


Pennon Group Plc

Annual Report

and Accounts 1999

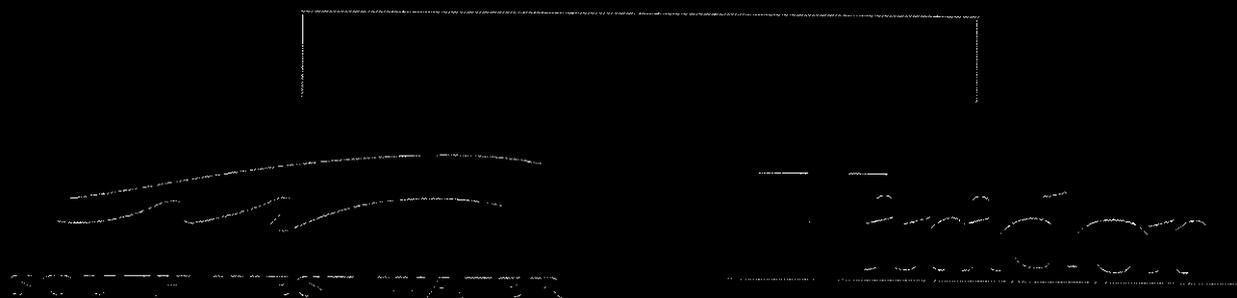
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Pennon Group Plc



Pennon Group Plc operates and invests primarily in the areas of water and sewerage services, waste management, environmental instrumentation and construction services.

There are two main subsidiaries:

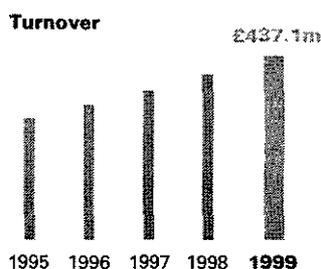
- **South West Water Limited** holds the water and sewerage appointments for Devon and Cornwall and parts of Somerset and Dorset.
- **Viridor Limited** combines a range of environmental businesses. It includes one of the premier waste disposal companies in the United Kingdom, an environmental instrumentation company with leading positions in its key segments worldwide and a specialist construction services company.

Pennon Group Plc has assets of £1.8 billion and currently employs 3,500 people.

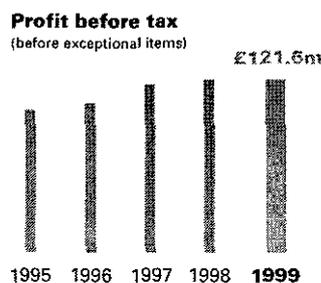
Highlights of the year

Sound progress made in all areas of the Group's business.

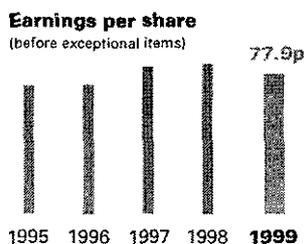
■ Turnover
**£437.1
million**



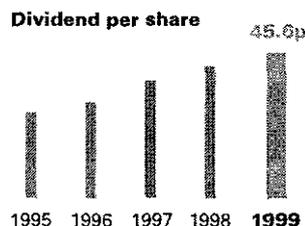
■ Profit before tax
**£121.6
million**



■ Earnings per share
77.9 pence

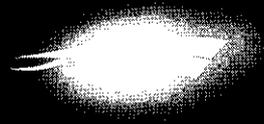


■ Dividend per share
45.6 pence



■ Enhanced levels of product and customer service

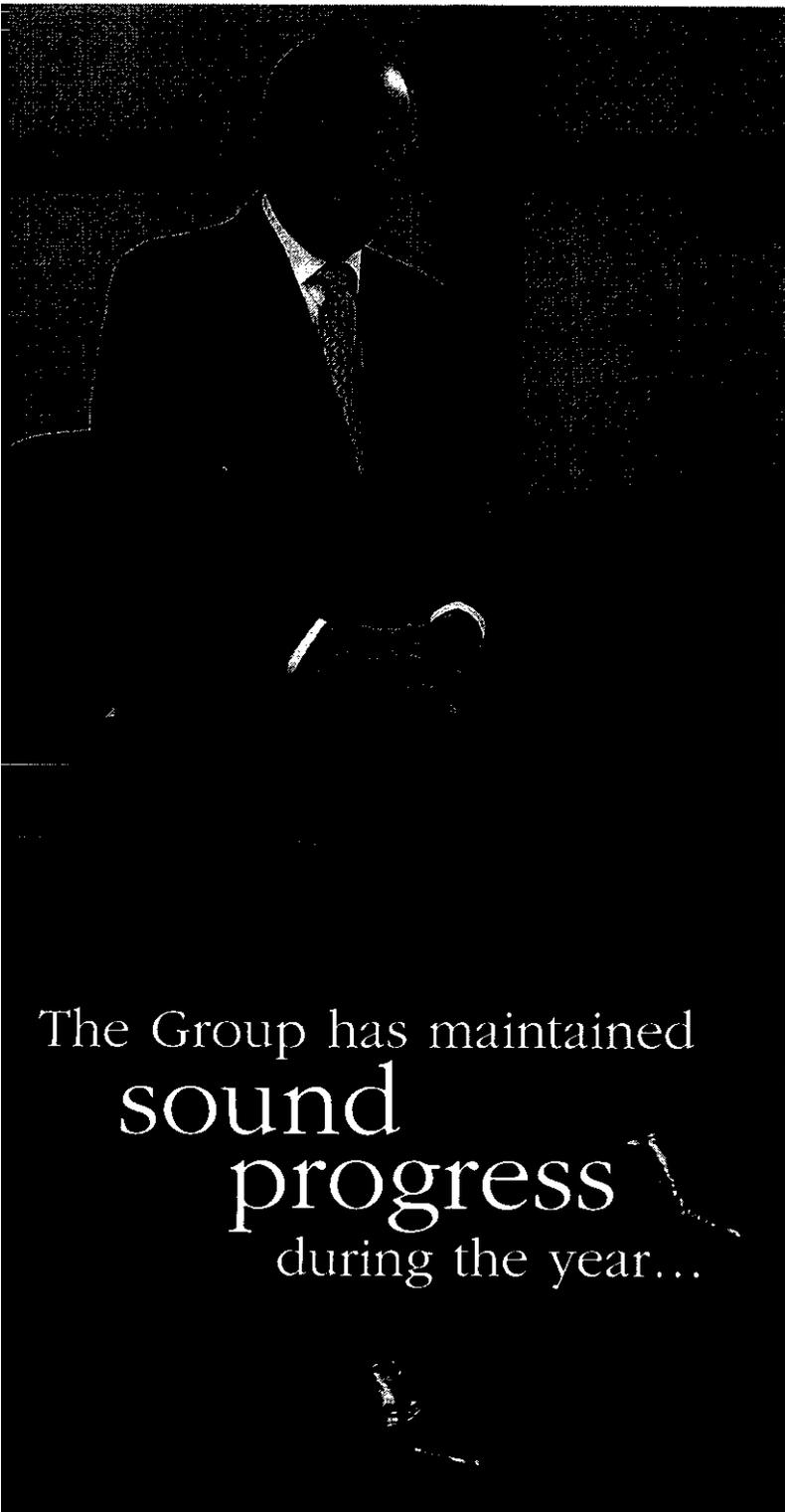
■ Substantial profit growth in non-regulated activities with a £15.4 million contribution



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Chairman's statement



The Group has maintained
**sound
progress**
during the year...

I am pleased to report that the Group has maintained sound progress during the year in all areas of its activities. South West Water Limited continued to provide significant improvements in product quality and customer service together with the delivery of further operational efficiencies.

The companies operating within Viridor Limited are among the leading businesses within their respective markets. Viridor continued to demonstrate its importance to the future of the Group with further substantial growth in turnover and profits.

■ Group progress

The Group continued to make solid financial progress during the year with Group turnover rising by 14.3% to £437.1 million. South West Water contributed £18.3 million of increased turnover with Viridor and other non-regulated businesses contributing an impressive increase of £36.4 million.

Profit before tax and exceptional items was maintained at £121.6 million and earnings per share excluding exceptional items were 77.9p. The Directors are recommending a final dividend of 30.9p per share which will result in a full year cash dividend of 45.6p – an increase of 11.2%.

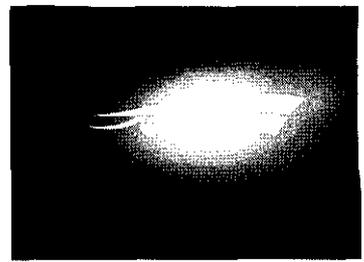
■ South West Water Limited

The utility business continued to improve its levels of customer service and quality of product while achieving further reductions in overheads and operating costs. Significant efficiency savings were achieved during the year as the restructuring initiatives which commenced in 1997 continued. Further savings are anticipated in the future as the company strives for even higher levels of efficiency.

During the year South West Water further improved its customer guaranteed standards scheme and introduced a number of new initiatives to further enhance levels of customer service. Market research results published during the year confirmed a significant increase in overall levels of customer satisfaction.

The ongoing capital investment programme continues to provide benefits for customers, the environment and the region as a whole with the company's 'Clean Sweep' bathing water improvement programme the most visible element of regional enhancement.

The operating review describes in more detail the progress made during the year when drinking water quality levels were further improved and leakage was lower than the targets set by Ofwat.



■ Viridor Limited

The non-regulated businesses continued to perform well in line with strategy. Several acquisitions were completed during the year which saw Viridor's contribution to Group turnover increase significantly.

Viridor Waste has developed to the point where it is one of the largest waste disposal businesses in the United Kingdom. The company's total consented landfill void has grown by more than 20% since March last year to 83 million cubic metres with a further 56 million cubic metres available for future development.

Viridor Instrumentation delivered a positive profit performance during the year despite the impact on its business from the relative strength of sterling and weakness in certain overseas markets. Restructuring of the business has helped attain a more focused approach. The acquisition of Orbisphere Management Holding SA enhanced its product range and has helped the company significantly improve both its operating profit and its margins.

During the year Viridor Contracting responded positively to changes in its market. The company staged a recovery in the second half of the year following difficult trading conditions in the first half as it restructured and refocused its activities.

The Viridor Limited companies are acknowledged as being one of the most successful groups of non-regulated businesses within the water sector and are now contributing almost 40% of Group turnover. This figure is expected to grow in the future.

The operating review provides comprehensive details of Viridor's performance during the year.

■ Competition in the water industry

The Group welcomes and encourages the development of competition in the water industry. Indeed, through its 50% ownership of Enviro-Logic Limited, it is attempting to shape the operating environment to provide larger customers with the freedom to choose their supplier. It was pleasing, therefore, when Albion Water – a subsidiary of Enviro-Logic – was chosen in April 1999 as the water supplier to Shotton Paper in North Wales.

Now that the complex regulatory and licensing issues have been determined for the Shotton scheme, it is essential that future applications are progressed more quickly or the long term objective of full competition in the water industry is unlikely to be realised.

Enviro-Logic is actively pursuing a number of similar opportunities throughout the UK.

■ Prospects

The Periodic Review is a major challenge facing the whole of the industry. Following two years of preparation, South West Water's Strategic Business Plan has been submitted to Ofwat and the Director General's Determination is awaited.

A comprehensive plan for managing water and sewerage services during the Eclipse in August 1999 has been evolved in conjunction with local organisations. The priority is to ensure all existing customers continue to be supplied with water and sewerage services.

The Group is on track to deal with the impact of the Year 2000 information technology problem on all of the Group's businesses and all business critical systems are now substantially compliant.

■ Board matters

Mr Bruce Hewett is retiring from the Board as a Non-executive Director at the end of the annual general meeting. My Board colleagues and I thank him for his contribution since his appointment in 1993.

■ Employees

In the two years it has been my privilege to be Chairman of the Group, many structural and organisational changes have taken place as the Group seeks to become more efficient and profitable. Throughout the many changes, employees have continued to demonstrate a high level of loyalty, commitment and professionalism and I thank them most sincerely for their efforts.

■ K G HARVEY
CHAIRMAN
PENNON GROUP PLC

Operating review

South West Water Limited



■ Improved customer services and further operational efficiencies

South West Water Limited continued to make considerable progress in all areas of its business during the year. Significant improvements in product quality and customer service, together with the delivery of further operational improvements, have resulted in a more efficient company dedicated to improving customer service.

■ Financial progress

South West Water's turnover increased by 7.4% to £270.1 million. The underlying operating costs prior to depreciation and exceptional items have reduced in real terms from the 1997/98 levels. The impact of operating new works, inflation and other cost increases has been absorbed by further efficiency savings and cost reductions amounting to £9.6 million.

Operating profit, excluding exceptional items, increased by 10.8% to £138.7 million.

Customers switching from an unmeasured charging basis to a metered basis continues to have an adverse impact on turnover and profits. Some 19,000 customers switched to measured billing with a consequent impact of £5.4 million for the year.

Net interest payable at £32.5 million rose by £19.0 million reflecting the need to fund the capital investment programme and a reduced benefit from finance leases. As a result, profit before tax reduced by £5.5 million (before exceptional items) to £106.2 million.

Capital expenditure for the year was £105.2 million with £43.0 million invested in water supply improvements including water treatment works upgrading, leakage control and water mains rehabilitation. Waste water services benefited from an investment of £62.2 million of which £28.4 million was invested in the company's 'Clean Sweep' bathing water improvement programme.

■ Reshaping the business for the future

A restructuring programme was initiated some two years ago to achieve a streamlined structure focused on customer service and to deliver significant reductions in operating and overhead costs. As part of that programme, a thorough review of the changing regulatory, customer, financial and economic circumstances facing the company was carried out.

Many elements of the programme entitled 'New Horizon' have now been successfully delivered against this backdrop. During the year operational performance continued to improve and the cost reductions achieved represented 11% of controllable operating costs.

One of the most significant initiatives within the programme is the successful outsourcing of certain aspects of the company's water distribution function. Two specialist contractors have won the contracts to carry out work on behalf of South West Water. No compulsory redundancies resulted from the change which is calculated to save the company in excess of £1 million per annum in future years. This sum includes items of capital expenditure.

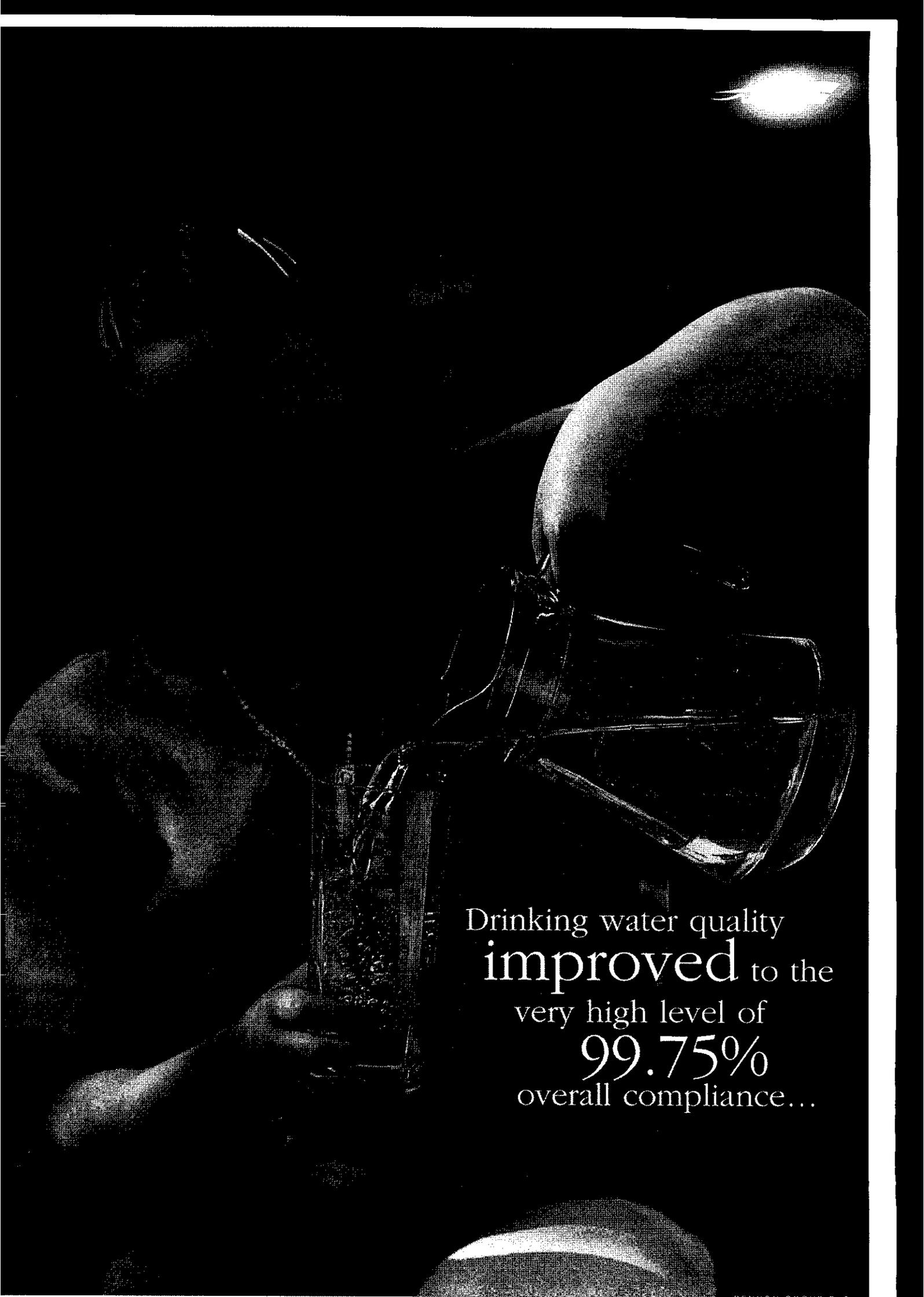
■ Customer service

As part of the company's drive towards delivery of ever improving levels of customer service, it has been carrying out market research amongst its customers to ascertain their views on the company, the services it provides and the levels of customer service it delivers.

Overall customer satisfaction levels have been steadily improving as the company has become more customer focused. The most recent market research results published during the year showed that around 80% of customers were satisfied with the service provided – a significant improvement on previous years.

During the year the company enhanced its guaranteed standards scheme following consultation with the local Ofwat Customer Service Committee and its own Customer Consultative Groups. The new arrangements will see increases in the level of payment it makes in the event of failure to achieve required standards in many areas of service.

Customer call centres were centralised to provide better levels of customer service and additional staff were also recruited in key customer service areas.



Drinking water quality
improved to the
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99.75%
overall compliance...

■ Drinking water supplies

Drinking water quality improved to the very high level of 99.75% overall compliance and there were no water restrictions in any part of the region.

South West Water's management of water supplies is based on a three part strategy – leakage reduction, further development of existing resources and a significant promotional programme advocating the more efficient use of water. The strategy was evolved in liaison with the Environment Agency to take account of environmental issues.

The company has continued to improve its performance in relation to leakage. It has consistently achieved the leakage targets set by Ofwat and is on track to meet the approved target of 84 megalitres per day for 1999/2000.

