

NORTHUMBRIAN WATER GROUP PLC

REPORT AND FINANCIAL STATEMENTS FOR

THE PERIOD ENDED

22 DECEMBER 1998

Registered Number 3114615



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CHAIRMAN'S STATEMENT

There is an old maxim: the measure of success of a water company is how much it goes unnoticed. That's no longer true; nor would we wish it to be. We work closely, sometimes uncomfortably closely, with regulators, with the environment, with customers. We no longer just deliver the goods; we are more exposed, more high profile, more accountable than ever before and that's good. Our business is increasingly competitive, increasingly global and we can't afford to play the wallflower.

Certainly, our first full year of membership of the enlarged Suez Lyonnaise des Eaux group has put us firmly on the world stage with all the additional benefits that brings of access to the best brains and best practices in the business. Northumbrian Water Group ("NWG"), through its companies, now operates in over 20 countries. We are gaining customers and business partners way outside our conventional industry, a practice unheard of a few years ago. For example our environmental and engineering consultancy provides services to nuclear power companies while our water companies are developing commercial partnerships with an electricity company. And with the completion of our energy from waste plant at Billingham and our first landfill gas power station, we, ourselves, have moved further into the energy generation business.

We may now perform on the world stage but the rules are unchanged. We have a responsibility to produce the finest products, to protect the environment, to deal fairly with our customers while not setting our staff unreasonable targets. That conundrum is set to become more difficult. The government has recently announced the largest ever environmental investment programme for the industry, and also called for the regulator to reduce prices by at least 10 per cent. It remains to be seen whether this can be achieved for the industry as a whole but it is clear that for NWG's water companies this is not achievable.

During 1998 we talked extensively with our customers. We believe we understand their concerns and priorities better than anyone. The message we got back was overwhelmingly clear; people want price stability, a quality product and a cleaner environment. Our two water companies have developed business plans that achieve these objectives.

NWG may be part of a global group but we haven't lost our regional focus. Our work on Teesside, for example – the massive and complex Tees Estuary Environmental Scheme – is helping Teesside to develop as a major industrial centre. Indirectly, we've helped to retain, and possibly create, jobs. We have approached this with a commercial mind, to ensure sound advantage to the region and to satisfy our customers.

For similar reasons we support local arts, educational, sport and community schemes. Through educational sponsorships we are helping to raise the scientific and technical capability of young people and the profile of engineering in society. Working with the Royal Academy of Engineering we are giving pupils from a school in Essex the opportunity to undertake a project to find ways of reducing demand for water. And through the Northumbrian Water Environmental Trust, now a year old, we've put over £1 million back into the community and environment and helped with projects as varied as drinks can recycling to a wildlife haven, an education resource centre to a national cycle route. We will be publishing the Group's fourth Environmental Performance report later this year.

We impact on our communities in more ways than just the supply of water and treatment of waste. Take the leisure aspect of our work. It could be argued that with angling, sailing, holiday cottages and a bird of prey centre, Kielder Water operates more as a recreational resource than a water resource; Hanningfield Reservoir too provides similar facilities. I get more letters from the public about angling than about any other water issue. This inclines me to believe that we really do know our customers better than anyone else.

Knowing what customers want is vital if we are to hold our own in the increasingly competitive, increasingly global, world of infrastructure services. We intend to be extremely visible and highly responsive.

Professor Sir Frederick Holliday

Chairman

25 March 1999

MANAGING DIRECTOR'S REVIEW

Our business is a balancing act. On the one hand, we have customers who demand, quite rightly, better services. On the other, we have regulators who constantly tighten the screws. Each year we have to work that bit harder to keep in balance. 1998 was no exception. But the fact that we have ended the year slightly ahead of our targets proves, I believe, that we are taking the right decisions, albeit tough ones.

Our UK water companies showed steady improvements, international water made progress, waste management is a continuing success, while our related services remained modest but active. Throughout all four divisions, the emphasis was on increased efficiencies.

The biggest change within the Group concerned Northumbrian Environmental Management Limited ("NEM"). In December 1998, it combined with SITA GB, our sister waste management company in the Suez Lyonnaise des Eaux group, to form SITA Holding UK Limited ("SHUK"). We now have a 35% share in the UK's leading waste management company. NEM has been a solid success story in recent years but further opportunities within its home region were limited. The merger means we can benefit from a large stake in an industrial sector with considerable growth potential.

The water companies continued to cut costs, which is good, but we've no room for complacency. In particular, Northumbrian Water Limited ("NWL") had difficult – but ultimately successful – discussions with Ofwat during the year to agree revised prices to reflect additional required capital spending along our North East coastline. Our water quality in both Essex and Suffolk Water plc ("ESW") and NWL is excellent, as is NWL's performance in sewage treatment. We believe we are delivering good levels of service to our customers and will continue to look for improvements which increase their satisfaction.

Northumbrian Lyonnaise International ("NLI") is now successfully managing water supply operations in Gibraltar, South Africa and Australia and bidding for further contracts in a number of countries in the face of tight competition. Finally, our related services companies turned in modest but useful profits, holding their own in competitive market places.

Overshadowing the whole year were the preparations for the 1999 periodic review. This sets the prices our water companies can charge customers for the five years from 2000 to 2005. The initial draft figures announced in October did not make comfortable reading – we would be expected to cut prices, after inflation, by more than 17.5%. While NWL is allowed at least a corresponding increase over the following four years, ESW is not. We are preparing our case to prove to Ofwat that the figures are unjustified (we have already made significant efficiencies), unrealistic (we have large capital investment programmes to deliver and in doing so our companies must remain financially viable) and unwanted (our customers have told us clearly that they prefer stable prices).

Competition is the new name of the game. Over the year, the two water companies have been exploiting new opportunities and targeting new customers. For example, we are bidding to supply effluent treatment services to a number of existing and new industrial customers.

	1 January – 22 December 1998 £m	Pro forma 1 January – 22 December 1997 £m
Turnover	545.6	504.7
Operating profit	222.3	201.5
Profit on ordinary activities before taxation	162.8	154.6
Profit on ordinary activities after taxation	133.1	128.7
Windfall tax	-	(79.4)
Profit on ordinary activities after windfall tax	133.1	49.3

We changed our financial year end in 1997 from 31 March to 31 December and, as explained in the Directors' Report on page 10, from 31 to 22 December in 1998. However, to compare performances in the last two years, we have used pro forma figures for the corresponding period of 1997. During 1998, Group turnover increased by 8.1% to £545.6m. Operating profit increased to £222.3m. Profit before taxation increased by 5.3% to £162.8m, despite higher interest charges incurred by large capital investment programmes. In January, we issued £200

million guaranteed Eurobonds to help finance NWL's investment programme. After taxation, the Group made a profit of £133.1m, an increase of £83.8m over 1997. This exceptional increase is due to the windfall tax that was provided for in full in 1997.

Future

1999 is a pivotal year. It's the last year under the current pricing structure for our two UK water companies. And it's the last opportunity to argue our case for a fair price settlement for the next five years. Whatever the outcome, we will continue to look for new ways of increasing efficiencies, while at the same time looking to win contracts to serve external clients. Innovation and aggressive competitiveness are the keys. Our two UK water companies will consequently continue to increase their customer focus.

Our international division is better placed, globally, to take advantage of the market and will be sharpening its commercial approach, and our related services companies will continue to build their client base outside the Group. We believe our waste management investment in SHUK will open up new opportunities for growth and development in this important sector.

Our industries no longer move slowly. Complacency was yesterday's luxury. The key is to spot the changes before they hit us. Only that way can we be ready to take advantage of them.

UK WATER

A considerable amount of time during the year was spent preparing for the Ofwat price review. Our priority was to find out what customers wanted. We are a service industry and we believe our customers' views are as important as environmental and economic considerations. We devoted a lot of time to detailed consultation through discussion groups, face to face computer-aided interviews, magazine surveys and public meetings. To increase reliability – and to avoid any suspicion of bias – we invited representatives from two of our regulatory bodies – the Environment Agency and Ofwat Customer Service Committees – to help design the research methodology. The response from customers, in both north and south regions, was clear and united: people want price stability and continued environmental improvements. They do not want bill increases; on the other hand lower prices were not a priority.

We presented these results and a huge amount of additional information in the late summer. The preliminary response by Ofwat – price cuts of over 17.5% - was not only disheartening but also, we believe, untenable. It neither reflects the views of customers nor recognises the limits for further efficiencies within the businesses. We are putting a great deal of effort into the next round of submissions and expect a more reasonable result in the next announcement.

Both companies also gave priority to preparations for the Year 2000. As part of a Group-wide project, all assets and systems with date-dependent microchips were identified. These are being tested so that potential problems can be rectified or systems replaced. The Group's emergency contingency plans are being reviewed and supplemented by specific event plans for the crucial turn of the year, prepared in conjunction with other bodies, including the major utilities and regional Emergency Planning Units.

NORTHUMBRIAN WATER LIMITED

- completion of two complex multi-million pound projects on Teesside
- high compliance levels for water and waste water
- organisational review of company operations
- top of the class in Which? Magazine report

One of our key issues during the year was the appropriate level for sewage treatment along our coastline. The situation is complicated by the fact that the major centres of population are on or near to the coast. Our business is driven by the need to invest heavily, but wisely, to protect that environment while still charging our customers a fair price, and constantly seeking to drive down costs.

One of the biggest tasks of the year was a detailed operational review of the company. We looked at both staffing and processes. Some savings are being achieved by voluntary severance but savings are being made in every part of the business.

Our capital investment programme continued at a high level in line with our obligations to meet European standards. We ended the year comfortably ahead of our investment target. The two major achievements were the effluent treatment and sludge processing plants at Bran Sands on Teesside. The £180 million effluent treatment works treats both sewage and industrial effluent previously discharged into the Tees. It is the only plant of its type in Britain and we have already signed substantial long term contracts with ICI, DuPont and British Steel to treat their effluent. In November, Mo Mowlam, Northern Ireland Secretary and MP for Redcar, opened the adjacent Regional Sludge Treatment Centre, designed by Entec. A first in Britain, it converts raw sewage sludge into pellets that will eventually be used to generate electricity, making the plant self-sustaining.

During the year, we finally got a government decision on the level of treatment required at four of our new coastal works. It was confirmed that upgrading to secondary treatment level was required. As a result, we successfully agreed a price adjustment with Ofwat to part-finance the costs.

