

Registered no: 02366661 (England and Wales)

**Thames Water Utilities Limited**

Annual Report and Financial Statements

For the year ended 31 December 2004



# Thames Water Utilities Limited

## Annual report for the year ended 31 December 2004

	Pages
Directors and secretary	2
Chairman's review	3 - 7
Corporate governance	8 - 12
Report on remuneration policy and remuneration	13 - 14
Directors' report	15 - 21
Report of the independent auditors	22 - 23
Profit and loss account	24
Balance sheet	25
Cash flow statement	26
Notes to the cash flow statement	27
Notes to the financial statements	28 - 47

# Thames Water Utilities Limited

## Directors and secretary at 31 December 2004

### Directors

W J Alexander	Chairman
J R Sexton	Managing Director
W U Böttcher	Managing Director RWE Thames Water Europe
C Anderson	Finance Director
J M England	Chief Operating Officer
S C Walker	RWE Thames Water Division Investment & Technology Director

### Independent non-executive directors

C Bowe	Deputy Chairman
P T Warry	
S Slipman	

(See page 16 for changes in directors since 31 December 2003).

### Company secretary and registered office

K G Johnson  
Clearwater Court  
Vastern Road  
Reading  
Berkshire  
RG1 8DB

# Thames Water Utilities Limited

## Chairman's review

Thames Water Utilities Limited, serving London and the Thames Valley area, is the largest water and wastewater company in the United Kingdom, based on the number of customers served.

The Company's operating environment in London presents some unique challenges. The nation's capital has some of the oldest infrastructure serving the largest and most densely populated city in the country, with very high concentrations of traffic and economic activity all round the clock. The population is steadily increasing, inevitably putting greater demands on the network, whose maintenance costs have accelerated in recent years. While there has been real progress in 2004 in tackling leakage and sewer flooding, it is acknowledged that more needs to be done.

Shortly after the end of the year, the Board of Directors accepted the Final Determination by the Director General of Water Services for the 2004 regulatory price review. This will enable Thames Water to increase its programme of investment. Prices will need to rise, but the review demonstrated that this is necessary to improve the essential infrastructure on which our customer service relies. The Company and its employees are fully committed to serving the needs of its customers, the communities within which it operates and the environment in an increasingly efficient and effective way.

## Customer service

During 2004 we have continued to deliver high quality, reliable services to our customers at a price which, as one of the lowest in the United Kingdom, represents excellent value for money.

One of our principal aims is to be responsive to service requests and enquiries from our customers at all times. This is particularly critical in emergencies, when the calls made by our customers increase greatly in number and importance. Our customer service centre has undergone a significant reorganisation to improve the way in which the centre and our operational teams in the field work together to improve communications and back-up arrangements, to ensure that we can respond with speed to operational incidents and customer enquiries.

We take care to provide extra support for our customers in particular need. We understand that some of our customers will have genuine difficulty in affording their water bills and for eligible customers, we are putting in place an innovative service to provide counselling advice. We continue to administer a customer assistance fund which helps people who are having difficulty paying their water bills to clear past debts and make a fresh start. We have a multi language facility for customer contacts and we have maintained our special services for our disabled customers (fulfilling our duties under the Disability Discrimination Act) including large print and Braille communications, audio-tape, talking bills, textphone (Minicom), sign language and other facilities.

## Operations

A reliable and high quality water supply is one of the highest priorities for us and our customers. The water quality regulations and the way in which compliance is monitored and reported have been revised and these were operative for the first time during 2004. Through our investment programme and operating practices, we continued to achieve excellent drinking water quality achieving 99.9% full compliance with these exacting standards (2003: 99.9%).

# Thames Water Utilities Limited

## Chairman's review (continued)

Similarly, our wastewater treatment works, which are required to meet some of the highest standards in the United Kingdom, have achieved very high levels of treated effluent quality: 99.9% fully compliant (2003: 99.9%). This is a significant achievement considering that we operate 349 works, treating wastewater from around 13 million people and a wide range of industries. We also achieved 100% compliance with regulations covering the use of sewage sludge in agriculture, for the tenth consecutive year. The water which is treated to high standards at our wastewater works makes a major contribution to river water quality and flows, as well as to the ecology and sustainability of the Thames Valley.

Performance against the Office of Water Services (Ofwat) Levels of Service for water and wastewater has been affected by ongoing leakage, notably in North and Central London, and by sewer flooding, particularly during the exceptionally severe storms in April and August. We apologise to those customers who were affected by these incidents. Fewer properties were inconvenienced by interruptions to water supplies compared with 2003, but unfortunately one large mains burst affected over 8,000 properties in North London in July of this year. All of these problems are to a significant extent a reflection of our ageing networks and we will continue to address these shortcomings through our major investment programme.

A programme of sustainable pressure management and zonal reconfiguration delivered significant savings of water and is a key component of our supply and demand strategy. This is consistent with our water supply obligations on maintaining adequate pressure and we have engaged with local authorities and WaterVoice to explain the reasons for this programme and the steps which should be taken in those cases where problems may be caused by inadequate plumbing arrangements in some high-rise buildings. Water supplies to customers have been maintained throughout the year without restrictions and this performance, coupled with the fact that following the price review we expect to continue to have one of the lowest average combined water and wastewater household bills in England and Wales, demonstrates excellent value for our customers.

Our water and effluent treatment processes are essential for the health and well being of our society and its economy and they are becoming ever more technically complex. A major landmark was the completion, ahead of schedule, of the award-winning new wastewater treatment works at Reading, which was officially opened in January 2005. Built on a brown field site at a total cost of approximately £80m, the works employs state of the art technology, with many of the processes being covered to control odour. Significant challenges remain to be addressed at some of our other large works, where fresh starts like that at Reading are not available.

The sudden storms of August 2004 highlighted two issues. Firstly, the desirability of yet higher treatment capacity for London's major sewage works, preparations for which are now in hand, and secondly the shortcomings of London's combined sewer network to deal with exceptional rainfall and storm flow conditions. We have an ambitious proposal to address this and its periodic impact on the Thames Tideway, which awaits ministerial approval.

In the UK, enforcement of legislation governing discharges to the water environment is applied under the terms of 'strict liability'. When pollution incidents do occur this is often due to exceptional weather conditions, or to blockages in sewers due to the illegal presence in our sewers of cooking fat and grease and unsuitable solid items of refuse which should be disposed of in other ways. Our incident prevention, control and response arrangements remain under regular review and improvements have been introduced. All incidents which occur are carefully examined and appropriate steps are taken to reduce the risk of failure in the future. The number of serious Category 1 and 2 pollution incidents in 2004 decreased markedly by almost 40% in comparison with 2003 and there was also a 33% reduction in the less serious Category 3 incidents.

# Thames Water Utilities Limited

## Chairman's review (continued)

Nonetheless, we very much regret that individual incidents, some of which had occurred in previous years, resulted in the Company being fined for pollution offences on eight occasions in 2004. Of these, three were the result of sewer blockages, three were caused by pump failures, one was the result of treatment process failure and one was due to a burst sewer main. We will continue to work in conjunction with Ofwat and the Environment Agency to establish ways in which procedures and performance can be further improved.

Our whole operational and customer service organisation and the associated business processes were brought together under the leadership of our Chief Operating Officer during 2004. Our teams are fully focused on delivery of regulatory and environmental requirements, health and safety, efficiency and improving customer service. Our 24-hour control centres have been reorganised to enable faster, more effective and more efficient responses to incidents. Our engineering functions have also been reviewed and steps are being taken to ensure we have access to the skills and resources necessary to carry through our major investment programmes, delivering innovative solutions at the right cost for the future.

### Corporate responsibility, environment and conservation

We are committed to being a socially responsible company and to playing our part in the challenge that society faces in achieving sustainable development. This means working in partnership with the communities that we serve and protecting the natural environment that lies at the very heart of our core business.

Our investment in water and wastewater treatment processes and infrastructure has helped maintain our excellent record of compliance with UK drinking water, effluent quality and sewage sludge standards.

Climate change, new housing, development pressure and changing land use are placing increasing pressure on water resources in the South East of England and the sustainable management of water resources is a key challenge facing the business. To ensure there is sufficient water to supply our customers, both now and in the future, we need to manage our water resources, treatment and distribution and take action to help our customers to use water more efficiently. Our 25-year water resources strategy updated in 2004 includes the development of major new resources to ensure our customers continue to have a secure water supply. One of the proposed resource schemes is an innovative new water treatment plant in London. A pilot plant is already in operation and, if planning permission is obtained early in 2005, a full scale plant will be constructed utilising the latest desalination technology to treat brackish water from the Thames Estuary, capable of providing up to 150 Megalitres of water per day, enough to supply 400,000 households.

Sustainable management of waste is a key priority for the business. We have continued to integrate good waste management practices across our operational and engineering activities and have identified recycling routes for incinerator ash and sewer grit, which we will bring on line in 2005. We have also achieved our target of 100% recycling of sewage sludge to beneficial use, with in excess of 50% of sewage sludge going to agriculture, forestry and land restoration and the remainder being used to generate energy.

The treatment and distribution of drinking water and wastewater is energy intensive and we are committed to ensuring effective use of energy and optimisation of renewable energy generation. In 2004, in partnership with the Carbon Trust, we undertook pilot trials at water and wastewater treatment works to improve our understanding of energy use at the works and to identify opportunities for efficiency savings.

# Thames Water Utilities Limited

## Chairman's review (continued)

We have also continued to use the by-products of wastewater treatment, sewage sludge and biogas, to generate renewable energy, with 138 GWh generated in 2004. We are continually looking for new generation opportunities. In 2004 we installed Combined Heat and Power (CHP) technology for generating usable electricity and heat together in a single process at the new Reading sewage treatment works and upgraded the plant at Basingstoke. We are assessing the costs and benefits of installation of CHP at other operational sites.

