



United Utilities

United Utilities PLC

Annual Report and Accounts 1998

Report made by the company

'These results show solid progress in the management of the business, as we pursue our strategy based firmly on our core skills. Improving performance and the savings that are being secured will benefit this and future years.'

Derek Green Chief Executive

1998



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United Utilities is a group of businesses providing services in water, wastewater, electricity distribution, electricity and gas supply, telecommunications and business operations outsourcing.

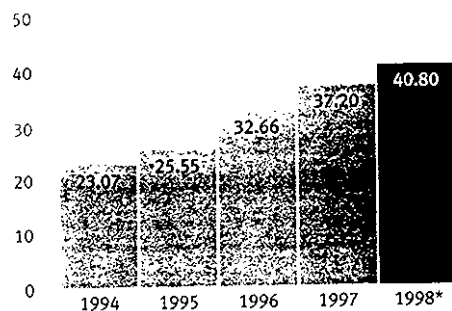
Our brand names include North West Water, Norweb, ENERGi, Norweb Communications and Vertex.

Based in North West England, United Utilities' businesses also operate nationally and internationally.

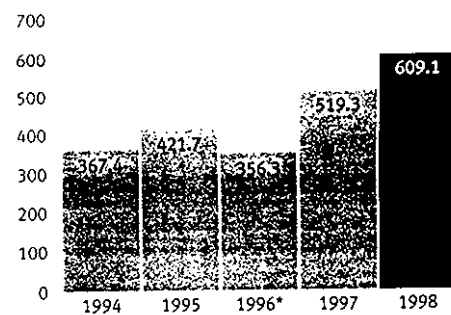
We are the UK's first multi-utility group – sharing resources to improve efficiency and flexible enough to offer customers single or multi-utility services.



United Utilities

Dividends per share (p)


*Underlying dividend

Operating cash flow (£m)


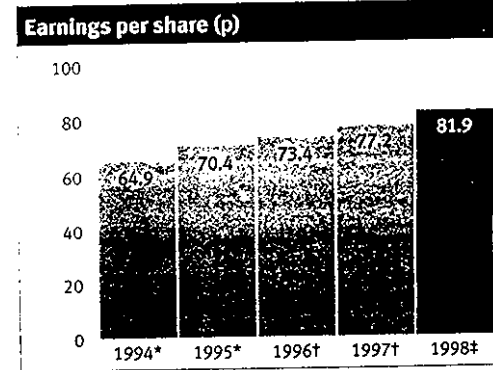
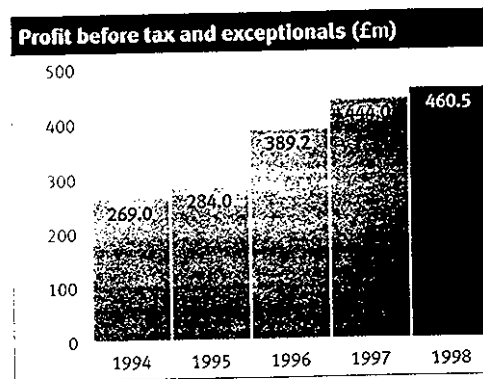
*After impact of £77.3 million for Norweb customer rebates

	1998	1997
Turnover from continuing operations	£2,150.2m	£2,102.3m
Operating profit ⁽¹⁾	£601.7m	£585.5m
Profit before tax and exceptional items	£460.5m	£444.0m
Adjusted earnings per share	81.9p	77.2p
Underlying dividend per share	40.8p	37.2p
Operating cash flow	£609.1m	£519.3m
Operating cash flow per share	113.9p	99.0p
Net borrowings	£2,140.6m	£1,627.0m
Equity shareholders' funds	£2,045.5m	£2,141.9m
Gearing	104.6%	76.0%
Dividend cover ⁽²⁾	2.0 times	2.1 times
Interest cover ⁽³⁾	4.3 times	4.4 times

Note:

1. Operating profit is defined as profit from continuing operations before non-operating items, exceptional items, interest and tax.
2. Dividend cover is calculated on underlying dividends before exceptional items and the results of discontinued operations.
3. Interest cover is calculated before exceptional items and the results of discontinued operations.

Highlights



*Adjusted and restated for bonus element of 1996 rights issue
†Excludes exceptional charges and divested businesses
‡Excludes windfall tax and profit on disposal of businesses

Solid progress in managing the business

Consistent application of strategy based on core skills

Substantial progress in improving performance and securing savings

Launch of ENERGI from Norweb and Tesco marketing partnership

NØR.WEB DPL, a joint venture with Nortel, launched

Vertex announces contract with Littlewoods

Profit before tax and exceptionals up 3.7% to £460.5 million

Adjusted earnings per share up 6.1% to 81.9 pence

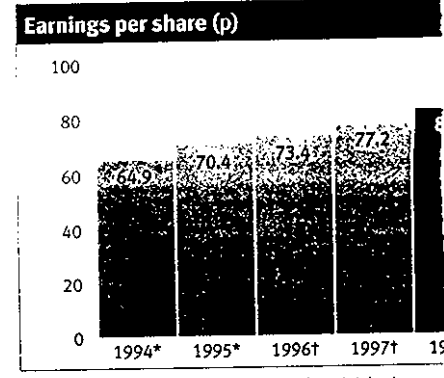
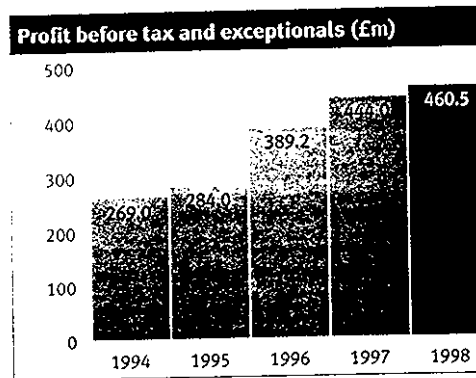
Operating cash flow per share up 15.1% to 113.9 pence

Underlying full year dividend of 40.8 pence per share, up 9.7%

Dividend cover a prudent 2.0 times

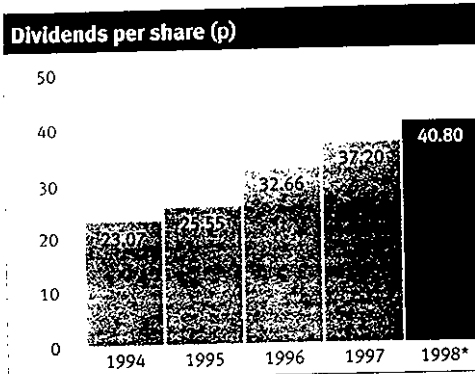
Interest cover of 4.3 times

Highlights

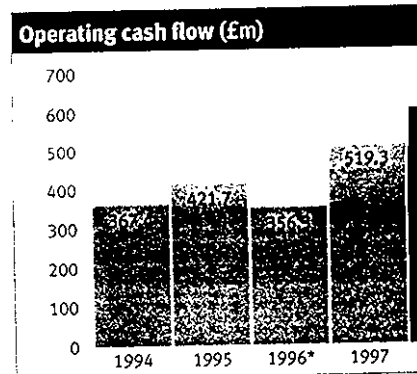


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Success comes from putting peop

My whole business philosophy is based on the fact that you can have the best equipment, the best systems, the best services and the best products, but it's the quality of the people that matters to convert all of that into a successful business. United Utilities has a team of skilled and committed people providing utility services to our customers that are crucial to their everyday lives and to the wellbeing of their communities.

First impressions

My first priority since joining the company, in November, has been to get to know as many people as possible within our businesses and to meet them where they work. At the same time, therefore, I have had an early introduction to some of the wide range of facilities we manage and operate, including water and wastewater treatment works, a customer service centre, our innovative electricity marketing, test and experience centre, an environmental education centre, the billing services centre, and some of our rural landholdings to which we provide access for the public.

I have been impressed by our very able and totally committed team of people, who have a very strong sense of their responsibility to our customers. This was borne out at Christmas when huge storms disconnected more than 200,000 customers from their electricity supplies. Whilst we are learning lessons, particularly on the communications front, from that experience, what is beyond doubt is that the response we had from our people was fantastic. The turn-out at the worst time of the year was quite remarkable.

I have been very pleased with our whole approach to the communities we serve. For example, how we make our extensive landholdings in North West England available to them, in a balanced way, to use and enjoy. I have been impressed too by the extensive, practical and effective application of technology in all facets of the services we provide.

Utilities are complicated businesses. Perhaps much more so than I and others have appreciated. We work in tightly regulated fields where the regulators, quite rightly, give high priority to the interests of the customers. This does have a major impact on every business decision.

We are also in an industry that attracts close media attention. You tend to read or hear only about the things that have gone wrong. And, inevitably and unfortunately, sometimes things do go wrong. We accept that and it is important that we are seen to be keen to respond to the problems and issues that our customers raise.

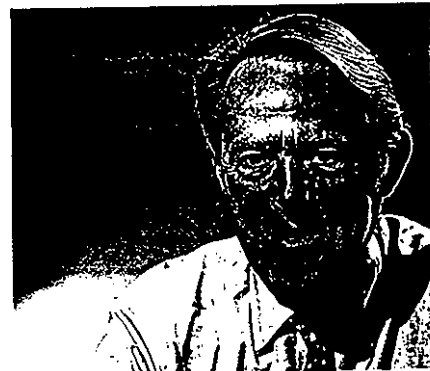
It is clear to me that we really do listen to our customers so that not only can we put things right but also we can learn how we can do things better in the future. But I accept, sometimes we do not always get it right. We certainly intend to try even harder in the future.

I will be working hard to get that message over and also to reinforce the fundamental point that we are a professional and sophisticated business striving to provide consistently high quality, value for money services to our customers.

Corporate responsibilities and the Board

We describe later in this report our commitment to the highest standards of corporate governance. This is much more than complying with codes of conduct, important though they have been in establishing standards and guidelines. We are reviewing carefully the conclusions and recommendations of the Hampel Committee and the provisions in the proposed Stock Exchange combined code.

The composition of the Board of directors and the knowledge and experience that each of them bring to our discussions and decision making are important factors in the quality of governance we provide collectively. Part of my role as Chairman is to ensure that the members of the Board fully understand the wide range of



Sir Christopher Harding



United Utilities has a team of skilled and committed people with a strong sense of their responsibility to our customers.

first

key issues and areas that are of significance for our business and can thus determine together the most effective way of tackling them.

I am particularly pleased that Sir Peter Middleton, who joined the Board as a non-executive director in 1994, has agreed to be Vice Chairman.

During the year, Derek Green was appointed as Chief Executive and we welcomed Sir Richard Evans, chairman of British Aerospace, to the Board as a non-executive director.

We said farewell to Sir Desmond Pitcher, who created United Utilities as the first multi-utility, and to Malcolm Faulkner, after 35 years in the electricity supply industry. We extend our very best wishes for the future to them both and their families.

Tim Rayner, previously our Group Legal Manager, was appointed Company Secretary in April of this year.

The 1998 report and results

Derek Green comments in more detail in his review on our strategic direction, as well as reviewing our operational performance.

Bob Ferguson comments similarly on the financial results. Turnover from continuing operations increased by 2.3 per cent to £2,150.2 million and profit before tax and exceptional items at £460.5 million was up 3.7 per cent.

Earnings per share, excluding exceptional items, grew by 6.1 per cent to 81.9 pence.

The Board is recommending a final dividend of 29.0 pence. To enable us to manage more effectively the Group's advance corporation tax position following the Chancellor's announcement about the abolition of advance corporation tax, the payment of that dividend will be delayed until April 1999. The dividend includes an enhancement of 1.36 pence to take account of the delay in payment.

We recognise that delay could be difficult for some shareholders and so we are offering a share alternative to the cash dividend, based on

the underlying dividend of 27.64 pence, with dealings in new shares expected to commence in October 1998. There is also a cash offer to shareholders taking up the share alternative, at an assured price equivalent to the underlying dividend per ordinary share and without dealing costs.

The future

This is the first opportunity I have had to report to you and I particularly wanted to describe for you some of my first impressions. I have found that United Utilities is a company firmly committed to a strategy for growing shareholder value that is based on its core skills, cost effective and carefully focused, with risks reduced wherever practicable, and dedicated to providing all our customers with reliable and good value for money services.

Our strategy is being implemented by a very able and committed team. I look forward to working with them, during what will be very important years for us as we approach the regulatory price reviews and as we enter the fully competitive energy markets.

Sir Christopher Harding *Chairman*

The company today



Water and wastewater

All key regulatory outputs achieved

Work on sludge processing centre at Shell Green nearing completion

Ofwat commends progress made in reducing leakage

Healthy water stocks with our reservoirs full

North West Water provides water and wastewater services to 2.8 million customer premises (domestic, commercial and industrial) in North West England, which has a population of some seven million.

It supplies on average 2,100 megalitres of water every day to its customers, delivered through 40,500 kilometres of aqueducts, trunk and distribution mains and 497 service reservoirs. It draws water from 143 reservoirs, as well as from rivers and aquifers, and operates 147 primary water treatment works.

Wastewater is collected through 32,700 kilometres of sewers with 1,515 pumping stations and treated at 617 wastewater treatment works for return to the environment.

Turnover £m

97	866.7
98	905.3

Operating profit £m

97	383.3
98	394.2

Electricity distribution

Achieved all overall service standards agreed with Offer

Electricity supply available to average customer 99.99% of the time

Employees' substantial commitment in restoring supplies after worst storm damage for 20 years

Maintained leading position within the industry for reliability of supply

Norweb Distribution maintains a 59,000 kilometre distribution network – around 14,000 kilometres of overhead lines and 45,000 kilometres of underground cables – and 39,501 substations to deliver electricity from power stations and the National Grid to 2.2 million customer premises in North West England.

It distributes 23,300 GWh of electricity annually to domestic customers, commerce and industry.

Turnover £m

97	329.0
98	342.7

Operating profit £m

97	132.1
98	154.5

Energy supply

ENERGi from Norweb brand launched combining electricity and gas marketing

New partnership with Tesco means customers earn ClubCard points from gas and electricity

Electricity prices now lower than at privatisation in 1990

First regional electricity company to achieve its four-year energy efficiency target

ENERGi from Norweb currently supplies electricity to 2.2 million customer premises throughout North West England in the franchise market (which is not yet open to competition) and to customers throughout UK who are already in the competitive market (the larger users of electricity).

ENERGi will sell both electricity and gas customers in the new fully deregulated energy markets. Gas is supplied through a joint venture with Utilicorp, and as the domestic market opens to competition 157,000 customers had, at the year end, contracted buy their gas from ENERGi.

Turnover £m

97	1,123.3
98	1,120.9

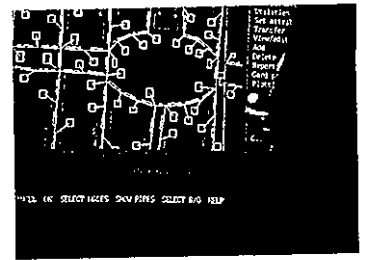
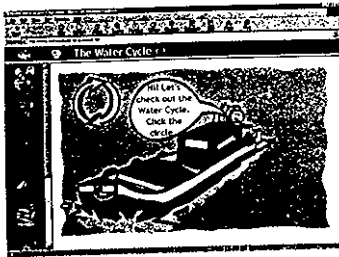
Operating profit £m

97	48.3
98	26.2



NORWEB





Telecommunications

Telecommunications business moves into profit only three years after inception

Outperforming on Ofel service and system reliability performance indicators

Launch of Digital PowerLine joint venture company NØR.WEB DPL

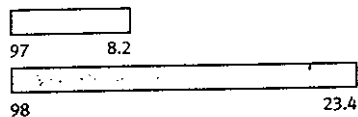
North West primary school becomes world's first public user linked to Internet via Digital PowerLine

Norweb Communications provides voice and data telecommunications services to the business community in North West England, and is expanding its national capability, through a trunk network based extensively on fibre optic cable.

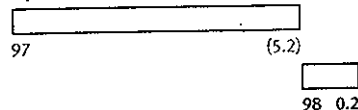
NØR.WEB DPL, a joint venture with Nortel, will develop and market Digital PowerLine technology in the UK and overseas, which allows data communications, including Internet traffic, to be transmitted over electricity power distribution networks up to 10 times faster than generally available technology.

Norweb Communications will market Digital PowerLine technology to customers in North West England.

Turnover £m



Operating (loss)/profit £m



Facilities management

Successful implementation of modern customer systems for energy and water

Substantial improvements in levels of customer service

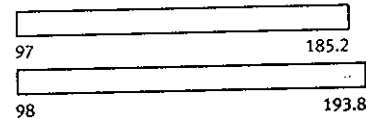
Opening of single billing and payment services centre replacing six facilities

Contract awarded to run call centre services for new Littlewoods business

Vertex provides a wide range of business operations outsourcing services to the United Utilities Group, and markets those services to other organisations. Key markets for Vertex are the utilities and central and local government.

Its range of business services, based on leading technology, includes customer services, operations systems, information technology, accounting, procurement and training, allowing its customers to concentrate on their core services, such as water, electricity and gas supply.

Turnover £m



Operating profit £m



International operations

Sharpened focus and reducing cost base

Joint venture enhancing performance of electricity distribution services in central Buenos Aires Province, Argentina

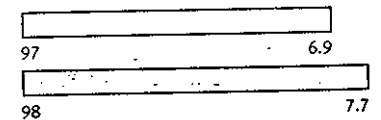
Despite severe drought, joint venture brings benefits for people in Manila, the Philippines

With 38 operating contracts, US Water consolidates position as water services provider in USA

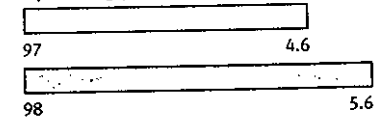
United Utilities International develops and operates contracts based on the Group's utility services skills. It operates through strategic businesses.

Water Services manages water and wastewater operating contracts; International Power seeks electricity distribution, supply transmission opportunities; US Water, jointly owned with Bechtel, operates water and wastewater systems in North America; and International Water, a joint venture with Bechtel, is responsible for all water and wastewater business development, project finance and bidding activity outside the

Turnover £m



Operating profit including associates £m



United Utilities

We have a cohesive strategy based firmly on our core skills

Since taking up my appointment as Chief Executive last July, I have carried out a thorough review of the Group's activities. In the light of that review, we have decided to maintain our fundamental strategic direction. Our revised business plan reflects planned performances in each of the businesses that are both cost effective and achievable. Specific actions are being taken to improve performance and the benefits of the application of tighter financial control are beginning to show through.

Business review

My review involved a comprehensive re-evaluation of the outlook for each of our businesses. It examined our strategic direction, our current and projected financial performance and, as a result, our ability to grow shareholder value and increase dividends.

It had to take account of the windfall tax and the impact of the electricity supply price review, together with the associated effects of the transition to full competition in the electricity supply market.

More important was to reflect the potential effects of the regulatory price reviews, which will come into force in the year 2000, for both water and wastewater services and electricity distribution.

Following its consideration of the conclusions of this review, the Board announced in November its decision to maintain our fundamental strategic direction, which is to:

- maximise available multi-utility synergies from North West Water's and Norweb Distribution's operations;
- capture maximum synergies in information technology, customer service and other business support functions, and add value from the business outsourcing market, through Vertex, our facilities management company;
- develop ENERGi from Norweb and Norweb Communications, recognising the different

processes and management needed for success in competitive markets, with cost effective support from Vertex; and

- enhance value by utilising our core skills in overseas markets.

This is a cohesive strategy based on our core skills. The Group's profits are derived primarily from our UK regulated utility activities of water and wastewater and electricity distribution. These provide a relatively low risk and stable income stream, notwithstanding the uncertainties caused by the regulatory price reviews.

We recognised that, as regulatory pressures increase, it will become more difficult to deliver substantial profit growth from those sources alone. We are planning, therefore, to enhance our future profitability by the development of our activities that are based squarely on our core skills, involve little incremental risk and represent an attractive return on the modest capital involved.

The review confirmed that the planned integration savings from the Norweb acquisition will be achieved. However, the non-regulated businesses were contributing more slowly than anticipated due to a lack of sufficient focus in the application of the strategy and that, together with over optimistic expectations, had understandably dented confidence.

The review also took into account the extra costs that are being incurred to meet additional requirements in the regulated businesses as well as the higher financial gearing which we face.

Improving performance

Our revised business plan prepared in the light of the review and the Board's decision reflects planned performances in each of the businesses that are both cost effective and achievable. In addition, specific actions that I said we would undertake to improve performance included:

- substantially reducing corporate costs;
- achieving additional efficiencies through further integration of North West Water and Norweb Distribution;



Derek Green



We plan to enhance future profitability by developing our activities that are based squarely on our core skills and involve little incremental risk.

- continuing to drive down the costs of Vertex's services whilst maintaining service levels to its customers in the Group, and continuing our commitment to controlled development of business outside the Group;
- targeting the ENERGi from Norweb marketing effort to retain our regional electricity customers and supply gas to them, with selective marketing outside the region;
- working with Nortel, a leading international telecommunications manufacturer, to exploit our Digital PowerLine technology; and
- more focused and lower cost development of our international activities together with a concentration on delivering profits from existing contracts.

Our financial results for 1997/98 show solid progress in the day-to-day management of the business, with the benefits of the application of tighter financial control beginning to show through.

Substantial progress has been made in improving performance, as I describe in the operational reviews of the businesses that follow, and some examples of our achievements in the non-regulated businesses include:

- the focused marketing effort by ENERGi from Norweb which had generated at the year end 157,000 domestic customers for gas supply;
- the establishment of a marketing partnership for gas and electricity with Tesco, under which customers can earn ClubCard points from their energy bills;
- the launch of the Digital PowerLine joint venture company, NOR.WEB DPL, with Nortel, which has attracted worldwide interest;
- the successful implementation by Vertex of modern, flexible customer systems for both electricity, looking to the requirements of the fully competitive market, and water; and
- Vertex's agreement with Littlewoods to provide a call centre service for their new business venture, BetDirect.

Securing savings

The necessary steps to achieve the planned integration savings from the acquisition of Norweb have been completed.

We are on target to achieve the further demanding cost reductions across all our businesses that we expect will yield £40 million additional savings by 1999. These further savings will offset the lower than anticipated contributions from the non-regulated businesses and the further costs to meet additional requirements in the regulated businesses.

Within our strategy of concentrating on our core skills, we will continue to drive for improvements across the businesses to secure savings and performance improvements benefiting the current year and future years.

Derek Green *Chief Executive*

Committed to high quality value for money services



Water and wastewater	
North West Water	
Turnover (£m)	905.3
Operating profit (£m)	394.2

Highlights

- all key regulatory outputs achieved
- work on sludge processing centre at Shell Green nearing completion
- Ofwat commends progress made in reducing leakage
- healthy water stocks with our reservoirs full.

We made sustained progress increasing customer satisfaction and profitability. Our major investment programme to raise standards for customers, modernising the water and wastewater infrastructure of North West England, is the biggest environmental improvement programme in the UK. We also continued to provide a free repair service for leaks on customers' supply pipes, and carried out other discretionary investment for customers.

In the recent review of efficiency by Ofwat, the industry regulator, we were ranked as above average efficiency on operating costs, and as one of the most efficient water and wastewater companies when comparing operating costs and capital maintenance together. We continued to share the benefits of our efficiency, paying a £6.50 rebate to our customers.

Water

Our programme of works to minimise the impact of any future drought has now been completed. We ended the year not only with very healthy stocks of water, but also with a much more resilient system better able to cope with peak demands and periods of dry weather.

Drinking water quality has been maintained at a consistently high standard, with 99.54 per cent of all measurements meeting the required quality standards at customers' taps.

Compliance with the quality standards for iron (98.0 per cent) and manganese (99.5 per cent), which can give rise to discoloured water, have shown significant improvement as a result of our continuing investment to replace old and corroding iron mains.

Compliance with the lead standard (96.9 per cent) continues to cause problems due to the large number of lead pipes in the region. However, we have made very considerable improvements through an extensive programme of phosphate dosing and through the replacement of those lead pipes that are owned by the company, rather than by customers.

We refurbished or replaced 1,508 kilometres of old water mains, improving water quality at customers' taps and reducing mains bursts. 48,842 properties have been given new water supply pipes, replacing mainly old lead pipes. 8,216 properties have been relieved of low-pressure problems.

Leakage reduction

Ofwat has commended our progress in reducing leakage. This year we achieved the agreed target to cut leakage to 580 million litres a day, and we remain confident we can meet Ofwat's mandatory target of 515 million litres a day for 1998/99.

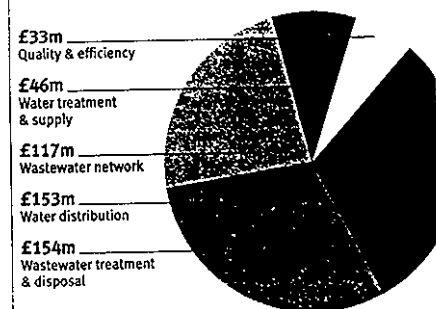
28,708 customers have now taken advantage of our free leak repair service, saving around 50 million litres of water a day. We have also more than halved the time it takes to repair a leak, from an average of 7.3 days at the start of the year to 3.1 days by March 1998.

Wastewater

This year we completed our £500 million capital investment programme agreed with the Environment Agency, to help improve the quality of bathing waters in the region. The assets constructed are operating satisfactorily and meeting the standards set by the Agency.

The Environment Agency recently directed that an additional programme of work,

Water and wastewater capital investment



North West Water meets the daily needs of seven million people, providing water and wastewater services throughout North West England. We continue to make sustained progress improving customer satisfaction and increasing profitability.

water and wastewater

estimated at over £100 million, should be undertaken to further reduce storm water discharges, and to upgrade a number of wastewater treatment works to meet new, higher environmental standards. Discharges from these works had not previously been thought by the Agency to have any effect on bathing waters. Subject to Ofwat approval, this work will be carried out in the near future, aiming to complete a substantial part by the 1999 bathing season.

Our £400 million Mersey Estuary pollution alleviation scheme is also now complete. A new 28 kilometre interceptor sewer runs the length of the north bank, closing the old outfalls and taking the flows of wastewater to Liverpool wastewater treatment works.

Our major sludge processing centre at Shell Green, near Widnes, is nearing completion and we remain on schedule to stop the disposal of sludge at sea by the end of 1998. We refurbished or replaced 73 kilometres of derelict sewers, and improved or closed 40 unsatisfactory sewer overflows.

Customer satisfaction

At the year end, quarterly opinion research showed an 81 per cent domestic customer satisfaction rating, the highest level yet achieved. We are moving in the right direction. This trend is mirrored in research with business customers and customers who come into direct contact with us.

We launched a number of performance initiatives under the banner of CustomerFirst, as part of our drive to provide a level of service which matches the expectations of our customers on both cost and service excellence. We said we would achieve this by listening to our customers, setting ourselves tough customer service targets, and sharpening our performance.

The CustomerFirst programme has been supported by a range of tailored services for customers with particular needs. Customers can also now pay their bills free of charge at Post Offices.

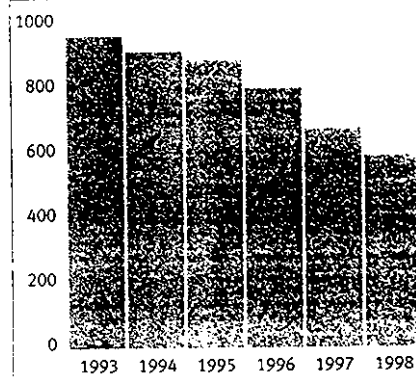
All key customer service standards set by Ofwat have improved, including those relating to low pressure, unplanned interruptions, complaints, and our overall telephone response.

The next price review

In 1999, Ofwat will set new price limits for water and wastewater bills for the five years after 2000. As part of this periodic review process, we have carried out major research and consultation with customers and other interested parties on the key issues: drinking water quality, river and sea water quality, meeting demand for water, and levels of customer service.

