

WESSEX WATER SERVICES LTD

Accounts for the nine months to
31 December 1998

Registered in England and Wales No. 2366648

*Wessex
Water*



DIRECTORS' REPORT

The directors present their report and the audited accounts for the nine months to 31 December 1998. As explained in the operational review the parent company Wessex Water Plc was acquired in the period by Enron Corp. and as a result the year end of 31 March was changed to 31 December.

PRINCIPAL ACTIVITIES

The main activities of the company are the supply of water and the treatment and disposal of waste water.

PROFIT AND DIVIDEND

The profit for the period after taxation was £73.5m. An interim dividend of 29.50 pence per share was paid on 21 December 1998. The directors propose a final dividend of 30.73 pence per share.

OPERATIONAL REVIEW

The company has continued to provide an excellent service and high quality standards for customers. The last nine month period has been important for the company as it prepares for the review of customer charges to be effective from 1 April 2000, and ensures that it will have no problems with the millennium date change.

On 30 July 1998 an offer was made by Enron Corp. of Houston, Texas for the entire share capital of the company's parent company Wessex Water Plc. This offer was successful and became unconditional on 21 September 1998.

EMPLOYMENT

Wessex Water offers equal opportunities to all applicants for employment. Disabled people are considered for employment, training, career development and promotion on the basis of their aptitude and abilities, in common with all employees.

A high priority is given to employee communications which include team meetings, an employee newspaper, newsletters and conferences.

ENVIRONMENT POLICY

Wessex Water protects, conserves and improves the environment and operates in a socially responsible manner. Working practices are continually revised as improved techniques and technologies become available. The company has an environmental advisory panel and an environmental and sustainability charter. A separate sustainability report is prepared indicating the progress made in this area during the year.

RESEARCH AND DEVELOPMENT

The company carried out research and development in support of existing activities to improve the reliability and effectiveness of water and waste water services.

CHARITABLE DONATIONS

During the year £84k was donated to UK charities.

SUPPLIER PAYMENT POLICY

The company's policy in respect of its suppliers is to agree the payment terms for transactions in advance and to make payments in accordance with those terms. At 31 December 1998 trade creditors represented approximately 46 days trade purchases (31 March 1998 - 45 days).

YEAR 2000

Wessex Water is well advanced in its work to overcome the risks associated with the year 2000 date change. The year 2000 project, started in 1996, is working on three principal areas - operational systems, mainframe applications and desktop computers. This work includes close liaison with suppliers to address compliance issues associated with embedded logic in operational equipment. Controls have been in place for some time to ensure that purchases of new equipment are year 2000 compliant and compatible with existing systems.

Total additional costs of the year 2000 project are expected to be in the order of £10 million between 1996 and 2000.

DIRECTORS

The following were directors of the company during the nine months to 31 December 1998

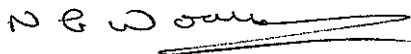
C F Skellett - Chairman	
S M Allen	Appointed 1 October 1998
L H Ames	
P A Barrett	Appointed 23 October 1998
Mrs L C Bennett	
C J Bishop	
Mrs E J Gawith	Resigned 1 October 1998
R N Hodge	Appointed 23 October 1998
W N Hood	
J G Jones	
Mrs K Morgan	Appointed 23 October 1998
P L M Sherwood	Appointed 27 October 1998
N A W Wheatley	

No directors had any interest in the shares of the parent company at 31 December 1998.

AUDITORS

Coopers & Lybrand resigned as the company's auditors on 1 December 1998 and Arthur Andersen were appointed as auditors on that day to fill a casual vacancy. A resolution for their appointment will be proposed at the Annual General Meeting.

By order of the board
N G Wooller
Company secretary
18 February 1999



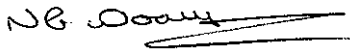
DIRECTORS' RESPONSIBILITIES

Company law requires the directors to prepare accounts for each financial year which give a true and fair view of the state of affairs of the company and of the company's profit or loss for the year. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts; and
- prepare the accounts on the going concern basis unless it is inappropriate to presume that the company will continue in business.

