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Annual Report & Accounts 2001



Pennon Group Plc

Highlights of the year

Pennon Group Plc 2001

■ Confirmation of strategic direction of the Group

■ Periodic Review dominates Group results

■ Turnover £435.1 million

■ Profit before tax £76.3 million*

■ Earnings per share 56.0p*

■ Dividend per share 36.0p

**before exceptional items*

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Chairman's statement

Pennon Group Plc 2001

The Board has confirmed the strategic direction of the Group which will in future concentrate on water and sewerage services and waste management.

■ Financial overview

Group turnover reduced by 6.8% to £435.1 million, reflecting the impact of the 12.2% price reduction imposed on South West Water Limited by the Director General of Water Services which saw the company's turnover decrease by £30.0 million to £250.2 million. Turnover in Viridor and other Group businesses fell by £1.9 million to £184.9 million influenced by the disposal of the construction services business in December 2000.

Group profit before tax and the exceptional item reduced by £45.3 million to £76.3 million and consequently earnings per share fell by 34.7% to 56.0p.

As foreshadowed in the Interim Results announced in December 1999, the Board has rebased the level of dividend. A final dividend of 24.4p is recommended which, with the interim dividend of 11.6p, will result in a full year dividend of 36.0p – a 24.7% reduction.

■ South West Water Limited

The water and sewerage business responded well to the challenges imposed by the Regulator's tough review and delivered the highest ever levels of compliance and customer service. That achievement is all the more significant given the tight regulatory targets set for operational and capital expenditure and the company is confident of maintaining a similar performance throughout the five year period to 2004/05.

■ Viridor Limited

Viridor Waste Limited experienced difficult trading conditions in some areas, aggravated by the very wet winter which had an adverse effect on leachate control costs. However, the company continues to be well placed to take advantage of the anticipated shortfall of landfill capacity in key parts of the UK.

Viridor Instrumentation Limited has seen improved performance across all its business areas, particularly from Orbisphere.

The performance of both South West Water and Viridor is described in more detail in the Business Review section.

■ Prospects

In May last year, in view of the need to mitigate the impact of the Final Determination on the Group's turnover and profitability, the Board announced it was to carry out a review of strategic options. During the review, a great many proposals were scrutinised by the Board taking into account the delicate balance which exists in seeking to meet the needs of all the Group's key stakeholders.

To ensure the hallmark of quality,

efficiency and reliability which will help to meet the three key goals of
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and the regional community.

Having considered alternative structures for the utility business, the Board has concluded that at present none offers an increase in shareholder value compared to the current integrated structure. However, efforts will continue to more efficiently structure the balance sheet.

It is intended that Viridor should focus on the waste management business and, to that end, having sold the construction services business, it is now proposed to dispose of Viridor Instrumentation with a view to returning value to shareholders.

The Board is confident its strategy will maximise shareholder value but it is absolutely vital, not just for Pennon Group Plc but for the water industry as a whole, that the current regulatory arrangements be reviewed. While the regulatory framework has generally worked well in the first decade after privatisation by lowering prices and encouraging the improvement of quality and standards, it is now clear that its emphasis on continuous cost reductions is not sustainable. Although the need for efficiency is unarguable, the focus must move to long-term investment needs.

Against that background, it is imperative that the Government enters into a constructive dialogue with the industry and its three regulators (Ofwat, the Drinking Water Inspectorate and the Environment Agency) to ensure that their sometimes conflicting requirements are resolved and long-term investment needs are taken into account in future price reviews. This dialogue will become all the more urgent as environmental and quality legislation is set to place ever greater demands on the industry. It is clear from the current situation that a more correct balance between the needs of customers and shareholders must be struck.

■ Social responsibility and community involvement

The Pennon Group is proud of its track record in the increasingly important area of corporate social responsibility and feedback from institutional investors has indicated that the Group is regarded as being in the vanguard in terms of its environmental reporting and ethical behaviour.

In past Annual Reports many of the Group's achievements in these areas have not been given the prominence they perhaps deserve and I am pleased to report, that for the first time, these issues are covered in more depth within the Business Review.



K.G. HARVEY, Chairman, Pennon Group Plc | 21 June 2001

In the twelve years since the privatisation of the water industry, the companies within the Pennon Group have developed via organic growth and acquisition together with significant restructuring initiatives designed to maintain competitiveness and profitability.

The pace of change since 1989 has been rapid, but both the regulated and non-regulated sectors of the business have adapted and responded to market changes.

The past year has produced differing fortunes for each element of the business with South West Water Limited performing well, Viridor Instrumentation Limited enjoying a significant upturn in turnover and profitability, whilst Viridor Waste Limited suffered as a result of difficult market conditions which have similarly affected most waste management companies. Viridor Properties completed a successful major property transaction.

South West Water Limited

The imposition of the Director General's one-off price reduction of 12.2%, resulted in a 10.7% decrease in turnover from £281.4 million to £251.4 million for 2000/01. However, South West Water responded well to the challenges posed by the tough Final Determination which required demanding operational and capital expenditure efficiencies.

Operating costs, before depreciation charges, increased by 1.4% to £92.8 million, incorporating further efficiency savings of £5.8 million.

Operating profit decreased by 26.9% to £107.3 million.

At the time of the last Periodic Review, Ofwat estimated that the number of customers who would switch from an unmeasured to a measured charging basis would be lower than that assumed by the company. In the event, the company's estimate was more accurate and during the year 27,500 customers switched to a measured charging basis producing an adverse impact on turnover of £4.7 million. As a result, based on current projections of customers opting to move to a measured charging basis, the company expects to apply to the Director General of Water Services for an Interim Price Determination in September 2001.

A restructuring programme to deliver significant reductions in overhead and operating costs was introduced some two years ago. This successful initiative is designed to ensure that South West Water outperforms the regulatory contract targets for the five year period 2000/01 to 2004/05.

South West Water's track record in the area of efficiency savings is excellent and since 1995 cost reductions totalling £33.4 million have been achieved.

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Despite the severity of the Regulator's Final Determination, and the consequential reduction in operational expenditure, first class levels of customer service have remained one of the company's key objectives. This focus was endorsed during the year by the presentation of the Government's Charter Mark award for excellence in public service.

Levels of customer satisfaction with the overall service provided by the company remain high and improvements in the 'Levels of Service Indicators' prescribed by Ofwat have been achieved.

Plentiful supplies of high quality drinking water are an absolute priority for customers and, as a direct result of careful planning and expenditure, the region's water supply capability has been significantly enhanced. There have been no water restrictions since 1996 and the company's innovative and industry-leading leakage reduction programme is delivering results in line with the mandatory leakage targets set by Ofwat.

Water mains renovation expenditure will be considerable during the K3 period. The length of mains scheduled for improvement is more than double that completed in the K2 period. Whilst quantity of supply has improved, so too has quality. Drinking water quality levels were elevated to the highest ever achieved by the company – 99.85% compliance with all water quality standards.

Excellent progress has also been made in the area of waste water treatment. South West Water's massive coastal waste water treatment improvement programme 'Clean Sweep', continues to provide both environmental and economic benefits and was a vital factor in the region achieving the best ever bathing water quality results during the year.

Inland waste water treatment works are also being updated and modernised as part of a rolling programme to ensure compliance with stringent environmental standards. In tandem with providing environmental benefits, the programme is also contributing towards the removal of planning embargoes which were preventing much needed commercial and residential property development.

Capital expenditure for the year increased by £20.8 million to £154.4 million, with £62.0 million invested in water supply improvements including water mains renovation, water treatment works enhancement and leakage control. Waste water services investment expenditure was £92.4 million of which £61.0 million was invested in the company's 'Clean Sweep' bathing water improvement programme.

Viridor Limited

A refocusing of the strategy of Viridor Limited led to the sale of construction services company T J Brent Limited in December 2000 and the subsequent announcement of the proposed disposal of Viridor Instrumentation Limited. This will enable Viridor to focus on the development of its waste management business.

Turnover in Viridor decreased by 1.5% to £203.8 million during the year and operating profit increased by £1.0 million to £20.8 million. The results reflect a significant increase in the profitability of Viridor Instrumentation on strong sales growth and, in Viridor Properties, from the disposal of land for retail development. The results were however impacted by cost increases incurred by Viridor Waste Limited.