Since the inception of its innovative 'Leak Seekers' programme in the early 1990s, the company is now saving the equivalent of enough water to supply the entire domestic needs of Cornwall every day.

In addition to reinforcement of certain water supply zones, each of the three strategic reservoirs, Colliford, Roadford and Wimbleball benefit from the added protection of pumping during winter months to augment storage levels.

The region-wide water conservation promotional programme continued throughout the year and included a 'water wise' roadshow, garden centre promotions and other water efficiency related initiatives.

A comprehensive plan for managing water and sewerage services during the Eclipse in August 1999 has been evolved in conjunction with local councils, police, emergency services and other organisations. The plan is designed to ensure that services are maintained to all connected properties.

During the year schemes were completed at Bratton Fleming and Restormel to improve water supplies to customers in North Devon and mid Cornwall.

■ Protecting and enhancing the environment

The Company's 'Clean Sweep' bathing water improvement programme continues to be the largest area of investment and during the year schemes were completed at Plymouth and Seaton & Downderry at a cost of £54 million.

Already more than 150 crude sewage discharges inherited at privatisation in 1989 have been eliminated and replaced with modern sewage treatment works at a cost of over £630 million at current prices. More than half of the schemes incorporate ultra violet disinfection.

Of the 141 designated bathing waters in the region, 128 of them met the mandatory EU bathing water standards and of these, 64 complied with the stringent European guideline standards required for 'Blue Flag' status.

The £50 million scheme for Plymouth was completed on schedule and provides sewage treatment to 120,000 customers for the first time. Work has begun on the £20 million project for Newquay. Planning approval has now been received for the £95 million scheme for Torbay, where over £30 million has already been invested in improvements to the existing sewer network. Planning permission has also been granted in respect of the schemes for Dawlish and Sidmouth. Work has now commenced on both schemes.

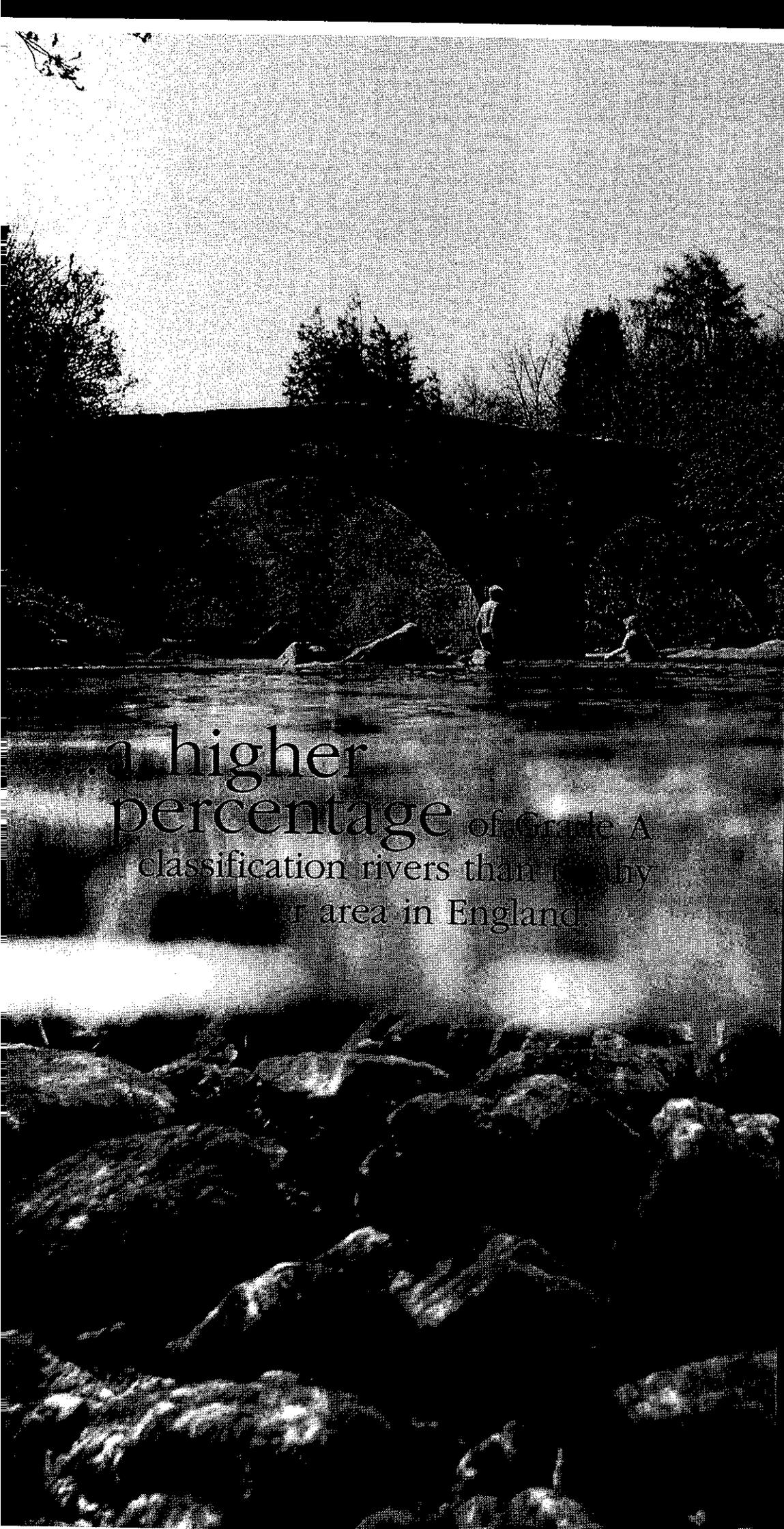
Since privatisation in 1989, over 200 inland sewage treatment works have been modernised and upgraded and 98% of the works now comply with consent standards. The company's improvement programme has helped the region achieve a higher percentage of Grade A classification rivers than in any other area in England. In tandem with providing enhanced levels of environmental protection for inland waterways, around 400 planning embargoes have been lifted as a direct result of investment.

■ Research and development

Research and development initiatives are focused on collaborative arrangements with national programmes, other water companies and academia.

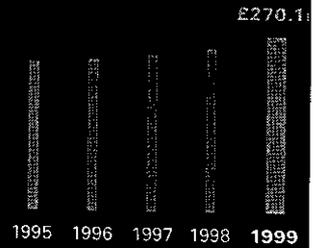
The company currently sponsors projects through UK Water Industry Research Limited (UKWIR) and the Engineering and Physical Sciences Research Council, in particular the Water Infrastructure and Treatment Engineering programme.

As part of the company's involvement with UKWIR, it has completed the seven contracts started last year. Many of these research contracts are assisting the UK Government during its discussions with the European Commission on the extent of future legal obligations including revised bathing water directives. In addition, the company has commenced the management of three further contracts,

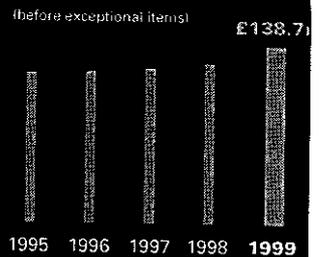


a higher percentage of Grade A classification rivers than in any other area in England

South West Water Limited - Turnover



South West Water Limited - Operating profit



South West Water Limited - Cumulative capital expenditure (from 1990)



two of which are in collaboration with the Department of the Environment, Transport and the Regions and the Environment Agency.

■ **The Periodic Review**

The outcome of the Periodic Review will be of crucial importance to the future operation of the company.

Following two years of preparation, which included independent professionally structured surveys of customers in the region, the company submitted its Strategic Business Plan to the Director General of Water Services in April 1999.

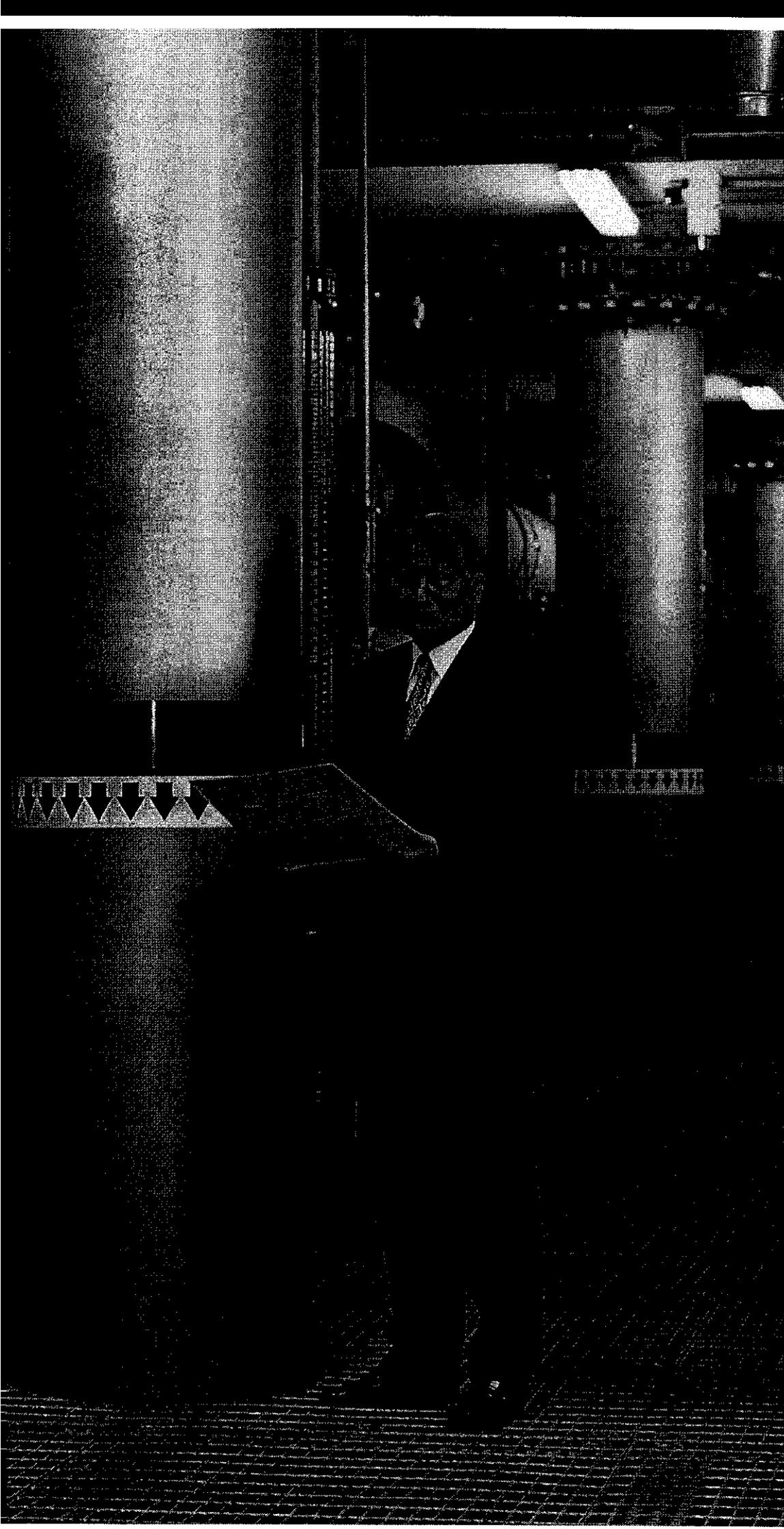
The Plan includes details of the company's strategy to deliver further substantial benefits to customers, the region and its environment, building on the significant achievements of the past ten years. Detailed customer research, planned in conjunction with Ofwat's Customer Service Committee and the Environment Agency, showed that the majority of customers wanted stable prices not rising faster than inflation, further improvements to waste water quality especially at coastal locations and further drinking water quality improvements.

The service quality improvements required by the Government, the Drinking Water Inspectorate and the Environment Agency appear inconsistent with stable prices but the Plan has sought to restrict price increases to an absolute minimum. The Director General is due to announce his draft Determination at the end of July and following a period of consultation and dialogue with other interested parties, his final Determination on prices for the years 2000 to 2005 will be made public in November 1999.

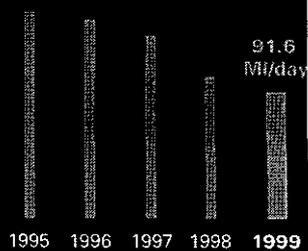
■ R J BATY
CHIEF EXECUTIVE
SOUTH WEST WATER LIMITED

The £50 million
scheme for Plymouth was
completed
on schedule...

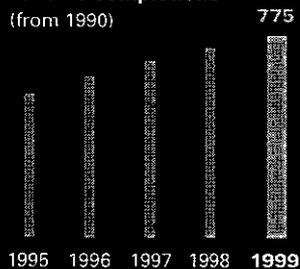
Bob Baty, Chief Executive of South West Water Limited, at the recently completed waste water treatment works at Plymouth.



Leakage



Cumulative major capital scheme completions (from 1990)



Operating review *Viridor*

Viridor Limited

■ Continuing successful strategic focus

During 1998/99, Viridor Limited made further substantial progress in adding shareholder value by growing both organically and through acquisitions. The companies operating within Viridor are among the leading businesses in their respective national and international markets and offer excellent long term potential.

Following the establishment of Viridor Limited last year in order better to reflect the importance of the non-regulated businesses to the future of the Group, its subsidiary company Haul Waste Group has been renamed Viridor Waste Limited, the EI Group has been renamed Viridor Instrumentation Limited, Viridor Contracting Limited became the holding company for T J Brent and Peninsula Properties becomes Viridor Properties Limited.

During the year, Terry Adams Limited (acquired in December 1997) was fully integrated into Viridor Waste. Further acquisitions were completed, the most notable of which was the purchase in December 1998 of Orbisphere Management Holding SA, a Geneva-based environmental instrumentation company. These and other smaller acquisitions have helped Viridor to grow substantially during the year and it is well placed to continue its development.

■ Financial progress

Viridor turnover increased by 11.6% to £189.3 million during the year. Operating profit rose by 35.6% to £23.6 million driven by a strong performance in waste management, including the full year effect of the Terry Adams acquisition. Environmental instrumentation profit also advanced while construction services recovered in the second half of the year after a disappointing first half.

■ Waste management

Viridor Waste is one of the largest waste disposal businesses in the United Kingdom and is a leading waste collector in the South West of England. Its strategy is to increase its market share in waste disposal.

During the year, Viridor Waste acquired two further consented landfill sites in Scotland with a total of 3.3 million cubic metres of capacity. These sites, located in the West of Scotland, complement Viridor Waste's award winning Dunbar site in East Lothian which is strategically positioned for the East of Scotland market.

Over 7 million cubic metres of additional capacity has been achieved on various landfill extensions and planning permission has also been gained for a further 6 million cubic metres for a new inert site with rail access in Kirton Lindsey, Lincolnshire.

The planning successes achieved, allied to the acquisitions made, net of usage during the year, have seen Viridor Waste's total consented landfill void grow by more than 20% since March 1998 to 83 million cubic metres, with a further 56 million cubic metres of unconsented void for potential future development. The company is therefore strongly positioned to capitalise on the increasing shortage of landfill capacity in the United Kingdom.

Three new landfill sites were opened during the year at Broadpath, Devon; Whitehead, Greater Manchester; and Squabb Wood, Hampshire. A further major new site at Erin, Derbyshire is scheduled to open during 1999/2000.

Viridor Waste's landfill gas power generation capacity has increased from 14.5 to 24.5 megawatts, with an additional 4.3 megawatts contracted. These increases have helped to offset the impact of the ending of its NFFO 1 and 2 contracts in December 1998.

The £4 million materials recycling facility at Viridor Waste's Masons landfill site near Ipswich is now fully operational. With the backing of a unique partnership between Viridor and Wastepack, it will ensure that companies, local authorities and Suffolk residents can all contribute to the achievement of packaging recovery targets from waste by providing both the facility and secure outlets for the reclaimed materials.

The company also secured major contracts from hospital trusts and other organisations for its clinical waste incineration plant in Plymouth. The contracts ensure the plant will operate at high capacity utilisation in the future.

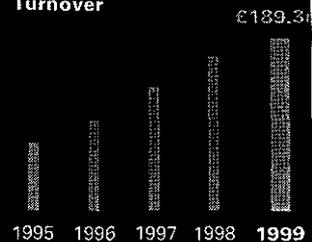
ISO14001, the international environmental accreditation standard has now been achieved at eighteen Viridor Waste sites – more than in any other company in the UK waste industry. During the year, in line with its environmental policies and intention to be a good neighbour, Viridor Waste donated a total of £4.7 million from landfill tax credits to a variety of environmental bodies assisting local projects in the neighbourhood of its landfills or undertaking research into sustainable waste management.

Turnover in Viridor Waste rose by 38.8% to £83.4 million with operating profit rising by 57% to £17.9 million. Operating margins increased to 21.5% compared with 19% last year.

Hillhead quarry complex in Devon prior to the commencement of its restoration by landfill.

Viridor Waste's total consented
landfill void is now
83 million
cubic metres...

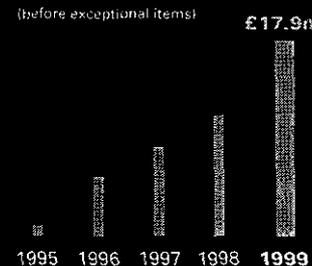
**Viridor Limited -
Turnover**



**Viridor Limited -
Operating profit**
(before exceptional items)



**Waste management -
Operating profit**
(before exceptional items)



■ Environmental instrumentation

Viridor Instrumentation is a leading international supplier of environmental monitoring equipment. It trades in over 150 countries with research and development and manufacturing facilities in the UK, Switzerland and the USA and has a share of up to 50% of the world market in key product areas.

The company reacted positively to the impact on its business from the relative strength of sterling and the dollar and the weakness of Far Eastern markets. Its business has been restructured under four world-wide units focusing on municipal water (GLI), process water and gas (Orbisphere), natural water (Hydrolab) and materials testing (ELE). This, combined with the Orbisphere acquisition, has produced improved operating profits despite difficult world trading conditions.

Orbisphere, a Geneva-based leading international manufacturer of analytical instruments for liquids and gas for the process industry market was acquired in December 1998 for £33.1 million. Its leading position within the process industry complements Viridor Instrumentation's strong position in the municipal water industry. Orbisphere's products also complement those of the rest of Viridor Instrumentation. Significant long term synergies are expected in technology, product development, manufacturing and international marketing and distribution.

Expenditure on research and development is important for the continued growth of Viridor Instrumentation and amounted to 5% of its turnover. During the year several new products were launched including a new fully automatic environmental monitoring station, a unique pH sensor and a Teflon conductivity sensor designed specifically for the high purity water market.

Turnover in Viridor Instrumentation fell by 1.9% to £41.0 million while operating profit increased by 27.6% to £3.7 million, after absorbing goodwill amortisation of £0.5m.

■ Construction services

Viridor Contracting's subsidiary, T J Brent, is a market leader in construction services in the South West of England and a major player in mechanical and electrical contracting and process engineering within the UK's, waste water industry. During the year the company responded positively to changes in its market arising from water companies modifying their approach to water mains improvements. An exit from the building sector was also made as part of the company's restructuring.