The increased sewage treatment requirements do not stop there. The government has recently decided that secondary treatment is required at all significant coastal works. All told, the company will upgrade to secondary treatment at 14 works by 2001. In addition, at six of our coastal and estuarial works, ultra-violet disinfection will be installed within a few years.

Work also continued on our £10 million leakage detection and repair programme. We bettered our Ofwat target of 187 megalitres per day in 1997/98 and are on the way to achieving our even more demanding target in the current year.

The organisational review helped us rethink our marketing strategy. We are putting more effort into offering our industrial customers a more comprehensive, individually designed service. For example, we have won a twenty year contract to design, build and run an on-site effluent treatment plant for chemical company Union Camp, near Chester-le-Street. We are also making rapid progress in offering water and waste water services to business customers outside our region.

The annual Ofwat customer standards report, while putting us above average in many categories, identified areas for further improvement. We've already addressed our performance in one area, meter reading, and made significant changes. An independent survey in the June issue of the consumer magazine Which? placed NWL in the "best" category across all the eight service and environmental issues covered. We were the only water and sewerage company to achieve such a high score.

During the year we received other measures of our high standards. Despite increasingly stringent compliance tests, we achieved a drinking water quality pass rate of 99.8% maintaining our position amongst the top UK water companies. Our waste water standard was equally high. Our staff at Kielder Water won the Utility Industry Achievement Award for customer service, our new sludge processing centre at Bran Sands won NWL and Entec the Engineering Council's Environment Award in its built environment class and our coastal long sea outfall scheme won the Institute of Project Managers' Project of the Year. The latter beat several prestigious contenders, including London Underground's Jubilee Line.

	1 January – 22 December 1998 £m	Pro forma 1 January – 22 December 1997 £m
Turnover	352.6	333.6
Operating Profit	178.8	175.5

Future

Efficiency is still the driving force. Operating costs are constantly under review, balanced by the need to maintain high standards of customer service. But, increasingly, the key word is competition. Even within our 'home' market, we can't afford to be complacent. Others are keen for a share of it. To keep ahead of the pack we have to be innovative and pro-active. The organisational review of the last twelve months has set us up to be just that.

ESSEX AND SUFFOLK WATER plc

- improved levels of water resources
- record water quality compliance level
- improved customer service
- company-wide efficiency review

The wet year was a blessing. We claim no responsibility for that. However, we will take credit for the efficiency drives, demand management and engineering schemes which we've introduced over the last few years and which were also responsible for ensuring reservoirs reached their highest levels for some years.

Despite the above average rainfall, water resources continued to dominate our year. The aquifer storage and recovery project – an ambitious scheme for artificially filling underground reserves – proved more complex than anticipated, but is making good progress. Our waste water recycling scheme at Langford, introduced as a temporary measure in 1997 and using water previously lost to sea, worked exceptionally smoothly. We are now working to introduce a permanent scheme. Neither were we complacent on leakage; even though at 11% our rate is half the industry average, and amongst the best in the industry, we made further savings during the year.

We had a good response to our free metering scheme. Customers took up the offer at a rate of over 600 a week, which partly contributed to the reduction in water demand of 6.86 megalitres per day. 'WaterSmart', our water efficiency programme, was singled out by Deputy Prime Minister John Prescott as a 'prime example' of possible efficiencies. Under the scheme, customers are given free advice plus efficiency checks on simple water saving measures around the home. Initial results showed water usage had been cut by over 10%.

We are also targeting industrial customers. During the year, we visited a number of our major industrial users to carry out water efficiency audits. We worked closely with Entec to provide customers with detailed proposals on how to reduce water consumption, waste production and energy use, and to improve waste treatment processes. In one large food processing company alone, savings of 17% were identified.

Efficiency-seeking drives were not confined to customers. In August, we started a nine month programme to review key processes throughout the company – from bill payments to chemicals purchasing, vehicle usage to complaints procedures. Already, the programme is bringing significant savings. We also reviewed procedures for new house connections and launched a one-stop shop service, whereby one department now deals with the entire process for linking new housing developments to the water mains network. This means we can offer a quicker service at a competitive price. In addition, we started a training and development programme for all management level staff as part of the drive to make the company more commercially aware.

During the year, we have concentrated resources into further improving our customer service performance. We took on temporary staff, set tougher performance targets, re-trained management staff and improved key processes. As a result, we improved our levels of service across a range of Ofwat indicators. This is an ongoing programme; we have allocated additional resources to further improve our position.

We did well on other measures. Our water quality compliance rate reached a record level of 99.9%. We also gained the international quality assurance standard ISO 9002 throughout the company.

	1 January – 22 December 1998 £m	Pro forma 1 January – 22 December 1997 £m
Turnover	114.3	104.7
Operating Profit	42.3	39.9

Future

We still face uncertainties over water resources. We can survive the short term but we do not, for one moment, think we have solved our long term supply difficulties. But we are confident we are pursuing the right strategies.

We will continue to promote water efficiency with more emphasis being given to commercial and industrial customers. We plan further investments in water metering. On the supply side, we aim to have the aquifer recharge programme up and running by 2001 and we will work hard to present a strong case to promote a permanent water recycling scheme. Longer term, we're evaluating options for additional reservoir storage, either through expanding an existing site or building a new reservoir.

INTERNATIONAL WATER

NORTHUMBRIAN LYONNAISE INTERNATIONAL

- South African associate's turnover doubled
- increased bid activity
- key presence in Indian subcontinent

When NLI was established in 1996, it was difficult to predict, accurately, the status of the markets and our progress three years down the line. At the time, international water and waste water markets were rapidly developing as governments increasingly sought private sector participation, but the requirements and dynamics of each market differed. The needs, and business expectations, of India are different from Australia which are different again from South Africa. Each demands a unique approach. Nevertheless, the last twelve months have seen our international operations develop significantly in terms of turnover, experience and cultural understanding.

During 1998, we won projects, through affiliated companies for the provision of waste water treatment in part of Sydney, Australia and Auckland, New Zealand. An existing contract with Swaziland Water Services was extended for a further two years. Elsewhere, all proposals that we submitted passed at least the prequalification stage, generating the opportunity to pursue further contracts in 1999.

Our South African associate's operation doubled in turnover and profitability. Particularly noteworthy are the two BOTTs – build, operate, train and transfer schemes, which are run through our joint venture company, Water and Sanitation Services, South Africa. These are breaking new ground in providing water and sanitation services to the large rural populations of the Eastern Cape and Northern Province, in partnership with the government.

In Gibraltar, where we work in partnership with the government, significant cost savings have been made within the mains rehabilitation programme using 'no dig' technology developed by the Northumbrian Lyonnaise Technology & Research Centre and Fastflow Pipeline Services.

During the year, we established an office in Bangalore, India and are currently pursuing a number of opportunities. This is an emerging market where state governments are considering delegated management of their water and waste water services. Elsewhere, construction work began on projects won. For example in Auckland, New Zealand, work started on a waste water treatment plant, while a water treatment 'build, operate and transfer' scheme in Oslo, Norway, is on schedule to be commissioned early in 1999.

Future

1999 will see our activity levels increase in all regions. It will be hard work. But after three years, we feel we now have the right balance of technical skill, marketing knowledge and commercial awareness to compete successfully in the global market.

WASTE MANAGEMENT

NORTHUMBRIAN ENVIRONMENTAL MANAGEMENT LIMITED

- record growth in profits
- completion of energy from waste plant
- strengthened regional presence through business acquisitions
- successful integration into the UK's leading waste management group

Underlying the year was the preparation for our integration into SHUK, but this did not distract from the continued development of the business as North East England's leading waste management company. We are rare in the waste industry in that we offer a fully integrated service from waste collection, transport and treatment through recycling, composting and energy production to landfill.

We strengthened this position early in the year by buying six local companies. With two specialising in transport and waste handling and the others in landfill and quarrying, their businesses neatly complement our existing range and has helped to increase our revenues by around 25%.

In May, our largest project to date came on stream. The £40 million energy from waste plant at Billingham on Teesside converts domestic waste into electricity, supplying 20 megawatts to the National Grid, sufficient to power a medium-sized town. The plant offers a long term solution to the problem of local authorities' waste disposal and the need to meet government-imposed waste recovery targets. As well as processing domestic waste from the four Cleveland councils, we have contracts with North Tyneside Council and a number of commercial and industrial customers.

At North Tyneside, we completed a £3 million waste transfer station on the site of the old incinerator. This sorts the waste before it is transported to Billingham. This purpose-built plant increases the efficiency of the operation.

In the spring, we also launched our programme of energy production at landfill sites. The methane gas that collects underground is drawn off through pipes and used to power a turbine generator. Three sites now produce 5 megawatts of electricity which is fed into the National Grid. Over the next two to three years, as other sites are converted, this will increase by a further 12 megawatts.

We secured several new clients including the massive MetroCentre shopping complex in Gateshead and are finalising proposals with Newcastle City Council to manage its household, industrial and commercial waste for the next 15 years. Our proposals for the latter, working closely with the council, are to develop a waste recovery strategy to maximise the value of waste as a useful resource. Through a combination of a refuse-derived fuel – which will heat a council housing complex – and composting of organic waste, we aim to achieve a waste recovery level in excess of eighty percent. In addition, the compost will be used to restore our various landfill sites.

The business acquisitions, the start of the Cleveland energy from waste plant and the continued vigilance on costs, all contributed to a record growth year.

	1 January – 22 December 1998 £m	Pro forma 1 January – 22 December 1997 £m
Turnover	46.0	31.7
Operating Profit	8.2	3.7

Future

While NEM is the market leader in the region, we recognised further growth was limited if we remained a purely regional company. Our activities sit well with those of SITA and we have both followed the same successful

strategy of organic growth combined with carefully chosen mergers and acquisitions. Now, as part of SHUK, we have a national platform for our services.

Projects for 1999 include further development at the energy from waste plant to recycle the ash residue, currently sent to landfill, into aggregate for the construction industry, the building of a 45,000 tonne composting plant in Northumberland and further electricity from methane production at landfill sites. While the integration into SHUK has brought fresh and exciting opportunities for the company and staff, we don't intend to lose our regional strengths where these are appropriate.

RELATED SERVICES

Our related services companies play a clearly defined role in the Group. They provide key support services to our core businesses, they work with companies outside the Group to develop commercial opportunities and they establish a useful presence in overseas markets. The sector has continued to experience growth in external markets.