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

By order of the board
N G Wooller
Company secretary
18 February 1999



AUDITORS' REPORT TO THE MEMBERS OF WESSEX WATER SERVICES LTD

We have audited the accounts on pages 4 to 13, which have been prepared under the historical cost convention, and the accounting policies set out on pages 6 and 7.

Respective responsibilities of directors and auditors

As described on page 3 the company's directors are responsible for the preparation of the accounts. It is our responsibility to form an independent opinion, based on our audit, on those accounts and to report our opinion to you.

Basis of opinion

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

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

Opinion

In our opinion the accounts give a true and fair view of the state of the company's affairs at 31 December 1998 and of its profit for the nine months then ended and have been properly prepared in accordance with the Companies Act 1985.

Arthur Andersen
ARTHUR ANDERSEN
Chartered Accountants and Registered Auditors
1 Surrey Street
London
WC2R 2PS
18 February 1999

PROFIT AND LOSS ACCOUNT
For the nine months to 31 December 1998

	NOTE	9 months to 31.12.98 £m	12 months to 31.3.98 £m
Turnover	2	202.2	256.9
Operating profit	2, 3	112.5	139.2
Net interest payable	4	(21.9)	(23.5)
Profit on ordinary activities before taxation		90.6	115.7
Taxation on profit on ordinary activities	5	(17.1)	(22.3)
Profit attributable to shareholders		73.5	93.4
Dividends paid and proposed	7	(49.0)	(161.1)
Transfer to reserves	16	24.5	(67.7)

The company's turnover and operating profit were generated from continuing activities.

There were no recognised gains or losses in either period other than the profit for each period.


The accompanying notes are an integral part of this profit and loss account.

BALANCE SHEET
31 December 1998

	NOTE	31.12.98 £m	31.3.98 £m
Fixed assets			
Tangible assets	8	1,156.7	1,098.6
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Current assets			
Stock and work in progress	9	1.1	1.0
Debtors	10	67.1	50.4
		<hr/>	<hr/>
		68.2	51.4
Creditors - amounts falling due within one year	11	(537.2)	(477.8)
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Net current liabilities	22	(469.0)	(426.4)
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Total assets less current liabilities		687.7	672.2
Creditors - amounts falling due after more than one year	12	(93.8)	(102.9)
Provisions for liabilities and charges	13	(8.6)	(8.1)
Deferred income	14	(22.5)	(22.9)
<hr/>			
Net assets	2	562.8	538.3
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Capital and reserves			
Called up equity share capital	15	81.3	81.3
Profit and loss account	16	481.5	457.0
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Equity shareholders' funds	16	562.8	538.3
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The accompanying notes are an integral part of this balance sheet.

These accounts were approved by the board of directors on 18 February 1999 and signed on its behalf by:



N A W Wheatley
director

NOTES TO THE ACCOUNTS
For the nine months to 31 December 1998

1 Accounting policies

a. Basis of preparation

The accounts have been prepared under the historic cost convention and in accordance with applicable accounting standards in the United Kingdom and, except for the treatment of certain grants and contributions (see note 1e) in accordance with the Companies Act 1985. The company has adopted all applicable accounting standards up to and including FRS11, Impairment of Fixed Assets and Goodwill.

b. Turnover

Turnover represents income receivable in the ordinary course of business, excluding VAT, for services provided inclusive of transactions with other subsidiaries of Wessex Water Ltd.

c. Tangible fixed assets and depreciation

Tangible fixed assets comprise infrastructure assets and other assets.