Capital expenditure for the year was £12.0 million, of which £11.0 million was invested by Viridor Waste, primarily on its continuing landfill operations.

Viridor Waste is one of the larger waste disposal businesses in the UK. It is active in recycling in partnership with a number of local authorities, in the generation of electricity utilising landfill gas and in clinical waste incineration. The company is also a major waste collector in South West England.

The business disposed of 3.0 million tonnes of waste during the year (1999/00 3.0 million). Gate fees increased by 4% but were insufficient to cover the significant increase in operating costs incurred during the year, particularly as a result of the exceptional conditions created by the wettest year on record; this resulted in significant additional leachate control costs.

During the year, the Government published its 'Strategy for Waste' which sets out the targeted reduction in the volume of waste being disposed of to landfill and the timescale within which the targets must be achieved. Working in harmony with local authorities, Viridor Waste is committed to playing its part in achieving those targets. The Government has also published information which suggests that the remaining life of consented landfill void in the whole of the country is around six years. That being the case, Viridor Waste is confident that the value of its 71 million cubic metres of fully consented void space will increase substantially in the future.

Whilst conditions in the waste disposal market during the year adversely affected Viridor Waste's results, Viridor Instrumentation improved its performance considerably.

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The company is a leading supplier of specialised environmental monitoring and process control equipment with research and development and manufacturing facilities in the UK, USA and Switzerland. It trades in over 150 countries and enjoys a share of up to 50% of the world market in certain product areas.

The instrumentation business achieved strong sales growth with particular successes being sales of Orbisphere analysers to the cola industry and a large ELE order from Thailand's universities.

During the year, the company completed its business rationalisation programme which included relocating its UK operation to smaller, lower cost premises in Bedfordshire and the relocation of one of its American based businesses – ELE International Inc. – to Alabama. Both moves have generated significant overhead savings.

Research and development expenditure continues to play a major role in the future growth of the company and during the year totalled 6% of turnover. New products launched included a multi-parameter water quality monitor. The company also acquired the rights to manufacture and market particle monitors and samplers.

Business to business e-commerce opportunities are being pursued throughout Viridor Instrumentation and during the year, US subsidiary GLI International Inc. commenced on-line transactions which now account for 25% of its turnover.

The Group continues to maximise the value of its property assets via a partnership between South West Water and Viridor Properties Limited. During the year, Viridor Properties sold surplus land surrounding a water treatment works in Plymouth to a major property company and construction of a retail development has commenced. This transaction created a profit of £3.0 million for the Group.

Viridor Contracting's subsidiary, T J Brent, including its Copa Products division, was sold by December 2000 for £12.4 million which included the assumption of debt amounting to £1.5 million. Overall, the sale resulted in a loss of £2.1 million after writing back £6.6 million of goodwill previously written off to reserves.

Employees

Highly skilled, well motivated employees are fundamental to the continued success of the Group which is committed to supporting them with the infrastructure, technology and opportunity to perform at the highest levels.

A number of proven employee communications initiatives are used throughout the Group and include a monthly team briefing system, employee newspapers and the use of the Group's intranet facility. E-communication is proving to be an extremely useful additional medium given the geographical diversity of the Group.

Employees of South West Water elect representatives from all levels to a Staff Council which deals with matters of interest to all staff employees, both trade union and non-trade union members alike. A staff association has also been established within Viridor Waste.

Employees in the UK are encouraged to become shareholders in the Company through the all-employee share schemes. The approval of shareholders to the introduction of an All Employee Share Option Plan will be sought at the Annual General Meeting. The plan will assist in furthering the Group's policy of seeking to align the interests of employees with those of shareholders.

The Group's training and development strategy remains a key factor for success and a wide range of programmes is available to suit all needs. Particular attention is given to the management of change and training for revised working practices to ensure success in the ever-changing market place.

The people management processes employed by the Group were recognised during the year via an 'Investors in People' award made to South West Water. Whilst the external accreditation was most welcome, the Group is not complacent and will continue its drive for industry-leading best practice.

A safe working environment for all employees is of paramount importance to the Group which regularly reviews its health and safety policy and standards of performance. The Group's health and safety strategy has continually evolved over the years with innovative risk assessment and control programmes being introduced. These have helped to ensure a low level of work related accidents and attendant reductions in operating costs.

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The Group encourages ethical employment practices by adopting key policies with Group-wide application. A non-discriminatory employment policy is in operation and every reasonable effort is made to ensure that no current or future employee is disadvantaged because of age, gender, religion, colour, ethnic origin, marital status, sexual orientation, or disability. In addition, a 'Whistleblowing' policy has been adopted.

Caring for the environment

The Group plays a leading role in enhancing and maintaining the environment. As noted, that is one of the three key goals set out in the Group's mission statement.

Two of the companies within the Group, South West Water and Viridor Waste, perform the important task of treating and disposing of society's waste in a carefully controlled and highly engineered manner. Viridor Instrumentation is increasingly involved in the development of equipment which assists its customers in reducing their impact on the environment.

An environmental policy has been in place since the early days of the Company's life and is regularly reviewed by the Environment Committee. That policy aims to achieve continuous improvement in environmental performance. Recognition of enhanced performance came recently when the Group improved its ranking in the Business in the Environment 2000 survey.

South West Water has achieved its highest ever performance in both clean and waste water compliance. Drinking water quality reached the very high level of 99.85% compliance while 98% of the company's sewage treatment works were fully compliant with their discharge consent conditions. The latter achievement is particularly creditable bearing in mind that the company inherited a situation where only 60% compliance was being achieved.

Reflecting its continuing commitment to high environmental standards, Viridor Waste has now achieved ISO 14001, the international environmental management standard, at all of its key sites.

The Group is a major producer of renewable energy. Viridor Waste increased its capacity for power generation from landfill gas from 24.5MW to 28MW while South West Water generates from hydro-electric sources. In total, the Group generates the equivalent of 111% of its electricity requirements from renewable sources. These activities contribute to the Government's plans to increase the proportion of energy from renewable sources.

As a result of the Government's introduction of the Climate Change Levy – a new tax on the business use of electricity, gas and oil – with effect from 1 April 2001, steps previously taken by Group companies to raise the awareness of employees of the release of greenhouse gases have assumed greater importance.

Construction activity associated with the Group's water, sewerage and waste management activities can have a significant impact on the neighbourhood as well as the natural habitat. The Group is committed to working closely with planners and interested parties to minimise such impacts and to ensure that sites blend in with the natural environment. At all landfill sites and on many construction projects, close liaison is maintained with the local community to discuss and, wherever possible, mitigate potential problems. This underscores the approach of the Group in its determination to be a good neighbour.

The outbreak of foot and mouth disease presented major challenges throughout the country in terms of the disposal of culled animals. Viridor Waste has assisted the Government in its management of the outbreak by accepting carcasses from precautionary culls at five of its engineered landfill sites. In doing so, it has paid due regard to the sensitivities of the neighbouring communities.

The Group's environmental performance will be more fully reported in the environmental report 'Enhancing the Environment 2001'.

Involvement in the community

As one of the few large Plcs headquartered in the West Country, the Company recognises that it has a number of social responsibilities wherever it operates but particularly in the relatively economically deprived region of its home territory – Devon and Cornwall.

In recognition of the impact of the outbreak of foot and mouth disease on the rural communities within its area, South West Water has sought to deal sympathetically with customers who may be suffering hardship as a result of the outbreak. In addition, it has assisted farms with the delivery of emergency water supplies wherever necessary. It has also made a donation to the 'Green Wellie Fund' which was established to assist the farming community and small rural businesses in the South West.

In April 2000, the South West Lakes Trust was established to take over responsibility for the management of South West Water's leisure activities. The Trust has been very active with various communities in the South West through the involvement of local volunteers on a number of environmental projects.

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The Group is proud to be associated with The Eden Project which opened to much acclaim in March 2001. The Project, near St Austell in Cornwall, has involved the construction of major biomes to recreate a range of plant habitats from across the world. It seems set to give a major boost to the tourist industry which is so important to the economy of the South West.

Community involvement is channelled through a number of initiatives:

■ *Charitable donations* – charitable donations amounting to £55,000 were made during the year. Such donations were primarily made to charities operating in Devon and Cornwall where the average size of donation of £1,000 can often make a significant difference to the service provided by those organisations.

