

NORTHUMBRIAN WATER GROUP PLC

REPORT AND FINANCIAL STATEMENTS FOR

THE PERIOD ENDED

31 MARCH 2004

Registered Number 4760441



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NORTHUMBRIAN WATER GROUP PLC

Northumbrian Water Group plc (the Company or NWG) was admitted to the Official List of the London Stock Exchange on 23 September 2003, following four months on AIM. The Company listed on AIM on 23 May 2003, the day that it purchased Atlantic Water Limited (AWL) for a consideration of £1,010 million (excluding acquisition costs).

AWL includes Northumbrian Services Limited (NSL), formerly Ondeo Services UK plc, and its subsidiary companies. The acquisition was financed by cash of £880 million, comprising £344 million (net of expenses) raised from institutional investors and a short term loan of £536 million from Deutsche Bank. The balance of the consideration was satisfied by the issue of shares to Suez, the previous ultimate parent company of AWL, valued at £130 million.

NSL comprises a number of companies of which the largest are Northumbrian Water Limited (NWL), Entec UK Limited (Entec), Analytical & Environmental Services Limited and Fastflow Pipeline Services Limited (Fastflow). A division of NSL, Northumbrian Water International, manages waste water treatment plants in Scotland and Ireland, and water operations in Gibraltar.

NWL is a regulated water and sewerage company operating in the north east and south east of England (trading as Northumbrian Water and Essex & Suffolk Water respectively) and is committed to maintaining its leading position in the UK water industry for customer service and environmental protection. NWL currently provides water and sewerage services to 2.6 million people in the north east of England and water services to 1.7 million people in the south east of England.

This first annual report and financial statements for NWG and its subsidiaries (together the Group) covers the period from incorporation of NWG (12 May 2003) to 31 March 2004. NWG did not trade in the period from 12 May 2003 to 23 May 2003 and the financial statements therefore include ten months trading of the new Group. To provide comparative figures, the results of NSL for the ten month period from 23 May 2002 to 31 March 2003 are included. Also provided are pro forma figures for the 12 months ended 31 March 2004, which include the 12 months trading results of NSL to 31 March 2004, with the addition of the NWG acquisition accounting from 23 May 2003. The pro forma figures include eight weeks of pre-acquisition profits. The pro forma results are presented to provide a comparative for the equivalent period next year. The comparative and pro forma results have been presented in note 31 to the financial statements.

HIGHLIGHTS 2003/04

£442.1 million

Turnover for the ten months trading ended 31 March 2004

£145.8 million

Operating profit before exceptionals

£56.5 million

Profit before taxation and exceptionals

£67.5 million

Profit after taxation and before exceptionals

- Turnover of **£442.1 million** for the ten months trading ended 31 March 2004 (2002/03: **£429.0million**); pro forma turnover of **£520.8 million** for the 12 month period to 31 March 2004.
- Profit before tax and exceptionals of **£56.5 million** (2002/03: **£80.6 million**) principally reflecting the increased interest charges arising from the acquisition; pro forma profit before tax and exceptionals of **£65.0 million** for the 12 month period to 31 March 2004.
- Proposed final dividend of **4.63 pence per share**, giving a total dividend of **6.95 pence per share** for the ten month trading period.
- Levels of customer service, drinking water quality and environmental protection continue to be amongst the highest in the industry.
- Ofwat interim determination of price limits of **10.0% plus inflation** applied in 2004/05.
- Post balance sheet event: **£212.1 million** raised from a 30 year AAA rated bond, in securitisation of Kielder Water operating contract to refinance short term debt and European Investment Bank confirmed its intention to remain a lender to the core business.

CHAIRMAN'S STATEMENT

Business highlights

It has been an eventful period for the Group. Our flotation on AIM on 23 May 2003, which won several awards for its innovative structure, was followed by admission to the Official List of the London Stock Exchange on 23 September 2003 and inclusion in the FTSE 250 Index on 23 December 2003.

We were particularly pleased at the confidence shown in us by the institutional investors who took up the initial placing and that our former parent, Suez, chose to maintain a strong connection with us.

Financial performance

Turnover for our first trading period from 23 May 2003 to 31 March 2004 was £442.1 million, an increase of 3% over the same period to 31 March 2003 (2002/03: £429.0 million). The pro forma turnover for the 12 month period to 31 March 2004 was £520.8 million.

Operating profit for the trading period was lower at £143.6 million (2002/03: £144.0 million). Pro forma operating profit for the 12 month period to 31 March 2004 was £164.3 million.

On 12 May 2004, the Group announced the securitisation of NWL's contract with the Environment Agency (EA) to operate the Kielder Water transfer scheme. The proceeds arising from a 30 year bond have been used to repay short term debt of £205.0 million provided to part-finance the acquisition of AWL. This bond has been rated AAA by Moody's, Fitch and Standard & Poor's (S&P's). This transaction significantly strengthens the Group's financial position ahead of the next regulatory period.

We were pleased to receive our first Moody's credit rating for NWL of Baa1 on 8 April 2004, followed by an improvement of S&P's rating outlook from BBB stable to BBB positive on 16 April 2004. On 11 December 2003, Fitch assigned a credit rating of BBB+ for NWL.

The European Investment Bank (EIB) confirmed, on 12 May 2004, its intention to remain as a lender to NWL following our change of ownership.

A final dividend of 4.63 pence per share for the period ended 31 March 2004 will be recommended by the Board to the Annual General Meeting on 3 August 2004 and, if approved, will be paid on 13 August 2004 to shareholders on the register at the close of business on 16 July 2004. Together with the interim dividend of 2.32 pence per share, the dividend for the period is 6.95 pence per share.

People

A new Board was created at flotation and was strengthened by the appointment of Derek Wanless in December 2003 and Jenny Williams in May 2004. They bring with them a wealth of financial and policy experience. Their appointments mean the Group now complies with the provisions of the Revised Combined Code regarding independent directors. Further details of changes to the Board are given on pages 19 and 22.

I would like to thank my colleagues for their support during this extraordinary period of change – both NWG directors and also directors of NWL.

We have high expectations of our employees, which they continually meet and exceed. I am particularly proud of their work in the community. It is a tribute to our management style, with its open philosophy and flat structures, that the business maintained its strong performance during this period of corporate change.

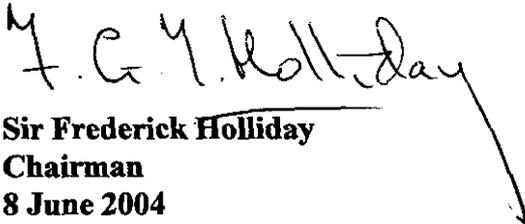
Strategy and prospects

The Group has established a leading position in its sector, with a record of delivery and reputation for excellence.

Our application in September 2003 for an interim determination of price limits by the Office of Water Services (Ofwat), resulted in NWL being able to raise its tariffs by 10% in real terms in 2004/05. It is important that the current Periodic Review of prices, with a conclusion due in December 2004, produces a sustainable outcome to allow NWL to build on its record.

We are monitoring environmental legislation in the UK and Europe. It is demanding, but we have anticipated the changes and are well placed to comply. We are acutely aware of the impact of higher costs on customers but believe we will continue to deliver value for money in terms of quality improvements.

The Group remains focused on its key activities: the delivery of excellent quality drinking water, the cleaning of domestic and industrial waste water to the highest standards and the provision of a selected range of related services. With efficient management of our assets, we can continue to generate the sustainable income streams and value our stakeholders demand and expect.

A handwritten signature in black ink that reads "F. G. Y. Holliday". The signature is written in a cursive style and is positioned above the printed name.

Sir Frederick Holliday

Chairman

8 June 2004

MANAGING DIRECTOR'S REVIEW

Key achievements

During a period of considerable change for the Group, its operating companies made good progress. NWL continued to perform well and turnover in our related services operations increased, more than offsetting the reduction in revenue following the sale of our information systems subsidiary, Imass Limited (Imass), in December 2002.

In the driest year on record since 1995, we maintained water supplies in both our northern and southern operations. This demonstrated the benefits of our investment in water resources and leakage detection in recent years. Our drinking water achieved the highest standard in the country in 2002 and maintained that very high quality in 2003.

We continued to invest in the business, upgrading our assets to comply with new or higher standards and maintaining our infrastructure. Total investment during the period was £158.4 million, down 13% on the equivalent period in 2002/03, including the completion of an innovative £14.5 million waste water recycling plant at Langford in Essex and a £30 million water treatment works at Wearhead in County Durham.

Our profitable related services companies are continuing to build their client bases outside the Group and our operations in Scotland, Ireland and Gibraltar continue to develop.

Protecting the environment is a critical business driver. We have a strong environmental team and our environmental policies are an integral part of the way we do business. Parts of the Group have already achieved ISO 14001 accreditation and we are on target to complete the roll-out across the whole of NWL by the end of 2004. By the end of the period all UK subsidiaries had achieved the ISO 9001:2000 quality standard.

A key component in delivering the Group's track record is the enthusiasm and dedication of our employees. One of the benefits of flotation is that they have an opportunity to share in the business in which they work. Approximately 30% have already taken advantage of this new opportunity and have joined the Share Incentive Plan launched in January 2004. Group average employee numbers are now 3,681, compared with 3,563 in NSL at December 2002. The increase of 118 in average employees is principally due to an increase of 147 and 78 at NWL and Fastflow respectively, offset by the disposal of Imass, which had 97 employees.

Outlook

The financial position of the Group has been significantly improved following the application of the interim price increase for 2004/05, the repayment of the short term loan with the proceeds of the Kielder Water securitisation and the confirmation that the EIB will remain a lender to NWL.

We look forward to the clarification of investment levels in NWL that will come with the outcome of the Ofwat Periodic Review in December 2004. We have prepared and submitted to Ofwat a well-balanced business plan, proposing a 28% increase in prices in real terms over the 2005 to 2010 review period. This would give us the capacity to deliver both quality improvements and maintain the high standards of service our customers expect.

The treatment of specialised industrial effluent offers the potential to mitigate the overall decline in industrial business. New contracts have been won this year and we are optimistic about future prospects of a similar nature.

We will continue to work closely with the regional development agencies in the north east and east of England to support moves to encourage business growth and attract new businesses to these areas.

We will continue to invest to ensure we can both meet our regulatory obligations and improve the efficiency and quality of the infrastructure underpinning our core business. We are focused on organic growth and will continue to use our specialist businesses to deliver innovative solutions to the Group and a growing portfolio of external customers.

John Cuthbert

John Cuthbert
Managing Director
8 June 2004

OPERATING REVIEW

UK WATER

Northumbrian Water Limited

NWL is a regulated water and sewerage company operating in the north east and south east of England. It trades as Northumbrian Water in the north, providing water and sewerage services to 2.6 million people. In the south, it trades as Essex & Suffolk Water and provides water services to 1.7 million people.

Financial performance

Turnover was £386.2 million for the trading period from 23 May 2003 to 31 March 2004 (2002/03: £372.9 million). The increased turnover in the current period is mainly due to the tariff increase in April 2003 after applying RPI, and increased income from commercial contracts. The pro forma turnover for the 12 month period to 31 March 2004 was £454.6 million.

Operating profit was £133.4 million for the trading period from 23 May 2003 to 31 March 2004 (2002/03: £130.9 million). The pro forma operating profit for the 12 month period to 31 March 2004 was £159.6 million.

An increase in operating costs of £10.8 million mainly reflects the following factors: increases in abstraction charges and rates (£3.4 million); increased manpower costs (£2.8 million); leakage costs charged to profit rather than capital following the achievement of the economic level of leakage in 2002/03 (£2.1 million); higher sludge treatment costs (£1.9 million) and bad debt costs (£0.8 million). Capital maintenance costs decreased by £1.0 million, reflecting the impact of commissioning new assets (£3.3 million), which was more than offset by a reduction in depreciation charges, following a comprehensive review of operating asset lives. This review was undertaken to support the depreciation charges included in the final business plan submitted to Ofwat in April 2004.

On 10 September 2003, NWL applied to Ofwat for an interim determination of price limits. On 5 November 2003, the Director General for Water Services announced his draft interim determination of 9.6% and this was followed on 11 December 2003 by his final determination. This allowed NWL to raise its tariffs by 10.0% in real terms in 2004/05. The application was made because NWL faced unanticipated additional costs caused by increased customer bad debt, water quality monitoring, new obligations requiring capital expenditure and lower than forecast demand for water.

During the period, NWL made preparations for the Ofwat Periodic Review that will set price limits for the five years from 2005 to 2010. A draft business plan was submitted to the regulator in August 2003, identifying that tariffs would need to rise by 37% during the period to ensure NWL can finance and carry out the activities and deliver the outputs required to fulfil its regulatory functions.

NWL's final business plan, modified in the light of the interim determination (IdoK), was submitted in April 2004. It seeks an increase in bills of 28% in real terms by 2010. Ofwat will announce its draft determination for consultation in August 2004 and its final determination in December 2004.

Investment

During the period, NWL invested £156.7 million (2002/03: £181.5 million), of which 40% related to major capital projects providing new facilities to improve the quality of drinking water and sewage treatment. A further 35% was invested in maintaining its existing 500 water and waste water treatment works and 40,700 kilometres of water and sewer pipes.

NWL's gearing, based on its net debt divided by a Regulatory Asset Value of £2,318.0 million at 31 March 2004, was 62%. On the same basis, the gearing of NWL's regulated business was 58%.

A major extension to the water treatment works at Broken Scar, Darlington, was completed at the end of 2003 to allow the plant to meet new drinking water standards and to increase operating efficiency. The project included relocating protected great crested newts to a new home to maintain the site's biodiversity.

A new £30 million Wear Valley water treatment works in Wearhead, County Durham, has been completed to safeguard the quality of water supplied to central Durham and Wearside. Built in an area of outstanding natural beauty, it was carefully designed to blend into its natural surroundings.

At Skinningrove, on the Cleveland coast, a new £8 million sewage treatment works was completed. Further north, a £6 million project to protect bathing water quality at Marske has provided underground tanks to store storm water that used to overflow into the sea.

Customer performance

NWL improved on its excellent customer service record against all bar one of the seven Ofwat customer service measures in 2003/04; the exception related to sewer flooding. The regulator has not yet published comparative results, but NWL anticipates that it will improve on the performance it achieved in 2002/03. In the previous three years, NWL had achieved seven out of a possible seven Ofwat customer service 'stars' (it is still the only water and sewerage company to have ever achieved this. During 2002/03, severe storms meant NWL lost the two stars that relate to sewer flooding.

These storm events also had a dramatic effect on NWL's ranking in Ofwat's overall performance assessment in 2002/03, accounting for two thirds of the points lost, losing NWL the 'top of the league' position it occupied in 2000/01 and 2001/02. The comparative results for 2003/04 have not yet been published, but NWL's performance has improved.

Drinking water quality compliance in NWL's northern and southern areas in 2003 was 99.93%, maintaining the excellent standard achieved the previous year. According to the Drinking Water Inspectorate's 2002 report, NWL's 99.93% compliance was the highest achieved by any water company during that year.

The rate of complaints per 10,000 connections recorded by WaterVoice, the customer watchdog for the water industry, in its Northumbria region in 2002/03, was the lowest amongst water and sewerage companies for the second year running. WaterVoice audits of NWL's handling of written complaints resulted in scores of 98.9% in the south and 86.4% in the north (both in Ofwat's 'good' category). Audits of telephone handling gave scores of 100% in both the northern and southern operating areas. NWL's customer research demonstrated continuing high levels of satisfaction with water and sewerage services.

A major refurbishment programme to reline or replace old cast iron water mains continued to address one source of complaints: discoloured water. NWL is proposing further work over the next five years to tackle this issue. NWL is also working in partnership with English Nature and Durham University to investigate opportunities to reduce the amount of colour in the raw water that comes from the peaty soil of the Pennines. Tackling the problem at source will deliver a more cost-effective solution than providing additional treatment stages.

NWL's northern area scored a maximum 100 in the Ofwat security of supply index in 2003/04, aided by Kielder Water, the largest man-made lake in Northern Europe which contains 220 billion litres of water. In its southern area, a drier climate and more concentrated population resulted in a lower index score of 90 – a significant improvement on the 68 scored in 2002/03. The improvement is the result of water resource planning, which is essential to balance demand and supply. A number of initiatives are in place to meet this challenge.

The new recycling plant at Langford increases available water supply in Essex by 8%. This innovative plant recycles water that would otherwise be lost to the sea and is the first of its kind in the UK. It was opened in October 2003, following a £14.5 million investment programme. An abstraction licence was granted for a new borehole in Suffolk, which became operational in April 2004. In the longer term, NWL is proposing a major £80 million investment project that would increase the capacity of Abberton reservoir by 60%.