As a responsible landowner, we have continued to ensure that biodiversity is an important consideration in our operations. We have tested wildlife-friendly mowing regimes at over 40 Thames Water sites to assess how grounds maintenance techniques can be adjusted for the benefit of wildlife, and during 2004 we completed our audit of over 900 sites to assess their biodiversity value. The results of our audits will now help us to protect and enhance the biodiversity interest on our land. We have assessed over 520 new engineering projects, as part of our award-winning environmental screening procedure, to ensure we minimise our disturbance to wildlife, archaeology and the landscape during essential improvements to the water and wastewater system across the Thames region.

We make many of our operational sites available for recreation and wildlife observation. Sailing is established on several of our reservoirs and we are working to provide greater access for disabled sailors in Oxfordshire and surrounding counties through the Farmoor Reservoir Pontoon Project, now in its second phase, in partnership with local groups.

We continued to build on the success of our flagship education activity "Reservoir to Tap: The Network Challenge" to engage young people in the issues involved in the management of a water distribution network. Working with a variety of partners including the British Council, local Education Business Partnerships and our employees throughout the Thames Water catchment area, we held Network Challenge events to encourage engineering skills and awareness among students.

In 2004, we received external recognition of our achievements in several areas. Our project to create a major new walking and heritage resource, the 40km continuous footpath along the historic aqueduct the New River from rural Hertfordshire to urban London, was rewarded with a national Green Apple award at a special event in the House of Commons in recognition of our environmental best practice. A project to create a new community woodland in Merton, Oxfordshire, received a commendation in the 2004 Oxfordshire Special Conservation Awards.

Our Corporate Responsibility Report on the year 2003 was awarded second place in the Corporate Social Responsibility Category of the Thames Valley Business Awards 2004. Further information on our 2004 environmental performance, our responses to environmental and wider sustainability challenges, together with details of conservation and recreation activities and broader community engagement, can be found in our annual Corporate Responsibility Report. The report will be available from our Customer Centre, PO Box 436, Swindon, SN38 1TU and accessible on the Internet ([www.thameswateruk.co.uk](http://www.thameswateruk.co.uk)) from May 2005.

# Thames Water Utilities Limited

## Chairman's review (continued)

### Looking to the future - outcome of Ofwat's price review

In April 2004 we submitted our Final Strategic Business Plan for the period 2005-2010 to the economic regulator Ofwat. The outcome of that review brings fresh challenges, but we are confident that it will allow us to make significant progress in areas vital to our customers and the future security of water supply and sewerage infrastructure in our region. The review will enable us to invest more than £3 billion in improving essential services. This will include upgrading over 1,300km of water mains, concentrating on those parts of central London where the older mains are located and leakage is highest. As well as working to reduce leakage further and promote water efficiency, we will develop additional and innovative water resources in the medium term while continuing to plan for the long term challenges to security of supply posed by population growth, climate change and environmental requirements. We will continue to raise quality levels for drinking water and wastewater effluent in line with the obligations determined by Government.

We are particularly determined to provide relief for a substantial number of the properties that are currently at risk of sewer flooding and we will work with Ofwat to ensure that priority is given to those properties at greatest risk. We will invest in further works to alleviate the problems of odour at our wastewater treatment works at Mogden in West London.

While our combined sewer overflow arrangements on the Thames Tideway are in line with all current UK legal consent standards and agreements with the Environment Agency, we will continue working with the regulators and the Government in joint investigations on a long term solution to problems caused at times of heavy rain. In the meantime further measures will be introduced in addition to the present arrangements to relieve water quality and aesthetic problems when these arise. In this and other areas of importance to our customers and the environment, if further outputs are required involving investment beyond our current allocation we will work with the regulators to secure the necessary funding.

We are in a long-term business. Our asset management programmes must ensure reliability of services for current and future generations and it has been recognised on all sides that prices will have to reflect this need, while maintaining an appropriate balance between the interests and concerns of our customers, the community and the environment. We face the new five-year Asset Management Plan period determined to meet the challenges ahead and to maintain Thames Water's position as a leading water and wastewater company.

### Our employees

Thames Water Utilities Limited is proud to be part of RWE AG and its Water Division, the third largest water business in the world. Our employees have continued to play a key role in the success of the Company, demonstrating a flexible approach and a willingness to embrace change. I would like to extend my personal thanks to all our employees for their enthusiastic hard work and commitment, sometimes in challenging circumstances. Along with our contractors and their employees, our people do a vital job in securing the health and safety of the public through our essential water and wastewater services.



**Bill Alexander**

Chairman



# Thames Water Utilities Limited

## Corporate governance

The Company is committed to high standards of corporate governance. Although the Company's shares are not listed on the Stock Exchange, in conducting the appointed water and wastewater business the directors pay particular regard to the principles of good governance in the FRC Combined Code 2003 (Combined Code) as approved for the purposes of the Listings Rules of the Financial Services Authority. In determining the scope and content of this report it has been our aim to maintain a proper level of disclosure in keeping with those Combined Code provisions which are applicable to the Company's particular circumstances.

### The Board

The primary responsibility of the Board is to determine the strategic direction of the Company and to promote good corporate governance. It meets bi-monthly, or as required, to monitor executive management and review operating and financial performance. The Board has adopted a formal schedule of matters reserved to it, which is reviewed annually and can only be amended by the Board. In reaching its decisions the Board takes account of the interests of the owners, customers and employees, as well as the Company's responsibilities to the environment.

The executive directors have been appointed with notice periods of less than one year.

Independent non-executive directors are appointed to the Board on the basis of their achievements in other companies and organisations and the experience and broader vision which they can contribute. The aim is that they should be persons of standing, with experience, local knowledge and understanding of the interests of the Company's customers. All independent non-executive directors are required to stand for re-election at least every three years, and are generally expected to serve for a period of up to six years.

The Board is satisfied that the non-executive directors are able to devote sufficient time to their duties to the Company. Non-executive directors are required to disclose to the Board before appointment other significant commitments, and are required to notify the Company Secretary of any change of details, including significant other business commitments. A copy of the terms and conditions of appointment of non-executive directors is available for inspection in the Company Secretary's office at the Company's registered office during normal business hours.

The Deputy Chairman of the Board, C Bowe, is regarded as the senior independent non-executive director.

Sir J Gains joined the Board on 1 April 2005 as an independent non-executive director and will undergo a tailored induction programme which includes external visits to the Company's main operating sites. In June 2004, January 2005 and February 2005, J M England, R J Aylard and S J Buck respectively joined the Board. Each of them have held executive roles with the Company, and so induction activities tailored to their additional responsibilities as a Board member are provided.

The Company Secretary is responsible for advising the Board on governance matters and ensuring that Board procedures are followed. All directors have access to his advice and services. The appointment and removal of the Company Secretary is a matter for the Board as a whole.

In furtherance of their duties, directors have access to independent professional advice at the Company's expense. No director obtained any such independent professional advice during 2004.

# Thames Water Utilities Limited

## Corporate governance (continued)

### Roles of the Chairman and Managing Director

There is a clear division of responsibility between the Chairman and the Managing Director of the Company. Although a director of the immediate parent company, RWE Thames Water plc, the Chairman is a non-executive director of the Company. The Chairman (or in his absence, the Deputy Chairman) is responsible for the effective running of the Board and ensuring that all directors, executive and non-executive, are consulted to enable them to play their full part in the Company's affairs. The Managing Director is responsible for the day-to-day management of the Company and the implementation of the policies and strategies adopted by the Board.

### Board Committees

Four formal committees have been established, as described below. Each of these has written terms of reference, which define the roles and responsibilities of the committee and these are reviewed annually. In addition, the Board can form committees, as and when required, with delegated authority in relation to specific issues. The minutes of all committees are reported to the Board. The Board is satisfied that each committee has been provided with sufficient resources to undertake its duties.

### Executive Committee

The main role of the Executive Committee is the executive management of the business, formulation of strategy and the approval of matters which are not specifically reserved for the Board and which have not been specifically delegated to another board committee. Within the Committee's role is primary responsibility for approval of capital investment and this is discharged through the Investment Committee, a formal sub-committee of the Board.

**Members:** The members of the Executive Committee consist of at least two executive directors of the Board and such other senior executives of the Company whom the Chairman and Managing Director agree shall be members of the Executive Committee.

### Audit Committee

The primary objective of the Audit Committee is to assist the Board of Directors in fulfilling its responsibilities relating to the adequacy and effectiveness of the Company's systems of internal control. This includes reviewing the Company's interim and annual financial statements, its accounting policies and the management of its financial and business risks; the effectiveness of the Company's internal audit function; and the independence, objectivity and effectiveness of the Company's external auditors. It makes recommendations to the Board in relation to the external auditors' appointment and remuneration. The Audit Committee reviews arrangements by which staff of the Company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The Audit Committee's objective is to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action. The terms of reference of the Committee include all matters indicated by the Combined Code and the Committee considers any other corporate governance issues referred to it by the Board.

# Thames Water Utilities Limited

## Corporate governance (continued)

### Audit Committee (continued)

The Audit Committee, which meets at least three times a year, is composed exclusively of independent non-executive directors. It meets with executive directors and management as well as privately with the external and internal auditors.

**Members:** C Bowe (Chairman), P T Warry, S Slipman

### The Remuneration Committee

The role of the Remuneration Committee is to determine the salaries and other remuneration of the executive directors. At present, this does not extend to the wider senior management. The Remuneration Committee is exclusively comprised of the independent non-executive directors of the Board and meets during the year as necessary. The Remuneration Committee is authorised by the Board to obtain external professional services, or consultants' advice, as necessary. The Chairman of the Board or his delegate attends meetings of the Remuneration Committee, but is not a member and does not vote on recommendations.

Service contracts for directors do not provide explicitly for early termination payments. In the event of early termination, the Remuneration Committee will, in each circumstance, determine the compensation that may be paid after applying such mitigation it considers is fair and reasonable. The Remuneration Committee's approach would be to take a robust line on reducing compensation to reflect departing directors' obligation to mitigate loss.

Members of the Remuneration Committee do not participate in decisions concerning their own remuneration. The Chairman determines the non-executive directors' salaries, after considering the advice of the Human Resources Director and independent benchmarking information. The Remuneration Committee approves an appropriate report for inclusion in the Company's Annual Report.