■ *South West Water community sponsorship programme* – again, relatively small donations can often have a significant impact. Funds amounting to £40,000 were awarded during the year across a wide spectrum of activities.

■ *Landfill Tax Credit Scheme* – the Landfill Tax Credit Scheme enables Viridor Waste to demonstrate its commitment to environmental improvements in a very positive way, particularly in areas near its landfill operations. Since the inception of the Scheme, Viridor Waste has made a total contribution of £21.3 million to Environmental Bodies and has provided support for a wide range of environmental and local amenity projects across the country. Funds of £7.2 million were awarded in the year under review. In recognition of the Government's desire to see a greater proportion of landfill tax credits being used for the benefit of recycling or waste related research and development, Viridor Waste has voluntarily adopted a target whereby 50% of its landfill tax credits will go to such initiatives in the future.

■ *Pennon Environmental Fund Committee* – the Committee was established in late 1999 with the aim of utilising Viridor Waste landfill tax credits for the specific benefit of the West Country. Since then it has supported a diverse range of environmental and community initiatives in the South West pursued by Environmental Bodies. In particular, it has provided support to the Pennon Water Champions programme which was set up in conjunction with the Devon and Cornwall Wildlife Trusts with a view to bringing about improvements to natural habitats and water-related projects. A number of local communities within Devon and Cornwall have also received financial assistance for amenity projects to benefit their residents.

The Group's financial results for the past year were dominated by the impact of the one-off price reduction imposed on South West Water Limited by the Director General of Water Services.

The water and sewerage business profit before tax at £67.0 million reduced by £41.0 million, reflecting the 12.2% tariff cut arising from the Periodic Review which was implemented from April 2000.

Viridor profit before tax at £19.5 million improved by £1.0 million.

Group net interest payable increased by £6.3 million to £51.4 million in 2000/01.

Earnings per share reduced by 34.7% to 56.0p, before the 2000/01 exceptional item.

Operating profit

Group turnover for the year reduced by 6.8% to £435.1 million. Total water and sewerage business turnover was £251.4 million, down 10.7% on 1990/00 principally resulting from the reduction in tariffs imposed by the Regulator. The £4.7 million adverse cost of customers moving from the unmeasured to the measured usage tariff was covered in part by an increase in the number of billed customers. Total turnover for Viridor businesses at £203.8 million was 1.5% down on 1990/00, and included £106.1 million for waste management (1990/00 £100.6 million), £54.9 million for instrumentation (1999/00 £49.6 million) and £37.1 million from construction services until the sale in December 2000 (1999/00 £56.0 million). Group operating costs for 2000/01 at £307.0 million increased by £7.1 million. Further efficiency benefits of £5.8 million were achieved in the water and sewerage business.

Group operating profit for the year reduced by £39.0 million to £128.1 million. The water and sewerage business achieved a £107.3 million operating profit, down £39.5 million on 1999/00. Viridor businesses contributed £20.8 million, or 16% of Group operating profit in 2000/01.

Viridor businesses operating profit performance for 2000/01 experienced a £1.0 million improvement. This was achieved in the instrumentation business, where operating profit improved by £1.9 million to £4.8 million, and from a successful property development which delivered £2.3 million. At waste management, higher environmental costs, arising from above average rainfall, and tight competitive pressures were responsible for a £2.1 million profit reduction to £13.1 million in 2000/01. The absence of a full year construction services trading, following the December 2000 sale, reduced operating profit by £1.1 million.

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Finance costs

Net interest payable was £51.4 million, which was 2.5 times covered by Group operating profits, compared with £45.1 million in 1999/00.

Gross interest payable was £56.8 million arising on borrowings, predominantly denominated in sterling. Gross interest receivable of £5.4 million was derived from the investment of temporarily surplus funds.

Profit before tax

Profit before tax and the exceptional item (business disposal loss) was £76.3 million, £45.3 million down on 1999/00.

Water and sewerage business profit before tax reduced by £41.0 million to £67.0 million, being largely driven by the operating profit reduction. An £8.1 million increased interest burden from funding the capital investment programme was ameliorated by a £6.6 million benefit following the £85.0 million equity cash provided by the Company in March 2000.

Non-regulated businesses provided £9.3 million profit before tax and the exceptional item, a £4.3 million reduction on the 1999/00 position, reflecting the provision of cash resources to the water and sewerage business.

The return on investment achieved for 2000/01 for waste management was 6% (1999/00 7%), representing profit before tax expressed as a percentage of acquisition cost. For instrumentation the return, before goodwill amortisation charges, was 7% (1999/00 5%).

Taxation

The Group had no United Kingdom or overseas taxation charge for the year (1999/00 £5.0 million). The Group's capital investment programme continues to generate substantial capital allowances to be set against taxable profits.

Earnings per share

Earnings per share reduced by 34.7% to 56.0p (before the exceptional item in 2000/01). The dominant factor was the tariff reduction in the water and sewerage business.

Dividends and retained earnings

The Directors recommend the payment of a final dividend of 24.4p per share for the year ended 31 March 2001. Together with the interim dividend of 11.6p per share paid on 6 April 2001 this makes a total dividend for the year of 36.0p per share, a reduction of 24.7% on the dividend for 1999/00. The dividend of 36.0p is paid out of earnings per share of 56.0p before the exceptional item. The cover for payment of dividends is 1.6 times.

The Directors had previously foreshadowed the proposed dividend cut of 25% to be applied in 2000/01. This action is necessary to maintain dividend covers at acceptable levels following the impact of the windfall tax, the Periodic Review price reductions and the review of Viridor profit projections. In the absence of unforeseen circumstances, the Directors expect to pursue a progressive dividend policy in subsequent years.

The total cost of the interim and recommended final dividend of the Company is £49.4 million. The retained profit of £24.8 million has been transferred to reserves.

The dividend payable by South West Water Limited to the Company for 2000/01 amounts to £60.4 million.

Investment

Capital expenditure by the Group on tangible fixed assets was £166.5 million (1999/00 £153.8 million) of which £154.4 million arose in the water and sewerage business (1999/00 £133.6 million).

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 £205.0 million (1999/00 £216.3 million). Capital expenditure and financial investment cash outflow increased from £140.6 million in 1999/00 to £153.2 million in 2000/01. Taxation cash outflow was £0.3 million (1999/00 £15.9 million). Equity dividends paid and servicing of net debt involved a cash outflow of £105.2 million (1999/00 £58.8 million).

Overall, the cash outflow of the Group, before the use of liquid resources and financing, was £41.7 million (1999/00 £1.5 million inflow).

Financings during the year included £89.0 million of finance lease facilities.

At 31 March 2001 loans and finance lease obligations were £783.1 million and the Group held current asset investments and cash of £65.1 million. Net borrowings, which increased by £51.2 million during the year to £718.0 million, represent 73% of shareholders' funds (1999/00 71%).

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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 2001 the limit was £2.4 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 2001, after taking account of interest rate swaps with a notional principal amount of £200.0 million, 57% of net debt was at fixed rate (1999/00 57%), with debt in place for periods of between 1 and 11 years (1999/00 2 and 12 years), with an average maturity of 6 years (1999/00 7 years).

During the prior year, interest rate swaps with a notional principal amount of £200.0 million, commencing from April 2006 and maturing in March 2030, were entered into as part of the Group's risk management policy. These derivatives diversify the mix of interest rate exposures by swapping the basis of floating rate interest payments from being based on UK bank rates to being based on European bank rates, as set out in the financial statements. The settlement of £18.2 million, received when these swaps were entered into, has been deferred and will be matched with interest charges on the underlying hedged debt over the periods of the swaps.

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 7.4% when measured against average net debt (1999/00 6.8%).

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 over £160.0 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 approved by the Board.

■ *Foreign currency risk*

The Group's principal exchange rate risk is to the value of overseas investments. Net equity value, including capitalised goodwill, is protected by the forward sale of foreign currency – at 31 March 2001 US dollar 22.0 million and Swiss franc 69.0 million. Foreign currency transaction exposure is covered on a case by case basis – at 31 March 2001 contracts for overseas transactions, with a sterling value of £2.0 million, existed for settlement in Swiss francs.

Payments to suppliers

It is the Company's payment policy for the year ending 31 March 2002 to follow the Code of The Better Payment Practice Group on supplier payments. The Company will agree payment terms with individual suppliers in advance and abide by such terms. Information about the Code can be obtained from www.payontime.co.uk. The ratio, expressed in days, between the amount invoiced to the Company by its suppliers during 2000/01 and the amount owed to its trade creditors at 31 March 2001 was 25 days.