T J Brent experienced difficult trading conditions in the first half of the year but, with restructuring and refocusing of activities, it staged a recovery in the second half.

During the year T J Brent acquired the intellectual property rights and contracts of a West Midlands based company, E Tomkinson & Co Limited. These have now been successfully integrated into the Copa MEICA division.

As part of its commitment to quality, T J Brent has further extended its ISO 9001/2 accreditation which now covers eight segments of its business.

In line with its strategy, T J Brent won a considerable number of contracts outside the Pennon Group. Its turnover increased by 6% to £60.3 million with external turnover increasing by 94.8% to £40.9 million or almost 70% of the total. Operating profit was £1.1 million.

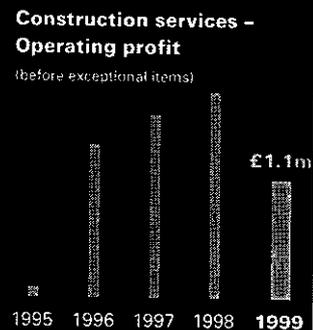
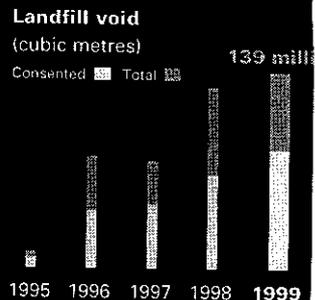
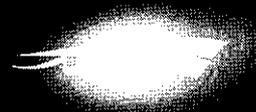
■ Property

A number of profitable property disposals were made during the year in line with the Group's overall strategy, including South West Water's former divisional office, Windsor House in Plymouth. Over the past three years the sale of property has realised around £27 million of cash for the Group.

■ C I J H DRUMMOND
CHIEF EXECUTIVE
VIRIDOR LIMITED

*Colin Drummond, Chief Executive of Viridor Limited,
in Geneva, the home of Orbisphere, holding an oxygen monitor.*

...a share of up to
50% of the
world market
 in key product areas.



Financial



Pennon Group Plc

review

■ Summary

A £32.9 million improvement in operating profit arose from a combination of cost control in South West Water Limited, profitable non-regulated business growth and the impact of exceptional items in 1998 and 1999.

Net interest payable increased significantly to £40.9 million in 1999. This was dominated by the need to fund the £104.0 million windfall tax payments, the Group's acquisitions and the water and sewerage business investment programme, together with a reduced gain on defeasance of finance leases.

■ Operating profit

Group turnover for the year increased by 14.3% to £437.1 million. Total turnover of the water and sewerage business was £270.1 million, up 7.4% on 1998. This improvement was mainly influenced by tariff increases and the impact of the 1998 customer rebate which was not repeated in 1999, offset by the adverse impact of customers moving from the unmeasured to the measured usage tariff. Total turnover for non-regulated businesses reached £195.6 million, up 9.8% on 1998. This includes £83.4 million from Viridor Waste, £41.0 million from Viridor Instrumentation and £60.3 million from the Viridor Contracting business.

Operating costs for 1999 at £274.4 million increased by £34.3 million (before exceptional items), primarily from business growth in the non-regulated segments.

Operating profit (before exceptional items) for the year was £162.7 million, up £20.4 million on 1998. The water and sewerage business contributed £138.7 million, up £13.5 million on 1998. Operating profit from non-regulated segments totalled £24.0 million, up £6.9 million on 1998, of which £23.6 million arose in the Viridor businesses.

■ Finance costs

Net interest payable was £40.9 million, compared with £20.3 million in 1998.

Gross interest payable was £52.3 million arising on borrowings, predominantly denominated in sterling. Gross interest receivable of £8.0 million is derived from investment of temporarily surplus funds in financial investments and on the money market, predominantly in sterling.

The Group delivered a further benefit of £3.9 million in 1999, from the utilisation of finance lease facilities linked to standby letters of credit counter-indemnified by cash deposits (1998 £12.2 million).

Net interest payable was 4.0 times covered by operating profits (before exceptional items).

■ Profit before tax

Profit before tax and exceptional items was £121.6 million, unchanged from 1998. The water and sewerage business contributed £106.2 million, down £5.5 million on 1998 after absorbing a £19.0 million increase in net interest payable.

Non-regulated businesses achieved a profit before tax of £15.4 million, £5.5 million up on 1998 (before exceptional items).

The 1999 results include a £5.0 million exceptional gain arising from the settlement of a legal claim on Browning-Ferris Industries Inc. The 1998 results included £15.0 million exceptional costs arising from a water and sewerage business restructuring provision and a business disposal loss.

■ Taxation

The Group's taxation charge for the year was £17.5 million. The Group's capital investment programme continues to generate substantial capital allowances to be set against taxable profits.

■ Dividends and retained earnings

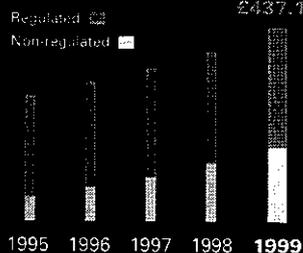
The Directors recommend the payment of a final dividend of 30.9p per share for the year ended 31 March 1999. Together with the interim cash dividend of 14.7p per share paid on 6 April 1999 this makes a total dividend for the year of 45.6p per share, an increase of 11.2% on the dividend for 1998.

The changes to corporate tax arrangements, notably the abolition of advance corporation tax, have largely removed the advantages to the Company in offering a scrip dividend alternative. The Directors have decided not to offer such an alternative with the 1999 final dividend. However, the Board is introducing a Dividend Reinvestment Plan, details of which are contained in a separate document being posted to shareholders with this Annual Report.

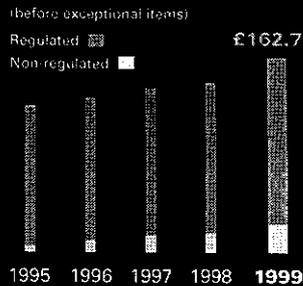
*Ken Hill, Group Director of Finance, on the trading floor of
Credit Lyonnais Securities Europe in the City of London.*



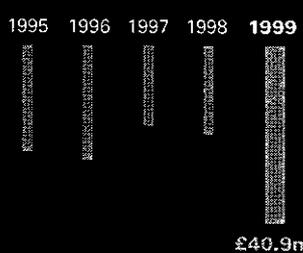
Group turnover



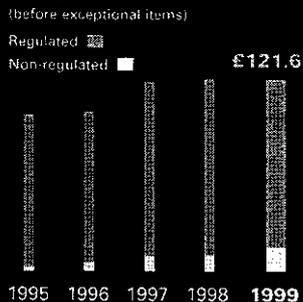
Group operating profit



Group net interest payable



Group profit before tax



Operating profit
increased by 14.3%
 to £162.7 million

The total cost of the interim and recommended final dividend of the Company is £61.9 million.

This year a retained profit of £47.2 million has been transferred to reserves.

The dividend paid by South West Water Limited to the Company for 1998/99, for ordinary business purposes, amounted to £60.0 million.

■ Investment

Capital expenditure by the Group on tangible fixed assets was £125.3 million (1998 £184.6 million) of which £105.2 million was for the water and sewerage business.

Business acquisitions during the year involved an investment of £37.1 million. After placing fair values on the underlying assets and liabilities acquired, a £29.1 million value for goodwill resulted, which will be amortised to profits over a 20 year period.

In the opinion of the Directors the current market value of land and buildings is not significantly different from the holding cost shown in the financial statements.

■ Financing

The cash inflow from operating activities was £193.6 million (1998 £198.6 million). Capital expenditure and financial investment cash outflow reduced from £185.7 million in 1998 to £125.0 million in 1999. Taxation cash outflow of £79.9 million (1998 £61.2 million) included the second windfall tax instalment of £52.0 million. Acquisitions and disposals involved a cash outflow of £29.7 million (1998 £20.8 million). Overall, cash outflow by the Group, before the use of liquid resources and financing, was £97.5 million (1998 £123.1 million).

Expenditure during the year was largely financed by the inclusion of £75.0 million of finance leases, previously collateralised by cash deposits. Also during the year, £21.0 million of finance lease facilities were drawn down and £15.9 million of cash was placed on deposit with financial institutions, as part of the financing initiative referred to in note 6 to the financial statements.

At 31 March 1999 loans and finance lease obligations were £718.8 million and the Group held current asset investments and cash of £63.7 million. Net borrowings, which increased by £110.6 million during the year to £655.1 million, represent 73% of shareholders' funds (1998 67%).

The borrowing powers of the Directors are limited to two and a half times capital and reserves, as defined in the Company's Articles of Association. At 31 March 1999 the limit was £2.2 billion. The Directors confirm that the Group can meet its short-term requirements from the existing borrowing facilities without breaching covenants or other borrowing restrictions.

■ Treasury activities

The Group's treasury operations are managed in accordance with policies established by the Board. Major transactions are individually approved by the Board. Treasury activities are reported to the Board and are subject to review by internal audit.

Financial instruments are used to raise finance and to manage risk. The Group does not engage in speculative activity.

The principal financial risks faced by the Group relate to interest rate, exchange rate and counterparty risk.

Finance and interest rate risk

The Group is financed by a combination of equity, retained profits, bank borrowings, finance leases, loan notes and a long-term debt market issue. Individual subsidiaries are financed through a combination of external debt, and loan and equity finance from the Company.

Derivatives, usually interest rate swaps, are used to manage the mix of fixed and floating rate debt – ensuring at least 50% of net debt is at fixed rate. At 31 March 1999, after taking account of interest rate swaps with a notional principal amount of £160 million, 60% of net debt was at fixed rate, with debt in place for periods of between 3 and 13 years, with an average maturity of 8 years. The notional principal amounts of the interest rate swaps are used to determine settlement under those swaps and are not, therefore, an exposure for the Group.

Net interest costs represent a rate of 6.8% when measured against average net debt.

The Group ensures continuity of funding by arranging new committed facilities and borrowings in accordance with anticipated requirements, supported by extensive short-term uncommitted bank facilities of around £300 million.

Current asset investments

The Group invests funds which are surplus to immediate operational requirements in high quality deposits and financial instruments in accordance with policies established by the Board. During the year, in order to reduce net interest rate exposure, interest rate swaps were utilised to align the basis of a portion of interest receivable with interest payable.

Foreign currency risk

The Group's principal exchange rate risk is to the value of overseas investments. Net equity value, including a portion of capitalised goodwill, is now protected by the forward sale of foreign currency – at 31 March 1999 US Dollar 15.5 million and Swiss Franc 50.0 million. Foreign currency transaction exposure is covered on a case by case basis (31 March 1999 nil).

Share capital

During the year the issued ordinary share capital increased from £131.4 million to £136.1 million largely as a result of shares issued under the Company's enhanced scrip dividend alternative and the Sharesave and Executive Share Option Schemes.

Permission was obtained from shareholders at the annual general meeting in July 1998 to purchase up to 10% of the Company's ordinary share capital. Renewal of the authority will be sought at the 1999 annual general meeting.

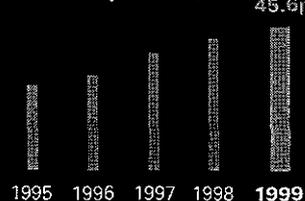
Shareholders' return

The dividend of 45.6p is paid out of earnings per share of 77.9p (before exceptional items). The cover for payment of dividends is 1.7 times.

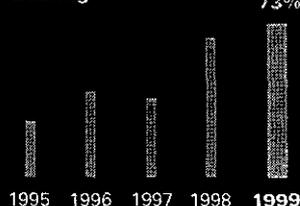
The Company's share price started the year at 978.5p and was 954p at 31 March 1999. The value of net assets per share at book value, at 31 March 1999, was 655.2p.

K L HILL
GROUP DIRECTOR OF FINANCE
PENNON GROUP PLC

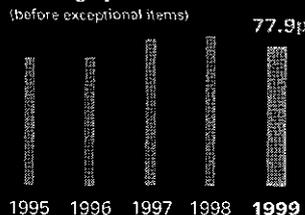
Dividend per share



Gearing



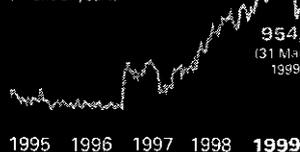
Earnings per share



Share price

1995 – 1999

(financial years)



Board of Directors

■ ■ ■ Kenneth George Harvey

BSc, CEng, FIEE (58)

Non-executive Chairman

was appointed on 1 March 1997. He was formerly chairman and chief executive of Norweb Plc. He was chairman of National Grid Holdings in 1995 and was previously deputy chairman of London Electricity and earlier its engineering director. He is also non-executive chairman of Beaufort Group Plc, Comax Plc and The Intercare Group Plc.

■ ■ ■ Stanislas Michael Yassukovich

CBE (64)

Non-executive Deputy Chairman

was appointed on 16 November 1992 and became Deputy Chairman on 13 November 1996. He is chairman of EASDAQ SA, Hemingway Properties Plc, Henderson Eurotrust Plc and Manek Investment Management Limited and deputy chairman of Bristol & West Plc, ABC International Bank Plc and Flextech Plc. He was formerly chairman of Merrill Lynch Europe and Middle East. He has been a deputy chairman of the Stock Exchange and from 1988 to 1991 was chairman of the Securities Association.

■ ■ ■ Robert John Baty

CEng, FICE, FCIWEM, MIMgt, ACI Arb, FIWO (55)

Chief Executive, South West Water Limited

was appointed on 1 March 1996. He was formerly engineering and scientific director of South West Water Services Limited having joined South West Water Authority in 1988. Previously he held senior engineering and operational appointments with North West Water Authority.

■ ■ ■ Colin Irwin John Hamilton Drummond

MA, MBA (48)

Chief Executive, Viridor Limited

was appointed on 1 April 1992. Prior to joining the Company he was a divisional chief executive of Coats Viyella Plc, having previously been corporate development director of Renold Plc, a strategy consultant with the Boston Consulting Group and an official of the Bank of England. He is a non-executive director of Vymura Plc.

■ ■ ■ Kenneth Leslie Hill

CPFA (58)

Group Director of Finance

was appointed on 21 September 1989. He is a public finance accountant with wide experience in the water industry. Prior to joining the Company he was finance director of Severn Trent Water. He is a non-executive director of Vocalis Plc and a City Disputes panellist.

■ ■ ■ Sir Geoffrey Howes Chipperfield

KCB (66)

Non-executive Director

was appointed on 1 October 1993. He was the permanent secretary and chief executive of PSA Services from 1991 and previously he was permanent secretary in the Department of Energy. He is chairman of the Energy Advisory Panel of the Department of Trade and Industry, chairman of the British Cement Association and pro-chancellor of University of Kent.

■ ■ ■ Alan Thomas Fletcher

MA (64)

Non-executive Director

was appointed on 26 May 1993. He is managing partner of Rubicon Partners, chairman of Vector Industries Limited, deputy chairman of Shepherd Building Group and a director of a number of subsidiary companies within those groups. Formerly he was chairman and chief executive of the Wilkinson Sword Group and chief operating officer of Swedish Match.

■ ■ ■ Bruce Alexander Ogston Hewett

BSc(Eng), MSc, EurIng, CEng, FICE, FCIWEM (63)

Non-executive Director

was appointed on 1 April 1993 as Director of Technical and Environmental Affairs. On his retirement from this executive position on 31 March 1997 he became a Non-executive Director. He has over 30 years' experience in the water industry, including nine years with international consulting engineers and he has held senior appointments with Southern Water Plc, including managing director of Southern Water Services Limited. A member of Eureau Commission 3 until 1998, he is a member of the British Committee of the International Water Services Association and the Devon Area Environment Group of the Environment Agency.

Committees of the Board

Audit

Sir Geoffrey H Chipperfield
(Chairman)

A T Fletcher

B A O Hewett

Environment

B A O Hewett (Chairman)

R J Baty

C I J H Drummond

Nomination

S M Yassukovich (Chairman)

Sir Geoffrey H Chipperfield

A T Fletcher

K G Harvey

Remuneration

A T Fletcher (Chairman)

Sir Geoffrey H Chipperfield

K G Harvey

Company Secretary and registered office

K D Woodier

Peninsula House

Rydon Lane Exeter EX2 7HR

Registered in England

No. 2366640

Auditors

PricewaterhouseCoopers

Chartered Accountants

31 Great George Street Bristol

BS1 5QD

Registrars

Lloyds TSB Registrars

54 Pershore Road South

Birmingham B22 1AD

Report of the Directors

The Directors of Pennon Group Plc ('the Company') present their tenth Annual Report, in respect of the year ended 31 March 1999, together with the audited financial statements of the Company for that year.

The financial statements will be laid before the shareholders at the tenth annual general meeting of the Company, to be held on 29 July 1999, notice of which is given on page 63.

■ Name change

The Company changed its name from South West Water Plc on 1 August 1998.

■ Principal activities

The principal activities of the Company and its subsidiaries ('the Group') continued to be the provision of water and sewerage services, waste management, environmental instrumentation and specialist construction services. The activities are described in more detail in the operating reviews.

■ Financial results and dividend

Group profit on ordinary activities after taxation was £109.1 million. The Directors recommend a final dividend of 30.9p per ordinary share, making a total for the year of 45.6p, the cost of which would be £61.9 million, leaving retained profit of £47.2 million to be transferred into reserves.

The financial review on pages 14 to 17 analyses the results in more detail, and sets out other financial information.

■ Directors

Sir Simon Day retired from the Board on 30 July 1998 and Mr B A O Hewett will retire as a Director of the Company at the end of the annual general meeting.

Messrs R J Baty and K L Hill are due to retire by rotation at the annual general meeting. Both Directors offer themselves for re-election and resolutions for their re-election will be proposed at the annual general meeting.

Messrs Baty and Hill have service contracts which provide for not less than one year's notice of termination, by the Company or by the respective Director, expiring at any time.

No Director has, or has had, a material interest, directly or indirectly, at any time during the year under review in any contract significant to the Company's business.

Details of Directors' interests in shares of the Company are given on pages 23 and 24.

■ Employees

The Group is committed to effective communication with all employees. Employees in South West Water Limited elect representatives from all levels to a Staff Council, which deals with matters of concern to all staff employees, both trade union and non-trade union members alike. The Staff Council complements other forms of employee communication used throughout the Group, including a monthly employee briefing system and an employee newspaper.

UK employees are encouraged to become shareholders in the Company through the all-employee Profit Sharing and Sharesave Schemes.

Training and development of staff is a priority and particular attention is given to the management of change and training for revised working processes.

The Group operates a non-discriminatory employment policy and makes every reasonable effort to provide disabled people with equal opportunities for employment, training and development, having regard to their particular aptitudes and abilities.

■ Year 2000

Many computer and related digital storage systems express dates using only the last two digits of the year. Such systems require modification to accommodate the Year 2000 in order to avoid malfunction and commercial disruption. The operations of the Group depend not only on in-house computer and related systems but also, to some degree, on those of other parties, including suppliers.