**Members:** S Slipman (Chairman), C Bowe, P T Warry

### Nominations to the Board

The establishment of a formal Nominations Committee was considered, but was not felt to be necessary in the particular circumstances of the Company as a non-listed private subsidiary company. Board level appointments are normally dealt with by the Chairman in consultation with fellow directors. A Nominations Committee, made up of the independent non-executive directors and the Chairman of the Board, by whom it is chaired, meets on an ad hoc basis to consider candidates for particular roles.

# Thames Water Utilities Limited

## Corporate governance (continued)

### Environmental and Corporate Responsibility Committee

The principal activities of the Environmental and Corporate Responsibility Committee are reviewing the Company's Environmental and Corporate Responsibility strategy, performance, reporting and the sustainability and social impact of the Company's activities. The Environmental and Corporate Responsibility Committee reviews the Company's discharge of its responsibilities for Conservation, Access and Recreation and approves the publication of the annual statutory Conservation Access and Recreation Report as part of the Corporate Responsibility Report.

**Members:** P T Warry (Chairman), S Slipman, J R Sexton

### Internal Control

The Board has overall responsibility for maintaining a sound system of internal control, including financial, operational and compliance controls and risk management and for reviewing its effectiveness. The internal control system is designed to manage, rather than eliminate, the risk of failure to meet business objectives and can only provide reasonable, not absolute, assurance against material misstatement or loss. The system has been in place for the year under review and up to the date of approval of the annual report and accounts. Key features of the overall system of internal control include:

- Regular board meetings with a formal schedule of matters reserved to the Board for decision.
- Clearly defined organisation structures, appropriate delegated authorities and established policies and procedures, reviewed annually, for conducting all significant aspects of the Company's business.
- A clear business process for the identification, evaluation and mitigation of risks, including regular reporting to the Audit Committee and the Board.
- A detailed five-year business plan, comprehensive annual budget and a clear process of monitoring business performance against that budget on a monthly basis. Revised financial forecasts are prepared quarterly.
- Established policies and procedures for the approval and control of major items of capital expenditure and for the acquisition and disposal of material assets or entering into of any arrangement which could give rise to a material liability for the Company.
- Formal arrangements for an independent internal audit department to carry out reviews of information systems and adherence to business and financial control procedures, under a broadly based programme of work approved by the Audit Committee.

# Thames Water Utilities Limited

## Corporate governance (continued)

### Internal Control (continued)

The directors routinely review the effectiveness of the system of internal control and risk management, principally by means of:

- Regular presentations to the Board and to the Executive Committee by directors of individual business units and functional heads, describing their risk management strategies and detailing the status of significant business risks.
- Quarterly reports to the Risk Management Committee, which although not a formal committee of the Board, meets as part of the monthly Executive team meeting and is chaired by the Managing Director. This committee receives regular advice and reports from a professional support group comprising senior managers from all parts of the Company's business, whose role is to review and challenge the robustness of risk management procedures applied within the business. Any significant changes to the Company's overall risk profile arising from the work of the Risk Management Committee are reported to the Audit Committee and the Board.
- Regular reports to the Audit Committee from the internal audit department on their independent audits of financial and other controls across the Company.

In addition, the directors have conducted an annual review of the effectiveness of the Company's system of internal control, which includes the period up to the date of this annual report. This included a process of self-certification by all business units, supervised by the internal audit department, through which executive directors and heads of business units were required to confirm compliance with prevailing internal control policies and procedures.

# Thames Water Utilities Limited

## Report on remuneration policy and remuneration

The Company's remuneration policy has particular regard to the principles set out in the current edition of the Combined Code on corporate governance. In relation to executive directors the policy is:

- To establish a firm link between an executive's performance and his/her total remuneration.
- To establish a firm link between the organisation's performance and the executive's total remuneration.
- To position base pay so that it takes account of individual contribution and experience and has regard to the market so that the Company will attract and retain the required calibre of business leader.

Roles are evaluated using external advice and the Hay Guide Chart Profile Method of Evaluation. This is the most widely used job sizing method being used by approximately 8,000 organisations worldwide. The remuneration package includes salary, performance-related bonus, a long-term incentive plan and pension provision. To date the Company's executive salaries have been typically positioned between median and upper quartile. Base pay is reviewed annually in April but may be reviewed at any time in exceptional circumstances. The Remuneration Committee approves all elements of the Company's remuneration of those of its executive directors whose responsibilities relate exclusively to the Company. It also approves the main Thames Water Utilities Limited related elements of the remuneration of those executive directors whose responsibilities extend to other parts of the RWE Thames Water Division. The increases in certain directors' remuneration, as shown in note 5 on pages 32 and 33, reflect increases in responsibility undertaken and performance related bonuses earned.

The Company's bonus scheme aims to reward significant improvement in the Company's performance and recognises the executive's personal contribution to that performance. Performance measures are a combination of the Company's financial targets, which are set at the beginning of the financial year, the Company's operational and customer service targets (notably Ofwat's Director General (DG) measures), and personal performance measures. The Company has taken a lead in the water industry by ensuring that these DG measures translate directly into bonus plans. Top-up pension schemes are provided by way of an Inland Revenue approved pension scheme and a funded unapproved retirement benefit scheme.

As an element of retention strategy, the Company's executive directors participate in the RWE Thames Water Division Long-Term Incentive Plan (LTIP) scheme that aims to encourage, reward, recognise and retain key people. Under the LTIP, executives are awarded conditional rights over a number of RWE shares based on the performance of RWE Thames Water Division. The Divisional Board (RWE Thames Water plc) determines annually whether the underlying financial performance of the Division justifies an award. There is no automatic right to participate in the LTIP and each year executives are selected at the discretion of the Divisional Board.

Details of the remuneration of the executive and independent non-executive directors who served during the year are set out in note 5 on pages 32 and 33. Significant elements of the responsibilities of the Managing Director of RWE Thames Water Europe related to his wider management role within the RWE Thames Water Division beyond Thames Water Utilities Limited and the remuneration disclosed in note 5 represents the appropriate proportion of his remuneration in respect of service to the Company. A proportion of J R Sexton's and C Anderson's responsibilities during the year extended beyond that solely of their Thames Water Utilities Limited directorships and related instead to responsibilities to the Division as a whole. The remuneration disclosed in note 5 represents the appropriate proportion of their remuneration in respect of services to the Company.

# Thames Water Utilities Limited

## Report on remuneration policy and remuneration (continued)

The non-executive Chairman is not remunerated by the Company, but is instead remunerated by RWE Thames Water plc and his remuneration is disclosed in the RWE Thames Water plc Annual Report and Accounts. The RWE Thames Water Division Investment & Technology Director receives remuneration solely in respect of his role as an employee of RWE Thames Water plc and is not remunerated by Thames Water Utilities Limited in respect of his role as a non-executive director of the Company.

Details of contracts of directors who served during the year are set out below:

	Date of contract	Unexpired term	Notice period	Contractual compensation upon early termination
<b>Current Directors</b>				
C Bowe	3 July 2001, extended for three years on 1 July 2004	2 years 6 months from 31 December 2004	One year	None
S Slipman	1 January 2002, extended for three years on 1 July 2004	2 years 6 months from 31 December 2004	One year	None
J M England	7 June 2004	Indefinite	Six months	No explicit provision (other than payment for outstanding holidays and pay in lieu of notice). The Company operates a redundancy policy, which may apply in addition.
W U Böttcher	19 September 2003	Indefinite	One year	No explicit provision (other than payment for outstanding holidays and pay in lieu of notice). The Company operates a redundancy policy, which may apply in addition.
<b>Former Directors</b>				
J R Sexton	31 July 1992	Resigned 31 January 2005	N/A	N/A
C Anderson	20 September 2001	Resigned on 31 January 2005	N/A	N/A
P T Warry	3 July 2001	Resigned on 21 January 2005	N/A	N/A

Approved by the Remuneration Committee



**S Slipman**  
Chairman of the Remuneration Committee  
1 April 2005

# Thames Water Utilities Limited

## Directors' report for the year ended 31 December 2004

The directors present their report and the audited financial statements for the year ended 31 December 2004.

### Principal activities

The principal activities of the Company are the supply of water to over 3.6 million premises and the collection and treatment of sewage from over 5.5 million premises, serving around 13 million customers in London and the Thames Valley.

Details of the progress made and information relating to the various activities of the Company during the year and plans for the future are given in the Chairman's Review on pages 3 to 7.

### Financial review of the year

The results for the year are set out in the profit and loss account on page 24.

Turnover of £1,173.8m for the year (2003: £1,136.2m), was up 3.3% on the same period in 2003. 2.3% of turnover growth was due to price increases linked to RPI. The remaining 1.0% of turnover growth was due to growth in the customer base due to new properties built in the area and initiatives to ensure all customers are billed in a timely and accurate manner for the services provided.

Profit on ordinary activities before taxation was £268.2m for the year (2003: £258.6m). Results continue to be adversely affected by increased pension costs to the Company and costs associated with continuing focus on leakage reduction and security of customer supplies. These increased costs have been offset by continuing operational efficiency programmes.

The SSAP 24 pension cost for the year was £18.3m (2003: £13.0m). To ensure our future pension obligations to employees are met, the Company pension scheme contribution rate has been increased. The Company made contributions of £12.7m for the year ended 31 December 2004 (2003: £7.9m) into the Company's pension schemes. Other information about the Company's pension schemes is set out in note 23 on pages 45 to 47 of these accounts.

Capital investment in the period has been particularly targeted towards security of drinking water supplies to our customers, leakage reduction, water and wastewater quality programmes and the alleviation of sewer flooding. Gross capital investment of £602.6m (2003: £605.7m), including net infrastructure renewal expenditure of £68.1m (2003: £65.0m), was made during the year. This continuing substantial investment programme is reflected in the depreciation charge of £268.9m (2003: £268.7m).