Share capital

During the year the issued ordinary share capital increased from £136.3 million to £136.9 million. The value of net assets per share at book value, at 31 March 2001, was 714p.

Permission was obtained from shareholders at the annual general meeting in July 2000 to purchase up to 10% of the Company's ordinary share capital. Renewal of the authority will be sought at the July 2001 annual general meeting.

Board of Directors

Pennon Group Plc 2001

Kenneth George Harvey

BSc, CEng, FIEE (60)

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 a non-executive chairman of Beaufort Group Plc and The Intercare Group Plc and a non-executive director of Lattice Group Plc.

Sir Geoffrey Howes Chipperfield

KCB, DCL (68)

Non-executive Deputy Chairman

was appointed on 1 October 1993 and became Deputy Chairman on 1 May 2000. 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.

Robert John Baty

CEng, FREng, FICE, FCIWEM, MIMgt.

ACI Arb, FIWO (57)

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 engineering and operational appointments with North West Water Authority.

Colin Irwin John Hamilton Drummond

MA, MBA (50)

Chief Executive, Viridor Limited

was appointed on 1 April 1992. Prior to joining the Company he was a divisional chief executive of Coats Viyella, 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.

Kenneth Leslie Hill

CPFA (60)

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 chairman of Eden Project Limited and Vocalis Plc and a City Disputes panellist.

Alan Thomas Fletcher

MA (66)

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.

Katharine Mary Hope Mortimer

MA, BPhil (55)

Non-executive Director

was appointed on 1 May 2000. She is currently a freelance financial consultant, a member of the Crown Agents Foundation Council and a director of Crown Agents Financial Services Limited and Crown Agents Asset Management Limited. She was formerly a director of N M Rothschild & Sons Limited, Director of Policy at the Securities and Investments Board and Chief Executive of Walker Books and was a member of the Competition Commission between 1995 and 2001.

Committees of the Board

Audit

Sir Geoffrey H Chipperfield (Chairman)

A T Fletcher

Ms K M H Mortimer

Environment

B A O Heuvel (Chairman) (co-opted member)

R J Baty

C I J H Drummond

Nomination

K G Harvey (Chairman)

Sir Geoffrey H Chipperfield

A T Fletcher

Remuneration

A T Fletcher (Chairman)

Sir Geoffrey H Chipperfield

Ms K M H Mortimer

Compliance

K D Woodier (Chairman)

R J Baty

C I J H Drummond

K L Hill

J Ostle

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

The Causeway, Worthing, West Sussex BN99 6DA

Report on remuneration policy and remuneration

Fennan Group Plc 2003

This report is made in compliance with Section B of the Best Practice Provisions on Directors' Remuneration, annexed to the Listing Rules of the UK Listing Authority.

Remuneration policy

The policy of the Group continues to be to provide 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. In conjunction with its remuneration consultants, Meis, the Remuneration Committee ('the Committee') has undertaken a review of the remuneration policy for Executive Directors and senior management. The Committee believed that, having regard to changing market practice, there was a need to address the balance between fixed and variable remuneration and to ensure that there was a sufficient retention element within the package. In addition, the Committee wished to further align the interests of the executives with those of shareholders by linking incentives to increasing shareholder returns.

In order to address these issues, two changes to the remuneration package have been approved by the Board on the recommendation of the Committee. From 2002 onwards, there will be an increase in the maximum potential bonus as noted in the section on performance related bonus below. It is also proposed to introduce a share option scheme for which shareholder approval will be sought at the Annual General Meeting. It is intended that, in the normal course, the scheme should be operated in any given year as an alternative to the existing restricted share plan. Details of the scheme are contained in the notes accompanying the Notice of Meeting.

Executive Directors

The remuneration package of the Executive Directors comprises:

i Salary and benefits – these are based on surveys conducted by its remuneration consultants and reviewed annually by the Committee.

ii Performance related bonus – annual performance related bonuses are awarded in accordance with an incentive bonus scheme for Executive Directors and 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. The average bonus paid to Executive Directors over the last three years has been 18% of salary. From 2002, the cash bonus payable up to a maximum of 40% of salary will be matched by an award of shares of an equivalent amount deferred for a period of three years.

iii Long-Term Incentive Plan – a restricted share plan for Executive Directors, 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. In addition, the Committee requires participants in the Plan to provide a matching investment in shares of the Company by way of shares they already hold or which they purchase. The basis of matching for Executive Directors in each award made between 1997 and 2000 has been one share for every four shares awarded. The eventual number of shares, if any, which participants may receive is

Executive Directors *continued*

dependent upon the achievement of the performance conditions of the Plan over a three year period. For the 1997 and 1998 awards these were:

- (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'.

As the above performance criteria were not met in respect of the 1997 awards, no shares vested and it is anticipated that a similar situation will apply to the 1998 awards.

For the 1999 and 2000 awards the performance condition was:

the total shareholder return achieved by the Company in the performance period must be greater than that of the company at or nearest to (but not above) the 50th percentile position of the comparator group.

A condition relating to the Company's earnings per share was not applied in 1999 or 2000 because the Committee had regard to the impact of the Final Determination by the Director General of Water Services in respect of price limits for South West Water Limited and current market practice.

The ranked performance of the Company, as described above in the conditions relating to total shareholder return, will determine the proportion of the awards (if any) to which participants will be entitled.

iv Provision for pension – Executive Directors participate in the Pennon Group 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 arrangement receive payments equivalent to the tax liability which arises in respect of Company contributions to the Supplementary Pension Scheme.

The pensionable pay for Executive Directors consists of the highest basic salary in any consecutive twelve month period of service within five years of retirement. Bonuses 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; and

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

Report on remuneration policy and remuneration

Pannon Group Plc 2001

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 2001 £000	Total 2000 £000
Non-executive Chairman						
K G Harvey	118	–	16	–	134	132
Executive Directors						
R J Baty	143	40	14	–	197	160
C I J H Drummond	143	25	14	29	211	181
K L Hill	149	40	14	12	215	192
Non-executive Directors						
Sir Geoffrey H Chipperfield	30	–	–	–	30	25
A T Fletcher	40	–	–	–	40	40
Ms K M H Mortimer	22	–	–	–	22	–
B A O Hewett (retired 29 July 1999)	–	–	–	–	–	12
S M Yassukovich (retired 31 March 2000)	–	–	–	–	–	27
	645	105	58	41	849	769

Other emoluments include car benefit and health cover.

The remuneration of Non-executive Directors is determined by the Board taking account of independent surveys of comparable appointments by remuneration consultants, the Monks Partnership. 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 2000/01 are shown in the table below:

	Increase in accrued pension during 2001 (net of inflation)	Increase in transfer value (net of inflation)	Accrued pension entitlement at 31 March 2001
	<i>a</i> £000	<i>b</i> £000	<i>c</i> £000
R J Baty	2	22	96
C I J H Drummond	9	113	32
K L Hill	2	33	95

Column *a* above is the increase in accrued pension during 2000/01 (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 accrued pension totals.

Directors have the option to pay additional voluntary contributions; neither the contributions nor the resulting benefits are included in the table shown on the previous page.

Directors' share interests:

(a) Shareholdings

The number of shares of the Company in which Directors held beneficial interests at 31 March 2001 and 31 March 2000 (or date of appointment if later) were:

	2001	2000		2001	2000
R J Baty	23,132	16,189	K G Harvey	2,350	3,180
Sir Geoffrey H Chipperfield	2,500	2,500	K L Hill	22,246	19,017
C I J H Drummond	12,516	8,076	Ms K M H Mortimer	-	-
A T Fletcher	1,424	1,321			

Messrs R J Baty and C I J H Drummond acquired an additional 58 and 38 shares respectively on 6 April 2001 as a result of reinvestment of dividends in a Personal Equity Plan.

