

# **NORTHUMBRIAN WATER GROUP PLC**

**(FORMERLY SAFFRONSTREAM LIMITED)**

**REPORT AND FINANCIAL STATEMENTS FOR**

**THE PERIOD ENDED**

**31 MARCH 1997**



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## CHAIRMAN'S STATEMENT

Eighteen months have passed since Northumbrian Water became part of the Lyonnaise des Eaux group. They have been intensely busy months during which we have fashioned a new, enlarged single group from its previously separate parts. Whilst it has not been easy, and has meant much change for many people, we have achieved a sound organisational basis for the development and growth of our new Group. Most particularly, we have successfully merged Northumbrian Water Limited with North East Water plc, completed the acquisition from Lyonnaise Europe plc of Essex and Suffolk Water plc, and we have established our international company, Northumbrian Lyonnaise International Limited, to expand our water and waste water services in selected areas of the world.

The Board has agreed a new, tightly focused strategy: water, waste water and waste management are our specialist areas, supported by carefully selected aspects of related services. A newly-founded Group Research Centre will allow the operating companies to benefit from the latest research and development in the design and management of those pipes, valves and other structures hidden from view underground but on whose integrity so much of our business depends. We intend to stay ahead of our competitors by in-house research and searching out best practice world-wide.

We benefit from the many advantages of being part of a large group which, after the planned merger with Compagnie de Suez, will be one of the largest multi-national, multi-utilities in Europe. We look forward to providing essential public services to the towns and cities of the world.

Northumbrian Water Group may be part of a global group but we also hold a strong position within the North East and South East regions of England. As one of the largest companies in the North East, we play an important role in the region's economic and environmental health and prosperity. We work hard to help attract business and jobs to the area - two recent inward investors, the German company, Siemens, and the Korean company, Samsung, both rely heavily on large supplies of quality water - and, increasingly, we are working in partnership with our major industrial customers. The Tees Estuary Environmental Scheme, mentioned in greater detail later in the Managing Director's review, is an excellent example of this partnering.

Our Group faces some of the most challenging issues of our time: changing climate; increasing demand; tightly specified environmental standards; demanding product legislation; a new periodic review and a new government.

It is with considerable pride that we present an excellent set of results. By careful management and tight control of costs, we have produced excellent profits for reinvestment, for the benefit of customers and for dividends. We shall strive to continue those "best in class" results through the coming years.

**Professor Sir Frederick Holliday, *Chairman***

18 June 1997

## MANAGING DIRECTOR'S REVIEW

### GROUP OVERVIEW

First years are always challenging. Our first full year as a member of the Lyonnaise des Eaux group was one of considerable challenge, but also considerable achievement. At the beginning of the year we set a number of strategic performance targets. Despite the unavoidable disruption caused by the change of ownership, it is pleasing to report that our performance is in line with or ahead of all of those targets.

Northumbrian Water Group (NWG) is now focused on four distinct but inter-related businesses: the supply of water and waste water services within the UK, an international business in water and waste water management, a waste management business in the UK and a range of related services. We have narrowed our business focus to concentrate on those activities in which the Group has proven skills, and it is no coincidence that these are also business activities which fit well with Lyonnaise des Eaux's international strategy.

During the year we merged our two northern water companies, North East Water plc (NEW) and Northumbrian Water Limited (NWL), adopting the latter name for the new business. Our southern water company, Essex and Suffolk Water (ESW), completed a major programme to safeguard the quality of its water supplies and we also created a new business, Northumbrian Lyonnaise International Limited (NLI), to undertake the development of the Group's international operations. Finally, we have disposed of several smaller businesses which did not offer growth potential or strategic value to the new Group.

The financial and operational restructuring of the Group was completed during June 1996, with the private placement of 15% of the Group's ordinary shares, the sale of 20% to a joint venture between United Water Resources Inc and Lyonnaise Europe plc, and a successful £200m Eurobond issue.

Despite these dramatic changes, we have avoided distraction from the day to day operation of the business. Full credit for this must go to all employees at all levels. Understandably, these changes caused some apprehension at the beginning of the year, and I would like to thank everyone for their faith, trust and continued hard work.

These are the first published results for the 'new' Northumbrian Water Group, and the results include nine days from the 1995/96 financial year. Being the first year, there are no published figures for 1995/96, however, I have used proforma figures for 1995/96 for comparative purposes within this commentary. Group turnover for the period at £509.6m (1995/96: £512.2m) was £2.6m lower, despite increases in the major business areas, principally as a result of the disposal of a number of non-core activities. The large increase in interest payable, resulting from the bridging finance in the early months and the debt taken on as part of the financial restructuring, left profit before tax only marginally ahead of last year at £147.4m (1995/96: £144.3m). The increased level of capital expenditure and the disposal of the previous Group's leasing companies gave rise to a lower tax charge, as a result of which, profits for the financial period after tax amounted to £126.1m (1995/96: £111.2m). Net debt increased during the year to £530.7m, largely as a result of the financial restructuring and the high level of expenditure on capital of £183.6m and on infrastructure renewals of £30.8m. Shareholders' Funds at 31 March 1997 totalled £878.3m, with gearing at 60.4%.

### UK WATER

Northumbrian Water Group includes two UK Water companies; Northumbrian Water Limited provides water and sewerage services in North East England whilst Essex and Suffolk Water plc is a water supply company operating in the South of England.

## NORTHUMBRIAN WATER LIMITED

This has been an historic year for Northumbrian Water Limited. We merged the activities and operations of NWL and NEW, achieved record levels of service, surpassed previous compliance levels and began work on two of the region's biggest engineering projects.

The merger of the two companies, despite differences in size and culture, was managed smoothly. We instigated a radical restructuring programme, replacing the hierarchical structure with a team-centred system, generating greater efficiency and flexibility. The necessary reduction in staffing levels was achieved through voluntary severance. The success of the merger, and the success of the year as a whole, was due in large part to the commitment and professionalism of our employees.

### **Finance and performance**

The operating efficiencies gained from the enlarged company began to show through quicker than forecast. As a result, we were able to advance the promised price reduction, or 'merger discount', on the water element of our bills, agreed by Ofwat, by a full twelve months. This allowed the 2% discount initially scheduled for introduction by the financial year 1998/99 to be introduced in 1997/98.

The year's operating costs of £167.7m showed a decline in real terms compared with the combined costs of the former companies during 1995/96. Demand from customers on metered supply, mainly industry, remained high, with sales revenue for the year increasing overall to £329.3m.

All of this was achieved without detriment to our operating performance levels. With a water quality pass rate of 99.8%, we surpassed NWL's and NEW's previous records, and remain in the top of the 'league' of the UK privatised water companies. On the waste water side, out of 400 sewage treatment works, all but one met the Environment Agency's required standards.

### **Investment programme**

During the last year we managed to gear up our investment rate from a level of £98m in the previous year to £167m - an average investment of almost £1½m per day.

In July 1996, we invited Tony Blair (Leader of the Opposition at the time and now the Prime Minister) to drive the first of thousands of piles needed in the construction of our Regional Sludge Treatment Centre at Bran Sands on Teesside. This £70m project, the most advanced of its type in Europe, will convert much of the region's sewage sludge into dry pellets. The pellets will be sold on as a fuel, a fertiliser or for use in the construction industry. Due to open in 1998, the Centre will enable us to end the disposal of sludge at sea, in line with European Union and UK directives.

In the spring, work also started on the Tees Estuary Environmental Scheme. This £140m project - a unique partnership with Teesside industries - will divert sewage and industrial effluent, currently discharged into the river, to a central treatment plant, also at Bran Sands. When completed early in the next century, the plant will be one of the largest of its kind in Europe.

During the year we also completed sewage interceptor schemes at Seaham and Saltburn on the coast. These marked the final stages of NWL's six year, £150m coastal bathing water improvement programme.

## **Partnership with Industry**

Growth by partnership is one of the key areas of NWL's business strategy. We aim to work with industrial customers to develop water and waste water services which match their needs at a competitive price.

In addition to working with industry at Bran Sands, we also worked closely with Interconnection Systems Limited (ISL), the South Shields-based printed circuit board manufacturers. The company was looking to expand and had targeted sites in Scotland and Spain, hence we needed a competitive advantage. Entec UK designed a plant capable of recycling up to 80% of the company's water needs, thus reducing the water unit costs. This tipped the scale in North East England's favour. ISL decided to expand on its current site, thus creating much-needed jobs in an area of high unemployment.

In early 1997, the German microelectronics giant, Siemens, completed its £1 billion factory on North Tyneside. Siemens is one of several international companies which have decided to locate in the region, including Fujitsu and Samsung. Their choice of location was heavily dependent upon abundant, reliable, high quality supplies of water at a competitive price.

## **Domestic customers**

Despite the extremely dry year, we met the water needs of our 2.6 million domestic customers. Once again, the huge reserve in Kielder Water, which can be transferred to the major rivers in the region, proved its worth.

Written customer complaints were halved from the previous year to roughly 1.3 per 1000 connected properties. This means we continue our record of having the lowest number of written complaints of all water and sewerage companies. During the year we also introduced new customer service standards. These far exceed the statutory minimum requirements and are part of our continuing drive to improve customer benefits.

## **Future**

Despite the past year's successes, we will continue the drive towards further increases in efficiency. Already we have begun a three-year, £10m leakage reduction programme to bring the present level of 17% - itself well below the industry average - to 14% by the year 2000. As well as improving leakage detection and control, we are working with major customers on water efficiency programmes.

We have also started the first phase of a sewage treatment upgrading programme along the region's coastline. The outfall construction work is being carried out in partnership with the Dutch firm ACZ Van Oord and Montgomery Watson, which has allowed considerable savings.

Whilst our industry is becoming increasingly competitive, the opportunities for NWL have never been better. As part of the Lyonnaise group we have a tremendous bank of skills and technical expertise upon which to call. We too can be called upon and during the year NWL employees have worked with Lyonnaise companies in Malaysia, South Africa, New Zealand, France and Australia, to name but a few. These opportunities are set to increase.

## **ESSEX AND SUFFOLK WATER PLC**

It has also been a year of change and achievement for Essex and Suffolk Water plc (ESW). We completed the structural reorganisation of the business that we started during the previous year. All our operations are now much more customer-focused. We also completed the major part of our pesticide removal programme and have seen significantly improved water quality levels as a result. We now have key projects in place to meet the challenge of managing our critical water resources.

## **Finance and performance**

1996/97 produced another sound financial performance. Demand from metered customers remained steady with overall turnover for the year increasing to £104.5m (£100.2m in 1995/96). Despite the challenging weather conditions, we made significant efficiency gains and operating profit improved by £1.6m to £39m.

Efficiency savings on the investment programme meant we were able to keep price increases in April 1997 to a lower level than the maximum allowed by Ofwat.

We achieved a record water quality performance; 99.5% compliance. For the first time this puts us in the top category of UK water companies, clearly demonstrating the value of our investment programme over the last five years.

## **Investment programme**

Our major £92m pesticide removal programme, started five years ago, is now nearing completion. In September 1996, the new treatment works at Hanningfield was opened by HRH The Duke of Gloucester. This £54m pesticide and nitrate removal plant is one of the most advanced in Europe. Not so large, but no less important, was the project at Langford treatment works, completed in July 1996. The dramatic improvement in our water quality, detailed above, can largely be attributed to these two schemes.