### Dividends

The Company paid an interim dividend of £45.8m and proposed a final dividend of £95.4m in respect of the year. The total dividend for the year of £141.2m compares with a total dividend of £136.1m for the year ended 31 December 2003.



# Thames Water Utilities Limited

## Directors' report for the year ended 31 December 2004 (continued)

### Board of directors

The directors of the Company who served during the year are:

W J Alexander	Chairman (non-executive)
J R Sexton	Managing Director (resigned 31 January 2005)
W U Böttcher	Managing Director, RWE Thames Water Europe
C Anderson	Finance Director (resigned 31 January 2005)
J M England	Chief Operating Officer (appointed 7 June 2004)
S C Walker	Director (non-executive)

Independent non-executive directors who served during the year are:

C Bowe	Deputy Chairman
P T Warry	(resigned 21 January 2005)
S Slipman	

Since the year-end, the following changes in Board membership have occurred:-

R J Aylard was appointed to the Board as External Affairs Director as from 21 January 2005.

J R Sexton resigned from the Board as from 31 January 2005 and W U Böttcher became Managing Director from 1 February 2005.

C Anderson resigned from the Board as from 31 January 2005 and S J Buck was appointed to the Board as Finance Director from 1 February 2005.

P T Warry, independent non-executive director, resigned from the Board as from 21 January 2005, and Sir J Gains was appointed to the Board as an independent non-executive director from 1 April 2005.

### Directors' interests

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

### Significant contracts

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

# Thames Water Utilities Limited

## Directors' report for the year ended 31 December 2004 (continued)

### Policy on payment of suppliers

The Company supports a number of initiatives to promote a payment culture consistent with agreed terms, including those proposed by the Construction Round Table and the Confederation of British Industry (CBI). All payments to suppliers, service providers and contractors are made on the basis of mutually agreed terms and conditions. During 2004 a major review of our contracts with our main service providers and contractors has been undertaken and the average amount due to trade creditors represented 68 days (2003: 54 days) purchases received from these creditors.

### Employees

We continue to recognise the essential role played by our employees in the successful operation of the Company and, in return, aim to provide employees with a safe and fulfilling environment in which to work and to develop their skills.

We have improved access for employees in gaining training and development and we have further developed the range of training solutions available for a wide range of needs. In particular, we have continued our focus on developing excellence in people management.

Our graduate recruitment programme continues to prove attractive to a high quality of recruit and we have been pleased to be able to offer our graduate recruits development opportunities in the form of secondments and training courses within the wider RWE Group.

Directors and managers have the opportunity to enhance their leadership, people and general business management skills, through access to formal qualifications and through links with UK and international business schools. We continue to see the benefits of informal and formal networking with colleagues in other parts of the RWE Group, in offering our leaders the opportunity to learn about and apply varied business models and approaches. A new appraisal process for managers has been developed, to improve the identification of potential in the business and to assist in career and succession planning. A further innovation has been the introduction, in September 2004, of a programme of Development Needs Analysis for managers. This is a comprehensive and individually oriented approach to addressing the development needs of our management population and is designed to complement the appraisal process.

We are pleased to continue to hold Investors In People accreditation in key areas of the business. Continuing to recognise the importance of customer service, we have supported a number of employees in successfully achieving external accreditation through the Institute of Customer Service awards, at various levels.

Formal consultation with employees in the Company continues to be via a partnership agreement. We have now begun to implement our plans to embed partnership working and have been working closely with our Trade Union colleagues and employees to heighten awareness of partnership principles and to champion a co-operative and collaborative approach to problem solving.

# Thames Water Utilities Limited

## Directors' report for the year ended 31 December 2004 (continued)

We are committed to sharing information with employees on key business issues and our communications framework is subject to continual review and development. We have in operation a variety of communication channels, including the employee magazine "team:thameswater," team briefings and regular e-mail updates, together with the holding of team building conferences and events.

The Company's work-life balance policy helps to ensure that employees are able to meet the demands of their job while at the same time being offered support with their wider home responsibilities.

The Company recognises the importance of diversity. We have outlined our commitment to the recruitment, development and retention of employees with disabilities through our Disability Policy. We are committed to ensuring that we treat people fairly and that we combat discrimination, through our Equal Opportunities Policy. The Environmental and Corporate Responsibility Committee has discussed a range of possible actions for further promoting diversity in the Company.

We recognise the valuable contribution our employees make by volunteering in the communities in which we operate and to support their activities we have been developing a new initiative called "Time to Give" which gives every employee two days off each year, in addition to annual leave, to volunteer for one of three organisations: WaterAid, The Royal Society for the Protection of Birds and Age Concern. Time to Give will be launched throughout Thames Water Utilities Limited in 2005. At the end of December 2004, in addition to the Company making water purification supplies and pumping equipment available, many of our employees responded generously to the Asian Tsunami disaster. This included three volunteers from the Company who went to Banda Aceh to work with aid organisations and the Indonesian Government to assess how best to progress rehabilitation work in the stricken region.

### Research and development

Expenditure on research and development of £5.8m was made during the year (2003: £6.1m).

The focus of the Company's research and development projects has become mainly aligned with developing knowledge and evaluating technical solutions for future capital investment programmes.

In 2004 research was carried out to evaluate alternative and innovative new water resources. This aims to address issues with rising water demands and predicted climatic change impacts on our current and finite fresh water resources. The technology and economics of treating saline and brackish waters have significantly improved in recent years, potentially enabling a wider range of source waters to be considered for the East London area. A major desalination pilot plant study programme was carried out for the proposed 150 Megalitre per day Gateway Water Treatment Plant. This could become the UK's first and Europe's largest desalination plant for municipal water supply. New technical challenges were presented by the tidal and brackish Thames Tideway source. Energy efficient, multistage reverse osmosis membrane technology was successfully tested at the pilot plant and incorporated into the proposed engineering designs.

Research has been carried out to more accurately determine trends in water usage both within defined geographical bounds, such as the new water distribution network and district metered areas, and combined with population and social trends information obtained from 2001 census data. A scoping study on emerging technologies for "smart" metering, real time meter reading and asset tagging was carried out to identify future options for advanced metering trials.

# Thames Water Utilities Limited

## Directors' report for the year ended 31 December 2004 (continued)

Planning for a renewal programme for Victorian water mains in London was strongly supported by research and development technical evidence and by the development of a new device for assessing the condition of medium diameter (200-300mm) cast iron pipes which was launched for the first time under London's streets in 2004. This is an intelligent pipeline inspection vehicle developed jointly with United Utilities and Severn Trent Water research teams and an external technology development organisation. The inspection device can travel through water filled pipes searching for cracks and corrosion and reporting on condition and need for rehabilitation or renewal over launch and retrieval distances of up to 2km. A programme of proving field trials is scheduled throughout 2005 to train users and to validate the sensor analysis system.

Research was conducted on London's combined sewer overflow system to examine water quality under storm-flow conditions. This included development and use of a novel collection system to determine the nature and loading of screenable materials. The results will support planning and selection of potential design solutions for future London Tideway storm sewage schemes.

Research on wastewater treatment technology has been directed to finding ways to upgrade existing biological treatment processes to meet more stringent effluent quality goals or increased flows and loads. Pilot plants have been operated and a full-scale plant was commissioned at Henley STW in the autumn of 2004. Also in the field of wastewater sludge treatment and disposal technology, a new liquid lime and polymer treatment system was fast-tracked from laboratory to full scale in 3 months and is now helping to significantly reduce sludge handling and related odour problems.

The Company continues to support longer-range national and international research on topics such as climate change and water quality implications of the new European Water Framework Directive through funding and collaboration with universities and organisations such as UK Water Industry Research (UKWIR).

### Health and safety

We have a proactive commitment to effective health and safety risk management and have in place the necessary policies and arrangements that establish our values and standards and monitor their application. Competence in managing health and safety is an essential part of professional management, relying upon co-operative effort and effective communication at all levels in the Company.

Our overall health and safety objectives are to:

- Prevent injury to employees and others affected by our work
- Prevent damage to plant, equipment and buildings
- Control accident potential and occupational ill health through attention to our well established Health and Safety Standards and Procedures
- Ensure co-operation and effective communication at all levels
- Continually improve health and safety management

# Thames Water Utilities Limited

## Directors' report for the year ended 31 December 2004 (continued)

The primary health and safety risk activities that the business manages on a day-to-day basis are:

- Work on, or near deep water
- Construction and tunnelling
- Machinery
- Streetworks
- Confined space work
- High voltage electricity
- Occupational health hazards
- Chemicals and gases

The necessary risk assessments, company standards and training programmes continue to be put in place to effectively control such risks and are subject to continual review.

During the year, a number of major initiatives have been implemented to progress our health and safety goals.

Key areas have included:

- The revision of the Company Health and Safety Policy to reflect organisational change.
- A review of the Thames Water Back Care Scheme resulting in the scheme being extended for all musculo-skeletal problems with the aim of enabling employees to have appropriate early treatment and enhancing the process for return to work.
- The introduction of an Asbestos Management Plan to comply with new legislation and the implementation of a strategic plan for asbestos surveys throughout the Company.
- Substantial work to meet our statutory obligations on Control of Major Accident Hazards (CoMAH Regulations), which has met the expectations of the Health and Safety Executive and the Environment Agency.
- A review and remodel of the Company's intranet system for health and safety communication on Company standards and procedures to support management in effective health and safety management.
- The production of two proprietary videos to support Health and Safety Induction and to introduce the concept of safety in the home.

### Health and safety performance

There have been no fatal accidents, prosecutions or enforcement notices during the year affecting the Company directly, although one dangerous occurrence was reported due to a failure of lifting equipment. Contractors working with the Company reported six dangerous occurrences and we are working with our contractors to ensure that their safety performance is continually improved.

Following on from the British Safety Council Audit in April 2004, the Company achieved a 92.1% overall score which qualified for the British Safety Council Five Star Audit Award. Thames Water was also presented in June with a British Safety Council Award as part of our submission to the National Safety Awards. The Health and Safety Executive (HSE) carried out an audit of Wastewater Operations in the London area as part of a regional initiative on Waste Operators.