As a result of participation in the Company's Dividend Reinvestment Plan, Directors acquired additional shares on 6 April 2001 as follows:

R J Baty	912	K G Harvey	45
C I J H Drummond	899	K L Hill	1,062
A T Fletcher	28		

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, at 31 March 2001, the following Directors had a contingent interest in the number of shares shown, 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 performance criteria were met:

	Date of conditional award:	September 1998	September 1999	September 2000	2001 Total	2000 Total
R J Baty		9,558	10,314	17,954	37,826	27,821
C I J H Drummond		9,558	10,314	17,954	37,826	27,821
K L Hill		9,852	10,683	18,612	39,147	29,067

On the basis of the financial results for the year ended 31 March 2001, it is not anticipated that any of the shares under the 1998 awards will vest, as the performance criteria have not been met.

Report on remuneration policy and remuneration

Pennon Group Plc 2001

(c) Executive Share Option Scheme

No options have been granted under the Executive Share Option Scheme since 1995 and, following the exercise of their outstanding options in May 1999, no Director now holds any options under the Scheme.

(d) Sharesave Scheme

Options to subscribe for shares of the Company under the Sharesave Scheme as at 31 March 2001 and 31 March 2000 were:

Grant date	1997	2000	2001	2000
Subscription price	556p	461p	Total	Total
R J Baty	–	1,260	1,260	3,475
C I J H Drummond	–	2,101	2,101	1,753
K L Hill	1,241	1,260	2,501	2,576

On 3 April 2000, Mr R J Baty exercised options under the Scheme in respect of 2,774 shares at an exercise price of 373p per share. At that date, the market price of the shares was 473p per share.

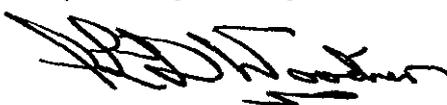
Messrs R J Baty and C I J H Drummond also exercised options under the Scheme on 1 September 2000 over 701 and 1,753 shares respectively at an option price of 556p per share. At that date, the market price of the shares was 617p per share.

Options over 1,335 shares at an exercise price of 775p per share granted to Mr K L Hill in 1998 lapsed during the year.

The exercise dates of the above options are shown in note 23 to the financial statements.

(e) Share price

The market price of the Company's shares at 31 March 2001 was 599p (2000 465p) and the range during the year to that date was 465p to 755p (2000 370p to 1,126.5p).



By Order of the Board

K D WOODIER, Company Secretary | 21 June 2001

Corporate governance — statement of compliance

Pennon Group Plc 2001

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 UK Listing Authority Rules are applied by the Company in practice. Throughout the year, the Company has complied with the provisions of the Combined Code.

Board of Directors

The Board of Directors currently comprises three Executive Directors and four Non-executive Directors. Ms K M H Mortimer was appointed a Non-executive Director on 1 May 2000. The Non-executive Directors are regarded as independent and Sir Geoffrey Chipperfield is the appointed senior Non-executive Director. The biographies on page 17 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. 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, risk management 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, Mr A T Fletcher and Ms K M H Mortimer 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. 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 Ms K M H Mortimer. 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 18 to 22.

Nomination Committee

The Nomination Committee is chaired by Mr K G Harvey and also comprises Sir Geoffrey Chipperfield and Mr A T Fletcher. It meets as and when required to select and recommend to the Board suitable candidates for appointment as Executive and Non-executive Directors. Consultants are used in the recruitment process.

Corporate governance – statement of compliance

Parsons Group Plc 2001

Environment Committee

The Environment Committee is chaired by Mr B A O Hewett (a co-opted member of the Committee and former Non-executive Director of the Company) 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.

Compliance Committee

The Compliance Committee is chaired by the Company Secretary, Mr K D Woodier and comprises all of the Executive Directors and the Head of Personnel. It meets five times a year and is responsible for reviewing the systems to manage risk and the effectiveness of the Group's internal control procedures including financial, operational and compliance controls.

Internal control

The Board has overall responsibility for the Group's systems of internal controls and for reviewing their effectiveness. These systems are designed to manage rather than to eliminate the risk of failure to achieve business objectives and, as is the case with any such systems, can only provide reasonable and not absolute assurance against material misstatement or loss.

Throughout the year and during the period prior to signature of this statement on 21 June 2001, the Board has operated procedures meeting the requirements of the Combined Code relating to internal control as set out in the guidance 'Internal Control : Guidance for Directors on the Combined Code' issued in September 1999. As part of these procedures the Board has formalised a risk management policy which provides for the identification of key risks in relation to the achievement of the business objectives of the Group. The Board and the Audit and Compliance Committees review internal control and risk management policies regularly to ensure that they are appropriate to the needs of the Group and with a view to achieving best practice in this area.

Prior to the commencement of the year under review, a full risk and control assessment was undertaken by the management of each business to identify financial and non-financial risks. Since April 2000, each business unit management committee has received as part of its regular management reports an enhanced and focused assessment of key risks against corporate objectives. The Board and the Compliance Committee receive regular reports throughout the year on key risk areas. Specifically, as part of the risk management policy, all senior managers are required to certify on an annual basis that they have established effective controls to manage risks and to operate in compliance with legislation and Group procedures. As part of the strategic planning process, the Board reviews corporate objectives and the key risks to the achievement of those objectives. All of these processes serve to ensure that a culture of effective control and risk management is embedded within the organisation and that the Group is in a position to react appropriately to new risks as they arise.

Internal financial control is achieved through a framework which comprises:

- (a) 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 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; 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. It is supported in this role by the Group's Internal Audit department which conducts reviews of financial systems, business unit operations and compliance with Group policies.

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 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

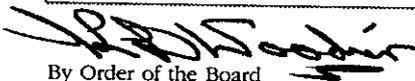
K D WOODIER, Company Secretary | 21 June 2001

Report of the Directors

Pennon Group Plc 2001

The information which is required to be included in the Directors' Report can be found on the following pages:

Charitable donations (Note: No political donations were made)	11
Directors	17, 18, 20
Employment policies	8
Financial results and dividend	12, 13, 14
Future developments	2
Policy on payments to suppliers	16
Principal activities	Inside front cover
Principal subsidiaries	56
Research and development	7, 38
Substantial shareholdings	63



By Order of the Board

K D WOODIER, Company Secretary | 21 June 2001

Report by the auditors on the financial statements

Pennon Group Plc 2001

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 18 to 22 relating to the remuneration of the Directors specified for our review by the Financial Services Authority) which have been prepared under the historical cost convention and the accounting policies set out on pages 31 to 35.

Respective responsibilities of Directors and auditors

The Directors are responsible for preparing the Annual Report. As described on page 25, this includes responsibility for preparing the financial statements, in accordance with applicable United Kingdom accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority 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 United Kingdom Companies Act. We also report to you if, in our opinion, the Directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding Directors' remuneration and transactions 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 23 to 25 reflects the Company's compliance with the seven provisions of the Combined Code specified for our review by the Financial Services Authority and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the Company's or Group's corporate governance procedures or its risk and control procedures.

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 Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the 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 2001 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.

Price Waterhouse Coopers

PRICEWATERHOUSECOOPERS, Chartered Accountants and Registered Auditors
Bristol | 21 June 2001

Group profit and loss account

Fannon Group Plc 2001

for the year ended 31 March 2001

	Notes	2001 £m	2000 Restated (note 4) £m
Turnover			
Continuing operations		412.1	427.6
Discontinued operation		23.0	39.4
Total turnover	2	435.1	467.0
Operating costs	3	(307.0)	(299.9)
Group operating profit			
Continuing operations		127.6	165.5
Discontinued operation		0.5	1.6
Total Group operating profit	2	128.1	167.1
Share of operating loss in associate		(0.4)	(0.4)
Total operating profit		127.7	166.7
Loss on disposal of discontinued operation	4	(2.1)	-
Net interest payable	5	(51.4)	(45.1)
Profit on ordinary activities before taxation	2	74.2	121.6
Tax on profit on ordinary activities	6	-	(5.0)
Profit on ordinary activities after taxation		74.2	116.6
Dividends	8	(49.4)	(65.1)
Retained profit transferred to reserves	24	24.8	51.5
Earnings per share			
	9		
Before exceptional item:			
Basic earnings per share		56.0p	85.8p
Diluted earnings per share		55.9p	85.4p
After exceptional item:			
Basic earnings per share		54.4p	85.8p
Diluted earnings per share		54.3p	85.4p
Dividend per share	8	36.0p	47.8p

Statement of total recognised gains and losses

for the year ended 31 March 2001

	Notes	2001 £m	2000 £m
Profit on ordinary activities after taxation		74.2	116.6
Currency retranslation differences on foreign currency net investments	24	0.2	(1.1)
Total gains and losses recognised for the year		74.4	115.5

There were no recognised gains or losses for the Company, other than profit for the year, in 2001 or 2000.
The notes on pages 31 to 61 form part of these financial statements.

