit)/retained profit transferred from/to reserves				(20.5)			188.4
Earnings per ordinary share	13			33.1p			82.8p
Non-recurring premium on the repurchase of Convertible Bonds				–			2.7p
Non-operating exceptional items				(3.1p)			–
Windfall tax				60.7p			–
Adjusted earnings per ordinary share	13			90.7p			85.5p

There is no difference between the profit on ordinary activities before taxation and the (deficit)/retained profit transferred from/to reserves for the year stated above and their historical cost equivalents.

Statement of recognised gains and losses

Year ending 31 March	1998 £m	1997 £m
Profit for the financial year	125.7	320.4
Currency translation differences	(2.2)	5.6
Advance corporation tax on the repurchase of shares	–	(44.9)
Total recognised gains for the financial year	123.5	281.1

Consolidated and Company balance sheets

At 31 March	Note	1998		1997		1997	
		£m	£m	£m	£m	Group	Company
Fixed assets							
Tangible assets	14		3,710.4		3,387.9	0.3	0.7
Investments in joint ventures:							
– Share of gross assets		178.3		81.0			
– Share of gross liabilities		(137.8)		(53.3)			
		40.5		27.7			
Investments in associates		6.8		6.6			
Fixed asset investments	15		47.3		34.3	1,291.9	955.6
			3,757.7		3,422.2	1,292.2	956.3
Current assets							
Stocks and work in progress	16		34.4		25.3	–	–
Debtors	17		285.2		306.4	294.9	104.6
Investments	18		100.4		134.1	23.2	33.3
Cash at bank and in hand			74.8		68.7	25.1	22.1
			494.8		534.5	343.2	160.0
Creditors: amounts falling due within one year	19		(1,067.2)		(864.7)	(562.6)	(410.8)
Net current liabilities			(572.4)		(330.2)	(219.4)	(250.8)
Total assets less current liabilities			3,185.3		3,092.0	1,072.8	705.5
Creditors: amounts falling due after more than one year	20		(979.6)		(839.5)	(182.9)	(102.2)
Provisions for liabilities and charges	22		(58.3)		(87.0)	(0.1)	(0.1)
Net assets			2,147.4		2,165.5	889.8	603.2
Capital and reserves							
Called up share capital	23/24		380.5		379.4	380.5	379.4
Share premium	24		52.1		48.6	52.1	48.6
Capital redemption reserve	24		41.4		41.4	41.4	41.4
Profit and loss account	24		1,673.4		1,696.1	415.8	133.8
Equity shareholders' funds			2,147.4		2,165.5	889.8	603.2

The notes on pages 28 to 47 form part of these accounts.

The accounts were approved by the Board on 19 June 1998.

Sir Robert Clarke, Chairman

D J Luffrum, Finance and Planning Director



Consolidated cash flow statement

Year ended 31 March	1998 £m	1998 £m	1997 £m	1997 £m
Cash flow from operating activities (note a)		591.5		562.3
Returns on investment and servicing of finance				
Interest received	5.9		17.1	
Interest paid	(54.0)		(55.6)	
Premium on repurchase of Convertible Bonds	–		(12.2)	
Interest element of finance lease rental payments	(15.4)		(13.4)	
Net cash outflow from returns on investment and servicing of finance		(63.5)		(64.1)
Taxation				
Windfall tax	(115.4)		–	
UK corporation tax paid	(39.9)		(26.3)	
Advance corporation tax on the purchase of shares	–		(44.9)	
Overseas tax paid	(1.7)		(3.4)	
Net cash outflow from taxation		(157.0)		(74.6)
Capital expenditure and financial investment				
Purchase and tangible fixed assets	(458.3)		(365.5)	
Capital contributions received	41.6		29.3	
Sale of tangible assets	10.5		3.0	
Net cash outflow from capital expenditure and financial investment		(406.2)		(333.2)
Acquisitions and disposals				
Purchase of fixed asset investments	(14.0)		(16.1)	
Sale of business (note b)	0.9		(17.7)	
Net cash outflow from acquisitions and disposals		(13.1)		(33.8)
Equity dividends paid		(135.6)		(103.2)
Cash outflow before management of liquid resources and financing		(183.9)		(46.6)
Management of liquid resources		33.7		82.4
Financing				
Issue of shares	4.7		7.8	
Purchase of own shares	–		(226.2)	
Cash inflow from increase in debt and lease financing	129.2		185.3	
		133.9		(33.1)
(Decrease)/increase in cash during period		(16.3)		2.7

Reconciliation of net cash flow to movement in net debt

	1998 £m	1997 £m
(Decrease)/increase in cash period	(16.3)	2.7
Cash inflow from increase in debt and lease financing:		
– loans due within one year	(12.1)	(184.4)
– loans due after more than one year	(120.2)	(38.1)
– capital repayment of finance leases	3.1	1.6
– purchase of Convertible Bonds	–	35.6
Cash inflow from decrease in liquid resources	(33.7)	(82.4)
Change in net debt resulting from cash flows	(179.2)	(265.0)
Other non-cash movements:		
– new finance leases	(18.1)	(33.8)
– conversion of Convertible Bonds	–	46.2
Foreign exchange translation differences	2.2	4.5
Net debt at 1 April	(195.1)	(248.1)
Net debt at 31 March	(889.5)	(641.4)
	(1,084.6)	(889.5)

Notes to the cash flow statement

a Reconciliation of operating profit to operating cash flow	1998 £m	1997 £m
Operating profit	492.3	440.7
Depreciation	117.4	108.1
(Increase)/decrease in stocks	(9.2)	15.7
Decrease/(increase) in debtors	27.9	(45.4)
(Decrease)/increase in creditors	(6.2)	60.1
(Decrease)/increase in long-term provisions	(28.7)	(16.3)
Other	(2.0)	(0.6)
Net cash inflow from operating activities	591.5	562.3

Of the net cash inflow from operating activities, £5.7m (1997: £10.5m) is in respect of cash outflows from non-operating exceptional items.

b Sale of businesses	1998 £m	1997 £m
Tangible fixed assets	0.2	1.2
Stocks	0.1	(1.2)
Debtors	0.2	20.7
Creditors	–	(24.5)
Net assets	0.5	(3.8)
Gain/loss on disposal	0.4	(13.9)
Satisfied by cash/bank loans	0.9	(17.7)

The cash flows of the businesses sold during the year were not material to the Group. The subsidiary undertakings sold during 1997 utilised £7.3m of the Group's operating cash flows, received £0.1m in respect of net returns on investments and servicing of finance and paid £0.1m in respect of capital expenditure.

c Analysis of net debt	at 1 April 1997 £m	Cash flow £m	Other non-cash movements £m	Exchange movements £m	at 31 March 1998 £m
Cash in hand	68.7	6.1	–	–	74.8
Bank overdraft	(49.1)	(22.4)	–	–	(71.5)
Net cash	19.6	(16.3)	–	–	3.3
Loans due within one year	(249.4)	(12.1)	–	–	(261.5)
Loans due after more than one year	(542.4)	(120.2)	–	2.2	(660.4)
Finance leases	(251.4)	3.1	(18.1)	–	(266.4)
Liquid resources	134.1	(33.7)	–	–	100.4
	(889.5)	(179.2)	(18.1)	2.2	(1,084.6)

The Group includes as liquid resources term deposits of less than one year and fixed and floating interest rate securities.

d Major non-cash transactions

During the year, the Group raised finance leases amounting to £18.1m to fund capital plant, equipment and vehicles.