A programme, to address the impact of the Year 2000 on the Group's businesses, has been ongoing since 1996 and the overwhelming majority of the necessary changes are complete. The programme included a risk analysis of the impact on the Group's businesses of Year 2000 failures by other parties, including key suppliers, who have participated in a formal Year 2000 compliance confirmation process. Extensive work has been carried out to assess, upgrade or replace all assets that may be affected by Year 2000 failures. All Year 2000 compliance work is now substantially completed.

The Year 2000 compliance programme has been designed to avoid Year 2000 change computer systems failure. However, that work cannot provide an absolute assurance. The Directors will provide resources to deal promptly with any residual failures which might occur.

REPORT OF THE DIRECTORS

The total cost of modifications to the Group's computer hardware and software is estimated at £4.4 million, of which £2.2 million is for new equipment that will be capitalised.

The remainder will be charged against profits in the year it is incurred, including £1.0 million in 1999.

Research and development

Research and development activities continued throughout the Group during the year, with expenditure of £2.0 million. Further information is included in the operating reviews.

Donations

During the year charitable donations amounting to £56,000 were made. No political donations were made.

Payments to suppliers

It is the Company's payment policy to follow the Confederation of British Industry (CBI) Code of Practice on supplier payments. The Company will agree payment terms with individual suppliers in advance and abide by such terms. Information about the Code, and copies thereof, may be obtained from the CBI at Centre Point, 103 New Oxford Street, London WC1A 1DU. The ratio, expressed in days, between the amount invoiced to the Company by its suppliers during 1998/99 and the amount owed to its trade creditors at 31 March 1999, was 51 days.

Substantial shareholdings

At 24 June 1999 interests in the issued share capital had been reported by:

	Shares	%
Sanford C Bernstein & Co Inc	10,754,882	7.90
AXA Group	7,966,434	6.19
Norwich Union Life Insurance Society	7,502,346	5.51
Standard Life Group	5,446,939	4.04

Future developments

The Periodic Review is a major challenge facing the whole of the industry. South West Water has submitted its Strategic Business Plan to Ofwat and the Director General's Determination is awaited. In the meantime, the company continues to improve customer service, product quality and operating efficiency.

The non-regulated business activities grouped under Viridor Limited are well positioned with a clear strategic focus. They have already demonstrated their importance to the future of the Group and further growth can be expected.

Auditors

PricewaterhouseCoopers were appointed auditors until the conclusion of the tenth annual general meeting and have indicated their willingness to continue in office. A resolution for their re-appointment will be proposed at the annual general meeting.

Appointed business

South West Water Limited is required to publish additional financial information relating to the 'Appointed Business' as water and sewerage undertaker in accordance with the Instrument of Appointment from the Secretary of State for the Environment. A copy of this information will be available from 15 July 1999 by application to the Company Secretary at Peninsula House, Rydon Lane, Exeter EX2 7HR.

Annual general meeting

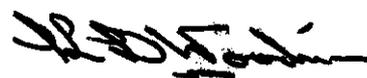
The tenth annual general meeting will be held at The Plymouth Pavilions, Millbay Road, Plymouth, Devon on 29 July 1999 at 11.00 a.m.

In addition to routine business, resolutions will be proposed at the annual general meeting to renew the existing authorities to issue a limited number of shares, to purchase up to 10% of the issued share capital and in respect of the Company's Sharesave Scheme. Details are set out in the notice of meeting on page 63.

By Order of the Board

K D WOODIER
COMPANY SECRETARY

Peninsula House Rydon Lane Exeter EX2 7HR
24 June 1999



Report on remuneration policy and remuneration

This report is made in compliance with Schedule B of the Combined Code annexed to the London Stock Exchange Listing Rules.

■ Remuneration policy

The policy of the Company continues to be to provide for Executive Directors a remuneration package which is adequate to attract, retain and motivate good quality executives and which is commensurate with the remuneration packages provided by companies of similar size and complexity.

■ Executive Directors

The remuneration package of the Executive Directors comprises:

i Salary and benefits – these are based on surveys conducted by external consultants and reviewed annually by the Remuneration Committee ('the Committee').

ii Performance related bonus – annual performance related bonuses are awarded in accordance with an incentive bonus scheme for Executive Directors and senior management and are based on the achievement of overall corporate and individual objectives established by the Committee. The maximum bonus achievable under the scheme for Executive Directors is 40% of basic salary.

iii Long-Term Incentive Plan – a restricted share plan for Executive Directors and senior management, as approved by shareholders at the annual general meeting on 29 July 1997, was operated by the Company during the year. In line with Schedule A of the Combined Code, the Committee ensures that awards under the Plan are subject to challenging performance criteria which are reflected in the Company's relative performance against comparators and it also ensures that awards made under the Plan are phased over time. The eventual number of shares, if any, which participants may receive is dependent upon the achievement of the performance conditions of the Plan over a three year period. These are:

- a* the Company's growth in earnings per share, calculated in accordance with IIMR guidelines, must be equal to at least 2.5% per annum above the Retail Prices Index; and
- b* the Company's total shareholder return (share price growth and dividends paid) must be at least equal to that of the company ranked at the 13th position (reading from the bottom) of a list of 25 companies in the FT-SE classified as 'Utilities'.

The ranked performance of the Company, as described in *b* above, will determine the proportion of the awards to which participants will be entitled.

iv Provision for pension – Executive Directors and senior management participate in the South West Water Pension Scheme and the Pennon Group Executive Pension Scheme. These are funded defined benefit schemes. Through membership of these schemes Executive Directors will be provided with a pension which, dependent on length of service, at normal retirement date will normally amount to two-thirds of final pensionable pay (subject to any restriction in respect of the Earnings Cap).

Messrs Drummond and Hill are subject to the Earnings Cap and are provided with additional pension benefits under the unapproved funded Supplementary Pension Scheme in order to bring their pension benefits up to the level which would have been provided under the other schemes if the Earnings Cap had not applied. Executive Directors included in the unapproved pension arrangements receive payments equivalent to the tax liability which arises in respect of Company contributions to the Supplementary Pension Scheme.

The pensionable pay for participants consists of the highest basic salary in any consecutive twelve month period of service within five years of retirement. Bonuses of Executive Directors are not included in pensionable pay.

In determining remuneration arrangements for Executive Directors, full consideration is given to their impact on the pension funds and costs of providing individual pension arrangements.

v Service agreements – all Executive Directors have one year rolling service agreements; and

vi The Executive Directors are also eligible to participate in the Group's Profit Sharing and Sharesave Schemes which are both all-employee schemes. All participants in the Profit Sharing Scheme receive an equal allocation of shares which are held in trust for a period of up to three years. Under the Sharesave Scheme, options are granted at a discount of up to 20% of the mid-market value averaged over the three days prior to the invitation date to participants who contract to save up to £250 per month over a period of three or five years.

REPORT ON REMUNERATION POLICY AND REMUNERATION

Emoluments of Directors

The emoluments of individual Directors are shown in the table below:

	Salary /fees £000	Performance bonuses £000	Other emoluments £000	Payments related to supplementary pension £000	Total 1999 £000	Total 1998 £000
<i>Chairman</i>						
K G Harvey	110	–	12	–	122	91
<i>Executive Directors</i>						
R J Baty	130	15	12	–	157	137
C I J H Drummond	130	33	12	22	197	151
K L Hill	134	38	11	11	194	198
<i>Non-executive Directors</i>						
Sir Geoffrey H Chipperfield	22	–	–	–	22	21
Sir Simon J Day (retired 30 July 1998)	7	–	–	–	7	21
A T Fletcher	35	–	–	–	35	23
B A O Hewett	21	–	–	–	21	41
S M Yassukovich	26	–	–	–	26	25
	615	86	47	33	781	708

Other emoluments include car benefit and health cover.

The fees of the Chairman were increased during the year to reflect the decision of the Board not to appoint a Group Chief Executive and a consequent increase in the commitment on the part of Mr K G Harvey.

The fees of Mr A T Fletcher were also increased during the year to reflect his appointment as a Non-executive Director of Viridor Limited.

The remuneration of Non-executive Directors is determined by the Board taking account of independent surveys of comparable appointments. Non-executive Directors do not vote on any resolutions submitted as part of this process.

Directors' pensions

Defined benefit pensions accrued and payable on retirement for Directors holding office during 1999 are shown in the table below:

	Increase in accrued pension during 1999 (net of inflation) <i>a</i> £000	Increase in transfer value (net of inflation) <i>b</i> £000	Accrued pension entitlement at 31 March 1999 <i>c</i> £000
R J Baty	18	273	78
C I J H Drummond	4	43	18
K L Hill	14	238	78

Column *a* above is the increase in accrued pension during 1999 (net of inflation). It recognises:

- i* the accrual rate for the additional year's service based upon the pensionable pay at the end of the year; and
- ii* the effect of pay changes in real terms (net of inflation) based upon the accrued pension at the start of the year.

Column *b* is the increase in the transfer value of column *a*. This has been calculated in accordance with Actuarial Guidance Note GN11 less, where paid, Directors' contributions.

Column *c* is the accumulated total pension at the end of the year payable at normal retirement age.

The Supplementary Pension Scheme, which mainly funds pension provision above the Earnings Cap, provides benefits in tax-paid lump sum form at retirement. Appropriate figures have been included in the above accrued pension totals.

Directors have the option to pay additional voluntary contributions; neither the contributions nor the resulting benefits are included in the above table.

■ Directors' share interests

a Shareholdings

The number of shares of the Company in which Directors held beneficial interests at 31 March 1999 and 31 March 1998 were:

	1999	1998		1999	1998
R J Baty	5,593	4,643	K G Harvey	2,117	2,000
Sir Geoffrey Chipperfield	1,500	1,500	B A O Hewett	12,377	12,068
C I J H Drummond	4,951	2,189	K L Hill	15,139	13,816
A T Fletcher	1,283	1,211	S M Yassukovich	—	—

As a result of reinvestment of dividends in a Personal Equity Plan, R J Baty, C I J H Drummond and B A O Hewett acquired an additional 37, 24 and 5 shares respectively on 6 April 1999.

Following exercises of options under the Executive Share Option Scheme on 28 May 1999, the number of shares in which Messrs R J Baty, C I J H Drummond and K L Hill held beneficial interests increased by 9,783, 2,000 and 1,000 respectively.

No Director had any interest in the shares of any subsidiary undertaking during the year.

b Restricted Share Plan

In addition to the above beneficial interests, the following Directors have a contingent interest in the number of shares shown below, representing the maximum number of shares to which they would become entitled under the Group's Long-Term Incentive Plan if all of the relevant criteria are met:

	Date of conditional award:	September 1997	September 1998	Total
R J Baty		7,949	9,558	17,507
C I J H Drummond		7,949	9,558	17,507
K L Hill		8,532	9,852	18,384

c Executive Share Option Scheme

Options to subscribe for shares of the Company under the Executive Share Option Scheme at 31 March 1999 and 31 March 1998 were

	Grant date:	1995	1993	1992	1991	1999	1998
	Subscription price:	503p	496p	418p	328p	Total	Total
R J Baty		7,500	15,000	4,600	20,000	47,100	47,100
C I J H Drummond		8,000	22,500	—	—	30,500	30,500
B A O Hewett		15,000	—	—	—	15,000	15,000
K L Hill		8,000	25,500	—	—	33,500	33,500

The exercise dates of the above options and the performance targets in respect of exercise are shown in note 25 to the financial statements.

Messrs R J Baty, C I J H Drummond and K L Hill exercised all of their outstanding options shown in the above table on 28 May 1999. On that date, the market price of the shares was 1,005p per share.

REPORT ON REMUNERATION POLICY AND REMUNERATION

Directors' share interests (continued)

d Sharesave Scheme

Options to subscribe for shares of the Company under the Sharesave Scheme as at 31 March 1999 and 31 March 1998 were:

Grant date: Subscription price:	1998 775p	1997 556p	1995 373p	1999 Total	1998 Total
R J Baty	–	701	2,774	3,475	3,475
C I J H Drummond	–	1,753	–	1,753	1,753
K L Hill	1,335	1,241	–	2,576	1,241

No Director exercised any options during the year. The options to subscribe at 775p were granted during the year.

The exercise dates of the above options are shown in note 25 to the financial statements.

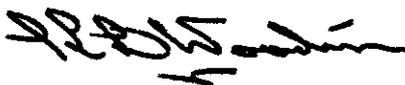
e Share price

The market price of the Company's shares at 31 March 1999 was 954p (1998 978.5p) and the range during the year to that date was 927.5p to 1,169p (1998 662.5p to 991.5p).

By Order of the Board

K D WOODIER
COMPANY SECRETARY

24 June 1999



Corporate governance – statement of compliance

The Board of Pennon Group Plc is committed to high standards of corporate governance and is accountable to the Company's shareholders for those standards. This Statement sets out how the principles of corporate governance contained in Section 1 of the Combined Code attached to the London Stock Exchange Listing Rules are applied by the Company in practice. Throughout the year, the Company has complied with the current provisions of Section 1 of the Combined Code.

■ Board of Directors

The Board of Directors currently comprises three Executive Directors and five Non-executive Directors. Mr B A O Hewett, a Non-executive Director, will retire from the Board at the conclusion of the annual general meeting and the remaining Non-executive Directors are regarded as independent. Mr S M Yassukovich is the appointed senior Non-executive Director. The biographies on page 18 demonstrate a broad range of business and financial experience and there is a clear separation in the roles of Chairman and the Chief Executives of South West Water Limited and Viridor Limited. The Board remains of the view that the appointment of a Group Chief Executive is unnecessary. All Directors are subject to re-election at least every three years.

The Board meets monthly and has adopted a schedule of matters reserved for its decision. These include the approval of financial statements, acquisitions and disposals, major items of capital expenditure, authority levels for other expenditure and approval of the Strategic Plan and annual operating budgets.

Directors have access to the advice and services of the Company Secretary and the Board has established a procedure whereby any Director, in order to fulfil their duties, may seek independent professional advice at the Company's expense. The training needs of Directors are reviewed on a regular basis.

All Directors are equally accountable for the proper stewardship of the Group's affairs with the Non-executive Directors having a particular responsibility for ensuring strategies proposed for the development of the business are critically reviewed. The Non-executive Directors also critically examine the operational and financial performance of the Group and fulfil a key role in corporate accountability through their membership of various Committees of the Board as set out below.

■ Audit Committee

The Audit Committee, consisting of Non-executive Directors, Messrs A T Fletcher and B A O Hewett under the chairmanship of Sir Geoffrey Chipperfield, meets at

least four times a year. Its Terms of Reference cover the points recommended by the Combined Code and in addition, it monitors the procedures and controls established by South West Water Limited to ensure compliance with the Water Industry Act 1991. The Group Director of Finance attends by invitation and the Company's auditors have the right of direct access to the Committee without the presence of any Executive Director.

■ Remuneration Committee

The Remuneration Committee comprises three Non-executive Directors being Mr A T Fletcher, who chairs the Committee, Sir Geoffrey Chipperfield and Mr K G Harvey. The Committee meets as and when required and is responsible for determining the remuneration and terms of employment of the Executive Directors and senior management of the Group. Members of the Remuneration Committee do not participate in decisions concerning their own remuneration. The report on remuneration policy and remuneration appears on pages 21 to 24.

■ Nomination Committee

The Nomination Committee is chaired by Mr S M Yassukovich and also comprises Sir Geoffrey Chipperfield, Mr A T Fletcher and Mr K G Harvey. It meets as and when required to select and recommend to the Board suitable candidates for appointment as Executive and Non-executive Directors.

■ Environment Committee

The Environment Committee is chaired by Mr B A O Hewett and also comprises the Chief Executives of South West Water Limited and Viridor Limited. It usually meets four times a year and is responsible for reviewing and monitoring the environmental policies of Group companies and their achievement of environmental objectives and targets.

■ Internal financial control

The Directors are responsible for the Group's system of internal financial control. A system can only provide reasonable and not absolute assurance against material mis-statement or loss.

There is an established internal control framework which comprises:

- a clearly defined structure which delegates authority, responsibility and accountability, including responsibility for internal financial control, to management of operating units;

b a comprehensive budgeting and reporting function with an annual operating budget approved by the Board of Directors, which also monitors monthly achieved results and updated forecasts for the year against budget;

c documented financial control procedures; managers of operating units are required to confirm annually that they have adequate financial controls in operation and to report all material areas of financial risk; compliance with procedures is reviewed by the Company's internal audit function; and

d an investment appraisal process for evaluating proposals for all major capital expenditure and acquisitions, with defined levels of approval and a system for monitoring the progress of capital projects.

The Audit Committee regularly reviews the operation and effectiveness of this framework.

The Board has noted the requirement of provision D.2.1 of the Combined Code that the Report on Internal Control should cover all controls, including financial, operational and compliance controls and risk management. The Company satisfies the requirements of paragraph 12.43A(b) of the Listing Rules in respect of Code provision D.2.1 by complying with the existing arrangements on internal financial controls pending further guidance which is due to be published in the summer of 1999.

■ ■ ■ **Going concern**

The Directors consider, after making appropriate enquiries, that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the financial statements.

■ ■ ■ **Directors' responsibility statement**

The Directors are required by the Companies Act 1985 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the profit or loss of the Group for the financial year.

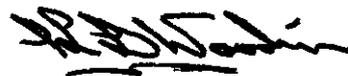
In preparing the financial statements appropriate accounting policies have been used and consistently applied and reasonable and prudent judgements and estimates have been made. All relevant accounting standards which the Directors consider to be applicable have been followed.

The Directors have responsibility for ensuring that accounting records are kept which disclose with reasonable accuracy the financial position of the Company and the Group and which enable them to ensure that the financial statements comply with the Companies Act 1985. They are responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

■ ■ ■ **Relations with shareholders**

The Company maintains a regular dialogue with its institutional shareholders and has a well developed investor relations programme. The Board encourages the participation of shareholders at the annual general meeting and complies with the provisions of the Combined Code in respect of relations with shareholders.

By Order of the Board



■ ■ ■ K D WOODIER
COMPANY SECRETARY

24 June 1999

Report by the auditors on the financial statements

■ Auditors' report to the shareholders of Pennon Group Plc

We have audited the financial statements on pages 28 to 61 (including the additional disclosures on pages 22 to 24 relating to the remuneration of the Directors specified for our review by the London Stock Exchange) which have been prepared under the historical cost convention and the accounting policies set out on pages 31 and 32.

■ Respective responsibilities of Directors and auditors

The Directors are responsible for preparing the Annual Report, including as described on page 26 the financial statements. Our responsibilities, as independent auditors, are established by statute, the Auditing Practices Board, the Listing Rules of the London Stock Exchange and our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Report of the Directors 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 is not disclosed.

We read the other information contained in the Annual Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

We review whether the statement on pages 25 and 26 reflects the Company's compliance with those provisions of the Combined Code specified for our review by the London Stock Exchange and we report if it does not. We are not required to form an opinion on the effectiveness of the Company's or Group's corporate governance procedures or its internal controls.

■ Basis of audit opinion

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

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

■ Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group at 31 March 1999 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.