The remaining works in this programme are on target to be completed ahead of the dates agreed with the Drinking Water Inspectorate.

## **Partnership with industry**

In 1995, we set up a dedicated team to work with our major industrial and commercial customers. Our resource problem in this region is a very real one, hence if we want to ensure security of supply, we need a better understanding of our customers' needs. Our team works with customers to analyse their water usage, monitor for leakage, introduce waste minimisation features and promote efficient operating systems.

## **Domestic customers**

Despite the exceptionally dry weather, no restrictions on use were imposed during the summer. Unfortunately, the winter saw no break in the trend of dry weather. The rate of reservoir refill in the critical period in the early part of 1997 has been sustained with the co-operation and support of the Environment Agency in the operation of the Ely-Ouse to Essex transfer scheme.

We made a number of significant improvements to our customer service during the year. A new computerised customer accounts and service system was installed, allowing us much greater flexibility and efficiency than before. We introduced a new package of customer service benefits, 'Customer Focus', which goes beyond the requirements of the statutory guaranteed standards scheme. The benefits are backed up by significant compensation payments should we fail to meet the standards, further proof of our commitment to improving customer care.

We also believe that it is important that we are open and accessible to our customers. To deal more effectively with telephone contacts from customers, we invested in a sophisticated call distribution system at our customer accounts facility at Lowestoft.

## **Future**

More than two years of very dry weather has impacted heavily on the refilling of our reservoirs, and groundwater is at historically low levels. Our tasks for the future are clear: we need to find new resources, improve water storage and increase water use efficiency. We have committed £37m to these tasks over the next 3 years.

Work has started already. Currently we are looking at ways of artificially recharging aquifers and also intend to reintroduce several groundwater sources. Despite our highly commendable leakage rate of 12% - one of the lowest in the country - we aim to reduce this further.

For much of this work we will draw on the skills and resources of the rest of the Group, in particular Entec UK and Lyonnaise's network of research centres.

We have also launched a pioneering scheme to help domestic customers implement simple water-saving measures in their homes. The service is free and many of its features are unique amongst Britain's water companies.

Running a water company in the driest region of Britain offers interesting challenges. However, with a well-focused team, a track record of operational efficiency, and ready access to some of the world's best technical expertise, we feel confident of tackling them.

## **INTERNATIONAL WATER**

### NORTHUMBRIAN LYONNAISE INTERNATIONAL LIMITED

The international water and waste water market is set for substantial growth as an increasing number of governments around the world seek private sector involvement. To develop these opportunities in selected areas of the world we have established Northumbrian Lyonnaise International Limited (NLI).

Our area of responsibility covers 49 countries and almost 1.5 billion people, including Australia, New Zealand, Anglo Africa, Scandinavia, Scotland, Ireland, the Indian sub-continent and parts of the Middle East.

Our initial focus is on markets where opportunities have already been identified. We have submitted bids for waste water plants for Edinburgh in Scotland, Oslo in Norway and in South Africa for a concession contract which includes customer management. In Oman, we have submitted a bid for the provision of water supply and distribution in the Al Massaratt region.

We have begun our review of a number of developing markets with the objective of establishing their potential and timescale for development. Our success is heavily dependent on our ability to draw upon the skills and expertise of other parts of the Northumbrian and Lyonnaise groups - in particular Entec UK and Degrémont, a Lyonnaise subsidiary. This unique access to a depth and breadth of skills provides us with a real competitive advantage.

## **WASTE MANAGEMENT**

### NORTHUMBRIAN ENVIRONMENTAL MANAGEMENT LIMITED

Northumbrian Environmental Management Limited (NEM) has developed over the last seven years into North East England's leading integrated waste management company, with operations which include landfill sites,

liquid treatment facilities and an energy-from-waste plant. Waste collection services and materials recycling are also provided, together with waste minimisation advice and implementation.

Our turnover for the year increased 44% to £26.5m (£18.4m in 1995/96) whilst operating profit has grown by 53% to £2.6m (£1.7m in 1995/96). This sustained year-on-year growth has been driven not just from acquisitions, but from developing close working relationships with our customers.

New business won during the year included a 25 year contract to dispose of North Tyneside Council's domestic refuse. This means NEM now handles 80% of the region's domestic waste treatment on long term contracts. The introduction of the Landfill Tax in October had negligible impact on landfill volumes, our largest product sector. Our two specialised industrial liquid waste plants, which service some of the biggest names in chemicals, brewing and food processing, continued to operate at or near full capacity. Enviricare Limited, our specialist waste collection service, saw volumes rise as the economy recovered, increasing its regional market share to around 30%.

### **Investment**

We are now close to completing a state of the art, energy-from-waste plant at Billingham on Teesside. This £41m plant, a first for the region, is a joint venture with the four unitary authorities which make up the former Cleveland County Council. The joint venture company, Cleveland Waste Management Limited, has a 25 year contract to dispose of the county's domestic waste. Trials of the plant are due to begin in June 1997, with an operational start date planned for October 1997. This plant demonstrates our ability to carry through a complex capital intensive project while still providing a competitively priced service, and our commitment to long-term service provision.

### **Future**

For the future, we will continue to strengthen our position in the region and we now have the experience and substance to enable us to look for expansion beyond North East England.

### **RELATED SERVICES**

During the year we have restructured and sharpened the focus of the previous Group's non-core businesses. The new structure concentrates on operations which provide valuable services to core businesses within the Group - Entec UK (environmental and engineering consultancy), IMASS (IT consultancy), AES (analytical services) and Fastflow Pipeline Services (pipeline technology) - or support our development priorities - Agrer and Entec Aid (aid-funded projects). This gives our core businesses access to a range of resources and a beneficial presence in key market areas.

The largest of the Related Services businesses is our environmental and engineering consultancy, Entec UK. Few UK consultancies can offer such a breadth and depth of skills and expertise in the environmental field - from environmental engineering and contaminated land remediation through to risk management and waste minimisation. Demand for 'intelligent' integrated solutions is growing, and increasingly Entec UK is winning contracts by offering clients a package of services.

One of Entec UK's key roles is to support the development of our core activities, both in the domestic and the international markets. During the year Entec UK worked with NLI on a number of major project bids, whilst continuing to provide specialist services to NWL, particularly for the Tees Estuary Environmental Scheme, and providing expertise to help manage Essex and Suffolk's water resource issues.

## **RESEARCH AND DEVELOPMENT**

One of the commitments made at the time of the acquisition of the Group by Lyonnaise was to establish a technical research centre in the region. In January 1997, the Northumbrian Water Group Research Centre was opened at Horsley, with a specific brief to establish a centre of excellence for underground asset management. The research carried out will be some of the most advanced of its type in the industry and will be shared throughout the Lyonnaise group as part of its world-wide network of research centres. NWG, of course, now enjoys the reciprocal benefits of this network.

## **FUTURE PROSPECTS**

We have come through our first year in good shape. The most important challenge now facing us is the next Ofwat periodic review, which will establish the prices which UK water companies can charge from 2000 to 2005. Although not due until 1999, early preparations will put us in a strong position to cope with what promises to be a very tough review.

The prime objective for our UK water companies is to continue to provide customers with excellent quality services at competitive prices. Having completed its review of the developing markets, our international business will be homing in on the most promising opportunities and our waste business will begin a new phase with the successful start-up of its energy-from-waste plant on Teesside.

Whilst the next few years will, I am sure, generate as many challenges as the last, my growing knowledge of the quality and commitment of the people throughout the Group serves to increase my confidence in our ability to meet whatever lies ahead.

**Patrick Babin**, *Group Managing Director*

18 June 1997

## **DIRECTORS' REPORT**

### **NORTHUMBRIAN WATER GROUP PLC (the Company)**

Directors' report for the period beginning with the incorporation of the Company on 17 October 1995 and ending 31 March 1997.

The Directors have pleasure in submitting their report on the affairs of the Company and of its subsidiaries (the Group) together with the financial statements and the Auditors' Reports for the period.

#### **Significant Events**

On 21 March 1996, the Company acquired 100% of the share capital of Northumbrian Holdings plc (now Northumbrian Holdings Limited) and 98.61% of Essex and Suffolk Water plc. The financial statements presented give the results of the above companies and their subsidiaries as from the date of acquisition. Further details of the acquisition and Group reorganisation are provided in notes 11 and 12.

#### **Activities**

The Company was incorporated on 17 October 1995 under the name Saffronstream Limited. On 1 April 1996, the Company changed its name to Northumbrian Water Group plc and was re-registered as a public limited company.

The principal activities of the Group are the provision of water, waste water, waste management and related services.

A review of the Group's business is contained in the Chairman's Statement (page 1) and the Managing Director's Review (page 2).

#### **Financial Results and Dividends**

The Group's results and dividends are as follows:

	£m
Profit for the financial period	125.5
Dividends	(41.4)
<hr/>	
Transferred to reserves	<b>84.1</b>

A final dividend of 4.61p net per ordinary share will be recommended by the Directors at the Annual General Meeting. It will be payable on 21 July 1997 to shareholders on the Company's Register of Members on 4 July 1997.

The total dividend for the period will be 9.7p net per ordinary share, being 4.85p interim dividend (paid pro rata to shareholders from the date upon which their shares were fully paid and they became members of the Company), 0.24p second interim dividend and 4.61p final dividend.

#### **Share Capital**

As at 5 June 1997, the issued share capital of the Company was £466,248,523 divided into 466,248,523 ordinary shares of £1 each.

Changes to the issued share capital of the Company during the financial period are set out in note 22 to the financial statements.

## Substantial Shareholdings

As at 5 June 1997, the Company's register of substantial shareholdings showed the following interests in 3% or more of the Company's ordinary shares:

Lyonnaise Europe plc	65.00%
Northumbrian Partnership	20.00%
Compagnie de Suez	7.67%

## Annual General Meeting

Details of the Annual General Meeting are set out in the Notice which accompanies this Report. The resolutions to be considered are set out in the Notice. There are no resolutions which constitute Special Business.

## Directors

None of the Company's directors have served throughout the period.

### The Directors of the Company as at 31 March 1997 were:

Professor Sir Frederick Holliday, Non-Executive Chairman (appointed 22.3.1996)  
Sir Derek Bradbeer, Non-Executive Deputy Chairman (appointed 1.4.1996)  
Patrick Babin, Group Managing Director (appointed 29.2.1996)  
Kam-Ling Chan, Non-Executive Director (appointed 27.9.1996)  
Peter Cheng, Non-Executive Director (appointed 27.9.1996)  
Donald Correll, Non-Executive Director (appointed 28.6.1996)  
John Cuthbert, Managing Director of Essex and Suffolk Water plc (appointed 29.2.1996)  
Anthony Harding, Managing Director of Northumbrian Water Limited (appointed 1.4.1996)  
Antony Haynes, Non-Executive Director (appointed 27.9.1996)  
Anne Minto, Non-Executive Director (appointed 1.4.1996)  
Gérard Payen, Non-Executive Director (appointed 1.4.1996)  
Hugh Speed, Executive Director (appointed 1.4.1996)  
Christopher Storey, Non-Executive Director (appointed 1.4.1996)  
J Michael Taylor, Group Finance Director (appointed 29.2.1996)  
John Ward, Non-Executive Director (appointed 1.4.1996)

### The following have served as Directors of the Company during the period:

Peter John Charlton (appointed 17.10.1995 - resigned 29.2.1996)  
Robert Elliott (appointed 1.4.1996 - resigned 27.9.1996)  
Simon Gray (appointed 1.4.1996 - resigned 31.3.1997)  
Peter Hutchinson (appointed 1.4.1996 - resigned 31.3.1997)  
Mainwaring Bainbridge ("Warren") Pescod (appointed 1.4.1996 - resigned 31.3.1997)  
Jacques Petry (appointed 1.4.1996 - resigned 27.9.1996)  
Martin Edgar Richards (appointed 17.10.1995 - resigned 29.2.1996)  
Sir John Riddell (appointed 1.4.1996 - resigned 31.3.1997)

### The following director was appointed after 31 March 1997:

Jean-Francois Didion, Non-Executive Director (appointed 1.4.1997)

In accordance with the Articles of Association of the Company, at this year's Annual General Meeting, Jean-Francois Didion will offer himself for re-appointment and Anthony Harding, Christopher Storey, J Michael Taylor and John Ward will retire by rotation and, being eligible, will offer themselves for re-election.