i Infrastructure assets comprise a network of systems of mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines, sea outfalls and infrastructure investigations and studies. Expenditure on infrastructure assets relating to enhancements of the network is treated as additions which are included at cost after deducting connection charges and grants. Expenditure on maintaining the operating capability of the network in accordance with defined standards of service is charged as an operating cost. The timing of the expenditure may fluctuate from the planned service level, and consequently accruals or deferrals are made in respect of infrastructure renewals expenditure. No depreciation is charged on infrastructure assets because the network of systems is required to be maintained in perpetuity and therefore has no finite economic life.

ii Other assets include properties, plant and equipment and are shown at cost less accumulated depreciation. Freehold land is not depreciated. Other assets are depreciated evenly over their estimated economic lives, which are principally as follows:

Buildings and operational structures	15 - 80 years
Plant, machinery and vehicles	3 - 30 years
Other assets	4 - 15 years

d. Leased assets

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

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

e. Grants and contributions

Grants and contributions in respect of specific expenditure on non-infrastructure fixed assets are treated as deferred income and recognised in the profit and loss account over the expected useful economic lives of the related assets.

Grants and contributions relating to infrastructure assets have been deducted from the cost of those assets. This is not in accordance with the Companies Act 1985 which requires assets to be stated at their purchase price or production cost, without deduction of grants and contributions which would be accounted for as deferred income. The departure from the requirement of the Act is, in the opinion of the directors, necessary to give a true and fair view. This is because infrastructure assets are not depreciated and accordingly the related grants and contributions would not be recognised through the profit and loss account. The effect on the value of fixed assets is disclosed in note 8.

f. **Stock and work in progress**

Stock and work in progress are stated at the lower of cost and net realisable value. In respect of work in progress, cost includes labour, materials and attributable overheads.

g. **Foreign currency**

All transactions denominated in foreign currencies are translated into sterling at the actual rates of exchange ruling at the dates of the transactions. Foreign currency balances are translated into sterling at the rates of exchange ruling at the balance sheet date.

h. **Research and development**

Research and development expenditure is written off in the year in which it is incurred.

i. **Taxation**

The charge for taxation is based on the profit for the period adjusted in accordance with tax legislation. Tax deferred or accelerated is accounted for in respect of all material timing differences to the extent that it is probable that a liability or asset will crystallise. Timing differences arise from the inclusion of items of income and expenditure in tax computations in periods different from those in which they are included in the accounts. Provision is made at the rate which is expected to apply when the liability or asset crystallises.

j. **Pensions**

The cost of providing benefits is charged to the profit and loss account on a basis designed to spread the cost over the expected average service lives of employees. Differences between the amounts funded and amounts charged to the profit and loss account are treated either as provisions or prepayments in the balance sheet. The pension schemes are of the defined benefit type, which are externally funded and valued by an independent actuary.

k. **Cash flow**

Under the provisions of FRS1 (revised) the company has not prepared a cash flow statement because its parent undertaking, Azurix Europe Ltd, which is incorporated in England and Wales prepares consolidated accounts which include the accounts of the company and which contain a cash flow statement.

2 **Segmental analysis**

	9 months to	12 months to
	31.12.98	31.3.98
	£m	£m

Analysis by class of business

a. **Turnover**

Water supply	66.2	84.7
Waste treatment	135.5	171.5
Intra group income	0.5	0.7
	<u>202.2</u>	<u>256.9</u>

b. **Operating profit**

Water supply	30.5	35.1
Waste treatment	82.0	104.1
	<u>112.5</u>	<u>139.2</u>

Operating profit by class of business is determined after allocating central costs on the basis of estimated time spent on each class of business. Interest payable cannot be allocated to class of business.