We must continue to invest to meet legal obligations. In addition, we could tackle various extra tasks to meet the expectations of our customers and the communities we serve. Whatever we invest ultimately has an impact on bills. Our view is that we must continue raising standards, but at a pace that will not lead to an overall increase in prices above inflation.

Total leakage (millions of litres per day)



The best service for customers with the power

Electricity distribution

Norweb Distribution

Turnover (£m)	342.7
Operating profit (£m)	154.5

Highlights

- achieved all overall service standards agreed with Offer
- electricity supply available to average customer 99.99 per cent of the time
- employees' substantial commitment in restoring supplies after worst storm damage for 20 years
- maintained leading position within the industry for reliability of supply.

Norweb Distribution continued to provide a high level of service for electricity customers throughout North West England. To increase operating efficiency, common functions and services are integrated with North West Water wherever possible.

Improving the network

We continued to update and improve our electricity distribution network for customers, with:

- 218 kilometres of overhead lines rebuilt
- 318 kilometres of underground cables installed
- 10 primary substations and 290 distribution substations re-equipped with modern switchgear.

Our network was badly affected over the Christmas holiday period by the worst storm damage for 20 years. At the peak, 223,000 customers were without supply, with 98 per cent reconnected within 24 hours. Unfortunately some were off supply for an unacceptable period, some for more than 24 hours. We deeply regret this, and paid compensation in line with guaranteed standards. We have now improved our procedures to restore supply faster in the event of such a major storm. Our customers can feel better protected in future.

We value our reputation for excellent customer service and are determined to maintain that.

We also increased capital investment to improve the reliability of those high voltage circuits which have an unacceptable level of supply failures. We also continued to develop our innovative 'live-line hot-glove' working, where engineers work on live high voltage overhead lines without turning off the power. We have continued to develop initiatives such as insulation of high voltage overhead lines, village refurbishment and use of mobile generators.

Service for customers

With our business restructuring now completed, we are focused on maintaining our leading position for reliability of supply and high standards of customer service, whilst continuing to improve our costs compared to the rest of the industry.

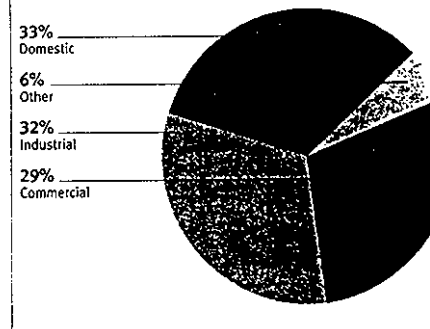
Our distribution service centre at Preston has won ISO 9002 accreditation for problem reporting, complaints handling and telephone answering. As an example of the major improvement in customer service, we reduced the number of complaints referred to the industry regulator Offer, particularly in the second half of the year.

We have also commissioned a new centralised network control centre in Manchester.

We again maintained at over 90 per cent the percentage of customers with unplanned interruptions reconnected within 3 hours. For the average customer, electricity supply was available 99.99 per cent of the time. The lost supply time per customer was only 71.2 minutes for the whole year, excluding the impact of the severe storms over the Christmas holiday period.

We delivered 1.6 million individual services to customers covered by guaranteed standards. Of these, only 67 missed the guaranteed timescale, for which we paid compensation. All overall standard targets agreed with Offer were achieved, reflecting the performance behind our Charter

Units distributed by customer class



Mark award. All our people are committed to highest levels of customer service.

The next price review

Looking ahead, Offer's 2000 price review for electricity distribution is likely to present new challenges. However, our commitment to excellent customer service, together with prudent cost control, will mean we are in a good position to meet the challenges and opportunities that lie ahead.

Norweb Distribution runs the electricity network in North West England. ENERGi from Norweb supplies electricity and gas to household and business customers in the growing open markets.



to please

Energy supply	
ENERGi from Norweb	
Turnover (£m)	1,120.9
Operating profit (£m)	26.2

Highlights

- ENERGi from Norweb brand launched combining electricity and gas marketing
- new partnership with Tesco means customers can earn ClubCard points from gas and electricity bills
- electricity prices now lower than at privatisation in 1990
- first regional electricity company to achieve its four-year energy efficiency target.

In June 1997, we launched ENERGi from Norweb, bringing together electricity and gas marketing under one brand. We also set up a marketing partnership between ENERGi and Tesco, where our customers can earn ClubCard loyalty points on their gas and electricity bills. ENERGi has received two prestigious awards for its marketing approach from the Federation of European Direct Marketing.

Electricity

This was our last full year as a monopoly electricity supplier. The phased introduction of competition for domestic customers from December 1998 means that all our 2.2 million customers will soon be able to choose their supplier. In the existing competitive market for electricity, we increased by a third the number of sites outside our region.

During the year, the regulator, Offer, proposed a revised form of price control from April 1998 based on a 'price cap'. We have reservations about the methodology, but our cap for the two years to 31 March 2000 is amongst the lowest in the industry and demonstrates that we already deliver low prices, through effective purchasing and cost management. Prices were further reduced in April 1998 and domestic

tariffs are now lower than when we were privatised in 1990. Our customers enjoy some of the lowest-priced electricity in the UK.

Gas

Norweb Gas is a joint venture with Utilicorp UK Limited, which holds a minority interest. Our success is built on combining Utilicorp's upstream supply expertise with Norweb's downstream customer-facing expertise. Together, Norweb Gas and Utilicorp have negotiated supply agreements that are market responsive and keep the business competitive.

Competition for domestic gas supply was introduced in Norweb's region in February 1998. As a result of our focused marketing, 157,000 domestic customers had signed an ENERGi gas contract by March 1998. We put special emphasis on doorstep sales, with face-to-face service. The regulatory authorities have used us as an example of good practice in this activity.

Customer service

Providing excellent customer service remains a key objective. We exceeded all overall standard targets set by Offer, and complaints by customers to Offer fell by nearly 20 per cent, giving our best ever performance.

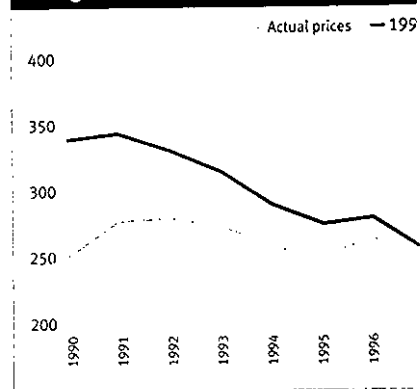
We installed a new customer information system in January 1998, and introduced an improved advisory service for our elderly and disabled customers. Customers can also now pay their bills free of charge at Post Offices.

Our user-friendly customer literature won us the Plain English Campaign's 'Utility of the Year Crystal Clear Award' for 1997. We are also establishing a 24-hour translation service for customers whose first language is not English.

ENERGi Services

The meter operator business, which specialises in the design and project management of schemes to instal meters, enjoyed further success, while Norweb Connections is

Average annual domestic electricity prices



developing innovative multi-utility solutions for the construction industry. In January, we became the first regional electricity company to achieve Offer's four-year energy efficiency target.

People awards

In recognition of our continuing achievements in preventing occupational accidents and illness, we won the RoSPA Gold Award for the sixth year running. We also won an Investor in People Award, reinforcing our commitment towards training and developing employees in line with business needs, and recognising the efforts being made to meet the challenge of change.

Technology at our fingertips to help customers



mal

Telecommunications

Norweb Communications	
Turnover (£m)	23.4
Operating profit (£m)	0.2

Highlights

- telecommunications business moves into profit only three years after inception
- outperforming on OfTel service and system reliability performance indicators
- launch of Digital PowerLine joint venture company NØR.WEB DPL
- North West primary school becomes world's first public user linked to the Internet via Digital PowerLine.

Norweb Communications now has two further distinct business areas relating to innovative Digital PowerLine technology, extending beyond its activities as a niche telecommunications operator.

UK operator business

The broadly-based Norweb Communications business includes switched telephony, leased capacity, intelligent network and facilities management services. Based on our fibre optic network, primarily within North West England, we provide data and voice services to large commercial and industrial customers in the North West, such as Manchester Airport, Siemens, Airtours and First Choice Holidays.

We intend to continue to leverage our investment in the North West, in order to develop our national capability through strategic alliances, winning more business from national customer groups and generating higher returns for a relatively modest outlay.

Customer service is always a high priority. We aim to outperform our competitors on the key service and reliability performance indicators published by the regulator, OfTel. Recent audited figures show a high level of network

reliability together with strong performance in service provision, restoration and complaint handling.

NØR.WEB DPL

In March 1998, we announced the formation of NØR.WEB DPL, a 50:50 joint venture between United Utilities and Nortel, the leading international telecommunications manufacturer.

Our Digital PowerLine technology uses existing electricity cables to transmit data at high speed. It can connect home computers to the Internet at relatively low cost, with service speeds around 20 times faster than the best modem and 10 times faster than ISDN. Digital PowerLine technology can also interface with devices such as TV set-top boxes.

We have been developing the technology for three years in collaboration with Nortel. The new joint venture company has access to the patents and know-how of both partners, and combines Norweb's experience in electrical power engineering and as a licensed telecommunications operator, with Nortel's technological expertise and worldwide channels to market.

Seymour Park School in Trafford, Greater Manchester, has become the world's first public user. The high-speed permanent connection provided by Digital PowerLine enables pupils to take full advantage of the educational potential of the Internet.

NØR.WEB DPL has agreements with companies with access to over 50 million customers, including RWE and EnBW of Germany, Vattenfall and Sydkraft of Sweden, and Norweb Communications.

DPL North West

Norweb Communications is a lead customer of NØR.WEB DPL. The technology offers the ability to develop the substantial opportunities to market information, communications and entertainment services to domestic, smaller business and education sector customers in

North West England. We are currently undertaking a marketing trial, to be followed by commercial development.

Initially the service offered by DPL North West will provide high speed Internet access. It will evolve to incorporate high quality, easy accessible information services and advanced communications applications. There will also be scope to generate revenue through advertising and home shopping. The programme of installation will be undertaken in a controlled, incremental manner, substantially reducing

Norweb Communications provides business telecommunications services and is developing Digital PowerLine technology. Vertex offers technology-based business operations outsourcing services to support customers in their core business.

the right connection

Facilities management	
Vertex Data Science	
Turnover (£m)	193.8
Operating profit (£m)	28.6

Highlights

- successful implementation of modern customer systems for energy and water
- substantial improvements in levels of customer service
- opening of single billing and payment services centre replacing six facilities
- contract awarded to run call centre services for new Littlewoods business.

Vertex, our facilities management business, provides a wide range of services to Group businesses. Vertex is well-positioned to win new contracts, particularly in sectors such as utilities and local government.

New billing and payment services centre

In January 1998, Vertex opened a state of the art billing and payment services centre in Warrington, rationalising six different operations around the region to one location. This major consolidation of people, processes and systems took just six months, with no loss of service to customers.

The centre already manages 50 million transactions a year, sending out 36 million bills and associated documents, valued at over £2 billion, to over 3 million addresses. Services include bill production and control, document management, payment management, printing, and disaster recovery.

New technology

Vertex continued to introduce new technology across a number of Group operations, to improve service for customers and increase efficiency.

For example, our new customer billing system is helping Norweb to meet the demands

of competition for energy. Some 2.2 million customer records were transferred in five days. At North West Water, another major IT project to increase customer service levels began to roll out during the year.

The Vertex contact management system features the latest case based reasoning, workflow and document imaging technologies, providing a highly flexible contact management system. It also enables a 'virtual contact centre', where employees in diverse locations can handle enquiries for a wide range of organisations.

Vertex Training Services

Vertex Training Services, a leading provider of technical training, continued to expand its client base and added consultancy services. It successfully completed the training of employees in the new systems for North West Water and Norweb, and began to pilot computer based training in a range of software applications. This is the first 'pay as you use' scheme in the UK.

Business excellence

To support our drive for business excellence and continuous improvement, we introduced a new framework for performance management and personal development. All parts of the business aim for accreditation such as ISO 9000 and Investor in People, and operations within our information technology services achieved ISO 9000 certification. Our Bolton call centre won an independent Recognition of Achievement Award, and at Lingley Mere, Warrington, our manager won the independent Call Centre Manager of the Year Award.

Market opportunities

The UK market for business operations outsourcing, worth an estimated £3 billion in 1997, continues to grow at over 20 per cent a year. Our investment in sales and marketing has produced a number of attractive opportunities, demonstrated by the recent announcement of

our agreement with Littlewoods to provide call centre service for a new telephone business, BetDirect. This represents Vertex first business operations outsourcing deal outside the utility sector.

The highest standards of quality and care

for the communities

International operations	
United Utilities International	
Turnover (£m)	7.7
Operating profit including associates (£m)	5.6
Development costs (£m)	15.0

Highlights

- sharpened focus and reducing cost base
- joint venture enhancing performance of electricity distribution services in central Buenos Aires Province, Argentina
- despite severe drought, joint venture bringing real benefits for people in Manila, in the Philippines
- with 38 operating contracts, US Water consolidates position as water services provider in USA.

During the year, our International operations assimilated major new projects in Argentina and the Philippines, and continued to develop existing projects in the USA, Australia and other parts of the world. We have sharpened our focus and reduced our cost base.

Argentina

We have now firmly established the joint venture which provides electricity supply and distribution for 1.2 million people in Buenos Aires Province. A team of senior managers from Norweb and our partner Camuzzi is working alongside employees of the former state-owned electricity supply company, to enhance its performance.

The business is ahead of target on profit growth, and on key indicators such as reduction of technical and non-technical losses, quality of service, health and safety performance and headcount. This demonstrates our ability to transfer our core skills in power distribution into the international market, and create genuine added value.

Australia

Our most recent Australian project is Riverland. Our consortium is responsible for the design, construction, finance and operation of ten water treatment works along 300 kilometres of the Murray River in South Australia. It has continued on schedule. Two works, Summit Storage and Swan Reach, were commissioned during the year. Six more works will open during 1998/99.

Existing plants serving Sydney and Melbourne continue to operate to specification, supplying customers with high quality water and generating better than anticipated profit streams for the company. The success of these projects has put United Utilities in a strong position to take full advantage of further opportunities for utility privatisation in the maturing Australian market.

The Philippines

Despite the severe drought created by the El Nino weather phenomenon, the joint venture between United Utilities, Bechtel, Ayala Corporation and Mitsubishi has started to bring real benefits for the people in the eastern half of Manila. Targets for leakage reduction are being beaten and water quality and availability are being raised.

The team is carrying out a vigorous programme to reduce operating expenditure and enhance revenue, and ensuring that capital investment is focused and delivers value for money.

Apart from the drought, all key parameters are in line with our original assumptions.

Scotland

We are providing full operations and maintenance services for the UK's first wastewater treatment facilities to be built and run under the Government's private finance initiative. The works, which will be

commissioned in 1998, will provide first-time full wastewater treatment for the towns of William and Inverness.

US Water

US Water, owned jointly with the Bechtel Corporation of America, continued to consolidate its position as a provider of water and wastewater services in the USA. With operating contracts and a strengthened team able to call on the skills and expertise of its owners, the company is in a position to bid for the much larger opportunities that are now a feature of the rapidly developing US utility market.

United Utilities International develops and operates contracts based on our core utility skills. We are committed to the communities we serve and to protecting the environment.



We serve

The community

Highlights

- community investment at almost £3 million, just over 1 per cent of pre tax profit
- United Utilities Community Forum established.

Investing in the community is at the heart of our business. This year we adopted a formal community policy: to work in partnership with the community for mutual benefit in a way which involves our employees, helps us achieve our business objectives and reflects the priorities of our stakeholders.

To co-ordinate the policy across all our businesses, we also set up a Community Forum chaired by our Chairman. Through a wide range of community partnerships, employee volunteers are involved in education, the environment, working with young people and people with extra needs, and promoting regional enterprise.

North West Water currently has the most active programme, and has been recognised as an example of best practice by *Business in the Community* in its 1998 Awards for Excellence in Corporate Community Investment.

Auditing our community investment

During the year, *Business in the Community* audited the Group's community investment for 1996/97 at almost £3 million, or just over 1 per cent of pre tax profit. This is just above the average investment for the top 50 FTSE companies. The majority is currently in cash. With the support of our employees, we are boosting opportunities for involvement and volunteering. The investment of time and resources can create a much bigger community impact when working alongside our partners.

In 1998, we published a separate annual report, *Community Review*, which gives full details of our community involvement.

The environment

Highlights

- substantially higher performance in the Business in the Environment Index of Corporate Environmental Engagement
- environmental management integrated into our business planning and control systems.

Our policy is to manage our total environmental impact in a structured and holistic way. We set out the framework in our environmental policy, published in 1996.

Our core business activities have a significant impact. They include our massive investment to help clean up rivers, estuaries and coastal waters; our significant programme of energy and water conservation; and our approach to conserving the landscape and its wildlife.

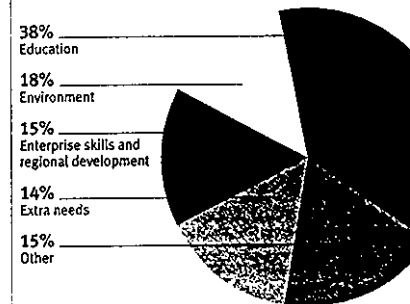
Environmental management

We also recognise the many opportunities for better environmental management in some of the less obvious areas of our business. For example, our purchasing and business partnership arrangements, and our large transport fleet.

During the year, we made progress in integrating environmental management into our business planning and control systems. This ensures that each business unit identifies and effectively addresses its specific environmental impacts. The controls address the key elements of recognised national and international environmental standards, such as BS EN ISO 14001, permitting possible certification at some stage.

An Environmental Management Panel of senior executives and independent experts reviews progress, identifies major issues and helps communicate best practice. We also benchmark our progress, and take part in the Business in the Environment Index of Corporate Environmental Engagement for FTSE 100 companies. Our score this year rose

Investment in the community



substantially, and is now better than the average for all participating companies.

We publish separately a full annual report on our environmental performance. Last year's report was commended by the Association of Chartered Certified Accountants.

Details of how to obtain a copy of this environmental report, the *Community Review* and other publications are given in the shareholder information section in this annual report.

A focused strategy delivering results

Group results

Following the acquisition of Norweb in November 1995, we have made significant progress in focusing on the performance of core businesses and delivering operational synergies. As Derek Green has outlined in his review, the necessary steps to achieve the planned integration savings from the acquisition of Norweb have been completed. Our focused strategy is delivering results against a background of change in some of the markets in which we operate.

Turnover from continuing operations increased by 2.3 per cent to £2,150.2 million following the substantial growth in 1996/97 as a result of the inclusion of the first full year of Norweb results. Overall turnover in 1997/98 decreased by 9.5 per cent compared with 1996/97 due to the divestment of non-core businesses largely completed in 1996/97.

Operating profit increased by 2.8 per cent in 1997/98 to £601.7 million. In 1996/97, operating profit rose £132.1 million to £585.5 million, an increase of 29.1 per cent. Approximately £87 million of that increase related to the full year impact and year on year growth of Norweb, with the balance relating to the increase in contribution from other businesses.

Profit before tax increased by 64.6 per cent in 1997/98 to £467.3 million, and included £6.8 million profit on disposal of businesses arising from the generation of additional proceeds on the completion of the disposal programme. Profit before tax in the previous year reflected a loss on disposal of businesses of £77.1 million (after goodwill write back, the details of which are set out in note 4 to the accounts) and a provision of £83.0 million against the Bangkok contract. In 1995/96, profit before tax was stated after making provisions of £123.8 million for business restructuring costs and recording a profit on disposal of businesses of £7.2 million.

Adjusted earnings per share rose by 6.1 per

cent to 81.9 pence, compared to the 5.2 per cent increase in the previous year. The calculation of the adjusted earnings per share is set out in note 10 to the accounts. The windfall tax of £414.8 million was the principal reason for the fall in earnings per share to 5.6 pence in 1997/98. Earnings per share in 1996/97 and 1995/96 were adversely affected by the exceptional items in those years as discussed above.

Operating cash flow per share increased to 113.9 pence from 99.0 pence in 1996/97 and 82.0 pence in 1995/96. The increase in 1997/98 reflects reduced expenditure connected with exceptional items, continuing emphasis on improving efficiency and stringent control of costs. The increase in 1996/97 reflects the first full year after the acquisition of Norweb in 1995/96.

At the end of January, an American Depositary Receipt programme was launched with a listing on the New York Stock Exchange. This listing is intended to make our shares more readily available to a wider range of US investors.

Dividends

Dividend policy was re-examined during the year in the light of our assessment of the potential impact of the impending regulatory price reviews, the achievable performance of our businesses and the impact of higher financial gearing. Consequently, we have decided to plan for prudent increases ahead of the regulatory reviews in order to underpin the sustainability of the dividend in the longer term. The proposed underlying full year dividend for 1997/98 of 40.8 pence per share represents an increase of 9.7 per cent on the previous year's dividend. Dividend cover remains prudent at 2.0.

In March 1998, the Chancellor, in his Budget statement, confirmed the proposals for the abolition of advance corporation tax (ACT) for dividends paid on or after 6 April 1999. Under the proposed regulations for the utilisation of surplus ACT, it is unlikely that we would be



Bob Ferguson Group Finance Director

Financial highlights

Year to 31 March	1998	1997
	£m	£m
Turnover from continuing operations	2,150.2	2,102.3
Operating profit (1)	601.7	585.5
Profit before tax and exceptional items	460.5	444.0
Profit before tax	467.3	283.9
Adjusted earnings per share (2)	81.9p	77.2p
Earnings per share	5.6p	44.9p
Underlying dividend per share (3)	40.8p	37.2p
Operating cash flow per share	113.9p	99.0p
Interest cover (4)	4.3	4.4
Dividend cover (5)	2.0	2.1

- (1) Throughout this financial review, operating profit is defined as profit from continuing operations before non-operating items, exceptional items, interest and tax.
- (2) Adjusted earnings per share excludes exceptional charges and the results of divested businesses.
- (3) The 1997/98 underlying dividend excludes the 1.36 pence per share enhancement.
- (4) Interest cover is calculated before exceptional items and the results of discontinued operations (see note 10 to the accounts).
- (5) Dividend cover is calculated on underlying dividends before exceptional items and the results of discontinued operations (see note 10 to the accounts).

Water and wastewater			
Year to 31 March	1998 £m	1997 £m	1996 £m
Turnover	905.3	866.7	828.2
Operating costs	(511.1)	(483.4)	(464.0)
Operating profit	394.2	383.3	364.2

Electricity distribution		
Year to 31 March	1998 £m	1997 £m
Turnover	342.7	329.0
Operating costs	(188.2)	(196.9)
Operating profit	154.5	132.1

able to recover fully the value of any additional ACT paid prior to 6 April 1999. As a result, we propose to delay payment of the final dividend to 6 April 1999, instead of paying it on the previously anticipated payment date of 1 October 1998. In order to compensate shareholders for the delay in paying the final dividend, we propose to increase the final dividend by 1.36 pence per share.

The expected benefit to the company is a saving of approximately £38 million of ACT which will be reflected in 1998/99.

We recognise that a delay in paying the dividend can prejudice certain shareholders and have arranged the option of a share alternative to the cash dividend based on the underlying dividend of 27.64 pence, with dealings in the new shares expected to commence on 1 October 1998. In addition, the company's brokers will be making a cash offer to shareholders taking up the share alternative at an assured price equivalent to the underlying dividend of 27.64 pence per share, without dealing costs.

The payment of the 1998/99 interim dividend will also be delayed to 6 April 1999. The Board will be considering the appropriateness of the company's share dividend plan, in relation to future dividends.

Water and wastewater

North West Water's results continued the trend shown in previous years. Turnover grew by 4.5 per cent in 1997/98 to £905.3 million in line with regulatory limits, compared to an increase of 4.6 per cent in 1996/97. Operating profit increased by 2.8 per cent to £394.2 million, compared to an increase of 5.2 per cent in 1996/97.

Operating costs increased by 5.7 per cent in 1997/98 and 4.2 per cent in 1996/97 reflecting general inflationary rises and increased depreciation charges resulting from the substantial capital investment programme. This trend of increase in underlying operating costs,

offset by efficiencies, will continue going forward as the significant capital investment programme continues.

Operating costs in 1997/98 included £27.4 million, compared to £40.1 million in the previous year and £23.4 million in 1995/96, for customer rebates, free leak repairs and other customer discretionary costs. Operating costs in 1995/96 also included £24.4 million for specific drought related expenditure.

Electricity distribution

Norweb Distribution's turnover increased by 4.2 per cent to £342.7 million in 1997/98. This increase reflected a 4 per cent price increase on distribution charges from 1 July 1997 to recover previously under-recovered revenue. Units distributed were static, compared with a 1.9 per cent increase in the previous year. Continued strong growth in the commercial sector was offset by reductions in the domestic sector, due to the milder winter, and in industrial units. In addition, increased turnover from the metering and connections operations reflected growth in activity levels from the developing competitive markets which they service.

Total operating costs fell by 4.4 per cent in the year to £188.2 million as further efficiency savings were delivered. Operating profit increased by £22.4 million to £154.5 million in 1997/98, an increase of 17.0 per cent. This was achieved by an increase in gross margin of £15.8 million, primarily as a result of the increase in turnover with the balance being attributable to a reduction in operating costs.

Turnover and profit growth in 1996/97 represented the impact of a full year's contribution from Norweb Distribution, compared to five months in the previous year. In underlying terms, on a full year comparative basis, operating profit in 1996/97 showed a decline of 5.4 per cent. The result for 1996/97 reflected an 11 per cent real reduction in regulated revenue, offset by efficiency savings in operating costs.

Electricity supply			
Year to 31 March	1998 £m	1997 £m	1996 £m
Turnover	1,097.1	1,105.3	596.9
Operating costs	(1,064.6)	(1,059.5)	(586.1)
Operating profit	32.5	45.8	10.8

Gas supply			
Year to 31 March	1998 £m	1997 £m	1996 £m
Turnover	23.8	18.0	10.3
Operating costs	(30.1)	(15.5)	(10.5)
Operating (loss)/profit	(6.3)	2.5	(0.2)

Telecommunications		
Year to 31 March	1998 £m	1997 £m
Turnover	23.4	8.2
Operating costs	(23.2)	(13.4)
Operating profit/(loss)	0.2	(5.2)

Energy supply

Electricity Turnover in the electricity supply business at £1,097.1 million represented a reduction of 0.7 per cent over the previous year, principally due to mild weather and lower tariffs. The £13.3 million fall in operating profit to £32.5 million is attributable to the absence of the £10 million clawback of previously under-recovered income, which benefited 1996/97, and the costs of preparation for full competition. Turnover and profit growth in 1996/97 represented the impact of a full year's contribution compared to five months in the previous year.

The principal cost associated with the electricity supply business is electricity purchase costs. Operating costs included £761.1 million in respect of electricity purchase costs, compared to £760.5 million and £455.2 million in 1996/97 and 1995/96 respectively. Operating profit is highly dependent upon the forecasting and management of electricity purchase costs.

This was our last full year as a monopoly electricity supplier. The phased introduction of domestic competition from December 1998 in our region means that all our 2.2 million customers will soon be able to choose their supplier. We have recently installed a modern flexible customer system and our existing customers already enjoy some of the lowest prices in the UK. The regulator has imposed a revised form of price control from April 1998 based on a price cap. The price cap for Norweb is RPI-3.4 per cent for 1998/99, and RPI-3.0 per cent for 1999/2000. This compares with the range of tariff reductions in England and Wales of between 6.2 per cent and 14.8 per cent and demonstrates our success in already delivering low prices by effective purchasing and cost management.

Gas Competition in domestic gas supply was introduced in Norweb's region in February 1998. Building on our position as the leading supplier of utility services in North West England, focused marketing on profitable

opportunities resulted in 157,000 domestic customers signing an ENERGi gas contract by March 1998. The deregulation of the domestic gas market provides significant opportunities for the Group. A new customer system, our expertise in providing customer service and the strategic benefits of having Utilicorp UK as our joint venture partner means we are well positioned to exploit the opportunities that arise.