As at 31 March 1997, none of the Directors had any interest in the shares of the Company. Details of the Directors' interests in the shares of the Company's ultimate parent company, Lyonnaise des Eaux SA, and a subsidiary of the Company, North East Water plc, are set out in note 5(b) to the financial statements.

### **Donations**

The Group made charitable donations totalling £134,660 during the period. No political donations were made.

### **Research and Development**

Research and development within the Group is now the responsibility of Northumbrian Water Group Research Centre Limited, a specialist subsidiary wholly owned by the Company.

### **Employees and Employment Policies**

The total number of people employed by the Group as at 31 March 1997 was 3,831.

The Company, and the Group, currently operate a Profit Related Pay scheme which has been accepted by the employees and is registered with the Inland Revenue.

Training and development of employees has always been important in the Company and the Group. The Company holds the "Investors in People" National Standard and seeks to ensure continued development by individual development interviews which are held at least once in each year to review and assess individual performance and training requirements.

The Group has an Equal Opportunities Policy and seeks to ensure its continued application through communication and training at all levels. Links established with employment service agencies, particularly with regard to the recruitment and retention of disabled people, are maintained.

Companies within the Group have established their own mechanisms such as team briefings, electronic mail and notice boards for communication between their own employees at all levels and inter-company communication is largely achieved through the Group's corporate newspaper, "WaterMark".

Health and safety policies are maintained and implemented through the Group's safety team.

Employee health and welfare services are provided by the Group's Occupational Health Nurse, Welfare Adviser and Medical Adviser.

### **Pensions**

Information about the pension schemes operated by the Group is contained in note 25 to the financial statements.

### **Auditors**

Arthur Andersen have expressed their willingness to be re-appointed as auditors of the Company.

## **Creditors**

The Company's policy is to make payment not more than thirty days after receipt of a valid invoice. The number of credit days for the Company at 31 March 1997 was 27 days. This has been calculated using total invoiced costs and the number of days since the Company commenced trading on 1 October 1996.

## **Corporate Governance**

The Directors can report that the Company complied with the recommendations of the Committee on Financial Aspects of Corporate Governance contained within that Committee's Code of Best Practice throughout the period, although it is not required to do so because the Company's shares are not listed on the Stock Exchange.

On 31 March 1997, the Board of Directors of the Company comprised 15 Directors, 10 of whom were Non-Executive Directors.

A number of standing committees operated during the period within defined terms of reference and reported to the Company's Board of Directors. The four principal standing committees were:

*Audit Committee* - this comprised Non-Executive Directors and provided an independent perspective on all financial reporting matters and ensured the maintenance of an objective and professional relationship between the Company and its external auditors.

*Remuneration Committee* - this comprised exclusively Non-Executive Directors and determined the remuneration and other terms and conditions of service of Executive Directors and a small number of senior executives.

*Executive Committee* - this comprised exclusively Executive Directors of the Company and dealt with day to day business matters.

*Nomination Committee* - this comprised all Directors of the Company and its function is to propose candidates for executive and non-executive appointments as Directors of the Company.

## **Internal Financial Control**

The Board of Directors has overall responsibility for the Group's system of internal financial controls. An effective system of financial control is able to provide reasonable assurance against material misstatement or loss. The Group's system of internal financial control was based on a framework of reporting regular management information within a defined organisational structure which groups the Company's subsidiaries into operating businesses. Underlying the Group's financial control system were detailed internal financial controls. These detailed controls were supported by a financial control manual held by each of those businesses.

The operating businesses had local Boards of Directors, responsible for the operational and financial control of those businesses. The local Boards reported to the Executive Committee and the Company's Board of Directors.

The Company's Board of Directors met regularly and considered all matters brought to it by the Boards of the operating businesses. These included major strategic, financial, organisational, compliance and regulation issues. Detailed five year business planning and annual budget exercises were undertaken which included an assessment of the key risks and success factors facing each business unit. These were reviewed by the Group Management Team (comprising Executive Directors and certain senior executives of the Group) before being submitted for Board approval. The operational and financial performance of each business was compared with plan and budget on a monthly basis by the Group Managing Director and Group Finance Director. Targets were set to measure

performance and regular re-forecasts were made. The Board received financial reports monthly for each business and on treasury investment and funding activities.

Each subsidiary Board submitted a report to the Group Board which detailed:

- major business and financial risks inherent in the subsidiary's business and compensating controls and monitoring procedures developed to address these risks;
- confirmation that the subsidiary had complied with all Group policies and procedures;
- confirmation of the existence and operation of detailed financial controls; and
- any exceptions to the above items.

A framework existed which required the approval of the Board of Directors of the Company for major investments, including those in new and foreign market places, and large capital expenditure programmes. The treasury strategy, which is approved by the Board, required that investments were limited to certain money market and treasury instruments and that the Group's exposure to any single bank, building society or market was controlled, with maximum deposits allowed with any single counter-party. The Group's investment strategy aimed to fix interest rates for part of the Group's borrowings and investments for periods determined by the forecast cash flow of the individual businesses, thus effectively managing the exposure to risk of changes in short term interest rates. Foreign currency exposure was also managed as part of the treasury strategy approved by the Board of Directors of the Company.

The Group had an internal audit department which reported to the Audit Committee on a regular basis and had access to the Group Finance Director, Group Managing Director and Chairman at all times. The Audit Committee Chairman also met regularly with the Group Audit Manager to discuss issues arising from internal audit work. The internal audit department completed an annual internal audit plan which focused on areas of specific risk within the Group and included a review of the related key financial controls. The Audit Committee also received reports from the external auditors regarding their findings. Where necessary, local Boards attended Audit Committee meetings to discuss and resolve any issues arising from internal or external audit work.

The Directors have reviewed the Company's system of internal financial control and believe that it provides reasonable assurance of:

- (a) the safeguarding of assets against unauthorised use or disposition;
- (b) the maintenance of proper accounting records and the reliability of financial information used within the business or for publication; and
- (c) material errors, fraud and other irregularities being either prevented or being detected within a short period of time.

#### **Directors' Responsibilities in respect of the preparation of the financial statements**

The Directors are required by company law to prepare financial statements which give a true and fair view of the state of affairs of the Company and its subsidiaries at the end of the period and of the profit or loss for that period.

The financial statements must be prepared in accordance with appropriate accounting policies which have to be used and applied consistently. Applicable accounting standards must also be followed and any judgements and estimates made must be reasonable and prudent. Any material departures from standards must be disclosed in the notes to the financial statements and the financial statements must be prepared on the going concern basis unless it is inappropriate to do so.

## **Auditors' Responsibilities**

The auditors are responsible for forming an independent opinion on the financial statements presented by the Directors, based on their audit, and reporting their opinion to shareholders. Company law also requires the auditors to report to shareholders if the following requirements are not met:

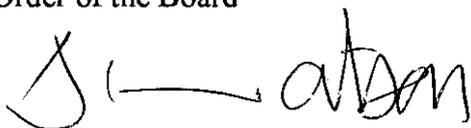
- (a) that the Company has maintained proper accounting records;
- (b) that the financial statements are in agreement with the accounting records;
- (c) that Directors' emoluments and other transactions with the Directors are properly disclosed in the financial statements; and
- (d) that they have obtained all information and explanations which, to the best of their knowledge and belief, are necessary for the purposes of their audit.

The auditors' opinion does not encompass the Directors' Report. The Companies Act, however, requires the auditors to report to the shareholders if the matters contained in the Directors' Report are inconsistent with the financial statements.

## **Financial Statements Preparation and Going Concern**

The Directors consider that it is appropriate to prepare the financial statements for the financial period on a going concern basis. The Directors have arrived at their decision based on consideration of the Group's detailed budget for 1997/98 and the five year business plans to 2002/03. This included a review of the capital expenditure and investment plans, the anticipated funding requirements and facilities available, and the reasonableness of the underlying assumptions of both the budget and business plans.

By Order of the Board

A handwritten signature in black ink, appearing to read 'David Watson', written over a horizontal line.

**David Watson, *Company Secretary***

18 June 1997

## EXECUTIVE AND NON-EXECUTIVE DIRECTORS

### **PROFESSOR SIR FREDERICK HOLLIDAY\***

CBE DSc FIBiol FRSE (61)

Chairman, 1996; Board Member, Lyonnaise des Eaux, 1996; Board Member, Wise Speke plc, 1996; Chairman, Northern Venture Capital Fund, 1985; Board Member, Shell UK Limited, 1980; Board Member, Union Railways, 1993-1996; Board Member, British Rail, 1990-1993; Vice Chancellor, Durham University, 1980-1990; Chairman, Northern Regional Board, Lloyds Bank, 1986-1989; President, Freshwater Biological Association; President, British Trust for Ornithology; Council Member, WaterAid; former Chairman, Nature Conservancy Council; past President, Scottish Marine Biological Association.

### **SIR DEREK BRADBEER**

OBE TD DL MA (65)

Non-Executive Deputy Chairman, 1996; Chairman, North East Water plc, 1992, and Director 1978-1992; Partner, Wilkinson Maughan Solicitors, Newcastle upon Tyne; past President, Law Society; Director, Legal Network Television; Chairman, Governors of the College of Law, 1990; Member, Criminal Injuries Compensation Board and of the Insurance Brokers Registration Council.

### **PATRICK BABIN**

HEC (39)

Group Managing Director, 1996; Corporate Director (Finance), Lyonnaise des Eaux, 1993-1996; Finance Director, Essex and Suffolk Water plc and Lyonnaise Europe plc, 1990-1992. Joined Lyonnaise des Eaux, 1987, following several years in the oil industry.

### **KAM-LING CHAN**

(56)

Non-Executive Director, 1996; Managing Director, Hip Hing Construction Company Limited, Hong Kong; Director, New World Development and New World Infrastructure Company, 1995; Managing Director, Sino-French Holdings (Hong Kong) Limited, (a joint-venture between Lyonnaise des Eaux of France and New World Infrastructure); Managing Director, Macau Water Supply Company Limited; Director, Macau Electricity Supply Company Limited.

### **PETER CHENG**

(44)

Non-Executive Director, 1996; Director, New World Hotels (Holdings) Limited, Hong Kong, 1984; Director, New World Development Company, 1992; Deputy Managing Director, New World Development Company; Director, Macau Water Supply Company Limited, Polytown Company Limited and Sun Hung Kai Industries Limited; Non-Executive Director, New World Development Company.