In our largest company, Entec UK, we have seen strong and consistent growth in turnover and profits and we are now one of only two multidisciplinary consultancies in the country able to offer a full range of services across all commercial and industrial sectors. During the period, we continued our supporting work with Group companies, notably on the two Bran Sands plants for NWL and supporting NLI bids. We continue to grow our work with external clients. On the engineering side we are now doing a significant amount of work with a number of large organisations in the UK water sector and continue to develop our services to industrial customers, such as Nestlé, Bush Boake Allen and Unilever. The development and increasing impact of new environmental legislation has supported growth in our environmental services, particularly related to central government research and best practice, and the remediation of contaminated land.

AES and Imass have continued to grow their external client base with the award of several prestigious contracts. During the period, we acquired the remaining 50% of Fastflow Pipeline Services Limited and, after a slow start to the period, have managed to secure several important contracts.

Our aid-funded consultancies, Agrer and Northumbrian Development Consultancy Services, experienced reduced funding for projects from most development agencies. They were able partially to offset the effects of this reduction by increasing their efficiency levels. In contrast our property company, Coquetdale Property Investment, had an excellent trading period with the disposal of various surplus properties from around the Group.

	1 January – 22 December 1998 £m	Pro forma 1 January – 22 December 1997 £m
Turnover	77.8	54.9
Operating Profit	0.5	2.9

Future

The strategy for the related services companies is to continue to expand our external client base, while, at the same time, continuing to provide support to companies within the Group.

RESEARCH

Officially opened in March 1998, our Northumbrian Lyonnaise Technology & Research Centre has had a successful and highly encouraging first year. Based in Horsley, Northumberland, it is part of Suez Lyonnaise des Eaux's worldwide network of technology and research centres. Its specific focus is underground asset management, an area in which, historically, North East England has a high skills level.

The centre's role is three-fold: to provide technical support to Northumbrian Water Group companies; to improve the efficiency of the companies' operations by identifying, and then transferring, the best technology; and to keep at the forefront of new technological developments. The centre is designed to be highly cost-effective. There is a small core team of research engineers and support staff that is supplemented on a project by project basis with outside expertise.

On the Research and Development front, the centre has been involved in the development of leakage management strategies, new lead service pipe liners and novel plastic pipe products, one of which is a high performance plastic pipe for use in especially tough terrain. This is a joint risk and cost-sharing exercise with Finnish pipework manufacturer, Uponor. The centre is currently negotiating a similar joint venture with the German plant and machinery manufacturer, Tracto Technik, to develop trenchless solutions to underground pipe laying and maintenance. Working in partnership brings significant benefits, not just in terms of efficiencies but also in quality assurance and risk minimisation.

In addition to work with NWL and ESW, during the period our staff have worked in sixteen countries. For example, they were involved in the preparation of the successful bid by Suez Lyonnaise des Eaux's US operator to take over the water supply services of Atlanta, Georgia, and similar support for Suez Lyonnaise des Eaux's bids in China, Argentina and Germany. We also gave support to NLI in its bids for water distribution contracts in Mozambique and Tanzania. In many cases, the team used a highly advanced and accurate network assessment technique, developed in-house – a good example of applied research.

IN CONCLUSION

We ended 1998 more efficient, more competitive, more street wise. Culturally, we have made a step-change. As a Group, we are less compartmentalised, less fragmented; there is a genuine sharing and cross-fertilisation of skills, ideas and knowledge. This will help us to maintain our position at the forefront of our industries.

We will also continue to play our part in the advancement of the wider Suez Lyonnaise des Eaux group. Several of our key people have been invited to take up posts elsewhere in the group – recognition that our staff are talented and valued. We demand a lot of our people. I make no apology for that. We are in tough industries and they will only get tougher. But the rewards are there.

Our achievements are only possible because of the skills and commitment of each individual within the Group. Everybody is to be congratulated for helping us come through what has been a very challenging, and at times difficult, year.

We can face the future with confidence, secure in the knowledge that we can meet and overcome challenges and compete successfully in our chosen markets.

Patrick Babin

Group Managing Director

25 March 1999

DIRECTORS' REPORT

NORTHUMBRIAN WATER GROUP plc

Directors' Report for the period 1 January to 22 December 1998.

The Directors are pleased to present their report on the affairs of the Company and its subsidiaries, together called the Group, along with the audited financial statements and the Auditors' Report for the period.

The group headed by the Company's ultimate parent undertaking, Suez Lyonnaise des Eaux, has completed a restructuring of its Waste Services activities in the UK during the year. This restructuring has comprised the combination of its UK waste businesses into one entity, SITA Holding UK Limited ("SHUK").

As part of this combination, the Group's 100% share in its own waste business, Northumbrian Environmental Management ("NEM"), was exchanged for a 28.8% share of SHUK. In addition, the Group acquired a further 6.2% for cash. SHUK now comprises the waste businesses of NEM and those previously owned by SITA GB and Browning-Ferris Industries UK.

In the consolidated accounts of Suez Lyonnaise des Eaux, no goodwill arises and no profit or loss is recognised as a consequence of this internal reorganisation. In the consolidated accounts of the Company, however, the 35% share of SHUK obtained in exchange for the Group's 100% share in NEM is treated as an acquisition under UK accounting rules. Accordingly, goodwill arises on the transaction, together with an unrealised profit on the disposal of NEM.

Under Financial Reporting Standard No. 10, "Goodwill and Intangible Assets", which came into effect for periods ending on or after 23 December 1998, the Group would have been obliged to capitalise the goodwill arising on the transaction and amortise it over a maximum of 20 years. Consequently, in order to enable the goodwill arising to be written off to reserves in the period, the Directors have decided to shorten the Group's accounting period and report at 22 December 1998. The accounting period will revert back to 31 December in 1999.

Activities

The principal activities of the Group during the period were the provision of water, waste water management, 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 (pages 2-9).

Financial Results and Dividends

The Group's results and dividends are as follows:

	Period to 22 December 1998	9 months to 31 December 1997
	£m	£m
Profit for the financial period	132.4	26.9
Dividends	(51.1)	(36.3)
Transferred to/(from) reserves	<u>81.3</u>	<u>(9.4)</u>

The Directors recommend a final dividend of 5.47p (9 months to 31 December 1997: 2.6p) per ordinary share. If approved, this dividend will be payable on 30 April 1999 to shareholders on the Company's Register of Members on 12 April 1999. Together with the interim dividend of 5.49p (9 months to 31 December 1997: 5.19p) per ordinary share, paid on 2 October 1998, the total dividend for the period will be 10.96p (9 months to 31 December 1997: 7.79p) per ordinary share.

Share Capital

There have been no changes to the issued share capital of the Company during the financial period.

Substantial Shareholdings

As at 22 December 1998, 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%
Northumbrian Partnership	20%
Suez Lyonnaise des Eaux	7.67%

Lyonnaise Europe plc is owned 80% by Suez Lyonnaise des Eaux and is a 50:50 partner in the Northumbrian Partnership.

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

The following served as directors throughout the period and were the Directors of the Company as at 22 December 1998:

Professor Sir Frederick Holliday CBE (63)

Non-Executive Chairman (appointed 22 March 1996).
Supervisory Board Member, Suez Lyonnaise des Eaux.

Sir Derek Bradbeer OBE TD (67)

Non-Executive Deputy Chairman (appointed 1 April 1996).
Consultant, Eversheds, Solicitors, Newcastle upon Tyne.

Patrick Babin (41)

Group Managing Director (appointed 29 February 1996).

Kam-Ling Chan (58)

Non-Executive Director (appointed 27 September 1996).
Managing Director, New World Services Limited, Hong Kong.

Peter Cheng (46)

Non-Executive Director (appointed 27 September 1996).
Director, New World Development Co. Limited, Hong Kong.

Donald Correll (48)

Non-Executive Director (appointed 28 June 1996).

Chairman and Chief Executive Officer, United Water Resources Inc., New Jersey, USA.

John Cuthbert (45)

Executive Director (appointed 29 February 1996).

Managing Director, Essex and Suffolk Water plc.

Jean-François Didion (59)

Non-Executive Director (appointed 1 April 1997).

Senior Vice President, International Water Division, Suez Lyonnaise des Eaux.

Anthony Harding (49)

Executive Director (appointed 1 April 1996).

Managing Director, Northumbrian Water Limited.

Antony Haynes (68)

Non-Executive Director (appointed 27 September 1996).

Former Chairman, Wellington Underwriting plc at Lloyd's of London.

Chairman, Essex and Suffolk Water plc.

Anne Minto (45)

Non-Executive Director (appointed 1 April 1996).

Human Resources Director, Smiths Industries plc.

Gérard Payen (46)

Non-Executive Director (appointed 1 April 1996).

Executive Vice President, Water, Suez Lyonnaise des Eaux.

Hugh Speed (62)

Non-Executive Director (appointed 1 April 1996).

Chairman, Northumbrian Water Limited

Christopher Storey (54)

Non-Executive Director (appointed 1 April 1996).

Director, Vaux Group plc.

John Ward OBE DL (65)

Non-Executive Director (appointed 1 April 1996).

Joint Deputy Chairman, Northern Rock plc.

In accordance with the Company's Articles of Association, Professor Sir Frederick Holliday, Kam-Ling Chan, Peter Cheng and Donald Correll will retire by rotation and, being eligible, will offer themselves for re-election at the Annual General Meeting.

Year 2000

All Group companies have continued to report monthly progress and issues to the Group as part of the Year 2000 Programme initiative, started in June 1997.

They are all making progress and have a deadline of 30 June 1999 to achieve millennium readiness. This includes not only their compliance programme but their readiness for the actual millennium "Event" itself, i.e. the several days either side of 31 December 1999. Ofwat has set a deadline of 31 July 1999 for all water companies to demonstrate readiness to a team of technical auditors. After that date, Ofwat will publish the names of the companies which it believes are not likely to be ready in time.

There is significant focus on the need for compliance of the national infrastructure organisations, in particular, the ability of the utilities to manage down the risks of the millennium bug. Ofwat, the Environment Agency, the Drinking Water Inspectorate, Water UK and other agencies have been working with, and auditing, the water companies at various stages in their programmes. NWL and ESW have Event planning projects in place and are working with the local county-based Emergency Planning Units (Police, Fire, Ambulance, etc), British Telecom, the local Regional Electricity Companies and Transco to co-ordinate plans.