Balance sheets

Pennon Group Plc 2001

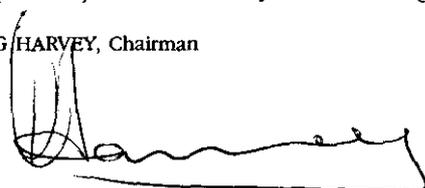
at 31 March 2001

	Notes	Group		Company	
		2001 £m	2000 £m	2001 £m	2000 £m
Fixed assets					
Intangible assets	12	24.7	23.3	-	-
Tangible assets	13	1,798.5	1,711.2	0.3	0.3
Investments	14	3.1	2.1	744.5	748.7
		1,826.3	1,736.6	744.8	749.0
Current assets					
Stocks	15	13.9	15.1	-	-
Debtors: amounts falling due after more than one year	16	7.1	8.4	161.8	162.5
Debtors: amounts falling due within one year	17	82.2	100.1	35.1	14.8
Investments	18	61.4	35.5	-	-
Cash at bank and in hand		3.7	3.8	-	-
		168.3	162.9	196.9	177.3
Current liabilities					
Creditors: amounts falling due within one year	19	(217.3)	(217.5)	(111.2)	(116.9)
Net current (liabilities)/assets		(49.0)	(54.6)	85.7	60.4
Total assets less current liabilities					
		1,777.3	1,682.0	830.5	809.4
Current liabilities					
Creditors: amounts falling due after more than one year	20	(727.9)	(664.5)	(268.7)	(272.9)
Provisions for liabilities and charges	21	(22.8)	(24.3)	-	-
Deferred income	22	(49.0)	(49.9)	-	-
Net assets	2	977.6	943.3	561.8	536.5
Capital and reserves					
Called-up share capital	23	136.9	136.3	136.9	136.3
Share premium account	24	151.3	148.6	151.3	148.6
Other reserves	24	-	-	-	3.1
Profit and loss account	24	689.4	658.4	273.6	248.5
Shareholders' funds	25	977.6	943.3	561.8	536.5

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

Approved by the Board on 21 June 2001 and signed on its behalf by:

K G HARVEY, Chairman



Group cash flow statement

Pennon Group Plc 2001

for the year ended 31 March 2001

	Notes	2001 £m	2000 £m
<i>Cash inflow from operating activities</i>	32a	205.0	216.3
<i>Returns on investments and servicing of finance</i>	32b	(39.9)	(10.1)
<i>Taxation</i>		(0.3)	(15.9)
<i>Capital expenditure and financial investment</i>	32b	(153.2)	(140.6)
<i>Acquisitions and disposals</i>	32b	12.0	0.5
<i>Equity dividends paid</i>		(65.3)	(48.7)
<hr/>			
Cash (outflow)/inflow before use of liquid resources and financing		(41.7)	1.5
<i>Management of liquid resources</i>	32b	(25.2)	20.8
<i>financing</i>	32b	65.6	(27.4)
<hr/>			
<i>Decrease in cash in year</i>		(1.3)	(5.1)

Notes to the financial statements

Ferron Group Plc 2001

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 Financial Services Authority 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 1h 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 2001, 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 Intangible fixed assets and amortisation

i 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 subsidiary or associated undertaking is sold the profit or loss on disposal is determined after including the attributable amount of unamortised goodwill or the goodwill previously written off to Group reserves.

Notes to the financial statements

Parsons Group Plc 2001

1. Accounting policies *continued*

e Intangible fixed assets and amortisation continued

ii Licences

Expenditure on licences acquired is included at cost and is amortised evenly over its useful economic life.

f 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.

ii Landfill sites

Landfill sites are included at cost less accumulation 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 shown opposite.

1. Accounting policies *continued*

f Tangible fixed assets and depreciation *continued*

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.

g 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.

b 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.

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,

Notes to the financial statements

Pennon Group Plc 2001

l. Accounting policies continued

b Grants and contributions continued

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 13.

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

i 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.

j Stocks

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

k 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.

l Research and development expenditure

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

1. Accounting policies *continued*

m 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.

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.

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.

Notes to the financial statements

Pennon Group Plc 2001

2 Segmental analysis

By class of business

	Turnover		Group operating profit		Profit before tax	
	2001 £m	2000 £m	2001 £m	2000 £m	2001 £m	2000 £m
Water and sewerage business	251.4	281.4	107.3	146.8	67.0	108.0
Less: Intra-group trading	(1.2)	(1.2)	–	–	–	–
	250.2	280.2	107.3	146.8	67.0	108.0
Non-regulated businesses:						
Viridor businesses:						
Waste management	106.1	100.6	13.1	15.2	11.7	14.0
Instrumentation	54.9	49.6	4.8	2.9	4.9	2.9
Construction services	37.1	56.0	0.5	1.6	0.4	1.4
Property and other	5.7	0.7	2.4	0.1	2.5	0.2
Total Viridor	203.8	206.9	20.8	19.8	19.5	18.5
Other non-regulated businesses	6.1	6.8	–	0.5	(10.2)	(4.9)
Less: Intra-group trading	(25.0)	(26.9)	–	–	–	–
Before exceptional item	184.9	186.8	20.8	20.3	9.3	13.6
Exceptional item:						
Discontinued operation disposal loss	–	–	–	–	(2.1)	–
After exceptional item	184.9	186.8	20.8	20.3	7.2	13.6
Group totals	435.1	467.0	128.1	167.1	74.2	121.6

	Net assets		Employees (average number)	
	2001 £m	2000 £m	2001	2000
Water and sewerage business	1,007.0	1,000.4	1,537	1,638
Non-regulated businesses:				
Viridor businesses:				
Waste management	85.9	90.4	453	438
Instrumentation	49.6	48.3	495	556
Construction services	–	5.4	617	837
Property and other	3.2	2.8	4	4
Total Viridor	138.7	146.9	1,569	1,835
Other non-regulated businesses	(161.5)	(197.2)	51	53
Total non-regulated businesses	(22.8)	(50.3)	1,620	1,888
Intra-group trading	(6.6)	(6.8)	–	–
Group totals	977.6	943.3	3,157	3,526

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		Group operating profit	
	2001 £m	2000 £m	2001 £m	2000 £m
United Kingdom	388.4	428.8	122.7	163.4
Continental Europe	18.6	14.1	1.6	0.5
Americas	28.1	24.1	3.8	3.2
	435.1	467.0	128.1	167.1

By geographical destination

	Turnover		Group operating profit	
	2001 £m	2000 £m	2001 £m	2000 £m
United Kingdom	383.5	423.4	123.5	164.1
Continental Europe	7.6	6.9	0.3	(0.2)
Americas	32.3	26.7	3.9	3.3
Other	11.7	10.0	0.4	(0.1)
	435.1	467.0	128.1	167.1

Intra-group trading 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 382 working outside the United Kingdom (2000 403).

The construction services segment, which substantially operated in the United Kingdom, was discontinued during the year (note 4). Intra-group turnover by this discontinued operation to the date of disposal was £14.1 million (2000 £16.6 million).

Notes to the financial statements

Pennon Group Plc 2001

3. Operating costs

	Continuing operations £m	Discontinued operation £m	Total 2001 £m	Continuing operations £m	Discontinued operation £m	Total 2000 £m
Manpower costs (note 10)	56.5	7.4	63.9	57.3	12.9	70.2
Raw materials and consumables	40.0	4.9	44.9	31.3	7.8	39.1
Rentals under operating leases:						
Hire of plant and machinery	3.6	0.2	3.8	3.5	0.2	3.7
Other operating leases	2.0	–	2.0	2.1	–	2.1
Research and development expenditure	3.3	–	3.3	4.1	–	4.1
Auditors' remuneration	0.4	–	0.4	0.4	–	0.4
Other external charges	45.1	8.5	53.6	44.4	14.8	59.2
Amortisation of intangible fixed assets	1.4	–	1.4	1.2	–	1.2
Depreciation:						
On owned assets	53.0	0.6	53.6	43.2	1.0	44.2
On assets held under finance leases	11.8	0.3	12.1	12.6	0.5	13.1
On assets held under defeased finance leases	4.7	–	4.7	3.6	–	3.6
Profit on disposal of tangible fixed assets	(0.7)	–	(0.7)	(0.5)	(0.2)	(0.7)
Deferred income released to profits	(1.2)	–	(1.2)	(1.2)	–	(1.2)
Other operating charges	64.6	0.6	65.2	60.1	0.8	60.9
	284.5	22.5	307.0	262.1	37.8	299.9

Fees payable to the Company's auditors for non-audit work, mainly in connection with taxation advice, amounted to £0.2 million (2000 £0.2 million).