### **DONALD CORRELL**

(46)

Non-Executive Director, 1996; Chairman and Chief Executive Officer, United Water Resources Inc, New Jersey, USA, 1994; Chief Executive Officer, United Water Resources, 1992-1994; President, United Water Resources, 1991-1992; Senior Vice-President - Finance, United Water New Jersey, 1988; Vice-President - Treasurer and Chief Financial Officer, United Water Resources, 1986-1991; joined United Water New Jersey as Assistant Treasurer, 1976; Director, Interchange State Bank and Interchange Financial Services Corporation; Member of the Board of Directors, National Association of Water Companies (NAWC); Chairman, NAWC's government relations committee; Commissioner, New Jersey Water Supply Authority; Director, New Jersey Utilities Association.

### **JOHN CUTHBERT**

BSc ACA MBA (44)

Executive Director, 1996; Managing Director, Essex and Suffolk Water plc, 1996; Managing Director, North East Water plc, 1993-1996 and Finance Director and Deputy Managing Director, 1991-1993; Financial Controller, North Eastern Co-operative Society, 1986-1990.

### **ANTHONY ("TONY") HARDING**

BSc CEng MICE MIWEM (48)

Executive Director, 1996; Managing Director, Northumbrian Water Limited, 1996; Director, Essex and Suffolk Water plc, 1993, and Managing Director, 1993-1996; joined Essex and Suffolk Water plc, 1974; Cardiff City Water and Welsh Water Authority, 1971-1974.

**ANTONY HAYNES**

MA (CANTAB) (66)

Non-Executive Director, 1996; Chairman, Essex and Suffolk Water plc, 1996 and Board Member since 1992; Executive Chairman, Wellington Underwriting Group at Lloyd's of London; Director, Booker plc, 1969-1994.

**ANNE MINTO\***

LLB DPM FRSA (44)

Non-Executive Director, 1996; Deputy Director General, Engineering Employers' Federation, 1994; Business Services Manager, Shell UK Exploration & Production, 1992-1993; Chairman, National Engineering GNVQ Advisory Committee; Member of the CBI Employment Policy Committee, the Central Arbitration Service and the Business Links Accreditation Board.

**GÉRARD PAYEN**

Ecole Polytechnique Paris, ENPC Paris (44)

Non-Executive Director, 1996; Executive Vice-President Group Water Activities, Lyonnaise des Eaux, 1995; Chief Operating Officer, Degrémont, 1992 and Executive Vice-President from 1988; Chairman, Ozonia, 1990-1995; Chairman, Degrémont UK, 1992-1995; Director of Project Execution Division of Degrémont (Water Treatment), 1985.

**HUGH SPEED**

BSc MEng FICE FIWEM CBIM (60)

Executive Director, 1996; Chairman, Northumbrian Water Limited, 1996; Vice-President, Lyonnaise International Water Division, 1993-1996; Board Director, Essex and Suffolk Water plc; Board Director and Managing Director, North East Water plc and formerly Chief Engineer, Newcastle and Gateshead Water Company, 1971-1993.

**CHRISTOPHER STOREY**

(53)

Non-Executive Director, 1996; Director, North East Water, 1992 and Sunderland and South Shields Water Company, 1984-1997; Director, City Hospital Sunderland NHS Trust, 1993; Director, Vaux Group, 1989, having joined the company in 1973; qualified solicitor, 1969.

**J MICHAEL TAYLOR\***

FCMA (51)

Group Finance Director, 1996; Group Finance Director, Hickson International plc, 1986-1991; Non-Executive Director, SITA (GB) and Theory B, 1996.

**JOHN WARD\***

OBE DL ACIB (63)

Non-Executive Director, 1996; Deputy Chairman, part of 1996; Chairman, Northumbrian Environmental Management Limited, 1996; Joint Deputy Chairman, Northern Rock Building Society; Deputy Chairman, Tyne and Wear Development Corporation; Director / Trustee, Newcastle upon Tyne Theatre Royal Trust Limited; Non-Executive Director, Cowie Group plc, Grainger Trust plc and Northern Investors plc.

\* Former Executive and Non-Executive Directors of Northumbrian Holdings plc.

## **REPORT OF THE AUDITORS**

*To the shareholders of Northumbrian Water Group plc.*

We have audited the financial statements set out on pages 18 to 38 which have been prepared under the historical cost convention and the accounting policies set out on page 22.

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

As described on page 13 the Company's Directors are responsible for the preparation of the financial statements and 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 issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the Company's and the Group's circumstances, consistently applied and adequately disclosed.

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

### **Opinion**

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and of the Group at 31 March 1997 and of the profit and cash flows of the Group for the period then ended and have been properly prepared in accordance with the Companies Act 1985.



**Arthur Andersen**  
Chartered Accountants and Registered Auditors  
Newcastle upon Tyne  
18 June 1997

## **REPORT BY THE AUDITORS TO NORTHUMBRIAN WATER GROUP PLC ON THE STATEMENT OF COMPLIANCE WITH THE CODE OF BEST PRACTICE**

In addition to our audit of the financial statements, we have reviewed the Directors' statements on pages 12 to 14 concerning the Company's compliance with the paragraphs of the Cadbury Code of Best Practice specified for our review by the London Stock Exchange and their adoption of the going concern basis in preparing the financial statements. The objective of our review is to draw attention to non-compliance with Listing Rule 12.43(j), which the Company has elected to follow, although it is not required to do so because it does not have shares listed on the London Stock Exchange. We have not reviewed the Company's compliance with listing rule 12.43(v) because the Company is not required to, and has not elected to, fully implement the Greenbury Code of Best Practice.

We carried out our review in accordance with the guidance issued by the Auditing Practices Board. That guidance does not require us to perform the additional work necessary to, and we do not, express any opinion on the effectiveness of either the Company's system of internal financial control or its corporate governance procedures nor on the ability of the Company (and Group) to continue in operational existence.

### **Opinion**

With respect to the Directors' statements on internal financial control on pages 12 and 13 and going concern on page 14 in our opinion the Directors have provided the disclosures required by the Listing Rules referred to above and such statements are not inconsistent with the information of which we are aware from our audit work on the financial statements.

Based on enquiry of certain Directors and officers of the Company, and examination of relevant documents, in our opinion the Directors' statement on pages 12 and 13 appropriately reflects the Company's compliance with the other aspects of the Code specified for our review by Listing Rule 12.43(j).



**Arthur Andersen**  
Chartered Accountants  
Newcastle upon Tyne  
18 June 1997

**CONSOLIDATED PROFIT AND LOSS ACCOUNT**  
For the period ended 31 March 1997

	Notes	1997 £m
<b>Turnover</b>	2	<b>509.6</b>
Operating costs	3	<b>(317.8)</b>
<b>Operating profit</b>	2	<b>191.8</b>
Share of associated undertakings' profits	11	<b>0.2</b>
Dividend income		<b>0.9</b>
Net interest payable	4	<b>(45.5)</b>
<b>Profit on ordinary activities before taxation</b>	2	<b>147.4</b>
Tax on profit on ordinary activities	8	<b>(21.3)</b>
<b>Profit on ordinary activities after taxation</b>		<b>126.1</b>
Minority interests		<b>(0.6)</b>
<b>Profit for the financial period</b>		<b>125.5</b>
Dividends paid and proposed	9	<b>(41.4)</b>
<b>Profit retained for the financial period</b>	23	<b>84.1</b>

The profit includes all recognised gains and losses in the period, accordingly no separate statement of total recognised gains and losses is presented.

There is no difference between the operating profit and profit for the financial period as stated above and their historical cost equivalents.

Turnover and profit for the period are all attributable to continuing activities.

The information on pages 21 to 38 form part of these financial statements.

Northumbrian Water Group plc

**BALANCE SHEETS**  
At 31 March 1997

	Notes	Group 1997 £m	Company 1997 £m
<b>Fixed assets</b>			
Tangible assets	10	1,554.5	0.4
Investments	11	0.9	1,029.5
		<b>1,555.4</b>	<b>1,029.9</b>
<b>Current assets</b>			
Stocks	13	6.1	-
Debtors: receivable after more than one year	14	30.3	-
Debtors: receivable within one year	14	118.1	85.0
Investments		0.2	-
Cash at bank and short term deposits	15	77.2	53.5
		<b>231.9</b>	<b>138.5</b>
<b>Creditors: amounts falling due within one year</b>	16	<b>(238.0)</b>	<b>(54.1)</b>
<b>Net current (liabilities)/assets</b>		<b>(6.1)</b>	<b>84.4</b>
<b>Total assets less current liabilities</b>		<b>1,549.3</b>	<b>1,114.3</b>
<b>Creditors: amounts falling due after more than one year</b>	17	<b>(584.7)</b>	<b>(300.0)</b>
<b>Provisions for liabilities and charges</b>	20	<b>(58.0)</b>	-
<b>Accruals and deferred income</b>	21	<b>(28.3)</b>	-
		<b>(671.0)</b>	<b>(300.0)</b>
<b>Net assets</b>		<b>878.3</b>	<b>814.3</b>
<b>Capital and reserves</b>			
Called up share capital	22	466.2	466.2
Share premium account	23	217.9	217.9
Group reconstruction relief reserve	23	107.6	-
Profit and loss account	23	84.1	130.2
<b>Equity shareholders' funds</b>	24	<b>875.8</b>	<b>814.3</b>
Minority equity interest		2.5	-
<b>Total capital and reserves</b>		<b>878.3</b>	<b>814.3</b>

Approved by the Board of Directors on 18 June 1997 and signed on its behalf by:



Sir Frederick Holliday, *Chairman*



J Michael Taylor, *Group Finance Director*

The information on pages 21 to 38 form part of these financial statements.

**CONSOLIDATED CASH FLOW STATEMENT**  
For the period ended 31 March 1997

	Notes	1997 £m
<b>Net cash inflow from operating activities</b>	a	219.0
<b>Returns on investments and servicing of finance</b>		
Interest received		10.2
Interest paid		(36.5)
Interest paid on hire purchase contracts and finance leases		(0.6)
Dividends received from fixed asset investments		1.1
Proceeds from assets held for resale		16.4
<b>Net cash outflow from returns on investments and servicing of finance</b>		(9.4)
<b>Taxation</b>		
Taxation paid		(23.8)
<b>Capital expenditure and financial investments</b>		
Purchase of tangible fixed assets	10	(183.6)
Disposal of tangible fixed assets		1.0
Capital grants received		6.6
<b>Net cash outflow from capital expenditure and financial investments</b>		(176.0)
<b>Purchase of subsidiary undertakings</b>	12	(469.4)
<b>Equity dividends paid</b>		(37.9)
<b>Cash outflow before management of liquid resources</b>		(497.5)
<b>Management of liquid resources</b>		
Purchase of short term deposits		(341.1)
Disposal of short term deposits		331.8
<b>Net cash outflow from management of liquid resources</b>	c	(9.3)
<b>Financing</b>		
New long term borrowings received		275.7
Borrowings repaid		(14.8)
Payment of principal under hire purchase contracts and finance leases		(1.2)
Issue of ordinary shares		278.2
Expenses paid in connection with share issues	23	(3.7)
<b>Net cash inflow from financing</b>		534.2
<b>Increase in cash in the period</b>	b & c	27.4
<b>Reconciliation of net borrowings</b>		
Increase in cash in the period		27.4
Cash inflow from increase in net borrowings		(259.7)
Cash outflow from management of liquid resources		9.3
Change in net borrowings resulting from cash flows	b	(223.0)
Loans and finance leases acquired with subsidiaries net of short term deposits acquired	b	(306.1)
Inception of finance lease contracts	b	(1.6)
Movement in net borrowings in the period		(530.7)
Net borrowings at start of the period		-
<b>Net borrowings as at 31 March 1997</b>	b	(530.7)

Net borrowings is the sum of all cash and short term deposits and all borrowings.