NWL continues its major efforts to tackle leakage. Its northern and southern operating areas both achieved the leakage targets agreed with Ofwat and are at the economic level of leakage.

Commercial performance

Whilst overall demand from industry for water and waste water services continued to decline, revenues from the treatment of specialised industrial effluent increased and contracts with an annual value of almost £1 million were won during the period. New commercial customers included Huntsman and Vopak. NWL continues to work closely with the East of England Development Agency and One NorthEast to encourage industrial expansion and inward investment.

NWL also signed a contract with United Utilities (UU) to provide water from its new Wear Valley water treatment works to UU's customers in Alston and Garrigill.

NWL's Bran Sands plant on Teesside continues to deal with industrial and domestic waste water in innovative ways. A successful pilot project was carried out to use sewage sludge pellets produced by the site's sludge treatment centre as a fuel in the manufacture of cement at Lafarge's works at Cauldon in Staffordshire. This will guarantee a secure and sustainable outlet for the sludge, minimising NWL's costs.

Other related activities that utilise NWL's expertise and assets continued to perform well. A buoyant housing market has contributed to a growth in revenue from Property Solutions, a division of NWL that provides water, sewerage, flooding, coal authority and environmental searches to private and commercial property purchasers, via their solicitors and developers. Its turnover was £2.4 million in 2003 – an increase of almost 50%.

Environmental performance

NWL continued to set high environmental standards. All 33 designated bathing waters along the coast of north east England achieved the European Union (EU) mandatory standards, with 70% meeting the much more stringent guideline standard. This improved bathing water quality reflects the significant investment made at NWL's major estuarial and coastal sewage works.

NWL began the roll-out of the environmental management system ISO 14001 across the business during 2003 and is on schedule to gain certification by the end of 2004.

Energy consumption, and therefore the climate change levy paid, is rising as a result of investment made to meet the requirements of the Urban Waste Water Treatment Directive. However, energy management strategies have been developed to increase energy efficiency and maximise renewable energy potential. NWL also signed a new waste contract during the period, key elements of which were waste minimisation and recycling.

Working with partners is a key element in NWL's environment programmes. NWL has 24 sites that are within or comprise Sites of Special Scientific Interest. It is working in partnership with English Nature to identify what needs to be done to meet the targets set by the Government for such sites and the requirements of the Countryside and Rights of Way Act.

NWL also has eight formal partnerships with wildlife trusts and the Broads Authority. For example, it is working with the Durham Wildlife Trust to create a 15-acre wetland on the site of a redundant sewage treatment plant to create a home for bitterns, one of Britain's rarest birds.

Community involvement

NWL is an integral part of the communities it serves and focuses its community support on five key areas: economy, social inclusion, environment, education and regional support.

Increasingly, its support is focused on building partnerships and providing resources and less on giving grants and sponsorship. NWL is a member of Business in the Community's PerCent Club (members give the equivalent of over 1% of pre-tax profits in terms of gifts in kind, donations and employee time) and it committed a larger percentage than other water companies in the club's giving list in 2003.

To encourage employees to be involved in their communities, NWL established its 'Just an hour' initiative. This allows employees to spend an hour of their work time a month to support a community or environmental initiative. Projects range from reading in schools to supporting learning in prison, protecting sand dunes and clearing paths in overgrown woodland. During the period, 24% of staff signed up for projects under 'Just an hour'.

As part of its portfolio of initiatives to protect health, NWL launched its 'Chill out' campaign in September 2003 to introduce mains-fed water coolers to schools in the north east, Essex and Suffolk. These provide school children with easy access to quality drinking water – it helps their concentration and therefore attainment – and is backed by the Government's 'Healthy Schools' initiative. To date, NWL has provided grants to install water coolers in 97 schools.

People

With over 2,400 employees across several different geographical locations, good communication is an essential part of NWL's commitment to its staff. This is achieved through a range of mechanisms, including a weekly newsletter, bi-monthly briefings, an internal magazine and regular Companywide Forum meetings. The Forum comprises management and employee representatives, with the employee representatives being 50% trade union elected and 50% employee elected.

To gauge employees' feelings on a range of issues, NWL carried out its biggest ever employee attitude survey in April 2003. The results were presented at employee roadshows, which provided the opportunity for employees to find out about the longer term direction of the business from the Managing Director and Finance Director.

Health and safety and sickness absence targets are an integral part of NWL's staff bonus mechanism. Significant reductions have been achieved in days lost through accidents, the number of accidents and sickness absence, and NWL is committed to making further annual improvements. Health and safety improvements have come through increased training, improved risk assessment procedures, internal site inspections and capital investment. A help desk will be established in August 2004. Occupational health initiatives include the appointment of a new medical advisor, the creation of an employee counselling helpline, the introduction of fitness standards for all operational staff, health screening for all other staff and absence management training.

The management development programme has continued, with a further 36 senior managers completing the course, and a new team leader training programme has been developed. Certification to the new ISO 9001:2000 was achieved in June 2003 and this includes a special emphasis on training and competency.

During 2003, NWL launched the first phase of its terms and conditions review to harmonise several different sets of terms and conditions relating to leave, payments and allowances, and training and development. The outcome of the review was reported to employees in February 2004. The second phase of the review has already started.

Further information on NWL's customer, environmental, community and people activities will be provided in the Group's Sustainable Development Performance Report, due to be published in September 2004, an introduction to which is provided in the sustainable development statement on pages 14 and 15.

Looking forward

The outcome of the Periodic Review is the most significant factor determining the outlook for NWL and the Group. The Government has decided that capital investment will continue to be needed at significant levels to meet legislative requirements. It is essential that, at this Periodic Review, Ofwat allows NWL realistic levels of funding to enable it to maintain its assets at the levels needed to continue to provide its high quality services.

NWL has been in active discussion with regulators on a number of forthcoming European directives. It believes the direction taken by the Water Framework Directive will ultimately have a positive impact on costs, as it places a greater emphasis on resolving the cause of quality issues, rather than treating the outcome.

The investment planned in Essex to increase the available water resources will help ensure that supply continues to meet demand and that demand is managed more effectively by increasing the number of water meters and encouraging the use of water saving devices.

NWL will continue to strive for the highest quality and environmental standards and to regain and retain its position as leader in the Ofwat levels of service league tables. It will also continue its efforts to further improve already high levels of efficiency.

NWL is confident that it has the systems, processes and people in place to meet the challenges ahead.

WATER INTERNATIONAL

Northumbrian Water International (NWI) is the trading division of NSL responsible for managing the Group's interests in contracts in Scotland, Ireland and Gibraltar. Turnover was £17.6 million for the trading period from 23 May 2003 to 31 March 2004 (2002/03: £15.0 million). The increase mainly reflects £3.5 million of additional income from the first full period of operations at Caledonian Environmental Services (CES), NWI's project company at Levenmouth. The pro forma turnover for the 12 month period to 31 March 2004 was £20.7 million.

In Scotland, the Group is party to two private finance initiative (PFI) contracts with Scottish Water for waste water treatment. At Levenmouth, where the Group has a 75% shareholding in both project and operating companies, the new plant came on stream late in 2002. At Ayrshire, all three plants constructed for the project were also commissioned in late 2002. The Group has a 50% interest in the Ayrshire project company and a 75% interest in the operating company.

As part of a joint venture with four other companies, wholly-owned Group subsidiary Northumbrian Water Projects Limited (NWPL) is party to a contract to design, build and operate a new waste water treatment plant

for Cork City Council in the Republic of Ireland. The design and build phase is nearing completion and NWPL will then take over responsibility for the plant for the 20-year operating period.

AquaGib Limited, owned by the Group in joint venture with the Government of Gibraltar, continues to operate Gibraltar's dual drinking and sea water distribution systems under its 30-year contract with the Government of Gibraltar.

RELATED SERVICES

The Group's non-water companies' turnover was £70.2 million for the trading period from 23 May 2003 to 31 March 2004 (2002/03: £68.4 million). The pro forma turnover for the 12 month period to 31 March 2004 was £82.1 million. The sale of Imass in December 2002 reduced turnover in the trading period to 31 March 2004 by £3.2 million, though this has been more than offset by a net increase in turnover from the other Group companies.

Entec UK Limited

Entec UK is one of the UK's largest environmental and engineering consultancy companies, employing around 700 people delivering projects to both the Group and a range of external organisations in the public and private sectors. Over the last four years it has grown strongly to reach a turnover of £33.8 million for the period, up 17% on the same period last year (2002/03: £29.0 million) and 74% of revenue is now generated outside the Group.

Services provided include water and industrial engineering, contaminated land remediation, development planning, risk and safety management, energy services, environmental appraisal, environmental management and compliance, water management and waste management consultancy. Recent projects include a sustainability appraisal for the Greater London Authority's Draft London Plan, technical advice to Greater Manchester Waste Disposal Authority for Europe's largest waste PFI contract, an assessment of projected non-CO₂ emissions for the Department for Environment, Food and Rural Affairs and an integral role in a number of NWL's ongoing investment projects.

Fastflow Pipeline Services Limited

With 230 employees, Fastflow provides water and gas network renewal and refurbishment services, based on no-dig technologies, to NWL and other water companies. It received accreditation to apply new rapid setting polymeric linings to water mains in April 2003, which should significantly reduce interruption time for water companies' customers.

Turnover reduced by 12% to £13.4 million during the period (2002/03: £15.2 million). A recent entry into the gas pipeline market should provide a good opportunity for growth going forward.

Analytical & Environmental Services Limited

AES is a leading environmental monitoring company employing 300 people and providing a wide range of sampling, analysis and technical services for air quality, drinking water, waste water and contaminated land. Customers include major industrial groups, environmental regulators and local authorities throughout the UK and Ireland.

Turnover, at £10.9 million, was stable for the period (2002/03: £10.3 million) and new services for occupational hygiene, noise and vibration assessment were successfully established.

A number of major contracts were also agreed during the period, including selection by the Irish Department of Environment to audit its drinking water laboratories and the renewal of a framework agreement with the Environment Agency for monitoring air quality in England and Wales.

Northumbrian Water Technical Centre Limited

Providing technical solutions to operations for water and waste water management, NWTC is a small, specialist business with an international customer base. Projects were completed in the period for customers in Brazil, Chile, Hungary, Indonesia and NWL.

NWTC's research and development adds value to the Group through the application of innovative solutions and develops partnerships with academic and research organisations. For example, collaboration on pipeline innovation has assessed new materials, fittings and installation techniques. NWTC's turnover during the period was £1.0 million (2002/03: £2.1 million).

SA Agrer NV and ULG Northumbrian Limited

These companies are international development consultancies, working on projects funded by major aid agencies and development banks. They bring expertise to the poorest communities worldwide, contributing to sustainable development for rural areas, including rural water supply and sanitation, agricultural development and management of natural resources. Together Agrer and ULG had a turnover for the period of £6.4 million (2002/03: £7.5 million).

FINANCE DIRECTOR'S REVIEW

Group financial performance

The Group's turnover was £442.1 million for the trading period from 23 May 2003 to 31 March 2004 (2002/03: £429.0 million), reflecting a £13.3 million increase in income at NWL, mainly due to the increase in RPI, and £3.5 million of additional income from the first full period of operations at CES, offset by a reduction of £3.2 million following the sale of Imass in December 2002. The pro forma turnover for the 12 month period to 31 March 2004 was £520.8 million.

Operating profit was £143.6 million for the trading period from 23 May 2003 to 31 March 2004 (2002/03: £144.0 million). Operating costs have increased by £10.8 million at NWL and by £2.5 million at CES, offset by a £3.4 million reduction in costs following the sale of Imass. In addition, exceptional operating costs of £2.2 million have been recognised in the current period relating to severance costs and costs associated with the move to the Official List. The pro forma operating profit for the 12 month period to 31 March 2004 was £164.3 million.

Net interest payable, before exceptionals, was £92.8 million for the trading period from 23 May 2003 to 31 March 2004 (2002/03: £65.3 million). This £27.5 million increase mainly reflects: increased debt to finance the acquisition (£21.9 million) and NWL's investment programme (£3.6 million); interest on long term funds raised by NWL in late 2002 (£3.3 million); the cost of committed facilities at NWL to back up EIB loans and short term working capital (£1.5 million) and NWG's equity share of the interest paid by the Ayrshire project company (£1.5 million). These increases were partially offset by the amortisation of the fair value adjustment to the Group's net debt (credit of £5.3 million). A further £8.8 million exceptional charge arose on the acquisition debt. Net interest payable (excluding exceptional items) was covered 2.4 times by operating profit after adding back depreciation.

A tax credit of £14.0 million, relating to corporation tax (£9.1 million) and deferred tax (£4.9 million), arose in the period. The former includes a credit on exceptional costs of £2.3 million and prior period adjustments for the NSL group, partially offset by tax on profits at 30%. The deferred tax credit is mainly due to a significant increase in discount, reflecting movements in yields since 23 May 2003, partially offset by the reversal of timing differences.

Profit on ordinary activities after tax for the trading period from 23 May 2003 to 31 March 2004 was £59.5 million (2002/03: £79.2 million). The pro forma profit on ordinary activities after tax for the 12 month period to 31 March 2004 was £67.5 million.

Operating activities generated a net cash inflow of £218.5 million. The main cash outflows from normal operations were net investment in fixed assets (£148.4 million), net interest payments (£101.0 million) and equity dividends paid (£12.0 million). The most significant cash outflow was £788.9 million to purchase AWL. These outflows were mainly financed by the issue of new shares (£368.5 million) and an increase in the Group's net debt (£464.9 million).

The Group's net debt (prior to adjusting for fair value of £101.1 million) was £1,768.4 million at 31 March 2004. This reflects the purchase of AWL and NWL's ongoing investment programme. The Group's gearing, based on net debt (before fair value) divided by a Regulatory Asset Value of £2,318.0 million at 31 March 2004, was 76%.

Financial review statement

The Group has disclosed the comparative period of the acquired trading group, NSL, for the 10 months ending 31 March 2003 and the pro forma figures for the 12 months ending 31 March 2004. These are presented in note 31 to the financial statements.

Earnings per share and dividends

Basic and diluted earnings per share were 11.5 pence. Earnings per share, adjusted for exceptional items and deferred tax, was 12.2 pence. A final dividend of 4.63 pence per share for the period ended 31 March 2004 will be recommended by the Board to the Annual General Meeting on 3 August 2004 and, if approved, will be paid on 13 August 2004 to shareholders on the register at the close of business on 16 July 2004. Together with the interim dividend of 2.32 pence per share, the dividend for the 10 month trading period is 6.95 pence per share. The dividend cover for the period, before exceptionals, is 1.9 times.

Financing and credit rating

The securitisation after the end of the period of NWL's contract with the EA to operate the Kielder Water transfer scheme has strengthened the Group's balance sheet. On 12 May 2004, the proceeds arising from a 30 year bond were used to repay short term debt of £205.0 million. This bond has been rated AAA by Moody's, Fitch and S&P's.

NWL received its first Moody's credit rating of Baa1 on 8 April 2004, followed by an improvement of S&P's rating outlook from BBB stable to BBB positive on 16 April 2004. On 11 December 2003, Fitch assigned a credit rating of BBB+ for NWL.

The European Investment Bank confirmed, on 12 May 2004 its intention to remain as a lender to NWL following the change of ownership.

International Financial Reporting Standards (IFRS)

The Group will publish its first financial statements under IFRS for the year ending 31 March 2006. The Group has not yet determined the full effect of adopting IFRS. The implementation plan will depend upon the completion of the standard setting process by the International Accounting Standards Board and the endorsement of standards by the EU. Based on information currently available, the major differences in accounting policies expected to have an impact on the Group are deferred tax, employee benefits, fixed asset accounting, business combinations, intangible assets and share-based payments.

Pensions

The Group operates a funded defined benefit pension scheme, providing benefits based on final pensionable remuneration to 2,406 employees. The disclosures required in accordance with FRS 17 'Retirement benefits' are contained in note 27 to the financial statements.

Accounting policies

The Group has adopted and applied the accounting policies set out in the 2002 financial statements of NSL, with the exception of the accounting for court costs and solicitors' fees, which are written off as incurred. The financial statements have been prepared on the going concern basis under the historical cost convention. The directors have arrived at their decision based on consideration of the Group's net current liabilities in relation to the Group's detailed budget for 2004/05 and the business plan for the period to 31 March 2010.



Chris Green
Finance Director
8 June 2004

SUSTAINABLE DEVELOPMENT STATEMENT

The Group is producing a comprehensive Sustainable Development Performance Report for 2003/04 that reports on its sustainable development activities.