■ PRICEWATERHOUSECOOPERS
CHARTERED ACCOUNTANTS
AND REGISTERED AUDITORS
Bristol

24 June 1999

Group profit and loss account

for the year ended 31 March 1999

	Notes	1999 £m	1998 restated (note 13) £m
Turnover			
Continuing operations		432.3	382.4
Acquisitions		4.8	-
Total turnover	2	437.1	382.4
Other operating income	4	5.0	-
Operating costs	3	(274.4)	(247.6)
Operating profit			
Continuing operations		167.3	134.8
Acquisitions		0.4	-
Total operating profit	2	167.7	134.8
Share of operating loss in associates		(0.2)	(0.4)
Business disposal loss	5	-	(7.5)
Net interest payable	6	(40.9)	(20.3)
Profit on ordinary activities before taxation	2	126.6	106.6
Tax on profit on ordinary activities	7	(17.5)	(117.0)
Profit/(loss) on ordinary activities after taxation	8	109.1	(10.4)
Dividends	9	(61.9)	(54.1)
Retained profit/(loss) transferred to/(from) reserves	26	47.2	(64.5)
Earnings per share			
	10		
Before exceptional items:			
Basic earnings per share		77.9p	83.3p
Diluted earnings per share		77.4p	82.8p
After exceptional items:			
Basic earnings per share		81.7p	(8.0p)
Diluted earnings per share		81.1p	(7.9p)
Dividend per share	9	45.6p	41.0p

Statement of total recognised gains and losses

for the year ended 31 March 1999

	Notes	1999 £m	1998 £m
Profit/(loss) on ordinary activities after taxation	8	109.1	(10.4)
Currency retranslation differences on foreign currency net investments	26	(0.9)	-
Total gains and losses recognised for the year		108.2	(10.4)
Prior year adjustment	13	2.4	
Total gains and losses recognised since last Annual Report		110.6	

There were no recognised gains or losses for the Company, other than profit for the year, in 1999 or 1998.

The notes on pages 31 to 61 form part of these financial statements.

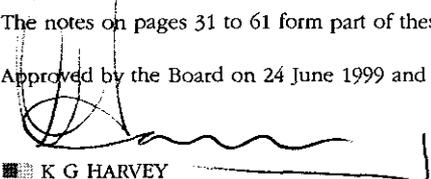
Balance sheets

at 31 March 1999

	Notes	Group		Company	
		1999 £m	1998 restated (note 13) £m	1999 £m	1998 £m
Fixed assets					
Intangible assets	14	27.0	–	–	–
Tangible assets	15	1,623.2	1,555.9	0.2	0.3
Investments	16	2.2	3.0	664.4	609.6
		1,652.4	1,558.9	664.6	609.9
Current assets					
Stocks	17	15.5	16.2	–	–
Debtors: amounts falling due after more than one year	18	9.8	12.3	162.0	175.3
Debtors: amounts falling due within one year	19	91.7	79.4	55.2	82.5
Investments	20	56.4	95.2	26.7	25.7
Cash at bank and in hand		7.3	2.9	–	–
		180.7	206.0	243.9	283.5
Current liabilities					
Creditors: amounts falling due within one year	21	(206.9)	(372.0)	(99.8)	(238.6)
Net current (liabilities)/assets		(26.2)	(166.0)	144.1	44.9
Total assets less current liabilities					
Creditors: amounts falling due after more than one year	22	(675.9)	(523.2)	(282.9)	(200.5)
Provisions for liabilities and charges	23	(26.5)	(29.3)	–	–
Deferred income	24	(32.1)	(31.7)	–	–
Net assets	2	891.7	808.7	525.8	454.3
Capital and reserves					
Called-up share capital	25	136.1	131.4	136.1	131.4
Share premium account	26	147.0	149.0	147.0	149.0
Other reserves	26	–	–	3.1	3.1
Profit and loss account	26	608.6	528.3	239.6	170.8
Shareholders' funds	27	891.7	808.7	525.8	454.3

The notes on pages 31 to 61 form part of these financial statements.

Approved by the Board on 24 June 1999 and signed on its behalf by:


K G HARVEY

CHAIRMAN

Group cash flow statement

for the year ended 31 March 1999

	Notes	1999 £m	1998 restated (note 13) £m
Cash inflow from operating activities	34a	193.6	198.6
Returns on investments and servicing of finance	34b	(31.1)	(18.8)
Taxation	34b	(79.9)	(61.2)
Capital expenditure and financial investment	34b	(125.0)	(185.7)
Acquisitions and disposals	34b	(29.7)	(20.8)
Equity dividends paid		(25.4)	(35.2)
Cash outflow before use of liquid resources and financing		(97.5)	(123.1)
Management of liquid resources	34b	34.0	90.4
Financing	34b	64.6	32.7
Increase in cash in year		1.1	-

Notes to the financial statements

■ 1 Accounting policies

The following paragraphs describe the main policies:

a Accounting convention

The financial statements have been prepared under the historical cost convention and in compliance with all applicable accounting standards, the requirements of the London Stock Exchange and except for the treatment of grants and contributions on infrastructure assets, with the Companies Act 1985. An explanation of this departure from the requirements of the Companies Act 1985 is given in note 1g below.

b Basis of consolidation

The Group financial statements include the results of the Company and its subsidiary undertakings, each made up to 31 March 1999, together with the attributable share of results and reserves of associated undertakings on the basis of their latest financial statements. The results of subsidiary and associated undertakings acquired or disposed of during the year are included for the periods of ownership.

c Turnover

Turnover, excluding Value Added Tax, represents the income receivable in the ordinary course of business for goods and services provided.

d Landfill tax

Landfill tax is included within both turnover and operating costs.

e Tangible fixed assets and depreciation

i Infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls)

Infrastructure assets comprise a network that, as a whole, is intended to be maintained in perpetuity at a specified level of service by the continuing replacement and refurbishment of its components.

Expenditure on infrastructure assets relating to increases in capacity or enhancement of the network, in accordance with defined standards of service, and to the maintenance of the operating capacity of the network, is treated as an addition and included at cost after deducting grants and contributions.

The depreciation charge on infrastructure assets represents the level of annual expenditure required to maintain the

operating capacity of the network and is calculated from an independently certified asset management plan.

The adoption of Financial Reporting Standard 12 'Provisions, Contingent Liabilities and Contingent Assets' has required a changed method of accounting for infrastructure assets. The effect of this change is disclosed in note 13.

ii Landfill sites

Landfill sites are included at cost less accumulated depreciation. The cost of a landfill site is depreciated over its estimated operational life taking account of the usage of void space. Cost includes acquisition and development expenses.

iii Other assets (including properties, overground plant and equipment)

Other assets are stated at cost less accumulated depreciation.

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

Leasehold buildings	Over the period of the lease
Freehold buildings	30 – 60 years
Operational structures	40 – 80 years
Fixed plant	20 – 40 years
Vehicles, mobile plant and computers	3 – 10 years

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

f Leased assets

Assets held under finance leases are included in the balance sheet as tangible fixed assets at their equivalent capital value and are depreciated over their estimated economic lives or the finance lease period, whichever is the shorter. The corresponding liability is recorded as a creditor. The interest element of the rental costs is charged against profits, using the actuarial method, over the period of the lease.

Rental costs arising under operating leases are charged against profits in the year they are incurred.

g Grants and contributions

Grants and contributions receivable in respect of capital expenditure on non-infrastructure assets are included in the balance sheet as deferred income and are released to profits over the depreciable lives of the assets to which they relate.

1 Accounting policies (continued)

g Grants and contributions (continued)

Grants and contributions receivable relating to infrastructure assets have been deducted from the cost of tangible fixed assets. This is not in accordance with the Companies Act 1985 which requires tangible fixed assets to be shown at cost and hence grants and contributions as deferred income. This departure from the requirements of the Companies Act 1985 is, in the opinion of the Directors, necessary for the financial statements to show a true and fair view as while a provision is made for depreciation of infrastructure assets, these assets do not have determinable finite lives and therefore no basis exists on which to recognise grants and contributions as deferred income. The effect of this treatment on the value of tangible fixed assets is disclosed in note 15.

Grants and contributions receivable in respect of expenditure charged against profits in the year have been included in the profit and loss account.

b Investments

Listed investments held as current assets are stated at the lower of cost and net realisable value.

Short-dated unlisted securities held as current assets are stated at cost plus accrued income.

i Stocks

Stocks are stated at the lower of cost and net realisable value. Cost includes labour, materials and an element of overheads.

j Pension costs

The expected cost of pensions in respect of the Group's defined benefit pension schemes is charged against profits so as to spread evenly the cost of pensions over the service lives of employees in the schemes. A pension surplus (or deficit) is released (or charged) to profits using the straight line method, over the average remaining service lives of employees in the scheme.

Pension costs for the Group's defined contribution schemes are charged against profits in the year in which they are incurred.

k Research and development expenditure

Research and development expenditure is charged against profits in the year in which it is incurred.

l Taxation

Tax payable on profits for the year is provided at current rates. Tax deferred or accelerated as a result of timing differences between the treatment of certain items for taxation and for

accounting purposes is provided for to the extent that it is probable that a material liability or asset will crystallise in the foreseeable future.

m Goodwill

From 1 April 1998 goodwill, arising from the acquisition of subsidiary and associated undertakings, representing the excess of the purchase consideration over the fair value of net assets acquired, is capitalised and classified as an asset on the balance sheet. Where goodwill has a finite economic life it is amortised evenly over that period. Previously such goodwill arising on acquisitions was written off directly to Group reserves.

When a previously acquired subsidiary or associated undertaking is sold the profit or loss on disposal is determined after including the attributable amount of unamortised goodwill.

n Foreign currency

Assets and liabilities denominated in foreign currencies are translated into sterling at the rates ruling at the balance sheet date. Profit and loss accounts are translated at average rates for the relevant accounting period. Exchange differences arising from the retranslation of the opening net investment in overseas enterprises at closing rates, offset by translation differences on foreign currency loans and forward currency contracts which hedge such investments, are dealt with in reserves.

o Landfill restoration and environmental costs

Provisions for restoration, aftercare and environmental control costs are made when an obligation arises. Where the obligation recognised as a provision gives access to future economic benefits a tangible fixed asset is recognised. Provisions are otherwise charged against profits.

Where the effect of the time value of money is material the current amount of the provision is the present value of the expenditures expected to be required to settle obligations. The unwinding of the discount to present value is included as a financial item within net interest payable.

The adoption of Financial Reporting Standard 12 'Provisions, Contingent Liabilities and Contingent Assets' has necessitated changes to certain provisions established in prior years. The effect of these changes is disclosed in note 13.

p Financial instruments

Derivative financial instruments are used to hedge interest rate and foreign exchange risks. All such hedging instruments, including interest differentials and foreign exchange gains and losses that arise, are matched with their underlying hedged item.

2 Segmental analysis

By class of business:

	Turnover		Operating profit		Profit before tax	
	1999	1998 restated	1999	1998 restated	1999	1998
	£m	(note 13) £m	£m	(note 13) £m	£m	£m
Water and sewerage business:						
Before exceptional items	270.1	251.5	138.7	125.2	106.2	111.7
Less: Intra-group trading	(1.5)	(1.2)	—	—	—	—
	268.6	250.3	138.7	125.2	106.2	111.7
Exceptional items:						
Restructuring provision	—	—	—	(7.5)	—	(7.5)
After exceptional items	268.6	250.3	138.7	117.7	106.2	104.2
Non-regulated businesses:						
Viridor businesses:						
Waste management	83.4	60.1	17.9	11.4	17.3	10.9
Environmental instrumentation	41.0	41.8	3.7	2.9	3.6	2.6
Construction services	60.3	56.9	1.1	1.9	0.7	1.5
Property and other	4.6	10.8	0.9	1.2	1.1	0.8
Total Viridor	189.3	169.6	23.6	17.4	22.7	15.8
Other non-regulated businesses	6.3	8.5	0.4	0.4	(7.3)	(5.2)
Less: Intra-group trading	(27.1)	(46.0)	—	(0.7)	—	(0.7)
Before exceptional items	168.5	132.1	24.0	17.1	15.4	9.9
Exceptional items:						
Settlement of legal claim	—	—	5.0	—	5.0	—
Business disposal loss	—	—	—	—	—	(7.5)
After exceptional items	168.5	132.1	29.0	17.1	20.4	2.4
Group totals	437.1	382.4	167.7	134.8	126.6	106.6

	Net assets/(liabilities)		Employees (average number)	
	1999	1998 restated	1999	1998
	£m	(note 13) £m		
Water and sewerage business	882.8	877.2	1,700	1,734
Non-regulated businesses:				
Viridor businesses:				
Waste management	88.4	80.6	441	312
Environmental instrumentation	48.9	15.5	437	443
Construction services	5.4	2.4	875	838
Property and other	2.7	3.3	4	4
Total Viridor	145.4	101.8	1,757	1,597
Other non-regulated businesses	(129.7)	(163.5)	51	89
Total non-regulated businesses	15.7	(61.7)	1,808	1,686
Intra-group trading	(6.8)	(6.8)	—	—
Group totals	891.7	808.7	3,508	3,420

■ 2 Segmental analysis (continued)

By class of business (continued):

Water and sewerage business comprises the regulated water and sewerage services undertaken by South West Water Limited.

Net liabilities of other non-regulated businesses include parent company financing of business acquisitions. Profit before tax of other non-regulated businesses is shown after interest arising thereon.

By geographical origin:

	Turnover		Operating profit	
	1999 £m	Total 1998 restated (note 13) £m	1999 £m	Total 1998 restated (note 13) £m
United Kingdom	408.6	358.9	165.2	132.2
Continental Europe	4.8	—	0.4	—
Americas	23.7	23.5	2.1	2.6
	437.1	382.4	167.7	134.8

By geographical destination:

	Turnover		Operating profit	
	1999 £m	Total 1998 restated (note 13) £m	1999 £m	Total 1998 restated (note 13) £m
United Kingdom	400.8	345.1	164.5	131.8
Continental Europe	4.3	2.5	0.4	0.3
Americas	22.2	19.6	2.0	2.2
Other	9.8	15.2	0.8	0.5
	437.1	382.4	167.7	134.8

Intra-group trading arose in the United Kingdom.

The exceptional items set out in notes 4 and 5 arose in the United Kingdom.

Net assets and profit before tax are not separately disclosed by geographical origin and destination since they are substantially located in the United Kingdom.

The employee numbers include 291 working outside the United Kingdom (1998 258).

The analyses presented above include the following amounts for the operations acquired during the year:

	Turnover £m	Operating profit £m	Net assets/ (liabilities) £m	Location: Geographical origin
Waste management	—	—	4.0	United Kingdom
Environmental instrumentation	4.8	0.4	33.3	Continental Europe
	4.8	0.4	37.3	

3 Operating costs

	Continuing operations 1999 £m	Acquisitions 1999 £m	Total 1999 £m	Total 1998 restated (note 13) £m
Manpower costs (note 11)	59.4	1.6	61.0	53.8
Raw materials and consumables	38.2	0.4	38.6	37.0
Rentals under operating leases:				
Hire of plant and machinery	1.9	–	1.9	2.2
Other operating leases	2.9	0.1	3.0	3.3
Research and development expenditure	1.6	0.4	2.0	2.1
Auditors' remuneration	0.3	–	0.3	0.3
Other external charges	68.4	–	68.4	61.2
Amortisation of goodwill	–	0.5	0.5	–
Depreciation:				
On owned assets	40.0	0.1	40.1	34.6
On assets held under finance leases	14.0	–	14.0	12.9
On assets held under defeased finance leases	3.2	–	3.2	1.7
Provision for impairment	–	–	–	3.9
Profit on disposal of tangible fixed assets	(1.0)	–	(1.0)	(0.4)
Deferred income released to profits	(1.3)	–	(1.3)	(1.0)
Other operating charges	42.4	1.3	43.7	36.0
	270.0	4.4	274.4	247.6

Fees payable to the Company's auditors for non-audit work, mainly in connection with taxation advice and acquisitions, amounted to £0.3 million (1998 £0.3 million).

4 Exceptional items

	1999 £m	1998 £m
Operating profit of continuing operations is after (crediting)/charging the following exceptional items in (other operating income)/operating costs:		
Settlement of legal claim on Browning-Ferris Industries Inc.	(5.0)	–
Water and sewerage business restructuring (note 23)	–	7.5
	(5.0)	7.5

5 Business disposal loss

	1999 £m	1998 £m
Loss from the disposal of an interest in Societa Italo Britannica dell'Acqua Srl	–	7.5

The business disposal loss is after charging £7.1 million of acquisition goodwill previously written off to reserves.

6 Net interest payable

	1999 £m	1998 restated (note 13) £m
Interest payable:		
Bank loans and overdrafts	(18.2)	(15.1)
Other loans	(19.3)	(23.2)
Interest element of finance lease rentals	(13.5)	(7.9)
Other finance costs	(1.3)	(0.3)
	(52.3)	(46.5)
Interest receivable:		
Listed redeemable securities	1.4	1.7
Other investments (as defined in note 20)	6.6	12.8
	8.0	14.5
Unwinding of discount in provisions	(0.5)	(0.5)
Gain on defeasance of finance leases	3.9	12.2
Net interest payable	(40.9)	(20.3)

Interest element of finance lease rentals is shown after netting £4.9 million (1998 £8.5 million) interest receivable on cash deposited against collateralised finance lease obligations (note 28).

The gain on defeasance of finance leases results from the in-substance early extinguishment (defeasance) of obligations under finance leases. South West Water Limited has:

- a utilised finance lease facilities for certain water and sewerage business tangible fixed assets; and
- b deposited amounts, equal to the present value of rental obligations arising from those finance leases, with United Kingdom financial institutions, to counter-indemnify the letters of credit issued by those financial institutions to the lessors in order to secure those rental obligations.

These deposited funds, which totalled £143.8 million at 31 March 1999 (1998 £127.9 million), together with interest earned thereon, may be used to settle the rental obligations under those finance leases. If the finance leases terminate due to the insolvency of the financial institutions which have issued the letters of credit no liability will fall on South West Water Limited, or any Pennon Group company.

The rentals payable under the finance leases will vary if interest rates, or effective tax rates, change. The Group has deferred the recognition of income, based upon the Directors' assessment of likely outcomes, for possible future costs arising from such variations in arriving at the gain recognised.

A gain of £3.9 million (1998 £12.2 million) has been recognised, equivalent to the difference between the finance lease proceeds and the funds deposited with financial institutions to cover rentals arising therefrom, after deferring income in recognition of possible rental variations and costs as follows:

	1999 £m	1998 £m
Gain on defeasance of finance leases	5.1	15.7
Less: Deferred income (note 24)	(1.2)	(3.3)
Less: Costs	-	(0.2)
	3.9	12.2

7 Tax on profit on ordinary activities

	1999 £m	1998 £m
United Kingdom taxation:		
Corporation tax at 31%:		
Current year	43.3	12.8
Prior year	22.7	(2.3)
Advance corporation tax:		
Current year dividends	—	9.4
Previous year utilisation	(48.8)	(6.9)
Overseas taxation	0.3	—
	17.5	13.0
Exceptional item:		
United Kingdom taxation:		
Windfall tax	—	104.0
	17.5	117.0

No provision for deferred tax has been made (note 23).