There were 805 lost working days for the year 2004 resulting from reportable accidents. This equates to an incidence rate, expressed as the number per 1000 employees, of 17.6 (2003: 8.75). Although there have been a higher number of reportable accidents in 2004, many of them involving trips and falls, the number of lost days resulting from accidents has decreased by 113 (2003: 918 days). It should be noted that lost days reported and recorded are in accordance with statutory requirements and do not include long-term absence (industrial injuries) of a small number of employees who were absent from work during the period.

# Thames Water Utilities Limited

## Directors' report for the year ended 31 December 2004 (continued)

### Initiatives for 2005

Looking forward, we are committed to a range of development initiatives, which include:

- Delivering a robust director and senior manager health and safety training programme to ensure continued improvement for occupational health and safety at a senior level.
- Continuing to deliver health and safety management training following revision of the existing programme.
- Improving the risk assessment process within the business.
- Delivering a new approach to accident investigation leading to improved safety performance.
- Ensuring an effective health and safety audit programme and establishing a robust tracking system to monitor continual improvement.

### Directors' responsibilities

Company law requires the directors to prepare financial statements for each financial period that give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. The directors are required to prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the Company will continue in business.

The directors confirm that suitable accounting policies have been used and applied consistently. They also confirm that reasonable and prudent judgements and estimates have been made in preparing the financial statements for the year ended 31 December 2004 and that applicable accounting standards have been followed.

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

### Auditors

A resolution to reappoint PricewaterhouseCoopers LLP as auditors to the Company will be proposed at the annual general meeting.

### Approved by the Board



**K G Johnson**  
Company Secretary  
1 April 2005

# **Thames Water Utilities Limited**

## **Report of the independent auditors to the members of Thames Water Utilities Limited**

We have audited the financial statements, which comprise the profit and loss account, the balance sheet, the cash flow statement and the related notes.

### **Respective responsibilities of directors and auditors**

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

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

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

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the chairman's review, corporate governance statements, report on remuneration policy and remuneration and the directors' report.

The maintenance and integrity of the Thames Water Utilities Limited website is the responsibility of the directors, the work carried out by the auditors does not involve the consideration of these matters and accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Legislation in the United Kingdom governing the preparation and dissemination of the financial statements may differ from legislation in other jurisdictions.

# Thames Water Utilities Limited

## Report of the independent auditors to the members of Thames Water Utilities Limited (continued)

### Basis of audit opinion

We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the 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 the Company's affairs at 31 December 2004 and of its profit and cash flows for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

*PricewaterhouseCoopers LLP*

**PricewaterhouseCoopers LLP**  
**Chartered Accountants and Registered Auditors**  
**Reading**  
1 April 2005



# Thames Water Utilities Limited

## Profit and loss account for the year ended 31 December 2004

	Note	2004 £m	2003 £m
Turnover	2	1,173.8	1,136.2
Operating costs	3	<u>(778.9)</u>	<u>(767.0)</u>
<b>Operating profit</b>		<b>394.9</b>	<b>369.2</b>
Profit on sale of fixed assets	4	6.7	14.5
Net interest	6	<u>(133.4)</u>	<u>(125.1)</u>
<b>Profit on ordinary activities before taxation</b>	2	<b>268.2</b>	<b>258.6</b>
Taxation on profit on ordinary activities	7	<u>(78.8)</u>	<u>(74.6)</u>
<b>Profit for the year</b>		<b>189.4</b>	<b>184.0</b>
Dividends	8	<u>(141.2)</u>	<u>(136.1)</u>
<b>Retained profit for the year</b>	19 & 20	<u><b>48.2</b></u>	<u><b>47.9</b></u>

All amounts above relate to continuing operations.

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

The Company has no recognised gains and losses other than the profit stated above and therefore no separate statement of recognised gains and losses has been presented.

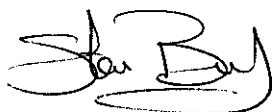
# Thames Water Utilities Limited

## Balance sheet at 31 December 2004

	Note	2004 £m	2003 £m
<b>Fixed assets</b>			
Tangible assets	9	5,220.5	4,924.6
Investments	10	<u>0.1</u>	<u>0.1</u>
		<b>5,220.6</b>	<b>4,924.7</b>
<b>Current assets</b>			
Stocks and work in progress	11	5.9	5.8
Debtors	12	417.9	441.9
Cash at bank and in hand		<u>1.5</u>	<u>-</u>
		<b>425.3</b>	<b>447.7</b>
<b>Creditors: amounts falling due within one year</b>	13	<b>(1,406.4)</b>	<b>(1,267.6)</b>
<b>Net current liabilities</b>		<b>(981.1)</b>	<b>(819.9)</b>
<b>Total assets less current liabilities</b>		<b>4,239.5</b>	<b>4,104.8</b>
<b>Creditors: amounts falling due after more than one year</b>	14	<b>(1,806.3)</b>	<b>(1,784.7)</b>
<b>Provisions for liabilities and charges</b>	16	<b>(861.9)</b>	<b>(797.0)</b>
<b>Net assets</b>		<b><u>1,571.3</u></b>	<b><u>1,523.1</u></b>
<b>Capital and reserves</b>			
Called up share capital	17	1,029.0	1,029.0
Share premium	18	100.0	100.0
Profit and loss account	19	<u>442.3</u>	<u>394.1</u>
<b>Equity shareholders' funds</b>	20	<b><u>1,571.3</u></b>	<b><u>1,523.1</u></b>

The notes on pages 27 to 47 form part of these financial statements.

The financial statements were approved by the Board of Directors on 1 April 2005 and were signed on its behalf by:



**S J Buck**  
Finance Director

# Thames Water Utilities Limited

## Cash flow statement for the year ended 31 December 2004

	Note	2004 £m	2003 £m
<b>Net cash inflow from operating activities</b>	(a)	<b>628.6</b>	740.6
<b>Returns on investments and servicing of finance</b>			
Interest received		2.7	0.7
Interest paid		(121.0)	(110.8)
Interest element in finance lease payments		<u>(11.8)</u>	<u>(11.7)</u>
<b>Net cash (outflow) from returns on investments and servicing of finance</b>		<b>(130.1)</b>	(121.8)
<b>Taxation</b>		<b>(16.3)</b>	(12.2)
<b>Capital expenditure and financial investment</b>			
Gross cost of purchased fixed assets		(556.7)	(526.9)
Infrastructure renewals expenditure		(63.9)	(67.6)
Receipt of grants and contributions		95.4	60.8
Sale proceeds of fixed assets		<u>8.7</u>	<u>15.6</u>
<b>Net cash (outflow) from investment activities</b>		<b>(516.5)</b>	(518.1)
<b>Equity dividends paid</b>		<u>(137.2)</u>	<u>(132.8)</u>
<b>Net cash (outflow) before financing</b>		<b>(171.5)</b>	(44.3)
<b>Financing</b>			
Capital element in finance lease payments		(6.6)	(5.4)
New loans		675.9	446.0
Repayment of loans		<u>(496.3)</u>	<u>(397.1)</u>
<b>Net cash inflow from financing</b>	(b) & (c)	<u><b>173.0</b></u>	43.5
<b>Increase/(decrease) in cash</b>	(b) & (c)	<u><b>1.5</b></u>	<u>(0.8)</u>

# Thames Water Utilities Limited

## Notes to the cash flow statement for the year ended 31 December 2004

### (a) Reconciliation of operating profit to net cash inflow from operating activities

	Note	2004 £m	2003 £m
Operating profit		394.9	369.2
Depreciation (infrastructure)	3	72.1	68.1
Depreciation (non-infrastructure)	3	196.8	200.6
(Increase)/decrease in stocks and work in progress		(0.1)	2.5
Decrease in debtors and prepaid expenses		21.6	24.4
(Decrease)/increase in creditors and accrued expenses		(49.4)	82.5
Release of deferred income		(7.3)	(6.7)
<b>Net cash inflow from operating activities</b>		<b>628.6</b>	<b>740.6</b>

### (b) Reconciliation of net cash flow to movement in net debt

	Note	2004 £m	2003 £m
Increase/(decrease) in cash in the period		1.5	(0.8)
Cash inflow from movement in net debt and financing		(173.0)	(43.5)
Increase in net debt resulting from cashflows		(171.5)	(44.3)
Non-cash increase in net debt		(4.9)	(6.6)
Total increase in net debt		(176.4)	(50.9)
Opening net debt		(2,189.0)	(2,138.1)
<b>Closing net debt</b>	(c)	<b>(2,365.4)</b>	<b>(2,189.0)</b>

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

### (c) Analysis of net debt

	2003 £m	Cashflow £m	Non-cash £m	2004 £m
Cash at bank and in hand	-	1.5	-	1.5
Debt due within 1 year	(496.2)	(194.7)	-	(690.9)
Debt due after 1 year	(1,452.7)	15.1	(4.9)	(1,442.5)
Finance leases	(240.1)	6.6	-	(233.5)
	<u>(2,189.0)</u>	<u>(173.0)</u>	<u>(4.9)</u>	<u>(2,366.9)</u>
<b>Total</b>	<b>(2,189.0)</b>	<b>(171.5)</b>	<b>(4.9)</b>	<b>(2,365.4)</b>

# Thames Water Utilities Limited

## Notes to the financial statements

### 1 Principal accounting policies

A summary of the more important accounting policies, which have been applied consistently, is set out below.

#### (a) Basis of preparation

The financial statements have been prepared in accordance with the historical cost convention and with applicable Accounting Standards in the United Kingdom and, except for the treatment of certain capital contributions, with the Companies Act 1985. An explanation of the departure from the requirements of the Act is given in note 1(d) below.

The Company has not prepared consolidated Group financial statements, as permitted under section 228 of the Companies Act 1985. The Company and its subsidiaries are included in the consolidated accounts of its parent company RWE Thames Water plc, a company registered in the United Kingdom.