Commitment

The Group's mission statement places sustainable growth at the centre of what it does: 'we want to be a national leader in the provision of sustainable water, waste water and environmental solutions, developing stakeholder value and growing our business through competitive advantage'.

In undertaking its operations, the Group has regard for its customers, its employees, the communities it serves, the environment it protects and the partners with which it works.

The Group is committed to the principles of sustainable development and has for many years been a signatory of the International Chamber of Commerce's Business Charter for Sustainable Development. NWL and the other main Group subsidiaries have created their own environment policies and an overarching sustainable development policy for the Group as a whole is currently being developed. The latter has been influenced by a visioning workshop, attended by the Managing Director, Finance Director and senior employees, that was facilitated by Forum for the Future and its director, Jonathan Porritt.

The Group has developed a Code of Conduct, which covers the relationships it has with customers, employees, suppliers, shareholders and investors; the environment and communities impacted by the Group; its corporate governance and involvement with political parties. The code can be viewed on the Group's website.

Internal leadership

The Group's predecessor, NSL, had a Board sub-committee on Ethics, Environment and Sustainable Development. The role of the committee was recently reviewed and redefined as the Sustainable Development Committee and adopted as a committee of the Company. Its terms of reference include: 'to establish best practice and ensure compliance across the Group on ethical, environmental, social and economic matters in the context of sustainable development'.

During the period, this committee has considered a range of issues, including the impact of climate change on NWL and its business customers (with expert assistance from Entec); NWL's involvement in the SIGMA project, which has developed a framework and tools for a sustainability management system; the production of the Group's Code of Conduct; involvement in various sustainability indices, including the FTSE4Good Index; and the creation of the Group's first Sustainable Development Performance Report.

Environmental management systems are in place in most Group subsidiaries. NWL has ISO 14001 across 38% of its business, mainly covering waste water activities. It is currently in the process of reviewing and redeveloping its existing system and, by the end of 2004, this will have been extended across the whole of its business. Entec and the NWI companies in Ayrshire and Levenmouth have already achieved accreditation and AES is on target to achieve certification early in the next financial year. Fastflow uses its own QUEST system, which is in accordance with the requirements of ISO 14001.

External leadership

The Group has applied to become part of the FTSE4Good Index. It has met the entrance criteria and its application will be considered in September 2004. The Group has also been invited to submit data to the Dow Jones Sustainability Index; it will also hear in September 2004 if it has gained admission to this index.

NWL is a member of Business in the Community (BiTC) and participates in the organisation's Corporate Responsibility and Environmental Indices. In the 2004 BiTC Corporate Responsibility Index, NWL improved its score on the previous year by 8.5%, from 77.9% to 86.4%, placing it in 51st place out of the 139 companies that took part.

In the 2004 BiTC Environmental Index, NWL also improved on its score the previous year, this time by 10%, from 73.11% to 83.08%, placing it in 81st place out of the 179 companies that participated. The completion of the ISO 14001 roll-out within NWL during 2004 should help to further improve its score in this index.

Group employees also contribute to national, regional and local sustainability committees. For example, the Managing Director is Chair of BiTC in the north; the Environment Director is a member of the England Biodiversity Group, the Special Protection Areas Working Group and the north east region's SustainE and Environment Forums; and NWL's Sustainable Development Manager is Chair of Water UK's Sustainability Network.

BOARD DIRECTORS' BIOGRAPHIES

Sir Frederick Holliday - Chairman (68)

Sir Fred Holliday had a distinguished academic and scientific career, including a period as Vice-Chancellor of Durham University, before joining the original Northumbrian Water Group plc as a non-executive director in 1991. He became its Chairman in 1993. He was a director of Shell UK from 1980 to 1989 and Chairman of the Go-Ahead Group plc until October 2002. Sir Fred is currently the Chairman of Brewin Dolphin Holdings plc and is Vice-President of the Freshwater Biological Association.

John Cuthbert - Managing Director (51)

John Cuthbert joined the water industry in 1991 and was appointed Managing Director of North East Water plc in 1993. Following the acquisition of the original Northumbrian Water Group plc by Lyonnaise des Eaux in 1995, he transferred within the Group to become Managing Director of Essex and Suffolk Water plc. John took over as Managing Director of NSL, and also of NWL, in 2001.

Chris Green - Finance Director (49)

Chris Green joined the original Northumbrian Water Group plc in 1990 and was appointed its Finance Director in 1997. Chris was appointed as Finance Director of NWL and oversaw its merger with Essex and Suffolk Water plc in 2000.

Martin Nègre - Independent Non-executive Director (57)

Martin Nègre was, until June 2001, the Chief Executive Officer of NSL and the chief corporate representative of its parent company, Suez, in the United Kingdom. He is currently the Chairman of Ecofin Water & Power Opportunities plc, a listed investment trust focused on utilities.

Sir Patrick Brown - Senior Independent Non-executive Director (64)

Sir Patrick Brown held various positions in the Department of Transport and the Department of the Environment, becoming Second Permanent Secretary and Chief Executive of the Property Services Agency in 1990. He was Permanent Secretary for the Department of Transport from 1991 to 1997. Sir Patrick became a non-executive director of the Go-Ahead Group plc in 1999 and its Chairman in 2002, a post that he currently holds. He is also Chairman of Amey plc.

Jacques Pétry - Non-executive Director (49)

Jacques Pétry was a non-executive director of the original Northumbrian Water Group plc in 1996 and of NSL from October 2002 to May 2003. He was, until March 2004, the Chairman and Chief Executive of Suez Environnement and Executive Vice-President of Suez, in charge of water and waste operations. He stood down as a director of the Company in May 2004.

Derek Wanless - Independent Non-executive Director (56)

Derek Wanless rose to become a director of National Westminster Bank in 1991 and its Group Chief Executive in 1992. He retired from this position in 1999. Since 2001, he has been involved in reviewing the trends affecting health services for the UK Government. Derek is currently a non-executive director of Northern Rock plc and of Business in the Community, a Commissioner of the Statistics Commission and a Trustee of the National Endowment for Science, Technology and the Arts. He joined the Board of NWG in December 2003.

Alain Chaigneau - Non-executive Director (52)

Prior to joining Suez in 1984, Alain Chaigneau worked for the French Treasury Department (Ministry of Economic Affairs). He has held a number of directorships within the Suez group since 1984 and he is currently Senior Executive Vice-President and Chief Financial Officer of Suez Environnement. Alain became a non-executive director of NWL in May 2004, a position he also held from April 2000 to May 2003.

Jenny Williams – Independent Non-executive Director (55) (appointed post-year end)

In addition to being Head of Water Finance and Flotation at the time of water privatisation, Jenny Williams has held a variety of directorships in a range of Government departments, including the Departments of the Environment, Transport and the Inland Revenue. She was a Director-General and Board member of the Lord Chancellor's Department from 2001 to 2003. She joined the NWG Board in May 2004.

Bernard Guirkinger – Non-executive Director (52) (appointed post-year end)

Bernard Guirkinger joined Lyonnaise des Eaux in 1977 and held a number of operational positions, becoming Lyonnaise des Eaux's Director in charge of Germany and North and Central Europe in 1995. He became Chief Executive Officer of Lyonnaise des Eaux France in 1996. In 2002, Bernard became Executive Vice-President of Suez Environnement in charge of the European water division and Chairman of Lyonnaise des Eaux France. He joined the NWL Board in July 2002 and the NWG Board in May 2004.

DIRECTORS' REPORT

The directors are pleased to present their report on the affairs of the Group, along with the audited financial statements and the Auditors' report, for the period from 12 May 2003 to 31 March 2004 (the period).

Activities

The principal activities of the Group during the period were the provision of water, waste water management and related services. A review of the Group's business for the period is contained in the Operating review on pages 5 to 11.

Financial results and dividends

The Group's results and dividends are as follows:

**Period from 12.05.2003
to 31.3.2004**
£m

Profit after tax and minority interests for the financial period	59.4
Dividends	<u>(36.0)</u>
Transferred to reserves	<u>23.4</u>

A final dividend payment of 4.63 pence per ordinary share will be recommended by the Board at the Annual General Meeting, scheduled for 3 August 2004. If approved, the final dividend will be paid on 13 August 2004 to ordinary shareholders whose names appear on the Company's Register of Members at the close of business on 16 July 2004. Together with the interim dividend of 2.32 pence per ordinary share, paid on 7 January 2004, the total dividend for the period will be 6.95 pence per ordinary share.

Substantial shareholdings

As at 1 June 2004, the Group had been notified of the following interests in 3% or more of its issued share capital:

	Number of shares	Percentage of share capital
Amvescap plc	98,751,491	19.04
Aviva plc	24,750,000	4.77
Deutsche Bank AG	18,916,962	3.65
Suez	129,655,961	25.00

Waiver of dividends

Northumbrian Water Share Scheme Trustees Limited, which currently holds 440,000 shares to be used in the future to satisfy the vesting and exercise of awards under the Group's Long Term Incentive Plan (LTIP), has waived the right to all future dividends on the shares it holds. Further details of the LTIP can be found in the remuneration report on pages 28 to 34.

Post balance sheet events

On 12 May 2004, the Group's financial position was improved by the announcement of the securitisation of NWL's contract with the Environment Agency for the operation of the Kielder Water transfer scheme. The proceeds of £212.1 million were used to repay short term debt, of £205.0 million, arising from the acquisition of the Group's business. The Board has been strengthened following the end of the period by the appointment of Jenny Williams as an additional independent non-executive director. Following his resignation, Jacques Pétry, a Lyonnaise Europe plc nominated director (see page 25), has been replaced by Bernard Guirkingner, who appointed Jean-Louis Chaussade as his alternate director.

Directors

The following individuals served as directors during the period and were directors of the Company as at 31 March 2004: Professor Sir Frederick George Thomas Holliday (appointed 23 May 2003), Sir Patrick Brown (appointed 12 May 2003), Alain Chaigneau (appointed 23 May 2003), John Arthur Cuthbert (appointed 23 May 2003), Christopher Michael Green (appointed 23 May 2003), Martin André Bernard Nègre (appointed 12 May 2003), Jacques Francis Pétry (appointed 23 May 2003 and resigned 27 May 2004) and Derek Wanless (appointed 1 December 2003). Alain Chaigneau and Jacques Pétry were both nominated for appointment by Lyonnaise Europe plc, a subsidiary of Suez that is entitled to nominate two directors to the Company's Board. Their alternate directors were Michel Botrel and Bernard Guirkinger respectively.

All the directors will retire at the forthcoming Annual General Meeting and will offer themselves for election in accordance with the Revised Combined Code on Corporate Governance and the Company's Articles of Association. The directors' biographies are set out on pages 16 and 17.

Directors' remuneration and interests

Information about the remuneration and interests of directors is contained in the remuneration report on pages 28 to 34.

Donations

The Group made charitable donations totalling £34,265 and political donations totalling £7,961 during the period. It is the Company's policy that it does not, directly or through any subsidiary, make what are commonly regarded as donations to any political party. The definition of donations in the Political Parties, Elections and Referendums Act 2000 (PPERA 2000) is wide and covers activities that form part of the normal relationship between the Company and political organisations, such as sponsoring receptions and fringe meetings at party conferences and taking tables at dinners, intended to heighten awareness within the political arena of key industry issues and matters affecting the Company. Political expenditure and/or donations up to a total of £40,000 for the Group for the period of two years from the date of the approval, were approved by the shareholders at the Extraordinary General Meeting of the Company held on 16 December 2003. During the period, the Group did not incur any political expenditure as defined in the PERPA 2000 but did make political donations, applying the wide definitions from the PERPA 2000, as follows:

Name of EU political organisation	Donations for the period
Labour	£5,989
Liberal Democrats	£889
Conservative	<u>£1,083</u>
Total	<u>£7,961</u>

Research and development

NWTC, a specialist subsidiary of the Group, co-ordinates all research and development activities relating to underground assets for the Group. The Group, through NWL, maintains a limited programme of research and development activities, which are linked to UK business operations. A review of the development of the businesses of NWL and NWTC during the period can be found in the Operating review on pages 5 to 11. During the period, the Group incurred research and development costs of £4.1 million.

Employees and employment policies

Equal opportunities

The Group operates an equal opportunity policy which, since the end of the period, has been incorporated into a new broader policy document called 'Our Code of Conduct' and adopted by the Board. A copy of the new Code of Conduct can be found on the Company's website at www.nwg.co.uk. The Company promotes equality of opportunity in recruitment, employment continuity, training and career development throughout the Group. The policy is designed to ensure that no applicant or employee receives less favourable treatment on the grounds of age, gender, marital status, nationality, ethnic or national origin, religion, disability or sexual orientation.

Training and development

Training and development of employees is important to the achievement of Group goals and policies. Individual training needs are assessed regularly and the corporate initiatives of subsidiaries include an accelerated development programme for graduates and a management development programme. Annual appraisals are conducted and training needs are properly assessed throughout the Group.

Communication

Employees receive the Group magazine 'Watermark', which includes articles on Group activities and news from subsidiary companies. When necessary, information is communicated via a Group-wide 'news flash' facility ensuring employees are kept abreast of news. Individual Group companies utilise a range of communication mechanisms, including team briefing, magazines, newsletters, intranet, noticeboards and regular team meetings. NWL won a silver award from the northern region of the Institute of Public Relations for its internal communication activities in 2003. The Group encourages open feedback and protects employees who wish to voice concerns about behaviour or decisions that they believe to be unethical. NWL and Entec also invite employee feedback through the use of annual questionnaires.

Health and safety

The Group health and safety policy is maintained and implemented through each subsidiary's individual health and safety team. Occupational health services are provided by the Group's medical advisor, Previa UK. Most employees are members of a Group-wide occupational health care plan.

Employee Share Incentive Plan

The directors believe that employee investment is a valuable method of strengthening the ties between the Company and Group employees by providing the opportunity to participate more closely in the Company's economic performance and results.

In January 2004, the Company launched its Share Incentive Plan (SIP), open to the Group's UK tax paying employees with at least three months service. Participants may purchase ordinary shares in the Company in a flexible and tax efficient way, by means of deductions from their pre-tax salary of between £10 and £125 per month. Employees may also make lump sum deductions from salary, provided not more than £1,500 in pre-tax salary in total is invested per tax year. For every three shares purchased by an employee under the SIP the Company will give him or her one free matching share, which must be kept in the SIP for at least three years. Participants keeping all their shares in the SIP for at least five years will retain the benefit of having purchased shares using pre-tax salary. Awards of all shares under the SIP are satisfied using existing ordinary shares purchased on the market only. Dividends are currently paid in cash directly to participants.

Pensions

Information about the pension schemes operated by the Group is contained in note 27 to the financial statements.

Auditors

During the period, Ernst & Young LLP were appointed as Auditors. A resolution will be put to the members at the forthcoming Annual General Meeting proposing their re-appointment. Ernst & Young LLP have expressed their willingness to be re-appointed as Auditors.

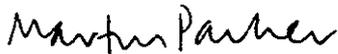
Creditors

The Company's policy is to agree payment terms with suppliers and to pay on time according to those agreed terms. In the absence of alternative agreement, the policy is to make payment not more than thirty days after receipt of a valid invoice. The ratio, expressed in days, between the amount invoiced to the Company by its suppliers during the period and the amount owed to its trade creditors at 31 March 2004 was 17 days.

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 2004/05 and the business plan for the period to 31 March 2010. Their analysis 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 plan.

By order of the Board



Martin Parker
Company Secretary
8 June 2004

CORPORATE GOVERNANCE REPORT

Introduction and general compliance statement

The Board is committed to achieving high standards of corporate governance and although the Revised Combined Code on Corporate Governance published in 2003 (the Revised Code) will only apply formally to the Company in respect of its financial reporting year commencing on 1 April 2004, the Board has endeavoured to comply with the principles and provisions of this code from the time of the Company's admission to the Official List of the London Stock Exchange, in September 2003. This statement describes how the Company has applied the Revised Code provisions and, where different, the current Combined Code on Corporate Governance published in June 1998 (the Combined Code). The period between the Company being listed on AIM on 23 May 2003 and 31 March 2004 is referred to in this corporate governance report as the period.

The Board recognises the importance to the Company and its shareholders of good corporate governance, which it regards as an integral part of the running of the Company. All directors and relevant employees are trained on the spirit and detail of the current standards of corporate governance and any related guidance, and compliance is monitored closely.

Following a thorough review of the Company's compliance against the Revised Code, the Board considers its adherence to the principles of the Revised Code is generally good. The Board considers that the Company has complied throughout the period with the provisions of the Combined Code, except with regard to the method of appointments to the Board (A.5), appointments of limited duration (A.6.1), all members of the Remuneration Committee being independent (B.2.2) and having at least three members on the Audit Committee (D.3.1). The Board is taking action to correct certain areas in which full compliance with the Revised Code has yet to be achieved. Non-compliances are reported and, where relevant, explained later in this report.