Gas supply turnover continued to grow and increased by £5.8 million, to £23.8 million, following the increase of £7.7 million to £18.0 million in 1996/97. The marketing investment of £6.4 million incurred in the year to establish the business as a leading supplier in competitive markets has been charged against profit in the year. This and the additional overhead cost of gearing up for an increased customer base resulted in an operating loss of £6.3 million compared with a profit of £2.5 million in the previous year and a loss of £0.2 million in 1995/96.

Telecommunications

Only three years after the launch of switched operator services in the North West, the telecommunications business has generated a profit of £0.2 million, compared with losses of £5.2 million in 1996/97 and £1.5 million in 1995/96. This has been achieved through strong growth in turnover reflecting an increase in both the number of customers connected and their usage.

In March, NOR.WEB DPL, a 50:50 joint venture company between United Utilities and Nortel, was announced. Norweb Communications is a lead customer of NOR.WEB DPL and in the coming year will commence commercial deployment of Digital PowerLine in North West England. The profit potential of the joint venture company is not yet clear; however, we are optimistic given the anticipated growth in the telecommunications market for data and tele-working.

Facilities management			
Year to 31 March	1998 £m	1997 £m	1996 £m
Turnover	193.8	185.2	-
Operating costs	(165.2)	(158.1)	-
Operating profit	28.6	27.1	-

International operations			
Year to 31 March	1998 £m	1997 £m	1996 £m
Turnover	7.7	6.9	9.9
Operating profit including associates	5.6	4.6	5.9
Development expenditure	(15.0)	(12.4)	(8.9)

Other activities		
Year to 31 March	1998 £m	1997 £m
Turnover	64.5	60.9
Operating costs	(57.1)	(53.2)
Operating profit	7.4	7.7

Facilities management

Facilities management operations commenced on 1 April 1996 as a primary vehicle to achieve synergy benefits following the acquisition of Norweb. Turnover, almost exclusively with other subsidiary companies, increased by 4.6 per cent to £193.8 million as major new services were delivered, and operating profit increased by 5.5 per cent to £28.6 million as further efficiency savings were achieved. These savings were made in an extremely demanding year that included the successful implementation of modern customer systems for all of Norweb's electricity and gas customers and North West Water's measured customers.

International operations

Operating profit, including our share of the results of associated undertakings, improved to £5.6 million, up from £4.6 million, assisted by the first contributions from the new projects in Manila and Argentina. This follows a reduction in 1996/97 due to the sale of 50 per cent of our interest in US Water during 1995/96.

In the past three years, development costs have increased as the breadth of activity has expanded to include electricity. Development costs of £15.0 million in the year reflect International Power's first full year of operation and increased bid activity in US Water and International Water. Development costs fell in the second half of the year, with a more focused and lower cost approach being taken to pursuing opportunities that meet our strict financial and territory criteria. International development projects are inherently speculative and can take several years to come to fruition. Our objective is to secure long-term operational sources of income and we seek to limit our exposure by operating through project-specific companies.

The economic crisis which has affected South East Asia recently has had little impact on the results for the year. Equity exposure in that region is small and in Indonesia, where the crisis has been most acute, we have no investments.

Other activities

Within this category we have included the trading results of the Bangkok contract, Norweb Contracting and our insurance and property activities.

Bangkok

One of our subsidiary companies is a partner in a consortium which has been engaged in the construction of a sewage treatment works and associated sewerage network in Bangkok since late 1993, following the submission of a tender in 1992. The contract value at the time of the award was £150 million and the contract period was 38 months.

The contract has been affected by delays and additional work as a result of changes to the specification required by the client's engineer and the failure of the client to provide appropriate possession of essential sites. An £83.0 million exceptional provision was charged to the profit and loss account in 1996/97. This reflected a decision by the client to cease negotiations on the increased costs that the project had incurred, indicating at that time that the consortium should register a formal dispute and seek recovery through arbitration.

On 6 March 1998, the consortium terminated the contract and issued a notice of arbitration against the client. After considering all the information available to us, including the impact of the recent currency crisis in South East Asia, and bearing in mind the legal and commercial complexities, we believe that the costs of the project, up to and including termination, have already been fully provided for.

Taxation

The combination of North West Water and Norweb continues to result in a more efficient tax structure for the Group. This, combined with the relatively high take up in the year of the share alternative to the cash dividend, resulted in the ordinary tax charge remaining low at an effective underlying tax rate of

5.2 per cent. The tax charge would have been lower, but for planning the utilisation of our current surplus ACT. The benefit of this will be received in 1999/2000 and later. The underlying rate compares with 16.9 per cent and 17.7 per cent in 1996/97 and 1995/96, both of which were impacted by exceptional charges. The underlying rate is lower than the current standard corporation tax rate of 31 per cent due to significantly higher tax allowances compared to accounting depreciation.

The exceptional tax charge for the year relates to the windfall tax – a special one-off tax on the privatised utilities introduced by the current UK government. The total charge represents a tax of £259.6 million on North West Water and £155.2 million on Norweb. The first instalment was paid on 1 December 1997 and the remaining balance of £207.4 million will be paid on 1 December 1998.

Cash flows

Operating cash flow continued to follow the trends of previous years and increased to £609.1 million, from £519.3 million in 1996/97 and £356.3 million in 1995/96, reflecting the factors set out above in the discussion of operating cash flow per share.

Tax paid has increased significantly over previous years, principally as a result of the payment of the first instalment of the windfall tax of £207.4 million.

A significant level of investment continues to be made, mainly as a result of North West Water's capital investment programme, including infrastructure expenditure, which has grown from £440 million in 1995/96 to £505 million in 1996/97 and £502 million in 1997/98. The investment has been made to secure higher standards of drinking water and cleaner rivers, and includes further investment in coastal water clean up initiatives. In 1997/98, we made £59 million of discretionary capital expenditure reducing leakage and making more water resources available.

Capital investment in the electricity distribution business increased by £94 million to £190 million, due mainly to the development of essential IT systems required prior to the introduction of competition in electricity supply, together with a substantial increase in spend on the electricity distribution network.

In addition, £58.5 million was invested in international projects, principally in Argentina.

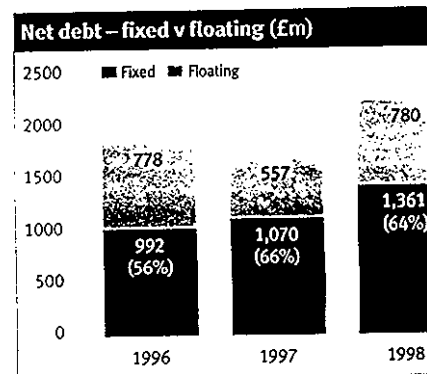
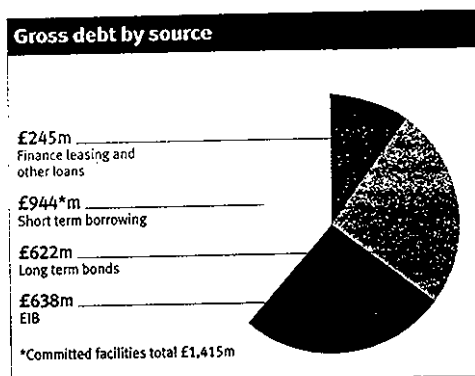
As a result of the increased outflows in respect of taxation and investment, net borrowings have increased by £513.6 million to £2,140.6 million at the year end. Gearing, measured as net debt divided by equity shareholders' funds, rose to 105 per cent at 31 March 1998, compared to 76 per cent and 89 per cent at 31 March 1997 and 1996 respectively, reflecting the impact of the windfall tax on shareholders' funds and the increase in net debt in the period. In the absence of the windfall tax, the gearing level would have been 78 per cent at 31 March 1998.

Year 2000

During the year, we made significant progress in understanding the scale and multi-faceted nature of the Year 2000 problem in relation to our business activities. With scoping and impact assessment now well advanced, we have been able to determine high-level conversion and test strategies, allowing work to commence on critical systems in North West Water and Norweb. The results from the first main IT system tested show a high degree of Year 2000 date integrity in the system and data.

The main issue facing us continues to be the availability of both business and IT resources. This issue is not unique to United Utilities, as demand for Year 2000 and EMU resources puts IT resources at a premium. Sixty permanent employees, and sixty consultants and contractors, are now engaged full time on the programme which will rise to over two hundred at the peak of activity.

Whilst we are confident that Year 2000



compliance for all business critical processes can be achieved, we recognise that there may not be sufficient time to test all non-critical systems. It is for this reason that we intend to set up a separate Group-wide business contingency project which will be incorporated into our overall business continuity planning.

There is no panacea to the Year 2000 date change problem. There can be no assurance that the steps taken by any company will successfully minimise vulnerabilities of its software and systems, or those of its suppliers, to the problems associated with the transition to the Year 2000. The solution requires a concentrated, analytical approach backed by considerable resources to methodically search out, convert and test for compliance. We are communicating with our major trading counterparties to ensure they are also addressing the issue. The cost of the programme is estimated to be between £35 million and £50 million in the period to 31 March 2000, a significant proportion of which will be charged to the profit and loss account.

Treasury policy

The Group's treasury function seeks to reduce or eliminate financial risk, to ensure sufficient funding is available to meet foreseeable needs, and to invest cash assets safely. It operates within policies and procedures approved by the Board. It does not act as a profit centre and does not undertake any speculative trading activity. We review the credit quality of counterparties and limit individual aggregate credit exposures accordingly.

Financing

During the year, we raised approximately £1.6 billion in new bank facilities and term debt, which enabled the debt associated with the acquisition of Norweb in 1995 to be refinanced and its maturity profile extended. This included £1.1 billion in medium term committed bank facilities, \$500 million in 10-

year bonds offered to the public in the United States, the proceeds of which were swapped into sterling, and £200 million in a 10-year loan from the European Investment Bank. The new bank facilities will be used largely to provide back up for our \$1.5 billion commercial paper programme also launched during the year.

As at 31 March 1998, the Group's net debt comprised £1,504 million of term borrowings and long term leasing and £637 million of short term facilities. These short term facilities are fully supported by substantial medium term committed bank facilities which total £1.2 billion. In addition, we have access to significant uncommitted bank facilities.

During the year, United Utilities PLC was assigned long term credit ratings for the first time. Standard and Poor's Rating Services rated the company and the US Bond A+ and Moody's Investors Services rated the US Bond A2.

Interest rate management

The net interest charge for the year increased by £9.3 million to £141.2 million, largely as a result of the increased debt. Net interest payable in 1996/97 increased to £131.9 million from £75.0 million in 1995/96 principally due to the full year impact of the Norweb acquisition debt.

The weighted average interest rate was 7.9 per cent, based on average debt of £1,785 million compared to 7.8 per cent in 1996/97 and 7.7 per cent in 1995/96.

Our exposure to interest rate fluctuations is managed through the use of interest rate swaps and financial futures contracts traded on LIFFE. At 31 March 1998, approximately 64 per cent of net debt was fixed for more than one year through fixed rate borrowings and interest rate swaps, compared to 66 per cent at 31 March 1997 and 56 per cent at 31 March 1996. The LIFFE contracts are used to hedge short term interest rate exposure.

European Monetary Union (EMU)

EMU will start on 1 January 1999 comprising

11 countries. The UK will not enter in this initial stage and has not yet committed its entry date. We believe that during this stage the impact of EMU on the Group will be minimal due to the geographical nature of businesses. We are assessing the risks and opportunities of EMU in the longer term with particular regard for the potential impact of inflation and interest rates.

US GAAP results

Under US GAAP, the result after taxation, minority interests and equity shareholders' funds at the year end were as set out below.

Differences between UK and US GAAP principally arise from the accounting treatment of pension costs, infrastructure assets, interest incurred on construction projects, goodwill taxation, deferred taxation and the recognition of the dividend payments. A detailed reconciliation between UK and US GAAP is set out in note 35 to the accounts.

US GAAP results

	UK £m
Results for the year:	
1998	30.1
1997	235.4
1996	224.4
Equity shareholders' funds:	
1998	2,045.5
1997	2,141.9
1996	1,992.1

The directors



This page from left to right

Top: Sir Christopher Harding, Derek Green, Bob Ferguson. Below: John Beckitt, Gordon Waters.

Facing page from left to right

Top: Eric Clark, Dr Rodney Leach, Sir Richard Evans. Below: Sir Peter Middleton, Jane Newell, John Seed.



Sir Christopher Harding (age 58) *Chairman*

Sir Christopher joined United Utilities as a non-executive director and Deputy Chairman in November 1997, becoming non-executive Chairman on 1 April 1998.

He is also non-executive chairman of Legal & General Group Plc (since May 1994) and of Newarthill plc, the holding company for Sir Robert McAlpine Limited. He is a non-executive director of GEC plc.

After graduating from Oxford, where he read History at Corpus Christi College, Sir Christopher joined Imperial Chemical Industries in 1961, where he held a number of senior personnel management positions.

In 1969, he joined Hanson plc, becoming managing director of Hanson Transport Group in 1974 and a non-executive director of Hanson plc in 1979. Following the demerger of Hanson plc, he became a non-executive director of The Energy Group until October 1997. He was appointed vice chairman of Hanson Transport Group Limited in 1991.

He was chairman of British Nuclear Fuels plc from April 1986 until June 1992, and chairman of BET plc from May 1992 to May 1996.

Sir Christopher was knighted in 1991, and is a Freeman of the City of London. He is chairman of the board of the Prince's Youth Business Trust, and a board member of the Foyer Federation of Youth.

Derek Green (age 58) *Chief Executive*

Derek was appointed Chief Executive of United Utilities in July 1997. He joined North West Water Group PLC in 1992 as Managing Director of the core utility business North West Water Limited. He became executive responsible for the two core utilities Norweb Distribution and North West Water following the formation of United Utilities PLC in January 1996. He is non-executive Chairman of Vertex Data Science Limited.

He is a chartered surveyor with extensive experience in the construction industry, both in the UK and overseas. Between 1969 and 1975, he worked for Holiday Inn Inc. as director of project development Europe, North Africa and the Middle East.

From 1975 to 1988, Derek worked for the Fairclough/AMEC Construction Group, and was appointed to the group executive board. During this time, he held directorships of Fairclough Building and Fairclough (Scotland) Limited. He was chief executive of both AMEC International Construction Limited and AMEC Projects Limited. He was also responsible for the activities of Worley Engineering Limited and Mapel Limited.

In 1988, he joined BTR as group chief executive for the aggregates business, carried out through Tilcon Holdings in the UK and Tilcon Inc. in the USA.

He is a non-executive director of Graham Group.

Bob Ferguson (age 55) *Group Finance Director*

Bob was appointed Group Finance Director of North West Water Group PLC in 1992. Following the acquisition of Norweb in November 1995, he became Group Finance Director of the newly-formed United Utilities.

Bob began his career with Liverpool Corporation in 1959, and trained as a chartered accountant. He held various posts in housing, education, and environmental health and protection, before being promoted to group accountant with Merseyside County Council.

In 1974, he moved to the North West Water Authority as principal accountant, becoming assistant director of finance in 1981, and head of finance in 1987.

He led the privatisation team responsible for preparing the business for its successful flotation in November 1989 and, following privatisation, became Director of Finance for North West Water Limited. He was appointed Deputy Managing Director in 1991, and during that year studied at Harvard Business School on the Programme for Management Development. A year later he was appointed Group Finance Director.

He is also chairman of Innvotec North West Trust Limited, which manages the £10 million United Utilities Venture Fund. This partnership between investors and the European Regional Development Fund provides venture capital for growing small and medium-sized businesses. The aim is to assist economic regeneration in North West England.

John Beckitt (age 50) *Managing Director, Energy and Telecommunications*

John was appointed to the Board in 1995, having joined the Group in 1994 as Managing Director, Process Equipment.

He was appointed Managing Director, Energy and Telecommunications, in April 1997.

He is also chairman of the recently formed joint venture company with Nortel, NØR.WEB DPL, to develop our Digital PowerLine technology.

John graduated from Birmingham University as a chemical engineer in 1968 and joined ICI as a process engineer.

He went on to operate and commission a number of major chemical plants in Fleetwood and Teeside between 1971 and 1981 before returning to Cheshire in techno-commercial and business management roles for a wide range of ICI's regional and international businesses headquartered in the North West.

John managed the successful restructuring of a number of these businesses before being asked to manage the turnaround of ICI's Soda Ash facilities in mid-Cheshire between 1983 and 1987.

John then became marketing manager and ultimately international business manager of ICI's Klea CFC and HFC refrigerants business.

Gordon Waters (age 51) *Managing Director, International*

As Managing Director, International, Gordon is responsible for all the Group's involvement in both power and water outside England. He joined the Group in 1996, and was appointed to the Board in 1997.

A qualified civil engineer and structural engineer, he graduated from the City University London in 1969. He is a major UK consulting engineering practice before work for a number of major UK construction companies, involved in large civil engineering projects both in the UK and overseas.

From 1983 to 1987, he worked for Mowlem Construction becoming construction director for their regional civil engineering division based in North West England.

From 1987 to 1996, he worked for Tarmac Construction Limited, becoming managing director of the civil engineering division in 1992, and joining the board of Tarmac Construction Limited in 1993. He was responsible for all their major projects and regional civil engineering companies and specialist companies both in the UK and overseas. In 1995, he joined the board of TBV Power Limited and became additionally responsible for all Tarmac's involvement in power, both internationally and in the UK.



Eric Clark
(age 63)

Eric was appointed a non-executive director in April 1993. He is also a non-executive director of the Dana Corporation Inc., and the Merseyside Development Corporation.

He read physics at Durham University and worked with the UK Atomic Energy Authority, before joining Associated Industrial Consultants from 1967 to 1970. He then joined Plessey, becoming managing director of Plessey Controls in 1974, chief executive of Plessey Telecommunications Limited in 1979, and in 1984 managing director of Plessey Telecommunications and Office Systems Limited.

He joined BICC Cables and the board of BICC plc in November 1985. He was appointed chairman and managing director of BICC Cables in 1986, and executive chairman in 1994, also serving as chairman of Optical Fibres, a partnership between BICC and Corning Glass of the USA. He retired from BICC in 1996.

He is a former President of the industry trade associations the British Cablemakers Confederation, Eurocabel, and the International Cablemakers Federation.

He was awarded the CBE in 1995 for services to the cable industry, and was elected a Companion of the Institute of Management in 1984.

Dr Rodney Leach
(age 66) *Chairman of the Audit Committee*

Rodney became a founding non-executive director of the Group in September 1989, having been appointed a member of the North West Water Authority earlier that year.

A Lancastrian by birth and now resident in Cumbria, he is a physics graduate of Birmingham University and worked for nine years on the design, commissioning and operation of UK nuclear power stations. In 1965, he joined McKinsey & Company Inc., where he became a partner. He had a major involvement in developing the concepts underlying worldwide freight containerisation, and subsequently joined P&O in 1974 as head of the European transport division, becoming an executive director and chairman of P&O Cruises.

In 1985, he moved to Vickers Shipbuilding and Engineering Limited, in Cumbria, as chief executive responsible for the UK nuclear submarine construction programme, and as chairman of Cammell Laird Shipbuilders Limited in Birkenhead. He led the successful privatisation of the two companies in 1986, retiring at the end of 1988. He was a non-executive director of Jasmin plc and deputy chairman of an NHS Trust in Cumbria until 1997.

Rodney is a chartered engineer and a Fellow of the Royal Institute of Naval Architects, the Institute of Management, and the Chartered Institute of Marketing. He is a Freeman of the City of London.

Sir Richard Evans
(age 55)

Sir Richard was appointed a non-executive director in September 1997.

Born in North West England, he has worked in the aircraft and aerospace industry for 30 years. He became chief executive of British Aerospace PLC in 1990, and was appointed chairman in May 1998.

He has had a long association, through BAC and BAe, with their Warton division in Lancashire, where he was deputy managing director from 1983 to 1986. He joined the board of British Aerospace in 1987 as marketing director.

He was a director of the programme management companies for the Anglo/French Jaguar aircraft, and for the Anglo/German/Italian Tornado aircraft. He was also director in charge of the Jaguar manufacturing programme in India.

Sir Richard was awarded the CBE in 1986 for services to export, and was knighted in the 1996 Queen's birthday honours. He is a Deputy Lieutenant of Lancashire, an honorary member of the NSPCC Council, and the principal supporter of the BAe Charity Challenge.

Sir Peter Middleton
(age 64) *Vice Chairman*

Sir Peter joined the Board as a non-executive director in January 1994.

He was deputy chairman of Barclays Bank PLC, and chairman of Barclays Capital from 1991 to May 1998. He is now a non-executive director of Barclays Bank, General Accident PLC, and Bass PLC.

Sir Peter attended the Universities of Sheffield and Bristol and was a visiting fellow at Nuffield College, Oxford from 1981 to 1989. He has been a member of the Council of the Manchester Business School and the London Business School and is presently a Pro Chancellor of Sheffield University.

After National Service, he joined HM Treasury, serving as Permanent Secretary from 1983 to 1991.

Sir Peter is chairman of the Institute of Contemporary British History, is a governor of the National Institute of Economic and Social Research, a governor of the Ditchley Foundation and a board member of the Centre for Economic Policy Research, and the Centre for the Study of Financial Innovation. He is a member of the Financial Reporting Council.

Jane Newell
(age 54)

Jane joined the Board as a non-executive director in 1996. She is Chair of the United Utilities Pension Scheme and the Norweb Group of the Electricity Supply Pension Scheme.

She spent 10 years as an international civil servant before reading French and Linguistics at Victoria University of Wellington, where she won a University Grants Committee doctoral scholarship. After returning to the UK in 1983, she spent eight years as administrator and fundraiser for the Liverpool School of Tropical Medicine, where she subsequently became a member of the Council, and chairman of Council from 1995 to 1997.

In 1992, Jane was appointed a founder trustee and subsequently chairman of the Maxwell Pensioners Trust, the Secretary of State for Social Security, for which she was awarded an OBE in 1997. She is also a trustee of the Glaxo Wellcome Pension Plan and of the Dixon Group Pension Scheme, and a director of Liverpool Association for Tropical Health Limited.

She is an external assessor for the Home Office for promotions in the police, prison and fire services, a South Western Bench in Inner London, and vice chair of the board of governors of South Bank University.

John Seed
(age 59) *Chairman of the Remuneration Committee*

John joined the Board as a non-executive director in 1997.

John was formerly chief executive of South Western Electricity plc. A chartered engineer, he spent 29 years in general management posts before becoming director of Eastern Electricity, holding a number of engineering posts before becoming director of South Western Electricity in 1986, becoming managing director at privatisation and then chief executive in 1991.

He is also a non-executive director of Prism Rail plc, Rebus Group plc, British Smaller Companies VCT plc, chairman of Windelectric Limited. He was a non-executive director of the Bath Royal United Hospital Trust from 1997, and chairman of Great Western Assured Growth from 1991 to 1997.

John is a Fellow of the Institution of Electrical Engineers and a Companion of the Institute of Management. He is also a Fellow of the Royal Society of Arts.

Directors' report

Principal activities and business review

The Group provides a range of utility services, including the planning, design and operation of water and wastewater, electricity distribution and telecommunications systems, and the supply of electricity and gas. In addition, the Group provides business operations outsourcing services supporting both Group businesses and external customers.

The Group's principal subsidiary and associated undertakings are listed in note 12 to the accounts.

The Chairman's statement, the Chief Executive's review, and the financial review on pages 4 to 23 report on the Group's activities during the year and likely future developments.

Dividend

We recommend a final dividend of 29.0 pence per ordinary share for the year ended 31 March 1998. Subject to approval of that recommendation by shareholders at the annual general meeting, the dividend will be paid on 6 April 1999 to shareholders on the register at close of business on 12 June 1998. The final dividend includes an enhancement of 1.36 pence per ordinary share to recognise the delay in the payment date. Shareholders will be offered a share alternative to the cash dividend, based on the underlying final dividend of 27.64 pence per ordinary share, with dealings in new shares expected to commence on 1 October 1998. In addition, Dresdner Kleinwort Benson will be making a cash offer to shareholders taking up the share alternative.

Business at the annual general meeting

Full details of the resolutions to be proposed at the 1998 annual general meeting are set out in the notice of meeting, and there are explanatory notes about the resolutions in the leaflet containing the formal notice, which is enclosed with this report.

Substantial shareholding

At 31 May 1998, the company had been notified by Capital Group Companies, Inc. and by Prudential Corporation plc that they held interests in 8.03 per cent and 3.27 per cent respectively of the company's issued ordinary share capital.

Directors

The names of the present directors and biographical details are given on pages 24 and 25. Further information about the directors seeking re-election is set out in the Remuneration Committee's report on pages 27 to 32, together with information about remuneration and interests in ordinary shares in the company.

Employment policies

Employees are key to achieving our business strategy. We are fully committed to improving the skills of our employees and to extending Investor in People accreditation throughout the Group. Through training and development and nurturing a culture in which our employees feel valued, we encourage them to work to their full potential. We respect the dignity and rights of every employee, support employees in performing various roles in society and challenge prejudice and stereotyping.

We are committed to open and regular communications with our employees about business issues and developments and issues of general interest to them, through both formal and informal processes. Employee involvement is further encouraged through means such as the employee sharesave and suggestion and recognition schemes. Proper attention to health and safety is an indispensable part of our commitment to high standards in every aspect of our business.

Research and development

The Group is committed to develop innovative, cost-effective and practical solutions for providing high quality services to our customers. In this work, we seek to take maximum advantage of the wide-ranging expertise, abilities and facilities within the Group. We also seek to ensure that we properly focus our investment in the development and application of technology, that we have the right skills to employ technology to competitive advantage and that we continue to be alert to technological opportunities.

Payments to suppliers

The Group's policy is normally to pay suppliers according to agreed terms of business. These terms are agreed with suppliers on entering into binding contracts and the Group's policy is to adhere to the payment terms providing the relevant goods or services have been supplied in accordance with the contracts. In accordance with The Companies Act 1985 (Directors' Report) (Statement of Payment Practice) Regulations 1997 SI 1997 No. 571, the company had 34 days of purchases outstanding at the end of the financial year.

Charitable donations

During the year, we have continued to support a range of charitable projects and to support in other ways the communities of which our businesses are an integral part. Charitable donations in the year amounted to £576,163 (1997 - £814,986). No political contributions were made.

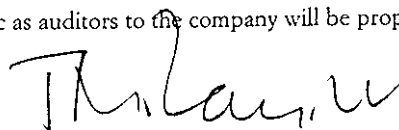
Auditors

A resolution to re-appoint KPMG Audit Plc as auditors to the company will be proposed at the annual general meeting.

Signed on behalf of the Board of directors.

Tim Rayner Secretary

8 June 1998



Remuneration Committee's report

Strategy

The Group aims to attract, develop, retain and motivate talented employees at all levels, and seeks to provide competitive salaries and benefits for all its employees.

Within that framework, the Remuneration Committee approves the Group's policy and general recruitment terms, remuneration benefits, employment conditions and severance terms for executive directors and other senior executives.

The Committee's policy objectives are to ensure that the remuneration packages:

- are directly aligned with the performance of the Group and the interests of the shareholders; and
- fairly and responsibly reward executives for their contribution to the Group's performance.

The Remuneration Committee

The Committee's composition, operation and responsibilities comply with the recommendations of the Greenbury Study Group relating to remuneration committees incorporated in section A of the best practice provisions annexed to the Listing Rules of the London Stock Exchange. In formulating and implementing its policy objectives, the Committee gives full consideration to section B of the best practice provisions annexed to the Listing Rules, and takes professional advice from within and outside the company.

The members of the Committee are Eric Clark, Rodney Leach, Jane Newell and John Seed (who succeeded Eric Clark as chairman of the Committee in January), all of whom are non-executive directors. They have no personal financial interest in the company other than as shareholders and the fees paid to them as non-executive directors. They have no conflicts of interest arising from cross directorships and no day to day involvement in running the Group's businesses.