#### (b) Turnover

Turnover, which excludes value added tax, represents the income receivable in the ordinary course of business, for goods and services provided.

#### (c) Tangible fixed assets

Tangible fixed assets comprise:

##### (i) Infrastructure assets:

Infrastructure assets comprise a network of systems consisting of mains and sewers, impounding and pumped raw water storage reservoirs and sludge pipelines.

Expenditure on infrastructure assets is treated as additions to tangible fixed assets. 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 depreciation.

##### (ii) Other assets:

Other assets include properties, over ground plant and equipment.

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. Employee costs incurred in implementing the capital schemes of the company are included within the cost of fixed asset additions.

Other assets are depreciated evenly over their estimated economic lives, which are principally as follows:

Operational structures	40 - 80 years
Other buildings	20 - 60 years
Fixed and mobile plant	7 - 40 years
Vehicles, computers, fixtures and fittings	3 - 10 years

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 1 Principal accounting policies (continued)

#### (d) Capital contributions

Capital contributions received in respect of infrastructure assets have been deducted from the cost of fixed assets. This is not in accordance with Schedule 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 financial statements to give a true and fair view because infrastructure assets do not have a finite life. Accordingly related capital contributions would not be recognised in the profit and loss account. The effect of the departure on the value of tangible fixed assets is disclosed in note 9.

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

#### (e) 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 economic 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.

#### (f) Investments

Investments held as fixed assets are stated at cost less provisions for impairment in value. Investments held as current assets are stated at the lower of cost and net realisable value.

#### (g) Stocks

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

#### (h) Foreign currencies

All transactions denominated in foreign currencies are translated into sterling at the actual rate of exchange ruling on the date of the transaction. Assets and 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.

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 1 Principal accounting policies (continued)

#### (i) Pension costs

The majority of the Company's employees belong to pension schemes which are funded by both employer's 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 service lives of employees. Any difference between the cost charged and the amounts paid by the Company is treated as a prepayment or accrual.

In accordance with the permitted transitional arrangements under FRS 17, 'Retirement Benefits', the costs, accruals and prepayments recorded in the financial statements continue to be reported under the requirements of SSAP 24 'Accounting for Pension Costs'.

Information on the Company's pension arrangements, including transitional disclosures made under FRS 17, can be found in note 23 to these financial statements and in the financial statements of the immediate parent company RWE Thames Water plc.

#### (j) Research and development

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

#### (k) Taxation

The charge for taxation is based on the profit for the year as adjusted for disallowable and non-taxable items.

Provision is made for deferred tax liabilities, and assets only to the extent that the directors consider it more likely than not that there will be suitable taxable profits from which the future reversal of the timing differences can be deducted, in accordance with FRS 19.

Deferred tax is measured at the average tax rates that are expected to apply to the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantially enacted by the balance sheet date. Deferred tax is measured on a non-discounted basis.

#### (l) Related party disclosures

The Company is exempt under the terms of FRS 8 from disclosing related party transactions with entities that are part of the RWE AG Group.

#### (m) Derivative financial instruments

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

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 2 Segmental analysis

The directors consider that the Company has one class of business and this is conducted wholly within the United Kingdom.

### 3 Operating costs

Analysis of operating costs by type of expense:

	Note	2004 £m	2003 £m
Manpower costs	5	158.8	157.4
Materials and consumables		23.7	22.8
Other operating charges		365.1	346.1
Depreciation:			
- owned asset (infrastructure)		72.1	68.1
- owned assets (non-infrastructure)		187.2	191.5
- assets held under finance leases		9.6	9.1
Rentals under operating leases:			
- hire of plant and machinery		3.1	2.0
- other		7.7	7.7
Auditors' remuneration:			
- for statutory audit work		0.3	0.3
- for regulatory audit work		0.1	0.1
Research and development		5.8	6.1
		<u>833.5</u>	<u>811.2</u>
Own work capitalised		<u>(54.6)</u>	<u>(44.2)</u>
		<u>778.9</u>	<u>767.0</u>

The auditors received remuneration of £30,000 in respect of non-audit work (2003: £21,776).

### 4 Profit on sale of fixed assets

	2004 £m	2003 £m
Profit on disposal of fixed assets	<u>6.7</u>	<u>14.5</u>
Taxation attributable, included in the charge for the year	<u>1.4</u>	<u>0.6</u>



# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 5 Information regarding directors and employees

Aggregate directors remuneration:

	2004 £000	2003 £000
Salary	706	595
Bonus	615	228
Other benefits	38	50
Total aggregate emoluments	<u>1,359</u>	<u>873</u>

Retirement benefits are accruing to 3 directors (2003: 3) under a defined benefit scheme.

Aggregate remuneration of each of the executive directors:

	2004 £000	2003 £000
J R Sexton	415	244
W U Böttcher	351	111
C Anderson	391	200
J M England	102	-
T J V Jones	-	224
Total aggregate emoluments	<u>1,259</u>	<u>779</u>

Aggregate remuneration of each of the independent non-executive directors:

	2004 £000	2003 £000
C Bowe	40	38
P T Warry	30	28
S Slipman	30	28
Total aggregate emoluments	<u>100</u>	<u>94</u>

#### Highest paid director

The highest paid director was J R Sexton. In addition to the aggregate emoluments disclosed above, J R Sexton had accrued pension benefits of £100,707 at 31 December 2004 (2003: £87,881).

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 5 Information regarding directors and employees (continued)

#### Non-executive Chairman

The above details of directors' remuneration do not include W J Alexander, who was remunerated by RWE Thames Water plc in respect of his services to the Division as a whole. Details of his remuneration are disclosed in the financial statements of RWE Thames Water plc.

#### Other non-executive directors

S C Walker is remunerated by RWE Thames Water plc in respect of his services to the Division as a whole, as RWE Thames Water Division Investment & Technology Director. S C Walker is not remunerated in respect of his role as a non-executive director of the Company, accordingly his remuneration is not disclosed in the aggregate disclosures above.

#### Managing Director RWE Thames Water Europe

W U Böttcher is remunerated by RWE Thames Water plc in respect of his services to the Division as a whole. The remuneration disclosed above represents the appropriate proportion of his remuneration in respect of services to the Company. Details of his remuneration in respect of services to other areas of the Division are disclosed in the financial statements of RWE Thames Water plc.

#### Managing Director and Finance Director

A proportion of J R Sexton's and C Anderson's responsibilities during the year extended beyond that solely of their Thames Water Utilities Limited directorships and related instead to responsibilities to the Division as a whole. The remuneration disclosed above represents the appropriate proportion of their remuneration in respect of services to the Company.

#### 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.

#### Employee information

The average number of persons employed by the Company, including executive directors, during the year was:

	2004 Number	2003 Number
Average number of employees	<u>4,696</u>	<u>4,805</u>

Employment costs including executive directors' remuneration were:

	2004 £m	2003 £m
Salaries and wages	131.1	136.2
Social security costs	12.6	11.7
Pension costs (note 23)	<u>18.3</u>	<u>13.0</u>
Total	162.0	160.9
Employment costs included within research and development costs	<u>(3.2)</u>	<u>(3.5)</u>
Net employment costs	<u>158.8</u>	<u>157.4</u>

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 6 Net interest

	2004 £m	2003 £m
Bank loans, overdrafts and other loans:		
- group loans	(91.1)	(80.8)
- bank loans	(32.5)	(36.4)
- other loans	(3.1)	(1.5)
Finance charges in respect of finance leases	<u>(10.2)</u>	<u>(9.9)</u>
Interest payable and similar charges	(136.9)	(128.6)
Interest receivable	<u>3.5</u>	<u>3.5</u>
Net interest	<u>(133.4)</u>	<u>(125.1)</u>

### 7 Taxation

#### (a) Analysis of charge in year

		2004 £m	2003 £m
Current year:			
Amounts payable in respect of corporation tax for the period		33.3	22.1
Adjustments in respect of previous periods		<u>(19.4)</u>	<u>0.4</u>
Total current tax	7(b)	<u>13.9</u>	<u>22.5</u>
Deferred tax:			
Origination and reversal of timing differences	16	49.2	52.1
Adjustments in respect of previous periods	16	<u>15.7</u>	<u>-</u>
Total deferred tax		<u>64.9</u>	<u>52.1</u>
Taxation on profit on ordinary activities		<u>78.8</u>	<u>74.6</u>

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 7 Taxation (continued)

#### (b) Factors affecting tax charge for year

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

	2004 £m	2003 £m
Profit on ordinary activities before tax	<u>268.2</u>	<u>258.6</u>
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30% (2003: 30%)	80.5	77.6
Effects of:		
Income not taxable (intra-group disposals of property)	(0.8)	(4.0)
Capital allowances for period in excess of depreciation	(47.9)	(37.7)
Disallowable expenditure	1.5	1.0
Utilisation of tax losses	-	(14.8)
Adjustments to tax charge in respect of previous periods	<u>(19.4)</u>	<u>0.4</u>
Current tax charge for the year	<u>13.9</u>	<u>22.5</u>

### 8 Dividends

	2004 £m	2003 £m
Interim paid: 4.5p (2003: 4.3p) per ordinary share	45.8	44.7
Final proposed: 9.3p (2003: 8.9p) per ordinary share	<u>95.4</u>	<u>91.4</u>
	<u>141.2</u>	<u>136.1</u>

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 9 Tangible fixed assets

	Land and buildings £m	Plant and equipment £m	Infrastructure assets £m	Total £m
<b>Cost</b>				
At 1 January 2004	1,927.2	2,614.9	2,835.7	7,377.8
Additions	117.0	256.8	228.8	602.6
Disposals	(13.9)	(54.2)	-	(68.1)
<b>At 31 December 2004</b>	<b>2,030.3</b>	<b>2,817.5</b>	<b>3,064.5</b>	<b>7,912.3</b>
<b>Capital contributions</b>				
At 1 January 2004	-	-	378.4	378.4
Additions	-	-	35.8	35.8
<b>At 31 December 2004</b>	<b>-</b>	<b>-</b>	<b>414.2</b>	<b>414.2</b>
<b>Depreciation</b>				
At 1 January 2004	455.2	1,038.0	581.6	2,074.8
Provided during the year	30.6	166.2	72.1	268.9
Disposals	(13.1)	(53.0)	-	(66.1)
<b>At 31 December 2004</b>	<b>472.7</b>	<b>1,151.2</b>	<b>653.7</b>	<b>2,277.6</b>
<b>Net Book Value</b>				
<b>At 31 December 2004</b>	<b>1,557.6</b>	<b>1,666.3</b>	<b>1,996.6</b>	<b>5,220.5</b>
At 31 December 2003	1,472.0	1,576.9	1,875.7	4,924.6

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

	2004 £m	2003 £m
Freehold land and buildings	1,534.3	1,447.7
Leasehold - over 50 years	8.9	8.8
- under 50 years	14.4	15.5
	<b>1,557.6</b>	<b>1,472.0</b>

Depreciation has not been charged on freehold and leasehold land stated in the accounts at cost of £30.0m (2003: £30.6m).