The Company's principal operating subsidiary, NWL, has also endeavoured to maintain its own high standards of corporate governance and comply with the Combined Code wherever practicable during the period.

The Board

During the period, the Board comprised Sir Fred Holliday (Chairman), John Cuthbert (Managing Director), Chris Green (Finance Director), Sir Patrick Brown (Senior Independent Non-executive Director), Alain Chaigneau, Jacques Pétry, Martin Nègre and Derek Wanless. Since the end of the period, Jacques Pétry has resigned and the Company was pleased to announce the appointment of Bernard Guirkingner and Jenny Williams. Martin Parker is the Company Secretary. The letters of appointment of Derek Wanless and Jenny Williams limit the duration of their appointment. The appointments of the other non-executive directors are not limited in duration. This position is not compliant with the Combined Code or the Revised Code (see page 30). Biographical details of the directors of the Company appear on pages 16 and 17.

The executive directors are John Cuthbert and Chris Green. Those individuals considered by the Board to be independent non-executive directors are Sir Patrick Brown, Martin Nègre, Derek Wanless and Jenny Williams. The Company therefore complies with the Revised Code's requirement that half of the directors, excluding the Chairman, are independent non-executive directors.

In determining the independence of Martin Nègre, the Board has taken into account that he was, until April 2001, the Chief Executive Officer of NSL (as an employee of the Suez group), during which time it was wholly owned by Suez. He is also the Chairman of Ecofin Water & Power Opportunities plc, which held 11,623,406 shares (2.24%) in the Company at 31 March 2004. The Board has considered the position of Martin Nègre and has determined that he is independent in character and judgement and that his past and current relationships and circumstances are not likely to affect his judgement.

The Board meets at least six times a year. Under the direction of the Chairman, the Company Secretary ensures that the directors receive all necessary information and ensures that relevant information flows effectively between the Board, its sub-committees and senior management. The Company Secretary also co-ordinates the induction process and assists with professional development, as required. A table showing the number of Board meetings held and attendance by individual directors can be found at the end of this report (see page 27).

The Board has overall responsibility for determining the Group's corporate strategy and the annual operating budget, setting the broad direction of the Group and directing its strategy and structure to ensure its continuance and prosperity. The Board monitors and controls the implementation of strategy, policies and plans, and legal and fiduciary obligations. Non-executive directors are encouraged to constructively challenge and help develop proposals on strategy. During the period, the Chairman met with the non-executive directors in the absence of the executive directors. This meeting addressed, amongst other business, the performance of the executive directors. Sir Patrick Brown, the Senior Independent Non-executive Director, met with the non-executive directors, without the Chairman or executive directors being present, to evaluate the Chairman's performance.

The Company has adopted formal guidelines, which set out the matters reserved to the Board for approval and those matters that are or can be delegated to the sub-committees and management. These guidelines are circulated widely to directors of subsidiaries and relevant senior managers within the Group. Urgent decisions not delegated to a specific committee can be taken by the Standing Committee between Board meetings, with decisions taken by a Standing Committee being reported at the next meeting of the Board.

The Company recognises its responsibilities towards its stakeholders and to the environment. To help meet those responsibilities the Company has, since the end of the period, adopted a Code of Conduct and will endeavour to act in accordance with this Code in all its activities.

The Chairman, in consultation with the Company Secretary, takes primary responsibility for the evaluation of the performance of the Board, its committees and individual directors. During the period, the Chairman has assessed the performance of each director against defined criteria and has discussed his assessment with each director individually. During the period, pending the appointment of additional independent non-executive directors, the performance of the Board and its committees were not evaluated formally. This is not compliant with the Revised Code. However, now that the additional independent directors have been appointed and membership of the committees is itself compliant, processes by which to evaluate Board and committee performance are being prepared.

The following committees of the Board were established in May 2003:

Audit Committee

During the period, pending the appointment of additional independent non-executive directors, the committee comprised Sir Patrick Brown and Alain Chaigneau. This position was not compliant with the Combined Code or the Revised Code. With effect from 27 May 2004, the Audit Committee comprises independent non-executive directors Sir Patrick Brown (Chairman), Derek Wanless and Jenny Williams, in accordance with the requirements of the Revised Code. The Managing Director and Finance Director also attend Audit Committee meetings at the invitation of the Chairman of the Audit Committee, but have no right of attendance.

The main duties of the Audit Committee are:

- to monitor and review the integrity of the financial statements and any formal announcements;
- to review the Company's internal financial controls and internal control and risk management systems;
- to monitor and review the effectiveness of the internal audit function;

- to make recommendations in respect of the external Auditors and approve its remuneration and terms of engagement;
- to review the external Auditors' independence;
- to develop and implement policy on the engagement of the external Auditors to supply non-audit services.

In addition to performing these duties, the Audit Committee planned for the introduction of the International Financial Reporting Standards for the financial year ended 31 March 2006.

The Audit Committee has approved a formal process for the prior approval of all non-audit services to safeguard the objectivity and independence of the external Auditors. Certain services are prohibited. All other services require prior approval, either from the Audit Committee Chairman, if under £50,000, or from the Audit Committee, if over £50,000. The Company requires the Auditors to report annually details of all non-audit services provided. Furthermore, the Auditors must confirm to the Audit Committee, in accordance with SAS610 (Communication of audit matters to those charged with governance), that it has considered its relationship with the Company and that, in its professional judgement, the objectivity of the audit engagement partner and audit staff is not impaired.

More detailed information on the functions performed by the Audit Committee is provided in its terms of reference, available on the Group's website. During the period, the Audit Committee met four times. A table illustrating committee meetings held and attendance by individual members is provided below (see page 27).

Remuneration Committee

During the period, pending the appointment of additional independent non-executive directors, the members of the committee were Martin Nègre, Sir Patrick Brown and Jacques Pétry. This position was not compliant with the Combined Code or the Revised Code. With effect from 27 May 2004, the Remuneration Committee comprises independent non-executive directors Martin Nègre (Chairman), Sir Patrick Brown and Derek Wanless, in accordance with the requirements of the Revised Code. The Managing Director has also attended the Remuneration Committee meetings at the invitation of its Chairman.

The main duties of the Remuneration Committee are:

- to review and recommend the remuneration, pension entitlements and other benefits of the executive directors and, as appropriate, other senior executives of the Group;
- to review the operation of share incentive schemes for directors and senior managers and the granting of awards under such schemes.

More detailed information on the functions performed by the Remuneration Committee is provided in its terms of reference, available on the Group's website. Full details of the directors' remuneration and a statement on the Company's remuneration policy can be found in the remuneration report on pages 28 to 34.

During the period, the Remuneration Committee met twice. A table illustrating committee meetings held, and attendance by individual members, is provided below (see page 27).

Nomination Committee

During the period, pending the appointment of further independent non-executive directors, it was felt that all Board members were able to provide a valuable contribution to the nomination process. The functions of the Nomination Committee were therefore performed by the Board until 27 May 2004. With effect from that date, the members of the Nomination Committee (following the revision of its membership on 27 May 2004) are Sir Fred Holliday (Chairman), Sir Patrick Brown, Martin Nègre, Derek Wanless, Jenny Williams, Bernard Guirkingier and John Cuthbert. The majority of members are independent non-executive directors, in accordance with the requirements of the Revised Code.

The main duty of the Nomination Committee is to identify and nominate candidates to fill Board vacancies for approval by the Board. More detailed information on the functions performed by the Nomination Committee is provided in its terms of reference, available on the Group's website.

Derek Wanless was appointed as an independent non-executive director on 1 December 2003 and Jenny Williams as an independent non-executive director on 27 May 2004, after the end of the period. With the exceptions of Derek Wanless and Jenny Williams, all the directors of the Company were appointed at the time of, or in connection with, incorporation in May 2003. In relation to the appointments of Derek Wanless and Jenny Williams, the Chairman sought advice and suggestions both within and outside the Company, considering career details and references in respect of several candidates for each post.

Bernard Guirkinger, who was also appointed after the end of the period, was nominated as a director by Lyonnaise Europe plc (the subsidiary of Suez that is entitled to nominate two directors to the Company's Board) following the resignation of Jacques Pétry.

The Committee is developing a formal and transparent procedure for the appointment of new directors to the Board and, with the exception of directors nominated by Lyonnaise Europe plc, this is expected to be applied to all future appointments.

Sustainable Development Committee

The Sustainable Development Committee comprises Sir Fred Holliday, John Cuthbert and Bernard Guirkinger; participation is also invited from subsidiaries around the Group. The Sustainable Development Committee establishes best practice and ensures compliance across the Group on all ethical, environmental, social and economic matters in the context of sustainable development. For more information on this committee, see the sustainable development statement (see pages 14 & 15).

Treasury Committee

The Treasury Committee comprises Sir Patrick Brown, Derek Wanless and Alain Chaigneau. Derek Wanless joined the Treasury Committee on 27 May 2004. The Treasury Committee is responsible for reviewing and recommending treasury policies to the Board, as well as monitoring the current economic environment and the likely future financing requirements of the Group.

Review of internal controls

The Board has overall responsibility for the Group's system of internal control. There are inherent limitations in any system of internal control and even the most effective system can only provide a reasonable, and not absolute, assurance against material misstatement or loss. The Company has reviewed the effectiveness of the Group's system of internal control, outlined below, as follows during the period:

- the Audit Committee and internal auditor have considered the methodology of the annual business risk analysis used;
- the internal auditor, Group Financial Controller and internal lawyers of the Company have reviewed the effectiveness of the Group's management guidelines and financial controls, and suggestions for revisions to the detail of financial reporting to the Board are being investigated;
- a working group, including relevant senior managers, has been set up within NWL to revise its financial control manual.

Organisational structure

Local boards of directors in the Group's trading subsidiaries (the Subsidiary Boards), are responsible for the operational and financial control of their own businesses. Subsidiary Boards report to the Managing Director or Finance Director and to the Company's Board on matters including major strategic, financial, organisational, compliance and regulatory issues.

For a number of years the Subsidiary Boards have performed a full annual business risk analysis using a risk methodology developed by Entec, to meet the recommendations of the Turnbull Report. This methodology sets out and rates all identified risks, including operational, external, financial, environmental, reputation, social and ethical risks. The results of the risk reviews are reported to the Audit Committee and a summary is reported to the Company's directors. Some subsidiaries, such as NWL, consider risks on a more frequent basis. Its management team considers significant risks in a structured way every two months, assessing the likelihood and potential impact of the relevant risks both before and after risk management measures have been put in place.

On a monthly basis, the Managing Director and the 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

Each Subsidiary Board holds a copy of the Group's financial control manual and management guidelines, which contain full details of the procedures for distribution of information and financial reporting.

Budgets and business planning

The Group prepares detailed medium term business plans and annual budgets, which are reviewed by the Managing Director and Finance Director 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.

The approval of the Board is required for major investments, including those in new and overseas markets, 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. This manages 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.

Relations with shareholders

The Company values constructive communication with its shareholders. The executive directors of the Company maintain regular dialogue with its large institutional investors, as well as delivering detailed presentations when the Company announces its interim and preliminary results. During the period, the Chairman's contact with major shareholders was on an ad hoc basis. Although the Board recognises that compliance with the provisions of the Revised Code in respect of relations with shareholders has not been fully achieved, steps are being taken to correct this. The Chairman would welcome contact by any major shareholder, and would be happy to discuss matters of governance and strategy with such shareholder. Institutional shareholders have not made any formal requests to meet with non-executive directors or vice versa. The Company is also currently looking at structured ways in which it may be able to help the non-executive directors develop an understanding of the views of major shareholders.

Shareholders can access the Company's website and are encouraged to attend the Company's Annual General Meeting, at which the Board will present the key financial results, business developments and events during the period. The Chairman, executive directors and the Chairmen of all Board committees are expected to be available at the Annual General Meeting to answer any questions raised by shareholders.

DIRECTORS' ATTENDANCE AT BOARD AND COMMITTEE MEETINGS DURING THE PERIOD

NAME	BOARD 28.5.03	AUDIT 31.7.03	BOARD 1.8.03	BOARD 1.10.03	AUDIT 10.11.03	AUDIT 26.11.03	REMUN- ERATION 26.11.03	BOARD 26.11.03	BOARD 13.2.04	AUDIT 19.3.04	REMUN- ERATION 25.3.04	BOARD 26.3.04
Sir Fred Holliday	✓		✓	✓				✓	✓			✓
Sir Patrick Brown	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Alain Chaigneau	✓	×	×	✓	✓ (BY TEL)	✓		✓	✓	✓		✓
John Cuthbert	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Chris Green	✓	✓	✓	✓	✓	✓		✓	✓	✓		✓
Martin Nègre	✓		✓				✓	✓	✓		✓	✓
Jacques Pétry	✓		✓	×			✓	✓	×		×	×
Derek Wanless									✓			✓
Bernard Guirkinger as alternate for J. Pétry				✓					✓		✓	✓
Michel Botrel as alternate for Alain Chaigneau												

✓ *Attended*

× *Absent*

Not a member of the Board or relevant committee

REMUNERATION REPORT

The Remuneration Committee

The Remuneration Committee (the Committee) of the Board is responsible for determining the remuneration and terms of employment of the executive directors and senior management of the Group. During the period between 12 May 2003 and 31 March 2004 (referred to in this remuneration report as the period) the Committee comprised three non-executive directors: Martin Nègre (Chairman), Sir Patrick Brown and Jacques Pétry. Since the end of the period, Jacques Pétry has been replaced on the Committee by Derek Wanless, so that all members are now regarded by the Company as independent. The Committee met twice during the period and received advice from John Cuthbert and from The Remuneration Practice, the remuneration consultants appointed by the Committee. During the period, The Remuneration Practice has advised the Committee on salary and bonus levels for executive directors and senior managers and has been asked to advise the executive directors on fee levels for non-executive directors. It has not provided other services to the Company during the period.

Statement of remuneration policy

The policy of the Company, which will be applied in 2004/05 and is intended to be applied in subsequent years, is to provide remuneration that is sufficient to attract, retain and motivate directors of the quality required to successfully run the Company, and that is commensurate with remuneration provided by comparable companies. The remuneration packages of the executive directors and details of the remuneration of non-executive directors are set out below. A significant proportion of executive directors' remuneration links rewards to corporate and individual performance.

Elements of remuneration

Executive directors : basic salary and benefits

The basic salaries of the directors are set out on page 31. The payment of basic salaries is not related to performance. Executive directors' basic salaries and benefits are reviewed annually, taking into account market comparators and individual performance. Benefits include membership of a defined benefit pension scheme, car allowance and healthcare.

Non-executive directors : fees and benefits

The Chairman receives an annual fee of £125,000 and benefits in kind, which include the use of a company car and driver and work related accommodation. The car, driver and accommodation are available to the Company when not used by the Chairman. All other non-executive directors are paid a fee of £30,000 per annum. This includes payment for services rendered as a member or chairman of any Board committee. The fees of non-executive directors are reviewed from time to time, with advice from The Remuneration Practice, to take account of inflation and to ensure the level of fees remains fair and competitive. Other than the Chairman, the non-executive directors do not receive benefits in kind, but expenses are reimbursed for attending meetings. Neither the Chairman nor the other non-executive directors participate in pension schemes operated by the Company.

Annual bonus

Executive directors have the opportunity of earning a bonus equal to up to 40% of their basic salaries against targets, including the financial performance of the Company and personal performance. Targets for the period 1 January to 31 December 2003 were set in November 2002 for John Cuthbert and Chris Green in their roles as executive directors of NSL and NWL. Neither the targets nor the structure of the bonus mechanism were changed by the Committee when John Cuthbert and Chris Green were appointed as directors of the Company in May 2003. The bonus mechanism requires NSL to achieve at least 95% of the budgeted profit before tax in order for any bonus to be payable.

At its meeting on 25 March 2004 the Committee agreed that the changes in the financial structure of the Group following the disposal by Suez in May 2003 make it difficult to assess this with certainty in relation to NSL. The Committee therefore agreed, for the purpose of the bonuses, to treat the profit before tax threshold as having been met, in the light of the actual financial performance of the Company since May 2003, and the exceptional demands placed on the executive directors in relation to the disposal process. In relation to 2004/05, the profit before tax target will apply to the Company.

The Chairman and other non-executive directors do not participate in the annual bonus scheme.