c. **Net assets**

Water supply	189.3	180.5
Waste treatment	373.5	357.8
	<u>562.8</u>	<u>538.3</u>

	9 months to 31.12.98 £m	12 months to 31.3.98 £m
3 Operating profit		
a. Operating profit is shown after charging (crediting) the following items:		
Operational costs		
Manpower costs (note 6)	16.4	20.1
Materials and consumables	12.0	17.4
Other operational costs	27.9	37.8
	<u>56.3</u>	<u>75.3</u>
Depreciation		
Depreciation	24.8	30.6
Amortisation of grants and contributions	(0.6)	(0.7)
Loss on disposals of fixed assets	0.7	1.5
	<u>24.9</u>	<u>31.4</u>
Infrastructure renewals charge	8.5	11.0
	<u>89.7</u>	<u>117.7</u>
b. Operational costs include:		
Operating leases for plant and machinery	0.5	0.8
Other operating leases	0.3	0.3
Research and development	0.1	0.1
Directors' remuneration (note 6)	0.6	0.6
Audit fees	0.1	0.1
	<u>0.1</u>	<u>0.1</u>
4 Net interest payable		
Interest payable:		
On bank loans	(18.7)	(18.3)
On other loans	(0.3)	(0.4)
On finance leases	(3.9)	(6.5)
Total interest payable	<u>(22.9)</u>	<u>(25.2)</u>
Interest receivable	1.0	1.7
Net interest payable	<u>(21.9)</u>	<u>(23.5)</u>
Included in interest payable on loans is £12.8m (31.3.98 - £11.2m) payable to group companies.		
5 Taxation		
a. Taxation on profit on ordinary activities		
UK corporation tax at 31%	<u>17.1</u>	<u>22.3</u>
b. Deferred taxation		
No deferred tax has been provided as projections indicate that the potential liability will not crystallise within the foreseeable future. The full potential amount of deferred taxation calculated at 30% (31.3.98 - 31%) on all timing differences is as follows:		
Accelerated capital allowances	215.3	208.0
Other timing differences	(4.8)	(4.5)
	<u>210.5</u>	<u>203.5</u>
Included in accelerated capital allowances are timing differences on infrastructure assets.		

	9 months to 31.12.98 £m	12 months to 31.3.98 £m
6 Directors and employees		
a. Total employment costs of the company were:		
Wages and salaries	21.5	26.4
Social security costs	1.7	2.0
Other pension costs	2.4	2.4
	<u>25.6</u>	<u>30.8</u>
b. Total employment costs are charged as follows:		
Capital schemes	8.3	9.5
Infrastructure renewals expenditure	0.9	1.2
Manpower costs	16.4	20.1
	<u>25.6</u>	<u>30.8</u>
	9 months to 31.12.98 £000	12 months to 31.3.98 £000
c. Total directors' remuneration		
Fees	24	10
Salary	400	423
Bonuses	136	121
Benefits in kind	31	44
	<u>591</u>	<u>598</u>
Seven directors have benefits accruing under defined benefit pension schemes.		
d. Highest paid director		
Salary	119	112
Bonus	37	40
Benefits in kind	6	8
	<u>162</u>	<u>160</u>
The highest paid director had an accrued pension entitlement of £123,672 at 31 December 1998 (31.3.98 - £96,081).		
	31.12.98	31.3.98
e. Monthly average number of employees during the period:	<u>1,338</u>	<u>1,354</u>

7 Dividends

The dividend policy is to declare ordinary dividends of two thirds of the historic profit attributable to shareholders, subject to a current cost ordinary dividend cover of one, plus an amount equal to the charge for utility tax.

	9 months to 31.12.98 £m	12 months to 31.3.98 £m
Interim dividend of 29.50p on 81,350,000 ordinary shares (31.3.98 - nil)	24.0	-
Final dividend of 30.73p per share on 81,350,000 ordinary shares (31.3.98 - 76.46p)	25.0	62.2
	<u>49.0</u>	<u>62.2</u>
Special dividend of 121.54p per share on 81,350,000 ordinary shares	-	98.9
	<u>49.0</u>	<u>161.1</u>

The special dividend was the amount equal to the utility tax charge levied by the Inland Revenue on Wessex Water Plc (now known as Wessex Water Ltd). This dividend was paid on 1 December in 1997 and 1998.