Although not a member of the Committee, on occasion and for matters not related to himself, the Chief Executive may attend meetings and is consulted by the Committee on proposals relating to the remuneration of the other executive directors and other senior executives. Sir Christopher Harding is not a member of the Committee but, as Chairman, is consulted by the Committee on proposals relating to the remuneration of the Chief Executive.

Remuneration package for executive directors

This comprises the following elements:

Salary

Basic salaries are reviewed annually, taking account of company and personal performance and supported by independent assessment of market rates based on the practice of a group of major companies in the FTSE 100, including utilities and other companies of a similar size and complexity to the Group.

Short term incentive awards

Short term incentive awards under the incentive plan approved by shareholders in 1996, up to a maximum of 40 per cent of annual salary, are made in respect of an individual financial year, based on financial performance in that year. All awards are subject to stretching performance criteria. Awards to executive directors are contingently made in shares in the company, ownership of which will normally only vest in the executive director after a further two financial years if he remains with the company for that period.

Long term incentive awards

Long term incentive awards under the incentive plan are related to the returns enjoyed by the company's shareholders. Company performance is assessed on the basis of total shareholder return (TSR), which includes share price appreciation and gross dividends, measured over a period of three consecutive financial years, except in the case of the first awards shortly due to be made in respect of which TSR has been assessed over the two financial years to 31 March 1998. TSR is compared with the performance achieved by the two comparator groups of companies – the FTSE 100 utility companies, and the remaining FTSE 100 companies excluding the utility companies. No award is earned in respect of a comparator group if the company's TSR ranks in the bottom half of that group.

If and when the company's relative ranking in a comparator group moves into and through the top half of the group, the proportion of salary awarded for each per cent of absolute TSR increases up to a maximum of 1.75 per cent for each comparator group. Awards are capped in respect of a comparator group if company TSR reaches an average of 25 per cent per annum over the three financial years. At that rate of return, the value of a shareholders' investment would have doubled over those three years.

There is also a further performance hurdle which provides that no awards are made if growth in adjusted earnings per share over the relevant period does not exceed the increase in the retail prices index over that period by at least 2 per cent per annum. One third of an award is payable in cash and two thirds are contingently awarded in shares. Ownership of such shares will normally only vest in the executive after a further period of two financial years, if he remains with the company for that period.

Taxable benefits

Taxable benefits comprise, as appropriate, a car, travel, telephone allowance, mobile telephone, medical and life insurance.

Remuneration Committee's report

Pension

Full information about pension arrangements and entitlements is given below.

Share options

Executive directors are eligible to participate in the employee sharesave scheme. With the introduction of the incentive plan, the granting of options under the executive share option scheme to executive directors was discontinued in 1996. Full details of share options are given below.

Contracts of service

All executive directors serve under contracts which are terminable by the company giving not more than two years' notice. This notice period, having regard to prevailing market conditions and current practice, provides executive directors with a reasonable degree of security, enabling them to concentrate on securing and enhancing the future of the company. The Committee's policy on termination of contracts is to apply mitigation as far as is fair and reasonable in each circumstance.

Non-executive directors' remuneration

Non-executive directors' remuneration is determined by the Board as a whole. The annual remuneration currently payable to non-executive directors is a fee of £20,000, £5,000 for chairmanship of a Board committee, £1,000 for membership of a Board committee, and appropriate amounts for additional and special responsibilities. The non-executive directors do not have contracts of service and do not participate in the incentive plan, pension or healthcare arrangements. They are not eligible to be granted options under either the executive share option scheme or the employee sharesave scheme. Taxable benefits comprise, as appropriate, telephone allowance and travel.

Directors' emoluments

Emoluments comprise salaries, fees, taxable benefits and the value of short term incentive awards. The aggregate emoluments of directors in the year ended 31 March 1998 amounted to £2.079 million (1997 – £1.649 million).

Individual directors' emoluments for the financial year were:

	Salary/Fees		Short-term incentive award		Taxable benefits			Total
	1998 £'000	1997 £'000	1998 £'000	1997 £'000	1998 £'000	1997 £'000	1998 £'000	1997 £'000
Sir Desmond Pitcher	310.0	310.0	124.0	–	9.6	16.3	443.6	326.3
Derek Green	272.7	209.0	120.0	42.1	18.1	15.9	410.8	267.0
John Beckett	167.9	162.5	68.0	66.0	12.0	14.4	247.9	242.9
Malcolm Faulkner	140.5	116.9	52.8	23.5	12.1	9.4	205.4	149.8
Bob Ferguson	191.0	179.3	79.4	–	14.0	14.2	284.4	193.5
Gordon Waters	134.6	–	55.7	–	9.0	–	199.3	–
Brian Staples	100.0	300.0	–	–	0.6	5.9	100.6	305.9
Sir Christopher Harding	20.8	–	–	–	–	–	20.8	–
Eric Clark	25.7	24.0	–	–	0.9	0.5	26.6	24.5
Sir Richard Evans	11.7	–	–	–	–	–	11.7	–
Rodney Leach	26.7	26.0	–	–	1.2	1.4	27.9	27.4
Sir Peter Middleton	40.7	40.0	–	–	–	–	40.7	40.0
Jane Newell	25.2	12.1	–	–	–	–	25.2	12.1
John Seed	24.5	20.5	–	–	0.5	0.9	25.0	21.4
Frank Sanderson	9.0	29.0	–	–	0.2	1.2	9.2	30.2

Notes:

The value of short term incentive awards under the incentive plan in respect of the year ended 31 March 1998 will be satisfied by the allocation by the trustee of the United Utilities Employee Share Trust to executive directors of ordinary shares in the company, based on a share price of 850 pence being, in accordance with the rules of the plan, the average of the mid market prices of an ordinary share over the 30 business days commencing 15 business days before the year end, with the exception of Sir Desmond Pitcher and Malcolm Faulkner, who left the company on 31 March 1998 and whose awards will, in accordance with the rules of the plan, be paid in cash. The non-executive directors do not participate in the incentive plan.

The highest paid director in the year ended 31 March 1998 was Sir Desmond Pitcher. Sir Desmond's employment with the company terminated on 31 March 1998. The company has paid Sir Desmond £443,630 in lieu of the notice of termination to which he was entitled under his service agreement, the amount paid having been discounted for early receipt. The total of (i) the amount paid to Sir Desmond in lieu of notice of termination and (ii) his emoluments for the year ended 31 March 1998 set out in the table above is £887,230 (1997 – £326,300).

The company terminated the employment of Malcolm Faulkner by reason of redundancy on 31 March 1998. On leaving the company, Malcolm Faulkner received a cash sum of £39,829, being the cash sum equal to the market value at 31 March 1998 of ordinary shares in the company that he would otherwise have received in due course arising from the short term incentive award in respect of the year ended 31 March 1997. The company has made a special contribution of £264,000 to the Electricity Supply Pension Scheme in connection with the termination of his employment, resulting in enhanced pension benefits details of which are given below. The total of (i) the pension contribution paid in connection with Malcolm's termination of employment and (ii) his emoluments for the year ended 31 March 1998 set out in the table above is £469,400 (1997 – £149,800).

Remuneration Committee's report

The entitlements of Sir Desmond Pitcher and Malcolm Faulkner on termination by the company of their service contracts and directorships were determined by the Committee taking into account all relevant circumstances, including their ages.

Brian Staples' employment with the company terminated on 31 July 1997, which is currently the subject of legal proceedings.

Gordon Waters, Sir Richard Evans and Sir Christopher Harding were appointed directors with effect from 1 June, 1 September and 1 November 1997 respectively. Frank Sanderson retired as a director on 25 July 1997.

Sir Christopher Harding receives fees as a non-executive director and additional remuneration in respect of the duties associated with his appointment as Chairman amounting in total to £100,000 per annum.

Long term incentive awards

In accordance with the rules of the incentive plan, awards of ordinary shares in the company and/or cash are due shortly to be made under the plan for the first time to directors, as follows:

	Value of award	
	1998 £'000	1997 £'000
Sir Desmond Pitcher	147.3	--
Derek Green	101.7	--
John Beckett	64.6	--
Malcolm Faulkner	49.3	--
Bob Ferguson	75.4	--
Gordon Waters	26.4	--

Note:

In accordance with the rules of the incentive plan, the first awards are being made after two years and performance has been measured over the two financial years to 31 March 1998. The incentive plan provides that no long term incentive awards were to be made in 1997 and that, accordingly, the awards made in 1998 are doubled. In accordance with the rules of the plan, two thirds of the value of the awards will be satisfied by the allocation by the trustee of the United Utilities Employee Share Trust to executive directors of ordinary shares in the company, based on a share price of 850 pence, being, in accordance with the rules of the plan, the average of the mid market prices of an ordinary share over the 30 business days commencing 15 business days before 31 March 1998, and the remaining third will be paid in cash, with the exception of Sir Desmond Pitcher and Malcolm Faulkner, whose awards will, in accordance with the rules of the plan, be paid wholly in cash. The non-executive directors do not participate in the incentive plan.

Share ownership

Share ownership is generally regarded as an effective means of aligning the interests of executives and shareholders. The Group promotes greater ownership of shares in the company through the making of incentive awards in shares and through encouraging executive directors to accumulate and hold shares with a value approximating their annual salary.

At 31 March, the directors and their immediate families had the following interests, all of which were beneficial interests, in ordinary shares in the company and options to subscribe for ordinary shares:

	1998			1997 or on appointment		
	Ordinary shares	Share options		Ordinary shares	Share options	
Executive option scheme		Employee sharesave scheme	Executive option scheme		Employee sharesave scheme	
Sir Desmond Pitcher	47,350	55,936	3,914	47,350	55,936	3,914
Derek Green	17,944	50,854	--	12,148	50,854	4,903
John Beckett	2,593	41,112	3,586	2,453	126,199	3,586
Malcolm Faulkner	5,833	--	4,607	5,815	--	4,607
Bob Ferguson	40,295	65,374	4,005	44,913	65,374	4,005
Gordon Waters	1,117	--	3,623	1,057	--	3,623
Sir Christopher Harding	10,172	--	--	--	--	--
Eric Clark	7,049	--	--	6,669	--	--
Sir Richard Evans	245	--	--	232	--	--
Rodney Leach	14,079	--	--	14,079	--	--
Sir Peter Middleton	4,574	--	--	4,574	--	--
Jane Newell	3,379	--	--	2,020	--	--
John Seed	3,907	--	--	3,875	--	--

Remuneration Committee's report

Further details of directors' options to subscribe for ordinary shares, including details of options exercised by directors during the year, are as follows:

	Share options as at 31 March 1997 or on appointment	Options granted during the year	Exercise price per share	First date exercisable	Last date exercisable	Options exercised during the year	Market price on exercise
<i>Employee sharesave scheme</i>							
Sir Desmond Pitcher	3,914	-	440.6p	1/3/1999	31/8/1999	-	-
Derek Green	4,903	-	369.5p	1/2/1998	31/7/1998	4,903	826.5p
John Beckitt	3,586	-	481.0p	2/2/2001	1/8/2001	-	-
Malcolm Faulkner	2,796	-	308.3p	1/3/1999	31/8/1999	-	-
	1,811	-	476.0p	1/3/1999	31/8/1999	-	-
Bob Ferguson	2,556	-	404.8p	2/3/2000	1/9/2000	-	-
	1,449	-	476.0p	2/2/2002	1/8/2002	-	-
Gordon Waters	3,623	-	476.0p	2/2/2002	1/8/2002	-	-
<i>Executive option scheme</i>							
Sir Desmond Pitcher	55,936	-	380.2p	5/7/1998	5/7/2003	-	-
Derek Green	38,182	-	334.2p	18/6/1997	18/6/2002	-	-
	4,522	-	482.2p	20/1/1999	20/1/2004	-	-
	3,488	-	479.8p	15/12/1997	15/12/2004	-	-
	1,162	-	408.2p	15/12/1999	15/12/2004	-	-
	3,500	-	584.5p	20/12/1998	20/12/2005	-	-
John Beckitt	85,087	-	479.8p	15/12/1997	15/12/2004	85,087	850.5p (10,643) 880.5p (74,444)
	28,362	-	408.2p	15/12/1999	15/12/2004	-	-
	12,750	-	584.5p	20/12/1998	20/12/2005	-	-
Malcolm Faulkner	-	-	-	-	-	-	-
Bob Ferguson	6,008	-	394.2p	6/1/1998	6/1/2003	-	-
	19,382	-	566.9p	20/1/1997	20/1/2004	-	-
	6,460	-	482.2p	20/1/1999	20/1/2004	-	-
	17,831	-	479.8p	15/12/1997	15/12/2004	-	-
	5,943	-	408.2p	15/12/1999	15/12/2004	-	-
	9,750	-	584.5p	20/12/1998	20/12/2005	-	-
Gordon Waters	-	-	-	-	-	-	-

Notes:

Derek Green's interest in ordinary shares at 31 March 1998 includes 200 ordinary shares held in the form of American depository receipts.

The mid market price of a share on 31 March 1998 was 886.0 pence and the range in the year was 621.5 pence to 886.0 pence.

On their leaving the company, the numbers of share options under the employee sharesave scheme exercisable by Sir Desmond Pitcher and Malcolm Faulkner were reduced, and the first and last dates exercisable brought forward, in accordance with the rules of the scheme as they apply to employees leaving the company prior to completion of savings contracts. Similarly, the last date exercisable for the options held by Sir Desmond under the executive option scheme was brought forward.

The aggregate notional gain made by directors on the exercise of share options during the year (based on the difference between the mid market price of a share on the day on which options were exercised and the exercise price) was £360,138.94 (1997 - £407,208.38). Details of individual executive directors' notional gains are:

	Notional gains	
	1998 £'000	1997 £'000
Sir Desmond Pitcher	-	240.1
Derek Green	22.4	16.4
John Beckitt	337.7	-
Malcolm Faulkner	-	-
Bob Ferguson	-	150.7
Gordon Waters	-	-

The non-executive directors are not eligible to be granted options under either the employee sharesave scheme or the executive share option scheme.

Under the terms and conditions of the employee sharesave scheme, for every month (up to no more than six months) savings are behind, the last date exercisable will be delayed by one month.

No option held by the directors named above lapsed during the year.

Remuneration Committee's report

Each executive director of the company is a member of the class of discretionary beneficiaries of the United Utilities Employee Share Trust and the United Utilities Qualifying Employee Share Ownership Trust and is therefore treated as having an interest in the ordinary shares held by United Utilities Employee Share Trust Limited as trustee of the United Utilities Employee Share Trust (56,000 shares at 31 March 1998) and in the ordinary shares held by United Utilities QUEST Trustee Limited as trustee of the United Utilities Qualifying Employee Share Ownership Trust (292,171 shares at 31 March 1998). As at 31 May 1998, United Utilities Employee Share Trust Limited held 56,000 shares and United Utilities QUEST Trustee Limited held 219,525 shares.

Save as mentioned above, no director had any interest in any share capital of any other Group company or in any debenture of any Group company.

Except for the purchase of shares by reinvestment of a dividend in a United Utilities personal equity plan held by John Seed's wife and the change in the holding of United Utilities QUEST Trustee Limited referred to above, from the end of the financial year until 31 May 1998 there have been no changes in the above interests.

Pension arrangements

All the current executive directors are members of and have made contributions to the United Utilities Pension Scheme (UUPS), which is a defined benefit pension scheme providing an entitlement on retirement at age 60 equal to 1/30th of pensionable remuneration for each completed year of service but subject to an overall maximum of 20 years. The normal retirement age is 60 but early retirement is possible from age 50 with the agreement of the company.

As a consequence of changes made by the Finance Act 1989, the company is unable to provide pensions from the UUPS for its executive directors who have joined the company since 1989 on the same basis as pensions for directors who joined the company before that date. In line with many other companies, the company has therefore established separate arrangements for these executive directors. Accordingly, on the retirement of John Beckett, Derek Green and Gordon Waters, the company has undertaken to pay the difference between their pensionable entitlements based upon the relevant proportion of their final pensionable remuneration and the maximum amount payable under the rules of the UUPS. At the present time these arrangements remain unfunded. This undertaking will not result in any greater or additional benefits for these directors than would have been payable had it been possible for their pensions to be provided fully in the UUPS on the same basis as directors who had joined the company prior to 1989.

Awards under the incentive plan are not pensionable and, in order to protect the contractual entitlements of those executive directors whose previous annual bonus payments had, under the rules of the Water Pension Scheme (now part of UUPS), been pensionable, pension calculations have been adjusted. New executive directors will be recruited on the basis that pensionable remuneration includes basic salary only.

Details of the pension benefits calculated as having been earned by each executive director are:

	Increase in accrued pension during the year £'000 pa	Transfer value equivalent of increase £'000	Accumulated total accrued pension at year end £'000 pa
Sir Desmond Pitcher	24.4	390.7	67.2
Derek Green	21.3	330.3	70.6
John Beckett	7.3	92.7	68.1
Malcolm Faulkner	13.9	527.4	74.4
Bob Ferguson	6.6	87.8	152.6
Gordon Waters	7.1	89.4	14.2
Brian Staples	4.2	60.2	44.6

Notes:

The accumulated total accrued pension at year end is that which would be paid annually on retirement based on service to 31 March 1998.

The increase in accrued pension during the year excludes any increase for inflation.

The transfer value equivalent of increase has been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11, less directors' contributions.

Members of the relevant schemes have the option to pay additional voluntary contributions. Neither the contributions nor the resulting benefits are reflected in the above table.

Sir Desmond Pitcher's employment with the company terminated on 31 March 1998. The company has agreed to credit Sir Desmond with an additional eighteen months' service, being the balance of the period of notice to which he was entitled under his contract of service, but without any allowance for increases in pensionable pay during that period. The transfer value equivalent of increase takes into account the increase in pension entitlement during the year, the early payment of his pension without actuarial reduction and the additional period of service credited.

The company terminated the employment of Malcolm Faulkner by reason of redundancy on 31 March 1998. Malcolm Faulkner was a member of and contributed to the Electricity Supply Pension Scheme (ESPS), which is a defined benefit pension scheme. Under the terms of the ESPS, he was entitled to a lump sum in addition to the accumulated total accrued pension at year end shown in the table above. The increase in his accrued lump sum during the year was £73,625 and this increase is included in the transfer value equivalent of increase shown in the table. The accumulated lump sum at the year end was £222,046.

Remuneration Committee's report

The increase in accrued pension during the year shown in the table in respect of Malcolm Faulkner together with the increase in accrued lump sum during the year results in part from a special contribution of £264,000 made by the company to the ESPS in connection with the termination of his employment. The transfer value equivalent of increase takes into account that special contribution, the increase in normal pension and lump sum entitlements during the year and the early payment of his pension without actuarial reduction, pursuant to the rules of the ESPS.

Brian Staples' employment with the company terminated on 31 July 1997, with an entitlement to a deferred pension payable from normal retirement age. The accumulated total accrued pension at year end shown above is his deferred pension entitlement calculated at 31 July 1997.

The non-executive directors do not receive any pension contributions nor participate in any of the Group's pension schemes.

Directors standing for re-election

Five directors are standing, and are recommended by the Board, for re-election at the 1998 annual general meeting. As non-executive directors, Sir Peter Middleton, Sir Richard Evans and Sir Christopher Harding do not have contracts of service. John Beckitt and Derek Green each have a contract of service terminable by the company on two years' notice.

Corporate governance

Corporate governance, in general terms, is the way in which a company is controlled and directed and, in particular, is concerned with the role of the board of directors, how the board operates and accountability within a company. This section of the annual report describes the company's current structure and system of corporate governance.

Your Board is responsible for the company's corporate governance regime and supports the highest standards of corporate governance within this company. As required by the Listing Rules of the London Stock Exchange, the Board confirms that the company has complied throughout the year, and continues to comply, both with the code of best practice of the Cadbury Committee on the financial aspects of corporate governance and also with the best practice provisions regarding the composition and operation of remuneration committees annexed to the Listing Rules.

The Board has taken note of the final report of the Hampel Committee on Corporate Governance published in January. The Hampel Committee subsequently produced a draft document setting out principles of good corporate governance and a code of best practice, combining its recommendations with those included in the reports of the earlier Cadbury and Greenbury Committees. Following a consultation exercise, the London Stock Exchange is currently considering amendments to its Listing Rules to take account of the new combined code. Whilst the Board believes that, broadly, the company's practices already comply with both the general principles and also the recommendations in the combined code, it will be undertaking a detailed review of the company's corporate governance regime in the light of these developments. That review will include the Group's internal controls, the role and membership of committees and remuneration policies.

The Board

The Board currently comprises four executive and seven non-executive directors. It meets regularly during the year and focuses on strategy formulation and the strategic direction of the Group, the development of policy for the Group, and the review of the management and the financial performance of the company and the Group's business units. In this context, the Board has reserved to itself decision making on specific key issues such as approving business acquisitions and disposals, major capital expenditure and significant financing matters, and has approved a formal structure of authorities for decision making below Board level. Some specific responsibilities have been delegated to committees of the Board, as described below.

All directors have access to the advice and services of the Secretary, and there is a formal procedure for directors to obtain independent professional advice in the furtherance of their duties should that be necessary, the cost of which would be met by the company.

Board committees

The Board's principal committees are the Audit, the Nomination and the Remuneration Committees. The memberships and functions of the Audit and the Nomination Committees are described below. Details of the Remuneration Committee are included in its report, on page 27.

The Audit Committee reviews the internal and external audit activities, monitors compliance with statutory requirements for financial reporting, and reviews the half year and annual financial statements before they are submitted to the Board for approval. Its members are Rodney Leach (chairman), Eric Clark, Jane Newell and John Seed, all of whom are non-executive directors.

The Nomination Committee considers and makes recommendations to the Board on the composition, balance and membership of the Board. Its members are Sir Christopher Harding (chairman), Derek Green, Rodney Leach, Sir Peter Middleton and John Seed, a majority being non-executive directors.

Internal financial control

The Board is responsible for the Group's system of internal financial control, and has reviewed its effectiveness. The Board considers that it is designed to provide reasonable, but not absolute, assurance with respect to the preparation of financial information and the safeguarding of assets. The key internal financial control procedures which the Board has established and which operated throughout the period covered by the financial statements are as follows:

- control environment: the culture and values of the Group are communicated through specific policies covering the quality, integrity and ethics of personnel. The Group's business units operate within a framework of policies and procedures laid down in organisation and authority manuals and the Group's personnel are required to comply with these policies and procedures as relevant to their functions and responsibilities, and are accountable as such. Policies and procedures cover key issues such as authorisation levels, segregation of duties (wherever practicable), recording of data and physical security;
- identification and evaluation of business risk: the Group has annual reporting procedures that identify the major financial, commercial and operating risks within the Group, and procedures for the regular review and management of those risks. Internal audit undertakes regular reviews of the most significant areas of risk and ensures that key control objectives remain in place. Significant risk areas, including those arising from the development of new activities, are subject to consideration by the Board;

Corporate governance

- information and financial reporting systems: there are comprehensive planning and financial reporting procedures which include detailed operational budgets for the year ahead and projections for subsequent years. These are approved and reviewed by the Board. Key performance indicators are also reviewed by the Board monthly to assess progress towards objectives. The Board reports to shareholders half yearly;
- investment appraisal: there are clear policies and procedures for capital expenditure, which include short and long term budgets, detailed appraisal and review procedures and defined levels of authority; and
- monitoring systems and corrective action: all operating units prepare self-certification questionnaires which confirm compliance with required standards of internal control. The questionnaires are reviewed and substantively verified by both internal and external auditors as part of their annual statutory audit. Any corrective action which may be necessary is agreed and implemented. The responsibilities of the internal auditors include, specifically, reviewing on behalf of the Board (and reporting directly to the Audit Committee on) the Group's internal financial controls.

Going concern

After making enquiries, the directors are of the opinion that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt a going concern basis in preparing these financial statements.

Directors' responsibilities

The directors are required by the Companies Act 1985 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and the Group as at the end of the financial year and of the profit or loss for the financial year. The directors consider that in preparing the financial statements, the Group has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates. All accounting standards which they consider to be applicable have been followed, subject to any explanation and departure set out in the notes to the accounts. The directors have responsibility at law for ensuring that the company keeps accounting records which disclose with reasonable accuracy at any time the financial position of the company and which enable them to ensure that the financial statements comply with the Companies Act 1985. The directors also have a general responsibility at law for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Auditor's reports

AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS TO THE MEMBERS OF UNITED UTILITIES PLC

We have audited the financial statements on pages 36 to 66. We have also examined the amounts disclosed relating to the emoluments, share options and pension entitlements of directors which form part of the Remuneration Committee's report on pages 27 to 32.

Respective responsibilities of directors and auditors

As described on page 34, the company's directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Auditing Standards generally accepted in the United Kingdom and in the United States. 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 Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations 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.

United Kingdom opinion

In our opinion, the financial statements give a true and fair view of the state of the affairs of the company and the Group as at 31 March 1998 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

United States opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 March 1998 and 1997 and the results of its operations and cash flows for each of the years in the three year period ended 31 March 1998 in conformity with generally accepted accounting principles in the United Kingdom.

Generally accepted accounting principles in the United Kingdom vary in certain significant respects from generally accepted accounting principles in the United States. Application of generally accepted accounting principles in the United States would have affected net income for each of the years in the three year period ended 31 March 1998 and consolidated shareholders' equity at 31 March 1998 and 1997 to the extent summarised in note 35 to the accounts.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
Manchester
8 June 1998

KPMG Audit Plc

REVIEW REPORT BY KPMG AUDIT PLC TO UNITED UTILITIES PLC ON CORPORATE GOVERNANCE MATTERS

In addition to our audit of the financial statements, we have reviewed the directors' statement on pages 33 and 34 on the company's compliance with the paragraphs of the Cadbury code of best practice specified for our review by the Listing Rules and their adoption of the going concern basis in preparing the financial statements. The objective of our review is to draw attention to non-compliance with the disclosure requirements of the Listing Rules 12.43(j) and 12.43(v).

Basis of opinion

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

Opinion

With respect to the directors' statements on internal financial control and going concern on pages 33 and 34, in our opinion the directors have provided the disclosures required by the Listing Rules and such statements are not inconsistent with the information of which we are aware from our audit work on the financial statements.

Based on enquiry of certain directors and officers of the company, and examination of relevant documents, in our opinion the directors' statement on pages 33 and 34 appropriately reflects the company's compliance with the other paragraphs of the Code specified for our review by the Listing Rules.

KPMG Audit Plc
Chartered Accountants
Manchester
8 June 1998

KPMG Audit Plc

Consolidated profit and loss account

For the year ended 31 March 1998													
	Note	Continuing operations		1998 Total £m	Continuing operations		Discontinued operations £m	1997 Total £m		Discontinued operations			
		£m	£m		Before exceptional items £m	Exceptional items £m		Before exceptional items £m	Exceptional items £m				
Turnover	2	2,150.2	–	2,150.2	2,102.3	–	274.9	2,377.2	1,528.1	–	310.5	–	1.8
Net operating costs	3	(1,547.4)	–	(1,547.4)	(1,517.2)	(83.0)	(284.5)	(1,884.7)	(1,087.5)	(103.8)	(299.7)	(20.0)	(1.5)
Operating profit		602.8	–	602.8	585.1	(83.0)	(9.6)	492.5	440.6	(103.8)	10.8	(20.0)	3
(Loss)/Income from investments in associated undertakings	2, 12	(1.1)	–	(1.1)	0.4	–	–	0.4	12.8	–	–	–	–
Profit before non-operating items, interest and tax	2	601.7	–	601.7	585.5	(83.0)	(9.6)	492.9	453.4	(103.8)	10.8	(20.0)	3
Profit/(Loss) on disposal of businesses	4	–	6.8	6.8	–	0.9	(78.0)	(77.1)	–	7.2	–	–	–
Profit on ordinary activities before interest		601.7	6.8	608.5	585.5	(82.1)	(87.6)	415.8	453.4	(96.6)	10.8	(20.0)	3
Net interest payable and other similar charges	7			(141.2)				(131.9)					(
Profit on ordinary activities before taxation				467.3				283.9					2
Taxation on profit on ordinary activities	8			(24.2)				(47.9)					(
Profit on ordinary activities after taxation				443.1				236.0					2
Exceptional taxation – windfall tax				(414.8)				–					
				28.3				236.0					2
Minority interest				1.8				(0.6)					
Profit for financial year				30.1				235.4					2
Dividends	9			(228.8)				(195.3)					(1
Transfer (from)/to reserves	24			(198.7)				40.1					
Earnings/(Loss) per share – net basis	10			5.6p				44.9p					5
– nil basis	10			(6.1)p				46.9p					6.
Adjusted earnings per share													
– net basis	10			81.9p				77.2p					7
– nil basis	10			70.2p				79.2p					8

See accompanying notes to the accounts.