Long Term Incentive Plan (LTIP)

Under this plan, executive directors and senior managers may receive, at the discretion of the Remuneration Committee, a conditional award of shares in the Company with a value of up to 75% of basic salary. In relation to the LTIP awards made in the period, however, the Committee decided that the value of awards would not exceed the value of the annual cash bonus opportunity of the relevant directors or managers. John Cuthbert and Chris Green were therefore made conditional LTIP awards worth 40% of their basic annual salaries as at 1 October 2003, based on the Company's share price on that date (the start of the performance period referred to below), which was 102.9p per share. This resulted in LTIP awards of 85,603 and 56,618 shares respectively.

The proportion of the shares awarded that will vest is based on the Company's performance in terms of total shareholder return (TSR) (i.e. share price movements and re-invested dividends) during a fixed three-year period (from 1 October 2003) against the TSR of two comparator groups of companies. Up to 70% of the shares awarded will vest based on a comparison of the Company's TSR against the TSR of other quoted water companies, comprising Kelda Group plc, AWG plc, Pennon Group plc, Severn Trent plc, United Utilities plc, Bristol Water plc and East Surrey Holdings plc. Up to the remaining 30% of the shares awarded will vest based on a comparison of the Company's TSR against the TSR of companies (other than investment trusts) included in the FTSE 250 Total Return Index.

These performance targets will be applied on a graduated scale so that the better the performance of the Company, the greater the proportion of each award that will vest and thus the greater the number of shares that each participant will be able to acquire. For example, in relation to the performance based on the other quoted water companies, 30% of the 70% allocated to this target will vest if the Company has a median performance compared to the comparator group. The proportion of the award that will vest will increase the higher the relative position of the Company compared to the comparator group. Where the Company is the top performing company in the comparator group, 100% of the 70% will vest. None of the 70% will vest where the Company's performance is below the median performance.

Similarly, in relation to the performance based on the FTSE 250 Total Return Index, 30% of the 30% allocated to this target will vest if the Company's TSR equals that of the index and 100% of the 30% will vest where the Company's performance is the index growth plus at least 6% over the performance period, with a sliding scale for pro rata performance.

The performance conditions described above were chosen to align the interests of participants in the LTIP with those of shareholders. An independent firm of chartered accountants will be engaged to assess the extent to which the performance conditions have been met, so that the process is rigorous and transparent.

Employee Share Incentive Plan (SIP)

In January 2004, the Company launched a Group-wide employee SIP, brief details of which are given in the Directors' report (see page 20). During the period, all executive directors had the opportunity to participate in this plan. The first shares were purchased and allocated under the plan on 4 May 2004. The interests of the executive directors in shares purchased under the plan appear in the table on page 33.

Performance graph

As at 31 March 2004 the Company had less than one year of performance data to display. The Company was incorporated on 12 May 2003, traded on AIM from 23 May 2003, was admitted to the Official List of the London Stock Exchange on 23 September 2003 and was included in the FTSE 250 Index on 23 December 2003. Accordingly, the directors consider that it would not be appropriate for a performance graph to be included for this first reporting period.

Service contracts

The executive directors, John Cuthbert and Chris Green, have service contracts with the Company entered into on 22 May 2003 that are terminable on 12 months notice by either party and that expire when the directors reach normal retirement age. The service contracts of the executive directors do not contain provisions relating to compensation for termination. In the event of termination by the Company of any executive director's service contract, the Board would determine what payments, if any, should be made to the director, depending on the circumstances of the termination.

Sir Patrick Brown and Martin Nègre were appointed as non-executive directors of the Company by letters of appointment dated 12 May 2003. Sir Fred Holliday, Jacques Pétry (who resigned on 27 May 2004) and Alain Chaigneau were appointed as non-executive directors of the Company by letters of appointment dated 23 May 2003. The terms of appointment of Sir Patrick Brown, Martin Nègre, Sir Fred Holliday, Jacques Pétry and Alain Chaigneau do not limit the period of the appointments or provide for notice periods. They do, however, provide that no compensation for loss of office will be payable on termination, except for fees accrued. Derek Wanless was appointed as a non-executive director of the Company on 1 December 2003 and has a letter of appointment dated 18 December 2003. Jenny Williams was appointed as a non-executive director of the Company on 27 May 2004 and has a letter of appointment dated 7 June 2004. The appointments of Derek Wanless and Jenny Williams are for fixed periods of three years, terminable early by six months' notice by either side and do not provide for compensation for loss of office in excess of fees accrued.

External appointments of executive directors

During the period John Cuthbert was appointed as a non-executive director of One NorthEast, a regional development agency. His fee for this position is £7,500 per annum which is paid to, and retained by the Company.

Directors' emoluments (audited information)

The emoluments of the directors of the Company for their services as directors of the Company and (where relevant) its subsidiaries are set out below, rounded to the nearest thousand pounds:

	Fees £ 000	Basic salary £ 000	Benefits £ 000	Bonus ¹ £ 000	Total for ten months to 31 March 2004
Executive directors					
John Cuthbert	-	197	7	69	273
Chris Green	-	130	9	51	190
Non-Executive directors					
Sir Fred Holliday	107	-	23	-	130
Sir Patrick Brown	26	-	-	-	26
Alain Chaigneau ⁴	26	-	-	-	26
Martin Nègre	26	-	-	-	26
Jacques Pétry ^{2, 4}	26	-	-	-	26
Derek Wanless ³	10	-	-	-	10
Total remuneration	221	327	39	120	707

Notes:

1. The annual bonus is payable in June 2004 and is shown pro rata for the period.
2. Resigned on 27 May 2004.
3. Appointed on 1 December 2003.
4. The fees of these directors are paid to Lyonnaise Europe plc.

Directors' pensions and pension benefits (audited information)

The main features of the Northumbrian Water Pension Scheme are set out in note 27 to the financial statements.

The accrued defined benefit pensions and corresponding transfer values for the executive directors are as follows:

	Accrued pension at 23 May 2003 £ 000	Accrued pension at 31 March 2004 £ 000	Increase in accrued pension £ 000	Increase in accrued pension net of inflation £ 000	Transfer value of net increase in accrued pension £ 000	Transfer value of accrued pension at 23 May 2003 £ 000	Transfer value of accrued pension at 31 March 2004 £ 000	Total change in transfer value less directors' contributions £ 000
John Cuthbert	71.5	91.8	20.3	19.1	229.4	597.0	1,232.0	621.0
Chris Green	32.8	49.8	17.0	16.5	194.9	247.0	615.0	360.0

Notes:

1. Accrued pensions shown are the amounts that would be paid annually on retirement based on service to the end of the year, or date of leaving, or retirement, if earlier.
2. Voluntary contributions paid by the directors and resulting benefits are not shown.
3. The change in transfer value includes the effect of fluctuations in the transfer value due to factors beyond the control of the Company and directors, such as changes in stock market conditions.
4. The transfer values have been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11. The transfer value basis of calculation has changed between 23 May 2003 and 31 March 2004 due to amendments in legislation.
5. The total contribution paid by the Company during the period was £19,530.

Directors' interests in shares and debentures (audited information)

The directors had the following beneficial or family interests in the ordinary 10 pence shares of the Company as at 31 March 2004:

	Number of shares held at the start of the period or subsequent date of appointment	Number of shares held as at 31 March 2004 ¹
Sir Patrick Brown	-	43,000
John Cuthbert	-	80,000
Chris Green ²	-	50,000
Sir Fred Holliday	-	8,700
Martin Nègre	-	100,000
Derek Wanless	-	30,000

Notes:

1. There have been no changes in any of the above interests from the end of the period to 1 June 2004.
2. These shares are beneficially owned by Mrs. Geraldine Green.

The directors had the following beneficial or family interests in debentures of NSL, a subsidiary of the Company, as at 31 March 2004:

	Class of debentures	Amount of debentures held at the start of the period or subsequent date of appointment	Amount of debentures held as at 31 March 2004 ¹
John Cuthbert	8.625% bonds 28.6.2006	-	40,000
Chris Green ²	8.625% bonds 28.6.2006	-	25,000

Notes:

1. There have been no changes in any of the above interests from the end of the period to 1 June 2004.
2. These debentures are beneficially owned by Mrs. Geraldine Green.

Directors' interests in LTIP awards (audited information)

As at 31 March 2004, the directors had the following conditional interests in the ordinary 10 pence shares of the Company, awarded in accordance with the terms of the LTIP:

	Awards held at the start of the period or subsequent date of appointment	Shares awarded during the period ¹	Date of award	End of the relevant three year performance period ¹	Awards vested/lapsed during the period ²	Number of awards held as at 31 March 2004 ³
John Cuthbert	-	85,603	27.1.2004	30.9.2006	-	85,603
Chris Green	-	56,618	27.1.2004	30.9.2006	-	56,618

Notes:

1. A summary of the LTIP performance conditions relevant to the vesting of awards is provided on page 29.
2. No awards lapsed or vested during the period.
3. There have been no changes to any of the above interests in awards under the LTIP from the end of the period to 1 June 2004.
4. The market value of the shares on the date of award was 113.75p per share.
5. In order to measure the value of awards made under the LTIP, the Association of British Insurers recommends that the Company should calculate and disclose an estimate of their expected value. The expected value is the present value of the sum of all the various possible outcomes at vesting and reflects the probabilities of achieving those outcomes. The Company sought external advice from PricewaterhouseCoopers LLP as to the expected value of an award under the LTIP and this information was provided to shareholders in December 2003 when the LTIP was approved. PricewaterhouseCoopers LLP advised that each initial award made under the LTIP would have a value of approximately 43% of the maximum face value of the award.
6. The cost of conditional awards is charged to the profit and loss account over the three year performance period to which they relate after taking account of the probability of performance criteria being met. In the period, £14,913 was charged to the profit and loss account.

Ordinary 10 pence shares required to fulfil LTIP awards which have vested will be provided by Northumbrian Water Group plc Employee Trust. Martin Nègre and Sir Patrick Brown are regarded for the purpose of the Companies Act 1985 as being interested in the shares of the trust, which at 31 March 2004 was a total of 440,000 ordinary 10 pence shares.

Directors' interests in shares under the Share Incentive Plan (audited information)

The directors who held office as at 31 March 2004 had the following interests in the ordinary 10 pence shares in the Company, purchased and held in accordance with the terms of the SIP¹. Changes which have occurred since the end of the period are also illustrated in the table below²:

	Number of SIP shares held at the start of the period or subsequent date of appointment	Number of SIP shares held as at 31 March 2004	Number of SIP shares held as at 1 June 2004 ²
John Cuthbert	-	-	1,716
Chris Green	-	-	1,716

Notes:

1. A summary of the SIP can be found in the directors' report on page 20.
2. This figure includes the shares paid for by the participant and the free shares granted by the Company.
3. In accordance with the terms of the SIP, applications had to be received on or before 27 February 2004 in order to be included in the first share purchases, which were made on 4 May 2004.

This remuneration report was approved by the Board and signed on its behalf by the Company Secretary. It will be put to the shareholders for approval at the Annual General Meeting.



Martin Parker
Company Secretary
8 June 2004

DIRECTORS' RESPONSIBILITIES

Statement of directors' responsibilities

Company law requires the directors to prepare financial statements that 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 United Kingdom law and accounting standards have been followed subject to any material departures disclosed and explained in the financial statements;
- make judgements and estimates that are reasonable and prudent;
- prepare the financial statements on a 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. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

REPORT OF THE AUDITORS

Independent auditors' report to the members of Northumbrian Water Group plc

We have audited the Group's financial statements for the period ended 31 March 2004, which comprise the Consolidated Profit and Loss Account, Consolidated Balance Sheet, Company Balance Sheet, Consolidated Cash Flow Statement, Notes to the Consolidated Cash Flow Statement and the related notes 1 to 31. These financial statements have been prepared on the basis of the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the Annual Report, including the financial statements which are required to be prepared in accordance with applicable United Kingdom law and accounting standards as set out in the statement of directors' responsibilities in relation to the financial statements.

Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements, United Kingdom Auditing Standards and the Listing Rules of the Financial Services Authority.

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

We review whether the Corporate Governance Report reflects the Company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises Highlights 2003/04, Chairman's Statement, Managing Director's Review, Operating Review, Finance Director's Review, Sustainable Development Statement, Board Directors' Biographies, Directors' Report, Corporate Governance Report, the unaudited part of the Directors' Remuneration Report and shareholder information. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom 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 and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the directors in the

preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' Remuneration Report to be audited 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 and the part of the Directors' Remuneration Report to be audited.

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 as at 31 March 2004 and of the profit of the Group for the period then ended; and
- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985.



Ernst & Young LLP
Registered Auditors, Newcastle upon Tyne
15 June 2004

Northumbrian Water Group plc

Consolidated profit and loss account
For the period ended 31 March 2004

	Notes	Before exceptional items £m	Exceptional items £m	Total £m
Turnover: Group and share of joint ventures		448.6	-	448.6
Less share of joint ventures' turnover		(6.5)	-	(6.5)
Group turnover	2	442.1	-	442.1
Operating costs				
- operating costs before exceptional costs	3	(296.3)	-	(296.3)
- exceptional costs	5	-	(2.2)	(2.2)
Operating profit	2	145.8	(2.2)	143.6
Share of associated undertakings' operating profit		2.5	-	2.5
Share of joint ventures' operating profit		1.0	-	1.0
Total operating profit: Group and share of joint ventures and associates		149.3	(2.2)	147.1
Interest payable and similar charges				
- net interest payable	4	(92.8)	-	(92.8)
- amortisation of financing costs	4/5	-	(8.8)	(8.8)
Profit on ordinary activities before taxation	2	56.5	(11.0)	45.5
Tax on profit on ordinary activities				
- current taxation	7	6.8	2.3	9.1
- deferred taxation	7	4.2	0.7	4.9
Profit on ordinary activities after taxation		67.5	(8.0)	59.5
Minority interest		(0.1)	-	(0.1)
Profit attributable to shareholders		67.4	(8.0)	59.4
Dividends paid and proposed	8	(36.0)	-	(36.0)
Retained profit for the financial period	25	31.4	(8.0)	23.4
Basic earnings per share	9			11.5p
Adjusted earnings per share	9			12.2p
Diluted earnings per share	9			11.5p
Dividend per share				6.95p

All the above results are attributable to acquisitions in the period.

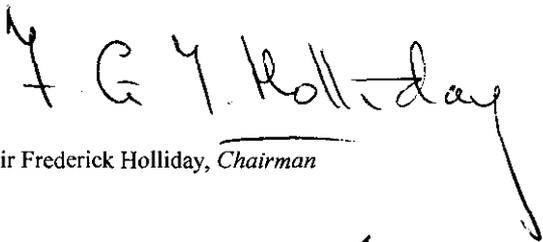
The Company has no recognised gains and losses other than those included in the profit above of £59.4 million and therefore no separate statement of total recognised gains and losses has been presented.