8 **Tangible fixed assets**

	Freehold land & buildings	Infra- structure assets	Plant machinery & vehicles	Other assets	Payments on account & assets in course of construction	Total
	£m	£m	£m	£m	£m	£m
Cost						
At 1 April 1998	370.4	473.3	367.9	27.8	75.0	1,314.4
Additions	3.3	13.5	18.3	2.7	48.2	86.0
Transfers on commissioning	7.0	7.1	14.4	1.2	(29.7)	-
Disposals	(0.3)	-	(1.2)	(0.1)	(0.6)	(2.2)
Grants and contributions	-	(2.0)	-	-	-	(2.0)
At 31 December 1998	380.4	491.9	399.4	31.6	92.9	1,396.2
Depreciation						
At 1 April 1998	65.4	-	135.6	14.8	-	215.8
Provision for the period	4.6	-	17.2	3.0	-	24.8
Disposals	-	-	(1.0)	(0.1)	-	(1.1)
At 31 December 1998	70.0	-	151.8	17.7	-	239.5
Net book value						
At 31 December 1998	310.4	491.9	247.6	13.9	92.9	1,156.7
At 31 March 1998	305.0	473.3	232.3	13.0	75.0	1,098.6

Infrastructure assets comprise a network of systems of mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines, sea outfalls and infrastructure investigations and studies.

Other assets include furniture and fittings, laboratory and other equipment.

The net book value of assets held under finance leases is £82.3m (31.3.98 - £83.7m).

The depreciation charge for the nine months on assets held under finance leases is £1.4m (12 months to 31.3.98 - £1.9m).

The net book value of infrastructure assets at 31 December 1998 is stated after the deduction of grants and contributions amounting to £47.3m (31.3.98 - £45.3m) in order to give a true and fair view (note 1e).

Included in freehold land and buildings above is an amount of £6.3m (31.3.98 £6.3m) in respect of land which is not depreciated.

	31.12.98 £m	31.3.98 £m
9 Stock and work in progress		
Stock	0.4	0.3
Work in progress	0.7	0.7
	<u>1.1</u>	<u>1.0</u>
10 Debtors		
Amounts falling due within one year		
Trade debtors	35.5	24.1
Infrastructure renewals prepayment	3.5	2.2
Other debtors	5.7	4.1
Prepayments and accrued income	22.4	20.0
	<u>67.1</u>	<u>50.4</u>
11 Creditors - amounts falling due within one year		
Bank overdraft repayable on demand	31.6	44.7
Loans repayable	243.2	10.9
Obligations under finance leases	12.9	11.9
Trade creditors	9.6	4.2
Amounts owed to parent company	106.3	212.5
Dividend	25.0	111.6
Other creditors	0.6	0.5
Corporation tax	22.6	16.5
Taxation and social security	0.7	0.8
Accruals and deferred income	84.7	64.2
	<u>537.2</u>	<u>477.8</u>

Wessex Water Services Ltd has acted as guarantor for certain borrowing facilities and currency exchange agreements made available to other group companies. The terms of amounts owed to the parent company are interest at base rate plus one per cent, interest is settled monthly.

12 Creditors - amounts falling due after more than one year		
Loans repayable		
- within 1 - 2 years	3.2	3.2
- within 2 - 5 years	34.9	38.1
	<u>38.1</u>	<u>41.3</u>
Obligations under finance leases		
- within 1 - 2 years	15.2	14.0
- within 2 - 5 years	37.9	45.7
Other	2.6	1.9
	<u>93.8</u>	<u>102.9</u>

The interest rates on loans outstanding of £38.1m have been swapped into a mixture of fixed and floating rates through a combination of currency and interest rate swaps, the interest rates payable being between 5.16% and 8.46%. There is no exchange rate exposure under the currency swaps. The loans are fully repayable by 15 June 2002.