Notes to the accounts

1 Principal accounting policies

A summary of the more important Group accounting policies together with an explanation of where they have not been applied consistently, is set out below:

Change in accounting policy

FRS9 'Associates and Joint Ventures' and FRS10 'Goodwill and Intangible Assets' were issued in November and December 1997 respectively. FRS9 is effective for accounting periods ending on or after 23 June 1998 and FRS10 for accounting periods on or after 23 December 1998. The Group has adopted the standards early and the revised policy for associate and joint venture companies is set out in note (g) and for goodwill in note (n). The change in goodwill policy has a negligible impact on current results.

The Group has not reinstated goodwill written off in prior periods.

a Basis of preparation

The accounts have been prepared in accordance with the historical cost convention and with applicable accounting standards in the UK and, except for the treatment of certain capital contributions and retranslation of long-term foreign currency liabilities, with the Companies Act 1985. An explanation of these departures from the requirements of the Act is given in note 1(e) and (j) below.

b Basis of consolidation

The consolidated accounts include the accounts of the Company and all of its subsidiaries, associate 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. In the event that the accounts of undertakings are drawn up to a year end different from that of the parent company, appropriate adjustments are made to the Group accounts 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
- associate: the Group has a participating interest and exercises significant influence
- joint venture: the Group holds a long-term interest and shares control under a contractual agreement.

c 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.

d Tangible fixed assets comprise Infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs and sludge pipelines); landfill sites; and other assets (including properties, overground plant and equipment).

- Infrastructure assets comprise a network of systems. Expenditure on infrastructure assets relating to increases in capacity or enhancements of the network is treated as additions. Expenditure on maintaining the operating capability of the network in accordance with defined standards of service is charged as an operating cost and is classified as infrastructure renewals expenditure. No depreciation is charged on infrastructure assets because the network of systems is required to be maintained in perpetuity and therefore has no finite economic life.
- Landfill sites are included at cost less accumulated depreciation. The provision for depreciation is based upon the average cost per cubic metre of void space consumed from the deposit of waste. Provision is made for site restoration where it is anticipated that expenditure will be required at the end of the life of the site.
- 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 | 30–60 years |
| Fixed and mobile plant | 20–40 years |
| Vehicles, computers, fixtures and fittings | 4–10 years |

Notes to the accounts

1 Principal accounting policies (*continued*)

- e 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 which 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 accounts to give a true and fair view because infrastructure assets do not have a finite life and are not depreciated. Accordingly, related capital contributions would not be recognised in the profit and loss account. The effect of the departure on the value of tangible fixed assets is disclosed in note 14.

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 useful lives of the assets.

f Leased assets

Where assets are financed by leasing arrangements which transfer substantially 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 generally depreciated over the shorter of their estimated useful lives and the lease period.

All other leases are regarded as operating leases. Rental costs arising under operating leases are expensed in the year in which they are incurred.

g Investments

Fixed asset investments

- In the accounts of the Company investments held as fixed assets are stated at cost less provisions for permanent diminution in value.
- In the Group accounts 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 based on audited financial statements for the year. In the consolidated balance sheet, the interests in associated undertakings and joint ventures are shown in the Group's share of the net assets, exclusive of goodwill.

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

- h 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.

i Pension costs

The majority of the Group's employees belong to pension schemes which are funded by both employers' and employees' contributions and which are of the defined benefit type. The pension cost is assessed in accordance with the advice of an independent qualified actuary to recognise the expected cost of providing pensions on a systematic and rational basis over the expected remaining service lives of employees. Any difference between the cost charged and the amounts paid by the Group is treated as a prepayment or accrual.

Notes to the accounts

1 Principal accounting policies (*continued*)

j Foreign currencies

All transactions denominated in foreign currencies are translated into sterling at the actual rate of exchange ruling on the date of transaction. Assets and liabilities, including long-term liabilities, in foreign currencies are translated into sterling at rates of exchange ruling at the balance sheet date. All exchange differences arising are dealt with in the profit and loss account. This treatment is required by Statement of Standard Accounting Practice (SSAP) Number 20 in order to give a true and fair view of the Group's results. Compliance with SSAP 20 overrides Schedule 19 Paragraph 12 of the Companies Act 1985 which states that only profits realised at the balance sheet date should be included in the profit and loss account. The effect of currency retranslation is disclosed in note 4. The results of overseas subsidiary undertakings 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.

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

l Taxation

The charge for taxation is based on the profit for the year as adjusted for disallowable and non-taxable items. Tax deferred or accelerated is accounted for in respect of all material timing differences to the extent that it is probable that a liability or asset will crystallise. Provision is made at the rate which is expected to be applied when the liability or asset is expected to crystallise.

m 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.

n Goodwill arising on acquisition, being the excess of the purchase price over the fair value of the net assets of subsidiary, joint venture and associated undertakings acquired, is capitalised and amortised over its estimated useful economic life. Impairment tests on the carrying value of goodwill are undertaken:

- at the end of the first full financial year following acquisition;
- in other periods if events or changes in circumstances indicate that the carrying values may not be recoverable.

In previous years, the accounting policy for goodwill arising on acquisition has been to write off such goodwill against reserves in the year in which it arose. In such cases, the profit or loss on disposal of a previously acquired subsidiary, joint venture or associated undertaking is determined by including the attributable amount of purchased goodwill previously eliminated against reserves.

o Interest

Interest payable is written off to the profit and loss account as it is incurred except that relating to monies borrowed to finance:

- specific long-term contracts which is included in the cost of long-term contract work in progress; interest receivable from the temporary investment of these monies is credited to the cost of long-term contract work in progress;
- the up front construction element of Build, Operate and Transfer schemes.

Notes to the accounts

2 Discontinued operations/non-operating exceptional items

The Group provided for non-operating exceptional items of £95m in the year ended 31 March 1996 following its decision to implement a managed withdrawal from stand alone design and construction activities and the development of only those products and services businesses which are closely related to core utility strengths. The provision comprises the write down of assets, reorganisation costs, and the write back of goodwill.

The provision utilised up to 31 March 1998 was £62.7m. £6.2m was incurred during the year of which £5.5m was charged to operating profit comprising turnover, operating costs, and other operating income of £5.9m, £14.7m and £3.3m respectively and £0.7m to asset write downs. There still remain some residual issues and £12.3m of the unutilised provision has been carried forward to the financial year ended 31 March 1999 to cover these items. The balance of £20m has been released to the profit and loss account.

Some Group companies, formerly engaged in design and construction activities in the Asia Pacific rim, were scheduled for sale or closure and previously classified as discontinuing activities. These companies have been transformed into process engineering, procurement and project management businesses and are now classified as continuing activities. Comparatives have been restated accordingly.

A non-operating exceptional charge of £8.3m has been made in the year to cover the loss on disposal of fixed assets incurred in redeveloping the Group's business centre in Reading.

3 Segmental analysis

The segments by class of business are:

Utilities: the regulated water and wastewater business,

International operations: international water and wastewater operations and the marketing of technical managerial services,

Products: the development and manufacture of products for the treatment of water, wastewater and industrial process fluids,

Services: the provision of underground, waste management and urban environmental services,

Other activities: those carried out by the Company in managing the Group,

Insurance and Property.