The information on pages 21 to 38 form part of these financial statements.

Northumbrian Water Group plc

**NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT**  
For the period ended 31 March 1997

**a Net Cash Inflow from Operating Activities**

	Notes	1997 £m
Operating profit		191.8
Depreciation of tangible fixed assets	10	35.2
Profit on disposal of tangible fixed assets		(0.5)
Amortisation of capital grants	21	(1.2)
Infrastructure renewals provision	20	24.7
Infrastructure renewals spend	20	(30.8)
Restoration provision	20	1.3
Restoration spend	20	(0.6)
Other provisions - net of spend		(2.5)
Increase in stocks		(4.4)
Decrease in debtors		16.1
Decrease in creditors		(10.1)
<b>Net cash inflow from operating activities</b>		<b>219.0</b>

**b Analysis of Net Borrowings**

	At start of period £m	Cash flow £m	In respect of acquisitions* £m	Other non-cash changes £m	Total 1997 £m
Cash at bank	-	40.7	-	-	40.7
Bank overdrafts	-	(13.3)	-	-	(13.3)
	-	27.4	-	-	27.4
Borrowings due after 1 year	-	(275.7)	(215.1)	(44.8)	(535.6)
Borrowings due within 1 year	-	14.8	(71.9)	44.8	(12.3)
Finance leases	-	1.2	(46.3)	(1.6)	(46.7)
	-	(232.3)	(333.3)	(1.6)	(567.2)
Short term deposits	-	9.3	27.2	-	36.5
<b>Net borrowings</b>	-	<b>(223.0)</b>	<b>(306.1)</b>	<b>(1.6)</b>	<b>(530.7)</b>

\* Excluding cash and overdrafts

**c Analysis of Cash Balances**

	Movement for the Period		Total 1997 £m
	In respect of new subsidiaries £m	Trading for the period £m	
Cash at bank and short term deposits	167.0	(89.8)	77.2
Less: short term deposits with maturity dates greater than one day	(27.2)	(9.3)	(36.5)
	139.8	(99.1)	40.7
Bank overdrafts	(30.9)	17.6	(13.3)
	108.9	(81.5)	27.4

**d Major Non Cash Transactions**

On 21 March 1996, the Company issued to Lyonnaise Europe plc 151,163,906 ordinary shares at a premium of £0.705 per share (note 22) as consideration for the acquisition of Northumbrian Holdings plc, 77,890,000 ordinary shares for the acquisition of Essex and Suffolk Water plc and a further 74,007,000 ordinary shares relating to the acquisition of North East Water plc by Northumbrian Holdings plc.

## NOTES TO THE FINANCIAL STATEMENTS

### 1 Accounting Policies

The financial statements have been prepared in accordance with applicable Accounting Standards in the United Kingdom, with the exception of the treatment of capital grants and contributions relating to infrastructure assets, which is not in accordance with the Companies Act 1985 (see 1(g) below).

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

**(a) Basis of accounting** The financial statements have been prepared under the historical cost convention. As discussed in the Directors' Report on page 14, the financial statements have been prepared on a going concern basis.

**(b) Basis of consolidation** The consolidated financial statements include the Company and its subsidiary undertakings. Where, for commercial reasons, the consolidating reference date of a subsidiary is a date other than 31 March, interim financial statements made up to 31 March have been used. The results of subsidiaries acquired during the year are included from the date of their acquisition. The results of subsidiaries disposed of during the year are included to the date of their disposal. Intra-group sales and profits are eliminated fully on consolidation.

**(c) Associated undertakings** The Group's share of profits less losses of associated undertakings is included in the consolidated profit and loss account and the Group's share of their net assets/(liabilities) is included in the consolidated balance sheet.

**(d) Goodwill** Goodwill arising on consolidation represents the excess of the fair value of the consideration given over the fair value of the net assets acquired. Goodwill arising on the acquisition of subsidiaries and investment in associates is written off immediately against reserves.

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

**(f) Tangible fixed assets and depreciation** Tangible fixed assets, including assets in the course of construction, comprise: Infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls) and other assets (including properties, overground plant and equipment).

**(i) Infrastructure assets** Infrastructure assets comprise a network of systems. Expenditure on infrastructure assets relating to increases in capacity or enhancements of the network is treated as additions which are included at cost. 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.

**(ii) Other assets** Other assets are included 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: Freehold buildings, 30-60 years; Short leasehold land and buildings, 25 years or lease term if shorter; Operational structures, plant and machinery, 4-80 years; Fixtures, fittings, tools and equipment, 4-10 years; Landfill sites on the basis of airspace used in the period in relation to total airspace of the site.

**(iii) Assets in the course of construction** Assets in the course of construction are not depreciated until commissioning.

**(g) Government grants and contributions** Revenue grants are credited to the profit and loss account when received.

Capital grants and contributions relating to infrastructure assets have been deducted from the cost of those assets as permitted under Statement of Standard Accounting Practice Number 4. This is not in accordance with the Companies Act 1985 which requires fixed assets to be stated at their purchase price or production cost without deduction of grants and contributions which are treated as deferred income. This departure from the requirement of the Act is, in the opinion of the Directors, necessary for the financial statements to give a true and fair view as infrastructure assets are not depreciated and it is therefore not appropriate to recognise related capital grants and contributions as deferred income. The effect of the departure on the value of tangible fixed assets is disclosed in note 10.

Capital grants and contributions relating to other assets are treated as deferred income and amortised in the profit and loss account over the expected useful economic lives of the qualifying assets.

**(h) Hire purchase and leasing** Where assets are financed by hire purchase or leasing arrangements which transfer substantially all the risks and rewards of ownership to the Group, the assets are treated as if they had been purchased and the corresponding capital cost is treated as a liability. Rentals or leasing payments are treated as consisting of a capital element and finance costs, the capital element reducing the outstanding liability and the finance costs being written off to the profit and loss account over the period of the hire purchase contract or lease in proportion to the reducing outstanding liability. Rental costs arising under operating leases are expensed in the year they are incurred.

**(i) Stocks** Stores are stated at cost less any provisions necessary to recognise damage and obsolescence. Work in progress and finished goods are valued at the lower of cost and net realisable value. Cost includes labour, materials, transport and an element of overheads.

**(j) Pension costs** The cost of providing pension benefits is charged to the profit and loss account so as 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 as prepayments or provisions in the balance sheet. On acquisition, the pension surplus has been recognised as an asset on the balance sheet.

**(k) Taxation** The charge for current taxation is based on the profit for the year as adjusted for taxation purposes. 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 financial statements. 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 in the foreseeable future, except that the deferred tax effects of timing differences arising from pension and other past retirement revaluations are recognised in full. Provision is made at the rate which is expected to apply when the liability or asset crystallises.

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

**(m) Foreign currencies** Assets and liabilities of subsidiaries in foreign currencies are translated into sterling at rates of exchange ruling at the end of the financial year and the results of foreign subsidiaries are translated at the average rate of exchange for the year. Differences on exchange arising from the retranslation of the opening net investment in subsidiary companies, and from the translation of the results of those companies at average rate, are taken to reserves. All other foreign exchange differences are taken to the profit and loss account in the year in which they arise.

## 2 Segmental Analysis

### (a) Analysis by Class of Business and by Geographical Origin

	Water UK £m	Water International £m	Waste Management £m	Related Services £m	Total 1997 £m
<b>Turnover:</b>					
UK	446.7	-	27.0	63.6	537.3
Rest of Europe	-	-	-	5.3	5.3
<b>Total turnover</b>	<b>446.7</b>	<b>-</b>	<b>27.0</b>	<b>68.9</b>	<b>542.6</b>
Inter segment	(0.7)	-	(0.7)	(31.6)	(33.0)
<b>External turnover</b>	<b>446.0</b>	<b>-</b>	<b>26.3</b>	<b>37.3</b>	<b>509.6</b>
<b>Operating profit:</b>					
UK	207.6	(2.4)	2.6	(2.5)	205.3
Rest of Europe	-	-	-	0.2	0.2
	207.6	(2.4)	2.6	(2.3)	205.5
Corporate centre					(4.6)
Other central non allocable costs and provisions					(8.6)
Regional fund					(0.5)
<b>Operating profit</b>					<b>191.8</b>
Net common costs					(44.4)
<b>Profit on ordinary activities before taxation</b>					<b>147.4</b>

The corporate centre comprises those costs related to the performance of the Holding Company's functions.

The regional economic and environmental regeneration fund "Kick-Start" has a variable annual contribution from the Group in relation to overall business performance.

Net common costs, comprising share of associated undertakings' profits, investment income and net interest payable, are analysed on the face of the profit and loss account.

### (b) Analysis of External Turnover by Geographical Destination

	1997 £m
UK	494.0
Rest of Europe, Middle East and Far East	8.4
Rest of World	7.2
<b>External turnover</b>	<b>509.6</b>

### (c) Net assets

	Water UK £m	Water International £m	Waste Management £m	Related Services £m	Total 1997 £m
Subsidiary undertakings	1,342.4	(0.9)	58.6	7.5	1,407.6
Share of associated undertakings' net assets					0.3
Net operating assets					1,407.9
Unallocated net liabilities					(529.6)
<b>Net assets</b>					<b>878.3</b>

Net operating assets include tangible fixed assets, stocks, debtors and creditors which relate to segmental operating activities. Unallocated net liabilities include other fixed asset investments, current investments, cash and short term deposits, borrowings, current taxation balances, dividends and other common assets and liabilities.

The net assets of the Group are almost entirely situated in the United Kingdom.