The corporation tax charge for the year reflects proposed actions to utilise a substantial proportion of advance corporation tax charged against profits in previous years.

The windfall tax arises under the Finance (No. 2) Act 1997. Equal instalments of £52.0 million were paid on 1 December 1997 and 1 December 1998.

8 Profit of parent company

	1999 £m	1998 £m
Profit on ordinary activities after taxation dealt with in the accounts of the parent company	96.7	58.2

As permitted by section 230 of the Companies Act 1985, no profit and loss account is presented for the Company.

9 Dividends

	1999 £m	1998 £m
Interim dividend of 14.7p (1998 13.2p) per share paid 6 April 1999	19.8	17.4
Proposed final dividend of 30.9p (1998 27.8p) per share payable 1 October 1999	42.1	36.7
	61.9	54.1

■ ■ ■ 10 Earnings per share

	Profit after tax £m	1999 Earnings per share		Profit after tax £m	1998 Earnings per share	
		Basic p	Diluted p		Basic p	Diluted p
Before exceptional items	104.1	77.9	77.4	108.6	83.3	82.8
Exceptional items:						
Settlement of legal claim	5.0	3.8	3.7	-	-	-
Water and sewerage business restructuring	-	-	-	(7.5)	(5.8)	(5.7)
Business disposal loss	-	-	-	(7.5)	(5.8)	(5.7)
Windfall tax	-	-	-	(104.0)	(79.7)	(79.3)
After exceptional items	109.1	81.7	81.1	(10.4)	(8.0)	(7.9)

Earnings per share before exceptional items have been calculated to show the impact of such items on the results, as they can have a distorting effect on earnings from year to year and therefore warrant separate consideration.

The calculation of basic earnings per share is based on the profit on ordinary activities after taxation divided by the weighted average number of ordinary shares in issue during the year of 133.6 million (1998 130.3 million).

All share options with an exercise price lower than the average market price of the Company's shares during the year have been included in the calculation of diluted earnings per share. The weighted average number of shares in issue during the year, taking account of the dilutive effect of share options, was 134.5 million (1998 131.2 million).

The adoption of Financial Reporting Standard 14 'Earnings Per Share' (FRS 14) has required a restatement of certain comparatives. The weighted average number of shares in issue in 1998 was previously reported at 131.2 million and basic earnings per share before exceptional items in 1998 were shown at 82.8p (7.9p loss after exceptional items). The application of FRS 14 has had a similar effect in 1999.

■ ■ ■ 11 Employees and employment costs

The average number of persons (including Directors) employed by the Group was 3,508 (1998 3,420).

	Continuing operations 1999 £m	Acquisitions 1999 £m	Total 1999 £m	Total 1998 £m
Employment costs comprise:				
Wages and salaries	67.4	1.5	68.9	66.4
Social security costs	6.1	0.1	6.2	6.0
Pension costs (note 32)	1.0	-	1.0	(1.7)
Total employment costs	74.5	1.6	76.1	70.7
Charged as follows:				
Manpower costs (note 3)	59.4	1.6	61.0	50.9
Research and development expenditure	1.3	-	1.3	1.2
Restructuring costs provision (note 23)	1.4	-	1.4	2.9
Capital schemes	12.4	-	12.4	15.7
	74.5	1.6	76.1	70.7

12 Directors' emoluments

	1999 £000	1998 £000
Executive Directors:		
Salary	394	287
Performance bonus	86	173
Other emoluments	35	28
Payments in respect of tax liability from supplementary pension arrangements	33	20
Non-executive Directors	233	200
Total emoluments	781	708

Directors did not exercise any share options during 1999 (1998 £25,000 gain).

The emoluments of the highest paid Director, including gains on the exercise of share options, were £197,000 (1998 £198,000). The highest paid Director did not exercise any share options in 1999 or 1998.

Total emoluments include £225,000 (1998 £185,000) payable to Directors for services as directors of subsidiary undertakings.

At 31 March 1999 and 31 March 1998 retirement benefits were accruing to three Directors under defined benefit pension schemes. The accrued pension entitlement at 31 March 1999 under defined benefit pension schemes of the highest paid Director was £18,000 (1998 £66,000). No pension contributions were payable to defined contribution schemes in 1999 or 1998.

More detailed information concerning Directors' emoluments, shareholdings and share options is shown in the report on remuneration policy and remuneration on pages 21 to 24.

13 Prior year adjustment

The adoption of Financial Reporting Standard 12 'Provisions, Contingent Liabilities and Contingent Assets' (FRS 12) has necessitated an adjustment to certain provisions made in prior years. FRS 12 has also required a changed method of accounting for infrastructure assets as it is no longer possible to account for the difference between planned and actual expenditure on infrastructure renewals as a provision or prepayment.

As a result of these changes in accounting policy, the comparatives have been restated as follows:

a Group balance sheet

	Tangible fixed assets £m	Provisions for liabilities and charges £m	Deferred income £m	Profit and loss reserve £m
1998 reported	1,555.3	(37.3)	(25.5)	(525.9)
Application of FRS 12	0.6	8.0	(6.2)	(2.4)
1998 restated	1,555.9	(29.3)	(31.7)	(528.3)

The changes arising from the application of FRS 12 involve the elimination or reclassification of certain provisions for liabilities and charges.

b Group profit and loss account

	Turnover £m	Other operating income £m	Operating costs £m	Net interest payable £m
1998 reported	382.1	0.7	(248.5)	(19.8)
Application of FRS 12	-	-	0.5	(0.5)
Reclassification	0.3	(0.7)	0.4	-
1998 restated	382.4	-	(247.6)	(20.3)

The changes arising from the application of FRS 12 relate to the unwinding of the discount in provisions. In addition, the infrastructure renewals charge has been reclassified as depreciation. Other operating income has also been reclassified.

c Group cash flow statement

	Cash inflow from operating activities £m	Capital expenditure and financial investment £m
1998 reported	188.6	(175.7)
Application of FRS 12	10.0	(10.0)
1998 restated	198.6	(185.7)

The changes arising from the application of FRS 12 involve the reclassification of infrastructure renewals as capital expenditure.

■ 13 Prior year adjustment (continued)

d Notes to the Group cash flow statement

	Operating profit £m	Depreciation charge £m	Increase in provisions for liabilities and charges £m	Purchase of tangible fixed assets £m
1998 reported	134.3	42.2	1.1	(179.3)
Application of FRS 12	0.5	7.0	2.5	(10.0)
1998 restated	134.8	49.2	3.6	(189.3)

The changes arising from the application of FRS 12 involve the unwinding of the discount in provisions, and the reclassification of infrastructure renewals as capital expenditure.

The effect of the accounting policy changes on the current year is similar to the quantified effect on the prior year, except for provisions for liabilities and charges and the profit and loss reserve where the prior year adjustment involves the elimination of a landfill remediation provision.

■ 14 Intangible assets

Goodwill

	Group	
	1999 £m	1998 £m
Cost:		
Arising on acquisitions	29.1	—
Currency retranslation	(1.6)	—
At 31 March	27.5	—
Amortisation:		
Charge for year and at 31 March	0.5	—
Net book value at 31 March	27.0	—

Goodwill is amortised evenly over its useful economic life of twenty years. The charge in 1999 is for a four month period.

■ ■ ■ 15 Tangible fixed assets

	Land and buildings £m	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers £m	Construction in progress £m	Group Total 1999 £m	Company Total 1999 £m
Cost:							
At 1 April 1998	116.3	648.9	476.0	483.1	91.2	1,815.5	0.4
Prior year adjustment	-	61.8	-	-	-	61.8	-
At 1 April 1998 (restated)	116.3	710.7	476.0	483.1	91.2	1,877.3	0.4
Additions	13.8	38.0	8.0	40.8	24.7	125.3	0.1
Currency retranslation	0.1	-	-	0.1	-	0.2	-
Grants and contributions	-	(3.5)	-	-	-	(3.5)	-
Arising on acquisitions	5.5	-	-	0.5	-	6.0	-
Disposals	(0.8)	(0.2)	-	(6.1)	-	(7.1)	(0.1)
Transfers	-	35.7	-	41.7	(77.4)	-	-
At 31 March 1999	134.9	780.7	484.0	560.1	38.5	1,998.2	0.4
Depreciation:							
At 1 April 1998	18.7	-	82.2	159.3	-	260.2	0.1
Prior year adjustment	-	61.2	-	-	-	61.2	-
At 1 April 1998 (restated)	18.7	61.2	82.2	159.3	-	321.4	0.1
Charge for year	9.0	7.3	9.0	33.4	-	58.7	0.1
Disposals	-	(0.2)	-	(4.9)	-	(5.1)	-
At 31 March 1999	27.7	68.3	91.2	187.8	-	375.0	0.2
Net book value:							
At 31 March 1999	107.2	712.4	392.8	372.3	38.5	1,623.2	0.2
At 31 March 1998 (restated)	97.6	649.5	393.8	323.8	91.2	1,555.9	0.3
Assets held under finance leases included above:							
Cost: At 31 March 1999	-	-	193.9	119.4	-	313.3	-
Depreciation: Charge for year	-	-	3.2	10.3	-	13.5	-
Depreciation: At 31 March 1999	-	-	16.1	54.1	-	70.2	-
Assets held under defeased finance leases included above:							
Cost: At 31 March 1999	-	75.3	68.1	29.8	4.1	177.3	-
Depreciation: Charge for year	-	0.7	1.0	1.5	-	3.2	-
Depreciation: At 31 March 1999	-	1.5	1.4	2.7	-	5.6	-

The adoption of Financial Reporting Standard 12 'Provisions, Contingent Liabilities and Contingent Assets' has required a prior year adjustment (note 13) to take effect from the year to 31 March 1989, when infrastructure renewals accounting was adopted. The previous prepayment on the infrastructure renewals provision has been subsumed into tangible fixed assets by the inclusion of accumulated cost and depreciation, and involves a prior year adjustment to accumulated depreciation on defeased finance leases.

Tangible fixed assets of the Company comprise fixed and mobile plant, vehicles and computers.

15 Tangible fixed assets (continued)

The cost of land and buildings and of operational properties includes non-depreciable land of £1.7 million (1998 £2.1 million) and £8.8 million (1998 £7.4 million) respectively.

The net book value of land and buildings comprises:

	1999 £m	1998 £m
Freehold	65.7	57.6
Long leasehold	0.8	0.2
Short leasehold	40.7	39.8
	107.2	97.6

The net book value of infrastructure assets is stated after deducting £40.6 million (1998 £37.1 million) grants and contributions.

The net book value of infrastructure assets includes £2.8 million (1998 £0.6 million) for the accumulated difference between expenditure on maintaining operating capacity and depreciation charges. Expenditure in the year was £9.6 million (1998 £10.0 million).

Out of the total depreciation charge for the Group of £58.7 million (1998 £51.2 million), the sum of £1.4 million (1998 £2.0 million) has been charged to capital projects and £57.3 million (1998 £49.2 million) against profits.

16 Fixed asset investments

	Shares £m	Loans £m	Group Total 1999 £m	Company Total (Shares) 1999 £m
Subsidiary undertakings				
Cost:				
At 1 April 1998				608.5
Additions				311.7
Disposals				(256.5)
Provision for impairment				(0.5)
At 31 March 1999				663.2
Associated undertakings				
Cost (Company) or share of net assets (Group):				
At 1 April 1998	0.2	–	0.2	0.8
Loss for year	(0.2)	–	(0.2)	–
At 31 March 1999	–	–	–	0.8
Own shares				
Cost:				
At 1 April 1998	0.9	–	0.9	0.3
Additions	1.0	–	1.0	0.3
Provision for impairment	(0.7)	–	(0.7)	(0.2)
At 31 March 1999	1.2	–	1.2	0.4
Other investments				
Cost:				
At 1 April 1998	0.3	1.6	1.9	–
Disposals	(0.3)	(0.6)	(0.9)	–
At 31 March 1999	–	1.0	1.0	–
Total investments				
At 31 March 1999	1.2	1.0	2.2	664.4
At 31 March 1998	1.4	1.6	3.0	609.6

Investments made by the Company during the year in subsidiary undertakings comprise the subscription for shares to facilitate business acquisitions and growth, and the formation of Viridor Limited.

A Long-Term Incentive Plan is operated for senior management of the Group. Awards under the Plan, involving the release of ordinary shares in the Company to participants, is dependent upon performance conditions being met. These shares are released out of an Employee Share Ownership Plan, a discretionary trust, established to facilitate the operation of the incentive scheme. More information on the operation of the incentive scheme is included in the report on remuneration policy and remuneration on pages 21 to 24.

16 Fixed asset investments (continued)

During the year the trustees of the Employee Share Ownership Plan purchased 99,000 of the Company's ordinary shares (1998 155,000) financed through non-interest bearing advances made by sponsoring Group companies. The market value of the 254,000 shares held as Group investments at 31 March 1999 was £2.4 million (1998 £1.5 million). 83,000 of those shares (1998 53,000) held as Company investments had a market value of £0.8 million at 31 March 1999 (1998 £0.5 million). The costs of the incentive scheme are charged to profits over the period of its operation, and are included in employment costs.

Details of principal subsidiary and associated undertakings of the Group are set out in note 31.

17 Stocks

	Group		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
Raw materials and consumables	8.3	6.4	—	—
Work in progress	1.9	5.5	—	—
Finished goods	5.3	4.3	—	—
	15.5	16.2	—	—

18 Debtors: amounts falling due after more than one year

	Group		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
Amounts owed by subsidiary undertakings	—	—	161.2	172.8
Prepayments for pension costs	9.2	10.3	0.3	0.7
Other prepayments and accrued income	0.6	2.0	0.5	1.8
	9.8	12.3	162.0	175.3

19 Debtors: amounts falling due within one year

	Group		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
Trade debtors	61.9	52.3	—	—
Amounts owed by subsidiary undertakings	—	—	53.6	80.6
Other debtors	7.0	3.1	0.8	0.2
Prepayments for pension costs	0.5	—	—	—
Other prepayments and accrued income	20.8	22.6	0.6	1.7
Advance corporation tax recoverable	1.5	1.4	0.2	—
	91.7	79.4	55.2	82.5

■ 20 Current asset investments

	Group		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
Listed investments	16.3	21.1	–	–
Other investments:				
Overnight deposits	0.2	5.0	–	–
Other	39.9	69.1	26.7	25.7
	40.1	74.1	26.7	25.7
	56.4	95.2	26.7	25.7
Market value of listed investments	16.4	21.2	–	–

Other investments include certificates of deposit, variable rate notes, commercial paper and other short-dated unlisted securities.

In 1998 £75.0 million of Group investments were deposited against collateralised finance lease obligations (note 28).

■ 21 Creditors: amounts falling due within one year

	Group		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
Loans:				
Bank loans and overdrafts	0.7	2.1	19.1	17.7
Short-term loans	2.1	25.2	–	25.0
European Investment Bank loans	10.8	10.3	–	–
Unsecured loan stock notes	21.9	72.4	21.9	72.4
	35.5	110.0	41.0	115.1
Obligations under finance leases	8.4	11.6	–	–
Trade creditors	53.0	64.6	0.6	0.8
Amounts owed to subsidiary undertakings	–	–	2.4	0.4
Other creditors	14.8	17.3	6.6	10.0
Advance corporation tax	–	12.4	–	12.2
Corporation tax	13.3	11.5	–	–
Foreign tax	0.9	–	–	–
Windfall tax	–	52.0	–	52.0
Other taxation and social security	9.1	14.1	0.1	–
Accruals and deferred income	23.1	30.4	0.3	–
Interim dividend	6.7	11.4	6.7	11.4
Proposed final dividend	42.1	36.7	42.1	36.7
	206.9	372.0	99.8	238.6

22 Creditors: amounts falling due after more than one year

	Group		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
Loans:				
Sterling bond	150.0	150.0	150.0	150.0
European Investment Bank loans	85.5	96.3	—	—
Other bank loans	130.0	50.1	130.0	50.0
	365.5	296.4	280.0	200.0
Obligations under finance leases	309.4	224.6	—	—
Amounts owed to subsidiary undertakings	—	—	2.9	0.4
Other creditors	1.0	2.2	—	0.1
	675.9	523.2	282.9	200.5

23 Provisions for liabilities and charges

	Environmental and landfill restoration £m	Finance lease rental variations £m	Infrastructure renewals £m	Restructuring costs £m	Other provisions £m	Group Total 1999 £m
At 1 April 1998	25.2	6.2	(0.6)	3.8	2.7	37.3
Prior year adjustment (note 13)	(2.4)	(6.2)	0.6	—	—	(8.0)
At 1 April 1998 (restated)	22.8	—	—	3.8	2.7	29.3
Charged against profits	2.0	—	—	1.7	—	3.7
Released to profits	(1.5)	—	—	(1.7)	—	(3.2)
Utilised during year	(1.3)	—	—	(1.6)	(0.4)	(3.3)
At 31 March 1999	22.0	—	—	2.2	2.3	26.5

Environmental and landfill restoration provisions will be utilised over the period 2000 to 2064. The provisions have been established assuming current waste management technology based upon estimated costs at future prices, which have been discounted to present value. The restructuring provision principally relates to severance costs, most of which is expected to be incurred in the next financial year. Other provisions arise from onerous contracts, which will unwind over the period to 2017.

Deferred taxation

The maximum potential liability for deferred taxation, for which no provision is considered necessary, was:

	Group	
	1999 £m	1998 £m
Tax effect of timing differences due to:		
Accelerated capital allowances	181.2	226.7
Other timing differences	4.6	(3.5)
	185.8	223.2
Advance corporation tax recoverable	(10.5)	(47.1)
Maximum potential liability	175.3	176.1

23 Provisions for liabilities and charges (continued)

Deferred taxation (continued)

The adoption of Financial Reporting Standard 12 'Provisions, Contingent Liabilities and Contingent Assets' has required a changed method of accounting for infrastructure assets, as disclosed in note 1e. Infrastructure assets are now depreciated. As a result the comparatives have been restated to include an additional £147.9 million of accelerated capital allowances on infrastructure assets.

24 Deferred income

	Group	
	1999 £m	1998 £m
At 1 April:		
Amount to be released after more than one year	25.5	22.4
Prior year adjustment (note 13)	6.2	2.9
	31.7	25.3
Amount to be released within one year	1.2	1.0
	32.9	26.3
Restated	32.9	26.3
Additions	1.7	7.6
Released to profits	(1.3)	(1.0)
	33.3	32.9
At 31 March	33.3	32.9
Amount to be released within one year	(1.2)	(1.2)
	32.1	31.7
Amount to be released after more than one year	32.1	31.7

Finance lease variations (note 6) included above amount to £7.4 million (1998 £6.2 million). Additions for 1998 include £3.3 million arising from the prior year adjustment (note 13).