All Group companies are considering their supply chains of customers and suppliers. Where these third parties are considered to be critical to the operation of the business, then face-to-face meetings are being held. It is because of the need to rely mainly on assurances from third party dependencies, that no organisation can give any guarantees that it is fully compliant. However, wherever possible, the companies will be making provision to mitigate any loss of supplies or services; for example, the water companies will have standby generators, where appropriate, and stocks of essential chemicals will be kept topped up. Finally, additional staff, both internal and external contractors, will be on-site, and on standby, in the event of any disruptions to normal operations.

The total cost incurred on the programme in the period to 22 December 1998 was £1.5m.

The total estimated cost for completing the programme is currently in the region of £13m. This includes both external and internal costs. Expenditure incurred on upgrades or replacement of assets will be capitalised where there is an enhancement to the operating performance of the asset as a result. Where no enhancements are achieved, expenditure will be written off to the profit and loss account.

Donations

The Group made charitable donations totalling £124,028 (9 months to 31 December 1997: £125,926) during the period. No political donations were made.

Research and Development

Research and Development within the Group is now co-ordinated by Northumbrian Lyonnaise Technology & Research Centre Limited, a specialist subsidiary wholly owned by the Company, which has links with other Suez Lyonnaise des Eaux group research organisations worldwide. The Group incurred costs of research and development in the period of £6.2m (9 months to 31 December 1997: £5.8m).

Employees and Employment Policies

Equal Opportunities

The Group operates an Equal Opportunities policy and seeks to promote equality of opportunity in recruitment, employment continuity, training and career development. The policy is designed to ensure that no applicant or employee receives less favourable treatment on the grounds of gender, marital status, nationality, ethnic or national origin, religion, disability or sexual orientation. Links established with external agencies, particularly with regard to the recruitment and retention of disabled people, are maintained.

Training and Development

Training and development of employees is a priority in the Company and in the Group. The Company has maintained its "Investors in People" National Standard and seeks to ensure continued development by individual Performance Development Reviews which are held regularly to review and assess individual performance and training requirements. This year the Group has again run its International Development Programme, created to ensure that highly skilled and experienced staff are ready and available to meet the ongoing worldwide business needs of the Group and its parent, Suez Lyonnaise des Eaux.

Communication

Communication with staff is achieved through the Group's corporate newspaper "WaterMark" and the increased use of the Group's intranet facilities. Employees are regularly informed about matters concerning their interests and the financial and economic factors affecting the Group. Companies within the Group have also established their own communication mechanisms such as team briefings, electronic mail and notice boards. Further, the companies are circulated with an English version of "Terre Bleue", Suez Lyonnaise des Eaux's corporate magazine.

Health and Safety

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 Medical Adviser. Most employees are members of a Group wide corporate health care plan managed by PPP.

Employee Investment Plan

During the financial period, and for the second consecutive year, the Group has operated an all employee preferential investment plan based on shares in its ultimate parent company, Suez Lyonnaise des Eaux. Through the plan, employees can invest in a fund which holds Suez Lyonnaise des Eaux shares, purchased at a discount to market value. Participation in the fund is limited to Suez Lyonnaise des Eaux group employees. The opportunity to invest in this plan has been offered to all Group employees in the UK and extended to its subsidiary in Belgium, and associated company in South Africa.

To encourage participation in the plan, the Group has made a discretionary contribution of up to £100 per employee; in the current period, 34% of the Group's employees (1997: 32%) invested in this fund.

The Board of Directors believes that such employee investment is a valuable method of strengthening the ties between Group employees and Suez Lyonnaise des Eaux by giving them the opportunity to participate more closely in its economic performance and results.

As a result of the successful implementation of this investment plan, the Company was awarded a commendation in the category of "Employee Share Ownership in UK subsidiaries of Overseas Companies" at the 1998 ProShare Awards for Promoting Excellence in Employee Share Ownership and Private Investor Services.

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 22 December 1998 was 4 days (31 December 1997: 6 days). This has been calculated using total invoiced costs and the number of days since 1 January 1998.

Corporate Governance

The Company's shares are not listed on the Stock Exchange and its accounting period ends before 31 December 1998. The Company is, therefore, not required to comply with rule 12.43A of the Yellow Book or with the Combined Code on Corporate Governance prepared by the Hampel Committee.

The Directors can, however, report that the Company has continued to comply with the recommendations of the Cadbury Committee on financial aspects of Corporate Governance.

Further, the Directors have taken due account of the recommendations of the Combined Code in determining the format and content of their report. They have endeavoured to maintain a proper level of disclosure, in keeping with the Combined Code provisions that they found were applicable to the Group's particular circumstances.

On 22 December 1998, the Board of Directors of the Company comprised 15 Directors, of whom 12 are Non-Executive Directors. (Hugh Speed became a Non-Executive Director on his retirement from employment with the Company on 31 July 1998.)

The following Standing Committees operated during the period within defined terms of reference and reported to the Company's Board of Directors.

Audit Committee

The Audit Committee comprised exclusively Non-Executive Directors. It met several times during the period with internal and external auditors. The Audit Committee considered the appointment of external auditors, provided an independent perspective on all financial reporting matters, internal control procedures and the consistency of accounting policies. It co-ordinated the action of the external auditors and the Group's internal audit team.

Remuneration Committee

The Remuneration Committee comprised exclusively Non-Executive Directors. The Remuneration Committee determined, and agreed with the Board, the policy for remuneration and other terms of service of Executive

Directors and some other members of the executive management. The objective of such policy is to ensure that members of the executive management are provided with appropriate performance incentives and are, in a fair and responsible manner, rewarded for their individual contributions to the success of the Company. In addition, the Director General of Ofwat keeps the Chairman of the Remuneration Committee informed of performance in respect of the water companies' levels of service, including leakage.

Further details of the Group's remuneration policy are disclosed in note 5 to the accounts.

Executive Committee

This comprised exclusively the Executive Directors of the Company and dealt with day to day business. An ad hoc Standing Committee dealt with matters outside the scope of the Executive Committee's terms of reference.

Nomination Committee

This comprised all Directors of the Company and its function is to review regularly the Board structure, composition and size and make all necessary adjustments, including proposing candidates for executive and non-executive appointments as Directors of the Company.

The Company Secretary acted as Secretary for the above Committees, except for the Remuneration Committee. Appropriate notice was given for each meeting and meetings were minuted.

Internal Controls

The Board of Directors has overall responsibility for the Group's system of internal financial control.

There are inherent limitations in any system of internal financial control and even the most effective system can only provide a reasonable, and not absolute, assurance against material misstatement or loss.

The Directors have reviewed the effectiveness of the Group's system of financial control, the major elements of which are detailed below:

Organisational Structure

Local Boards of Directors in the Group trading subsidiaries, the subsidiary boards, are responsible for the operational and financial control of their own businesses. Subsidiary boards report to the Executive Committee and to the Company's Board of Directors on matters including major strategic, financial, organisational, compliance and regulatory issues.

On a monthly basis, the Group Managing Director and the Group Finance Director compare the actual operational and financial performance of each business with plan and budget. Targets are set to measure performance and regular forecasts are made.

Information and Reporting System

The Company's subsidiaries are grouped into operating business units. Each of these business units holds a copy of the Group's financial control manual.

The Company's Board receives monthly financial reports for each business unit; the Board also monitors treasury and funding activities.

Budgets and Business Planning

The Group prepares detailed five year business plans and annual budgets which are reviewed by the Group Management Team (comprising Executive Directors and certain senior executives of the Group) and submitted to the Company's Board for approval. Business plans and budgets include an assessment of the key risks and success factors facing each business unit.

A framework exists which requires 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, requires that investments are limited to certain money market and treasury instruments and that the Group's exposure to any single bank, building society or market is controlled, with maximum deposits allowed with any single counterparty. The Group's investment strategy aims 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 the risk of changes in short term interest rates. Foreign currency exposure is also managed as part of the treasury strategy approved by the Board of Directors of the Company.

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

Company law requires the Directors to prepare financial statements which give a true and fair view of the state of the Group's affairs as at the end of each accounting period and of the profit and loss for the accounting period.

In preparing the financial statements, the Directors are required to:

- select appropriate accounting policies and apply them consistently;
- state whether applicable accounting standards have been followed;
- disclose any material departures from selected accounting policies or applicable accounting standards;
- make judgements and estimates that are reasonable and prudent;
- prepare the financial statements on the going concern basis unless they consider it to be inappropriate.

The Directors are responsible for ensuring that the Company keeps sufficient accounting records to disclose with reasonable accuracy the financial position of the Group and that the financial statements comply with the Companies Act 1985.

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:

- that the Company has maintained proper accounting records;
- that the financial statements are in agreement with the accounting records;
- that Directors' emoluments and other transactions with the Directors are properly disclosed in the financial statements; and
- 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. However, the Companies Act 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 1999 and the five year business plans for the period from 1999 to 2003. 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 'D. Watson', written over a horizontal line.

David Watson

25 March 1999

REPORT OF THE AUDITORS

To the shareholders of Northumbrian Water Group plc.

We have audited the financial statements set out on pages 20 to 40 which have been prepared under the historical cost convention and the accounting policies set out on page 24.

Respective responsibilities of directors and auditors

As described on page 17, 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.

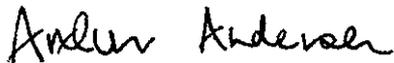
Basis of opinion

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 22 December 1998 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
Pearl Assurance House
7 New Bridge Street
Newcastle upon Tyne
NE1 8BQ

25 March 1999

CONSOLIDATED PROFIT AND LOSS ACCOUNT
For the period ended 22 December 1998

	Notes	Period to 22.12.1998 £m	9 months to 31.12.1997 £m
Turnover	2	545.6	391.7
Operating costs	3	(323.3)	(232.8)
Operating profit	2	222.3	158.9
Share of associated undertakings' losses		(0.2)	-
Investment income		0.8	0.6
Net interest payable	4	(60.1)	(37.1)
Profit on ordinary activities before taxation	2	162.8	122.4
Tax on profit on ordinary activities	8	(29.7)	(15.9)
		133.1	106.5
Windfall tax	8	-	(79.3)
Profit on ordinary activities after taxation		133.1	27.2
Minority interests		(0.7)	(0.3)
Profit for the financial period		132.4	26.9
Dividends paid and proposed	9	(51.1)	(36.3)
Retained profit/(loss) for the financial period	23	81.3	(9.4)

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

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS & LOSSES
For the period ended 22 December 1998

	Period to 22.12.1998 £m	9 months to 31.12.1997 £m
Profit/(loss) attributable to shareholders	81.3	(9.4)
Unrealised profit on disposal of subsidiary, after attributable goodwill of £7.3m	36.7	-
Exchange differences and other transfers	1.3	(0.3)
Total recognised gains/(losses) in the financial period	119.3	(9.7)

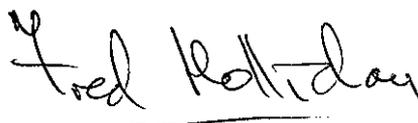
The information on pages 23 to 40 forms part of these financial statements.