### 3 Operating Costs

	1997 £m
<b>Operating profit is stated after charging/(crediting)</b>	
Materials and consumables	19.2
Manpower costs (note 7)	76.2
Depreciation on tangible fixed assets:	
owned	32.0
under hire purchase contracts and finance leases	3.2
Infrastructure renewals (note 20)	24.7
Amortisation of Government grants (note 21)	(1.2)
Other operating charges	153.6
Operating leases:	
plant and machinery	2.5
other	3.3
Costs of research and development	3.4
Auditors' remuneration:	
audit	0.2
non-audit services	0.2
Regional fund	0.5
<b>Total Operating Costs</b>	<b>317.8</b>

### 4 Net Interest Payable

	1997 £m
Interest payable on debentures, bank and other loans and overdrafts	(51.5)
On hire purchase contracts and finance leases	(2.4)
	(53.9)
Interest receivable	8.4
<b>Net interest payable</b>	<b>(45.5)</b>

## 5 Directors' Remuneration and Interests

### (a) Directors' remuneration

The remuneration of the Directors of the Company was:

	Fixed remuneration 1997 £000	Performance related bonus 1997 £000	Retirement pensions received 1997 £000	Pension contributions 1997 £000	Benefits in kind 1997 £000	Total 1997 £000
<b>Serving directors</b>						
Sir Frederick Holliday	70	-	-	-	23	93
Sir Derek Bradbeer	40	-	-	-	-	40
Patrick Babin *	93	22	-	11	43	169
Kam-Ling Chan	10	-	-	-	-	10
Peter Cheng	10	-	-	-	-	10
Donald Correll	15	-	-	-	-	15
John Cuthbert *	105	22	-	7	10	144
Anthony Harding*	120	28	-	26	9	183
Antony Haynes	33	-	-	-	-	33
Anne Minto	20	-	-	-	-	20
Gérard Payen	20	-	-	-	-	20
Hugh Speed *	126	21	-	18	25	190
Christopher Storey	20	-	-	-	-	20
J Michael Taylor *	99	19	-	14	11	143
John Ward	25	-	-	-	3	28
<b>Sub total</b>	<b>806</b>	<b>112</b>	<b>-</b>	<b>76</b>	<b>124</b>	<b>1,118</b>
<b>Retired directors</b>						
Robert Elliott	10	-	7	-	-	17
Simon Gray	20	-	-	-	-	20
Peter Hutchinson	20	-	-	-	-	20
Professor "Warren" Pescod	20	-	-	-	-	20
Jacques Petry	15	-	-	-	-	15
Sir John Riddell	20	-	-	-	-	20
<b>Total Remuneration</b>	<b>911</b>	<b>112</b>	<b>7</b>	<b>76</b>	<b>124</b>	<b>1,230</b>

\* Executive Director

The aggregate remuneration of the highest paid Director, excluding pension contributions, was £172,000.

None of the other Directors received any remuneration for their services to the Company or Group.

The Company's remuneration policy for Directors complies with the guidance "The Remuneration of Directors - A Framework for Remuneration Committees" issued by the Institute of Directors.

#### Executive Directors

The emoluments of the Executive Directors, including the annual bonus, are determined by the Remuneration Committee who receive independent external advice. In addition to this market information, account will be taken of changes in job size, the individual's assessed experience, competency and performance and also have regard to budgetary constraints and public perceptions. The Remuneration Committee is comprised solely Non-Executive Directors.

The bonus scheme for senior executives was modified in 1996 and approved by the Remuneration Committee. The scheme is based upon principles of rewarding achievement on agreed objectives relating as far as possible to quantifiable criteria. Performance appraisals are conducted annually by the Group Managing Director, who makes recommendations for bonus payments to the Remuneration Committee. The scheme can reward both collective and individual performance and is variable from 0% to a maximum of 30% of base salary. There are no other performance-linked incentive schemes for executives.

Benefits in kind include work related accommodation and provision of company cars and fuel.

The emoluments of the Non-Executive Directors are determined by reference to Hay Management Consultants. The Chairman and Deputy Chairman are contracted for an average of two days each week and the level of salary is commensurate with this and the duties and responsibilities they perform. The other Non-Executive Directors are expected to be available to the Company for an average of two days each month, which includes membership of certain Board Committees. All notice periods comply with the recommendation of the Cadbury Report on Corporate Governance. Each Non-Executive Director is appointed for a three year period with the option for a renewal of a further three years.

Other than the Chairman, the Non-Executive Directors do not receive benefits from the Company, but expenses are reimbursed for attending meetings. The Chairman is provided with work related accommodation and transport, both of which are available to the Company when not used by the Chairman.

The Non-Executive Directors, including the Chairman, do not participate in any of the bonus arrangements or pension schemes.

#### Service contracts

The service contracts for all Executive Directors have been set at two years, on a rolling basis. The contracts do not include actions which would be taken in the event of an Executive or Non-Executive being removed from office. In such circumstances the Board aims to seek an amicable settlement within the terms of the individual's contract of employment.

None of the Executive Directors has paid appointments or directorships outside of the Northumbrian Water Group of companies.

#### (b) Directors' interests

The Directors who held office at 31 March 1997 had the following interests in the shares, other than share options, and debentures of the ultimate parent company, Lyonnaise des Eaux SA:

Name of Director	Name of group undertaking and description of shares or debentures	31 March 1997		Start of period or subsequent date of appointment	
		Beneficial	Non-beneficial	Beneficial	Non-beneficial
Hugh Speed	Ordinary shares of Ffr60 each in Lyonnaise des Eaux	240	-	240	-

The Directors who held office at 31 March 1997 held the following options over ordinary shares of French francs (Ffr)60 each in Lyonnaise des Eaux SA:

Name of Director	Start of period or date of appointment	Granted	31 March 1997	Exercise price
Patrick Babin	1,000	-	1,000	Ffr430
	1,500	-	1,500	Ffr485
	2,000	-	2,000	Ffr493
	-	2,500	2,500	Ffr456
<i>Total</i>	<i>4,500</i>	<i>2,500</i>	<i>7,000</i>	
J Michael Taylor	-	400	400	Ffr456
Anthony Harding	500	-	500	Ffr485
	1,500	-	1,500	Ffr493
	-	1,600	1,600	Ffr456
<i>Total</i>	<i>2,000</i>	<i>1,600</i>	<i>3,600</i>	
John Cuthbert	500	-	500	Ffr485
	1,200	-	1,200	Ffr493
	-	1,200	1,200	Ffr456
<i>Total</i>	<i>1,700</i>	<i>1,200</i>	<i>2,900</i>	
Hugh Speed	800	-	800	Ffr485
	1,200	-	1,200	Ffr493
	-	1,200	1,200	Ffr456
<i>Total</i>	<i>2,000</i>	<i>1,200</i>	<i>3,200</i>	
Gérard Payen	1,000	-	1,000	Ffr457
	2,000	-	2,000	Ffr430
	3,000	-	3,000	Ffr485
	3,000	-	3,000	Ffr493
	-	3,000	3,000	Ffr456
<i>Total</i>	<i>9,000</i>	<i>3,000</i>	<i>12,000</i>	
Donald Correll	500	-	500	Ffr485
	1,000	-	1,000	Ffr493
	-	1,000	1,000	Ffr456
<i>Total</i>	<i>1,500</i>	<i>1,000</i>	<i>2,500</i>	

No options have been exercised or lapsed during the period.

The options are exercisable between the following dates:

All options with an exercise price of Ffr457 were granted on 15 April 1992 and were exercisable between 15 April 1994 and 15 April 1997.

All options with an exercise price of Ffr430 were granted on 7 July 1993 and are exercisable between 7 July 1995 and 7 July 1998.

All options with an exercise price of Ffr485 were granted on 15 July 1994 and are exercisable between 15 July 1996 and 15 July 2002.

All options with an exercise price of Ffr493 were granted on 14 June 1995 and are exercisable between 14 June 1997 and 14 June 2003.

All options with an exercise price of Ffr456 were granted on 24 July 1996 and are exercisable between 24 July 1998 and 24 July 2004.

The highest and lowest prices of the Lyonnaise des Eaux SA ordinary shares during the period were Ffr 690 and Ffr 426, respectively.

The Directors who held office at 31 March 1997 had the following interests in the shares of North East Water plc, a subsidiary of the Company:

Name of Director	Name of group undertaking and description of shares or debentures	31 March 1997		Start of period or subsequent date of appointment	
		Beneficial	Non-beneficial	Beneficial	Non-beneficial
Sir Derek Bradbeer	Ordinary shares of £1 each in North East Water plc	485	-	1,020	-

No other Director holds any interest required to be disclosed in accordance with Schedule 7 of the Companies Act 1985.

#### Directors' Pension Entitlements

	Pension Scheme	Accrued entitlement at 31 March 1997	Accrued Lump Sum 31 March 1997
		£000	£000
J M Taylor	WPS	36	-
J Cuthbert	LUKPS	11	33
A Harding	LUKPS	33	99
H Speed	LUKPS	70	-

P Babin participates in pension schemes administered by Lyonnaise des Eaux SA, and not any of the Group's UK pension schemes.

As explained in note 25 the Group operates three defined benefit final salary schemes, the Water Pension Scheme (WPS), the Lyonnaise UK Pension Scheme (LUKPS) and the Water Mirror Image Pension Scheme (MIS).

#### Notes

- The pension entitlement and lump sum shown is that which has been accrued at 31 March 1997 based on pensionable service and the rules of the scheme, except for H Speed who became entitled to retirement benefits from LUKPS on 28 September 1996.
- For members who joined WPS or LUKPS after 31 May 1989, salary for pension purposes is limited to the earnings cap defined in the Finance Act 1989 (£82,000 as at 31 March 1997).
- J Cuthbert and A Harding, members of LUKPS, have been granted augmentations to pensionable service, in addition to the service that they complete as contributory members of the Scheme. This augmented pensionable service accrues uniformly over their contributory membership of the Scheme, which was the pensionable service taken into account in calculating accrued benefits at the beginning and end of the Company's financial year increases by more than one year.
- The Water Pension Scheme allows a member to commute part of the annual pension to purchase a tax-free lump sum. This is at the member's discretion and is decided at the time of retirement. The details disclosed for J M Taylor are based upon the maximum annual pension entitlement, with no lump sum commutation.

#### 6 Transactions with Directors and Officers

There are no transactions or arrangements which would require disclosure under the provisions of the Companies Act 1985.

## 7 Employee Information

(a) The total employment costs of all employees (including Directors) of the Group were:

	1997 £m
Wages and salaries	77.5
Social security costs	7.0
Other pension costs	8.5
<b>Total employment costs</b>	<b>93.0</b>

(b) Total employment costs were charged as follows:

Capital schemes and infrastructure renewals	16.8
Manpower costs	76.2
	<b>93.0</b>

(c) The average monthly number of employees of the Group during the financial period was:

	1997 Number
Water UK	2,510
Water International	12
Waste Management	239
Related Services	1,084
	<b>3,845</b>

## 8 Tax on Profit on Ordinary Activities

	1997 £m
UK corporation tax at 33%	21.3

The tax charge for the period has been reduced by £27m primarily due to the availability of capital allowances for which no deferred tax was provided.

## 9 Dividends

	1997 £m
Interim paid	20.0
Final proposed of 4.61p per ordinary share	21.4
	<b>41.4</b>

On 16 December 1996, the company paid two interim dividends for the period ending 31 March 1997, one of 4.85 pence (net) per £1 ordinary share to shareholders on the Company's Register of Members at the close of business on 25 November 1996, save that holders of such shares were only entitled to payment of an amount in respect of the period from the date on which they were fully paid up to and including 30 September 1996 calculated on a pro rata basis, and a second dividend of 0.24 pence (net) per £1 ordinary share to all shareholders appearing on the Company's Register of Members at the close of business on 25 November 1996.