Balance sheets

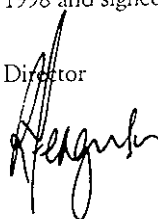
At 31 March 1998	Note	Group		Company	
		1998 £m	1997 £m	1998 £m	1997 £m
Fixed assets					
Tangible assets	11	5,296.8	4,790.3	9.0	9.1
Investments	12	116.5	93.9	2,953.9	2,811.9
		5,413.3	4,884.2	2,962.9	2,821.0
Current assets					
Stocks	14	13.6	8.5	—	—
Debtors	15	455.1	427.8	777.5	372.4
Investments	16	313.5	308.3	16.8	9.9
Cash at bank and in hand		11.9	29.4	5.0	—
		794.1	774.0	799.3	382.3
Creditors:					
Amounts falling due within one year	17	(2,199.7)	(1,851.3)	(883.8)	(675.4)
Net current liabilities		(1,405.6)	(1,077.3)	(84.5)	(293.1)
Total assets less current liabilities		4,007.7	3,806.9	2,878.4	2,527.9
Creditors:					
Amounts falling due after more than one year	18	(1,681.6)	(1,235.1)	(361.1)	(75.3)
Provisions for liabilities and charges	20	(281.8)	(429.3)	(8.4)	(12.3)
Net assets		2,044.3	2,142.5	2,508.9	2,440.3
Capital and reserves					
Called up share capital	24	544.8	529.6	544.8	529.6
Share premium account	24	633.8	622.0	633.8	622.0
Profit and loss account	24	866.9	990.3	1,330.3	1,288.7
Equity shareholders' funds		2,045.5	2,141.9	2,508.9	2,440.3
Minority interest		(1.2)	0.6	—	—
Capital employed		2,044.3	2,142.5	2,508.9	2,440.3

See accompanying notes to the accounts.

Approved by the Board of directors on 8 June 1998 and signed on its behalf by

Sir Christopher Harding
Chairman

Bob Ferguson
Group Finance Director

Consolidated cash flow statement

For the year ended 31 March 1998	Note	1998 £m	1997 £m	1996 £m
Net cash inflow from operating activities	28	609.1	519.3	356.3
Returns on investments and servicing of finance	29	(137.3)	(121.3)	(137.9)
Taxation		(236.3)	29.5	(49.1)
Capital expenditure and financial investment	30	(621.7)	(517.0)	(133.7)
Acquisitions and disposals	31			
Acquisitions		(53.8)	–	(1,208.3)
Disposals		29.5	357.5	(1.0)
Equity dividends paid		(114.2)	(145.8)	(115.7)
Cash (outflow)/inflow before use of liquid resources and financing		(524.7)	122.2	(1,289.4)
Management of liquid resources	32	1.5	(57.3)	(29.3)
Financing				
Issues of shares	33	9.3	10.0	559.0
Increase/(Decrease) in debt	33, 34	509.3	(109.6)	774.0
(Decrease)/Increase in cash		(4.6)	(34.7)	14.3

Reconciliation of net cash flow to movement in net debt

For the year ended 31 March 1998	Note	1998 £m	1997 £m	1996 £m
(Decrease)/Increase in cash		(4.6)	(34.7)	14.3
Cash (inflow)/outflow from (increase)/decrease in debt and lease financing		(509.3)	109.6	(774.0)
Cash (inflow)/outflow from management of liquid resources		(1.5)	57.3	29.3
Change in net debt resulting from cash flows		(515.4)	132.2	(730.4)
Acquired net debt		–	–	(414.3)
Exchange adjustments		1.8	11.1	(10.4)
Movement in net debt		(513.6)	143.3	(1,155.1)
Opening net debt		(1,627.0)	(1,770.3)	(615.2)
Net debt at 31 March	34	(2,140.6)	(1,627.0)	(1,770.3)

See accompanying notes to the accounts.

Statements of total recognised gains and losses

For the year ended 31 March 1998	Group				Company
	1998 £m	1997 £m	1996 £m	1998 £m	1997 £m
Profit for financial year	30.1	235.4	224.4	194.3	343.5
Exchange adjustments	3.9	0.6	(6.5)	—	—
Total recognised gains and losses for the financial year	34.0	236.0	217.9	194.3	343.5

Reconciliations of movements in equity shareholders' funds

For the year ended 31 March 1998	Note	Group			Company	
		1998 £m	1997 £m	1996 £m	1998 £m	1997 £m
Profit for financial year		30.1	235.4	224.4	194.3	343.5
Dividends	9	(228.8)	(195.3)	(163.8)	(228.8)	(195.3)
Retained (loss)/profit for the financial year		(198.7)	40.1	60.6	(34.5)	148.2
Goodwill on disposals	4	—	126.2	2.1	—	3.7
Shares issued in lieu of cash dividends	24	76.1	16.0	8.4	76.1	16.0
New share capital issued	24	27.0	13.5	758.0	27.0	13.5
Capitalisation of reserves in respect of shares issued via QUEST	24	(4.7)	—	—	—	—
Goodwill on acquisitions		—	(46.6)	(1,076.9)	—	—
Exchange adjustments	24	3.9	0.6	(6.5)	—	—
Net (decrease)/increase in equity shareholders' funds for the year		(96.4)	149.8	(254.3)	68.6	181.4
Opening equity shareholders' funds		2,141.9	1,992.1	2,246.4	2,440.3	2,258.9
Equity shareholders' funds at 31 March		2,045.5	2,141.9	1,992.1	2,508.9	2,440.3

See accompanying notes to the accounts.

Notes to the accounts

1 Accounting policies

(a) Basis of preparation of financial statements

The consolidated financial statements of United Utilities PLC and its subsidiaries (the Group) set out on pages 36 to 66 have been prepared under the historical cost convention, in accordance with applicable accounting standards and the Companies Act 1985 except as noted below under item (h).

The Group is a leading supplier of high quality utility and business support services. The services include the planning, design and operation of water and wastewater, electricity distribution and telecommunication systems, and the supply of electricity and gas. In addition, the Group provides a range of business operations outsourcing services supporting both the Group and external customers.

The results of businesses acquired during the year are included from the date of acquisition, being the date that effective control passes. Unless otherwise stated, the acquisition method of accounting has been adopted. The results of businesses sold in the year are included to the date of divestment. The results of NORWEB plc are included from 8 November 1995.

The preparation of financial statements in conformity with generally accepted accounting principles in the United Kingdom requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(b) Cash

In the consolidated cash flow statement and related notes, cash includes cash at bank, deposits repayable on demand and overdrafts; deposits are repayable on demand if they are in practice available within 24 hours without penalty.

(c) Turnover

Turnover, except for the electricity supply and distribution businesses, represents the income receivable in the ordinary course of business for goods or services provided and excludes value added tax and foreign sales tax.

In relation to the electricity supply and distribution businesses, turnover represents the value of energy consumption during the year, which includes an estimate of the sales value of units supplied to customers between the date of the last meter reading and the year end, exclusive of value added tax. Where there is an over-recovery of revenues against the regulated maximum allowable amount, revenues are deferred equivalent to the over-recovered amount. The deferred amount is deducted from turnover and included in creditors within accruals and deferred income. Where there is an under-recovery, no account is taken of any potential future recovery.

(d) Research and development

Expenditure on research and development is expensed as incurred.

(e) International development costs

Costs incurred in the development of international activities are either written off or, where appropriate, capitalised and fully provided against until their recovery is considered to be secured by profitable contracts. Such capitalised costs are amortised over the expected life of the contract.

(f) Goodwill

In accordance with Financial Reporting Standard 7, the net assets of companies and businesses acquired are included in the consolidated financial statements at their fair value to the Group and after adjustments to bring the accounting policies of the companies and businesses acquired into alignment with those of the Group. Goodwill arising on acquisition, being the excess of the fair value of consideration over the fair value of net assets acquired, is written off directly against reserves on consolidation.

(g) Tangible fixed assets

Tangible fixed assets comprise infrastructure assets (mains, sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls) and other assets (including properties, overground plant and equipment and electricity operational assets).

(i) Infrastructure assets

Infrastructure assets comprise a network of water and wastewater systems. Expenditure on infrastructure assets relating to increases in capacity or enhancements of the network is treated as additions, which are included at cost after deducting related grants and contributions.

Expenditure on maintaining the operating capability of the network in accordance with defined standards of service is charged as an operating cost. No depreciation is charged on infrastructure assets because the network of systems is required to be maintained in perpetuity and therefore has no finite economic life.

Charges for infrastructure renewals expenditure take account of planned expenditure on maintaining the operating capability of infrastructure assets in accordance with the operational policies and standards underlying the Group's investment programme. The timing of the investment programme and other operational considerations may result in uneven patterns of infrastructure renewals expenditure. Charges to the profit and loss account are adjusted by way of accruals or deferrals, as appropriate, to take account of any significant fluctuations between actual and planned expenditure.

Employee costs incurred in implementing the capital schemes of the Group are capitalised within fixed assets.

Notes to the accounts

(ii) Other assets

Additions are included at cost. Freehold land is not depreciated. Other assets are depreciated evenly over their estimated economic lives which are principally as follows:

Buildings	30–60 years
Operational assets	5–80 years
Fixtures, fittings, tools and equipment	3–40 years
Pre-1974 assets of North West Water Limited	22–27 years
Capitalised computer software costs	3–10 years

Assets in the course of construction principally with an estimated economic life of greater than 20 years are not depreciated until the year following commissioning.

(h) Grants and contributions

Capital contributions towards infrastructure assets are deducted from the cost of those assets. This is not in accordance with Schedule 4 to the Companies Act 1985 under which the infrastructure assets should be stated at their purchase price or production cost and the capital contributions treated as deferred income and released to the profit and loss account over the useful life of the corresponding assets. The directors are of the opinion that, as infrastructure assets have no finite economic lives (see note (g) above) and the capital contributions would therefore remain in the balance sheet in perpetuity, the treatment otherwise required by the Companies Act 1985 would not present a true and fair view of the Group's effective investment in infrastructure assets. The financial effect of this accounting policy is set out in note 11.

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

(i) Leased assets

Assets financed by leasing arrangements which transfer substantially all the risks and rewards of ownership to the lessee (finance leases) are capitalised in the consolidated balance sheet and the corresponding capital cost is shown as an obligation to the lessor. Leasing repayments comprise both a capital and a finance element. Where the lease is of a fixed interest rate nature, the finance element is written off to the profit and loss account so as to produce an approximately constant periodic rate of charge on the outstanding obligation. Where the lease is of a floating interest rate nature, the finance element written off to the profit and loss account reflects the floating interest rate charge incurred during the period on the outstanding obligation. Such assets are depreciated over the shorter of their estimated useful lives and the period of the lease.

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

(j) Fixed asset investments

Fixed asset investments, except for investments in associated undertakings, are stated at cost less amounts written off for permanent diminution such that carrying amounts (where they represent less than original cost) approximate market value.

(k) Current asset investments

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

(l) Stocks

Stocks are stated at cost less any provision necessary to recognise damage and obsolescence.

Finished goods and goods for resale are stated at the lower of cost, including appropriate production overheads, and net realisable value.

(m) Pensions

The Group operates a number of defined benefit schemes, which are independent of the Group's finances, for the substantial majority of its employees. Actuarial valuations of the schemes are carried out as determined by the trustees at intervals of not more than three years, the rates of contribution payable and the pension cost being determined on the advice of the actuaries, having regard to the results of these valuations. In any intervening years, the actuaries review the continuing appropriateness of the contribution rates.

The cost of providing pensions is expensed over employees' working lives. Variations from regular cost are allocated over the average remaining service lives of current employees. Any difference between the charge to the profit and loss account in respect of funded plans and the contributions payable to each plan is recorded in the consolidated balance sheet as a prepayment or provision.

Details of pension arrangements and funding are set out in note 25.

(n) Foreign currency

Transactions in foreign currencies are recorded at the exchange rates ruling on the dates of the transactions, adjusted for the effects of any hedging arrangements. Assets and liabilities denominated in foreign currencies are translated into sterling at the relevant rates of exchange ruling at the consolidated balance sheet date.

On consolidation, the balance sheets of overseas subsidiaries are translated into sterling at exchange rates applicable at the year end. The profit and loss accounts are translated into sterling using the average rate. Exchange differences resulting from

Notes to the accounts

the translation of such balance sheets at rates ruling at the beginning and end of the year, together with the differences between profit and loss accounts translated at average rates and rates ruling at 31 March, are dealt with as movements on Group reserves.

Where net investments in overseas subsidiaries are matched in whole or in part by foreign currency borrowings, the exchange differences arising on the re-translation of such borrowings are also recorded as movements on Group reserves and any excess taken to the profit and loss account.

(o) **Deferred taxation**

The charge for taxation is based on the profits for the year and takes into account taxation deferred, using the liability method, in respect of timing differences to the extent that it is probable that a liability will crystallise in the foreseeable future. Such timing differences arise primarily from the differing treatment for taxation and accounting purposes of provisions and the depreciation of fixed assets.

(p) **Associated undertakings**

The appropriate share of the results of associated undertakings is recognised in the consolidated profit and loss account where the directors consider that the Group is in a position to exert significant influence over the associated undertaking. Such influence normally is presumed to exist for investments in undertakings in which the Group's direct ownership or indirect ownership is between 20 per cent and 50 per cent.

(q) **Financial instruments**

Debt instruments

New borrowings are stated at net proceeds received after deduction of issue costs. The issue costs of debt instruments are charged to the profit and loss account at a constant rate over the life of the instrument.

Interest rate swaps and financial futures

Interest rate swap agreements and financial futures are used to manage interest rate exposure. Instruments that are designed as a hedge of a debt are accounted for on an accruals basis, with amounts payable or receivable in respect of these instruments being recognised as adjustments to interest expense of the designated liability.

Realised gains and losses that occur from the early termination of such instruments designated as a hedge are deferred and are amortised to interest expense over the period of the hedged position, to the extent that the originally designated liability remains outstanding.

In order to qualify for hedge accounting, the notional amount of the Group's interest rate swaps and financial futures must not exceed the amount of its existing variable rate debt, must change the interest rate characteristics of the underlying debt and the contractual maturities cannot exceed the maturities of the debt.

Currency swaps

The Group enters into currency swaps to manage its exposure to fluctuations in currency rates. Principal amounts are revalued at exchange rates ruling at the date of the Group balance sheet and included in the sterling value of debt. Exchange gains and losses are taken directly to reserves and are included in the statement of total recognised gains and losses in accordance with SSAP 20.

In order to qualify for hedge accounting, the forward contract/currency swap must relate to an existing asset, liability or firm commitment, be in the same currency as the hedged item and reduce the risk of foreign currency exchange movements on the Group's operations.

Contracts for differences (CfDs)

The Group records the cost and income attributable to CfDs in its accounting records when settlement is made. Where the settlement date for a CfD does not fall on the period end, then accrual accounting is used to reflect the known variances between the contract strike prices and Pool prices (see note 23).

(r) **Stock based compensation arrangements**

The company has two continuing share option schemes, an employee sharesave scheme and an executive option scheme. Shares issued as a result of the exercise of options granted in accordance with the rules of the schemes (see note 24) are recorded in share capital and share premium at their exercise price at the date the option is exercised. No compensation expense is recorded for the difference between the exercise price and the stock price at the date of grant or exercise.

The cost of short term and long term incentive awards to executive directors in accordance with the incentive plan (see the Remuneration Committee's report) are expensed on a straight line basis over the period in which performance is measured. The amount to be expensed is based upon management's estimate of the probability that the performance criteria will be met.

(s) **Environmental remediation**

Environmental expenditures that relate to current or future revenues are expensed or capitalised as appropriate. Expenditures that relate to an existing condition caused by past operations and that do not contribute to current or future earnings are expensed.

Liabilities for environmental costs are recognised when environmental assessments or clean-ups are probable and the associated costs can be reasonably estimated. Generally, the timing of these provisions coincides with the commitment to a formal plan of actions or, if earlier, on divestment or on closure of inactive sites.

The Group has not complied with Financial Reporting Standards 9 (Associates and Joint Ventures) and 10 (Goodwill and Intangible Assets) as the effective dates have not passed.

Notes to the accounts

2 Segmental information

Turnover, profit before non-operating items, interest and tax and net operating assets for each class of business and by geographical origin are:

Note	Turnover			Profit before non-operating items, interest and tax			Net operating assets		
	1998 £m	1997 £m	1996 £m	1998 £m	1997 £m	1996 £m	1998 £m	1997 £m	1996 £m
Continuing businesses:									
Water and wastewater	905.3	866.7	828.2	394.2	383.3	364.2	3,910.2	3,387.6	3,236.5
Electricity distribution	342.7	329.0	154.1	154.5	132.1	70.4	1,170.0	1,050.3	1,004.7
Energy supply	(6) 1,120.9	1,123.3	607.2	26.2	48.3	10.6	73.5	29.3	(45.5)
Telecommunications	23.4	8.2	1.5	0.2	(5.2)	(1.5)	43.3	33.7	0.6
Facilities management	193.8	185.2	–	28.6	27.1	–	(1.2)	212.2	–
International operations	7.7	6.9	9.9	5.6	4.6	5.9	9.8	8.6	8.1
Other activities	64.5	60.9	74.3	7.4	7.7	1.4	(55.7)	(14.8)	62.5
	2,658.3	2,580.2	1,675.2	616.7	597.9	451.0	5,149.9	4,706.9	4,266.9
International development	–	–	–	(15.0)	(12.4)	(8.9)	4.5	(2.4)	0.3
	2,658.3	2,580.2	1,675.2	601.7	585.5	442.1	5,154.4	4,704.5	4,267.2
Inter-business eliminations	(2) (508.1)	(477.9)	(147.1)	–	–	–	–	–	–
	2,150.2	2,102.3	1,528.1	601.7	585.5	442.1	5,154.4	4,704.5	4,267.2
Divested businesses:									
Process equipment	–	106.8	172.0	–	(1.2)	7.9	–	–	82.9
Norweb retail	–	164.3	127.5	–	(6.3)	3.7	–	(19.2)	165.9
Norweb generation	–	3.8	2.5	–	(2.1)	11.1	–	7.3	(3.1)
Disposed contracting businesses	–	–	8.5	–	–	(0.6)	–	–	–
	2,150.2	2,377.2	1,838.6	601.7	575.9	464.2	5,154.4	4,692.6	4,512.9
Exceptional provision	(5) –	–	–	–	(83.0)	–	–	–	–
Business restructuring	(5) –	–	–	–	–	(123.8)	–	–	–
	2,150.2	2,377.2	1,838.6	601.7	492.9	340.4	5,154.4	4,692.6	4,512.9
By geographical origin:									
	(3)								
United Kingdom	2,120.0	2,273.5	1,629.6	601.8	580.8	355.0	5,147.1	4,700.3	4,447.4
Europe	0.4	12.0	24.7	–	(0.9)	4.9	–	–	10.4
The Americas	1.0	75.4	124.9	(1.5)	(3.7)	(19.6)	0.2	1.4	50.9
Rest of the world	28.8	16.3	59.4	1.4	(83.3)	0.1	7.1	(9.1)	4.2
	2,150.2	2,377.2	1,838.6	601.7	492.9	340.4	5,154.4	4,692.6	4,512.9

- (1) Profit before non-operating items, interest and tax comprises operating profit amounting to £602.8 million (1997 – £492.5 million; 1996 – £327.6 million) and (loss)/income from investments in associated undertakings of £(1.1) million (1997 – £0.4 million; 1996 – £12.8 million).
- (2) The inter-business eliminations totalling £508.1 million (1997 – £477.9 million; 1996 – £147.1 million) include £303.1 million (1997 – £273.5 million; 1996 – £139.3 million) between the electricity distribution and the energy supply operations and £190.6 million (1997 – £180.9 million; 1996 – £nil) from facilities management primarily to the water and wastewater, electricity distribution and energy supply operations.
- Inter-business sales made by the process equipment businesses are eliminated prior to disclosure in the above segmental analysis. If the businesses' inter-business sales were included above the amounts shown for process equipment sales would be increased by £nil million to £nil million in 1998 (1997, £26.1 million to £132.9 million; 1996 – £9.5 million to £181.5 million). The inter-business eliminations would be increased by an equal amount.
- (3) The geographical destination of turnover does not differ materially from the geographical origin analysis above.
- (4) Net operating assets comprise fixed assets and net current liabilities excluding net borrowings, investments, taxation and dividends.
- (5) In 1997, the exceptional provision of £83.0 million, relating to other activities, is the expected loss to be incurred on the Bangkok contract. Business restructuring costs in 1996 of £123.8 million comprise £103.8 million on continuing operations, relating to the integration of NORWEB plc, and £20.0 million on discontinued operations, relating to restructuring of the process equipment businesses.
- Of the £103.8 million, £60.9 million relates to the electricity distribution operations, £39.9 million relates to the facilities management business, and the remaining £3.0 million relates to other activities. For US GAAP purposes, these exceptional items would be classified as a component of operating profit of the appropriate business segment.
- (6) The electricity and gas supply businesses have been reclassified to energy supply. In 1997 and 1996, gas supply was included in gas supply and telecommunications.

Notes to the accounts

Total assets, capital expenditure and depreciation for each class of business and by geographical origin are:

	Note	Total assets		Capital expenditure		Depreciation	
		1998 £m	1997 £m	1998 £m	1997 £m	1998 £m	1997 £m
Continuing businesses:							
Water and wastewater		4,221.7	3,703.7	423.4	400.5	72.3	59.0
Electricity distribution		1,261.1	1,095.6	158.5	93.2	36.4	37.1
Energy supply	(6)	138.7	130.0	40.5	5.4	0.2	-
Telecommunications		55.3	35.8	18.5	14.9	1.8	1.7
Facilities management		36.6	238.8	23.6	31.2	27.2	24.0
International operations		102.0	20.0	0.2	0.1	0.2	0.1
Other activities		386.8	371.5	2.0	12.2	1.4	0.8
		6,202.2	5,595.4	666.7	557.5	139.5	122.7
International development		5.2	8.5	-	0.1	-	0.2
		6,207.4	5,603.9	666.7	557.6	139.5	122.9
Divested businesses:							
Process equipment		-	-	-	6.1	-	1.8
Norweb retail		-	2.1	-	6.3	-	4.7
Norweb generation		-	52.2	-	0.7	-	0.9
Disposed contracting businesses		-	-	-	-	-	-
		6,207.4	5,658.2	666.7	570.7	139.5	130.3
By geographical origin:							
	(3)	6,098.4	5,631.1	666.5	565.3	139.3	129.0
United Kingdom		-	2.1	-	0.1	-	0.2
Europe		0.2	0.4	-	5.2	-	1.0
The Americas		108.8	24.6	0.2	0.1	0.2	0.1
Rest of the world							
		6,207.4	5,658.2	666.7	570.7	139.5	130.3

Notes to the accounts

3 Net operating costs

	1998			1997		
	Continuing operations Total £m	Continuing operations £m	Discontinued operations £m	Total £m	Continuing operations £m	Discontinued operations £m
Employee costs:						
Wages and salaries	230.4	213.5	54.7	268.2	146.8	62.7
Social security costs	18.8	22.0	6.8	28.8	15.8	8.2
Pension contributions (note 25)	21.3	23.6	2.6	26.2	17.8	2.5
	270.5	259.1	64.1	323.2	180.4	73.4
Capital schemes	(56.9)	(56.9)	-	(56.9)	(35.3)	-
Infrastructure renewals	(9.0)	(6.1)	-	(6.1)	(4.9)	-
	204.6	196.1	64.1	260.2	140.2	73.4
Depreciation:						
Owned fixed assets	132.1	114.0	7.4	121.4	88.4	5.6
Fixed assets held under finance leases	7.4	8.9	-	8.9	9.1	-
	139.5	122.9	7.4	130.3	97.5	5.6
Infrastructure renewals	71.2	67.6	-	67.6	66.4	-
Other operating costs:						
Auditor's remuneration	0.3	0.2	-	0.2	0.2	0.1
Research and development	3.2	2.4	2.3	4.7	5.8	2.4
Operating leases – hire of plant and machinery	3.6	2.8	1.1	3.9	3.3	1.3
– land and buildings	2.6	2.0	0.2	2.2	4.4	3.7
Electricity purchases	761.1	760.5	-	760.5	455.2	-
Cost of sales	111.7	115.0	182.0	297.0	130.0	192.1
General and administration costs	120.3	122.8	27.4	150.2	78.2	21.1
Rent and rates	57.8	60.5	-	60.5	46.9	-
Customer rebates	18.3	28.3	-	28.3	18.3	-
Other	59.0	41.4	-	41.4	50.1	-
	1,137.9	1,135.9	213.0	1,348.9	792.4	220.7
Other income (note 5)	(5.8)	(5.3)	-	(5.3)	(9.0)	-
Net operating costs before exceptional items	1,547.4	1,517.2	284.5	1,801.7	1,087.5	299.7
Other operating costs – exceptional items:						
– Bangkok	-	83.0	-	83.0	-	-
– business restructuring	-	-	-	-	103.8	20.0
Total net operating costs	1,547.4	1,600.2	284.5	1,884.7	1,191.3	319.7

The increase in total net operating costs in 1997 is due essentially to the full year impact of the Norweb acquisition.

Fees payable to KPMG Audit Plc and its associates for non-audit services in 1998 were £0.7 million (1997 – £0.9 million; 1996 – £0.8 million). During the year, KPMG received no fees for management consultancy within the United Kingdom. The audit fee for 1998 in relation to the company amount £75,000 (1997 – £65,000).

Employee costs are included above on a gross basis before removing those components in connection with the Group's capital schemes and infrastructure renewals programme. The adjustments made in the above table for 'Capital schemes' are capitalised during the relevant period and included within tangible fixed asset additions. The credit for 'Infrastructure renewals' against employee costs is included to allow identification of the full cost of infrastructure renewals during a period, and is therefore removed from employee costs and included in the specific 'Infrastructure renewals' expense line.

Information on the remuneration of executive directors is contained in the Remuneration Committee's report.

Notes to the accounts

4 Profit/(Loss) on disposal of businesses

	1998 £m	1997 £m	1996 £m
Process equipment:			
Profit on disposal of businesses, before goodwill write back	2.9	48.2	-
Goodwill write back	-	(126.2)	-
Net profit/(loss) on disposal of process equipment businesses	2.9	(78.0)	-
Other:			
Profit on disposal of businesses	3.9	0.9	9.3
Goodwill write back	-	-	(2.1)
Net profit on disposal of other businesses	3.9	0.9	7.2
Total profit/(loss) on disposal of businesses	6.8	(77.1)	7.2

The tax arising on the disposals in 1997 was £19.9 million of which £13.4 million was taken account of in the acquisition balance sheet of NORWEB plc.