Northumbrian Water Group plc

BALANCE SHEETS
As at 22 December 1998

	Notes	Group		Company	
		22.12.1998 £m	31.12.1997 £m	22.12.1998 £m	31.12.1997 £m
Fixed assets					
Tangible assets	10	1,841.2	1,765.7	0.5	0.5
Investments	11	3.2	3.0	1,110.5	1,031.2
		1,844.4	1,768.7	1,111.0	1,031.7
Current assets					
Stocks	13	8.4	6.5	-	-
Debtors: receivable after more than one year	14	25.0	27.8	-	1.1
Debtors: receivable within one year	14	256.9	111.5	502.3	123.9
Investments		0.2	0.2	-	-
Cash at bank and short term deposits	15	50.1	44.6	32.3	46.0
		340.6	190.6	534.6	171.0
Creditors: amounts falling due within one year	16	(329.3)	(321.6)	(212.2)	(164.8)
Net current assets/(liabilities)		11.3	(131.0)	322.4	6.2
Total assets less current liabilities		1,855.7	1,637.7	1,433.4	1,037.9
Creditors: amounts falling due after more than one year	17	(902.1)	(684.1)	(645.5)	(300.0)
Provisions for liabilities and charges	20	(50.8)	(54.0)	-	-
Accruals and deferred income	21	(30.0)	(28.9)	-	-
		(982.9)	(767.0)	(645.5)	(300.0)
Net assets		872.8	870.7	787.9	737.9
Capital and reserves					
Called up share capital	22	466.2	466.2	466.2	466.2
Share premium account	23	217.9	217.9	217.9	217.9
Group reconstruction relief reserve	23	-	107.6	-	-
Profit and loss account	23	184.9	74.4	103.8	53.8
Equity shareholders' funds	24	869.0	866.1	787.9	737.9
Minority equity interest		3.8	4.6	-	-
Total capital and reserves		872.8	870.7	787.9	737.9

Approved by the Board of Directors on 25 March 1999 and signed on its behalf by:



Professor Sir Frederick Holliday, *Chairman*



P Babin, *Group Managing Director*

The information on pages 23 to 40 forms part of these financial statements.

Northumbrian Water Group plc

CONSOLIDATED CASH FLOW STATEMENT
For the period ended 22 December 1998

	Notes	Period to 22.12.1998 £m	9 months to 31.12.1997 £m
Net cash inflow from operating activities	a	245.5	204.6
Returns on investments and servicing of finance			
Interest received		7.6	5.5
Interest paid		(53.7)	(39.0)
Interest paid on hire purchase contracts and finance leases		(3.0)	(0.3)
Dividends received from other fixed asset investments		0.6	0.1
Dividends paid to minority interests		(0.2)	(0.1)
Net cash outflow from returns on investments and servicing of finance		(48.7)	(33.8)
Taxation			
Taxation paid on ordinary activities		(34.1)	(1.6)
Windfall tax paid		(39.7)	(39.6)
Net cash outflow from taxation		(73.8)	(41.2)
Capital expenditure and financial investments			
Purchase of tangible fixed assets		(224.9)	(234.9)
Purchase of associate companies		(21.6)	(0.5)
Disposal of tangible fixed assets		5.1	1.9
Capital grants received		8.5	4.6
Net cash outflow from capital expenditure and financial investments		(232.9)	(228.9)
Acquisitions and disposal of subsidiary undertakings		(10.4)	2.8
Equity dividends paid		(37.7)	(45.7)
Cash outflow before management of liquid resources		(158.0)	(142.2)
Management of liquid resources			
Purchase of short term deposits		(249.8)	(101.0)
Disposal of short term deposits		256.1	121.2
Net cash inflow from management of liquid resources		6.3	20.2
Financing			
New long term borrowings received	b	245.1	126.8
Borrowings repaid	b	(45.0)	(12.3)
New loans granted	b	(59.5)	-
Payment of principal under hire purchase contracts and finance leases	b	(1.6)	(0.6)
Net cash inflow from financing		139.0	113.9
Decrease in cash in the period		(12.7)	(8.1)
Reconciliation of net borrowings			
Decrease in cash in the period		(12.7)	(8.1)
Cash inflow from increase in net borrowings		(139.0)	(113.9)
Cash inflow from management of liquid resources		(6.3)	(20.2)
Change in net borrowings resulting from cash flows	b	(158.0)	(142.2)
Loans and finance leases acquired with subsidiaries net of short term deposits acquired		(1.4)	-
Loans and finance leases disposed of with subsidiaries		46.2	-
Increase in finance lease contracts		(3.3)	(1.7)
Movement in net borrowings in the period		(116.5)	(143.9)
Net borrowings at start of the period		(674.6)	(530.7)
Net borrowings at end of the period	b	(791.1)	(674.6)

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

The information on pages 23 to 40 forms part of these financial statements.

Northumbrian Water Group plc

NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

For the period ended 22 December 1998

a Net Cash Inflow from Operating Activities

	Notes	Period to 22.12.1998 £m	9 months to 31.12.1997 £m
Operating profit	2	222.3	158.9
Depreciation of tangible fixed assets	10	47.3	30.0
Profit on disposal of tangible fixed assets		(1.2)	(1.4)
Loss on disposal of subsidiary		-	0.9
Other non cash movements		0.1	-
Amortisation of capital grants	21	(1.6)	(1.0)
Infrastructure renewals provision	20	26.0	19.4
Infrastructure renewals spend	20	(22.8)	(23.2)
Restoration provision	20	1.3	1.2
Restoration spend	20	(1.8)	(0.6)
Other provisions - net of spend		(5.9)	(7.5)
Increase in stocks		(0.6)	(0.9)
(Increase)/decrease in debtors		(37.3)	7.8
Increase in creditors		19.7	21.0
Net cash inflow from operating activities		245.5	204.6

b Analysis of Net Borrowings

	At start of period £m	Cash flow £m	Other non-cash changes £m	As at 22.12.1998 £m
Cash at bank	28.3	11.8	-	40.1
Bank overdrafts	(9.0)	(24.5)	-	(33.5)
	19.3	(12.7)	-	6.6
New loans granted to associate and parent company	-	59.5	46.2	105.7
Borrowings due after one year	(617.4)	(245.1)	26.7	(835.8)
Borrowings due within one year	(45.0)	45.0	(26.8)	(26.8)
Finance leases	(47.8)	1.6	(4.6)	(50.8)
	(690.9)	(151.7)	41.5	(801.1)
Short term deposits	16.3	(6.3)	-	10.0
Net borrowings	(674.6)	(158.0)	41.5	(791.1)

c Analysis of Cash Balances

	At start of period £m	In respect of acquisition and disposal of subsidiaries £m	Trading for the period £m	As at 22.12.1998 £m
Cash at bank and short term deposits	44.6	-	5.5	50.1
Less: short term deposits with maturity dates greater than one day	(16.3)	-	6.3	(10.0)
	28.3	-	11.8	40.1
Bank overdrafts	(9.0)	7.4	(31.9)	(33.5)
	19.3	7.4	(20.1)	6.6

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 18, 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 accounting reference date of a subsidiary is a date other than that of the Company, financial statements made up to the Company's accounting reference date have been used. The results of subsidiaries acquired during the period are included from the date of their acquisition. The results of subsidiaries disposed of during the period 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 investments 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 commissioned.

(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) Fixed asset investments. Fixed asset investments are stated at their purchase cost, less provision for any permanent diminution in value.

(i) 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 period they are incurred.

(j) 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.

(k) 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.

(l) Taxation. The charge for current taxation is based on the profit for the period 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.

(m) Research and development. Research and development expenditure is charged to the profit and loss account in the period in which it is incurred.

(n) 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 period and the results of foreign subsidiaries are translated at the average rate of exchange for the period. Differences on exchange arising from the re-translation 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 period in which they arise.

2 Segmental Analysis

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

	UK		International		Waste		Related		Total	
	Water		Water		Management		Services		Period	9 months
	22.12.1998	31.12.1997	22.12.1998	31.12.1997	22.12.1998	31.12.1997	22.12.1998	31.12.1997	to	to
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Turnover:										
UK	466.9	343.6	-	-	46.0	25.2	73.5	45.2	586.4	414.0
Rest of Europe, Middle East and Far East	-	-	6.5	-	-	-	2.0	2.8	8.5	2.8
Rest of World	-	-	-	-	-	-	2.3	-	2.3	-
Total turnover	466.9	343.6	6.5	-	46.0	25.2	77.8	48.0	597.2	416.8
Inter segment	(1.0)	(0.6)	-	-	(3.4)	(0.6)	(47.2)	(23.9)	(51.6)	(25.1)
External turnover	465.9	343.0	6.5	-	42.6	24.6	30.6	24.1	545.6	391.7
Operating profit:										
UK	221.1	163.5	(3.2)	(1.7)	8.2	3.5	0.2	1.1	226.3	166.4
Rest of Europe, Middle East and Far East	-	-	0.3	(0.2)	-	-	0.1	0.2	0.4	-
Rest of World	-	-	(0.1)	(0.2)	-	-	0.2	-	0.1	(0.2)
	221.1	163.5	(3.0)	(2.1)	8.2	3.5	0.5	1.3	226.8	166.2
Corporate centre									(4.7)	(3.8)
Other central non-allocable costs and provisions									0.5	(3.2)
Regional fund									(0.3)	(0.3)
Operating profit									222.3	158.9
Net common costs									(59.5)	(36.5)
Profit on ordinary activities before taxation									162.8	122.4

The Corporate centre comprises those costs that relate to the performance of the Holding Company's functions.