Turnover

By class of business	1998			1997		
	Intra-segment £m	Inter-segment £m	Third parties £m	Intra-segment £m	Inter-segment £m	Third parties £m
Utilities	–	2.9	1,030.4	–	7.4	990.9
International operations:						
– continuing	4.3	0.1	171.9	6.4	–	126.3
– discontinued	–	–	5.9	–	5.4	33.8
Products	1.4	5.8	73.7	1.0	6.9	63.6
Services	0.1	104.0	82.3	0.2	54.9	54.6
Insurance and Property	0.8	18.3	24.8	0.2	16.4	18.2
	<u>6.6</u>	<u>131.1</u>	<u>1,389.0</u>	<u>7.8</u>	<u>91.0</u>	<u>1,287.4</u>

Geographical segment by origin	1998			1997		
	Intra-segment £m	Inter-segment £m	Third parties £m	Intra-segment £m	Inter-segment £m	Third parties £m
UK	131.8	4.0	1,318.8	89.9	5.5	1,180.3
Continental Europe	–	–	2.3	–	–	11.6
Americas	1.0	–	39.8	1.0	–	38.2
Asia Pacific	0.8	0.1	28.1	2.3	0.1	57.3
	<u>133.6</u>	<u>4.1</u>	<u>1,389.0</u>	<u>93.2</u>	<u>5.6</u>	<u>1,287.4</u>

Notes to the accounts

3 Segmental analysis (continued)

Geographical segment by destination	1998			1997		
	Intra-segment £m	Inter-segment £m	Third parties £m	Intra-segment £m	Inter-segment £m	Third parties £m
UK	131.9	4.0	1,148.2	83.9	9.4	1,094.1
Continental Europe	-	-	159.1	2.1	-	81.7
Americas	1.0	-	44.3	1.0	-	42.0
Africa	-	-	0.9	-	-	4.0
Asia Pacific	0.7	0.1	36.5	2.3	0.1	65.6
	<u>133.6</u>	<u>4.1</u>	<u>1,389.0</u>	<u>89.3</u>	<u>9.5</u>	<u>1,287.4</u>
Profit before tax			1998 £m	1998 £m	1997 £m	1997 £m
Utilities				441.5		414.6
International operations						
- continuing			6.1		3.2	
- discontinued			(0.1)	6.0	(0.4)	2.8
Products				5.6		4.5
Services				6.4		6.5
Insurance and Property				27.0		18.9
Other activities				(3.6)		(2.5)
				<u>482.9</u>		<u>444.8</u>
Inter-segment trading				(2.3)		(4.1)
Operating profit				<u>480.6</u>		<u>440.7</u>
Non-operating exceptional items:						
- Utilities				(8.3)		-
- International operations (net)				20.0		-
Profit on ordinary activities before interest and taxation				<u>492.3</u>		<u>440.7</u>
Interest				(73.7)		(56.7)
Non-recurring premium on the repurchase of Convertible Bonds				-		(12.2)
Profit on ordinary activities before taxation				<u>418.6</u>		<u>371.8</u>
Net assets			1998 £m	1998 £m	1997 £m	1997 £m
Utilities				3,458.2		3,177.8
International operations						
- continuing			31.2		5.6	
- discontinued			(30.6)	0.6	(26.1)	(20.5)
Products				15.0		15.2
Services				17.4		(5.7)
Insurance and Property				4.0		15.5
Other activities				(263.2)		(127.3)
				<u>3,232.0</u>		<u>3,055.0</u>
Net debt				<u>(1,084.6)</u>		<u>(889.5)</u>
Net assets				<u>2,147.4</u>		<u>2,165.5</u>

Notes to the accounts

3 Segmental analysis (*continued*)

By geographical segment	Profit/(loss) before tax		Net assets/(liabilities)	
	1998 £m	1997 £m	1998 £m	1997 £m
UK	474.6	434.1	3,198.2	3,051.2
Continental Europe	(0.2)	0.7	(3.0)	(17.2)
Americas	3.0	3.2	10.7	8.0
Asia Pacific	3.2	2.7	26.1	13.0
	480.6	440.7	3,232.0	3,055.0
Non-operating exceptional items:				
UK	11.7	–		
	492.3	440.7		
Interest	(73.7)	(56.7)		
Non-recurring premium on the repurchase of Convertible Bonds	–	(12.2)		
Net debt			(1,084.6)	(889.5)
	418.6	371.8	2,147.4	2,165.5

Segmental result before tax and net assets of joint venture and associated undertakings are not separately disclosed since they are not material to the Group.

4 Operating costs

Analysis of operating costs by type of expense	1998 £m	1998 £m	1997 £m	1997 £m
Manpower		239.1		234.5
Materials and consumables		215.6		139.2
Other operating charges		330.0		350.3
Infrastructure renewals charge		39.4		38.4
Depreciation:				
– owned assets	106.5		97.6	
– assets held under finance leases	10.9	117.4	10.5	108.1
Rentals under operating leases:				
– hire of plant and machinery	5.3		7.4	
– other	4.8	10.1	3.8	11.2
Research and development		9.0		8.4
Auditors' remuneration in respect of:				
– audit work	0.6		0.6	
– other statutory and regulatory requirements	0.1		0.1	
– non-audit work: UK	0.2		0.2	
: overseas	–	0.9	–	0.9
Foreign currency losses/(gains)		1.6		(2.0)
Own work capitalised		963.1		889.0
		(31.8)		(22.4)
		931.3		866.6

Notes to the accounts

4 Operating costs (continued)

- Included in other operating charges and manpower are costs of £14.8m (1997: £3.0m) and nil (1997: £4.6m) which have been offset by the utilisation of the discontinued business provision made in 1996 (see note 2).
- £0.9m (1997: nil) was paid to Coopers & Lybrand during the year in respect of information systems consultancy which has been capitalised.
- Included in auditors' remuneration is £85,000 in respect of audit fees incurred by the Company in 1998 (1997: £82,000).

5 Information regarding Directors and employees

The Company's policy regarding the remuneration of the Chairman and Executive Directors is set out in the report of the Remuneration Committee on pages 18 to 20, together with details of the remuneration of individual Executive Directors and their shareholdings in the Company on pages 19 and 20.

The remuneration for non-Executive Directors consists of fees for their services in connection with Board and Board Committee meetings. Fees are reviewed biennially by the Chairman and Executive Directors and were increased from £19,500 to £21,500 from 1 July 1997. In the case of Sir Christopher Leaver, fees receivable in his role as Vice Chairman increased from £45,000 to £49,600 with effect from 1 July 1997. The review used external comparative data for companies of a similar size. Non-Executive Directors do not have contracts of service, are not eligible for pension scheme membership and do not participate in any of the Company's bonus, long-term incentive schemes or other benefits.

Non-Executive Directors:	Fees		Number of Shares at 31 March	
	1998 £000	1997 £000	1998	1997
Sir Christopher Leaver	48	45	4,537	4,537
R M Carr	21	19	3,000	3,000
D C Clementi (retired 31 August 1997)	8	5	–	1,000
A J Hobson	21	19	1,000	1,000
L M S Knox (appointed 1 March 1998)	2	–	–	–
J M Thomson (retired 29 July 1997)	7	19	–	2,000
E J Worlidge (retired 29 July 1997)	7	19	–	2,521
Directors' remuneration in total			1998	1997
			£000	£000
Fees for non-Executive Directors			114	128
Remuneration of Executive Directors (see page 19)			880	833
Gains on the exercise of share options (see page 20)			220	139
Company pension contributions to money purchase schemes			18	18
Compensation for loss of office			185	–
Payments to former Director			15	15

Retirement benefits are accruing to one Director on a salary sacrifice money purchase pension scheme and to three Directors under a defined benefit scheme.

Transactions with Directors and officers

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

Notes to the accounts

5 Information regarding Directors and employees (*continued*)

Employee information	1998 £m	1997 £m
Group employment costs including Executive Directors' remuneration were:		
– Salaries and wages	217.1	210.4
– Social security costs	19.7	18.8
– Pension contributions (note 27)	8.8	10.6
	<u>245.6</u>	<u>239.8</u>

Total employment costs contain £4.7m (1997: £3.7m) and £1.8m (1997: £1.6m) which are included in the infrastructure renewals charge and research and development costs respectively in note 4.