Northumbrian Water Group plc

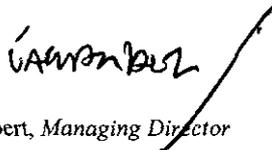
Balance sheets
As at 31 March 2004

	Notes	Group 31.3.2004 £m	Company 31.3.2004 £m
Fixed assets			
Intangible assets	10	64.4	-
Tangible assets	11	2,692.8	-
Investments in joint ventures: share of gross assets		12.5	-
share of gross liabilities		(9.1)	-
	12	3.4	-
Investments in associates	12	1.8	-
Other investments	12	0.4	1,022.7
		2,762.8	1,022.7
Current assets			
Stocks	14	4.8	-
Debtors: receivable within one year	15	118.1	50.2
Debtors: receivable after more than one year	15	14.3	-
Cash at bank and short term deposits	16	44.8	4.4
		182.0	54.6
Creditors: amounts falling due within one year	17	(247.5)	(47.2)
Net current (liabilities)/assets		(65.5)	7.4
Total assets less current liabilities		2,697.3	1,030.1
Creditors: amounts falling due after more than one year	18	(1,866.4)	(490.0)
Provisions for liabilities and charges	22	(165.1)	-
Accruals and deferred income	23	(142.8)	-
		(2,174.3)	(490.0)
Net assets		523.0	540.1
Capital and reserves			
Called up share capital	24	51.9	51.9
Share premium account	25	446.3	446.3
Other reserve	25	(0.5)	(0.5)
Profit and loss account	25	23.4	42.4
Equity shareholders' funds	26	521.1	540.1
Minority equity interest		1.9	-
Total capital and reserves		523.0	540.1

Approved by the Board on 8 June 2004 and signed on its behalf by:



Sir Frederick Holliday, *Chairman*



John Cuthbert, *Managing Director*

Northumbrian Water Group plc

Consolidated cash flow statement
For the period ended 31 March 2004

	Notes	Total £m
Net cash inflow from operating activities	a	218.5
Returns on investments and servicing of finance		
Interest received		7.1
Interest paid		(107.5)
Interest paid on hire purchase contracts and finance leases		(0.6)
Dividends paid to minority interests		(0.9)
Net cash outflow from returns on investments and servicing of finance		(101.9)
Capital expenditure and financial investments		
Purchase of tangible fixed assets		(163.5)
Proceeds on disposal of tangible fixed assets		0.6
Capital grants received		14.5
Net cash outflow from capital expenditure and financial investments		(148.4)
Acquisitions and disposals		
Acquisition of subsidiaries (see note 13)		(893.0)
Net cash acquired with subsidiaries (see note 13)		104.1
Acquisition of division (see note 10)		(0.3)
Net cash outflow from acquisitions and disposals		(789.2)
Equity dividends paid		(12.0)
Cash outflow before management of liquid resources		(833.0)
Management of liquid resources		
Purchase of short term deposits		(1,554.8)
Disposal of short term deposits		1,848.4
Net cash inflow from management of liquid resources		293.6
Financing		
Issue of new shares		368.5
Purchase of own shares		(0.5)
Loans received	b	536.0
Loans repaid	b	(348.9)
Payment of principal under hire purchase contracts and finance leases	b	(2.4)
Net cash inflow from financing		552.7
Increase in cash in the period		13.3
Reconciliation of net debt		
Increase in cash in the period		13.3
Cash inflow from increase in net debt and lease financing		(184.7)
Cash inflow from management of liquid resources		(293.6)
Increase in net debt resulting from cash flows	b	(465.0)
Other non-cash items		5.3
Inception of new finance lease contracts	b	(5.2)
Increase in net debt in the period		(464.9)
Loans and finance leases acquired with subsidiaries net of short term deposits	b	(1,404.6)
Net debt at end of the period	b	(1,869.5)
Net debt at the end of the period (including fair value adjustment)		(1,869.5)
Fair value adjustment less amortisation		101.1
Net debt at the end of the period (excluding fair value adjustment)		(1,768.4)

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

Northumbrian Water Group plc

Notes to the consolidated cash flow statement
For the period ended 31 March 2004

(a) Net cash inflow from operating activities

	Notes	Total £m
Operating profit	2	143.6
Depreciation of tangible fixed assets	3/11	72.9
Profit on disposal of tangible fixed assets		(0.5)
Amortisation of capital grants	23	(3.2)
Movement in reorganisation and restructuring provisions		(1.5)
Decrease in stocks		1.2
Decrease in debtors		15.5
Decrease in creditors		(9.5)
Net cash inflow from operating activities		218.5

(b) Analysis of net debt

	Cash flow £m	In respect of acquisitions £m	Other non-cash changes £m	As at 31.3.2004 £m
Cash at bank	30.4	-	-	30.4
Bank overdrafts	(17.1)	-	-	(17.1)
	13.3	-	-	13.3
Loan debtors due within one year	-	3.8	-	3.8
Loans due after one year	(187.1)	(1,633.6)	25.0	(1,795.7)
Loans due within one year	-	(24.7)	(19.7)	(44.4)
Finance leases	2.4	(58.1)	(5.2)	(60.9)
	(171.4)	(1,712.6)	0.1	(1,883.9)
Short term deposits	(293.6)	308.0	-	14.4
Net debt	(465.0)	(1,404.6)	0.1	(1,869.5)

(c) Analysis of cash balances

	In respect of acquisition of subsidiaries £m	Trading for the period £m	As at 31.3.2004 £m
Cash at bank and short term deposits	434.1	(389.3)	44.8
Less short term deposits with maturity dates greater than one day	(308.0)	293.6	(14.4)
	126.1	(95.7)	30.4
Bank overdrafts	(22.0)	4.9	(17.1)
	104.1	(90.8)	13.3

Northumbrian Water Group plc

Notes to the financial statements

1 Accounting policies

The financial statements have been prepared in accordance with applicable United Kingdom law and accounting standards. The accounting policies have been reviewed in accordance with the requirements of FRS 18. The directors consider the following accounting policies to be relevant in relation to the Group's financial statements. These have been applied consistently throughout the current period.

(a) Basis of accounting The financial statements have been prepared under the historical cost convention. As stated in the directors' report on page 21, the financial statements have been prepared on the going concern basis. The directors have arrived at their decision based on consideration of the Group's net current liabilities in relation to the Group's detailed budget for 2004/05 and the business plan for the period to 31 March 2010.

(b) Basis of consolidation The consolidated financial statements include the Company and its subsidiary undertakings. 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. Inter segment sales and profits are eliminated fully on consolidation. Where, for commercial reasons, the accounting reference date of a subsidiary is a date other than that of the Company, management accounts made up to the Company's accounting reference date have been used.

(c) Associated undertakings and joint ventures The Group's share of profits less losses of associated undertakings and joint ventures 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. Joint ventures are accounted for using the gross equity method. Goodwill arising on the acquisition of associates and joint ventures is accounted for in accordance with the accounting policy set out below.

(d) Goodwill Goodwill arising on the acquisition of subsidiary undertakings, businesses, associates and joint ventures, representing the excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, is capitalised and written off on a straight line basis over its useful economic life up to a maximum of 20 years. Provision is made for any impairment.

(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 physical overground and underground systems. Expenditure on infrastructure assets relating to increases in capacity or enhancements to the network and on maintaining the operating capability of the network, in accordance with defined standards of service, is treated as additions which are included at cost. Costs include internal and external costs to bring the asset into use. The depreciation charge for infrastructure assets is the estimated average amount of expenditure required to maintain the operating capability of the network, which is based on independently certified asset management plans, adjusted to reflect differences between estimated and actual expenditure over each five year regulatory period.

ii) Other assets Other assets are included at cost less accumulated depreciation and any provision for impairment. 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, 4-92 years; fixtures, fittings, tools and equipment, 4-10 years. Where the remaining useful economic life of the asset is estimated to be greater than 50 years, an impairment review is performed at the end of each reporting period to ensure that the carrying amount can be supported.

iii) Assets in the course of construction Assets in the course of construction are not depreciated until commissioned.

(g) Grants and contributions Revenue grants are credited to the profit and loss account in the period to which they relate. Capital grants and contributions relating to tangible fixed assets are treated as deferred income and amortised in the profit and loss account over the expected useful economic lives of the qualifying assets. Specifically, in the case of infrastructure assets, the expected useful economic lives have been determined by reference to the physical replacement cycle of those assets.

(h) Fixed asset investments Fixed asset investments are stated at their purchase cost, less any provision for impairment.

(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. Pension surpluses/deficits arising on acquisition are recognised as an asset/liability on the balance sheet, in accordance with FRS 17.

(l) Taxation The charge for current UK corporation tax is based on the profit for the period as adjusted for taxation purposes using the rates of tax enacted at the balance sheet date. Provision is made for deferred tax in respect of all timing differences that have originated but not reversed at the balance sheet date that will result in an obligation to pay more, or a right to pay less tax in future periods. Deferred tax is calculated at the tax rates that are expected to apply in the periods in which timing differences are expected to reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date. Deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted. As permitted by FRS 19, the Group has decided to adopt a policy of discounting deferred tax assets and liabilities to reflect the time value of money over the period between the balance sheet date and the dates on which it is estimated that the underlying timing differences will reverse. The discount rates used reflect the post-tax yields to maturity that can be obtained at the balance sheet date on UK Government bonds with similar maturity dates to those of the deferred tax assets or liabilities.

(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 and associates 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.

(o) Derivative financial instruments The Group utilises interest rate swaps, forward rate agreements and forward exchange contracts as derivative financial instruments. A derivative instrument is considered to be used for hedging purposes when it alters the risk profile of an underlying exposure of the Group in line with the Group's risk management policies. Interest rate swap agreements are used to manage interest rate exposures. Amounts payable or receivable in respect of these derivatives are recognised over the period of the contracts as adjustments to net interest payable in the profit and loss account. Forward exchange contracts are valued at the period end rates of exchange. Resultant gains and losses are offset against foreign exchange gains or losses on the related borrowings or, where the instrument is used to hedge a committed future transaction, are deferred until the transaction occurs.

(p) Liquid resources Liquid resources comprise external deposits.

(q) Share-based compensation arrangements In accordance with UITF 17 'employee share schemes', the costs of long term incentive awards to executive directors and senior managers in accordance with the Company's long term incentive plan (see the remuneration report) are expensed on a straight line basis over the period in which performance is measured. The amount to be expensed is based upon an estimate of the probability that the performance criteria will be met. In accordance with best practice, the Company has applied the early adoption of UITF 38 'Accounting for ESOP trusts'. In accordance with UITF 38, until such time as the Company's own shares held by the trust vest unconditionally in employees, the consideration paid for the shares will be deducted from shareholders' funds.

2 Segmental analysis

(a) Analysis by class of business and by geographical origin

	UK water 31.3.2004 £m	Water international 31.3.2004 £m	Related services 31.3.2004 £m	Total £m
Turnover:				
UK	386.2	10.8	65.4	462.4
Rest of Europe, Middle East and Far East	-	6.8	2.8	9.6
Rest of world	-	-	2.0	2.0
Total turnover	386.2	17.6	70.2	474.0
Inter segment	-	(0.5)	(31.4)	(31.9)
External turnover	386.2	17.1	38.8	442.1
Operating profit:				
UK	133.4	1.7	2.7	137.8
Rest of Europe, Middle East and Far East	-	0.4	0.5	0.9
	133.4	2.1	3.2	138.7
Central unallocated costs and provisions				4.9
Group operating profit				143.6
Share of associates' operating profit				2.5
Share of joint ventures' operating profit				1.0
Exceptional amortisation of financing costs				(8.8)
Net interest payable and similar charges				(92.8)
Profit on ordinary activities before taxation				45.5

Central unallocated costs and provisions includes those costs that relate to the performance of the Company's functions. It also includes one-off fair value adjustments of £3.2 million to restate balances at their estimated recoverable value and an accounting policy alignment adjustment of £6.0 million (see note 13b(ii)). These adjustments have been reversed at consolidation as they have also been adjusted in UK water.

(b) Analysis of external turnover by geographical destination

	Total £m
UK	427.0
Rest of Europe, Middle East and Far East	14.4
Rest of world	0.7
External turnover	442.1

(c) Net assets

	UK water 31.3.2004 £m	Water international 31.3.2004 £m	Related services 31.3.2004 £m	Total £m
Subsidiary undertakings	2,300.9	53.1	(23.9)	2,330.1
Share of associated undertakings' net assets	-	-	5.2	5.2
Net operating assets				2,335.3
Unallocated net liabilities				(1,812.3)
Net assets				523.0

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 (a) Operating costs

	Total £m
This is stated after charging/(crediting):	
Materials and consumables	22.4
Manpower costs (see note 6)	93.3
Own work capitalised	(24.7)
Depreciation of tangible fixed assets (see note 11)	72.9
Other operating charges	134.6
Total operating costs	298.5

Own work capitalised includes both employment and other costs charged to capital schemes.

(b) Operating profit

	Total £m
This is stated after charging/(crediting):	
Auditors' remuneration:	
audit *	0.2
non-audit services	0.5
Depreciation of tangible fixed assets: (see note 11)	
owned	69.7
under hire purchase contracts and finance leases	3.2
Profit on disposal of tangible fixed assets	(0.5)
Amortisation of capital grants (see note 23)	(3.2)
Operating leases:	
plant and machinery	0.2
other	2.3
Costs of research and development	4.1

* £50,000 of this relates to the Company.

4 Net interest payable and similar charges

	Total £m
Interest payable on debentures, bank and other loans and overdrafts	96.6
Exceptional amortisation of financing costs	8.8
Amortisation of discount, fees, loan issue costs and other financing charges	(5.2)
Interest payable on hire purchase contracts and finance leases	2.0
Group interest payable	102.2
Share of associates' interest payable	2.3
Share of joint ventures' interest payable	0.2
Total interest payable	104.7
Interest receivable	(3.1)
Net interest payable	101.6
Disclosed as:	
Net interest payable: Group	99.1
associates	2.3
joint ventures	0.2
	101.6

5 Exceptional costs

The exceptional operating costs comprise additional severance costs of £1.1 million and the costs associated with the uplift to the main market of £1.1 million. Financing costs of £8.8 million arising on the debt required for the acquisition, have been fully written off. Due to the magnitude of these costs, they have been disclosed as exceptional.

6 Employee information

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

	Total £m
Wages and salaries	78.7
Social security costs	7.0
Other pension costs	7.6
Total employment costs	93.3

Total employment costs were charged as follows:

Capital schemes and infrastructure renewals	23.8
Manpower costs	69.5
	93.3

The average monthly number of employees of the Group during the period was:

	Total number
UK water	2,406
Water international	119
Related services	1,156
	3,681

7 Tax on profit on ordinary activities

(a) Analysis of tax credit for the financial period

	Total £m
Current tax:	
UK corporation tax on profits for the period at 30%	1.4
Overseas tax	0.1
Adjustment in respect of prior periods of the NSL group	(10.9)
Group current tax credit	(9.4)
Share of associates' tax charge	0.2
Share of joint ventures' tax charge	0.1
Total current tax credit (see note 7b)	(9.1)

UK corporation tax on profits for the period includes a £2.3 million tax credit in respect of exceptional costs.

Deferred tax:	
Origination and reversal of timing differences in the period	17.9
Adjustment in respect of prior periods of the NSL group	(1.3)
	16.6
Increase in discount	(21.5)
Total deferred tax credit (see note 22)	(4.9)

Origination and reversal of timing differences in the period includes a £0.7 million tax credit in respect of exceptional costs.

Tax credit on profit on ordinary activities	(14.0)
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(b) Factors affecting the tax credit for the financial period

	Total £m
Profit on ordinary activities before taxation	45.5
Profit on ordinary activities multiplied by standard rate of UK corporation tax (30%)	13.7
Effects of:	
Expenses not deductible for tax purposes	6.0
Depreciation in respect of non-qualifying items	1.2
Overseas tax losses not recognised	0.3
Capital allowances in excess of depreciation	(20.4)
Other timing differences	2.2
Pension revaluation surplus	0.3
Fair value of debt amortisation	(1.6)
Differences in associates' / joint ventures' tax	0.1
Adjustment to tax charge in respect of prior periods of the NSL group	(10.9)
Total current tax credit (see note 7a)	(9.1)

(c) Factors that may affect future tax charges

The Group expects to continue to incur high levels of capital expenditure and, accordingly, it expects to be able to claim capital allowances in excess of depreciation at a similar level to the current period.

Deferred tax is provided on a discounted basis using post-tax yields on UK Government gilts. The charge for deferred tax may therefore be influenced by future fluctuations in gilt rates.

8 Dividends

	Total £m
Interim paid of 2.32 pence per £1 ordinary share	12.0
Final proposed of 4.63 pence per £1 ordinary share	24.0
	36.0

9 Earnings per share

Basic and diluted earnings per share (EPS) are calculated by dividing the profit attributable to shareholders by the weighted average number of ordinary shares in issue during the period.

	Earnings 31.3.2004 £m	Weighted average number of shares 31.3.2004 million	Earnings per share 31.3.2004 pence
Basic and diluted EPS	59.4	518.6	11.5

Adjusted EPS is considered by the directors to give a better indication of the Group's underlying performance and is calculated as follows:

Basic EPS	59.4	518.6	11.5
Deferred tax	(4.9)		(1.0)
Exceptional current tax	(2.3)		(0.4)
Exceptional operating costs	2.2		0.4
Exceptional amortisation of financing costs	8.8		1.7
Adjusted EPS	63.2	518.6	12.2

10 Intangible assets

	Goodwill £m	Other £m	Total £m
Acquisition of subsidiaries	-	64.2	64.2
Acquisition of division	0.2	-	0.2
At 31 March 2004	0.2	64.2	64.4

The other intangible asset represents the right to receive income under the operating agreement with the Environment Agency in respect of the Kielder Water transfer scheme.

The goodwill arising in the period is in respect of the acquisition of a division from National Britannia, for a consideration of £0.3 million. The fair value of assets acquired amounted to £0.1 million in respect of fixed assets. All goodwill is amortised over the estimated useful economic life up to a maximum of 20 years.