The Regional fund for economic and environmental regeneration, known as the "Northumbrian Water Kick-Start Fund", has a variable annual contribution from the Group in relation to overall business performance.

Net common costs, comprising share of associated undertakings' losses, 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

	Period	9 months
	to	to
	22.12.1998	31.12.1997
	£m	£m
UK	529.6	381.4
Rest of Europe, Middle East and Far East	14.1	8.5
Rest of World	1.9	1.8
External turnover	545.6	391.7

(c) Net assets

	UK		International		Waste		Related		Total	
	Water		Water		Management		Services			
	22.12.1998	31.12.1997	22.12.1998	31.12.1997	22.12.1998	31.12.1997	22.12.1998	31.12.1997	22.12.1998	31.12.1997
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Subsidiary undertakings	1,644.3	1,498.8	3.7	1.7	-	66.7	13.1	8.0	1,661.1	1,575.2
Share of associated undertakings' net (liabilities)/assets	-	-	-	-	(16.1)	-	2.6	-	(13.5)	0.3
Net operating assets									1,647.6	1,575.5
Unallocated net liabilities									(774.8)	(704.8)
Net assets									872.8	870.7

Net operating assets comprise tangible fixed assets, stocks, debtors and creditors which relate to segmental operating activities. Unallocated net liabilities comprise 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

	Period to 22.12.1998 £m	9 months to 31.12.1997 £m
Operating profit is stated after charging/(crediting)		
Materials and consumables	6.1	15.0
Manpower costs (note 7)	91.2	52.3
Depreciation on tangible fixed assets:		
owned	43.5	28.0
under hire purchase contracts and finance leases	3.8	2.0
Infrastructure renewals (note 20)	26.0	19.4
Amortisation of capital grants (note 21)	(1.6)	(1.0)
Other operating charges	144.0	106.5
Other operating income	(1.1)	-
Profit on disposal of tangible fixed assets	(1.2)	-
Operating leases:		
plant and machinery	2.0	1.4
other	3.8	2.7
Costs of research and development	6.2	5.8
Auditors' remuneration:		
audit	0.2	0.2
non-audit services	0.1	0.2
Regional fund	0.3	0.3
Total operating costs	323.3	232.8

4 Net Interest Payable

	Period to 22.12.1998 £m	9 months to 31.12.1997 £m
Interest payable on debentures, bank and other loans and overdrafts	64.7	39.6
On hire purchase contracts and finance leases	3.0	2.0
	67.7	41.6
Interest receivable	(7.6)	(4.5)
Net interest payable	60.1	37.1

5 Directors' Remuneration and Interests

(a) Directors' Remuneration

The remuneration of the Directors of the Company was:

	Fixed remuneration	Performance related bonus	Benefits in kind	Pension contributions	Total	
					Period to 22.12.1998	9 months to 31.12.1997
	£000	£000	£000	£000	£000	£000
Serving directors						
Professor Sir Frederick Holliday	71	-	21	-	92	72
Sir Derek Bradbeer	41	-	-	-	41	30
Patrick Babin *	93	18	48	11	170	131
Kam-Ling Chan	20	-	-	-	20	15
Peter Cheng	20	-	-	-	20	15
Donald Correll	20	-	-	-	20	15
John Cuthbert *	110	16	10	2	138	104
Jean-François Didion	20	-	-	-	20	15
Anthony Harding*	126	21	11	18	176	132
Antony Haynes	62	-	-	-	62	46
Anne Minto	20	-	-	-	20	15
Gérard Payen	20	-	-	-	20	15
Hugh Speed	99	5	43	-	147	146
Christopher Storey	20	-	-	-	20	15
John Ward	25	-	-	-	25	19
Sub total	767	60	133	31	991	785
Retired directors						
J Michael Taylor *	-	-	-	-	-	149
Total Remuneration	767	60	133	31	991	934

* Executive Director

H Speed became a Non-Executive Director on his retirement from employment with the Company on 31 July 1998.

J Michael Taylor resigned on 3 September 1997.

The aggregate remuneration of the highest paid Director, excluding pension contributions, was £159,000.

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 which receives 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 of Non-Executive Directors.

The bonus scheme for senior executives was approved by the Remuneration Committee. The scheme is based upon the principle 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. From 1 April 1998, the bonus period has been altered to match the Group's accounting period. The performance related bonuses shown above include an estimate for the period from 1 April 1998 to 22 December 1998 which will be subject to review by the Remuneration Committee following appraisal of the performance of the respective Directors.

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

Non-Executive Directors

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 the Group.

(b) Directors' interests

The Directors who held office at 22 December 1998 had the following beneficial interests in the ordinary shares, other than share options, and debentures of the Company's ultimate parent company, Suez Lyonnaise des Eaux:

Name of Director	Description of shares or debentures	22 December 1998	Start of period or subsequent date of appointment
Patrick Babin	Ordinary Shares of Ffr60	336	205
John Cuthbert	Ordinary Shares of Ffr60	63	39
Jean-François Didion	Ordinary Shares of Ffr60	85	65
Anthony Harding	Ordinary Shares of Ffr60	11	11
Professor Sir Frederick Holliday	Ordinary Shares of Ffr60	400	-
Gérard Payen	Ordinary Shares of Ffr60	1,754	1,484
Hugh Speed	Ordinary Shares of Ffr60	251	251

The Directors who held office at 22 December 1998 held the following options over ordinary shares of French francs (Ffr)60 each in Suez Lyonnaise des Eaux:

Name of Director	Start of period	Granted/(Exercised)	22 December 1998	Exercise price
Professor Sir Frederick Holliday	3,000	-	3,000	Ffr573
	-	3,000	3,000	Ffr978
<i>Total</i>	<i>3,000</i>	<i>3,000</i>	<i>6,000</i>	
Patrick Babin	1,000	(1,000)	-	Ffr430
	1,500	(1,500)	-	Ffr485
	2,000	(2,000)	-	Ffr493
	2,500	(2,500)	-	Ffr456
	3,500	-	3,500	Ffr573
	-	4,000	4,000	Ffr978
<i>Total</i>	<i>10,500</i>	<i>(3,000)</i>	<i>7,500</i>	
Donald Correll	500	(500)	-	Ffr485
	1,000	(1,000)	-	Ffr493
	1,000	(1,000)	-	Ffr456
	2,000	-	2,000	Ffr573
	-	2,000	2,000	Ffr978
<i>Total</i>	<i>4,500</i>	<i>(500)</i>	<i>4,000</i>	
John Cuthbert	500	(500)	-	Ffr485
	1,200	(1,200)	-	Ffr493
	1,200	-	1,200	Ffr456
	2,200	-	2,200	Ffr573
	-	2,300	2,300	Ffr978
<i>Total</i>	<i>5,100</i>	<i>600</i>	<i>5,700</i>	
Jean-François Didion	2,000	(2,000)	-	Ffr430
	3,000	-	3,000	Ffr485
	3,000	-	3,000	Ffr493
	3,000	-	3,000	Ffr456
	3,000	-	3,000	Ffr573
	-	2,000	2,000	Ffr978
<i>Total</i>	<i>14,000</i>	<i>-</i>	<i>14,000</i>	
Anthony Harding	500	(500)	-	Ffr485
	1,500	(1,500)	-	Ffr493
	1,600	(1,600)	-	Ffr456
	2,500	-	2,500	Ffr573
	-	2,600	2,600	Ffr978
<i>Total</i>	<i>6,100</i>	<i>(1,000)</i>	<i>5,100</i>	
Gérard Payen	1,000	(1,000)	-	Ffr430
	1,200	-	1,200	Ffr485
	8,000	-	8,000	Ffr493
	10,000	-	10,000	Ffr456
	12,000	-	12,000	Ffr573
	-	12,000	12,000	Ffr978
<i>Total</i>	<i>32,200</i>	<i>11,000</i>	<i>43,200</i>	
Hugh Speed	800	(800)	-	Ffr485
	1,200	(1,200)	-	Ffr493
	1,200	(1,200)	-	Ffr456
	1,400	-	1,400	Ffr573
<i>Total</i>	<i>4,600</i>	<i>(3,200)</i>	<i>1,400</i>	

No options have lapsed during the period.

The options are exercisable between the following dates:

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.

All options with an exercise price of Ffr573 were granted on 17 November 1997 and are exercisable between 17 November 2002 and 17 November 2005.

All options with an exercise price of Ffr978 were granted on 16 November 1998 and are exercisable between 16 November 2003 and 16 November 2006.

The highest and lowest prices of the Suez Lyonnaise des Eaux ordinary shares during the period were Ffr1,150 and Ffr662, respectively.

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		Accrued Lump Sum	
		22 December 1998 £000	31 December 1997 £000	22 December 1998 £000	31 December 1997 £000
John Cuthbert	NLPS	17	14	42	42
Anthony Harding	NLPS	43	39	120	117

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

As explained in note 25, the Group operates two defined benefit final salary schemes, the Northumbrian Lyonnaise Pension Scheme (NLPS) and the Water Mirror Image Pension Scheme (MIS).

Notes

- The pension entitlement and lump sum shown is that which has been accrued at 22 December 1998 based on pensionable service and the rules of the scheme.
- For members who joined NLPS after 31 May 1989, salary for pension purposes is limited to the earnings cap defined in the Finance Act 1989 of £87,600 for the 1998/1999 tax year (1997/1998 tax year: £84,000).
- J Cuthbert and A Harding, members of NLPS, 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 based on the pensionable service taken into account in calculating accrued benefits at the beginning and end of the Company's financial period.

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:

	Period to 22.12.1998 £m	9 months to 31.12.1997 £m
Wages and salaries	89.1	57.5
Social security costs	7.4	4.9
Other pension costs	6.6	5.2
Total employment costs	103.1	67.6

(b) Total employment costs were charged as follows:

	Period to 22.12.1998 £m	9 months to 31.12.1997 £m
Capital schemes and infrastructure renewals	11.9	15.3
Manpower costs	91.2	52.3
Total	103.1	67.6

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

	Period to 22.12.1998 Number	9 months to 31.12.1997 Number
UK Water	2,512	2,554
International Water	117	13
Waste Management	405	264
Related Services	1,125	893
Total	4,159	3,724

8 Tax on Profit on Ordinary Activities

	Period to 22.12.1998 £m	9 months to 31.12.1997 £m
UK corporation tax at 31% (1997: 31%):		
Current	30.6	17.8
Under provision in respect of previous periods	1.0	-
	31.6	17.8
Deferred taxation	(1.9)	(1.9)
	29.7	15.9

The tax charge for the period has been reduced by £23.5m (9 months to 31 December 1997: £25.8m) primarily due to the availability of capital allowances for which no deferred taxation was provided.