5 Other income (continuing operations)

	1998 £m	1997 £m	1996 £m
Profit on disposal of fixed assets	1.6	1.2	1.8
Net rents receivable	2.4	2.1	3.2
Management fees	0.5	0.9	2.1
Other	1.3	1.1	1.9
	5.8	5.3	9.0

6 Employees

	1998	1997	1996
Average number of persons employed by the Group during the year	9,902	12,242	10,237
Water and wastewater	4,106	4,140	4,770
Electricity distribution	1,777	1,922	1,556
Energy supply	329	314	238
Telecommunications	249	217	81
Facilities management	2,809	2,366	-
International operations	91	83	174
Other activities	541	541	399
Divestments:			
Process equipment	-	1,339	1,976
Norweb retail	-	1,302	987
Norweb generation	-	18	11
Disposed contracting businesses	-	-	45

Notes to the accounts

7 Net interest payable and other similar charges

	1998 £m	1997 £m	1996 £m
Interest payable:			
On bank loans, overdrafts and other loans	158.0	132.5	76.6
On finance leases	10.2	18.0	17.9
Total interest payable	168.2	150.5	94.5
Interest receivable	(27.0)	(18.6)	(19.5)
Net interest payable and other similar charges	141.2	131.9	75.0

8 Taxation on profit on ordinary activities

	1998 £m	1997 £m	1996 £m
UK corporation tax at 31% (1997, 1996 – 33%)	84.0	28.8	–
Overseas tax	1.6	7.7	2.2
Advance corporation tax (utilised)/unrelieved	(62.8)	10.7	45.4
Share of associates tax	1.4	0.7	0.6
	24.2	47.9	48.2

The tax charge is analysed between continuing and discontinued operations as follows:

	£m	£m	£m
Continuing operations	25.6	42.6	46.8
Discontinued operations	(1.4)	5.3	1.4
	24.2	47.9	48.2

Profit on ordinary activities before taxation (including exceptional items), as shown in the consolidated profit and loss account, is analysed over its component parts as follows:

	£m	£m	£m
Income before taxes on income:			
United Kingdom	475.2	455.8	308.9
Overseas	(7.9)	(171.9)	(36.3)
	467.3	283.9	272.6

The table below reconciles the notional charge at the UK corporation tax rate for the year to the actual charge for taxation:

	%	%	%
UK corporation tax rate	31.0	33.0	33.0
Deferred tax not provided on non-current assets	9.5	(28.3)	(39.5)
Deferred tax not provided on current assets	(22.9)	(6.5)	26.5
Movement in unprovided deferred tax arising from change in UK corporation tax rate	(9.6)	–	–
Bangkok project	(4.3)	9.7	–
Sale of process equipment businesses	–	11.2	–
Other	1.5	(2.2)	(2.3)
Actual tax rate	5.2	16.9	17.7

An analysis of the deferred tax balance is provided in note 21.

Notes to the accounts

9 Dividends

	1998 £m	1997 £m	1996 £m
Special dividend (1997 – nil; 1996 – 3.8 pence)	–	–	13.0
Interim dividend of 13.16p pence (1997 – 12.0 pence; 1996 – 9.27 pence)	70.8	61.8	48.4
Underlying final dividend of 27.64 pence recommended (1997 – 25.2 pence; 1996 – 19.59 pence)	150.6	133.5	102.4
Enhancement to final dividend of 1.36 pence recommended (1997 – nil; 1996 – nil)	7.4	–	–
	228.8	195.3	163.8

Provision is made for the proposed final dividends on the basis that the dividends will be fully settled in cash. The adjustments required to reflect the take-up of the dividends in the form of new shares are accounted for in the subsequent financial year.

10 Earnings/(Loss) per share

	1998	1997	1996
Net basis:			
Profit for financial year attributable to ordinary shareholders	£30.1m	£235.4m	£224.4m
Earnings per ordinary share	5.6p	44.9p	51.7p
	£m	£m	£m
Adjusted earnings per share:			
Profit for financial year attributable to ordinary shareholders	30.1	235.4	224.4
Adjustments:			
Windfall tax	414.8	–	–
Exceptional provisions: Bangkok, 1997; business restructuring, 1996	–	83.0	123.8
(Profit)/Loss on disposal of businesses	(6.8)	77.1	(7.2)
Results of divested businesses	–	9.6	(22.1)
Adjusted profit for financial year attributable to ordinary shareholders	438.1	405.1	318.9
Adjusted earnings per ordinary share	81.9p	77.2p	73.4p
Nil basis:			
(Loss)/Profit on ordinary activities after the elimination of the advance corporation tax credit or charge, as appropriate	£(32.7)m	£246.1m	£269.8m
(Loss)/Earnings per ordinary share	(6.1)p	46.9p	62.1p
	£m	£m	£m
Adjusted earnings per share:			
(Loss)/Profit on ordinary activities after the elimination of the advance corporation tax credit or charge, as appropriate	(32.7)	246.1	269.8
Adjustments:			
Windfall tax	414.8	–	–
Exceptional provisions: Bangkok, 1997; business restructuring, 1996	–	83.0	123.8
(Profit)/Loss on disposal of businesses	(6.8)	77.1	(7.2)
Results of divested businesses	–	9.6	(22.1)
Adjusted profit on ordinary activities after the elimination of the advance corporation tax credit or charge, as appropriate	375.3	415.8	364.3
Adjusted earnings per ordinary share	70.2p	79.2p	83.9p

The adjustment to profit and earnings per share has been made to eliminate the impact of non-recurring items and, by the adjustment for the results of divested businesses, to disclose the underlying earnings of continuing operations.

Earnings per ordinary share and the adjusted earnings per ordinary share on the net basis have been calculated by dividing profit and the adjusted profit for the financial year attributable to ordinary shareholders by 534.7 million, being the weighted average number of shares in issue during the year (1997 – 524.8 million; 1996 – 434.3 million).

Earnings per ordinary share and the adjusted earnings per ordinary share on the nil basis are calculated by eliminating the taxation credit of £62.8 million (1997 – £10.7 million charge; 1996 – £45.4 million charge) in respect of advance corporation tax.

There would be no significant dilution of earnings per ordinary share if the outstanding share options were exercised.

Notes to the accounts

11 Tangible fixed assets

Group	Land and buildings £m	Infra-structure assets £m	Operational assets £m	Fixtures, fittings, tools and equipment £m	Pre-1974 assets £m	Assets in course of construction £m	Total £m
Cost:							
At 1 April 1997	258.4	1,592.9	2,810.6	541.7	177.4	561.8	5,942.8
Exchange adjustments	-	-	-	(0.1)	-	-	(0.1)
Additions	11.8	50.5	136.8	31.0	-	436.6	666.7
Grants and contributions	-	(4.1)	-	-	-	-	(4.1)
Transfers	5.2	94.0	92.9	41.6	-	(240.3)	(6.6)
Disposals	(5.3)	(0.1)	(10.7)	(23.9)	-	-	(40.0)
At 31 March 1998	270.1	1,733.2	3,029.6	590.3	177.4	758.1	6,558.7
Depreciation:							
At 1 April 1997	48.7	-	667.2	309.2	127.4	-	1,152.5
Charge for the year	8.1	-	74.1	51.5	5.8	-	139.5
Disposals	(3.6)	-	(3.8)	(22.7)	-	-	(30.1)
At 31 March 1998	53.2	-	737.5	338.0	133.2	-	1,261.9
Net book value:							
At 31 March 1998	216.9	1,733.2	2,292.1	252.3	44.2	758.1	5,296.8
At 31 March 1997	209.7	1,592.9	2,143.4	232.5	50.0	561.8	4,790.3

Grants and contributions received relating to infrastructure assets have been deducted from the cost of fixed assets in order to show a true and fair view (accounting policy note 1(h)). As a consequence, the net book value of fixed assets is £77.4 million (1997 - £73.3 million) lower than it would have been had this treatment not been adopted.

Within tangible fixed assets are assets held under finance leases at the following amounts:

	1998 £m	1997 £m
Cost:		
Operational assets	250.8	250.8
Fixtures, fittings, tools and equipment	17.7	20.2
At 31 March	268.5	271.0
Accumulated depreciation:		
Operational assets	57.7	53.6
Fixtures, fittings, tools and equipment	16.3	16.4
At 31 March	74.0	70.0
Net book value:		
Operational assets	193.1	197.2
Fixtures, fittings, tools and equipment	1.4	3.8
At 31 March	194.5	201.0

An analysis of land and buildings between freehold and long and short leasehold is not readily available.

Pre-1974 assets comprise a pool of assets which was transferred to the Group from North West Water Authority, which the Group acquired in 1974 from its predecessors.

Notes to the accounts

	1998 £m	1997 £m
Capital commitments:		
Contracted but not provided for	382.5	380.1
Company		Fixtures, fittings, tools and equipment £m
Cost:		
At 1 April 1997		10.6
Additions		1.2
Disposals		(0.1)
At 31 March 1998		11.7
Depreciation:		
At 1 April 1997		1.5
Charge for the year		1.2
Disposals		-
At 31 March 1998		2.7
Net book value:		
At 31 March 1998		9.0
At 31 March 1997		9.1

12 Fixed asset investments

Group	Associated undertakings		Other investments				Total £m
	Unlisted £m	Loans £m	Unlisted £m	Loans £m	Listed £m	Other £m	
Cost:							
At 1 April 1997	51.8	0.4	2.8	2.1	15.5	21.3	93.9
Additions	51.6	8.3	16.4	-	6.9	-	83.2
Share of losses	(2.5)	-	-	-	-	-	(2.5)
Disposals	(30.3)	-	(0.5)	-	-	(21.3)	(52.1)
Loan repayment	-	(2.4)	-	(1.3)	-	-	(3.7)
Exchange adjustments	(1.8)	-	(0.4)	-	(0.1)	-	(2.3)
At 31 March 1998	68.8	6.3	18.3	0.8	22.3	-	116.5

A list of the Group's principal operating subsidiaries and associated undertakings is shown on page 51.

Share of losses is stated after a taxation charge of £1.4 million.

Included within other investments are:

- (i) a 20 per cent interest in Lakeland Power Limited; in the opinion of the directors they are unable to exercise significant influence over this company and accordingly it is accounted for as a trade investment;
 - (ii) the listed investments held by Carefree Insurance Limited, which had a market value of £22.6 million at 31 March 1998.
- Details of own shares acquired at nil cost to the Group are given in note 24 to the accounts.

Company	Shares in subsidiary undertakings £m	Other investments £m	Total £m
Cost:			
At 1 April 1997		1.4	2,811.9
Additions		0.4	145.8
Disposals		-	(3.8)
At 31 March 1998		1.8	2,953.9

Notes to the accounts

Details of principal operating subsidiary and associated undertakings, all of which are unlisted, are detailed below. These subsidiary undertakings are included within the consolidated Group financial statements. A full list of subsidiaries is attached to the annual return of the company.

	Class of share capital held	Proportion of share capital owned/voting rights	Nature of business
<i>Subsidiary undertakings:</i>			
Great Britain:			
North West Water Limited	Ordinary	100%	Water supply and sewerage services
NORWEB plc	Ordinary	100%	Provision of energy and related services
Norweb Gas Limited	Ordinary	75%*	Sale of gas
Vertex Data Science Limited	Ordinary	100%	Business operations outsourcing
United Utilities International Limited	Ordinary	100%	Consulting services and project management
North West Water (Scotland) Limited	Ordinary	100%*	Technical, consulting and project management services
Isle of Man:			
Carefree Insurance Limited	Ordinary	100%*	Provision of re-insurance services
Talbot Insurance Limited	Ordinary	100%*	Provision of insurance services
Republic of Ireland:			
Norweb North America Corporation	Ordinary	100%*	Investment
Australia:			
United Utilities Australia Pty Limited	Ordinary	100%*	Technical and management services
Malaysia:			
North West Water (Malaysia) SDN BHD	Ordinary	100%*	Technical and management services
<i>Associated undertakings:</i>			
Great Britain:			
International Water Limited	Ordinary	50%*	Investment in water and wastewater services
USA:			
US Water LLC	Ordinary	50%*	Contract operations and maintenance services
Argentina:			
Inversora Electrica de Buenos Aires SA	Ordinary	45%*	Electricity supply and distribution
Australia:			
Yan Yean Water Pty Limited	Ordinary	50%*	Water treatment operations
NWT Water Pty Limited	Ordinary	50%*	
Malaysia:			
Indah Water Operations SDN BHD	Ordinary	50%*	Wastewater network and treatment operations
Mexico:			
Agua de Mexico SA de CV	Ordinary	49%*	Technical and management services

The country under which each undertaking appears is both the country of its incorporation and of its principal operations. Shares are held directly by United Utilities PLC except where marked with an asterisk where they are held by subsidiary undertakings.

Notes to the accounts

13 Purchase of subsidiary

The Group acquired NORWEB plc on 8 November 1995 and the acquisition method of accounting was adopted. The provisional fair value of net assets acquired by the Group was identified at the date of acquisition. The provisional fair value amounted to £606.0 million and included a fair value adjustment of £217.9 million relating to provisions for liabilities and charges, of which £173.2 million was in respect of onerous gas and electricity contracts. In accordance with Financial Reporting Standard 7, the provisional fair value was re-assessed as at 31 March 1997. The revaluation adjustments arising from the re-assessment were principally a £100.2 million downwards revaluation relating to the disposal of the Norweb retail business, for which gross proceeds of £148.2 million (excluding the value to be realised from Carefree Insurance) were received, and a £50.0 million upwards revaluation relating to the disposal of the Norweb generation businesses, for which gross proceeds of £122.7 million were received. After fees and closure costs, total net cash received in relation to these disposals was £236.0 million. The calculation of goodwill arising is summarised below:

	£m
Net assets acquired	
Provisional fair value of net assets acquired	606.0
Revaluation adjustments – retail and generation	(48.1)
Other adjustments	1.5
Revised fair value at 31 March 1997	559.4
Consideration	
Cash	1,463.2
Shares allotted	197.0
Share option obligations	22.7
Total consideration	1,682.9
Goodwill arising	1,123.5

Unaudited pro-forma information for US GAAP purposes

The following unaudited pro-forma information shows the UK GAAP results for the year ended 31 March 1996 assuming the acquisition of NORWEB had taken place on 1 April 1995.

The pro-forma adjustments include only the effects of events directly attributable to the transaction that are factually expected to have a continuing impact. No pro-forma adjustments reflecting anticipated efficiencies in operations resulting from the transaction are included. The pro-forma results are shown for information only and are not directly comparable to historic results, nor indicative of future results.

	Year ended 31 March 1996
Turnover (£ million)	2,607.0
Profit before taxation (£ million)	394.7
Net income (£ million)	351.1
Net income per ordinary share (pence)	67.3
Adjusted net income per ordinary share (pence)	65.5
Net income per American depositary receipt (ADR) (pence)	134.6
Adjusted net income per American depositary receipt (ADR) (pence)	131.0

The following notes summarise the principal pro-forma adjustments that have been made in arriving at the above information:

Year ended 31 March 1996

Additional interest charges have been included in relation to the borrowings required to acquire NORWEB plc. This relates to the pre-acquisition period from April to October 1995. The principal of £849 million was calculated after netting off the rights issue proceeds of £563 million. The interest rate was based upon average LIBOR plus 20 basis points margin.

An additional interest charge has been included for the impact of increased dividends and interest payable in the year ended 31 March 1995.

The impact of the restructuring provision of £103.4 million has been removed from this year as it was pulled forward to the year ended 31 March 1995.

Additional special dividends relating to the increased number of shares have been included to reflect the impact of shares issued under the rights issue and as part of the Norweb purchase consideration.

A reduction in corporation tax has been included to reflect the impact of the increased interest charge.

Net income per ADR and adjusted net income per ADR have been calculated by multiplying the net income per ordinary share and the adjusted net income per ordinary share by two, that is, the number of ordinary shares equivalent to each ADR.

Notes to the accounts

14 Stocks

	Group	
	1998 £m	1997 £m
Stores	11.7	1.4
Work in progress	1.9	2.6
Finished goods and goods for resale	–	4.5
	13.6	8.5

15 Debtors

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Amounts falling due within one year:				
Trade debtors	223.9	233.3	–	–
Provisions for doubtful debts	(69.2)	(80.1)	–	–
	154.7	153.2	–	–
Unbilled debtors	197.1	179.4	–	–
	351.8	332.6	–	–
Amounts owed by subsidiary undertakings	–	–	777.4	364.0
Other debtors	59.5	39.5	–	–
Infrastructure renewals prepayment	5.5	21.7	–	–
Prepayments and accrued income	14.3	26.2	0.1	8.4
Amounts recoverable under contracts	0.9	1.0	–	–
	432.0	421.0	777.5	372.4
Amounts falling due after more than one year:				
Infrastructure renewals prepayment	20.0	–	–	–
Other debtors	3.1	6.8	–	–
	23.1	6.8	–	–
Total debtors	455.1	427.8	777.5	372.4

Unbilled debtors represent the sales of the electricity supply and water businesses not invoiced at the balance sheet date.

16 Current asset investments

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Managed funds and short term deposits	296.2	297.7	–	–
Other current asset investments	17.3	10.6	16.8	9.9
	313.5	308.3	16.8	9.9

Notes to the accounts

17 Creditors: amounts falling due within one year

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Loans	33.8	21.4	8.9	–
Bank overdrafts and temporary borrowings	944.7	918.3	242.3	187.7
Obligations under finance leases	4.0	5.8	–	–
Trade creditors	148.1	113.6	–	–
Amounts owed to subsidiary undertakings	–	–	242.4	224.1
Dividends	158.5	133.5	158.5	133.5
Taxation and social security	177.9	165.5	34.7	39.4
Windfall tax	207.4	–	129.8	–
Accruals and deferred income	480.3	423.7	22.2	21.2
Advance corporation tax	45.0	69.5	45.0	69.5
	2,199.7	1,851.3	883.8	675.4

18 Creditors: amounts falling due after more than one year

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Loans	1,264.6	803.8	361.1	75.3
Obligations under finance leases	201.6	204.8	–	–
Other creditors	21.9	43.1	–	–
Deferred grants and contributions (note 19)	193.5	183.4	–	–
	1,681.6	1,235.1	361.1	75.3

19 Deferred grants and contributions

	£m
At 1 April 1997	183.4
Received in the year	15.3
Credit to profit and loss account for the year	(5.2)
At 31 March 1998	193.5

Notes to the accounts

20 Provisions for liabilities and charges

	Group					Company	
	Restructuring £m	Onerous contracts £m	Bangkok £m	Retail divestment £m	Other £m	Total £m	Other £m
At 31 March 1997	127.7	166.6	42.0	41.8	51.2	429.3	12.3
Utilised	(49.0)	(5.7)	(21.2)	(20.6)	(39.8)	(136.3)	(3.9)
Profit and loss account	(6.5)	–	–	–	(4.7)	(11.2)	–
At 31 March 1998	72.2	160.9	20.8	21.2	6.7	281.8	8.4

Restructuring

The restructuring provisions relate primarily to:

- the cost of completing the reorganisation of North West Water operations;
- the cost of completing the voluntary redundancy programme established by NORWEB plc prior to the acquisition; and
- the cost of reorganising the Group following the acquisition of NORWEB plc (including an expansion of the Norweb voluntary redundancy programme outlined above).

The above costs primarily relate to terminations, training, relocation of employees and systems improvements.

Onerous contracts

On the acquisition of NORWEB plc, provision was made for gas and electricity contracts mainly in relation to long term power purchase agreements. These power purchase agreements contain annual commitments to purchase electricity and the longest contracts expire in the year ended 31 March 2011. The contract conditions were considered onerous compared to the conditions that existed at the date of acquisition when the fair valuation was made.

Bangkok

In February 1997, as a result of continuing disputes relating to the contract in Bangkok, an additional provision of £83.0 million was made against losses expected on the contract. In March 1998, the contract was formally terminated. The provision continues to reflect management's best estimate of the expected liabilities remaining in respect of this contract based on the circumstances prevailing at the balance sheet date.

Retail divestment

Provisions of £68.1 million were created on the disposal of retail. This provision reflects the liabilities remaining with the Group.

21 Deferred taxation

The full potential deferred tax liability, none of which is provided, is:

	1998 £m	1997 £m
Deferred tax liabilities:		
Accelerated tax allowances – infrastructure assets	429.8	442.4
Accelerated tax allowances – other assets	442.6	474.4
	872.4	916.8
Deferred tax assets:		
Advance corporation tax recoverable	(138.9)	(201.7)
Operating losses carried forward	(2.6)	(27.6)
Other	(132.8)	(152.1)
	(274.3)	(381.4)
Net deferred tax liabilities	598.1	535.4
Of which all relates to the United Kingdom:		
Current	(274.3)	(381.4)
Non-current	872.4	916.8
	598.1	535.4

No deferred tax asset or liability arises in the company's accounts under UK GAAP.

No provision is made for taxation in respect of liabilities which might arise on the distribution of earnings retained overseas.

Notes to the accounts

22 Borrowings

	1998 £m	1997 £m		
Bank overdrafts and temporary borrowings	944.7	918.3		
Term loans	1,298.4	825.2		
Finance leases	205.6	210.6		
	2,448.7	1,954.1		
Repayments fall due as follows:				
	Year	1998	Year	1997
After five years	2004+	1,152.3	2003+	680.5
From four to five years	2003	30.9	2002	133.7
From three to four years	2002	129.3	2001	51.6
From two to three years	2001	51.9	2000	102.1
From one to two years	2000	101.8	1999	40.7
After more than one year		1,466.2		1,008.6
Within one year	1999	982.5	1998	945.5
		2,448.7		1,954.1

Bank overdrafts and temporary borrowings

The bank overdrafts and temporary borrowings under both uncommitted and committed bank facilities are repayable in less than one year. The weighted average rate of interest on bank overdrafts and temporary borrowings was 7.7 per cent (1997 – 6.3 per cent). The Group had available committed bank facilities of £1,415.0 million (1997 – £1,248.0 million) of which £745.0 million was unutilised at 31 March 1998 (1997 – £838.0 million).

Term loans

Amounts repayable after more than five years comprise bank and other loans repayable between 2004 and 2053. Interest rates range from 6.45 per cent to 14.83 per cent on £905.2 million (1997 – £226.1 million) and are at floating rates on £47.5 million (1997 – £258.3 million).

On total borrowings, interest rates range from 6.45 per cent to 14.83 per cent on £1,056.2 million and are at floating rates on £1,392.5 million.

	Borrowings at 31 March		Weighted average interest rate at which borrowings are fixed		Weighted average period for which interest is fixed	
	1998 £m	1997 £m	1998 %	1997 %	1998 Years	1997 Years
Fixed rate borrowing						
Sterling	694.1	501.5	8.4	8.9	16.8	20.5
Netherlands guilders	42.6	42.6	9.3	9.3	3.7	5.0
United States dollars	319.5	21.3	6.6	9.4	9.5	4.0
	1,056.2	565.4	7.9	9.0	14.1	18.4
Floating rate borrowings						
Sterling	1,353.7	1,352.1				
United States dollars	38.8	36.6				
	1,392.5	1,388.7				
Floating rate investments						
Sterling (including cash)	(308.1)	(327.1)				
Net debt at 31 March	2,140.6	1,627.0				

Based on the floating rate net debt of £1,084.4 million at the year end, a 1 per cent change in interest rates would result in a £10.8 million change in profit before tax for the year.

Company

Excluding amounts owed to subsidiary undertakings, the company has borrowings totalling £612.3 million (1997 – £263.0 million) of which £251.2 million falls due within one year. The remaining loans totalling £361.1 million comprise £62.6 million repayable in 2001 and £298.5 million repayable in 2008. The loans repayable in 2001 comprise £42.6 million at a fixed rate of interest of 9.31 per cent and £20.0 million at 11.625 per cent. The loan repayable in 2008 is at a fixed rate of interest of 6.45 per cent.

Notes to the accounts

23 Financial instruments and risk management

The primary financial risks faced by the Group in relation to the treasury function are exchange rate risk and interest rate risk.

The Board has reviewed and agreed policies for managing each of these risks as summarised below. The Board has also approved all of the classes of financial instruments used by the Group. Group treasury, which is authorised to conduct the day-to-day treasury activities of the Group, reports at least annually to the Board.

The Group uses a variety of financial instruments, including derivatives, to raise finance for its operations and to manage the risks arising from those operations.

The Group borrows in the major global debt markets in a range of currencies at both fixed and floating rates of interest, using derivatives where appropriate to generate the desired effective currency profile and interest basis.

Under an interest rate swap, the Group agrees with another party to exchange at specific intervals the difference between fixed rate and floating rate interest amounts calculated by reference to an agreed notional principal amount. The notional principal of these instruments reflects the extent of the Group's involvement in the instruments, but does not represent its exposure to credit risk which is assessed by reference to the fair value.

Under a currency swap, the Group agrees with another party to exchange the principal amount of two currencies together with interest amounts in the two currencies agreed by reference to a specific interest rate basis and the principal amount. The principal of these instruments reflects the extent of the Group's involvement in the instruments, but does not represent its exposure to credit risk which is assessed by reference to the fair value.

All transactions are undertaken to manage the risks arising from underlying business activities and no speculative trading is undertaken. The counterparties to these instruments generally consist of financial institutions and other bodies with good credit ratings. Although the Group is potentially exposed to credit loss in the event of non-performance by counterparties, such credit risk is controlled through credit rating reviews of the counterparties and by limiting the total amount of exposure to any one party. The Group does not believe it is exposed to any material concentrations of credit risk.

Financial instruments utilised by the Group can be summarised as follows:

a) *Interest rate swaps*

Interest rate swaps are used solely to convert floating rate borrowings to fixed rates to reduce the financial risk to the Group from potential future increases in medium term interest rates.

b) *Financial futures*

Financial futures are used solely to limit the Group's exposure to possible future increases in short term interest rates.

c) *Forward contracts*

The Group generally hedges foreign exchange transaction exposures up to one year forward. Hedges are put in place using forward contracts at the time that the forecast exposure becomes reasonably certain.

d) *Currency swaps*

The Group uses currency swaps to hedge currency exposure where debt is raised in one currency to fund in a different currency.

e) *Contracts for differences*

Almost all electricity generated in England and Wales must be sold to the electricity Pool, and electricity suppliers must buy electricity from the Pool for resale to their customers. The Pool was established at the time of privatisation for bulk trading of electricity in England and Wales between generators and suppliers. The Pool is operated under a Pooling and Settlement Agreement to which all licensed generators and suppliers of electricity in Great Britain are party.

The Group has procedures in place to minimise exposure to Pool price variations, that is, the possibility that a change in Pool prices will increase the cost of electricity purchased from the Pool. These procedures involve Norweb entering into Contracts for Differences (CfDs). In general, CfDs are commonly settled in arrears by reference to actual half-hourly Pool prices. The Group's use of such derivative instruments relates directly to the underlying purchase of electricity from the Pool.

A CfD is typically a contract between two parties (for example, a generator of electricity and a regional electricity company) that requires each party to either make or receive payments daily, weekly, monthly or at other intervals, over a specific term based on the difference between an agreed price (that is, the bilaterally determined strike price) and the actual Pool calculated price (that is, the reference price), applied to an agreed quantity of electricity (that is, number of MWh). The duration for the contracts entered into by Norweb is commonly one to two years, but may be up to a maximum of 15 years.

At 31 March 1998, the Group was committed to hedging 73 million MWh (31 March 1997 – 91 million MWh) under CfDs. The average Pool purchase price for 1997/98 was £25.32 per MWh (1996/97 – £23.69 per MWh). The maximum Pool purchase price for 1997/98 was £497.42 per MWh (1996/97 – £591.00 per MWh). The minimum Pool purchase price for 1997/98 was £7.00 per MWh (1996/97 – £5.02 per MWh).

The fair value of outstanding CfDs at 31 March 1998 was £(299.6) million (31 March 1997 – £(402.8) million).

Notes to the accounts

The fair values of outstanding CfDs were based on the difference between projected Pool prices and agreed contract prices, discounted at the Group's cost of capital. The calculation of fair value takes into account a number of complex factors, including future Pool prices, plant availability, plant operating costs and inflation indices. The principal influence on the fair value is the projected Pool price. For the purposes of these calculations the projected Pool price is based on historic data.

These CfDs involve a degree of credit risk. This is the risk that the counterparty to the CfD defaults on settlement. The Group controls credit risk arising from entering into the CfDs through credit approvals, limits and monitoring procedures.

Fair values of financial instruments

US GAAP requires disclosure of an estimate of the fair value of certain financial instruments, whether or not recognised in the balance sheet. Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and therefore cannot be determined precisely. Changes in assumptions could significantly affect the estimates.