## 10 Tangible Fixed Assets

(a) Group:

	Freehold land and buildings £m	Short leasehold land and buildings £m	Infra- structure assets £m	Operational structures plant and machinery £m	Fixtures fittings tools and equipment £m	Landfill sites £m	Assets in the course of construction £m	Total 1997 £m
<b>Cost:</b>								
In respect of acquisition of subsidiaries	65.0	2.8	679.7	618.6	66.6	33.0	126.9	1,592.6
Additions	0.5	-	0.1	35.7	4.6	1.6	162.8	205.3
Schemes commissioned	5.0	-	69.1	76.7	7.3	-	(158.1)	-
Disposals	-	-	-	(1.3)	(1.9)	-	-	(3.2)
Grants - Infrastructure assets	-	-	(2.5)	-	-	-	(1.4)	(3.9)
At 31 March 1997	70.5	2.8	746.4	729.7	76.6	34.6	130.2	1,790.8
<b>Depreciation:</b>								
In respect of acquisition of subsidiaries	14.1	0.8	-	140.9	43.5	4.5	-	203.8
Provision for the period	2.2	0.1	-	21.8	8.9	2.2	-	35.2
Disposals	-	-	-	(1.3)	(1.4)	-	-	(2.7)
At 31 March 1997	16.3	0.9	-	161.4	51.0	6.7	-	236.3
Net book value at 31 March 1997	54.2	1.9	746.4	568.3	25.6	27.9	130.2	1,554.5

The cost of infrastructure assets is stated net of capital grants and contributions received in respect of those assets. As a result the net book value of infrastructure assets, including those assets in the course of construction, is £67.2m lower than it would have been had this treatment not been adopted.

Operational structures, plant and machinery includes an element of land and buildings dedicated to those assets.

The net book value of tangible fixed assets held under hire purchase contracts and finance leases at 31 March 1997 was as follows:

	1997 £m
Infrastructure assets	2.2
Operational structures, plant and machinery	34.0
Fixtures, fittings, tools and equipment	1.3
Assets in the course of construction	1.0
	<b>38.5</b>

Additions to tangible fixed assets for the period ended 31 March 1997 have been funded as follows:

Cash	183.6
Increase in accrual	21.1
Hire purchase contracts and finance leases	0.6
	<b>205.3</b>

(b) Company:

The Company had tangible fixed assets of £0.4m comprising mainly of fixtures and fittings.

## 11 Fixed Asset Investments

(a) Group:	Associated undertakings £m	Other investments £m	Total 1997 £m
On acquisition of subsidiary undertakings	0.2	-	0.2
Additions	-	0.6	0.6
Share of results for the period	0.2	-	0.2
Disposals	(0.1)	-	(0.1)
At 31 March 1997	0.3	0.6	0.9

All fixed asset investments are unlisted.

(b) Company:	Associated undertakings £m	Interests in subsidiaries £m	Other investments £m	Total 1997 £m
On acquisition of subsidiary undertakings	1.1	1,859.4	-	1,860.5
Additions	0.5	1.1	0.6	2.2
Redemption of ordinary shares	-	(133.2)	-	(133.2)
Provision for permanent diminution in value	-	(700.0)	-	(700.0)
At 31 March 1997	1.6	1,027.3	0.6	1,029.5

All fixed asset investments are unlisted.

The Company acquired the entire ordinary shareholding of Northumbrian Holdings plc (now re-registered on 29 November 1996 as Northumbrian Holdings Limited), 98.61% of the ordinary share capital of Essex and Suffolk Water plc and investments in small subsidiaries, EL Water Management Services Limited and North East Water Commercial Services Limited from Lyonnaise Europe plc for a total consideration of £1,095.5m (note 12).

In accordance with sections 132 and 133 of the Companies Act 1985, the Company has recorded the cost of its investment in Essex and Suffolk Water plc and part of its investment in Northumbrian Holdings plc at an amount equal to the nominal value of the shares issued plus the minimum premium value recognised. The resulting differences of £62.1m and £45.5m respectively arising on consolidation have been credited to the Group reconstruction relief reserve.

As part of a corporate reorganisation, Northumbrian Water Group plc acquired from its subsidiary Northumbrian Holdings plc on 30 September 1996 the investments in its trading subsidiaries for a net cash consideration of £872.6m.

Following this reorganisation, Northumbrian Holdings plc proceeded with a share redemption in the amount of £133.2m after payment of a dividend of £700m to its parent company Northumbrian Water Group plc. The investment was subsequently written down by £700m to its net asset value.

(c) The Group's interests in principal trading associates are as follows:

Name of undertaking	Country of incorporation or registration and operation	Description of shares held	Proportion of nominal value of issued shares held by Group %	Business activity
Lyonnaise Water Southern Africa (PTY) Limited	South Africa	Ordinary shares of 0.5 Rand	50	Water and sanitation services

(d) The Group's interests in principal trading subsidiaries are as follows:

Name of undertaking	Country of incorporation or registration	Description of shares held	Proportion of nominal value of issued shares held by Group and Company %	Business activity
Northumbrian Water Limited	England and Wales	Ordinary shares of £1	100	Water and sewerage services
Essex and Suffolk Water plc	England and Wales	Ordinary shares of £1	98	Water services
Northumbrian Lyonnaise International Limited	England and Wales	Ordinary shares of £1	100	International water and sewerage services
Entec Europe Limited (and subsidiary companies)	England and Wales	Ordinary shares of £1	100	Environmental and engineering consultancy
Northumbrian Environmental Management Limited (and subsidiary companies)	England and Wales	Ordinary shares of £1	100	Waste management
Northumbrian Water Group Research Centre Limited	England and Wales	Ordinary shares of £1	100	Research and Development

The Directors consider that to give full particulars of all subsidiary and associated undertakings would lead to a statement of excessive length. The above information relates to those subsidiary and associated undertakings or groups of undertakings whose results or financial position, in the opinion of the Directors, principally affect the figures of the Group.

All companies operate in England and Wales except for Northumbrian Lyonnaise International Limited and Entec Europe Limited and its subsidiaries who operate in Europe and the rest of the world.

## 12 Acquisitions of Subsidiaries

The acquisitions made by the Group during the period, and the related assets and liabilities acquired, were as follows:

	Northumbrian Holdings plc			Essex and Suffolk Water plc			Total Fair Value 1997 £m
	Book Values	Revaluations	Fair Value	Book Values	Revaluations	Fair Value	
	£m	£m	£m	£m	£m	£m	
Tangible fixed assets	1,152.2	2.6	1,154.8	227.0	7.0	234.0	1,388.8
Other long term assets	1.6	-	1.6	-	28.1	28.1	29.7
Assets held for resale	29.7	(19.0)	10.7	-	-	-	10.7
Current assets	277.6	-	277.6	28.9	-	28.9	306.5
Creditors: amounts falling due within one year	(145.2)	-	(145.2)	(75.4)	-	(75.4)	(220.6)
Creditors: amounts falling due after more than one year	(343.5)	-	(343.5)	(64.7)	(9.3)	(74.0)	(417.5)
	972.4	(16.4)	956.0	115.8	25.8	141.6	1,097.6
Minority interests	(0.6)	0.1	(0.5)	(1.2)	(0.4)	(1.6)	(2.1)
Net assets acquired	971.8	(16.3)	955.5	114.6	25.4	140.0	1,095.5
Fair value of consideration: cash	-	-	578.3	-	-	-	578.3
shares	-	-	377.2	-	-	140.0	517.2
	-	-	955.5	-	-	140.0	1,095.5

On acquisition, the fixed assets of Northumbrian Holdings plc and Essex and Suffolk Water plc have been revalued to their net recoverable amounts.

The revaluation of other long term assets comprised the recognition of a pension surplus following an actuarial revaluation as detailed in note 25. The related deferred tax provision is included in the revaluation of creditors falling due after more than one year.

Assets held for resale are the net book values of those entities acquired which were disposed of during the period. The revaluation recognises the adjustment necessary to write down the above values to their net realisable values.

The profit after tax of Northumbrian Holdings plc and of Essex and Suffolk Water plc for the year ended 31 March 1996 was £71.7m and £24.9m respectively.

The subsidiary undertakings have been consolidated by the Group using the acquisition method of accounting.

Net cash outflows in respect of the acquisitions comprised:

	1997 £m
Cash consideration	578.3
Cash at bank acquired	(139.8)
Bank overdrafts acquired	30.9
Net cash outflow	469.4

## 13 Stocks

	Group 1997 £m	Company 1997 £m
Stores	5.2	-
Work in progress	0.8	-
Finished goods	0.1	-
	6.1	-

**14 Debtors**

	Group 1997 £m	Company 1997 £m
<b>(a) Debtors: Receivable after more than one year</b>		
Net investment in finance leases	0.1	-
Pension surplus on acquisition (note 12)	28.1	-
Advance corporation tax recoverable	1.9	-
Other debtors	0.2	-
	<b>30.3</b>	<b>-</b>
<b>(b) Debtors: Receivable within one year</b>		
Trade debtors	75.8	0.1
Net investment in finance leases	1.0	-
Amounts owed by subsidiary undertakings	-	70.1
Corporation tax and advance corporation tax recoverable	2.0	9.4
Other debtors	12.5	2.6
Prepayments and accrued income	26.8	2.8
	<b>118.1</b>	<b>85.0</b>

**15 Cash at Bank and Short Term Deposits**

	Group 1997 £m	Company 1997 £m
Short term cash deposits	45.7	14.5
Certificates of deposit	26.0	23.0
Cash at bank	5.5	16.0
	<b>77.2</b>	<b>53.5</b>

All Group cash and £35.2m of short term deposits and certificates of deposit are realisable on demand.

**16 Creditors: Amounts falling due within one year**

	Group 1997 £m	Company 1997 £m
Bank loans and overdrafts (note 18)	21.6	-
Debentures (note 18)	4.0	-
Obligations under hire purchase contracts and finance leases (note 19)	0.9	-
Trade creditors	23.5	-
Amounts owed to subsidiary undertakings	-	9.7
Amounts owed to parent company	6.0	0.3
Other creditors	32.5	4.9
Taxation and social security (see (a) and (b) below)	26.7	1.9
Dividends payable		
- minority shareholders	0.2	-
- equity shareholders	21.4	21.4
Accruals and deferred income	101.2	15.9
	<b>238.0</b>	<b>54.1</b>

(a) The creditor for taxation and social security in the Group includes advance corporation tax of £1.9m and corporation tax amounting to £23m.

(b) The creditor for taxation and social security in the Company represents advance corporation tax amounting to £1.9m.

**17 Creditors: Amounts falling due after more than one year**

	<b>Group 1997 £m</b>	<b>Company 1997 £m</b>
Loans (note 18)	213.3	-
Debentures (note 18)	22.3	-
Eurobond - due 1 February 2002 bearing interest rate of 9.25%	100.0	100.0
Eurobond - due 28 June 2006 bearing interest rate of 8.625%	200.0	200.0
Obligations under hire purchase contracts and finance leases (note 19)	45.8	-
Corporation tax	0.3	-
Other creditors	3.0	-
	<b>584.7</b>	<b>300.0</b>

At 31 March 1997, the Group had entered into the following interest swap arrangements: £17m over a seven year period commencing on 28 August 1992 under which the Group is required to pay interest at 9.43% and will receive interest at a rate linked to LIBOR; £15m over a ten year period commencing on 10 May 1994 under which the Group is required to pay interest at a rate linked to LIBOR and will receive interest at 9.00%; and £10m over a seven year period commencing on 16 December 1996 under which the Group is required to pay interest at a rate linked to LIBOR and will receive interest at 7.45%.

**18 Loans**

	<b>Group 1997 £m</b>
Loans are repayable as follows:	
Less than one year	12.3
Between one and two years	9.0
Between two and five years	151.2
In more than five years	375.4
	<b>547.9</b>
Disclosed as due:	
Within one year : Bank loans and overdrafts	21.6
: Debentures	4.0
Less: Bank overdrafts	(13.3)
After one year : Loans	213.3
: Debentures	22.3
: Eurobonds	300.0
	<b>547.9</b>

Loans, any part of which falls due for repayment in more than five years and which are repayable by instalments, amount to £173.9m.