Windfall tax	-	79.3
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The windfall tax was a one-off tax levied on certain privatised utility companies by the UK government. It was provided in full in the 9 months to 31 December 1997 and was paid in two equal instalments on 1 December 1997 and 1 December 1998.

9 Dividends

	Period to 22.12.1998 £m	9 months to 31.12.1997 £m
Interim paid of 5.49 pence (9 months to 31 December 1997: 5.19 pence) per £1 ordinary share	25.6	24.2
Final proposed of 5.47 pence (9 months to 31 December 1997: 2.60 pence) per £1 ordinary share	25.5	12.1
	51.1	36.3

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 £m
Cost:								
At 1 January 1998	71.3	2.8	823.2	786.0	80.7	37.7	226.3	2,028.0
In respect of acquisition of subsidiaries	0.2	-	-	4.5	0.1	3.0	-	7.8
Additions	3.5	-	0.2	20.6	5.1	2.8	186.5	218.7
Schemes commissioned	11.3	-	38.7	91.7	15.1	-	(156.8)	-
Disposals to associate	(5.2)	-	-	(61.3)	(3.1)	(43.5)	(0.7)	(113.8)
Disposals	(3.4)	(0.1)	-	(0.3)	(0.4)	-	-	(4.2)
Grants - Infrastructure assets	-	-	(2.6)	-	-	-	(3.1)	(5.7)
At 22 December 1998	77.7	2.7	859.5	841.2	97.5	-	252.2	2,130.8
Depreciation:								
At 1 January 1998	18.0	0.4	-	177.7	57.5	8.7	-	262.3
Charge for the period	2.5	0.2	-	26.6	15.2	2.8	-	47.3
Disposals to associate	(0.8)	-	-	(5.9)	(1.5)	(11.5)	-	(19.7)
Disposals	(0.1)	-	-	(0.1)	(0.1)	-	-	(0.3)
At 22 December 1998	19.6	0.6	-	198.3	71.1	-	-	289.6
Net book value at 22 December 1998	58.1	2.1	859.5	642.9	26.4	-	252.2	1,841.2
Net book value at 31 December 1997	53.3	2.4	823.2	608.3	23.2	29.0	226.3	1,765.7

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 £78.3m (31 December 1997: £72.6m) 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 was as follows:

	22.12.1998 £m	31.12.1997 £m
Infrastructure assets	2.2	2.2
Operational structures, plant and machinery	31.1	32.7
Fixtures, fittings, tools and equipment	0.5	1.0
	33.8	35.9

(b) Company:

The Company had tangible fixed assets of £0.5m (31 December 1997: £0.5m), comprised mainly of fixtures and fittings.

11 Fixed Asset Investments

(a) Group:

	Associated undertakings £m	Other investments £m	Total £m
At 1 January 1998	2.4	0.6	3.0
Additions	96.9	-	96.9
Goodwill written off on acquisition of associate	(112.8)	-	(112.8)
At 22 December 1998	(13.5)	0.6	(12.9)
Disclosed as:			
- fixed asset investments	2.6	0.6	3.2
- provisions for liabilities and charges (Note 20)	(16.1)	-	(16.1)

All fixed asset investments are unlisted.

(b) Company:

	Associated undertakings £m	Interests in subsidiaries £m	Other investments £m	Total £m
At 1 January 1998	2.1	1,028.5	0.6	1,031.2
Additions	120.6	5.8	-	126.4
Disposals	-	(47.1)	-	(47.1)
At 22 December 1998	122.7	987.2	0.6	1,110.5

All fixed asset investments are unlisted. The principal addition comprises the acquisition of 35% of SHUK as disclosed in note 12.

(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 and Company %	Business activity
SITA Holding UK Limited (and subsidiary companies)	England and Wales	Ordinary shares of £1	35	Waste Management
Lyonnaise Water Southern Africa (PTY) Limited	South Africa	Ordinary shares of 0.5 Rand	50	Water and sewerage services
Baerum Vann AS	Norway	Ordinary shares of 100,000 Norwegian Krone	24	Water services

(d) The Group's interests in principal trading subsidiaries 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 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	99	Water services
Lyonnaise des Eaux (Gibraltar) Limited	Gibraltar	Ordinary shares of £1	67	Water and sewerage services
Entec UK Limited	England and Wales	Ordinary shares of £1	100	Environmental and engineering consultancy
Northumbrian Lyonnaise Technology & 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.

12 Acquisitions and Disposal of Subsidiaries

On 2 February 1998, the Group acquired an additional 50% of the share capital of Fastflow Pipeline Services Limited, bringing its total holding to 100%. The Group's waste disposal subsidiary, NEM, acquired six companies during the period. On 12 February 1998, it acquired 100% of the share capital of Sortwaste Environmental Limited and Gurteens Limited, and on 16 March 1998, it acquired 100% of the share capital of Ever 1007 Limited, Wm. E. Christer (Gravel) Company Limited, West Tyne (Gravel) Company Limited and Merryshields (Gravel) Company Limited.

On 22 December 1998, the Group sold its investment in NEM to SHUK, a subsidiary of SITA SA which is itself a fellow subsidiary of Suez Lyonnaise des Eaux. The consideration for the sale was in the form of shares in SHUK, representing 28.8% of its issued share capital. The Group also invested a further £21.4m in cash to acquire an additional 6.2% shareholding, bringing its total holding to 35% of the issued share capital. The difference of £112.8m between the fair values of consideration given of £96.7m and the Group's share of the tangible net liabilities of SHUK of £16.1m has been written off to reserves as goodwill on acquisition. The Group's profit on the sale of 65% of its subsidiary has been treated as unrealised and taken directly to reserves. As the transaction was completed on the last day of the accounting period, no results of the associate have been consolidated in these financial statements.

The book and fair values of the related assets and liabilities of the subsidiaries acquired, and the book values of the assets and liabilities of the subsidiary disposed of, were as follows:

	Purchase of subsidiaries £m	Sale of subsidiary £m
Fixed assets	7.8	94.1
Stocks	1.3	-
Debtors	4.4	15.3
Bank overdraft	-	(8.0)
Creditors due in less than one year	(5.4)	(16.0)
Creditors due after more than one year	(1.2)	(46.3)
Provisions for liabilities and charges	-	(7.8)
Net assets acquired/disposed of	6.9	31.3
Goodwill arising on acquisitions	10.9	-
Unrealised profit on disposal after attributable goodwill of £7.3m	-	36.7
Attributable goodwill written back on disposal of subsidiary	-	7.3
	17.8	75.3

Satisfied by:

Cash	17.8	-
Shares in associate company	-	75.3

The subsidiaries acquired have been consolidated by the Group using the acquisition method of accounting. The pre and post acquisition results and cashflows for the subsidiaries acquired during the period are immaterial and accordingly have not been separately disclosed.

Net cash flow in respect of the acquisitions and disposal comprised:

	Purchase of subsidiaries £m	Sale of subsidiary £m	Total £m
Cash consideration	(17.8)	-	(17.8)
Bank overdrafts (acquired)/disposed	(0.6)	8.0	7.4
Net cash (outflow)/inflow	(18.4)	8.0	(10.4)

13 Stocks

	Group	
	22.12.1998 £m	31.12.1997 £m
Stores	5.2	6.2
Work in progress	3.2	0.3
	8.4	6.5

14 Debtors

	Group		Company	
	22.12.1998 £m	31.12.1997 £m	22.12.1998 £m	31.12.1997 £m
Amounts receivable after more than one year:				
Pension surplus on acquisition	24.9	26.6	-	-
Advance corporation tax recoverable	-	1.1	-	1.1
Other debtors	0.1	0.1	-	-
	25.0	27.8	-	1.1
Amounts receivable within one year:				
Trade debtors	98.6	62.2	1.4	0.1
Net investment in finance leases	-	0.1	-	-
Amounts owed by subsidiary undertakings	-	-	391.1	121.8
Amounts owed by parent company and fellow subsidiaries	22.7	0.2	10.0	-
Amounts owed by associates	96.2	-	96.2	-
Corporation tax and advance corporation tax recoverable	0.2	1.1	-	-
Other debtors	9.6	11.6	3.3	1.5
Prepayments and accrued income	29.6	36.3	0.3	0.5
	256.9	111.5	502.3	123.9

In the Company, the debtor for amounts owed by subsidiary undertakings includes £9.5m (31 December 1997: £17.3m) in respect of amounts receivable for the provisional surrender of tax losses and advance corporation tax by the Company.

15 Cash at Bank and Short Term Deposits

	Group		Company	
	22.12.1998 £m	31.12.1997 £m	22.12.1998 £m	31.12.1997 £m
Short term cash deposits	11.6	36.0	11.6	36.0
Cash at bank	38.5	8.6	20.7	10.0
	50.1	44.6	32.3	46.0

All cash at bank and £1.6m (31 December 1997: £19.7m) of short term cash deposits are realisable on demand.

16 Creditors: Amounts falling due within one year

	Group		Company	
	22.12.1998 £m	31.12.1997 £m	22.12.1998 £m	31.12.1997 £m
Bank loans and overdrafts (note 18)	60.2	18.0	8.0	-
Commercial paper (note 18)	-	36.0	-	36.0
Obligations under hire purchase contracts and finance leases (note 19)	2.0	1.0	-	-
Trade creditors	16.4	23.3	-	-
Amounts owed to subsidiary undertakings	-	-	142.6	51.0
Amounts owed to parent company and fellow subsidiaries	13.9	12.6	-	-
Other creditors	45.6	28.8	5.3	4.4
Taxation and social security (see (a) and (b) below)	37.1	32.2	0.1	3.3
Windfall tax	-	39.7	-	39.7
Dividends payable				
- non-equity shareholders	0.2	0.1	-	-
- equity shareholders	25.5	12.1	25.5	12.1
Accruals and deferred income	128.4	117.8	30.7	18.3
	329.3	321.6	212.2	164.8

(a) The creditor for taxation and social security in the Group includes advance corporation tax of £4.5m (31 December 1997: £3.2m) and corporation tax amounting to £30.9m (31 December 1997: £26.0m).