Tangible fixed assets at 31 December 2004 include assets in the course of construction of £820.5m (2003: £678.6m).

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 9 Tangible fixed assets (continued)

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

	Cost		Net book value	
	2004 £m	2003 £m	2004 £m	2003 £m
Plant and equipment	<u>272.5</u>	<u>272.5</u>	<u>186.5</u>	<u>196.1</u>

### 10 Fixed asset investments

	2004 £m	2003 £m
Cost of shares in subsidiaries	<u>0.1</u>	<u>0.1</u>

At 31 December 2004 the Company held more than 10% of the allotted share capital of the following undertakings:

Name of undertaking	Nominal value and class of shares held	Proportion of nominal value of issued shares held	Activity
Gemwel Limited	£1 Ordinary	50%	Water and Sewerage Services
Thames Water Drainage Services Limited	£1 Ordinary	100%	Sewerage Management
Thames Water Procurement Limited	£1 Ordinary	100%	Procurement
Thames Water Utilities Finance plc	£1 Ordinary	100%	Finance Company
NPC Realisations Limited	£1 Ordinary	100%	In solvent liquidation

All of the above companies were incorporated and are registered in Great Britain.

At 31 December 2004 and 31 December 2003 the net asset values of Thames Water Drainage Services Limited and Thames Water Utilities Finance plc were £2 and £50,000 respectively. No profits or losses have been made in either of the periods concerned.

Thames Water Procurement Limited had a deficit on reserves of £1,524,000 at 31 December 2004 (2003: £1,525,000). Profit for the year ended 31 December 2004: £1,000 (2003: £1,000).

Gemwel Limited has a statutory accounting reference date of 31 March. At 31 March 2004 there was a deficit on reserves of £2,000 (2003: £75,000). Profit for the year ended 31 March 2004: £73,000 (2003: £157,000).

At 31 March 2004, final liquidation accounts for NPC Realisations Limited were produced and at this date the net asset value of NPC Realisations Limited was £Nil (2003: deficit on reserves of £3.5m). NPC Realisations Limited is in the process of being liquidated on a solvent basis.

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 11 Stocks and work in progress

	2004 £m	2003 £m
Raw materials and consumables	<u>5.9</u>	<u>5.8</u>

### 12 Debtors: amounts falling due within one year

	2004 £m	2003 £m
Trade debtors	174.5	172.9
Amounts owed by group undertakings	32.5	46.6
Other debtors	19.4	19.2
Insurance claims receivable	50.9	48.1
Prepayments and accrued income	<u>140.6</u>	<u>155.1</u>
	<u>417.9</u>	<u>441.9</u>

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

	2004 £m	2003 £m
Bank loans	15.0	45.2
Bank overdrafts	-	21.4
Obligations under finance leases	8.1	6.6
Trade creditors:		
- Operating	33.3	87.6
- Capital	120.5	125.7
Amounts owed to group undertakings	732.6	482.0
Insurance claims payable	50.9	48.1
Amounts payable in respect of corporation tax	7.6	9.8
Amounts payable in respect of group relief	6.4	7.0
Other taxation and social security payable	4.4	4.4
Accruals and deferred income	332.2	338.4
Proposed dividend	<u>95.4</u>	<u>91.4</u>
Total	<u>1,406.4</u>	<u>1,267.6</u>

Amounts owed to group undertakings includes interest bearing loans, which are described in more detail in note 14.

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

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

	2004 £m	2003 £m
Bank loans	409.6	418.6
Obligations under finance leases	225.4	233.5
Amounts owed to group undertakings (see below)	1,032.9	1,034.1
Accruals and deferred income	<u>138.4</u>	<u>98.5</u>
Total	<u>1,806.3</u>	<u>1,784.7</u>
<b>Amounts owed to group undertakings are:</b>		
	2004 £m	2003 £m
Inter company loans:		
- Within one year	675.9	429.6
- After more than one year	<u>1,032.9</u>	<u>1,034.1</u>
	1,708.8	1,463.7
Non-loan amounts due within one year	<u>56.7</u>	<u>52.4</u>
	<u>1,765.5</u>	<u>1,516.1</u>

Loan amounts owed to group undertakings, are comprised of:

- £225.0m (2003: £225.0m) owed to RWE Finance BV, a subsidiary of RWE AG, the ultimate parent undertaking, in respect of a fixed rate loan, due for repayment in 2021.
- £675.9m (2003: £424.6m) due to RWE Thames Water plc, the immediate parent undertaking, in respect of a floating rate loan wholly repayable within one year.
- £807.9m (2003: £814.1m) owed to Thames Water Utilities Finance plc, a subsidiary undertaking, of which £Nil (2003: £5.0m) is included within creditors due within one year and £807.9m (2003: £809.1m) within creditors due after more than one year.

The loan from Thames Water Utilities Finance plc relates to Guaranteed Bonds that it has in issue, the net proceeds of which have been loaned to Thames Water Utilities Limited under the same commercial terms. Thames Water Utilities Limited has guaranteed the principal and interest payments of the subsidiary undertaking due under the terms of the bonds.

RWE Thames Water plc has guaranteed the principal and interest payments of certain bank loans of the Company. The principal amount guaranteed as at 31 December 2004 was £421.1m (2003: £466.4m).

**Other loans and finance leases, as disclosed in more detail in note 15, are:**

	2004 £m	2003 £m
Inter company loans (as above)	1,708.8	1,463.7
Finance leases:		
- Within one year	8.1	6.6
- After more than one year	<u>225.4</u>	<u>233.5</u>
	<u>1,942.3</u>	<u>1,703.8</u>



# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 15 Financial instruments

FRS 13 requires the disclosure of the funding and treasury policy together with further details on financial assets and liabilities.

#### Funding and treasury policy

The Company's funding policy is to maintain a broad portfolio of debt. The debt arranged via Thames Water Utilities Finance plc is diversified by source and maturity in order to protect profits against risks arising from adverse movements in interest rates and currency exposures.

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

The Company's treasury operations are managed centrally by a small specialist team within the RWE Thames Water Division and are managed as a cost, not a profit centre; no material open or speculative positions are taken.

Short-term debtors and creditors have been excluded from the financial instruments' disclosures.

#### Interest rate risk profile of financial liabilities and assets

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

#### Financial liabilities

	Total at floating rates		Total at fixed rates		Total at book value		Fixed rate liabilities			
							Weighted average interest rate		Weighted average period until maturity for which rate is fixed	
	2004 £m	2003 £m	2004 £m	2003 £m	2004 £m	2003 £m	2004 %	2003 %	2004 Years	2003 Years
Bank loans & overdrafts										
- £ Sterling	54.0	69.2	370.6	416.0	424.6	485.2	7.2	7.4	6.2	5.7
Other loans & finance leases										
- £ Sterling	1,096.0	846.3	846.3	857.5	1,942.3	1,703.8	6.2	6.2	20.5	21.2
Total	1,150.0	915.5	1,216.9	1,273.5	2,366.9	2,189.0	6.5	6.6	16.1	16.1

The Company's interest rate swaps convert £53.4m (2003: £56.0m) of floating rate borrowing to fixed rate and £24.7m (2003: £26.6m) of fixed rate borrowing to floating rate. Cross currency swaps hedge currency risk on £91.3m (2003: £97.4m) of foreign currency borrowing through conversion to Sterling.

Short term lending bears interest at rates linked to LIBOR.

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 15 Financial instruments (continued)

#### Financial assets

	Total at floating rates		Total at fixed rates		Total at book value	
	2004 £m	2003 £m	2004 £m	2003 £m	2004 £m	2003 £m
Cash at bank and in hand						
- Sterling	1.5	-	-	-	1.5	-
Total	1.5	-	-	-	1.5	-

Base rate is the benchmark rate for all cash at bank.

#### Currency risk

The Company is not exposed to any significant currency risk after taking the effects of its cross currency swaps into consideration.

#### Fair values

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

	Book value	Book value	Fair value	Fair value
	2004 £m	2003 £m	2004 £m	2003 £m
<b>Primary financial instruments</b>				
<b>Financial assets</b>				
- Cash at bank and in hand	1.5	-	1.5	-
<b>Financial liabilities</b>				
- Bank loans	(421.1)	(466.4)	(447.7)	(497.6)
- Overdrafts	-	(21.4)	-	(21.4)
- Other loans & finance leases	(1,942.3)	(1,703.8)	(2,084.1)	(1,810.9)
<b>Derivative financial instruments</b>				
- Interest rate swaps	-	-	(7.9)	8.3
- Cross currency swaps	(3.5)	2.6	(2.6)	4.0
Total	(2,365.4)	(2,189.0)	(2,540.8)	(2,317.6)

Primary financial instruments include bonds, which are traded on a public market. Fair values for these have been calculated using the 31 December 2004 quoted prices. Mark to market techniques (discounting expected cash flows at prevailing interest and exchange rates) are employed in computing fair values for the remaining fixed rate borrowing and all derivative financial instruments. Floating rate liabilities have fair values, which approximate to book value.