4. Loss on disposal of discontinued operation

	2001 £m	2000 £m
Loss on disposal of discontinued operation	2.1	–

The loss on the disposal of the discontinued operation relates to the sale of the Company's interest in the ordinary share capital of T J Brent Limited and its Copa Products division, which had comprised the Group's construction services segment. The loss on disposal, which is an exceptional item reported after operating profit, is after charging £6.6 million of goodwill previously written off to reserves on acquisition. An analysis of net assets sold is shown in note 32f. The tax charge was not affected by the business disposal loss.

The results of T J Brent Limited, and its Copa Products division, up to the disposal date are shown as a discontinued operation. The comparatives in the profit and loss account have similarly been restated.

5. Net interest payable

	2001 £m	2000 £m
Interest payable:		
Bank loans and overdrafts	(16.9)	(17.5)
Other loans	(16.9)	(17.0)
Interest element of finance lease rentals	(20.1)	(14.9)
Other finance costs	(2.3)	(0.3)
	(56.2)	(49.7)
Interest receivable:		
Listed redeemable securities	0.6	0.6
Other investments (as defined in note 18)	4.2	4.2
	4.8	4.8
Unwinding of discount in provisions	(0.6)	(0.6)
Gain on defeasance of finance leases	0.6	0.4
Net interest payable	(51.4)	(45.1)

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 £144.9 million at 31 March 2001 (2000 £145.9 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 £0.6 million (2000 £0.4 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 as follows:

	2001 £m	2000 £m
Gain on defeasance of finance leases	1.0	0.5
Less: Deferred income (note 22)	(0.4)	(0.1)
	0.6	0.4

Notes to the financial statements

Pennon Group Plc 2001

6. Tax on profit on ordinary activities

	2001 £m	2000 £m
United Kingdom taxation:		
Corporation tax at 30%:		
Prior year	-	14.8
Advance corporation tax:		
Previous year utilisation	-	(10.5)
Overseas taxation	-	0.7
	-	5.0

No provision for deferred taxation has been made (note 21).

The corporation tax charge for 2001 benefits from actions in 2000 and 1999 to utilise all the advance corporation tax charged against profits in previous years.

7. Profit of parent company

	2001 £m	2000 £m
Profit on ordinary activities after taxation dealt with in the accounts of the parent company	72.0	74.6

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

8. Dividends

	2001 £m	2000 £m
Interim dividend of 11.6p (2000 15.4p) per share paid 6 April 2001	15.9	21.0
Proposed final dividend of 24.4p (2000 32.4p) per share payable 1 October 2001	33.5	44.1
	49.4	65.1

9. Earnings per share

	Profit after tax £m	2001 Earnings per share		Profit after tax £m	2000 Earnings per share	
		Basic p	Diluted p		Basic p	Diluted p
Before exceptional item	76.3	56.0	55.9	116.6	85.8	85.4
Exceptional item:						
Discontinued operation disposal loss	(2.1)	(1.6)	(1.6)	-	-	-
After exceptional item	74.2	54.4	54.3	116.6	85.8	85.4

Earnings per share before the exceptional item in 2001 have been calculated to show the impact of that item on the results, as exceptional items 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 136.3 million (2000 135.9 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 136.6 million (2000 136.5 million).

10. Employees and employment costs

The average number of persons (including Directors) employed by the Group was 3,157 (2000 3,526), including 617 for the discontinued operation (2000 837).

Employment costs comprise:	Continuing operations £m	Discontinued operation £m	Total 2001 £m	Continuing operations £m	Discontinued operation £m	Total 2000 £m
Wages and salaries	60.1	10.5	70.6	60.3	15.8	76.1
Social security costs	5.8	0.9	6.7	5.9	1.4	7.3
Pension costs (note 30)	1.6	-	1.6	1.4	-	1.4
Total employment costs	67.5	11.4	78.9	67.6	17.2	84.8
Charged as follows:						
Manpower costs (note 3)	56.5	7.4	63.9	57.3	12.9	70.2
Research and development expenditure	2.7	-	2.7	2.3	-	2.3
Restructuring provision	1.2	-	1.2	1.7	-	1.7
Capital schemes	7.1	4.0	11.1	6.3	4.3	10.6
	67.5	11.4	78.9	67.6	17.2	84.8

Notes to the financial statements

Pennon Group Plc 2001

11. Directors' emoluments

	2001 £000	2000 £000
Executive Directors:		
Salary	435	425
Performance bonus	105	37
Other emoluments	42	39
Payments in respect of tax liability from supplementary pension arrangements	41	32
Non-executive Directors	226	236
Total emoluments	849	769

The emoluments of the highest paid Director, including gains on the exercise of share options, were £215,000 (2000 £436,000).

Total gains made by Directors on the exercise of share options were £4,000 (2000 £601,000).

Total emoluments include £263,000 (2000 £219,000) payable to Directors for services as directors of subsidiary undertakings.

At 31 March 2001 and 31 March 2000 retirement benefits were accruing to three Directors under defined benefit pension schemes. The accrued pension entitlement at 31 March 2001 under defined benefit schemes of the highest paid Director was £95,000 (2000 £91,000). No pension contributions were payable to defined contribution schemes in 2001 or 2000.

More detailed information concerning Directors' emoluments, shareholdings and share options is shown in the report on remuneration policy and remuneration on pages 18 to 22.

12. Intangible fixed assets

	Goodwill £m	Licences £m	Group Total 2001 £m
Cost:			
At 1 April 2000	25.0	–	25.0
Additions	–	1.0	1.0
Currency retranslation	1.8	–	1.8
At 31 March 2001	26.8	1.0	27.8
Amortisation:			
At 1 April 2000	1.7	–	1.7
Charge for year	1.3	0.1	1.4
At 31 March 2001	3.0	0.1	3.1
Net book value:			
At 31 March 2001	23.8	0.9	24.7
At 31 March 2000	23.3	–	23.3

Intangible fixed assets are amortised evenly over their useful economic life. For goodwill this is twenty years and for licences five years.

13. 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 2001 £m	Company Total 2001 £m
Cost:							
At 1 April 2000	142.0	842.8	465.0	622.5	70.1	2,142.4	0.4
Arising on acquisition	0.9	–	–	–	–	0.9	–
Additions	7.5	48.8	12.0	33.8	64.4	166.5	0.1
Grants and contributions	–	(1.8)	–	–	–	(1.8)	–
Business disposal	(1.2)	–	–	(9.2)	–	(10.4)	–
Disposals	(2.7)	(0.6)	(20.2)	(37.4)	–	(60.9)	(0.1)
Transfers	1.2	2.9	17.0	17.0	(38.1)	–	–
Currency retranslation	0.4	–	–	0.5	–	0.9	–
At 31 March 2001	148.1	892.1	473.8	627.2	96.4	2,237.6	0.4
Depreciation:							
At 1 April 2000	36.9	75.5	100.4	218.4	–	431.2	0.1
Charge for year	10.4	12.9	9.1	39.7	–	72.1	0.1
Business disposal	(0.3)	–	–	(6.7)	–	(7.0)	–
Disposals	(0.7)	(0.6)	(20.2)	(36.1)	–	(57.6)	(0.1)
Currency retranslation	–	–	–	0.4	–	0.4	–
At 31 March 2001	46.3	87.8	89.3	215.7	–	439.1	0.1
Net book value:							
At 31 March 2001	101.8	804.3	384.5	411.5	96.4	1,798.5	0.3
At 31 March 2000	105.1	767.3	364.6	404.1	70.1	1,711.2	0.3
Assets held under finance leases included above:							
Cost: At 31 March 2001	–	11.8	226.9	143.7	11.1	393.5	–
Depreciation: Charge for year	–	0.1	3.6	8.4	–	12.1	–
Depreciation: At 31 March 2001	–	0.1	23.1	64.9	–	88.1	–
Assets held under defeased finance leases included above:							
Cost: At 31 March 2001	–	77.6	69.9	32.5	–	180.0	–
Depreciation: Charge for year	–	1.2	1.2	2.3	–	4.7	–
Depreciation: At 31 March 2001	–	3.3	4.0	6.5	–	13.8	–

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

Notes to the financial statements

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13. Tangible fixed assets *continued*

The cost of land and buildings and of operational properties includes non-depreciable land of £2.4 million (2000 £1.7 million) and £9.3 million (2000 £8.9 million) respectively.