11 Tangible fixed assets

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	Assets in the course of construction £m	Total £m
Cost:							
In respect of acquisition of subsidiaries on 23 May 2003	89.8	2.7	1,272.7	1,443.1	123.5	140.9	3,072.7
Additions	0.1	-	0.2	1.0	1.6	155.5	158.4
Schemes commissioned	1.6	-	82.1	119.8	34.6	(238.1)	-
Reclassifications	(2.5)	2.5	(27.1)	-	-	27.1	-
Disposals	-	-	(14.9)	(0.5)	(0.1)	-	(15.5)
At 31 March 2004	89.0	5.2	1,313.0	1,563.4	159.6	85.4	3,215.6
Depreciation:							
In respect of acquisition of subsidiaries on 23 May 2003	22.6	1.3	41.2	320.1	80.1	-	465.3
Charge for the period	3.4	0.8	25.0	29.6	14.1	-	72.9
Reclassifications	(0.6)	0.6	-	-	-	-	-
Disposals	-	-	(14.9)	(0.4)	(0.1)	-	(15.4)
At 31 March 2004	25.4	2.7	51.3	349.3	94.1	-	522.8
Net book value at 31 March 2004	63.6	2.5	1,261.7	1,214.1	65.5	85.4	2,692.8

Operational structures, plant and machinery include an element of land and buildings dedicated to those assets. The Group does not capitalise finance costs.

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

	31.3.2004 £m
Infrastructure assets	2.2
Operational structures, plant and machinery	25.7
Fixtures, fittings, tools and equipment	0.7
	28.6

12 Fixed asset investments

(a) Group

	Joint ventures £m	Associated undertakings £m	Other investments £m	Total £m
On acquisition of subsidiary undertakings on 23 May 2003	2.7	1.8	0.4	4.9
Share of profits	0.7	-	-	0.7
At 31 March 2004	3.4	1.8	0.4	5.6

All fixed asset investments are unlisted.

(b) Company

	Interests in subsidiaries 31.3.2004 £m
On acquisition of subsidiary undertakings on 23 May 2003	1,022.7
At 31 March 2004	1,022.7

(c) The Group's interests in principal trading associates at 31 March 2004 were 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
Ayr Environmental Services Limited	Scotland	Ordinary shares of £1	50	Waste water services

(d) Joint ventures

The Group holds 50% of the nominal value of issued ordinary £1 shares in Vehicle Lease and Service Limited (VLS), the Group's principal joint venture arrangement. VLS was incorporated in England and Wales and undertakes the business of hiring, leasing and servicing of vehicles and plant.

(e) The Group's interests in principal subsidiaries at 31 March 2004 were 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
AquaGib 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 Water Technical Centre Limited	England and Wales	Ordinary shares of £1	100	Research and development
Northumbrian Services Limited	England and Wales	Ordinary shares of £1	100	Holding of investments and loans
Analytical & Environmental Services Limited	England and Wales	Ordinary shares of £1	100	Analytical laboratory and scientific services
Fastflow Pipeline Services Limited	England and Wales	Ordinary shares of £1	100	Infrastructure replacement and rehabilitation
Caledonian Environmental Services plc	Scotland	Ordinary shares of £1	75	Waste water services
ULG Northumbrian Limited	England and Wales	Ordinary shares of £1	100	Aid-funded project work
SA Agrer NV	Belgium	Ordinary shares of £1	100	Aid-funded project work
Northumbrian Water Finance plc	England and Wales	Ordinary shares of £1	100	Holding of finance instruments

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.

13 Acquisition of subsidiaries

(a) AWL has been accounted for under the acquisition method of accounting. The assets and liabilities of NSL that were acquired are set out below:

	Book value £m	Fair value adjustments £m	Accounting policy alignment £m	Total fair value 23.5.2003 £m
Fixed assets (see note (i))	2,612.3	64.2	-	2,676.5
Stocks	6.0	-	-	6.0
Cash at bank and in hand	434.1	-	-	434.1
Debtors: receivable within one year (see note (ii))	140.2	(3.2)	(6.0)	131.0
Debtors: receivable after more than one year (see note (iii))	17.4	(2.0)	-	15.4
Creditors: amounts falling due within one year (see note (iv))	(229.6)	(6.3)	-	(235.9)
Creditors: amounts falling due after more than one year (see note (iv))	(1,602.1)	(100.1)	-	(1,702.2)
Provisions for liabilities and charges (see note (v))	(170.8)	(0.7)	-	(171.5)
Accruals and deferred income	(128.0)	-	-	(128.0)
Less minority interests	(2.7)	-	-	(2.7)
Net assets acquired	1,076.8	(48.1)	(6.0)	1,022.7

Satisfied by:

129,655,961 shares	129.7
Cash to ordinary shareholders	880.0
Costs of acquisition	13.0
	1,022.7

(b) Net cash outflows in respect of the acquisition comprised:

	Total £m
Cash consideration	880.0
Cash at bank and in hand acquired	(126.1)
Bank overdrafts acquired	22.0
Expenses paid in connection with acquisition	13.0
Net cash outflow	788.9

Explanatory notes to the fair value adjustments:

(i) Fixed assets

In accordance with FRS 10, an intangible asset has been recognised that represents the right to receive income under the operating agreement with the Environment Agency in respect of the Kielder Water transfer scheme. The value has been capped so as to not to create negative goodwill, in accordance with FRS 7.

(ii) Debtors: receivable within one year

Fair value adjustment to restate balances at their estimated recoverable value and accounting policy alignment to write off court costs and solicitors' fees as incurred.

(iii) Debtors: receivable after more than one year

In accordance with FRS 7, the value of the defined benefit scheme asset has been reduced.

(iv) Creditors: amounts falling due within one year and Creditors: amounts falling due after more than one year

The carrying values of fixed rate debt have been adjusted to reflect the market rate of interest on the date of acquisition (see notes 17, 18, 19, 21(h), 21(k)).

(v) Provisions for liabilities and charges

Deferred tax has been adjusted to reflect the discount rates effective at date of acquisition. A further adjustment has been made to reflect the deferred tax on the fair value adjustments.

(c) The results and total recognised gains and losses of NSL, based on NSL's accounting policies prior to acquisition, and excluding fair value adjustments arising from the acquisition, for the year to 31 December 2002 and for the pre-acquisition period from 1 January 2003 to 23 May 2003, are shown below:

Results:

	Period to 23.5.2003	Year to 31.12.2002
	£m	£m
Group turnover	206.2	504.0
Operating profit	61.6	165.3
Profit before tax	29.0	92.2
Taxation	(2.8)	(0.5)
Profit after tax	26.2	91.7
Minority interests	(0.5)	0.1
Retained profit	25.7	29.5

Total recognised gains and losses:

	Period to 23.5.2003	Year to 31.12.2002
	£m	£m
Profit for the period attributable to the members of the parent company	25.7	91.8
Exchange differences	-	0.2
FRS19 Deferred tax	-	(146.2)
Total recognised gains and losses	25.7	(54.2)

14 Stocks

	Group 31.3.2004
	£m
Stores	3.7
Work in progress	1.1
	4.8

15 Debtors

	Group 31.3.2004	Company 31.3.2004
	£m	£m
Amounts receivable within one year:		
Trade debtors	60.9	-
Amounts owed by subsidiary undertakings	-	49.2
Amounts owed by associate undertakings	3.8	-
Other debtors	9.4	0.2
Taxation	7.7	-
Deferred tax	-	0.3
Prepayments and accrued income	36.3	0.5
	118.1	50.2
Amounts receivable after more than one year:		
Pension surplus on acquisition	14.3	-

Trade debtors are shown net of bills paid in advance. In the Company, amounts owed by subsidiary undertakings includes amounts receivable for the provisional surrender of tax losses amounting to £2.7 million. The deferred tax asset in the Company relates wholly to other timing differences.

16 Cash at bank and short term deposits

	Group 31.3.2004 £m	Company 31.3.2004 £m
Cash at bank	30.4	3.0
Short term deposits	14.4	1.4
	44.8	4.4

17 Creditors: amounts falling due within one year

	Group 31.3.2004 £m	Company 31.3.2004 £m
Bank loans and overdrafts (see note 19) (including fair value adjustment of £6.3 million)	56.5	-
Debentures (see note 19)	5.0	-
Obligations under hire purchase contracts and finance leases (see note 20)	3.6	-
Trade creditors	20.9	-
Amounts owed to subsidiary undertakings	-	23.0
Other creditors	19.4	-
Amounts payable to associates for tax losses	3.6	-
Amounts payable to other companies for tax losses	1.7	-
Other tax and social security	4.4	-
Dividends payable: equity shareholders	24.0	24.0
Accruals and deferred income	108.4	0.2
	247.5	47.2

18 Creditors: amounts falling due after more than one year

	Group 31.3.2004 £m	Company 31.3.2004 £m
Loans (see note 19) (including fair value adjustment of £18.3 million)	552.7	-
Debentures (see note 19) (including fair value adjustment of £0.4 million)	9.6	-
Eurobond – due 28 June 2006 bearing interest rate of 8.625% (including fair value adjustment of £11.2 million)	211.2	-
Eurobond – due 11 October 2017 bearing interest rate of 6.0% (including fair value adjustment of £14.0 million)	314.8	-
Eurobond – due 6 February 2023 bearing interest rate of 6.875% (including fair value adjustment of £49.6 million)	401.2	-
Eurobond – due 29 April 2033 bearing interest rate of 5.625% (including fair value adjustment of £1.3 million)	247.9	-
Eurobond – due 31 March 2037 bearing interest rate of 6.627%	58.3	-
Amounts owed to subsidiary undertakings (see note 19)	-	490.0
Obligations under hire purchase contracts and finance leases (see note 20)	57.3	-
Other creditors	13.4	-
	1,866.4	490.0

At 31 March 2004, the Group had the following interest swap arrangements: £15.0 million 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%.

The fair value adjustments represent the movement to reflect the carrying values of fixed rate debt which have been adjusted to reflect the market rate of interest on the date of acquisition (see note 13b(iv)). These adjustments are being amortised from the date of acquisition.

19 Loans

	Group 31.3.2004 £m	Company 31.3.2004 £m
Loans are repayable as follows:		
Less than one year (including fair value adjustment of £6.3 million)	44.4	-
Between one and two years (including fair value adjustment of £6.3 million)	235.6	-
Between two and five years (including fair value adjustment of £19.0 million)	364.4	-
In more than five years (including fair value adjustment of £69.5 million)	1,195.7	490.0
	1,840.1	490.0
Disclosed as due:		
Within one year:		
Bank loans and overdrafts (including fair value adjustment of £6.3 million)	56.5	-
Debentures	5.0	-
Less bank overdrafts	(17.1)	-
After one year:		
Loans (including fair value adjustment of £18.3 million)	552.7	-
Eurobonds (including fair value adjustment of £76.1 million)	1,233.4	-
Debentures (including fair value adjustment of £0.4 million)	9.6	-
Amounts owed to subsidiary undertakings	-	490.0
	1,840.1	490.0

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 £242.0 million and bear rates of interest in the range of 5.05% to 8.55%. £18.8 million 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 £1,032.0 million and bear rates of interest in the range of 3.5% to 11.75%. Of these loans, £120.5 million bears 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 £1,274.0 million.

Included in the loans are debenture stocks as follows:

- (a) £8.6 million issued by North East Water plc and secured by a floating charge on the assets of Northumbrian Water Limited;
- (b) £5.6 million issued by Essex and Suffolk Water plc and secured by a floating charge on the assets of Northumbrian Water Limited.

The fair value adjustments represent the movement to reflect the carrying values of fixed rate debt which have been adjusted to reflect the market rate of interest on the date of acquisition (see note 13b(iv)). These adjustments are being amortised from the date of acquisition.

20 Obligations under hire purchase contracts and finance leases

	Group 31.3.2004 £m
Amounts due:	
In less than one year	3.6
Between one and two years	4.0
Between two and five years	10.4
In more than five years	66.1
Gross obligations	84.1
Less finance charges allocated to future periods	(23.2)
	60.9
Disclosed as due:	
Within one year	3.6
After more than one year	57.3
	60.9

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 £82.9 million.

21 Derivatives and financial instruments

(a) Group strategy

The level of capital expenditure which the Group is obliged to incur is such that it cannot be wholly financed by internally generated sources. As a result, the Group must rely upon raising additional finance on a regular basis, to be principally used to fund the long term assets required in its regulated business. The Group's strategy is to finance such investment by raising medium to long term debt, to provide a balance sheet match with long term assets and to fix a major proportion of interest rates.

(b) Treasury operations

The main purpose of the Group's treasury function is to assess the Group's ongoing capital requirement and to raise funding on a timely basis, taking advantage of any favourable market opportunities. It also invests any surplus funds the Group may have, based upon its forecast requirements and in accordance with the Group's treasury policy. On occasions, derivatives are used as part of this process, but the Group's policies prohibit their use for speculation.

(c) Risks arising from the Group's financial instruments

The main risks arising from the Group's financial instruments are liquidity risk, interest rate risk and foreign currency risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below. All treasury activities are conducted in accordance with these policies.

(d) Liquidity risk

As regards day to day liquidity, the Group's policy is to have available standby committed bank borrowing facilities with a value of no less than £50.0 million and with a bank agreement availability period of no less than three months.

(e) Interest rate risk

The Group finances its operations through a mixture of retained profits and bank borrowings. It borrows at both fixed and floating rates of interest and accordingly uses interest rate swaps to generate the desired interest profile and to manage the Group's exposure to interest rate fluctuations. The Group's policy is to keep a minimum 60% of its borrowings at fixed rates of interest. At 31 March 2004, 78% of the Group's borrowings (including fair value adjustment) were at fixed rates of interest.

(f) Foreign currency risk

The Group's policy is that any foreign currency exposure in excess of £100,000 sterling equivalent of a transactional nature or £3.0 million sterling equivalent of a translation nature, should be covered immediately on identification.

(g) Market price risk

The Group's exposure to market price risk principally comprises interest rate exposures. The Group's policy is to accept a degree of interest rate risk. On the basis of the Group's analysis, it is estimated that a 1% rise in interest rates would not have a material affect on the Group's pre-tax profits.

(h) Interest rate risk profile of financial assets and financial liabilities

The interest rates and currency profile of the Group's net debt at 31 March 2004 were:

	Total net borrowings £m	Variable rate net borrowings £m	Fixed rate net borrowings		
			Borrowings £m	Weighted average interest rate %	Weighted average period until maturity years
Sterling borrowings:					
Subordinated loan stock	3.6	-	3.6	5.25	33.0
Bank loans (including fair value adjustment of £19.5 million)	583.4	360.9	222.5	6.43	9.9
Eurobonds (including fair value adjustment of £81.1 million)	1,238.4	-	1,238.4	6.64	17.5
Debentures (including fair value adjustment of £0.5 million)	14.7	-	14.7	9.84	3.2
Finance leases	60.9	53.0	7.9	7.55	5.0
	1,901.0	413.9	1,487.1	6.65	16.2
Cash including overdrafts	(27.7)	(27.7)	-		
Sterling loans receivable	(3.8)	(3.8)	-		
Net debt at 31 March 2004	1,869.5	382.4	1,487.1		

In addition there are provisions due after more than one year of £6.3 million, on which no interest is payable.

As permitted by FRS 13, short term debtors and creditors have been excluded from the disclosures, other than the currency disclosures.

The variable rate net borrowings comprise sterling denominated bank borrowings and deposits that bear interest at rates based upon up to twelve months LIBOR.

Included in the debentures above are £2.1 million of irredeemable debentures that have been excluded from the calculation of the weighted average maturity and fixed periods.

The fair value adjustments represent the movement to reflect the carrying values of fixed rate debt which have been adjusted to reflect the market rate of interest on the date of acquisition (see note 13b(iv)). These adjustments are being amortised from the date of acquisition.

(i) Currency exposures

At 31 March 2004, after taking into account the effects of forward foreign exchange contracts, the Group had no currency exposures.

(j) Borrowing facilities

The Group has various undrawn committed borrowing facilities. The facilities available at 31 March 2004, in respect of which all conditions precedent have been met, are as follows:

	31.3.2004
	£m
Expiring in one year or less	-
Expiring in more than one year but not more than two years	90.0
At 31 March 2004	90.0

(k) Fair values of financial assets and financial liabilities

A comparison by category of book values and fair values of the Group's financial assets and liabilities as at 31 March 2004 is set out below:

	Book value	Fair value
	£m	£m
Primary financial instruments held or issued to finance the Group's operations:		
Short term financial liabilities and current portion of long term borrowings (including fair value adjustment of £6.3 million)	65.1	61.5
Long term borrowings (including fair value adjustment of £94.8 million)	1,853.0	1,825.1
Financial assets	(48.6)	(48.6)
Derivative financial instruments held to manage the interest rate and currency profile:		
Interest rate swaps	-	(3.4)
At 31 March 2004	1,869.5	1,834.6

The fair values of the interest rate swaps, forward foreign currency contracts and sterling denominated long term fixed rate debt with a book value of £1,113.2 million have been determined by reference to prices available from the markets on which the instruments involved are traded. All the other fair values shown above have been calculated by discounting cash flows at prevailing interest rates.