At 31 March	1998			1997		
	Book value £m	Gross contract amount £m	Current value £m	Book value £m	Gross contract amount £m	Current value £m
Short term debt and current portion of long term debt	978.5	978.5	978.5	939.7	952.8	952.8
Long term debt	1,264.6	1,269.4	1,371.0	803.8	796.4	851.3
	2,243.1	2,247.9	2,349.5	1,743.5	1,749.2	1,804.1
Interest rate swaps	–	779.6	35.9	–	687.7	16.7
Foreign exchange contracts and swaps	–	341.1	2.0	–	42.6	(9.2)
Total financial instruments	2,243.1	3,368.6	2,387.4	1,743.5	2,479.5	1,811.6

Fair values have been estimated using the following methods and assumptions:

Long term investments (excluding equity investments in associated undertakings)

The fair value of listed investments is based on year end quoted market prices. For other investments for which there are no quoted market prices, the fair values approximate to the carrying value.

Current assets and liabilities

Financial instruments included within current assets and liabilities (excluding cash and borrowings) are generally short term in nature and accordingly their fair values approximate to their book values.

Long term receivables and liabilities

The fair values of financial instruments included within long term receivables and liabilities (excluding borrowings) are based on discounted cash flows using appropriate market interest rates. Pension prepayments and amounts receivable and payable under finance leases are exempt from US GAAP fair value disclosure requirements.

Net borrowings and non-equity interests (excluding foreign exchange contracts)

The carrying values of cash and short term borrowings and current asset investments approximate to their fair values because of the short term maturity of these instruments. The fair value of quoted long term borrowings and guaranteed preferred securities is based on year end mid-market quoted prices. The fair value of other long term borrowings is estimated by discounting the future cash flows to net present values using appropriate market interest rates prevailing at the year end.

Currency and interest rate swaps

The Group enters into currency and interest rate swaps in order to manage its foreign currency and interest rate exposures. The fair value of these financial instruments was estimated by discounting the future cash flows to net present values using appropriate market interest rates prevailing at the year end. The carrying and fair values of currency and interest rate swaps include the related accrued interest receivables and payables.

Notes to the accounts

24 Called up share capital, share premium account and profit and loss account

The movements in shareholders' equity are as follows:

	Group and company			Group		Company	
	Ordinary shares authorised £m	Called up share capital £m	Share premium account £m	Profit and loss account £m	Total £m	Profit and loss account £m	Total £m
Balance at 31 March 1995	475.0	377.1	3.0	1,866.3	2,246.4	1,146.1	1,526.2
Profit for financial year	-	-	-	224.4	224.4	130.0	130.0
Dividends on ordinary shares	-	-	-	(163.8)	(163.8)	(163.8)	(163.8)
Increase in authorised share capital	185.0	-	-	-	-	-	-
Shares issued net of costs	-	144.0	612.0	-	756.0	-	756.0
Shares issued in lieu of cash dividend	-	2.0	-	-	2.0	-	2.0
Goodwill	-	-	-	(1,074.8)	(1,074.8)	-	-
Adjustment in respect of shares issued in lieu of cash dividend	-	-	-	8.4	8.4	8.4	8.4
Exchange adjustments	-	-	-	(6.5)	(6.5)	0.1	0.1
Balance at 31 March 1996	660.0	523.1	615.0	854.0	1,992.1	1,120.8	2,258.9
Profit for financial year	-	-	-	235.4	235.4	343.5	343.5
Dividends on ordinary shares	-	-	-	(195.3)	(195.3)	(195.3)	(195.3)
Increase in authorised share capital	60.0	-	-	-	-	-	-
Shares issued net of costs	-	3.0	7.0	-	10.0	-	10.0
Shares issued in lieu of cash dividend	-	3.5	-	-	3.5	-	3.5
Goodwill	-	-	-	79.6	79.6	3.7	3.7
Adjustment in respect of shares issued in lieu of cash dividend	-	-	-	16.0	16.0	16.0	16.0
Exchange adjustments	-	-	-	0.6	0.6	-	-
Balance at 31 March 1997	720.0	529.6	622.0	990.3	2,141.9	1,288.7	2,440.3
Profit for financial year	-	-	-	30.1	30.1	194.3	194.3
Dividends on ordinary shares	-	-	-	(228.8)	(228.8)	(228.8)	(228.8)
Increase in authorised share capital	-	-	-	-	-	-	-
Shares issued net of costs	-	2.2	11.8	-	14.0	-	14.0
Shares issued in lieu of cash dividend	-	13.0	-	-	13.0	-	13.0
Capitalisation of reserves in respect of shares issued via QUEST	-	-	-	(4.7)	(4.7)	-	-
Goodwill	-	-	-	-	-	-	-
Adjustment in respect of shares issued in lieu of cash dividend	-	-	-	76.1	76.1	76.1	76.1
Exchange adjustments	-	-	-	3.9	3.9	-	-
Balance at 31 March 1998	720.0	544.8	633.8	866.9	2,045.5	1,330.3	2,508.9

Underlying dividends per ordinary share are 40.8 pence (recommended) in 1998, 37.2 pence in 1997 and 28.86 pence in 1996. In 1998, an enhancement to the final dividend of 1.36 pence has been recommended. In 1996, a special dividend of 3.8 pence was paid in addition to the underlying dividend.

As allowed by section 230 of the Companies Act 1985, the company has not presented its own profit and loss account. The amount of Group profit for the financial year dealt with in the company's profit and loss account is £194.3 million (1997 - £343.5 million; 1996 - £130.0 million) after accounting for dividends receivable from subsidiary undertakings of £403.1 million (1997 - £412.6 million; 1996 - £179.9 million).

The cumulative amount of goodwill resulting from acquisitions during the years ended 1998, 1997, 1996 and prior years, net of goodwill attributable to subsidiaries or businesses demerged or disposed of prior to 31 March 1998, amounts to £1,124.5 million (1997 - £1,124.5 million; 1996 - £1,204.1 million). The cumulative amount of negative goodwill included in the goodwill reserve is £nil at 31 March 1998 (1997 - £nil; 1996 - £nil). Consolidated retained earnings at 31 March 1998 include retained earnings of associated undertakings of £11.9 million (1997 - £14.4 million; 1996 - £14.3 million). The cumulative amount of exchange adjustments included within consolidated retained earnings is £(1.8) million (1997 - £(5.7) million; 1996 - £(6.3) million).

Apart from dividends from North West Water Limited and NORWEB plc, which are subject to certain regulatory restrictions, there are no significant statutory or contractual restrictions on the distribution of current profits of subsidiary or associated undertakings; undistributed profits of prior years are, in the main, permanently employed in the businesses of these undertakings. The undistributed profits of Group undertakings overseas may be liable to overseas taxes and/or UK taxation (after allowing for double taxation relief) if they were to be distributed as dividends. No provision has been made in respect of potential taxation liabilities on realisation of assets at restated or revalued amounts or on realisation of associated undertakings at equity accounted value.

Notes to the accounts

The authorised share capital at 31 March 1995 was £475,000,001 divided into 475,000,000 ordinary shares of £1 each and one special rights redeemable preference share of £1. By an ordinary resolution passed at the extraordinary general meeting of the company held on 13 October 1995, which became unconditional on 8 November 1995, the authorised share capital was increased to £660,000,001 by the creation of 185,000,000 new ordinary shares of £1 each. The special rights redeemable preference share was redeemed on 31 December 1994.

Resolutions were passed at the annual general meeting on 26 July 1996 such that the special rights redeemable preference share was cancelled and the authorised ordinary share capital was increased to £720,000,000 by the creation of 60,000,000 new ordinary shares of £1 each.

The allotted and fully paid share capital of the company at 31 March 1998 was 544,810,508 ordinary shares (529,596,168 ordinary shares at 31 March 1997; 523,068,903 ordinary shares at 31 March 1996).

2,205,762 ordinary shares were allotted during the year ended 31 March 1998 (1997 – 3,042,273 ordinary shares, 1996 – 2,022,287 ordinary shares) for the exercise of options in accordance with the rules of the employee sharesave schemes and the executive share option scheme for a total consideration of £14.3 million (1997 – £10.2 million, 1996 – £6.0 million).

On 1 October 1997 7,629,651 ordinary shares and on 16 February 1998 5,363,989 ordinary shares were issued to ordinary shareholders who elected under the company's share dividend plan to receive shares instead of cash for the final dividend for the year ended 31 March 1997 and for the interim dividend for the year ended 31 March 1998.

Since 31 March 1998, 123,443 shares have been allotted on the exercise of options and at 31 May 1998, the company's issued share capital, credited as fully paid, was 544,933,951.

Notes to the accounts

The company has two continuing share option schemes – an employee sharesave scheme available to all eligible employees and an executive share option scheme for senior executives (excluding, with effect from the introduction of the Group's incentive plan, executive directors and other executives participating in the plan). The former is based on SAYE savings contracts with options exercisable within a six-month period from the conclusion of a three, five or seven year period as appropriate from the date of grant. Under the terms and conditions of this scheme, for every month (up to no more than six months) an employee fails to contribute the agreed monthly amount determined under the rules of the scheme, the last date exercisable will be delayed by one month. Options under the latter scheme are exercisable in a period beginning no earlier than three years (five years for discounted options, which are no longer granted) and ending no later than ten years from the date of grant. Options outstanding under the two share option schemes at 31 March, together with their exercise prices and dates, were:

	1998	1997	Exercise price	Normal dates of exercise
Employee sharesave scheme	–	53,452	170.2p (1)	1997
	13,327	378,242	244.3p (1)	1996 or 1998
	349,973	415,910	269.9p (1)	1997 or 1999
	216,197	676,252	369.5p (1)	1998 or 2000
	556,309	616,906	440.6p (1)	1999 or 2001
	898,604	956,485	404.8p (1)	2000 or 2002
	1,189,692	1,276,900	481.0p (1)	2001
	2,047,886	3,937,099	476.0p(1)	2002
	2,258,676	–	616.5p(1)	2001 or 2003
Executive option scheme	14,213	37,730	268.9p (3)	1993 to 2000
	15,505	22,480	305.2p (3)	1993 to 2000
	46,968	180,051	324.1p (3)	1995 to 2002
	110,979	208,938	275.7p (2)	1997 to 2002
	50,587	50,587	392.7p (3)	1995 to 2002
	69,056	73,384	334.2p (2)	1997 to 2002
	115,856	167,195	463.4p (3)	1996 to 2003
	69,941	100,088	394.2p (2)	1998 to 2003
	13,443	43,478	446.9p (3)	1996 to 2003
	83,637	97,068	380.2p (2)	1998 to 2003
	286,376	467,618	566.9p (3)	1997 to 2004
	155,665	194,535	482.2p (2)	1999 to 2004
	219,161	306,025	530.1p (3)	1997 to 2004
	91,273	103,607	450.8p (2)	1999 to 2004
	225,609	455,614	479.8p (3)	1997 to 2004
	142,245	151,854	408.2p (2)	1999 to 2004
	63,763	197,498	564.0p (3)	1998 to 2005
	21,252	65,828	479.8p (2)	2000 to 2005
	307,750	345,500	584.5p (3)	1998 to 2005
	699,684	775,488	544.5p (3)	1999 to 2006
	505,500	536,750	628.0p (3)	2000 to 2007
	358,946	–	632.0p(3)	2000 to 2007
	636,760	–	768.5p(3)	2001 to 2008
	11,834,833	12,892,562		

(1) The exercise price represents 80 per cent of the market price as at the date the option was granted.

(2) The exercise price represents 85 per cent of the market price as at the date the option was granted.

(3) The market price as at the date the option was granted equalled the exercise price.

An opportunity to join the employee sharesave scheme was offered during the years ended 31 March 1998 and 31 March 1997, and options were also granted under the executive share option scheme (and overseas executive share option scheme). In the year ended 31 March 1998, options were granted under the two option schemes in respect of a total of 3,318,716 ordinary shares (1997 – 5,316,494 ordinary shares), options for 1,871,259 ordinary shares (1997 – 3,042,273 ordinary shares) were exercised and options for 2,505,186 ordinary shares (1997 – 534,066 ordinary shares) lapsed or were cancelled.

Notes to the accounts

No options have been granted under the Norweb employee sharesave scheme since the acquisition of Norweb. Participating employees were given the opportunity of replacing their options for Norweb shares with options of an equivalent value for United Utilities shares. Options for United Utilities shares outstanding under the Norweb scheme at 31 March, together with their exercise price and date, were:

	1998	1997	Exercise price pence	Normal date of exercise
	3,802,735	4,799,524	308.29	2000

During the year, United Utilities established a Qualifying Employee Share Ownership Trust ("QUEST"), an employee benefit trust complying with requirements of the Finance Act 1989. The QUEST trustee assumed the obligation to satisfy options granted under the existing United Utilities' sharesave scheme and the Norweb sharesave scheme. It is intended that the QUEST will satisfy all future grants under the continuing United Utilities' sharesave scheme. All finance costs and administration expenses connected with the operation of the QUEST are written off to the profit and loss account as they accrue. The number of shares held in the QUEST at 31 March 1998 was 292,171 with a market value of £2,587,174 based on the mid-market price of a share at that date of 885.5 pence. All dividends have been waived in accordance with the trust deed between United Utilities PLC and United Utilities QUEST Trustee Limited as trustee. All shares held in the QUEST, subject to the trustee's discretion, are used to satisfy options granted to employees of the Group under sharesave schemes. The QUEST is not leveraged.

25 Pensions

The Group participates in a number of pension schemes principally in the UK. The major schemes are funded defined benefit schemes – the Water Mirror Image Pension Scheme (WMIS), the Water Pension Scheme (WPS) and the Electricity Supply Pension Scheme (ESPS), of which the WMIS and ESPS are closed to new employees. The assets of these schemes are held in trust funds independent of Group finances.

For WMIS and WPS, the employer's contributions and the pension cost under the accounting standard SSAP24 have been assessed in accordance with the advice of a firm of actuaries, William M Mercer Limited, using the projected unit method for the WPS and the attained age method for the WMIS. For this purpose, the actuarial assumptions adopted are based upon investment growth of 9 per cent per annum, pay growth of 7 per cent per annum and increases to pensions in payment and deferred pensions of 5 per cent per annum.

The last actuarial valuation of the two schemes was carried out as at 31 March 1996. The combined market value of the Group's share of the assets of these two schemes at the valuation date was £521.2 million. The combined actuarial value of the assets represented 107 per cent of the value of the accrued benefits after allowing for expected future earnings increases. In deriving the pension cost under SSAP24, the surplus in the schemes is being spread over the future working lifetime of the existing members.

For ESPS, the employer's contributions and the pension cost under the accounting standard SSAP24 have been assessed in accordance with the advice of a firm of actuaries, Bacon and Woodrow, using the attained age method. For this purpose, the main actuarial assumptions adopted are based upon investment growth of 9 per cent per annum, salary increases (exclusive of merit awards) of 6.5 per cent per annum and increases to pensions in payment of 5 per cent per annum.

The last actuarial valuation of ESPS was carried out as at 31 March 1995. The market value of the Group's share of the assets of ESPS at 31 March 1995 was £662.3 million. The actuarial value of the assets represented 112.8 per cent of the actuarial value of the accrued benefits. In deriving the pension cost under SSAP24, the surplus in the scheme is being spread over the future working lifetime of existing members.

The Group also operates other small funded defined benefit and defined contribution schemes. The pension cost for the defined benefit arrangements is calculated on principles consistent with those described above and for the defined contribution schemes is calculated as the company contributions paid.

The Group also operates a series of unfunded unapproved retirement benefit schemes. The cost of the unfunded unapproved retirement benefit schemes is included in the total pension cost, on a basis consistent with SSAP24 and the assumptions used for WPS.

The total pension cost for the period was £21.3 million (1997 – £26.2 million); (1996 – £20.3 million).

Information about the pension arrangements for executive directors is contained in the Remuneration Committee's report.

The 1997 Budget removed the ability of pension schemes to reclaim tax deducted from UK equity dividends. This will not cause a substantial change in the pension cost, but the effect will be taken into account in the review of assumptions appropriate for actuarial valuations to be carried out in 1998 for both major schemes of the Group.

From 1 April 1998, the Group introduced a new pension scheme, the United Utilities Pension Scheme (UUPS). United Utilities' share of WMIS and WPS, together with other small funded defined benefit and defined contribution schemes operated by the Group, will be merged into the UUPS.

Notes to the accounts

26 Lease commitments

Subsidiary undertakings are committed to making the following payments under operating leases during the year ending:

	31 March 1999		31 March 1998	
	Land and buildings £m	Plant and machinery £m	Land and buildings £m	Plant and machinery £m
Leases which expire:				
Within one year	0.3	0.1	0.8	1.5
Between two and five years	1.1	2.9	1.0	4.0
After five years	4.8	–	3.0	–
	6.2	3.0	4.8	5.5

Minimum future lease payments under capital leases and minimum rental commitments under non-cancellable leases of property, plant and equipment at 31 March 1998 were as follows:

	Finance leases £m	Operating leases £m
1999	4.0	9.2
2000	1.5	6.3
2001	0.5	4.2
2002	–	3.6
2003	–	3.4
Thereafter	199.6	133.7
Total	205.6	160.4

27 Contingent liabilities

The company and certain of its subsidiary undertakings have, in the ordinary course of business, entered into performance bonds of which £15.6 million were outstanding at 31 March 1998.

The company also guaranteed certain loans and overdrafts of Group undertakings up to a maximum amount of £780.6 million, including £637.5 million relating to North West Water Limited's loans from the European Investment Bank.

28 Net cash inflow from operating activities

	1998 £m	1997 £m	1996 £m
Operating profit	602.8	492.5	327.6
Exceptional charges within operating profit	–	83.0	123.8
Operating profit before exceptional items	602.8	575.5	451.4
Depreciation	139.5	130.3	103.1
Profit on disposal of tangible fixed assets	(1.6)	(1.2)	(1.8)
Stocks (increase)/decrease	(5.1)	(8.6)	13.3
Debtors increase	(37.9)	(90.7)	(85.1)
Creditors decrease	(36.5)	(5.3)	(117.5)
Outflow related to exceptional items	(52.1)	(80.7)	(7.1)
	609.1	519.3	356.3

Notes to the accounts

29 Returns on investments and servicing of finance

	1998 £m	1997 £m	1996 £m
Dividends received from National Grid	–	–	102.3
Norweb special dividend	–	–	(156.3)
Interest received	21.0	15.5	21.6
Interest paid	(149.7)	(127.0)	(77.1)
Interest paid on finance leases	(8.6)	(9.8)	(28.4)
	(137.3)	(121.3)	(137.9)

30 Capital expenditure and financial investment

	1998 £m	1997 £m	1996 £m
Purchase of tangible fixed assets, net of grants and contributions	(647.9)	(540.0)	(398.0)
Sale of tangible fixed assets	3.8	7.1	7.8
Purchase of fixed asset investments	(21.2)	(24.7)	(45.6)
Sale of fixed asset investments other than associated undertakings or joint ventures	43.6	40.6	302.1
	(621.7)	(517.0)	(133.7)

31 Acquisitions and disposals

	Acquisitions			Disposals		
	1998 £m	1997 £m	1996 £m	1998 £m	1997 £m	1996 £m
Tangible fixed assets	–	5.9	(1,014.2)	6.4	48.4	7.6
Investments	(53.8)	(87.4)	(395.0)	21.6	36.1	0.2
Net current assets/liabilities	–	61.1	(207.0)	(0.1)	234.1	4.9
Creditors due after more than one year	–	–	550.2	–	(6.8)	(0.1)
Provisions for liabilities and charges	–	67.0	264.4	(6.8)	(6.2)	–
Special dividend, including advance corporation tax	–	–	195.6	–	–	–
Fair value of net assets acquired	(53.8)	46.6	(606.0)			
Book value of net assets disposed				21.1	305.6	12.6
Goodwill acquired/written back on disposal	–	(46.6)	(1,076.9)	–	86.7	2.1
Consideration for undertakings acquired	(53.8)	–	(1,682.9)			
Shares allotted	–	–	197.0			
Share option obligations	–	–	22.7			
Profit/(Loss) on disposals				6.8	(77.1)	7.2
	(53.8)	–	(1,463.2)	27.9	315.2	21.9
Less:						
Cash included in undertakings acquired/disposed	–	–	254.9	(1.3)	(3.5)	(5.0)
Deferred consideration	–	–	–	2.9	(2.9)	(17.9)
Deferred costs	–	–	–	–	48.7	–
Cash consideration	(53.8)	–	(1,208.3)	29.5	357.5	(1.0)
Comprising						
(Outflow)/Inflow arising on						
current year's acquisitions/disposals	(53.8)	–	(1,208.3)	23.4	358.4	(1.0)
previous year's acquisitions/disposals	–	–	–	6.1	(0.9)	–
	(53.8)	–	(1,208.3)	29.5	357.5	(1.0)

Notes to the accounts

32 Management of liquid resources

	1998 £m	1997 £m	1996 £m
(Decrease)/Increase in bank deposits and certificates of deposit	(1.5)	57.3	29.3

33 Financing

	Financing – shares			Financing – debt			Total £m	
	Shares issued by company		Total £m	Loans £m	Short term borrowings other than overdrafts £m	Finance leases £m		Total £m
	Share capital £m	Share premium £m						
At 1 April 1995	(377.1)	(3.0)	(380.1)	(556.9)	(56.7)	(228.0)	(841.6)	(1,221.7)
Exchange adjustments	–	–	–	(6.4)	(4.0)	–	(10.4)	(10.4)
Financing								
New finance	(110.0)	(449.0)	(559.0)	(32.3)	(870.4)	–	(902.7)	(1,461.7)
Finance repaid	–	–	–	120.6	–	8.1	128.7	128.7
Cash flow	(110.0)	(449.0)	(559.0)	88.3	(870.4)	8.1	(774.0)	(1,333.0)
Acquisitions and disposals	(34.0)	(163.0)	(197.0)	(374.9)	(39.4)	–	(414.3)	(611.3)
Shares issued in lieu of cash dividends	(2.0)	–	(2.0)	–	–	–	–	(2.0)
At 1 April 1996	(523.1)	(615.0)	(1,138.1)	(849.9)	(970.5)	(219.9)	(2,040.3)	(3,178.4)
Exchange adjustments	–	–	–	4.2	6.9	–	11.1	11.1
Financing								
New finance	(3.0)	(7.0)	(10.0)	–	–	–	–	(10.0)
Finance repaid	–	–	–	20.5	79.8	9.3	109.6	109.6
Cash flow	(3.0)	(7.0)	(10.0)	20.5	79.8	9.3	109.6	99.6
Shares issued in lieu of cash dividends	(3.5)	–	(3.5)	–	–	–	–	(3.5)
At 1 April 1997	(529.6)	(622.0)	(1,151.6)	(825.2)	(883.8)	(210.6)	(1,919.6)	(3,071.2)
Exchange adjustments	–	–	–	1.0	1.9	–	2.9	2.9
Financing								
New finance	(2.2)	(7.1)	(9.3)	(499.1)	(40.1)	–	(539.2)	(548.5)
Finance repaid	–	–	–	24.9	–	5.0	29.9	29.9
Cash flow	(2.2)	(7.1)	(9.3)	(474.2)	(40.1)	5.0	(509.3)	(518.6)
Other non-cash movement – shares issued via QUEST	–	(4.7)	(4.7)	–	–	–	–	(4.7)
Shares issued in lieu of cash dividends	(13.0)	–	(13.0)	–	–	–	–	(13.0)
At 31 March 1998	(544.8)	(633.8)	(1,178.6)	(1,298.4)	(922.0)	(205.6)	(2,426.0)	(3,604.6)
				Repayment dates	Currency	Rate %		Amount £m
Loans repaid				European Investment Bank	£	various		20.5
				Loan notes	£	floating		3.5
				Local authority	£	various		0.9
								24.9

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34 Analysis of net debt

	Cash		Financing – debt				Current asset investments	Net debt
	£m	Due after one year £m	Loans Due within one year £m	Short term borrowings other than overdrafts £m	Finance leases £m	Total £m	£m	£m
At 1 April 1995	15.3	(525.1)	(31.8)	(56.7)	(228.0)	(841.6)	211.1	(615.2)
Exchange adjustments	–	(6.4)	–	(4.0)	–	(10.4)	–	(10.4)
Cash flow	14.3	73.2	15.1	(870.4)	8.1	(774.0)	29.3	(730.4)
Acquisitions and disposals	–	(374.9)	–	(39.4)	–	(414.3)	–	(414.3)
At 1 April 1996	29.6	(833.2)	(16.7)	(970.5)	(219.9)	(2,040.5)	240.4	(1,770.3)
Exchange adjustments	–	4.2	–	6.9	–	11.1	–	11.1
Cash flow	(34.7)	–	20.5	79.8	9.3	109.6	57.3	132.2
Other non-cash changes	–	25.2	(25.2)	–	–	–	–	–
At 1 April 1997	(5.1)	(803.8)	(21.4)	(883.8)	(210.6)	(1,919.6)	297.7	(1,627.0)
Exchange adjustments	(1.1)	1.0	–	1.9	–	2.9	–	1.8
Cash flow	(4.6)	(502.3)	28.1	(40.1)	5.0	(509.3)	(1.5)	(515.4)
Other non-cash changes	–	40.5	(40.5)	–	–	–	–	–
At 31 March 1998	(10.8)	(1,264.6)	(33.8)	(922.0)	(205.6)	(2,426.0)	296.2	(2,140.6)

Cash and short term borrowings

	Cash at bank		Short term borrowings		Net total £m	Cash (at bank and overdrafts) £m
	£m	Overdrafts £m	Other £m	Total £m		
At 1 April 1995	16.8	(1.5)	(56.7)	(58.2)	(41.4)	15.3
Exchange adjustments	–	–	(4.0)	(4.0)	(4.0)	–
Acquisitions and disposals	–	–	(39.4)	(39.4)	(39.4)	–
Cash flow	23.3	(9.0)	(870.4)	(879.4)	(856.1)	14.3
At 1 April 1996	40.1	(10.5)	(970.5)	(981.0)	(940.9)	29.6
Exchange adjustments	–	–	6.9	6.9	6.9	–
Cash flow	(10.7)	(24.0)	79.8	55.8	45.1	(34.7)
At 1 April 1997	29.4	(34.5)	(883.8)	(918.3)	(888.9)	(5.1)
Exchange adjustments	(1.1)	–	1.9	1.9	0.8	(1.1)
Cash flow	(16.4)	11.8	(40.1)	(28.3)	(44.7)	(4.6)
At 31 March 1998	11.9	(22.7)	(922.0)	(944.7)	(932.8)	(10.8)

Notes to the accounts

35 Summary of differences between UK and US Generally Accepted Accounting Principles

The Group's consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United Kingdom (UK GAAP), which differ in certain respects from generally accepted accounting principles in the United States (US GAAP). Differences which have a significant effect on the consolidated net income and shareholders' equity of the Group are set out below. While this is not a comprehensive summary of all differences between UK and US GAAP, other differences would not have a significant effect on the consolidated net income or shareholders' equity of the Group.

(a) **Pensions**

Under UK and US GAAP, pensions costs are determined on a systematic basis over the length of service of employees. US GAAP is more prescriptive in the application of the actuarial method, actuarial assumptions to be applied in the calculation of pensions costs and the allocation of costs to accounting periods.

(b) **Infrastructure renewals costs**

Under UK GAAP, the Group's expenditure on maintaining the operating capability of the network of water and wastewater systems is charged as an operating cost. Under US GAAP, the enhancement element of the cost is capitalised and depreciated in accordance with the paragraph below. The repair element of the cost is expensed as incurred.

The timing of the investment programme and other operational considerations may result in uneven patterns of infrastructure renewals expenditure. Under UK GAAP, charges to the profit and loss account are adjusted by way of accruals or prepayments, as appropriate, to take account of any significant fluctuations between actual and planned expenditure. Under US GAAP, repair costs are expensed as incurred.