Average monthly number of persons employed by the Group, including Executive Directors	1998 number	1997 number
Utilities	5,761	5,912
International operations	968	1,397
Products	663	605
Services	3,487	2,976
Property and Insurance	76	47
Other activities	40	64
	<u>10,995</u>	<u>11,001</u>

6 Other operating income

	1998 £m	1997 £m
Realised/unrealised gains and losses on fixed interest short-term investments	4.6	3.1
Insurance investment income	4.4	3.9
Net rents receivable	1.3	1.4
Miscellaneous	3.8	3.2
	<u>14.1</u>	<u>11.6</u>

7 Interest

	1998 £m	1997 £m
Bank loans, overdrafts and other loans:		
– Repayable within five years otherwise than by instalments	(22.0)	(10.1)
– Repayable within five years by instalments	(2.6)	(2.8)
– Not wholly repayable within five years	(45.5)	(45.1)
Finance charges in respect of finance leases	(15.4)	(13.4)
Other finance charges	–	(0.2)
Interest payable and similar charges	(85.5)	(71.6)
Interest receivable	11.8	14.9
	<u>(73.7)</u>	<u>(56.7)</u>

Notes to the accounts

8 Taxation on profit on ordinary activities

	1998 £m	1997 £m
UK corporation tax on income at 31% (1997: 33%)	66.8	38.4
Overseas taxation	1.7	3.5
Advance corporate tax written off	35.4	31.1
Prior years advance corporate tax relieved	(42.8)	(21.6)
Share of tax of joint venture companies	1.1	—
	<u>62.2</u>	<u>51.4</u>

9 Windfall tax

In accordance with the Finance (No 2) Act 1997 enacted on 31 July 1997, £230.7m has been charged to the profit and loss account in respect of the windfall tax of which £115.4m was paid on 1 December 1997. The balance of £115.3m will be paid on 1 December 1998.

10 Deferred taxation

The Group's medium and long-term plans for capital investment indicate that for the foreseeable future, the amount of tax allowances in respect of eligible plant and machinery will exceed the depreciation on existing and new assets. Accordingly, no provision for deferred taxation is required in the Group accounts. If a provision for deferred tax had been made on the full liability method, there would have been a corporate tax charge of £79.5m (1997: £121.9m).

An analysis of amounts unprovided is as follows:	1998 £m	Group 1997 £m
Accelerated capital allowances:		
– Infrastructure assets	305.0	302.5
– Other assets	366.3	354.2
Other timing differences	(5.8)	(3.9)
Losses	—	(0.5)
Advance corporation tax	(191.7)	(195.8)
	<u>473.8</u>	<u>456.5</u>

As infrastructure assets are not depreciated, deferred taxation will crystallise only in the event of any disposal of these assets at amounts in excess of their written down value for tax purposes. In the opinion of the Directors, the likelihood of such a liability crystallising in the future is remote.

11 Profit for the financial year

Of the consolidated profit attributable to shareholders, £428.2m (1996: £109.0m) has been dealt with in the accounts of the Company. A separate profit and loss account for the Company has not been presented as permitted by Section 230 of the Companies Act 1985.

12 Dividends on equity shares

	1998		1997	
	pence per share	£m	pence per share	£m
Interim	12.5	47.6	11.2	44.1
Final proposed	25.9	98.6	23.2	87.9
	<u>38.4</u>	<u>146.2</u>	<u>34.4</u>	<u>132.0</u>

Notes to the accounts

13 Earnings per ordinary share

Earnings per ordinary share of 33.1p (1997: 82.8p) have been calculated by dividing the profit for the financial year by the weighted average number of ordinary shares in issue during the year of 379.9m (1997: 387.0m).

Adjusted earnings per share of 90.7p (1997: 85.5p) is based on earnings before the deduction of non-operating exceptional items and the windfall tax and, in the opinion of the Directors, more appropriately reflects the underlying financial performance of the Group.

There would be no significant dilution of earnings per ordinary share from the exercise of outstanding share options.

14 Tangible fixed assets

	Group			Company
	Land and buildings £m	Infrastructure assets £m	Plant and equipment £m	Plant and equipment £m
Net cost at 1 April 1997	1,395.2	1,231.9	1,419.7	1.2
Foreign exchange adjustments	(2.9)	–	(1.5)	–
Additions at cost	96.7	139.6	249.0	(0.2)
Disposals	(7.6)	–	(41.5)	–
Capital contributions	–	(32.7)	–	–
Net cost at 31 March 1998	<u>1,481.4</u>	<u>1,338.8</u>	<u>1,625.7</u>	<u>1.0</u>
Depreciation at 1 April 1997	269.4	–	389.5	0.5
Foreign exchange adjustments	(0.7)	–	(0.6)	–
Provided during the year	26.2	–	91.2	0.2
Disposals	(2.2)	–	(37.3)	–
Depreciation at 31 March 1998	<u>292.7</u>	<u>–</u>	<u>442.8</u>	<u>0.7</u>
Net book value				
At 31 March 1998	<u>1,188.7</u>	<u>1,338.8</u>	<u>1,182.9</u>	<u>0.3</u>
At 31 March 1997	<u>1,125.8</u>	<u>1,231.9</u>	<u>1,030.2</u>	<u>0.7</u>

- In order to give a true and fair view (note 1e), the cost of infrastructure assets is stated after the deduction of capital contributions amounting to £182.4m (1997: £149.7m).
- The net book value of land and buildings is analysed as follows:

	Group	
	1998 £m	1997 £m
Freehold land and buildings	1,154.3	1,091.8
Leaseholds: over 50 years	28.4	28.0
under 50 years	6.0	6.0
	<u>1,188.7</u>	<u>1,125.8</u>

- No depreciation has been charged on freehold land included at a cost of £11.6m (1997: £11.8m).
- Details of the Group's tangible fixed assets which are held under finance leases are:

	Cost		Net book value	
	1998 £m	1997 £m	1998 £m	1997 £m
Plant and equipment	295.8	291.0	242.2	235.9

- Tangible fixed assets at 31 March 1998 include £464.8m (1997: £398.9m) of assets in the course of construction.

Notes to the accounts

15 Fixed asset investments

	Group	Company	
	Interests in associated undertakings and joint ventures £m	Investment in subsidiary £m	Investment in joint venture £m
Value at 1 April 1997	34.3	940.6	15.0
Foreign exchange adjustments	(3.7)	(1.1)	–
Reclassification	–	29.4	–
Additions	13.7	274.4	9.3
Amounts written back	–	24.3	–
Share of profits for the year	3.0	–	–
Value at 31 March 1998	47.3	1,267.6	24.3

Group

The cost of the Group's interests in associated undertakings and joint ventures at 31 March 1998 amounted to £52.3m (1997: £38.6m). The Group's share of post-acquisition accumulated profits at 31 March 1998 was £3.1m (1997: £0.1m). The associated undertakings and joint ventures are unlisted.

Company

Investments amounting to £14.7m were made by the Company during the year through subsidiary and associated undertakings to assist in the development of the Group's non-regulated trading activities. In addition, the Company invested a further £269m in cash in its wholly owned subsidiary, Thames Water Utilities Limited.

16 Stocks and work in progress

	Group	
	1998 £m	1997 £m
Raw materials and consumables	18.9	16.3
Work in progress	9.1	5.5
Finished goods and goods for resale	6.4	3.5
	34.4	25.3
Work in progress includes long-term contract balances as follows:		
Net cost less foreseeable losses	297.2	191.6
Applicable payments on account	(321.7)	(191.3)
	(24.5)	0.3

Applicable payments on account in excess of net costs less foreseeable losses are included in creditors.

The Company has no stocks and work in progress.