25 Called-up share capital

	1999 £m	1998 £m
<i>Authorised</i>		
175,000,000 ordinary shares of £1 each	175.0	175.0
<i>Allotted, called-up and fully paid</i>		
136,068,577 ordinary shares of £1 each (1998 131,372,809)	136.1	131.4
	1999 Number	1998 Number
<i>Ordinary shares allotted during the year</i>		
In lieu of £41.9 million cash (1998 £12.0 million) under scrip dividend alternative	4,335,310	1,794,638
For consideration of £0.4 million (1998 £1.1 million) under the Company's Executive Share Option Scheme to Directors and senior employees who exercised their options	85,000	239,800
For consideration of £2.9 million (1998 £1.7 million) to SWW Trustee Limited on behalf of employees who exercised their options under the Company's Sharesave Scheme	275,458	200,720
	4,695,768	2,235,158

25 Called-up share capital (continued)

Share options

Outstanding options to subscribe for shares of £1 each under the Company's share option schemes are:

Nature of scheme	Date granted and subscription price fully paid	Performance targets	Period when options normally exercisable	Thousands of shares in respect of which options outstanding at 31 March	
				1999	1998
Sharesave	5 July 1991 287p	–	1996 – 1998	–	142
	3 July 1992 332p	–	1997 – 1999	88	94
	2 July 1993 393p	–	1998 – 2000	36	140
	6 Jan 1995 373p	–	2000 – 2002	338	352
	8 July 1997 556p	–	2000 – 2004	669	782
	7 July 1998 775p	–	2001 – 2005	336	–
Executive	5 July 1991 328p	a	1994 – 2001	20	20
	3 July 1992 418p	a	1995 – 2002	14	41
	5 July 1993 496p	b	1996 – 2003	138	182
	6 Jan 1995 503p	c	1998 – 2005	174	188
				1,813	1,941

The performance targets for exercise of Executive Scheme options are:

- a gross dividend yield of 9.68% on the 1989 water share offer price;
- b increase in earnings per share in excess of the Retail Prices Index movement over the period March 1993 to date of exercise; and
- c increase in earnings per share in excess of the Retail Prices Index movement over the period March 1994 to date of exercise.

At 31 March 1999 there were 1,622 participants in the Sharesave Scheme (1998 1,542) and 40 in the Executive Scheme (1998 56).

Options granted to Directors, included above, are shown in the report on remuneration policy and remuneration on pages 21 to 24.

26 Reserves

	Group and Company share premium account £m	Company other reserves £m	Group profit and loss account £m	Company profit and loss account £m
At 1 April 1998	149.0	3.1	525.9	170.8
Prior year adjustment (note 13)	–	–	2.4	–
At 1 April 1998 (restated)	149.0	3.1	528.3	170.8
Retained profit for year	–	–	47.2	34.8
Currency retranslation differences on foreign currency net investments	–	–	(0.9)	–
Premium on shares issued	0.9	–	–	–
Adjustment for shares issued under the scrip dividend alternative	(4.3)	–	35.9	35.9
Adjustment for shares issued under the Sharesave Scheme through Employee Share Ownership Trust	1.9	–	(1.9)	(1.9)
Share issue expenses	(0.5)	–	–	–
At 31 March 1999	147.0	3.1	608.6	239.6

Currency retranslation differences on foreign currency net investments is after a £0.7 million gain arising on a currency hedge (1998 £0.3 million).

The cumulative value of goodwill at 31 March 1999 resulting from acquisitions, which has been written off to reserves, is £173.4 million (1998 restated at £173.4 million for the prior year adjustment of £2.4 million).

27 Statement of movements in shareholders' funds

	Group		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
Profit/(loss) on ordinary activities after taxation	109.1	(10.4)	96.7	58.2
Dividends	(61.9)	(54.1)	(61.9)	(54.1)
	47.2	(64.5)	34.8	4.1
Other recognised gains and losses for the year	(0.9)	-	-	-
Adjustment for shares issued under the scrip dividend alternative	35.9	17.2	35.9	17.2
Shares issued for cash consideration (net of expenses)	2.7	2.8	2.7	2.8
Adjustment for shares issued under the Sharesave Scheme through Employee Share Ownership Trust	(1.9)	(1.0)	(1.9)	(1.0)
Goodwill written off (net)	-	(63.1)	-	-
Shareholders' funds (equity interest):				
Addition/(reduction) for year	83.0	(108.6)	71.5	23.1
At 1 April (restated)	808.7	917.3	454.3	431.2
At 31 March	891.7	808.7	525.8	454.3

Shareholders' funds at 1 April 1998 have been restated to include the prior year adjustment of £2.4 million (note 13). The restatement at 1 April 1997 is £1.4 million, and the goodwill written off to reserves in 1998 has been reduced by £1.0 million.

28 Loans and other borrowings

Loans

	Group		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
Repayable:				
Over five years	235.6	211.7	200.0	162.5
Over two and up to five years	118.5	73.8	80.0	37.5
Over one and up to two years	11.4	10.9	-	-
Falling due after more than one year (note 22)	365.5	296.4	280.0	200.0
Falling due within one year (note 21)	35.5	110.0	41.0	115.1
	401.0	406.4	321.0	315.1

£6.3 million floating rate unsecured guaranteed loan stock notes, repayable at par in 2004 or on notice being given by the noteholders, were issued in July and August 1998 to satisfy contingent consideration payable in connection with the December 1997 acquisition of Terry Adams Limited. Of this, £4.0 million relates to contingent consideration not provided at 31 March 1998 for a landfill site (note 30).

28 Loans and other borrowings (continued)

Obligations under finance leases

	Group		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
Repayable:				
Over five years	293.5	205.2	—	—
Over two and up to five years	9.5	7.7	—	—
Over one and up to two years	6.4	11.7	—	—
Falling due after more than one year (note 22)	309.4	224.6	—	—
Falling due within one year (note 21)	8.4	11.6	—	—
	317.8	236.2	—	—

Included above are accrued finance charges arising on obligations under finance leases totalling £37.1 million (1998 £26.6 million), of which £4.2 million (1998 £6.2 million) is repayable within one year.

In addition, at 31 March 1998 obligations under finance leases of £75.0 million had been offset against cash of an equal amount which had been deposited with the lessor's bank group (collateralisation); South West Water Limited could insist this cash be utilised to meet the finance lease obligations as they fell due. During the year South West Water Limited withdrew the cash deposits placed with the lessor's bank group. Accordingly, a finance lease obligation of £75.0 million is included above.

Loans and obligations under finance leases

Included above are instalment debts, of which any part falls due for repayment after five years, and non-instalment debts due after five years:

	Group		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
Loans	296.4	256.7	200.0	150.0
Obligations under finance leases	305.3	219.2	—	—
	601.7	475.9	200.0	150.0

Loans are repayable over the period 2000 to 2021. The rates of interest payable on loans and other borrowings, any part of which is due after five years, range between 5.1% and 11.3%.

Borrowing facilities

Undrawn committed borrowing facilities of £22.6 million were available to the Group at 31 March 1999 which expire as follows:

	£m
Within one year or less	2.6
Over two and up to five years	20.0
	22.6

In addition, the Group has short-term uncommitted bank facilities of around £300 million.

29 Financial instruments

Disclosures on financial and treasury policies are also included in the financial review on pages 14 to 17.

Interest rate and currency profile of financial assets and liabilities

After taking into account interest rate swaps and forward currency contracts entered into by the Group, the interest rate and currency profile of the Group's financial assets and liabilities was:

	Financial assets		Financial liabilities	
	1999 £m	1998 £m	1999 £m	1998 £m
Floating rate	57.2	166.4	(322.3)	(337.2)
Fixed rate	6.6	7.7	(396.5)	(380.4)
On which no interest is paid	1.6	3.0	(2.6)	(4.0)
	65.4	177.1	(721.4)	(721.6)
Which is included in:				
Net debt	63.7	173.1	(718.8)	(717.6)
Provisions for liabilities and charges	-	-	(2.3)	(2.7)
Other long-term monetary assets/(liabilities)	1.7	4.0	(0.3)	(1.3)
	65.4	177.1	(721.4)	(721.6)

Financial assets and liabilities with a fixed interest rate, or on which no interest is paid, are denominated in sterling.

Included above, in 1998, are £75.0 million collateralised financial assets and liabilities (note 28)

	Financial assets		Financial liabilities	
	1999 £m	1998 £m	1999 £m	1998 £m
Floating rate financial assets and liabilities are denominated in:				
Sterling	53.4	164.4	(289.1)	(328.0)
US Dollar	2.7	2.0	(10.3)	(9.2)
Swiss Franc	0.6	-	(22.9)	-
Other currencies	0.5	-	-	-
	57.2	166.4	(322.3)	(337.2)
Fixed rate financial assets and liabilities:				
Weighted average interest rate	5.0%	7.5%	8.8%	9.1%
Weighted average period for which rate is fixed	0.7 years	0.4 years	7.8 years	8.6 years
Range of interest rates	4.7% to 5.8%	7.1% to 7.7%	5.4% to 11.3%	6.7% to 11.3%
Financial assets and liabilities on which no interest is paid:				
Weighted average period until maturity	0.5 years	1.6 years	10.2 years	9.1 years

The floating rate financial assets earn interest, in some cases fixed in advance for periods up to twelve months, based on short-term money market rates.

The floating rate financial liabilities bear interest at rates, in some cases fixed in advance for periods up to twelve months, related to the London Inter-Bank Offered Rate (LIBOR) or equivalent. The range of interest rates applying at 31 March 1999 was 2.8% to 6.3% (1998 5.6% to 7.2%).

The maturity profile of floating rate and fixed rate financial liabilities is shown in note 28. Other financial liabilities fall due for payment principally over five years.

Interest rate swaps are used to achieve a mix of fixed and floating rates – ensuring at least 50% of net debt is at fixed rate. At 31 March 1999 interest rate swaps linked to financial liabilities, with a notional principal value of £160.0 million, existed with a weighted average maturity of 4.6 years (1998 £100.0 million, with 6.0 years). In addition, during the year an interest rate swap with a notional principal value of £20.2 million existed to align the basis of a portion of interest receivable with interest payable (1998 £49.8 million).

29 Financial instruments (continued)

Interest rate and currency profile of financial assets and liabilities (continued)

Forward currency contracts are used to hedge a portion of the net investment in overseas subsidiaries. At 31 March 1999 forward currency sales of US Dollar 15.5 million and Swiss Franc 50.0 million existed for settlement in twelve months (1998 US Dollar 15.4 million with twelve month settlement).

Financial assets and liabilities exclude short-term debtors and creditors (other than loans and obligations under finance leases falling due within one year).

Currency profile of net monetary assets and liabilities

Net monetary assets and liabilities of Group companies that are not denominated in their functional currency give rise to exchange gains and losses that are credited, or charged, to the profit and loss account. Net foreign monetary assets and liabilities comprise:

	Sterling £m	US Dollar £m	Yen £m	Other £m	1999 Total £m	1998 Total £m
Functional currency of Group operation:						
Sterling	-	1.4	-	-	1.4	0.3
US Dollar	(0.5)	-	-	-	(0.5)	-
Swiss Franc	0.9	2.7	1.1	1.9	6.6	-
	0.4	4.1	1.1	1.9	7.5	0.3

The 1998 balance was held in US Dollars.

Forward currency contracts which are used to hedge a portion of the net investment in overseas subsidiaries are not included in the analysis above. The exchange gains and losses on those hedges are included in the statement of total recognised gains and losses.

Fair values of financial assets and liabilities

The fair values of the Group's financial assets and liabilities are as follows:

	1999		1998	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Financial assets:				
Current asset investments	56.4	56.5	170.2	170.4
Cash at bank	7.3	7.3	2.9	2.9
Other	1.7	1.7	4.0	3.8
	65.4	65.5	177.1	177.1
Financial liabilities:				
Short-term debt	(35.5)	(35.6)	(110.0)	(110.2)
Long-term debt	(365.5)	(438.8)	(296.4)	(359.1)
Finance lease obligations	(317.8)	(317.8)	(311.2)	(311.2)
Other	(2.6)	(2.3)	(4.0)	(3.5)
	(721.4)	(794.5)	(721.6)	(784.0)
Derivative financial instruments (used to manage interest rate and currency profile):				
Interest rate swaps	-	(7.7)	-	(3.6)
Forward currency contracts	-	(0.3)	-	-
	-	(8.0)	-	(3.6)

29 Financial instruments (continued)

Fair values of financial assets and liabilities (continued)

Floating rate debt, short-dated unlisted current asset investments and cash at bank is assumed to have a fair value equal to the book value. Other fair values shown above have been determined by utilising, where available, market rates at 31 March or otherwise have been calculated by discounting cash flows at prevailing interest and exchange rates.

Hedging interest rate and currency exposures

As explained in the financial review the Group uses derivative financial instruments to manage certain interest rate risks and currency exposures. The unrecognised gains and losses on such instruments are:

	Gains £m	Losses £m	1999 Total net losses £m	Gains £m	Losses £m	1998 Total net losses £m
Unrecognised gains and losses on hedges:						
At 1 April	0.3	(3.9)	(3.6)	0.3	-	0.3
Of which recognised in current year	0.3	(0.6)	(0.3)	0.1	-	0.1
	-	(3.3)	(3.3)	0.2	-	0.2
Arising and not recognised in current year	-	(4.7)	(4.7)	0.1	(3.9)	(3.8)
At 31 March	-	(8.0)	(8.0)	0.3	(3.9)	(3.6)
Expected to be recognised:						
In next year	-	(1.9)	(1.9)	0.3	(0.6)	(0.3)
Thereafter	-	(6.1)	(6.1)	-	(3.3)	(3.3)
	-	(8.0)	(8.0)	0.3	(3.9)	(3.6)

Gains and losses on instruments used for hedging are recognised as the exposure that is being hedged is itself recognised.

■ 30 Acquisitions

On 7 December 1998 the entire issued share capital of Orbisphere Management Holding SA was acquired by Water West Limited (a 100% owned Group company, subsequently renamed Viridor Instrumentation Limited) for a cash consideration of £33.1 million, including costs of £0.8 million. For the period 1 January 1998 to 7 December 1998 the profit after tax amounted to £1.2 million; and £1.9 million for the year ended 31 December 1997.

The acquisition of Terry Adams Limited on 12 December 1997 provided for contingent consideration with a maximum of £28.0 million, linked to planning approval of landfill sites, which was not included in the acquisition cost. During the year £4.0 million of that contingent consideration was settled through the issue of loan stock notes (note 28). The contingent consideration matches the fair value of the landfill site acquired.

The entire issued share capital of VWM (Scotland) Limited was acquired during the year for a nominal consideration.

The operating assets and liabilities of the above acquisitions were:

	Book value			Fair value adjustments £m	Fair value total £m
	Orbisphere Management Holding SA £m	Other £m	Total £m		
Tangible fixed assets	1.4	4.9	6.3	(0.3)	6.0
Stocks	3.2	—	3.2	(0.9)	2.3
Debtors due within one year	3.6	—	3.6	(0.3)	3.3
Cash at bank and in hand	1.8	—	1.8	—	1.8
Creditors due within one year	(2.4)	—	(2.4)	(0.8)	(3.2)
Loans	(1.3)	(0.9)	(2.2)	—	(2.2)
Net assets acquired	6.3	4.0	10.3	(2.3)	8.0
Goodwill (note 14)					29.1
Consideration and costs					37.1

All fair value adjustments arose in connection with the acquisition of Orbisphere Management Holding SA. Accounting policy harmonisation changes were required for tangible fixed assets, stocks and debtors due within one year. Within creditors due within one year, the fair value adjustment arose from a re-assessment of the taxation affairs of the acquired business for pre-acquisition periods.

All acquisitions were accounted for using the acquisition method.

During the year £0.7 million fair value acquisition accruals and provisions were established (1998 £12.4 million), £0.7 million were utilised (1998 £0.6 million), £1.5 million were released (1998 nil), £2.4 million were eliminated as a prior year adjustment (note 13), and at 31 March 1999 £18.5 million (1998 £22.4 million) were carried forward.

31 Principal subsidiary and associated undertakings

Subsidiary undertakings:

	Country of incorporation, registration and principal operations
Water and sewerage	
South West Water Limited*	England
Waste management	
Viridor Waste Limited†	England
Greenhill Enterprises Limited	England
Haul Waste Limited	England
Haul Waste Disposal Limited	England
VWM (Scotland) Limited	Scotland
Terry Adams Limited	England
Dragon Waste Limited	England
Sandspinnners Limited	England
Environmental instrumentation	
Viridor Instrumentation Limited†	England
ELE International Limited	England
Exe International Inc	United States
ELE International Inc	United States
GLI International Inc	United States
Hydrolab Corporation	United States
GLI International Limited	England
Orbisphere Management Holding SA	Switzerland
Orbisphere Canada Inc	Canada
Orbisphere France Sarl	France
Orbisphere GmbH	Germany
Orbisphere Laboratories Geneve SA	Switzerland
Orbisphere Laboratories Japan Inc	United States
Orbisphere Laboratories Neuchatel SA	Switzerland
Orbisphere UK Limited	England
Orbisphere Laboratories Overseas Corporation	United States
Orbisphere South Africa (Pty) Limited	South Africa
Construction services	
Viridor Contracting Limited†	England
T J Brent Limited	England
Property	
Viridor Properties Limited†	England
Insurance services	
Peninsula Insurance Limited*	Guernsey
Other companies	
Viridor Limited*	England
Exe Continental Limited*	England

*indicates the shares were held directly by the Company; † indicates the shares were held by Viridor Limited.

All shares in issue are ordinary shares. The subsidiary undertakings are wholly owned, except for Dragon Waste Limited where 81% of the ordinary shares are held by Terry Adams Limited.

Associated undertakings:

	Share capital in issue	Percentage held	Activity
Enviro-Logic Limited	2,000 A ordinary shares 2,000 B ordinary shares	100% —	Water and sewerage concessions

Shares were held directly by the Company.

32 Pensions

The Group operates a number of pension schemes. The two major schemes are funded defined benefit schemes and the assets of the schemes are held in separate trustee administered funds.

The latest actuarial valuations of the two main schemes were as at 31 March 1998. At that date, the market value of the schemes' assets was £186.2 million, and the actuarial value of those assets represented 127% and 149% of the benefits that had accrued to members, after allowing for expected future increases in earnings. The assumptions which have the most significant effect on the results of the valuations are those relating to the rate of return on investments, the rate of dividend growth, and the rates of increase in earnings and pensions. The valuations assume that the investment return would be 8.5% per annum, the dividend growth would be 4.5% per annum, pensionable pay increases would average 6.5% per annum and that present and future pensions would increase at a rate of 4.5% and 5.0% per annum for the two main schemes.

The pension cost of the defined benefit schemes has been determined on the advice of independent qualified actuaries using the projected unit method. The employers' regular pension cost for the year of the two main schemes is 12.2% and 15.9% of pensionable earnings (1998 11.0% and 14.2%). The net pension charge for the year ended 31 March 1999 was £1.0 million (1998 £1.7 million credit) which benefits from the actuarial surpluses, after allowing for possible benefit improvements. Following the actuarial valuations, employer contributions to the two main schemes have ceased until the next actuarial review (which is expected to be as at 31 March 2001).