(c) **Depreciation of infrastructure assets**

Depreciation is not provided on infrastructure assets in the Group's consolidated financial statements prepared under UK GAAP because the network of systems is required to be maintained in perpetuity and therefore has no finite economic life. Expenditures on maintaining the operating capability of the network in accordance with defined standards of service are charged as an operating cost. Under US GAAP, depreciation is required to be charged on all assets, excluding land, and infrastructure assets are written off in equal annual instalments over a period of 100 years, being the estimated economic life under US GAAP.

(d) **Restructuring and integration costs**

Under UK GAAP, when a decision has been taken to restructure part of a group's business, provisions are made for the impairment of asset values together with severance and other costs. US GAAP requires a number of specific criteria to be met before such costs can be recognised as an expense. Among these is the requirement that all the significant actions arising from a restructuring and integration plan and their expected completion dates must be identified by the balance sheet date.

(e) **Capitalisation of interest**

Under UK GAAP, the capitalisation of interest is not required. Under US GAAP, interest is required to be capitalised on qualifying assets during the time required to prepare them for their intended use. The capitalised interest should be amortised over the life of the asset.

(f) **Goodwill**

Under UK GAAP, the Group writes off goodwill arising on acquisitions against retained earnings in its consolidated balance sheet in the year of acquisition. Under US GAAP, goodwill is capitalised on the balance sheet and amortised by charges against income over its estimated useful life, not to exceed 40 years. For US GAAP, goodwill has been amortised over periods varying between 20 and 40 years.

Under UK GAAP, the profit or loss on disposal of all or part of a previously acquired business is calculated after taking account of the gross amount of any goodwill previously eliminated directly against reserves.

Under US GAAP, an adjustment to profit or loss on disposal is required in respect of goodwill previously amortised.

In addition the US/UK GAAP adjustments set out in this section apply to the calculation of goodwill on acquisition. Accordingly, adjustments have been made to reflect these differences.

(g) **Retail and generation results**

As part of the acquisition of NORWEB plc in November 1995, the Group undertook a strategic review of its existing and recently acquired operations. As a consequence of this review, the Group identified that the newly acquired retail and generation operations would not form part of the future activities of the Group and would be sold. The fair value exercise completed after the acquisition, and updated during the year ended 31 March 1997 in accordance with UK GAAP, adjusted the value of the assets held to the amounts realised on disposal (see note 13). The transaction to dispose of the retail business was completed in November 1996. This transaction resulted in a downward adjustment in the value of the assets of £100.2 million which resulted in a corresponding increase in goodwill. The disposal of the vast majority of the generation business occurred in two separate transactions. In the first transaction, the terms and conditions were agreed by letter in November 1996 and completed in March 1997. This transaction resulted in an upward adjustment in the value of the assets of £43.3 million and a corresponding decrease in goodwill. The substantial terms under which the remaining part of the generation business was sold were agreed in the fourth quarter of fiscal year 1997 and resulted in an upward adjustment in the value of assets of £6.7 million and a corresponding decrease in goodwill. For US GAAP, the adjustments to the value of

Notes to the accounts

assets resulting from these transactions were treated as adjustments to goodwill. For US GAAP, the operating results of these businesses have been eliminated from net income.

Under UK GAAP, the profit and loss accounts of operations acquired in a business combination are consolidated unless plans to dispose of those businesses are sufficiently well progressed to require such businesses to be shown as current asset investments. Under US GAAP, those profit and loss accounts would not be consolidated and the cash flows from those operations to be disposed of would be considered in the purchase price allocation. The difference between the carrying value of those operations to be disposed of at the date of sale and the proceeds from the sale result in a reallocation of the purchase price.

There was no significant difference between the profit or loss generated by these businesses during the holding period and the earnings received or losses funded by the Group during that period.

(h) Deferred taxes

Under UK GAAP, deferred taxes are accounted for to the extent that it is considered probable that a liability or asset will crystallise in the foreseeable future. Under US GAAP, deferred taxes are accounted for on all timing differences and a valuation allowance is established in respect of those deferred tax assets where it is more likely than not that some portion will remain unrealised. Deferred tax also arises in relation to the tax effect of the other US GAAP adjustments.

The change in the rate of UK corporation tax from 1 April 1997, reduced to 31 per cent from 33 per cent, resulted in a £49.6 million reduction in the opening deferred tax liability under US GAAP.

(i) Ordinary dividends

Under UK GAAP, the proposed dividends on ordinary shares, as recommended by the directors, and the associated advance corporation tax payable are deducted from shareholders' equity and shown as a liability in the balance sheet at the end of the period to which they relate. Under US GAAP, such dividends are only deducted from shareholders' equity at the date of declaration of the dividend.

(j) ESOP adjustment

Under UK GAAP, shares acquired by a company-controlled Employee Share Ownership Plan (ESOP) are included in the balance sheet as an asset. Finance costs and administrative expenses incurred in relation to the ESOP are charged to the profit and loss account as they accrue. Provision is made through the profit and loss account for any permanent diminution in value of shares owned by the ESOP. Under US GAAP, shares acquired by a company-controlled ESOP are considered to be treasury stock and recorded as a reduction in shareholders' equity. The Norweb ESOP was discontinued in the year and no longer holds any shares (see note 24).

(k) Earnings per share (EPS)

Under UK GAAP, primary EPS is based on the weighted average number of ordinary shares outstanding during the period. Earnings per share is the profit in pence attributable to each equity share, based on the profit of the period after tax, minority interests and extraordinary items, divided by the number of equity shares in issue and ranking for dividend in respect of the period. This method is also used for basic EPS under US GAAP. In the UK, it is acceptable to disclose an additional earnings per share provided that it is calculated on a consistent basis over time. The adjustment to profit and earnings per share has been made to eliminate the impact of 'non-recurring' items and, by the adjustment for the results of divested businesses, to disclose the underlying earnings of continuing operations.

Under US GAAP, diluted earnings per share must also be disclosed. This is based on net income, and computed using the weighted average number of ordinary shares outstanding and the dilutive effect of all share options and ordinary share equivalents under the treasury stock method.

Under UK GAAP, the weighted average number of ordinary shares in issue during the year should exclude the shares held by the ESOP trust in respect of which dividends have been waived. Under US GAAP, all shares held by a non-leveraged ESOP should be treated as outstanding in computing earnings per share. As the number of shares held by the Norweb ESOP trust was approximately 300,000 in 1997 and 1996, of a total issued share capital of approximately 530 million and 523 million in 1997 and 1996 respectively, such shares have not been included in the weighted average number of shares outstanding because the impact on earnings per share would be immaterial. The ESOP was discontinued in the year and no longer holds any shares.

Earnings per share computed in accordance with US GAAP has been based on the following number of shares:

	1998 Number (in millions)	1997 Number (in millions)	1996 Number (in millions)
Weighted average number of shares under US GAAP – basic EPS	534.7	524.8	434.3
Common stock equivalents – dilutive share options	–	3.5	3.9
Weighted average number of shares under US GAAP – diluted EPS	534.7	528.3	438.2

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(l) Effect on net income of differences between UK and US GAAP

For the year ended 31 March	Note	1998 £m	1997 £m	1996 £m
Net income in accordance with UK GAAP		30.1	235.4	224.4
US GAAP adjustments:				
Pension costs	35(a)	(4.7)	(15.8)	(10.7)
Infrastructure renewals costs	35(b)	3.9	(26.1)	(0.3)
Depreciation of infrastructure assets	35(c)	(16.6)	(14.9)	(13.8)
Restructuring and integration costs	35(d)	(55.6)	(46.5)	81.5
Capitalisation of interest	35(e)	55.1	43.9	36.8
Amortisation of capitalised interest	35(e)	(5.9)	(4.2)	(3.4)
Amortisation of goodwill	35(f)	(28.9)	(34.6)	(18.6)
Goodwill disposed of on sale of businesses	35(f)	–	35.5	0.6
Retail and generation results	35(g)	–	8.4	(14.8)
Deferred taxes	35(h)	(62.7)	(108.6)	(53.8)
Income taxes on US GAAP adjustments	35(h)	11.8	21.2	(42.0)
Net (loss)/income in accordance with US GAAP		(73.5)	93.7	185.9
Net (loss)/income from continuing operations in accordance with US GAAP		(81.7)	176.9	237.7
Net profit/(loss) of discontinued operations in accordance with US GAAP		8.2	(83.2)	(51.8)
Net (loss)/income per £1 ordinary share (pence) in accordance with US GAAP basic method from:				
Continuing operations		(15.2)	33.7	54.7
Discontinued operations		1.5	(15.9)	(11.9)
Total	35(k)	(13.7)	17.8	42.8
Net (loss)/income per £1 ordinary share (pence) in accordance with US GAAP diluted method from:				
Continuing operations		(15.2)	33.4	54.2
Discontinued operations		1.5	(15.7)	(11.8)
Total	35(k)	(13.7)	17.7	42.4

(m) Cumulative effect on shareholders' equity of differences between UK and US GAAP

At 31 March	Note	1998 £m	1997 £m
Shareholders' equity in accordance with UK GAAP	24	2,045.5	2,141.9
US GAAP adjustments:			
Pensions	35(a)	(51.2)	(46.5)
Infrastructure renewals costs	35(b)	55.8	51.9
Depreciation of infrastructure assets	35(c)	(107.4)	(90.8)
Restructuring provisions	35(d)	23.1	78.7
Capitalisation and amortisation of interest	35(e)	250.7	201.5
Goodwill	35(f, g)	1,099.8	1,128.7
US GAAP adjustments on goodwill calculation	35(f)	50.4	50.4
Deferred taxes	35(h)	(598.1)	(535.4)
Income taxes on US GAAP adjustments	35(h)	(68.9)	(80.7)
Dividends	35(i)	158.0	133.5
ESOP	35(j, k)	–	(1.7)
Shareholders' equity in accordance with US GAAP		2,857.7	3,031.5

Notes to the accounts

(n) Classification differences between UK and US GAAP

Provisions for liabilities and charges

Provisions for liabilities and charges under UK GAAP include £70.4 million (1997 – £117.2 million) which are due within one year and which would be reclassified to current liabilities under US GAAP. The remainder of the provisions would be reclassified as long term liabilities under US GAAP.

Businesses held for resale

Under UK GAAP, if certain criteria regarding the time between acquisition and anticipated disposal are met, the assets and liabilities of businesses held for resale may be classified as current asset investments. If these criteria are not met, the assets and liabilities should be disclosed within the statutory headings. Under US GAAP, the net assets of such businesses would be re-classified as a current asset investment.

The businesses held for resale at 31 March 1997 were retail and generation, and the relevant net assets are included in the consolidated balance sheet as follows. As long term borrowings are not allocated specifically to businesses, it should be noted that no reclassification of these balances has been made.

	1998			1997			1996		
	Retail £m	Generation £m	Total £m	Retail £m	Generation £m	Total £m	Retail £m	Generation £m	Total £m
Current assets	–	–	–	–	13.4	13.4	148.0	6.3	154.3
Non-current assets	–	–	–	2.1	38.8	40.9	98.7	58.1	156.8
Current liabilities	–	–	–	(20.8)	(26.5)	(47.3)	(20.4)	(16.2)	(36.6)
Net assets/(liabilities)	–	–	–	(18.7)	25.7	7.0	226.3	48.2	274.5

Grants

Under UK GAAP, grants are disclosed within deferred grants and contributions as creditors in the balance sheet. Under US GAAP, these amounts would be set against the assets to which they relate, and £193.5 million (1997 – £183.4 million) would be reclassified from long term liabilities to tangible fixed assets.

Exceptional items

Under UK GAAP, profits on disposal of businesses may be disclosed as exceptional items, after operating profit.

Under US GAAP, all exceptional items would have been reflected within operating profit. In 1998, a profit of £6.8 million (1997 – loss of £77.1 million; 1996 – profit of £7.2 million) would have been included within operating profit.

(o) Cash flows

Under UK GAAP, the Group complies with Financial Reporting Standard 1 (Revised) Cash Flow Statements (FRS 1), the objective and principles of which are similar to those set out in Statement of Financial Accounting Standards No. 95 'Statement of Cash Flows' (SFAS 95). The principal difference between the two standards is in respect of classification. Under FRS 1 (Revised), the Group presents its cash flows for (a) operating activities; (b) returns on investments and servicing of finance; (c) taxation; (d) capital expenditure and financial investment; (e) acquisitions and disposals; (f) dividends to ordinary shareholders; (g) management of liquid resources; and (h) financing activities. SFAS 95 requires only three categories of cash flow activity (a) operating; (b) investing; and (c) financing.

Cash flows arising from taxation and returns on investments and servicing of finance under FRS 1 (Revised) would be included as operating activities under SFAS 95; dividend payments would be included as a financing activity under SFAS 95 and cash flows from capital expenditure, long term investments, acquisitions and disposals would be included as investing activities under SFAS 95. In addition, under FRS 1 (Revised), cash represents cash at bank and in hand less bank overdrafts; cash equivalents (i.e. liquid resources) are not included with cash. Movements of liquid resources are included under a separate heading. Under US GAAP, cash and cash equivalents are not offset by bank overdrafts repayable within twenty four hours from the date of the advance. Such overdrafts are classified within financing activities under US GAAP.

Set out below, for illustrative purposes, is a summary consolidated statement of cash flows under US GAAP:

	1998 £m	1997 £m	1996 £m
Net cash provided by operating activities	235.5	427.5	169.3
Net cash used in investing activities	(646.0)	(159.5)	(1,343.0)
Net cash provided/(used) by financing activities	394.1	(278.7)	1,197.0
Effect of exchange rate changes on cash	(1.1)	–	–
Net (decrease)/increase in cash and cash equivalents	(17.5)	(10.7)	23.3
Cash and cash equivalents at beginning of year	29.4	40.1	16.8
Cash and cash equivalents at end of year	11.9	29.4	40.1

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36 Additional US GAAP disclosures

(a) Deferred tax

The components of the estimated net deferred tax liability that would be recognised under US GAAP are as follows:

	1998 £m	1997 £m
Deferred tax liabilities:		
Accelerated tax allowances	942.1	977.6
Deferred tax assets:		
ACT recoverable	(138.9)	(201.7)
Operating losses	(20.2)	(27.6)
Other temporary differences	(133.6)	(132.2)
	(292.7)	(361.5)
Less valuation allowance	17.6	-
	(275.1)	(361.5)
Net deferred tax liability	667.0	616.1
Of which all relates to the United Kingdom:		
Current	(275.1)	(361.5)
Non current	942.1	977.6
	667.0	616.1

£2.6 million of operating losses carried forward and advance corporation tax recoverable have no expiration dates and will be offset against future taxable profits.

The remaining components of the deferred tax assets are primarily short term timing differences.

Management consider that it is more likely than not that the results of future operations will generate sufficient taxable income to realise the deferred tax assets.

(b) Pension disclosures

The net periodic pension cost under Statement of Financial Accounting Standards No. 87 'Employers' Accounting for Pensions' (SFAS 87) is as follows:

	1998 £m	1997 £m	1996 £m
Service cost	26	26	20
Interest cost	98	96	62
Actual return on assets	(341)	(132)	(220)
Net amortisation and deferral	234	35	165
Net periodic pension cost	17	25	27
Termination benefits	9	17	3
Curtailement	-	-	1
Acquisition impact	-	-	(13)
Employer contributions	(26)	(27)	(28)
Increase/(Decrease) in accrual	-	15	(10)

The assumptions used for the SFAS 87 calculations are as follows:

	1998 %	1997 %	1996 %
Discount rate	7.75	8.50	8.75
Salary growth	5.75	6.50	6.75
Long term return on assets	8.50	8.50	8.50
Pension increases	4.00	4.50	5.00

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The funded status of the plans under SFAS 87 is as follows:

	1998 £m	1997 £m
Vested benefit obligation	(1,434)	(1,127)
Accrued benefit obligation	(1,434)	(1,127)
Projected benefit obligation	(1,513)	(1,264)
Plan assets	1,722	1,418
Excess plan assets over projected benefit obligation	209	154
Unrecognised transition obligation	12	14
Unrecognised prior service cost	6	-
Other unrecognised gain	(252)	(193)
Accrued pension cost under US GAAP	(25)	(25)

(c) Stock compensation

In October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 'Accounting for Stock-Based Compensation' (SFAS 123), which encouraged the use of a fair value based method of accounting for compensation expense associated with stock options and similar plans. For US GAAP purposes, the company has elected to continue to use the intrinsic value based method prescribed by Accounting Principles Board Opinion No. 25 'Accounting for Stock Issued to Employees', as permitted by SFAS 123. SFAS 123 requires additional disclosures, including pro forma calculations of net earnings and earnings per share as if the fair value method of accounting prescribed by SFAS 123 had been applied in 1998, 1997 and 1996. The pro forma data presented below is not representative of the effects on reported amounts for future years, since SFAS 123 does not apply to awards prior to 1995 and additional awards are expected in the future.

	1998		1997		1996	
	As reported	Pro forma	As reported	Pro forma	As reported	Pro forma
Profit after tax (£ million)	30.1	26.6	235.4	234.6	224.4	224.1
Average shares outstanding (millions)	534.7	534.7	524.8	524.8	434.3	434.3
Earnings per share (pence)	5.6	5.0	44.9	44.7	51.7	51.6
Average fair values of grants during the year (£)	-	1.56	-	1.23	-	1.47
Black Scholes option pricing models assumptions:						
Risk free interest rate		6.6%-7.5%		7.6%-8.1%		7.4%-7.6%
Expected life (years)		3-10		3-10		3-10
Volatility		21%		21%		23%

The additional information required by paragraph 47(a) of SFAS 123 is set out below:

	1998		1997		1996	
	No (m)	Price (p)	No (m)	Price (p)	No (m)	Price (p)
Outstanding at beginning of year	12.9	459	11.2	404	11.5	366
Adjustment for rights issue	-	-	-	-	0.3	-
Granted during the year	3.3	647	5.3	502	2.0	510
Exercised during the year	(1.9)	393	(3.1)	335	(1.7)	302
Forfeited during the year	(2.5)	475	(0.5)	434	(0.9)	366
Outstanding at end of year	11.8	519	12.9	459	11.2	404
Exercisable at end of year	1.3	458	2.9	396	1.7	365

The rights issue in 1996 gave rise to adjustments in both the number and price of options outstanding at the date of the rights issue.

No options lapsed during any of the years under review.

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(d) Discontinued operations

During the years ended 31 March 1998 and 1997, the Group sold its investment in the process equipment businesses. During the year ended 31 March 1996, the Group sold its contracting businesses. The results of these operations under US GAAP are shown below.

For US GAAP purposes, the trading results of the retail and generation disposals are eliminated from the income statement.

	1998 £m	1997 £m	1996 £m
Revenue	-	106.8	180.5
Net operating costs	-	(120.5)	(197.4)
Operating loss before exceptional items		(13.7)	(16.9)
Profit/(Loss) on disposal of businesses	2.9	(42.5)	-
Operating profit/(loss) after exceptional items	-	(56.2)	(16.9)
Income from investments in associated undertakings	-	-	11.3
Profit/(Loss) on ordinary activities before interest	2.9	(56.2)	(5.6)
Net interest payable	-	(11.7)	(14.1)
Profit/(Loss) on ordinary activities before taxation	2.9	(67.9)	(19.7)
Taxation on profit on ordinary activities	-	(15.3)	(32.1)
Profit/(Loss) for financial year	2.9	(83.2)	(51.8)

(e) Recent US accounting pronouncements

SFAS 130 – Reporting Comprehensive Income.

Statement of Financial Accounting Standards No. 130 'Reporting Comprehensive Income' (SFAS 130) was issued in June 1997 and is effective for fiscal years beginning after 15 December 1997. Reclassification of financial statements for earlier periods provided for comparative purposes is required. It requires that all items that are required to be recognised under accounting standards as components of comprehensive income should be reported in a financial statement that is displayed with the same prominence as other financial statements. It requires that an enterprise (a) classify items of other comprehensive income by their nature in a financial statement and (b) display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of a statement of financial position. The Group does not believe that adopting SFAS 130 will have a material impact on its financial statements.

SFAS 131 – Disclosure about Segments of an Enterprise and Related Information

Statement of Financial Accounting Standards No. 131 'Disclosure about Segments of an Enterprise and Related Information' (SFAS 131) was issued in June 1997 and is effective for fiscal years beginning after 15 December 1997. In the initial year of application, comparative information for earlier years is to be restated. It requires that companies disclose segment data based on how management makes decisions about allocating resources to segments and measuring their performance. It also requires entity-wide disclosures about the products and services an entity provides, the material countries in which it holds assets and reports revenues and its major customers. The Group does not believe that adopting SFAS 131 will have a material impact on its financial statements.

SFAS 132 – Pension and other postretirement benefit disclosures

In February 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 132 'Employers' Disclosure About Pensions and other Postretirement Benefits' (SFAS 132). SFAS 132 revises disclosure requirements about employers' pension and other postretirement benefit plans. SFAS 132 is effective for financial periods beginning after 15 December 1997. The Group has not determined the impact that SFAS 132 will have on its pension and other postretirement benefit disclosures.

Five year summary

	1994 £m	1995 £m	1996 £m	1997 £m	1998 £m
Profit and loss accounts					
Turnover	924	1,012	1,839	2,377	2,150
Net operating costs	(600)	(671)	(1,511)	(1,884)	(1,547)
Operating profit	324	341	328	493	603
(Loss)/Income from investments in associated undertakings	(2)	4	13	–	(1)
(Loss)/Profit on disposal of businesses	–	(14)	7	(77)	6
Net interest payable and other similar charges	(53)	(47)	(75)	(132)	(141)
Profit on ordinary activities before taxation	269	284	273	284	467
Tax on profit on ordinary activities	(9)	(25)	(48)	(48)	(24)
Profit on ordinary activities after taxation	260	259	225	236	443
Exceptional taxation – windfall tax	–	–	–	–	(415)
	260	259	225	236	28
Minority interest	–	–	–	(1)	2
Profit for financial year	260	259	225	235	30
Dividends	(86)	(94)	(164)	(195)	(229)
Transfer to/(from) reserves	174	165	61	40	(199)
Balance sheets					
Fixed assets	2,860	3,103	4,528	4,884	5,413
Net current assets/(liabilities)	40	(13)	(858)	(1,077)	(1,405)
Creditors falling due after more than one year	(788)	(790)	(1,268)	(1,235)	(1,682)
Provisions for liabilities and charges	(61)	(54)	(410)	(429)	(282)
Net assets	2,051	2,246	1,992	2,143	2,044
Equity share capital and share premium	373	380	1,138	1,152	1,178
Reserves and retained profits	1,678	1,866	854	990	867
Minority interest	–	–	–	1	(1)
Capital employed	2,051	2,246	1,992	2,143	2,044

Shareholder information

Financial calendar

The 1998 annual general meeting will be held on Friday, 24 July 1998 at 10.30 am at the Bridgewater Hall, Manchester. The notice of meeting and explanatory notes about the resolutions to be proposed are set out in the leaflet enclosed with this report.

Other forthcoming events are:

- payment of interest on the unsecured floating rate loan notes, on 18 September 1998;
- announcement of the half year results, in November 1998;
- payment of interest on the unsecured floating rate loan notes, on 18 March 1999;
- payment of the 1998 final dividend, on 6 April 1999;
- payment of the 1999 interim dividend, on 6 April 1999;
- preliminary announcement of the full year results, in May 1999;
- publication of the annual report and accounts and the annual review and summary financial statement, in June 1999; and
- the annual general meeting, in July 1999.

About your shareholding

If you wish to enquire about or need any information about your shareholding, please contact the company's registrar, Lloyds Bank Registrars, 54 Pershore Road South, Kings Norton, Birmingham B30 3EP (telephone: 0121 433 8000), quoting reference number 813. If you have received more than one copy of this annual report, there may be more than one account in your name on the company's register of members. To amalgamate your holdings, please contact the registrar giving details of the accounts concerned and how you wish them to be amalgamated.

Payment of dividends by BACS

Payment of the company's dividends direct to a shareholder's bank or building society account is made through the BACS (Bankers' Automated Clearing Service) system. The benefit to shareholders is that tax vouchers are sent direct to them rather than to their bank or building society. If you have not already arranged to have your dividends paid direct to your bank or building society account and would like to do so, please contact the company's registrar, at the address given above.

Personal equity plans

Details about the United Utilities single company and corporate personal equity plans are available from the Plan Manager, Halifax Investment Services Limited, Trinity Road, Halifax HX1 2RG (telephone: 0800 371769).

American depositary receipts

United Utilities ordinary shares are listed on the New York Stock Exchange in the form of American depositary shares (ADSs), evidenced by American depositary receipts, and trade under the symbol UU. Each ADS represents two ordinary shares. The Bank of New York is the depositary and their address for enquiries is The Bank of New York, Shareholder Relations, PO Box 11258, Church Street Station, New York NY 10286-1258 (telephone: 1 (888) BNY-ADRS (US toll free) and outside the US, 212-815-5204).

Publications

American depositary receipt holders may obtain a copy of the annual report on form 20-F, which must be filed with the Securities and Exchange Commission in the US, from the depositary. Other shareholders may obtain a copy from Jane Lawton, Compliance Manager, at the Group Corporate Centre, Birchwood Point Business Park, Birchwood Boulevard, Birchwood, Warrington WA3 7WB (telephone: 01925 285000).

In addition to this annual report which deals with the Group's activities overall, we produce other reports, leaflets and factsheets dealing in greater detail with particular activities or aspects of our business. For further information, please contact John Drummond, Group Director of Communications, at Dawson House, Great Sankey, Warrington WA5 3LW (telephone: 01925 234000).

Copies of the separate regulatory accounts for the year ended 31 March 1998 for North West Water and for Norweb, which are filed respectively with the Director General of Water Services and the Director General of Electricity Supply, are available free of charge. If you would like copies, please contact Jane Lawton.

Web site

Further information about United Utilities can also be found on our Web site at <http://www.unitedutilities.com>.

Unsolicited mail

The law obliges the company to make its register of members available to other organisations. Because of this, you may receive mail you have not asked for. If you wish to limit the amount of personally addressed unsolicited mail you receive, please write for information and an application form to the Mailing Preference Service, Freepost 22, London W1E 4EZ.

Glossary

Term used in annual report	US equivalent or brief description
Accounts	Financial statements
Acquisition accounting	Purchase accounting
Advance corporation tax	No direct US equivalent. Tax paid on company distribution recoverable from UK taxes due on income
Allotted	Issued
Associated undertaking	20 – 50% owned investee
Called-up share capital	Ordinary shares, issued and fully paid
Capital allowances	Tax term equivalent to US tax depreciation allowances
Class of business	Industry segment
Closing rate method	Current rate method
Creditors	Accounts payable/payables
Creditors: amounts falling due after more than one year	Long term debt liabilities
Creditors: amounts falling due within one year	Current liabilities
Debtors	Accounts receivable/receivables
Depreciation	Amortisation
Finance lease	Capital lease
Employee share option	Employee stock option
Equity shareholders' funds	Stockholders' equity
Financial year	Fiscal year
Fixed asset investments	Long term investments
Freehold	Ownership with absolute rights in perpetuity
Freehold land	Land owned
Gearing	Leverage
Group, or consolidated, accounts	Consolidated financial statements
Interest receivable	Interest income
Interest payable	Interest expense
Loan capital	Long term debt
Net asset value	Book value
Nominal value	Par value
Ordinary share	Common stock/share
Pension scheme	Pension plan
Profit	Income (or earnings)
Profit and loss account (reserve)	Retained earnings
Profit and loss account	Income statement
Reconciliation of movements in equity shareholders' funds	Statement of changes in stockholders' equity
Reserves	Stockholders' equity other than capital stock
Share capital	Ordinary shares, capital stock or common stock issued and fully paid
Share premium account	Premiums paid in excess of par value
Shares in issue	Shares outstanding
Stocks	Inventories/operating stocks
Tangible fixed assets	Property, plant and equipment
Turnover	Revenues (or sales)