Notes to the accounts

17 Debtors

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Due within one year:				
Trade debtors	160.1	182.8	–	–
Amounts recoverable on contracts	1.6	10.0	–	–
Amounts owed by subsidiary undertakings	–	–	294.3	103.7
Other debtors	20.4	26.4	0.5	–
Prepayments and accrued income	96.0	78.0	0.1	0.9
Infrastructure renewals expenditure	5.5	8.3	–	–
	<u>283.6</u>	<u>305.5</u>	<u>294.9</u>	<u>104.6</u>
Due after more than one year:				
Trade debtors	0.9	0.4	–	–
Prepayments and accrued income	0.4	0.3	–	–
Other debtors	0.3	0.2	–	–
	<u>285.2</u>	<u>306.4</u>	<u>294.9</u>	<u>104.6</u>

18 Current asset investments

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Fixed term deposits and certificates of deposit	18.7	54.0	3.9	10.5
Fixed and floating interest rate securities	81.7	80.1	19.3	22.8
	<u>100.4</u>	<u>134.1</u>	<u>23.2</u>	<u>33.3</u>

The market value of investments is not significantly different from cost.

19 Creditors: amounts falling due within one year

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Bank loans	74.3	237.1	–	212.7
Bank overdrafts	71.5	49.1	40.9	30.9
Other loans	185.2	4.8	183.3	–
Obligations under finance leases	3.2	1.4	–	–
Progress claims and advance payments	97.0	100.7	–	–
Trade creditors:				
– operating	56.4	61.1	–	–
– capital	108.6	97.8	–	–
Bills of exchange payable	2.0	7.5	–	–
Amounts owed to subsidiary undertakings	–	–	77.1	39.7
Advance corporation tax	39.6	30.8	39.6	30.8
Taxation and social security	35.9	25.0	1.7	–
Windfall tax	115.3	–	115.3	–
Accruals and deferred income	175.0	144.2	4.5	4.3
Other creditors	4.6	17.3	1.6	4.5
Proposed dividend	98.6	87.9	98.6	87.9
	<u>1,067.2</u>	<u>864.7</u>	<u>562.6</u>	<u>410.8</u>

Notes to the accounts

20 Creditors: amounts falling due after more than one year

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Bank loans	307.5	263.5	-	-
Other loans	352.9	278.9	82.6	-
Obligations under finance leases	263.2	250.0	-	-
Amounts owed to subsidiary undertakings	-	-	100.3	102.2
Deferred income	48.8	40.1	-	-
Other creditors	7.2	7.0	-	-
	<u>979.6</u>	<u>839.5</u>	<u>182.9</u>	<u>102.2</u>

21 Borrowings

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Bank loans and overdrafts				
- Within one year	145.8	286.2	40.9	243.6
- Between one and two years	25.6	15.5	-	-
- Between two and five years	52.7	50.4	-	-
- After more than five years	229.2	197.6	-	-
	<u>453.3</u>	<u>549.7</u>	<u>40.9</u>	<u>243.6</u>
Other loans and finance leases				
- Within one year	190.4	13.7	183.3	-
- Between one and two years	4.1	1.9	-	-
- Between two and five years	218.6	164.5	57.0	-
- After more than five years	393.4	362.5	25.6	-
	<u>806.5</u>	<u>542.6</u>	<u>265.9</u>	<u>-</u>
Total borrowings	<u>1,259.8</u>	<u>1,092.3</u>	<u>306.8</u>	<u>243.6</u>

- Loans are repayable between 1998 and 2030.
- Loans wholly repayable after more than five years hence are:

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
- Bank loans	150.0	100.0	-	-
- Other loans	145.9	124.4	25.6	-
	<u>295.9</u>	<u>224.4</u>	<u>25.6</u>	<u>-</u>

- Other loans include:
 - £150m 10% Guaranteed Bonds due 2001
 - \$150m 6% Notes due 2004
- Loans totalling £32.4m (1997: £32.4m) which are secured on the revenues of Thames Water Utilities Limited.
- During the year, the Group signed a US\$1 billion Euro-Medium Term note programme. The programme provides for both the Company and Thames Water Utilities Limited to access the capital markets in a range of currencies and maturities. At 31 March 1998, £82.7m had been borrowed with a weighted average term of 5.5 years at a weighted average fixed rate of 6.8%.

Notes to the accounts

21 Borrowings (continued)

	Group	
	1998 £m	1997 £m
● Loans repayable by instalments after more than five years hence are:		
– Bank loans	79.2	97.6
– Other loans	–	1.9
– Finance leases	247.5	236.2
	<u>326.7</u>	<u>335.7</u>

- The Group is committed to further outstanding lease obligations of £5.8m (1997: £16.7m) to fund future capital investment.
- The range of interest rates on outstanding bank loans are 6.25% to 11.5% (1997: 3.5% to 11.5%) and on other loans 3% to 11% (1997: 3% to 11%). These interest rates are those contracted on the underlying borrowings before taking account of interest rate protection. Interest rates on finance leases are linked to LIBOR.
- The following interest rate protection arrangements are in place:
 - the Company has interest rate collars fixing the maximum and minimum rates payable on sterling borrowings of £75m. The weighted average maximum rate payable is 8.2%, the weighted average minimum rate payable is 6.6% with an average remaining term of nine months.
 - the Company has in place an interest rate swap which converts £10m of sterling borrowings from floating rates based on LIBOR, to a fixed rate of 7.42%.
 - the Group has in place long-dated interest rate swaps which fix the rate of interest at an average of 7.65% on sterling borrowings of £65m for a remaining weighted average term of 15 years.
 - the Group has in place long-dated interest rate swaps which convert £35m of sterling borrowings from an average fixed rate of 10.4% to floating rates (based on LIBOR) for a weighted average remaining term of one year.

22 Provisions for liabilities and charges					Group	Company
	Closure and contract provisions £m	Insurance liabilities £m	Other £m	Pensions £m	Total £m	Other provisions £m
Balance at 1 April 1997	44.8	37.1	3.4	1.7	87.0	0.1
Foreign exchange adjustments	–	–	(0.1)	(0.1)	(0.2)	–
Provided during the year	0.5	1.2	1.4	0.1	3.2	–
Utilised during the year	(7.9)	–	(0.9)	(0.4)	(9.2)	–
Released during the year	(22.0)	–	(0.2)	(0.3)	(22.5)	–
Balance at 31 March 1998	<u>15.4</u>	<u>38.3</u>	<u>3.6</u>	<u>1.0</u>	<u>58.3</u>	<u>0.1</u>

Of the £7.9m and £22.0m utilisation and release of closure and contract provisions, £6.2m and £20m is in respect of the discontinued business non-operating exceptional items provided in 1996.

23 Share capital

	Group and Company	
	1998 £m	1997 £m
Authorised		
525,000,001 ordinary shares of £1 each	525.0	525.0
Allotted, called up and fully paid		
380,528,871 ordinary shares of £1 each (1997: 379,366,486)	380.5	379.4

Details of ordinary shares allotted during the year are as follows:	Number of shares allotted		Consideration	
	1998 000	1997 000	1998 £m	1997 £m
Scrip dividends	–	3,339		
Purchase of own shares	–	(41,364)	–	(224.6)
Conversion of Convertible Bonds	–	10,799		
Employee shares schemes:				
– Sharesave Scheme	661	1,884	2.0	4.6
– Executive Share Option Scheme	394	503	1.7	1.9
– Profit Sharing Scheme	108	224	0.9	1.2
	<u>1,163</u>	<u>(24,615)</u>	<u>4.6</u>	<u>(216.9)</u>

Notes to the accounts

23 Share capital (continued)

Employee Shares Schemes

The Company has adopted the following schemes for employees to subscribe for ordinary shares in the Company in accordance with the rules of the respective schemes:

- the Thames Water Sharesave Scheme is a 'save as you earn' share option scheme open to all eligible employees with options exercisable, in normal circumstances, after completion of a three, five or seven year contract;
- the Thames Water Executive Share Option Scheme is a scheme for senior executives with options exercisable between the third and tenth anniversaries of the date of grant. No options were granted under the scheme during the year;
- the Thames Water Profit Sharing Scheme is a scheme open to all eligible employees whereby a bonus may be declared in the form of shares in Thames Water Plc, subject to profit targets being attained and to the conditions for eligibility. Shares have been appropriated under this scheme and are held in trust under the terms of the scheme.