The fair value adjustments represent the movement to reflect the carrying values of fixed rate debt which have been adjusted to reflect the market rate of interest on the date of acquisition (see note 13b(iv)). These adjustments are being amortised from the date of acquisition.

(l) Gains and losses on hedges

The Group enters into forward foreign currency contracts to eliminate the currency exposures that arise on sales denominated in foreign currencies immediately those sales are transacted. It also uses interest rate swaps to manage its interest rate profile. Changes in the fair value of instruments used as hedges are not recognised in the financial statements until the hedged position matures.

An analysis of these unrecognised gains and losses as at 31 March 2004 is as follows:

	Gains £m	Losses £m	Total net gains/(losses) £m
Unrecognised gains and losses on hedges at 23 May 2003	1.4	0.7	0.7
Gains and losses arising in previous years that were recognised to March 2004	(0.6)	0.4	(0.2)
Gains and losses arising before 23 May 2003 that were not recognised to March 2004	0.8	0.3	0.5
Gains and losses arising to March 2004 that were not recognised to March 2004	2.6	(0.3)	2.9
Unrecognised gains and losses on hedges at 31 March 2004	3.4	-	3.4
Of which:			
Gains and losses expected to be recognised in 2004/05	3.4	-	3.4
Gains and losses expected to be recognised in 2005/06 or later	-	-	-

22 Provisions for liabilities and charges

	Group			
	Reorganisation and restructuring provision £m	Deferred taxation £m	Other £m	Total £m
In respect of acquisition of subsidiaries on 23 May 2003	6.2	163.7	1.6	171.5
Credited to the profit and loss account	(0.4)	(4.9)	-	(5.3)
Utilised during the period	(1.1)	-	-	(1.1)
At 31 March 2004	4.7	158.8	1.6	165.1

The reorganisation and restructuring provision represents outstanding severance and pension contributions of £1.5 million in respect of costs of restructuring programmes within the Group and £3.2 million relating to discretionary pension liabilities. The former representing the best estimate of amounts payable, principally in the next 24 months.

Other provisions relate to dilapidations in respect of leasehold properties which will be payable at the end of the term of the lease.

The provision for deferred tax comprises:

	Group 31.3.2004 £m
Accelerated capital allowances	483.7
Losses carried forward	(2.3)
Pension revaluation surplus	4.3
Other timing differences	(56.2)
Undiscounted provision for deferred tax	429.5
Discount	(270.7)
	158.8

In addition, there are tax losses of approximately £10.4 million available to be carried forward and set against future profits arising in territories outside the United Kingdom.

23 Accruals and deferred income

	Group £m
Capital grants and contributions:	
In respect of acquisition of subsidiaries on 23 May 2003	128.0
Additions	18.0
Amortisation in the period (see note 3)	(3.2)
At 31 March 2004	142.8

24 Called up share capital

The share capital of the Company and Group is shown below:

	31.3.2004 £m
Authorised:	
700 million ordinary shares of 10 pence each	70.0
Allotted, called up and fully paid:	
518.6 million ordinary shares of 10 pence each	51.9

On 12 May 2003, NWG was incorporated with an authorised share capital of £75 million divided into 750,000,000 shares of 10 pence each, of which two were subscribed at par, nil paid.

On 14 May 2003, the share capital was increased by the allotment and issue of 499,998 ordinary 10 pence shares. On 16 May 2003, the authorised capital was reduced from £75 million to £70 million by the cancellation of 50,000,000 ordinary shares of 10 pence each, which at such date had not been taken or agreed to be taken.

On 23 May 2003, the issued share capital was increased by the allotment and issue of 518,123,845 ordinary 10 pence shares. On 23 May 2003, all previously issued and newly issued shares were fully paid up to £1.00 on each share.

388,967,884 ordinary 10 pence shares were issued in consideration for cash at £1 per share and the remaining 129,655,961 were issued to Suez, the previous ultimate parent company of AWL, as part consideration for the acquisition of subsidiaries.

The Northumbrian Water Group plc Employee Trust, through Northumbrian Water Share Scheme Trustees Limited, currently holds 440,000 ordinary 10 pence shares in the Company for use under the Company's Long Term Incentive Plan (LTIP). All of these shares have been conditionally awarded under the LTIP. Details of the main features of the LTIP and the conditions for vesting can be found in the remuneration report on page 29. As at 31 March 2004, the share price of the ordinary 10 pence shares in the Company was 111.25 pence.

25 Reserves

Group	Own shares £m	Share premium account £m	Profit and loss account £m
At 12 May 2003	-	-	-
Issue of shares 23 May 2003 (net of expenses)	-	446.3	-
Purchase of own shares for the LTIP	(0.5)	-	-
Retained profit for the financial period	-	-	23.4
At 31 March 2004	(0.5)	446.3	23.4
Company			
At 12 May 2003	-	-	-
Issue of shares 23 May 2003 (net of expenses)	-	446.3	-
Purchase of own shares for the LTIP	(0.5)	-	-
Retained profit for the financial period	-	-	42.4
At 31 March 2004	(0.5)	446.3	42.4

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 £78.4 million.

26 Reconciliation of movement in equity shareholders' funds

	Group Total £m	Company Total £m
Profit for the financial period	59.4	78.4
Dividends	(36.0)	(36.0)
Retained profit for the financial period	23.4	42.4
Purchase of own shares for the LTIP	(0.5)	(0.5)
Issue of shares (net of expenses)	498.2	498.2
Increase in equity shareholders' funds	521.1	540.1
Opening equity shareholders' funds at 12 May 2003	-	-
Closing equity shareholders' funds	521.1	540.1

27 Pensions

The Group operates a funded defined benefit pension scheme, providing benefits based on final pensionable remuneration to 2,406 employees. The scheme, named the Northumbrian Water Pension Scheme, comprises four unitised sub-funds – WPS Section, Northumbrian Water Section (North), Northumbrian Water Section (South) and the MIS Section.

The assets of the scheme are held separately from those of the Group in independently administered funds.

The most recent actuarial valuation of the scheme was at 31 December 2001. At that date the market value of assets amounted to £441.0 million in aggregate (excluding MIS which was transferred into the scheme on 1 April 2002 and was valued at approximately £20.0 million). The 2001 valuation disclosed that the combined value of the assets represented 109% of the value of the accrued liabilities. NSL contributed a further £15.0 million to the scheme on 2 January 2003.

The following table sets out the agreed contributions based on the 31 December 2001 valuations for WPS, North and South sub-funds. The contributions for the MIS sub-fund were agreed based on the 31 March 2001 valuation.

	Section			
	WPS	North	South	MIS
Members' contributions	6%	5%	5%	5% / 6%
Employer's contributions	15.5%	10.5%	Nil	6% / 7.2%

The MIS employer contributions increased to 21%/20.7% of pensionable earnings for 5%/6% members respectively from July 2003, following advice from the actuary. In addition the Company has agreed to pay £0.3 million p.a. for ten years starting on 1 January 2005.

The employer contribution rate was assessed, at the December 2001 valuation, using the Projected Unit Method and the following actuarial assumptions:

	Group 31.3.2004 %
Investment return:	
Pre retirement	6.1
Post retirement	5.7
Pay increases	3.5
Pension increases	2.5
Price inflation	2.5

The next valuation will be carried out at 31 December 2004. An independent qualified actuary performs the actuarial valuation. Additional disclosures regarding the Group's defined benefit scheme are required under the transitional provisions of FRS 17 'Retirement benefits' and these are set out below.

During the period the Group made contributions amounting to £6.5 million to the defined benefit pension scheme and the Northumbrian Water Group Personal Pension Plan, which provides defined contribution benefits to 705 employees, £5.3 million of which related to the defined benefit pension scheme.

A qualified actuary, using revised assumptions that are consistent with the requirements of FRS 17, has updated the actuarial valuation described above at 31 December 2001. Investments have been valued, for this purpose, at fair value.

FRS 17 actuarial assumptions:

	Group 31.3.2004 %
Pay increases	4.0
Pension increases	3.0
Price inflation	3.0
Discount rate	5.5

The fair value of the assets in the scheme, the present value of the liabilities in the scheme and the long term expected rate of return at 31 March 2004 were:

	Long term expected rate of return 31.3.2004 %	31.3.2004 £m
Equities	6.8	335.4
Corporate bonds	5.5	37.7
Government bonds	4.8	41.8
Property	5.8	47.5
Cash	4.0	12.7
Total fair value of assets		475.1
Present value of scheme liabilities		(565.7)
Deficit in the scheme		(90.6)
Related deferred tax asset		27.2
Net pension liability		(63.4)

Analysis of the amount that would have been charged to operating profit under FRS 17:

	31.3.2004 £m
Current service cost	10.6
Curtailments and settlements	0.5
	11.1

Analysis of the amount that would have been credited to net finance income under FRS 17:

	31.3.2004 £m
Expected return on pension scheme assets	22.2
Interest on pension scheme liabilities	(23.5)
	(1.3)

Analysis of the actuarial loss that would have been recognised in the statement of total recognised gains and losses:

	31.3.2004 £m
Actual return less expected return on pension scheme assets	(30.4)
Experience gains and losses arising on the scheme liabilities	(8.0)
Changes in assumptions underlying the present value of the scheme liabilities	0.8
	(37.6)

Analysis of movement in deficit during the period:

	31.3.2004 £m
Deficit in scheme at 23 May 2003	(121.5)
Current service cost	(10.6)
Total other finance income	1.0
Actuarial gain	37.6
Impact of curtailments and settlements	(0.5)
Other	(0.6)
Net return	(1.3)
Contributions	5.3
Deficit at 31 March 2004	(90.6)

History of experience gains and losses:

	31.3.2004
Difference between the expected and actual return on scheme assets:	
Amount (£m)	30.4
Percentage of scheme assets	6.4%

Experience gains and losses on scheme liabilities:

Amount (£m)	8.0
Percentage of the present value of scheme liabilities	1.4%

Total actuarial gain recognised in the statement of total recognised gains and losses:

Amount (£m)	37.6
Percentage of the present value of scheme liabilities	6.7%

Reconciliation of net assets and reserves under FRS 17:

Net assets – Group:

	31.3.2004 £m
Net assets in balance sheet	523.0
SSAP 24 balance	(14.3)
Related deferred tax	4.3
Net assets excluding defined benefit assets/(liabilities)	513.0
FRS 17 net pension liability	(63.4)
Net assets including defined benefit assets/(liabilities)	449.6

Reserves – Group:

	31.3.2004 £m
Profit and loss account in balance sheet	23.4
SSAP 24 balance	(14.3)
Related deferred tax	4.3
Profit and loss account excluding amounts relating to defined benefit assets/(liabilities)	13.4
FRS 17 net pension liability	(63.4)
Profit and loss account including defined benefit assets/(liabilities)	(50.0)

28 Financial commitments

(a) Capital expenditure

	Group 31.3.2004 £m
Expenditure contracted for	53.3

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 business.

(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	31.3.2004 £m
Leases which expire:			
Within one year	0.1	0.6	0.7
Within two to five years	0.3	1.3	1.6
After five years	0.6	0.2	0.8
	1.0	2.1	3.1

29 Commitments – Company

The Company has issued letters of continuing support to subsidiary companies with net current liabilities amounting to £193.9 million of which £178.7 million is in respect of NWL. These subsidiary companies are expected to meet their working capital requirements from operating cash flows.

30 Post balance sheet event

On 12 May 2004, the Group's financial position was improved by the announcement of the securitisation of NWL's contract with the Environment Agency for the operation of the Kielder Water transfer scheme. The proceeds of £212.1 million were used to repay short term debt, of £205.0 million, arising from the acquisition of the Group's business.

31 Financial review statement

The Group has disclosed the comparative period for the acquired group, NSL, for the ten months ending 31 March 2003 and the pro forma figures for the 12 months ending 31 March 2004. The latter includes eight weeks of pre-acquisition trading results and the accounting effect of the acquisition on 23 May 2003.

	NWG 12.5.2003 to 31.3.2004	NSL 23.5.2002 to 31.3.2003	NSL 1.4.2003 to 31.3.2004 Pro forma
	£m	£m	£m
Turnover: Group and share of joint ventures	448.6	435.2	528.3
Less share of joint ventures' turnover	(6.5)	(6.2)	(7.5)
Group turnover	442.1	429.0	520.8
Operating costs			
- operating costs before exceptional costs	(296.3)	(285.0)	(354.3)
- exceptional costs	(2.2)	-	(2.2)
Operating profit	143.6	144.0	164.3
Share of associated undertakings' operating profit	2.5	0.6	2.5
Share of joint ventures' operating profit	1.0	1.1	1.3
Total operating profit: Group and share of joint ventures and associates	147.1	145.7	168.1
Investment income	-	0.2	-
Net interest payable and similar charges			
- net interest payable	(92.8)	(65.3)	(105.3)
- amortisation of financing costs	(8.8)	-	(8.8)
Profit on ordinary activities before taxation	45.5	80.6	54.0
Tax on profit on ordinary activities	14.0	(1.4)	13.5
Profit on ordinary activities after taxation	59.5	79.2	67.5
Minority interest	(0.1)	(0.2)	(0.6)
Profit for the financial period	59.4	79.0	66.9
Dividends paid and proposed	(36.0)	(62.3)	(36.0)
Retained profit for the financial period	23.4	16.7	30.9

Shareholder information

Sustainable Development Performance Report

The Northumbrian Water Group plc Sustainable Development Performance Report 2003/2004 will be published in September 2004. Requests for copies can be made to:

Environment Department
Northumbrian Water Group plc
Northumbria House
Abbey Road, Pity Me
Durham, DH1 5FJ
Email: environment@nwl.co.uk
Tel: 0191 301 6794
Fax: 0191 301 6578

Group websites

www.nwg.co.uk
www.nwl.co.uk
www.eswater.co.uk
www.entecuk.com
www.aes-labs.co.uk
www.ulgnorthumbrian.com
www.agrer.com

Registrar

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Fax: 020 8639 2342
Email: ssd@capitaregistrars.com
Web: www.capitaregistrars.com

Shareholder queries

Tel: 0191 301 6704 or 0191 301 6701
Fax: 0191 301 6705

Requests for financial statements and other Company or Group literature

Email: communications@nwl.co.uk

Annual General Meeting

The notice and information relevant to the Annual General Meeting to be held on 3 August 2004 and the proxy voting card will be enclosed with this annual report and financial statements in the mailing to shareholders. Shareholder questions and any requests for special needs can be directed to:

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Northumbria House
Abbey Road, Pity Me
Durham, DH1 5FJ
Tel: 0191 301 6701
Fax: 0191 301 6705

Company Secretary and registered office

Martin Parker
Company Secretary
Northumbrian Water Group plc
Northumbria House
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Durham, DH1 5FJ
Tel: 0191 301 6746
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Northumbrian Water customer queries

Customer Services: 0845 717 1100
Customer Accounts: 0845 733 5566

Essex & Suffolk Water customer queries

Customer Services: 0845 782 0999
Customer Accounts: 0845 782 0111

NORTHUMBRIAN WATER GROUP PLC**RESULTS FOR THE PERIOD 12 MAY 2003 TO 31 MARCH 2004****Company - Profit and Loss Account**12 May 2003
to
31 March
2004
£m

Turnover	3.6
Operating costs	(6.5)
Operating loss	(2.9)
Investment income	106.5
Investment payable	(28.9)
Profit on ordinary activities before taxation	74.7
Taxation	3.7
Profit on ordinary activities after taxation	78.4
Dividends paid	(12.0)
Dividends proposed	(24.0)
Retained profit for the financial period	42.4

All the above results are all attributable to acquisitions in the period.

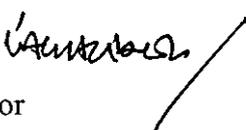
NORTHUMBRIAN WATER GROUP PLC

RESULTS FOR THE PERIOD 12 MAY 2003 TO 31 MARCH 2004

Company Balance Sheet

	As at 31 March 2004 £m
Fixed assets	1,022.7
Current assets	
Debtors	50.2
Cash and short term deposits	4.4
	54.6
Creditors: amounts falling due within one year	(47.2)
Net current assets	7.4
Total assets less current liabilities	1,030.1
Creditors: amounts falling due in more than one year	(490.0)
Net assets	540.1
Called up share capital	51.9
Share premium account	446.3
Other reserve	(0.5)
Profit and loss account	42.4
Capital and reserves	540.1

Approved by the board of Directors on 8 June 2004 and signed on its behalf by:


Director