Loans, any part of which falls due for repayment in more than five years and which are repayable other than by instalments, amount to £252.3m. No part of these loans fall due for repayment within five years.

Loans which are wholly repayable within five years, amount to £121.7m.

On loans which are repayable by instalments, the instalments falling due in more than five years amount to £123.1m.

Included in the loans are debenture stocks as follows:

- (a) £8.7m issued by North East Water plc. The obligation on the debenture stocks was transferred to Northumbrian Water Limited on 31 March 1996. The debenture stocks are secured by a floating charge on the assets of Northumbrian Water Limited.
- (b) £17.6m issued by Essex and Suffolk Water plc. The debenture stocks are secured by a floating charge on the assets of that company.

## 19 Obligations under Hire Purchase Contracts and Finance Leases

	Group 1997 £m
Amounts due:	
In less than one year	0.9
Between one and two years	1.2
Between two and five years	4.8
In more than five years	94.3
Gross obligations	101.2
Less: finance charges allocated to future periods	(54.5)
	46.7
Disclosed as due:	
Within one year	0.9
After more than one year	45.8
	46.7

The aggregate gross amount of obligations under hire purchase contracts and finance leases, any part of which falls due for repayment in five years or more, is £100.5m.

## 20 Provisions for Liabilities and Charges

	Group					Total 1997 £m
	Merger provision £m	Aftercare and restoration provisions £m	Infrastructure renewals expenditure £m	Deferred tax £m	Other £m	
	In respect of subsidiaries acquired	30.9	7.0	11.5	9.3	
Transferred from the profit and loss account	-	1.3	24.7	-	8.0	34.0
Reclassifications/transfers	-	-	1.5	-	-	1.5
Utilised during the period	(9.0)	(0.6)	(30.8)	-	(1.5)	(41.9)
At 31 March 1997	21.9	7.7	6.9	9.3	12.2	58.0

The deferred tax provision relates to the pension revaluation surplus recognised as part of the fair value adjustment of the acquired assets of Essex and Suffolk Water plc.

## 21 Accruals and Deferred Income

	Group 1997 £m
Capital grants:	
In respect of subsidiaries acquired	26.8
Additions	2.7
Amortisation in the period	(1.2)
At 31 March 1997	28.3

## 22 Called up Share Capital

The share capital of the Company is shown below:

1997  
£m

Authorised:	
1,000m ordinary shares of £1 each	1,000.0
Allotted, called up and fully paid:	
466.2m ordinary shares of £1 each	466.2

During the period 466,248,523 ordinary shares were allotted as follows:

	Number allotted 000s	Issue price £	Premium £m
In respect of the consideration for 100% of the ordinary share capital of Northumbrian Holdings plc	151,164	1.705	106.6
In respect of the consideration for 98.61% of the ordinary share capital of Essex & Suffolk Water plc	77,890	1.705	-
In respect of further consideration relating to the acquisition of North East Water plc by Northumbrian Holdings plc	74,007	1.705	-
For cash under the terms of a private placement	69,937	1.705	49.3
For cash to the Northumbrian Partnership	93,250	1.705	65.7
	466,248	-	221.6

The placing constituted a private placement in the UK and certain other countries and a public offering in France of unlisted new ordinary shares of Northumbrian Water Group plc, with warrants to subscribe for Lyonnaise des Eaux SA ordinary shares.

Each unit of the investment comprises one new ordinary share of Northumbrian Water Group plc, one warrant to subscribe for Lyonnaise des Eaux SA ordinary shares and a put option to sell Northumbrian Water Group plc ordinary shares to Lyonnaise des Eaux SA.

The holder of 35 warrants has the right to subscribe for one Lyonnaise des Eaux SA ordinary share (subject to adjustment), exercisable shortly before trading commences in Northumbrian Water Group plc shares on the London Stock Exchange, if a listing is obtained and, in any event, during the period 1 January 2000 up to and including 30 April 2001.

The warrant exercise price is calculated by reference to a formula giving a minimum exercise price of Ffr 540, if the Lyonnaise des Eaux SA ordinary share price is equal to or below Ffr 800. If the Lyonnaise des Eaux SA ordinary share price is above Ffr 800 the exercise price will be Ffr 540, plus one half of the amount by which the Lyonnaise des Eaux SA ordinary share price exceeds Ffr 800.

The put option entitles a warrant holder to sell up to such number of Northumbrian Water Group plc ordinary shares to Lyonnaise des Eaux SA at the exercise price of £1.96 each, provided that such warrant holder has previously exercised some or all of his warrants in accordance with the terms and conditions of the Warrant Instrument.

The Northumbrian Partnership is a partnership which is equally owned by Lyonnaise Europe plc and a subsidiary of United Water Resources Inc, a company incorporated in the United States of America.

In accordance with sections 132 and 133 of the Companies Act 1985, the Company has recorded the cost of its investment in Essex and Suffolk Water plc and a part of its investment in Northumbrian Holdings plc at an amount equal to the nominal value of the shares issued plus the minimum premium value recognised. The resulting differences of £62.1m and £45.5m respectively arising on consolidation have been credited to the Group reconstruction relief reserve.

## 23 Reserves

	Share premium account  £m	Group reconstruction relief reserve  £m	Profit and loss account  £m
<b>Group:</b>			
Shares issued (note 22)	221.6	-	-
Expenses of share issue	(3.7)	-	-
Profit retained for the financial period	-	-	84.1
Group reconstruction relief reserve (note 22)	-	107.6	-
<b>At 31 March 1997</b>	<b>217.9</b>	<b>107.6</b>	<b>84.1</b>
<b>Company:</b>			
Shares issued (note 22)	221.6	-	-
Expenses of share issue	(3.7)	-	-
Profit retained for the financial period	-	-	130.2
<b>At 31 March 1997</b>	<b>217.9</b>	<b>-</b>	<b>130.2</b>

As permitted by section 230 of the Companies Act 1985, the Company's profit and loss account has not been included in these financial statements. The profit for the financial period is £171.6m.

## 24 Reconciliation of Movement in Equity Shareholders' Funds

	<b>Group 1997 £m</b>
Profit for the financial period	<b>125.5</b>
Dividends	<b>(41.4)</b>
Profit retained for the financial period	<b>84.1</b>
Shares allotted - nominal value	<b>466.2</b>
- premium	<b>217.9</b>
Group reconstruction relief reserve	<b>107.6</b>
<b>Increase in equity shareholders' funds</b>	<b>875.8</b>
Opening equity shareholders' funds	<b>-</b>
<b>Closing equity shareholders' funds</b>	<b>875.8</b>

## 25 Pensions

The Group operates three defined benefit final salary schemes - the Water Pension Scheme (WPS); the Water Mirror Image Pension Scheme (MIS); and the Lyonnaise UK Pension Scheme (LUKPS). The assets of the Schemes are held separately from those in the Group in independently administered funds.

The employer's contributions to WPS and MIS and the pension costs have been assessed in accordance with the advice of the consultant actuaries, William M Mercer Limited, and in the case of LUKPS, Sedgwick Noble Lowndes Limited, using the projected unit method for WPS and LUKPS and the attained age method for MIS. For this purpose, the main actuarial assumptions adopted for all schemes are based upon investment growth of 9% per annum; pay growth of 7% per annum; and increases in pensions in payment and deferred pensions of 5% per annum.

The last actuarial valuation of WPS and MIS was carried out as at 31 March 1996. The market value of the assets at the valuation date for WPS was £106m and the actuarial valuation of the assets represented 107% of the value of the accrued benefits after allowing for expected future earnings increases. For MIS, the market value of the assets at the valuation date was £16m and the actuarial valuation of the assets represented 114% of the value of the accrued benefits after allowing for expected future earnings increases.

The last actuarial valuation of LUKPS was carried out as at 1 November 1996. The fund is split into a Northern Section and Southern Section. The market value of the assets at the valuation date for the Northern Section was £87m and the actuarial valuation of the assets represented 104% of the value of the accrued benefits after allowing for future earnings increases. For the Southern Section, the market value of the assets at the valuation date was £118m and the actuarial valuation of the assets represented 134% of the value of the accrued benefits after allowing for expected future earnings increases. The surplus will be utilised by reducing future pension contributions. The total pension cost for the year was £8.5m.

## 26 Financial Commitments

### (a) Capital expenditure:

	Group 1997 £m
Expenditure contracted for	78.8

In addition to these commitments the Group has longer term expenditure plans which include investment to meet shortfalls in performance and condition and to provide for new demand and growth within the water and sewerage businesses.

### (b) Lease commitments:

The Group has entered into non-cancellable operating leases in respect of land and buildings, plant, machinery and motor vehicles. The total amount payable under these leases in the next year is as follows:

	Land and buildings £m	Other £m	Total Group 1997 £m
Leases which expire:			
Within one year	-	0.6	0.6
Within two to five years	0.3	2.8	3.1
After five years	0.4	-	0.4
	0.7	3.4	4.1

## 27 Contingent Liabilities

### (a) Deferred taxation:

No deferred taxation provision has been made in the Group or Company, except relating to pension surpluses, as it is not expected that any liabilities will crystallise in the foreseeable future. The full potential amount of deferred taxation calculated at 33% on all timing differences is as follows:

	Group 1997 £m	Company 1997 £m
Accelerated capital allowances	301.5	-
Other timing differences	(20.7)	(0.2)
	280.8	(0.2)

As infrastructure assets are not depreciated, deferred taxation will crystallise only in the event of a disposal of such assets at amounts in excess of their tax written down value. In the opinion of the Directors, the likelihood of a liability crystallising in the foreseeable future is remote. The tax effect of accelerated capital allowances on infrastructure assets has been included in the amounts set out above.

(b) The Company is party to a cross guarantee arrangement with certain subsidiary undertakings in respect of their bank overdrafts. The potential liability outstanding at 31 March 1997 amounted to £24.5m.

(c) The Company has guaranteed loan and bank facilities of subsidiary undertakings which in aggregate amount to £202.9m at 31 March 1997 and interest rate swap agreements of subsidiary undertakings, the contingent liability of which cannot be determined since it is dependent on future variable interest rates.

## **28 Related Party Transactions**

Transactions with other members of the Group headed by Lyonnaise des Eaux SA, outside the Northumbrian Water Group, totalled purchases of £16.2m and sales of £0.5m. The amount as at 31 March 1997 due to these companies was £6.8m and due from these companies was £0.3m.

The companies with which members of Northumbrian Water Group have had transactions during the period, included in the above balances were as follows:

- Degrémont SA
- Lyonnaise des Eaux de Berlin
- Lyonnaise des Eaux SA
- Lyonnaise des Eaux Management & Services SA
- Lyonnaise Europe plc

## **29 Ultimate Parent Company**

The ultimate parent company and the controlling party of the Company is Lyonnaise des Eaux SA, incorporated in France. The only group which consolidates the results of the Company and Group is Lyonnaise des Eaux SA. Copies of the consolidated financial statements are available to the public from Lyonnaise des Eaux SA, 72 Avenue de la Liberté, 92753 Nanterre Cedex, Paris, France.