Options granted and outstanding at 31 March 1998

Date of grant	Number of ordinary shares	Option price per share	Normal date of exercise
Thames Water Sharesave Scheme			
Three-year scheme			
28 November 1996	471,842	442p	Feb 2000 – Jul 2000
3 December 1997	490,906	685p	Feb 2001 – Jul 2001
Five-year scheme			
10 July 1992	1,503	349p	Oct 1997 – Mar 1998
9 July 1993	416,136	372p	Oct 1998 – Mar 1999
1 December 1994	1,008,409	421p	Feb 2000 – Jul 2000
30 November 1995	872,381	420p	Feb 2001 – Jul 2001
28 November 1996	547,502	442p	Feb 2002 – Jul 2002
3 December 1997	560,523	685p	Feb 2003 – Jul 2003
Seven-year scheme			
12 July 1991	198,149	288p	Oct 1998 – Mar 1999
29 November 1991	217,360	296p	Feb 1999 – Jul 1999
10 July 1992	175,919	349p	Oct 1999 – Mar 2000
9 July 1993	118,172	372p	Oct 2000 – Mar 2001
1 December 1994	305,396	421p	Feb 2002 – Jul 2002
30 November 1995	253,507	420p	Feb 2003 – Jul 2003
28 November 1996	174,598	442p	Feb 2004 – Jul 2004
3 December 1997	194,753	685p	Feb 2005 – Jul 2005
Thames Water Executive Share Option Scheme			
2 July 1991	47,000	347p	1994 – 2001
24 June 1992	40,000	418p	1995 – 2002
19 November 1993	7,000	521p	1996 – 2003
8 December 1994	152,100	453p	1997 – 2004
8 December 1995	253,910	560p	1998 – 2005

Notes to the accounts

23 Share capital (continued)

Thames Water Long-Term Restricted Share Plan

Awards made giving conditional rights to acquire shares

Date of award	Number of ordinary shares	Normal vesting date
2 August 1996	12,569	31 March 2000
9 July 1997	29,473	31 March 2001

These shares will only vest in full if the Company's performance ranks first or second in a comparator group over a four year period (see page 18).

Thames Water Cash/Share Bonus Plan

Date of award	Number of ordinary shares	Normal vesting date
9 July 1997	4,052	9 July 2000

24 Movement in Equity Shareholders' Funds

	Share capital £m	Share premium £m	Capital redemption reserve £m	Profit and loss account £m	1998 Total £m	1997 Total £m
The Group						
Balance at 1 April	379.4	48.6	41.4	1,696.1	2,165.5	2,170.3
Foreign exchange adjustments	-	-	-	(2.2)	(2.2)	5.6
Profit for the financial year	-	-	-	125.7	125.7	320.4
Dividends on equity shares	-	-	-	(146.2)	(146.2)	(132.0)
Adjustment for the issue of scrip shares	-	-	-	-	-	18.5
New share capital subscribed (see note 23)	1.1	3.5	-	-	4.6	7.8
Purchase of own shares	-	-	-	-	-	(226.2)
Advance corporation tax on the purchase of shares	-	-	-	-	-	(44.9)
Conversion of Convertible Bonds	-	-	-	-	-	46.2
Share issue expenses	-	-	-	-	-	(0.2)
Balance at 31 March	380.5	52.1	41.4	1,673.4	2,147.4	2,165.5
The Company						
Balance at 1 April	379.4	48.6	41.4	133.8	603.2	825.0
Profit for the financial year	-	-	-	428.2	428.2	109.0
Dividends	-	-	-	(146.2)	(146.2)	(132.0)
Adjustment for the issue of scrip shares	-	-	-	-	-	18.5
New share capital subscribed (see note 23)	1.1	3.5	-	-	4.6	7.8
Purchase of own shares	-	-	-	-	-	(226.2)
Advance corporation tax on the purchase of shares	-	-	-	-	-	(44.9)
Conversion of Convertible Bonds	-	-	-	-	-	46.2
Share issue expenses	-	-	-	-	-	(0.2)
Balance at 31 March	380.5	52.1	41.4	415.8	889.8	603.2

The cumulative goodwill taken to Group reserves, net of goodwill relating to undertakings disposed of, as at 31 March 1998 amounts to £71.5m (1997: £71.5m).

Notes to the accounts

25 Operating leases

At 31 March 1998, the Group was committed to making the following payments in respect of non-cancellable operating leases.

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Land and buildings				
Leases which expire:				
– Within one year	0.2	0.5	–	–
– Between one and two years	0.3	0.3	–	–
– Between two and five years	0.4	0.5	–	–
– After more than five years	4.1	3.8	0.4	0.4
	<u>5.0</u>	<u>5.1</u>	<u>0.4</u>	<u>0.4</u>
Other				
Leases which expire:				
– Within one year	1.3	0.6	–	–
– Between one and two years	2.2	1.1	–	–
– Between two and five years	1.4	3.3	–	–
– After more than five years	–	0.2	–	–
	<u>4.9</u>	<u>5.2</u>	<u>–</u>	<u>–</u>

26 Capital commitments

	Group	
	1998 £m	1997 £m
Contracted for but not provided in the financial statements	<u>203</u>	<u>176</u>

- In addition to these commitments, the Group has long-term capital investment plans to meet shortfalls in performance and asset condition and to provide for new demand and growth.
- The Company has no capital commitments.

27 Pension schemes

Pension arrangements for the majority of the Group's UK employees are of the defined benefit type funded through pension schemes whose assets are held separately from those of the Group in independently administered funds. In addition, there are unfunded defined benefits provided for certain Directors; details are included on pages 19 and 20. Overseas arrangements are established in accordance with local custom and practice.

The total ongoing pension cost of the Group during the year ended 31 March 1998 was £8.8m (1997: £10.6m) of which £0.6m (1997: £0.7m) relates to the overseas schemes. The pension cost relating to the UK schemes is assessed in accordance with advice received from Robert Stenlake of Bacon & Woodrow, the consulting actuary to the schemes. The pension costs relating to the overseas schemes are assessed in accordance with local practice, with liabilities provided to meet the pensions reporting requirements of Statement of Standard Accounting Practice number 24 where material differences arise.

In relation to the three main UK schemes, the regular cost of benefits amounted to £18.3m (1997: £16.0m) and the surplus resulted in a variation amounting to a reduction in the pension cost of £9.5m (1997: £5.4m). The increase in the variation reflects the change in actuarial assumptions and experience reflected in the valuations as at 6 April 1996.

As at 31 March 1998, a prepayment in respect of the funded UK schemes amounting to £0.2m was included in other debtors (1997: £4.4m) (see note 17) and provision in respect of the unfunded arrangements amounting to £0.7m (1997: £0.5m) was included in creditors (note 19).

Notes to the accounts

27 Pension schemes (continued)

Contributions to the UK schemes for the year ended 31 March 1998 are based on actuarial reviews of the various schemes as at 6 April 1996. Contributions by the employer were reduced from 1 April 1997 for the two larger schemes and from 1 April 1998 for the third smaller scheme. The pension charge for the year ended 31 March 1998 reflects the surplus disclosed by these valuations and a subsequent review in light of the changes to the tax treatment of pension schemes introduced in the July 1997 Budget.