Book values of primary financial instruments are shown gross of the effect of any hedging instrument. Therefore, the effect of revaluing foreign currency borrowing at closing rates is included in the fair valuation.

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 15 Financial instruments (continued)

<b>Maturities</b>	<b>2004</b>	2003
	<b>£m</b>	£m
Bank loans and overdrafts		
- Within one year	15.0	66.6
- Between one and two years	13.6	17.0
- Between two and five years	149.9	106.3
- After more than five years	<u>246.1</u>	<u>295.3</u>
	<u>424.6</u>	<u>485.2</u>
Other loans and finance leases		
- Within one year	684.0	436.2
- Between one and two years	23.9	8.1
- Between two and five years	113.5	69.3
- After more than five years	<u>1,120.9</u>	<u>1,190.2</u>
	<u>1,942.3</u>	<u>1,703.8</u>
<b>Total borrowing</b>	<u><b>2,366.9</b></u>	<u><b>2,189.0</b></u>

- Loans are repayable between 2005 and 2032.
- Loans wholly repayable after more than five years are:

	<b>2004</b>	2003
	<b>£m</b>	£m
Bank loans	246.1	295.3
Other loans	<u>949.6</u>	<u>998.8</u>
	<u><b>1,195.7</b></u>	<u><b>1,294.1</b></u>

- Other loans include:
  - £330m 6.75% MTN Eurobonds due 2028.
  - £200m 6.50% MTN Eurobonds due 2032.
  - £175m 3.375% index-linked bond due 2021.
  - £225m 6.60% inter-company loan from parent undertaking due 2021.

- Loans repayable by instalments after more than five years hence are:

	<b>2004</b>	2003
	<b>£m</b>	£m
Finance leases	<u>171.3</u>	<u>191.4</u>

- The ranges of interest rates on outstanding bank loans are 2.3% to 11.5% (2003: 2.3% to 11.5%) and other loans and finance leases are 1.7% to 6.8% (2003: 1.7% to 6.8%).

These interest rates are those contracted on the underlying borrowing before taking account of interest rate protection. There are no interest free loans.

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 15 Financial instruments (continued)

#### Borrowing facilities

The Company has a committed borrowing facility with RWE AG of £150m, this facility replaced a number of committed facilities with a range of financial institutions which expired during the year.

Expiring:	2004 £m	2003 £m
Within one year	<u>150.0</u>	<u>150.0</u>

At 31 December 2004 and 31 December 2003, no funds have been borrowed under the committed facilities referred to above.

Thames Water Utilities Finance plc also has a US\$ 4 billion (2003: US\$ 4 billion) uncommitted Euro-Medium Term Note programme, which provides the Company with access to the capital markets in a range of currencies and maturities. At 31 December 2004, outstanding debt obligations of Thames Water Utilities Finance plc were £807.8m (2003: £814.0m), with a weighted average term of 22.0 years (2003: 22.7 years) at a weighted averaged rate of 6.10% (2003: 6.05%).

### 16 Provisions for liabilities and charges

Provisions for liabilities and charges consists entirely of a provision for deferred taxation. There are no amounts of deferred tax unprovided (2003: £nil).

#### The movement in the provision was as follows:

	Note	2004 £m
Provision brought forward at 1 January 2004		797.0
Deferred tax charge:		
- Current year	7(a)	49.2
- Prior year	7(a)	<u>15.7</u>
Provision carried forward at 31 December 2004		<u>861.9</u>

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

	2004 £m	2003 £m
Accelerated capital allowances	866.3	804.5
Other timing differences	<u>(4.4)</u>	<u>(7.5)</u>
	<u>861.9</u>	<u>797.0</u>

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 17 Share capital

	2004 £m	2003 £m
<b>Authorised</b>		
1,029,050,000 (2003: 1,029,050,000) ordinary shares of £1 each	<u>1,029.0</u>	<u>1,029.0</u>
<b>Allotted, called up and fully paid</b>		
1,029,050,000 (2003: 1,029,050,000) ordinary shares of £1 each	<u>1,029.0</u>	<u>1,029.0</u>

### 18 Share premium reserve

	2004 £m	2003 £m
Premium of 25p on issue of 400 million £1 ordinary shares	<u>100.0</u>	<u>100.0</u>

### 19 Profit and loss account

	£m
At 1 January 2004	394.1
Profit for the year	<u>48.2</u>
At 31 December 2004	<u>442.3</u>

### 20 Reconciliation of movements in shareholders' funds

	2004 £m	2003 £m
Profit for the financial year	189.4	184.0
Dividends	<u>(141.2)</u>	<u>(136.1)</u>
Net movement in shareholders' funds	48.2	47.9
Shareholders' funds at 1 January	<u>1,523.1</u>	<u>1,475.2</u>
Shareholders' funds at 31 December	<u>1,571.3</u>	<u>1,523.1</u>

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 21 Capital commitments

	2004 £m	2003 £m
Contracted for but not provided	<u>196.3</u>	<u>269.1</u>

In addition to these commitments, the Company has long-term capital investment plans to provide for future growth.

### 22 Operating leases

At 31 December 2004 the Company was committed to making the following payments during the next year in respect of non-cancellable operating leases:

	2004		2003	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
<b>Leases which expire:</b>				
Within one year	-	0.3	0.4	0.4
Between one and two years	0.1	0.3	-	0.4
Between two and five years	0.1	-	0.2	-
After more than five years	5.0	-	5.7	-
	<u>5.2</u>	<u>0.6</u>	<u>6.3</u>	<u>0.8</u>

### 23 Pension schemes

Pension arrangements for the majority of the Company's employees are of the defined benefit type, funded through pension schemes covering employees within the RWE Thames Water Group, whose assets are held separately from those of the Group in independently administered funds. In addition, there are unfunded defined benefits provided for directors and senior employees affected by the cap on earnings, which cannot be provided through approved arrangements.

The Company's pension arrangements are of the group multi-employer scheme nature, such that the Company's pension schemes assets and liabilities cannot be separately identified on a reasonable and consistent basis, from those of the RWE Thames Water Group. Accordingly, the Company has made the appropriate FRS 17 transitional disclosures, required of a company with group multi-employer pension schemes. Full adoption of FRS 17 will become mandatory for accounting periods ending after 1 January 2005, until then the transitional arrangements will apply.

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 23 Pension schemes (continued)

#### SSAP 24

Details of the actuarial position of the Group pension schemes are given in the financial statements of RWE Thames Water plc, for the year ended 31 December 2004. The key assumptions for the UK schemes are set out below:

Method	Projected unit method for schemes open to new members. Attained age method for closed scheme.
Interest rate	5.8% pa
Earnings increases	3.7% pa
Pension increases	2.7% pa
Asset valuation	Market value

The latest full actuarial valuation was undertaken at 31 December 2001. Scheme assets at that date amounted to £947m and this represents 123% of the value of benefits accrued to members as at 31 December 2001.

An interim valuation was undertaken at 31 August 2003. Estimated scheme assets at that date amounted to £863m and this represents 100% of the value of benefits accrued to members as at 31 August 2003.

During the year the Company made contributions of £12.7m (2003: £7.9m) into the Company's pension schemes for the benefit of members.

The total ongoing pension cost for the Company during the year ended 31 December 2004 was £18.3m (2003: £13.0m). The pension cost is assessed in accordance with advice received from Hewitt, Bacon and Woodrow, the independent and professionally qualified consulting actuaries to the schemes. The SSAP 24 pension cost has increased following the interim valuation undertaken at 31 August 2003, which indicated a reduced pension surplus.

The regular cost of benefits amounted to £17.7m (2003: £16.7m) and the reduced actuarial surplus resulted in a variation amounting to an increase in the pension cost of £0.6m (2003: reduction in the pension cost of £3.7m).

At 31 December 2004 a prepayment in respect of the funded schemes amounting to £0.8m (2003: £6.4m) was included in debtors.

In addition to the ongoing cost of the UK Pension arrangements, the Company operates discretionary arrangements under which it augments benefits on retirement. These augmentations are funded by way of additional employer contributions to the schemes. In the year ended 31 December 2004 payments amounted to £2.7m (2003: £0.6m).

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 23 Pension schemes (continued)

#### FRS 17

Information on the Group schemes is disclosed in accordance with FRS 17 in the RWE Thames Water plc Group accounts, prepared for year ended 31 December 2004.

The latest full actuarial valuation was undertaken as at December 2001. At this date, the Group schemes were in surplus to the extent of £143.3m. An Interim valuation was undertaken at 31 August 2003.

The next full actuarial valuation as at 31 December 2004 will be undertaken by Hewitt, Bacon and Woodrow (the independent and professionally qualified consulting actuaries to the schemes) during 2005.

The December 2001 valuation has been updated at 31 December 2004 by Hewitt, Bacon and Woodrow using revised assumptions that are consistent with the requirements of FRS 17 and shown in the table below. At this date, the Group schemes were in deficit to the extent of £104.9m (2003: £35.2m).

The main financial assumptions for the UK schemes used for FRS 17 purposes are shown in the following table:

Price inflation	2.9%
Salary increases	3.9%
Pension increases	3.0%
Discount rate for scheme liabilities	5.25%

RWE Thames Water Group has taken advice from Hewitt, Bacon and Woodrow in respect of the funding position of the Group pension schemes. The FRS 17 deficit does not have a direct impact on funding. With consideration of the funding position of the schemes, the company contribution rate has been increased where necessary in accordance with Hewitt, Bacon and Woodrow recommendations.

### 24 Ultimate parent company and controlling party

The ultimate parent company and controlling party is RWE AG, a company incorporated in Germany.

Copies of the consolidated financial statements of the immediate parent company, RWE Thames Water plc may be obtained from The Company Secretary, RWE Thames Water plc, Clearwater Court, Vastern Road, Reading, Berkshire, RG1 8DB.

Copies of the ultimate parent company's accounts may be obtained from RWE Aktiengesellschaft, Opernplatz 1, D-45128 Essen, Germany.