Pension prepayments included as debtors of the Group amount to £9.7 million (1998 £10.3 million), representing the accumulated difference between the Group pension charge (or credit) and employer contributions paid.

33 Commitments and contingent liabilities

	Group		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
Capital commitments				
Contracted but not provided	52.5	56.0	24.0	28.5
Commitments under operating leases				
Rentals during the year following the balance sheet date:				
Land and buildings leases expiring:				
Within one year	0.2	0.2	—	—
Between one and five years	1.2	0.6	—	—
After five years	2.6	2.2	—	—
Other leases expiring:				
Within one year	0.1	0.1	—	—
Between one and five years	0.4	0.2	—	—
	4.5	3.3	—	—
Contingent liabilities				
Contractors' claims on capital schemes	1.1	8.1	—	—
Guarantees	23.0	16.7	414.6	363.5
	24.1	24.8	414.6	363.5

Guarantees by the Company are principally in respect of borrowing facilities of subsidiary undertakings. Guarantees by the Group are principally in respect of performance bonds entered into in the normal course of business. No liability is expected to arise in respect of the guarantees.

34 Notes to the Group cash flow statement

<i>a Reconciliation of operating profit to net cash inflow from operating activities</i>	1999 £m	1998 restated (note 13) £m
Operating profit	167.7	134.8
Depreciation charge	57.3	49.2
Amortisation of goodwill	0.5	–
Provision for impairments:		
Tangible fixed assets	–	3.9
Fixed asset investments	0.7	0.4
Deferred income released to profits	(1.3)	(1.0)
(Decrease)/increase in provisions for liabilities and charges	(3.3)	3.6
Decrease in stocks	3.1	6.2
Increase in debtors (amounts falling due within and over one year)	(9.7)	(1.6)
(Decrease)/increase in creditors (amounts falling due within and over one year)	(20.4)	3.5
Profit on disposal of tangible fixed assets	(1.0)	(0.4)
Net cash inflow from operating activities	193.6	198.6

Net cash inflows from operating activities accounted for as exceptional items, included above, were £3.4 million. These relate to the settlement of a legal claim (1998 nil) offset by the utilisation of the water and sewerage business restructuring provision (1998 £1.9 million).

b Analysis of cash flows for headings netted in the Group cash flow statement

<i>i Returns on investments and servicing of finance</i>	1999 £m	1998 £m
Interest received	12.4	24.7
Interest paid	(38.5)	(39.3)
Interest element of finance lease rentals	(5.6)	(4.3)
Costs associated with defeased leases (note 6)	(0.1)	(0.2)
Gain on currency hedge	0.7	0.3
Net cash outflow for returns on investments and servicing of finance	(31.1)	(18.8)

<i>ii Taxation</i>	1999 £m	1998 £m
Windfall tax	(52.0)	(52.0)
Other taxes	(27.9)	(9.2)
Net cash outflow for taxation	(79.9)	(61.2)

The windfall tax is accounted for as an exceptional item (note 7).

<i>iii Capital expenditure and financial investment</i>	1999 £m	1998 restated (note 13) £m
Purchase of tangible fixed assets	(131.9)	(189.3)
Grants and contributions:		
Infrastructure assets	3.6	3.5
Non-infrastructure assets	0.8	0.2
Receipts from disposal of tangible fixed assets	2.6	1.6
Purchase of Company shares by Employee Share Ownership Plan	(1.0)	(1.3)
Other investments disposals/(additions)	0.9	(0.4)
Net cash outflow for capital expenditure and financial investment	(125.0)	(185.7)

34 Notes to the Group cash flow statement (continued)

b Analysis of cash flows for headings netted in the Group cash flow statement (continued)

iv Acquisitions and disposals

	1999 £m	1998 £m
Purchase of businesses	(33.1)	(22.7)
Purchase of interest in associated undertaking	-	(0.8)
Net cash acquired with businesses	1.8	1.6
Sale of businesses:		
Associated undertakings	-	0.3
Other businesses	1.6	0.8
Net cash outflow for acquisitions and disposals	(29.7)	(20.8)

v Management of liquid resources

	1999 £m	1998 £m
Purchase of current asset investments	(265.4)	(316.8)
Sale of current asset investments	299.4	407.2
Net cash inflow from management of liquid resources	34.0	90.4

Liquid resources comprise readily disposable current asset investments.

vi Financing

	1999 £m	1998 £m
Issue of ordinary share capital	3.3	2.8
Adjustment for shares issued under the Sharesave Scheme through Employee Share Ownership Trust	(1.9)	(1.0)
Share issue expenses	(0.5)	-
	0.9	1.8
Debt due within one year (other than bank overdrafts): Reduction	(92.5)	(104.8)
Debt due after more than one year: Increase	80.0	46.3
Cash withdrawn from deposit against finance lease obligations (note 28)	75.0	75.0
Cash placed on deposit with financial institutions (note 6)	(15.9)	(75.2)
Defeased finance lease drawdowns (note 6)	21.0	90.9
Other finance lease drawdowns	1.9	5.0
Capital element of finance lease rental payments	(5.8)	(6.3)
	63.7	30.9
Net cash inflow from financing	64.6	32.7

34 Notes to the Group cash flow statement (continued)

c Analysis of net debt

	At 1 April 1998 £m	Cash flow £m	Acquisitions (excluding cash items) £m	Non-cash movements £m	At 31 March 1999 £m
Cash at bank and in hand	2.9	4.4	–	–	7.3
Current asset investments: Overnight deposits	5.0	(4.8)	–	–	0.2
Bank overdrafts	(2.1)	1.5	–	(0.1)	(0.7)
	5.8	1.1	–	(0.1)	6.8
Debt due within one year (other than bank overdrafts)	(107.9)	92.5	(8.5)	(10.9)	(34.8)
Debt due after more than one year	(296.4)	(80.0)	–	10.9	(365.5)
Finance lease obligations	(236.2)	(76.2)	–	(5.4)	(317.8)
	(640.5)	(63.7)	(8.5)	(5.4)	(718.1)
Current asset investments: Other than overnight deposits	90.2	(34.0)	–	–	56.2
	(544.5)	(96.6)	(8.5)	(5.5)	(655.1)

Non-cash movements include transfers between categories of debt for changing maturities, increased accrued finance charges within finance lease obligations, and the in-substance extinguishment of finance lease obligations (note 6).

d Reconciliation of net cash flow to movement in net debt

	1999 £m	1998 £m
Increase in cash in the year	1.1	–
Cash inflow from increase in debt and finance leasing	(63.7)	(30.9)
Cash inflow from decrease in liquid resources	(34.0)	(90.4)
Increase in net debt arising from cash flows	(96.6)	(121.3)
Acquisitions (excluding cash items):		
Loans acquired with businesses	(2.2)	(3.6)
Loan stock notes issued as part consideration for businesses acquired (note 28)	(6.3)	(68.5)
Non-cash movements:		
In-substance extinguishment of finance lease obligations (note 6)	5.1	15.7
Increase in accrued finance charges on finance lease obligations	(10.5)	(11.4)
Other	(0.1)	0.4
Increase in net debt in the year	(110.6)	(188.7)
Net debt at 1 April	(544.5)	(355.8)
Net debt at 31 March	(655.1)	(544.5)

e Major non-cash transactions

During the year the Company issued 4.3 million ordinary shares (1998 1.8 million) in lieu of £41.9 million (1998 £12.0 million) cash under the scrip dividend alternative (note 25).

■ 34 Notes to the Group cash flow statement (continued)

f Purchase of businesses

	1999 £m	1998 £m
Net assets acquired:		
Tangible fixed assets	6.0	39.5
Fixed assets investments	—	1.4
Stocks	2.3	0.4
Debtors due within one year	3.3	12.0
Cash at bank and in hand	1.8	3.8
Bank overdrafts	—	(2.2)
Creditors due within one year	(3.2)	(17.2)
Loans	(2.2)	(3.6)
Provisions for liabilities and charges	—	(10.4)
Fair value of net assets acquired	8.0	23.7
Goodwill	29.1	70.2
	37.1	93.9
Satisfied by:		
Cash consideration	33.1	21.5
Loan stock notes	4.0	68.5
Contingent consideration	—	3.9
	37.1	93.9

Provisions for liabilities and charges in 1998, and hence goodwill written off to reserves, have been restated to exclude the prior year adjustment of £1.0 million (note 27).

During the year £2.3 million of the contingent consideration, arising on businesses purchased in 1998, was paid (1998 £2.0 million for businesses acquired in an earlier year).

The businesses acquired during the year utilised £0.1 million of the Group's net cash inflow from operating activities (1998 £4.5 million contribution), utilised £0.8 for taxation (1998 £1.3 million) and utilised £0.1 million for capital expenditure and financial investment (1998 £1.3 million).

g Sale of businesses

	1999 £m	1998 £m
Net assets disposed of:		
Associated undertakings	—	0.7
Goodwill written back to reserves	—	7.1
	—	7.8
Business disposal loss	—	(7.5)
Total satisfied by: Cash consideration	—	0.3

During the year £1.6 million of the deferred consideration, arising from businesses sold in earlier years, was received (1998 £0.8 million).

■ 35 Related party transaction

On 6 February 1998 Exe Continental Limited, a 100% owned Group company, made arrangements to dispose of its investment in unsubordinated loan stock in Societa Italo Britannica dell'Aqua Srl, an associated undertaking, as set out in note 5.

Five year financial summary

	1999 £m	1998 £m	1997 £m	1996 £m	1995 £m
Profit and loss account					
Turnover	437.1	382.4	343.6	314.4	286.2
Operating profit	167.7	134.8	130.2	134.1	86.2
Share of operating (loss)/profits in associates	(0.2)	(0.4)	1.2	1.6	1.2
Business disposal (loss)/profit	-	(7.5)	19.2	-	-
Net interest payable	(40.9)	(20.3)	(18.0)	(26.6)	(24.2)
Profit on ordinary activities before taxation	126.6	106.6	132.6	109.1	63.2
Tax on profit on ordinary activities*	(17.5)	(117.0)	(14.3)	(10.3)	(8.2)
Profit/(loss) on ordinary activities after taxation	109.1	(10.4)	118.3	98.8	55.0
Dividends	(61.9)	(54.1)	(47.4)	(38.9)	(34.5)
Retained profit/(loss) transferred to/(from) reserves	47.2	(64.5)	70.9	59.9	20.5
Earnings per share (basic):					
Before exceptional items	77.9p	83.3p	81.2p	72.4p	71.8p
Exceptional items	3.8p	(91.3)p	10.9p	5.3p	(28.1)p
After exceptional items	81.7p	(8.0)p	92.1p	77.7p	43.7p
Dividend per share	45.6p	41.0p	36.7p	30.5p	27.3p
* including £104.0 million windfall tax in 1998					
	£m	£m	£m	£m	£m
Capital expenditure					
Acquisitions	37.1	93.9	0.9	103.0	0.2
Tangible fixed assets	125.3	184.6	157.2	110.3	159.4
	£m	£m	£m	£m	£m
Balance sheet					
Fixed assets	1,652.4	1,558.9	1,397.8	1,301.2	1,182.2
Net current (liabilities)/assets	(26.2)	(166.0)	(42.9)	63.6	349.5
Non-current liabilities	(734.5)	(584.2)	(439.0)	(524.7)	(687.4)
Net assets	891.7	808.7	915.9	840.1	844.3
Number of employees (average for year)					
Water and sewerage business	1,700	1,734	1,765	1,815	2,084
Waste management	441	312	297	322	271
Environmental instrumentation	437	443	411	357	255
Construction services	875	838	567	398	339
Other businesses	55	93	113	113	134
	3,508	3,420	3,153	3,005	3,083

The adoption of Financial Reporting Standard 12 'Provisions, Contingent Liabilities and Contingent Assets', and Financial Reporting Standard 14 'Earnings Per Share', has required revised presentation of certain comparative numbers for 1998. Comparatives for earlier years have not been restated.

Notice of meeting

The tenth annual general meeting of Pennon Group Plc will be held at The Plymouth Pavilions, Millbay Road, Plymouth, Devon on Thursday, 29 July 1999 at 11.00 am for the transaction of the following business:

Resolution 1

To receive the Report of the Directors and the financial statements for the year ended 31 March 1999.

Resolution 2

To declare a final dividend for the year ended 31 March 1999.

Resolution 3

To re-elect Mr R J Baty as a Director.

Resolution 4

To re-elect Mr K L Hill as a Director.

Resolution 5

To re-appoint PricewaterhouseCoopers as auditors until the conclusion of the next general meeting at which financial statements are laid before the Company and to authorise the Directors to fix their remuneration.

Resolution 6

To propose the following as an ordinary resolution:

That, in accordance with Article 5 of the Company's Articles of Association, the Directors be authorised to allot relevant securities up to a maximum nominal amount of £38,500,000, that such authority shall expire on the day five years after the passing of this resolution and that all previous authorities under section 80 of the Companies Act 1985 be revoked.

Resolution 7

To propose the following as a special resolution:

That, in accordance with Article 6 of the Company's Articles of Association, a) the Directors be given power to allot equity securities for cash, b) that for the purpose of paragraph (A)(ii) of that Article, the nominal amount to which this power is limited is £6,810,000 and c) this power shall expire on 29 October 2000 or, if earlier, at the conclusion of the next annual general meeting of the Company.

Resolution 8

To propose the following as a special resolution:

That the Company is generally and unconditionally authorised to make market purchases (within the meaning of section 163 of the Companies Act 1985) of Ordinary Shares of £1 each in the capital of the Company ('Ordinary Shares') on such terms and in such manner as the Directors of the Company may from time to time determine provided that:

a the maximum number of Ordinary Shares that may be purchased under this authority is 13,620,000 (being 10% of the current issued share capital of the Company);

b the maximum price which may be paid for an Ordinary Share purchased under this authority is an amount equal to 105% of the average of the middle market quotations for Ordinary Shares, as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which that share is purchased, and the minimum price which may be paid is £1 per Ordinary Share; and

c this authority will, unless previously varied, revoked or renewed, expire at the conclusion of the next annual general meeting of the Company, but the Company may make a contract to purchase Ordinary Shares under this authority before its expiry which will or may be executed wholly or partly after the expiry of this authority and may make purchases of Ordinary Shares pursuant to such a contract.

Resolution 9

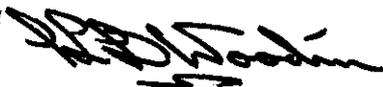
To propose the following as an ordinary resolution:

That approval be given to the renewal of the Pennon Group Sharesave Scheme for a further ten year period and that the Directors be authorised to operate the Scheme in accordance with the Scheme Rules.

By Order of the Board

K D WOODIER
COMPANY SECRETARY

Peninsula House Rydon Lane Exeter EX2 7HR
24 June 1999



Notes

Pursuant to Regulation 34 of the Uncertificated Securities Regulations 1995, only those shareholders registered in the register of members as at 6.00 pm on 27 July 1999 will be entitled to attend or vote at the meeting in respect of the number of shares registered in their name at that time. Changes to entries on the register after 6.00 pm on 27 July 1999 will be disregarded in determining the rights of any person to attend or vote at the meeting.

A person entitled to attend and vote at the meeting is entitled to appoint one or more proxies to attend and, on a poll, vote instead of him or her. A proxy need not be a member of the Company.

A Form of Proxy is enclosed and, if used, should be lodged with the Company's Registrars, Lloyds TSB Registrars, not less than 48 hours before the time fixed for the meeting.

Explanatory notes on certain business of the annual general meeting

Authority to allot shares

Resolution 6 requests shareholder approval by way of an ordinary resolution to renew for a period not exceeding five years the Directors' existing general and unconditional authority to allot securities in accordance with the Companies Act 1985 and the Articles of Association of the Company. This authority would continue that granted in July 1998. The share capital to which this authority relates of £38,500,000 Ordinary Shares represents approximately 28% of the issued share capital at the date of this report, being the balance between the current issued share capital and the authorised share capital of the Company.

Resolution 7 requests shareholder approval by way of a special resolution to renew until next year's annual general meeting the Directors' existing authority to allot equity securities for cash without first being required to offer such securities to existing shareholders. The share capital to which this authority relates represents approximately 5% of the issued share capital at the date of this report.

The Directors consider that they should have the above authorities in order to be able to take advantage of opportunities as they arise and to retain flexibility although they have no current plans to issue shares.

Authority to purchase Ordinary Shares of the Company

Resolution 8 requests shareholder approval by way of a special resolution to renew the Company's authority to purchase up to 10% of its Ordinary Shares at or between the minimum and maximum prices specified in the resolution. This authority is requested in order to increase the Company's flexibility to optimise the long-term financial and tax efficiency of its capital structure. The Directors have no specific plans to exercise such powers in the immediate future but will keep the matter under review and will only make such purchases if they would result in an increase in the Company's earnings per share and are in the best interests of the Company's shareholders generally.

Sharesave Scheme

The Pennon Group Sharesave Scheme was adopted in 1989 at the time of the Company's flotation. In accordance with market practice, no options may be granted under the Scheme more than ten years after its adoption without the approval of shareholders.

The Sharesave Scheme has been operated successfully since its introduction in 1989 and it has been an important element in motivating the Group's employees. The Directors take the view, therefore, that the Sharesave Scheme should continue to be operated for a further period of ten years and Resolution 9 requests Shareholder approval by way of an ordinary resolution to do this.

Shareholder information

■ Financial calendar

Financial year end	31 March
Tenth annual general meeting	29 July 1999
1999 Final dividend payable	1 October 1999
2000 Interim results announcement	November 1999
2000 Interim dividend payable	April 2000
2000 Preliminary results announcement	May 2000
Eleventh annual general meeting	July 2000
2000 Final dividend payable	October 2000

■ Shareholders' analysis at 31 March 1999

	Number of shareholders	Percentage of total shareholders	Percentage of ordinary shares
1 - 100	5,493	18.8	0.2
101 - 1,000	20,033	68.8	6.0
1,001 - 5,000	2,849	9.8	3.4
5,001 - 50,000	463	1.6	6.5
50,001 - 100,000	107	0.4	5.5
Over 100,000	183	0.6	78.4
	29,128	100.0	100.0
Individuals	26,818	92.0	8.9
Companies	288	1.0	1.9
Trust companies (pension funds, etc)	18	0.1	0.3
Banks and nominees	1,993	6.8	86.2
Insurance companies	11	0.1	2.7
	29,128	100.0	100.0

■ Shareholder services

Share dealing service

The low-cost share dealing service enables investors to buy and sell shares in the Company on a low-cost basis and to make regular investments in the Company.

Individual Savings Accounts

By holding their shares in the Company in a Mini or a Maxi Individual Savings Account, shareholders may gain tax advantages.

Dividend Reinvestment Plan

The Dividend Reinvestment Plan enables shareholders to reinvest their dividends to purchase additional shares in the Company.

Details of the Dividend Reinvestment Plan are being circulated to shareholders with this Report and details of the other shareholder services are available from the Company Secretary's Department, telephone: 01392 446677.