For accounting purposes, any surplus is being recognised as a percentage of pensionable salaries spread over the average future working lifetime of the members. For funding purposes, more conservative actuarial assumptions have been used and any surplus, or deficit, may be recognised more quickly.

The principal assumptions used in determining the pension cost were that salary increases, excluding allowance for promotional increases, would be 7% per annum and that the rate of return on investments would amount to 8.75% per annum. Pension increases are pre-funded in line with inflation, assumed to be at a rate of 5% per annum, for three of the four UK pension schemes and are granted in line with the rules of each scheme and any statutory requirements. For the remaining UK scheme, pension increases are at the rate of 5% per annum or the annual movement in the Retail Prices Index if less, the assumed rate of increases is 4.5% per annum. Dividend growth is assumed to be 5% per annum.

The actuarial methods used were the Projected Unit method for those schemes which remain open to new members and the Attained Age method for the scheme which no longer allows future entrants.

For the three largest schemes of the Group, which cover the vast majority of UK employees, the total market value of assets as at the last valuation date was £696m and the actuarial value of these assets represented 120% of the value of the benefits that had accrued to members after allowing for expected future salary increases.

28 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	Sale value £m	Balance £m
Izmit Su As	Joint venture	143.3	2.0 (creditor)
Pathum Thani Water Company	Associate	0.2	—
TWCKK	Joint venture	1.0	1.7 (debtor)
United Water	Joint venture	0.5	—
Thames Dick Super Aquaduct Partners Inc	Joint venture	2.1	—
Binnie Thames Water Limited	Joint venture	0.3	—
St James Homes Limited	Joint venture	4.0	—
BJT Water Limited	Joint venture	—	0.1 (debtor)

29 Guarantees

The Company has guaranteed the overdrafts and loans of certain subsidiaries up to a maximum of £507.3m (1997: £412.1m). The Company has also guaranteed facilities for contract bonding on behalf of certain subsidiaries amounting to £79.6m at 31 March 1998 (1997: £135.1m). In addition, there are a number of parent company guarantees in respect of subsidiary company contractual obligations which have been entered into in the normal course of business. No loss is expected to arise under these arrangements.

Notes to the accounts

30 Thames Water Utilities Limited

Condition F of the Instrument of Appointment under which Thames Water Utilities Limited operates requires specified accounting statements to be published with its annual accounts or those of its parent company. Anyone requiring a copy of these accounts including the specified statements for the year ended 31 March 1998 should apply to: The Company Secretary, Thames Water Plc, Nugent House, Vastern Road, Reading, Berkshire RG1 8DB. Tel 0345 414140 (calls from the UK will be charged at the local rate).

31 Group undertakings

At 31 March 1998, the Group held more than 10% of the allotted share capital of the following principal trading undertakings.

Subsidiary undertakings	Country of incorporation registration and operation	Class of share capital held	Proportion of shares held		Nature of business
			Directly	Indirectly	
Thames Water Utilities Limited	Great Britain	Ordinary	100%		Water and wastewater services
CONNECT 2020 Limited	Great Britain	Ordinary		100%	Procurement logistics
International Operations:					
Thames Water International Services Holdings Limited	Great Britain	Ordinary	100%		Management company
Thames Water International Services Limited	Great Britain	Ordinary		100%	Marketing of technical managerial services
Thames Water Overseas Limited	Great Britain	Ordinary		100%	Management company
Thames Water Overseas Consultancy Limited	Great Britain	Ordinary		100%	Marketing of technical managerial services
PWT Projects Limited	Great Britain	Ordinary		100%	Process engineering
Water Projects International Limited	Great Britain	Ordinary		100%	Process engineering
Thames Water Asia/Pacific Pty Limited	Australia	Ordinary		100%	Process engineering
Thames Water International (Singapore) Pty Limited	Singapore	Ordinary		100%	Process engineering
Thames Water Engineering (Malaysia) Sdn.Bhd	Malaysia	Ordinary		100%	Process engineering
Thames Water (Malaysia) Sdn.Bhd	Malaysia	Ordinary		90%	Water operations and maintenance
Kelantan Water (Malaysia) Sdn.Bhd	Malaysia	Ordinary		70%	Water operations and maintenance
Thames Water International (Thailand) Limited	Thailand	Ordinary		100%	Water operations and maintenance
Thames Water International (Hong Kong) Limited	Hong Kong	Ordinary		100%	Process engineering
Simon Hartley (Hong Kong) Limited	Hong Kong	Ordinary		100%	Wastewater projects
Products:					
Thames Water Products Limited	Great Britain	Ordinary	100%		Management company
Simon Hartley Limited	Great Britain	Ordinary		100%	Water and wastewater equipment
PCI Membrane Systems Limited	Great Britain	Ordinary		100%	Municipal and industrial membrane filtration
T M Products Limited	Great Britain	Ordinary		100%	Pipeline products, water treatment and disinfection
Thames Water Technologies Limited	Great Britain	Ordinary		100%	Product technology

Notes to the accounts

31 Group undertakings (continued)

Products (continued):	Country of incorporation registration and operation	Class of share capital held	Proportion of shares held		Nature of business
			Directly	Indirectly	
Thames Water Holdings Inc	USA	Common Convertible		100% 100%	Management company
Ashbrook Corporation Inc	USA	Ordinary		100%	Water and wastewater equipment
Hydro-Aerobics Inc	USA	Ordinary		100%	Packaged water treatment systems
F B Leopold Company Inc	USA	Ordinary		100%	Water and wastewater treatment equipment
Services:					
Thames Water Environmental Services Limited	Great Britain	Ordinary		100%	Management company
Metro Rod Plc	Great Britain	Ordinary		100%	Drain and pipe cleaning services
Morgan Collis Group Limited	Great Britain	Ordinary		100%	Sewerage services
Subterra Limited	Great Britain	Ordinary		100%	Pipeline rehabilitation services
Thames Incineration and Recycling Limited	Great Britain	Ordinary		100%	Waste and incineration facilities management
Thames Water Contracting Plc	Great Britain	Ordinary		100%	Utilities and grounds maintenance
Thames Waste Management Limited	Great Britain	Ordinary		100%	Pipeline rehabilitation services
Property and Insurance:					
Isis Insurance Company Limited	Isle of Man	Ordinary	100%		Insurance
Kennet Properties Limited	Great Britain	Ordinary	100%		Property
Thames Water Investments Limited	Great Britain	Ordinary	100%		Property
Thames Water Property Limited	Great Britain	Ordinary	100%		Property
Thames Water Developments Limited	Great Britain	Ordinary	100%		Property
A full list of subsidiary undertakings within the Group will be filed at Companies House with the Company's annual return.					
Joint Ventures:					
Binnie Thames Water Limited	Great Britain	Ordinary		50%	International consultancy
Gemwel Limited	Great Britain	Ordinary		50%	Water and sewerage services
St James Homes Limited	Great Britain	Ordinary		50%	Property
Thames Dick Super Aquaduct Partners Inc	USA	Ordinary		50%	Water operations and maintenance
Izmit Su As	Turkey	Ordinary	35%		Water operations and maintenance
BJT Water Company Limited	Thailand	Ordinary		40%	Industrial estate management
Thames Water Japan Limited	Japan	Ordinary		50%	Finance company
United Water International Pty Limited	Australia	Ordinary		47.5%	Water operations and maintenance
Bovis Thames (Shanghai) Limited	British Virgin Islands	Ordinary		50%	Management company
Associate undertakings:					
Pathum Thani Water Company Limited	Thailand	Ordinary		30%	Water operations and maintenance