13 Provisions for liabilities and charges	1.4.98 £m	Provided £m	Utilised £m	31.12.98 £m
Pensions	5.2	0.6	0.1	5.7
Office relocation	2.9	0.2	0.2	2.9
	<u>8.1</u>	<u>0.8</u>	<u>0.3</u>	<u>8.6</u>

	31.12.98 £m	31.3.98 £m
14 Deferred income		
Grants and contributions		
At 1 April	22.9	23.5
Received in the period	0.2	0.1
Less amortisation	(0.6)	(0.7)
At 31 December (31 March)	<u>22.5</u>	<u>22.9</u>
15 Called up share capital		
Ordinary shares of £1 each: Authorised, allotted, called up and fully paid	<u>81.3</u>	<u>81.3</u>
16 Profit and loss account and shareholders' funds	Profit & loss account £m	Share- holders' funds £m
At 1 April 1998	457.0	538.3
Transfer to reserves	24.5	24.5
At 31 December 1998	<u>481.5</u>	<u>562.8</u>
17 Commitments		
a. Operating lease payments under leases on land and buildings due within the next year in respect of leases which expire:	31.12.98 £m	31.3.98 £m
Between 2 and 5 years	0.2	0.2
Over 5 years	0.2	0.2
	<u>0.4</u>	<u>0.4</u>
b. At 31 December 1998 the company had interest rate and currency instrument agreements outstanding with commercial banks with a principal value of £301.3m (31.3.98 - £60.0m).		
c. Capital expenditure contracted but not provided at 31 December 1998 was £78.3m (31.3.98 - £47.2m).		
18 Contingent liabilities		
There are no material contingent liabilities at 31 December 1998 for which provision has not been made in these accounts.		

19 Pensions

The defined benefit schemes, which cover the majority of staff, are the Wessex Water Pension Scheme (WWPS), the Wessex Water Mirror Image Pension Scheme (WWMIS), and the Wessex Water Executive Pension Scheme (WWEPS). The assets are held in separate trustee administered funds. The pension cost charged to the profit and loss account has been determined on the advice of independent qualified actuaries and is such as to spread the cost of pensions over the service lives of members of the schemes.

The total pension cost of the company, including amounts set aside for employees retiring early, was £2.4m (12 months to 31.3.98 - £4.1m).

The latest actuarial valuations for WWPS, WWMIS and WWEPS were undertaken as at 31 March 1996. The projected unit method was used for the WWPS valuation and the attained age method for the WWMIS and WWEPS valuations. The assumptions which have the most significant effect on the results of a valuation are those relating to the rate of return on investments and the rates of increase in salaries and pensions. It was assumed that the investment returns would be 8% per annum for all schemes, that salary increases would average 6% per annum in the WWPS and WWMIS, and 7.5% in the WWEPS, and that present and future pensions would increase at the rate of 3.75% per annum in the WWPS and WWEPS, and 4% per annum in the WWMIS. The same actuarial methods and assumptions were used for assessing pension costs. The market value of the WWPS assets as at 31 March 1996 was £84.8m, for WWMIS £33.9m and for WWEPS £1.6m. The valuation showed that the actuarial value of the assets at 31 March 1996 represented 103%, 110% and 105% of the actuarial value of the accrued benefits for the WWPS, WWMIS and WWEPS respectively.

The next actuarial valuation will be as at 31 December 1998.

20 Related parties

There are no related party transactions requiring disclosure in these accounts.

21 Ultimate parent company

The directors consider the ultimate parent company to be Azurix Corp., a Delaware corporation, and the consolidated accounts of this company will be available to the public from Enron Corp., 1,400 Smith Street, Houston, Texas, USA. Enron Corp. has an indirect 50% interest in Azurix Corp.

The smallest group into which the accounts of the company will be consolidated is that headed by Azurix Europe Ltd, and the consolidated accounts of this company will be available to the public from Companies House.

22 Going concern

The current liabilities of the company exceed its current assets. The directors have considered the financial position of the company and have concluded that it will be able to meet its liabilities as they fall due for the foreseeable future. For these purposes the foreseeable future is taken to mean a period of at least 12 months from the date of approval of these accounts.