(b) The creditor for taxation and social security in the Company includes advance corporation tax amounting to £Nil (31 December 1997: £3.2m).

17 Creditors: Amounts falling due after more than one year

	Group		Company	
	22.12.1998 £m	31.12.1997 £m	22.12.1998 £m	31.12.1997 £m
Loans (note 18)	318.4	295.1	151.1	-
Debentures (note 18)	22.3	22.3	-	-
Eurobond - due 1 February 2002 bearing interest rate of 9.25%	100.0	100.0	100.0	100.0
Eurobond - due 28 June 2006 bearing interest rate of 8.625%	200.0	200.0	200.0	200.0
Eurobond - due 6 February 2023 bearing interest rate of 6.875%	194.4	-	194.4	-
Amounts owed to parent company and fellow subsidiaries	0.7	-	-	-
Obligations under hire purchase contracts and finance leases (note 19)	48.8	46.8	-	-
Other creditors	17.5	19.9	-	-
	902.1	684.1	645.5	300.0

At 22 December 1998, 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%; £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%; and £25m over a five year period commencing on 23 May 1997 under which the Group is required to pay at a rate linked to LIBOR and will receive interest at 7.48%.

18 Loans

	Group		Company	
	22.12.1998 £m	31.12.1997 £m	22.12.1998 £m	31.12.1997 £m
Loans are repayable as follows:				
Less than one year	26.8	45.0	-	36.0
Between one and two years	11.0	26.8	-	-
Between two and five years	218.2	155.3	251.1	100.0
In more than five years	606.6	435.3	394.4	200.0
	862.6	662.4	645.5	336.0
Disclosed as due				
Within one year : Bank loans and overdrafts	60.2	18.0	8.0	-
: Commercial paper	-	36.0	-	36.0
: Amounts owed to parent company and fellow subsidiaries	0.1	-	-	-
Less: Bank overdrafts	(33.5)	(9.0)	(8.0)	-
After one year : Loans	318.4	295.1	151.1	-
: Debentures	22.3	22.3	-	-
: Eurobonds	494.4	300.0	494.4	300.0
: Amounts owed to parent company and fellow subsidiaries	0.7	-	-	-
	862.6	662.4	645.5	336.0

Loans to the Group from third parties, any part of which falls due for repayment in five years or more and which are repayable by instalments, amount to £234.3m (31 December 1997: £257.1m) and bear rates of interest in the range of 6.95% to 11.05% (31 December 1997: 6.95% to 11.05%) and £0.7m (31 December 1997: £8.3m) of these loans bear interest rates linked to LIBOR.

Loans to the Group from third parties repayable otherwise than by instalments which fall due for repayment after more than five years amount to £446.7m (31 December 1997: £252.3m) and bear rates of interest in the range of 3.5% to 12.0% (31 December 1997: 3.5% to 12.0%). Of these loans, £15.0m (31 December 1997: £15.0m) bear interest rates linked to LIBOR.

The aggregate amount of Group loans any part of which falls due for repayment in five years or more is £681.0m (31 December 1997: £509.4m).

Loans to the Company from third parties repayable otherwise than by instalments which fall due for repayment after more than five years amount to £394.4m (31 December 1997: £200m).

Included in the loans are debenture stocks as follows:

(a) £8.7m issued by North East Water plc and secured by a floating charge on the assets of Northumbrian Water Limited.

(b) £13.6m issued by Essex and Suffolk Water plc and secured by a floating charge on that company's assets.

19 Obligations under Hire Purchase Contracts and Finance Leases

	Group	
	22.12.1998 £m	31.12.1997 £m
Amounts due:		
In less than one year	2.0	1.0
Between one and two years	2.5	1.3
Between two and five years	5.7	5.9
In more than five years	83.2	92.2
Gross obligations	93.4	100.4
Less: finance charges allocated to future periods	(42.6)	(52.6)
	50.8	47.8
Disclosed as due:		
Within one year	2.0	1.0
After more than one year	48.8	46.8
	50.8	47.8

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 £91.1m (31 December 1997: £99.0m).

20 Provisions for Liabilities and Charges

	Group						Total £m
	Investment in associate £m	Reorganisation & restructuring provision £m	Aftercare and restoration provisions £m	Infrastructure renewals expenditure £m	Deferred taxation £m	Other £m	
At 1 January 1998	-	14.7	8.3	5.1	9.4	16.5	54.0
Transferred from/(to) the profit and loss account	-	3.4	1.3	26.0	(1.9)	(2.2)	26.6
Reclassifications/transfers	-	-	-	(3.5)	-	(2.9)	(6.4)
Purchase of investment in associate	16.1	-	-	-	-	-	16.1
Disposal to associate	-	-	(7.8)	-	-	-	(7.8)
Utilised during the period	-	(4.9)	(1.8)	(22.8)	-	(2.2)	(31.7)
At 22 December 1998	16.1	13.2	-	4.8	7.5	9.2	50.8

The deferred taxation provision relates principally to the pension revaluation surplus in respect of Essex and Suffolk Water plc.

The investment in associate relates to the acquisition during the year of a 35% share in SHUK, as described in note 12 above.

21 Accruals and Deferred Income

	Group £m
Capital grants:	
At 1 January 1998	28.9
Additions	2.8
Disposal to associate	(0.1)
Amortisation in the period	(1.6)
At 22 December 1998	30.0

22 Called up Share Capital

The share capital of the Company is shown below:

	At 22.12.1998 and 31.12.1997 £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

23 Reserves

	Share premium account £m	Group reconstruction relief reserve £m	Profit and loss account £m
Group:			
At 1 January 1998	217.9	107.6	74.4
Exchange differences and other transfers	-	-	1.3
Retained profit for the financial period	-	-	81.3
Goodwill written off on acquisition of subsidiaries	-	(10.9)	-
Goodwill written off on acquisition of associate	-	(96.7)	(16.1)
Unrealised profit on disposal of subsidiary after attributable goodwill of £7.3m	-	-	36.7
Goodwill previously written off on acquisition of subsidiaries	-	-	7.3
At 22 December 1998	217.9	-	184.9
Company:			
At 1 January 1998	217.9	-	53.8
Retained profit for the financial period	-	-	50.0
At 22 December 1998	217.9	-	103.8

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. Its profit for the financial period was £101.1m (9 months to 31 December 1997: loss of £40.1m).

The cumulative amount of goodwill written off to reserves amounts to £116.4m (31 December 1997: £nil).

24 Reconciliation of Movement in Equity Shareholders' Funds

	Period to 22.12.1998 £m	9 months to 31.12.1997 £m
Profit for the financial period	132.4	26.9
Dividends	(51.1)	(36.3)
Retained profit/(loss) for the financial period	81.3	(9.4)
Exchange differences and other transfers	1.3	(0.3)
Goodwill written off on acquisition of subsidiaries	(10.9)	-
Goodwill written off on acquisition of associate	(112.8)	-
Unrealised profit on disposal of subsidiary after attributable goodwill of £7.3m	36.7	-
Goodwill previously written off on acquisition of subsidiaries	7.3	-
Increase/(decrease) in equity shareholders' funds	2.9	(9.7)
Opening equity shareholders' funds	866.1	875.8
Closing equity shareholders' funds	869.0	866.1

25 Pensions

Until 31 March 1998, the Group operated 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).

With effect from 1 April 1998 the Group withdrew from WPS, the assets and liabilities of which were transferred to a new section within the LUKPS. With effect from 1 April 1998, LUKPS was renamed the Northumbrian Lyonnaise Pension Scheme (NLPS).

The employer's contributions to WPS, MIS, LUKPS and NLPS have been assessed and paid in accordance with the advice of independent actuaries. The last actuarial valuation of WPS and MIS was carried out as at 31 March 1996 and for LUKPS as at 1 November 1996. No valuation has been carried out on NLPS and hence no information is available on either the market value of its assets or the value of the accrued benefits of its members, allowing for future earnings increases. The market value of the assets at the last valuation date for MIS 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.

26 Financial Commitments

(a) Capital expenditure:

	Group	
	22.12.1998 £m	31.12.1997 £m
Expenditure contracted for	60.6	85.0

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	Period to 22.12.1998 £m	9 months to 31.12.1997 £m
Leases which expire:				
Within one year	-	1.0	1.0	0.8
Within two to five years	0.7	3.0	3.7	3.0
After five years	-	-	-	0.4
	0.7	4.0	4.7	4.2

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 not provided, calculated at 30% (31 December 1997: 31%), on all timing differences and infrastructure assets is as follows:

	Group		Company	
	22.12.1998 £m	31.12.1997 £m	22.12.1998 £m	31.12.1997 £m
Accelerated capital allowances	312.9	305.9	-	-
Other timing differences	(21.9)	(23.4)	(1.7)	(0.2)
	291.0	282.5	(1.7)	(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 which has been included in the amounts set out above is £185.1m, assuming a tax rate of 30% (31 December 1997: £180.4m, assuming a tax rate of 31%).

(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 22 December 1998 amounted to £17.0m (31 December 1997: £31.6m).

(c) The Company has guaranteed loan and bank facilities of subsidiary undertakings which in aggregate amount to £240.6m at 22 December 1998 (31 December 1997: £246.7m) 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 Suez Lyonnaise des Eaux, outside of the Group, comprised purchases of £9.7m (9 months to 31 December 1997: £19.1m) and sales of £3.1m (9 months to 31 December 1997: £1.7m). As at 22 December 1998, the amount due to these companies was £0.5m (31 December 1997: £3.7m) and due from these companies was £1.8m (31 December 1997 : £1.3m).

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

- Aguas Argentinas
- Corporate Dynamics
- Degrémont
- Lyonnaise des Eaux de Berlin
- Lyonnaise des Eaux Geneva
- Lyonnaise des Eaux Khatib and Alami
- Lyonnaise des Eaux Management & Services
- Lyonnaise Europe plc
- Lyonnaise South East Asia
- Safege
- Suez Lyonnaise des Eaux

29 Ultimate Parent Company

The ultimate parent company and the controlling party of the Company is Suez Lyonnaise des Eaux, incorporated in France. The only group which consolidates the results of the Company and Group is Suez Lyonnaise des Eaux. Copies of the consolidated financial statements are available to the public from Suez Lyonnaise des Eaux, 1 Rue d'Astorg, 75008 Paris, France.