Group five year summary

Profit and loss account

Year ended 31 March	1998 £m	1997 £m	1996 £m	1995 £m	1994 £m
Turnover:					
– Continuing	1,410.3	1,264.9	1,193.6	1,173.6	1,093.2
– Discontinued	5.9	33.8	–	–	–
– Joint ventures	(27.2)	(11.3)	–	–	–
	<u>1,389.0</u>	<u>1,287.4</u>	<u>1,193.6</u>	<u>1,173.6</u>	<u>1,093.2</u>
Operating profit					
– Continuing	477.4	440.4	376.1	360.0	293.8
– Discontinued	(0.1)	(0.4)	–	–	–
– Joint ventures	3.3	0.7	–	–	–
	<u>480.6</u>	<u>440.7</u>	<u>376.1</u>	<u>360.0</u>	<u>293.8</u>
Non-operating exceptional items	11.7	(12.2)	(95.0)	–	–
Interest	(73.7)	(56.7)	(52.4)	(56.3)	(52.1)
Profit on ordinary activities before taxation	418.6	371.8	228.7	303.7	241.7
Taxation on profit on ordinary activities	(62.2)	(51.4)	(25.2)	(21.5)	(19.4)
Windfall tax	(230.7)	–	–	–	–
Profit for the financial year	<u>125.7</u>	<u>320.4</u>	<u>203.5</u>	<u>282.2</u>	<u>222.3</u>
Capital Investment	485.3	409.7	349.0	314.0	376.6
Earnings per share	33.1p	82.8p	50.7p	71.3p	56.8p
Adjusted earnings per share	90.7p	85.5p	74.3p	71.3p	65.8p
Dividend per share	38.4p	34.4p	28.3p	25.3p	22.5p

Balance sheet

As at 31 March	1998 £m	1997 £m	1996 £m	1995 £m	1994 £m
Fixed assets	3,757.7	3,422.2	3,140.9	2,900.9	2,703.4
Net current (liabilities)/assets	(572.4)	(330.2)	8.7	(22.8)	(73.3)
Creditors: amounts falling due after more than one year	(979.6)	(839.5)	(773.6)	(718.5)	(673.8)
Convertible debt	–	–	(81.8)	(81.4)	(80.9)
Provisions for liabilities and charges	(58.3)	(87.0)	(123.9)	(43.0)	(42.6)
Net assets	<u>2,147.4</u>	<u>2,165.5</u>	<u>2,170.3</u>	<u>2,035.2</u>	<u>1,832.8</u>
Share capital	380.5	379.4	404.0	399.7	393.4
Share premium	52.1	48.6	8.2	6.2	3.9
Capital redemption reserve	41.4	41.4	–	–	–
Reserves and retained profits	<u>1,673.4</u>	<u>1,696.1</u>	<u>1,758.1</u>	<u>1,629.3</u>	<u>1,435.5</u>
Equity shareholders' funds	<u>2,147.4</u>	<u>2,165.5</u>	<u>2,170.3</u>	<u>2,035.2</u>	<u>1,832.8</u>

- 1998 turnover and operating profit discloses the Group's share of turnover and operating profit of joint ventures in accordance with FRS9 'Associates and Joint Ventures'.
- 1994 operating profit is stated after charging operating exceptional items of £35m.

Shareholder information and services

Category	Number of holders	%	Holding	%
Individuals	201,685	96.14	62,783,873	16.51
Bank or nominees	6,885	3.28	297,495,896	78.18
Investment trust	85	0.04	622,029	0.16
Insurance company	21	0.01	1,353,382	0.36
Other company	642	0.31	5,152,150	1.35
Pension trust	38	0.02	5,421,545	1.42
Other corporate body	416	0.20	7,699,996	2.02
Total	209,772	100.00	380,528,871	100.00
Band analysis as at 31 March 1998				
1-500	183,977	87.70	44,187,776	11.62
501-1,000	18,000	8.59	12,058,297	3.17
1,001-5,000	6,205	2.96	11,304,135	2.98
5,001-50,000	1,009	0.48	16,861,942	4.44
50,001-100,000	183	0.09	13,554,907	3.56
100,001-1,000,000	341	0.16	105,204,456	27.63
1,000,001+	57	0.02	177,357,358	46.60
Total	209,772	100.00	380,528,871	100.00

Financial Calendar

Financial year ended 31 March 1998

2 June 1998 Preliminary announcement of final results

6 July 1998 Ex-Dividend date for final dividend

10 July 1998 Record (or qualifying) date for 1998 final dividend

28 July 1998 Barbican Centre, London 1998 Annual General Meeting

1 September 1998 Final dividend payable.

Financial year ending 31 March 1999

3 November 1998 Announcement of half-yearly results for six months to 30 September 1998

6 April 1999 Interim dividend payable.

Payment Direct to Bank

Cash dividends mandated by shareholders to a bank or to certain building society accounts will be paid via BACS (Bankers Automated Clearing Services). Tax vouchers will normally be posted direct to the shareholder's registered address.

Shareholder Enquiries

With effect from 12 March 1998, the Company's share register has been maintained by Computershare Services PLC, formerly the registration business of The Royal Bank of Scotland. Their address is as follows: The Registrar, Thames Water Plc, Computershare Services PLC, PO Box 435, Owen House, 8 Bankhead Crossway North, Edinburgh EH11 4BR. Shareholders who require help or information about their shareholding may either write to the Registrar at this address or telephone on 0131 523 6666.

Shareholders with enquiries about Thames Water Plc or other shareholder matters can write to The Company Secretary's Office, Nugent House, Vastern Road, Reading, Berkshire RG1 8DB or telephone on 0345 414140 - local call rates apply from the UK.

Thames Water Nominee Service

A special Thames Water Nominee Service is now available, enabling shareholders to deal quickly and cost effectively in CREST.

Shareholders who transfer their shares into the Thames Water Nominee Service will receive all shareholder information and dividend payments, and, in place of their share certificates, will be sent a half-yearly statement with advice notes whenever shares are bought or sold through the service. There will be no annual charge for the maintenance of holdings in the Thames Water Nominee Service which is being administered by Computershare Services PLC. Shareholders who prefer to retain their share certificates need do nothing, and this may be the most appropriate course of action for those who do not deal in shares on a regular basis.

Thames Water PEPs

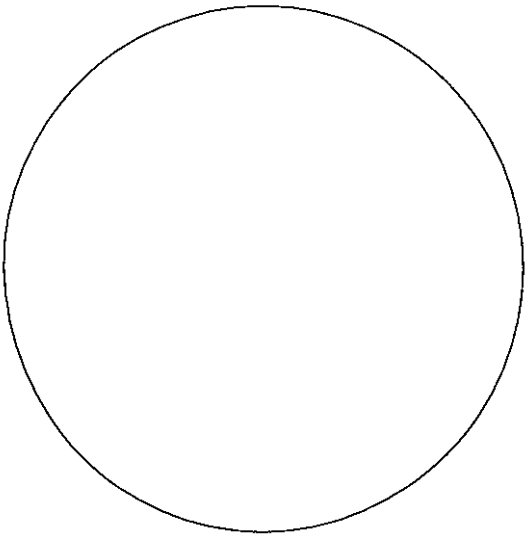
The Company has arranged with The Royal Bank of Scotland Plc to offer shareholders a Single Company PEP (maximum investment for 1998/99 tax year £3,000) and a General (Corporate) PEP (maximum investment for 1998/99 tax year £6,000) as a means of holding Thames Water shares without incurring capital gains tax on any growth in their value or paying income tax on dividends.

Share Dealing Services

Shareholders are able to use a low cost postal dealing service operated for Thames Water Plc by Cazenove & Co. A £10 minimum charge applies per transaction. A telephone dealing service operated by Stocktrade is also available. A £15 minimum charge applies per transaction. For details of any of the above services please contact our Registrars at the address on this page.

Share Price Information Line (CityCall)

You can obtain the current share price by calling 0891 222302. Calls cost 50p per minute at all times.



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