The net book value of land and buildings comprises:

	2001 £m	2000 £m
Freehold	62.0	62.8
Long leasehold	0.8	0.8
Short leasehold	39.0	41.5
	101.8	105.1

The net book value of infrastructure assets is stated after deducting £44.3 million (2000 £42.5 million) grants and contributions.

The net book value of infrastructure assets includes £5.9 million (2000 £4.0 million) for the accumulated difference between expenditure on maintaining operating capacity and depreciation charges. Expenditure in the year was £14.8 million (2000 £8.7 million).

Disposals during the year include the impact of a data cleansing review of tangible fixed assets records which was undertaken in connection with the introduction of a new computer system in the water and sewerage business. This resulted in the identification of a number of fully written down assets which were no longer in use.

Out of the total depreciation charge for the Group of £72.1 million (2000 £62.6 million), the sum of £1.7 million (2000 £1.7 million) has been charged to capital projects and £70.4 million (2000 £60.9 million) against profits.

14. Fixed asset investments

	Subsidiary undertakings £m	Own shares £m	Other investments £m	Total investments 2001 £m
Group				
Cost:				
At 1 April 2000	—	1.5	0.6	2.1
Additions	—	0.6	0.5	1.1
Provision for impairment	—	(0.1)	—	(0.1)
At 31 March 2001	—	2.0	1.1	3.1
Company				
Cost:				
At 1 April 2000	748.2	0.5	—	748.7
Additions	7.6	0.4	0.5	8.5
Disposals	(12.7)	—	—	(12.7)
At 31 March 2001	743.1	0.9	0.5	744.5

All investments are in shares except other investments for the Group which includes £0.6 million loans at 31 March 2001 and 2000.

The transactions by the Company during the year in subsidiary undertakings primarily arose from the disposal of the construction services segment.

14. Fixed asset investments *continued*

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 18 to 22.

During the year the trustees of the Employee Share Ownership Plan purchased 78,000 of the Company's ordinary shares (2000 139,000) financed through non-interest bearing advances made by sponsoring Group companies. The market value of the 471,000 shares held as Group investments at 31 March 2001 was £2.8 million (2000 £1.8 million). 174,000 of those shares (2000 131,000) held as Company investments had a market value of £1.0 million at 31 March 2001 (2000 £0.6 million). The costs of the incentive scheme are recognised as a provision for impairment and 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 29.

15. Stocks

	Group		Company	
	2001 £m	2000 £m	2001 £m	2000 £m
Raw materials and consumables	7.8	7.2	–	–
Work in progress	0.6	3.6	–	–
Finished goods	5.5	4.3	–	–
	13.9	15.1	–	–

16. Debtors: amounts falling due after more than one year

	Group		Company	
	2001 £m	2000 £m	2001 £m	2000 £m
Amounts owed by subsidiary undertakings	–	–	160.6	161.2
Other debtors	1.1	1.2	1.1	1.1
Prepayments for pension costs	6.0	7.2	0.1	0.2
	7.1	8.4	161.8	162.5

17. Debtors: amounts falling due within one year

	Group		Company	
	2001 £m	2000 £m	2001 £m	2000 £m
Trade debtors	55.5	70.6	–	–
Amounts owed by subsidiary undertakings	–	–	34.7	14.0
Other debtors	6.7	5.7	0.2	0.2
Prepayments for pension costs	1.8	1.6	0.1	0.1
Other prepayments and accrued income	16.9	20.7	0.1	0.5
Tax recoverable	1.3	1.5	–	–
	82.2	100.1	35.1	14.8

Notes to the financial statements

Pannan Group Plc 2001

18 Current asset investments

	Group		Company	
	2001 £m	2000 £m	2001 £m	2000 £m
Listed investments	7.1	9.3	–	–
Other investments:				
Overnight deposits	0.6	0.1	–	–
Other	53.7	26.1	–	–
	54.3	26.2	–	–
	61.4	35.5	–	–

At 31 March 2001 the market value of listed investments was £7.2 million (2000 £9.3 million).

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

19 Creditors: amounts falling due within one year

	Group		Company	
	2001 £m	2000 £m	2001 £m	2000 £m
Loans:				
Bank loans and overdrafts	3.9	2.4	24.0	15.4
Short-term loans	10.0	0.8	10.0	–
European Investment Bank loans	12.1	11.4	–	–
Unsecured loan stock notes	16.4	17.8	16.4	17.8
	42.4	32.4	50.4	33.2
Obligations under finance leases	13.2	9.7	–	–
Trade creditors	62.0	54.6	0.2	0.3
Amounts owed to subsidiary undertakings	–	–	3.6	10.7
Other creditors	17.2	15.2	6.6	6.8
Corporation tax	2.0	1.7	–	–
Foreign tax	0.9	1.6	–	–
Other taxation and social security	11.8	13.8	0.3	0.1
Accruals and deferred income	18.4	23.4	0.7	0.7
Interim dividend	15.9	21.0	15.9	21.0
Proposed final dividend	33.5	44.1	33.5	44.1
	217.3	217.5	111.2	116.9

20. Creditors: amounts falling due after more than one year

	Group		Company	
	2001 £m	2000 £m	2001 £m	2000 £m
Loans:				
Sterling bond	150.0	150.0	150.0	150.0
European Investment Bank loans	62.0	74.1	—	—
Other bank loans	110.1	120.1	110.0	120.0
	322.1	344.2	260.0	270.0
Obligations under finance leases	405.4	319.8	—	—
Amounts owed to subsidiary undertakings	—	—	8.7	2.9
Other creditors	0.4	0.5	—	—
	727.9	664.5	268.7	272.9

21. Provisions for liabilities and charges

	Environmental & landfill restoration £m	Restructuring £m	Other provisions £m	Group Total 2001 £m
At 1 April 2000	20.3	1.0	3.0	24.3
Arising in year	2.3	0.5	0.1	2.9
Released to profits	(0.6)	—	—	(0.6)
Utilised during year	(2.3)	(1.3)	(0.2)	(3.8)
At 31 March 2001	19.7	0.2	2.9	22.8

Environmental and landfill restoration provisions will be utilised over the period from 2002 to beyond 2050. 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, which are expected to be incurred in the next financial year. Other provisions include onerous operating lease commitments, which will unwind over the period to 2017, and £1.2 million for the decommissioning of an operational site in the water and sewerage business in 2004.

Deferred taxation

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

	Group	
	2001 £m	2000 £m
Tax effect of timing differences due to:		
Accelerated capital allowances	217.9	202.7
Other timing differences	4.7	7.3
Maximum potential liability	222.6	210.0

Notes to the financial statements

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22. Deferred income

	Finance lease variations (note 5) £m	Forward interest rate swaps (note 27) £m	Grants and contributions £m	Group Total 2001 £m	Finance lease variations (note 5) £m	Forward interest rate swaps (note 27) £m	Grants and contributions £m	Group Total 2000 £m
At 1 April:								
Amount to be released:								
After more than one year	7.5	18.2	24.2	49.9	7.4	–	24.7	32.1
Within one year	–	–	1.2	1.2	–	–	1.2	1.2
	7.5	18.2	25.4	51.1	7.4	–	25.9	33.3
Additions	0.4	–	–	0.4	0.1	18.2	0.7	19.0
Released to profits	–	–	(1.2)	(1.2)	–	–	(1.2)	(1.2)
At 31 March:								
Amount to be released:								
Within one year	–	–	(1.3)	(1.3)	–	–	(1.2)	(1.2)
After more than one year	7.9	18.2	22.9	49.0	7.5	18.2	24.2	49.9

23. Called-up share capital

	2001 £m	2000 £m
Authorised		
175,000,000 ordinary shares of £1 each	175.0	175.0
Allotted, called-up and fully paid		
136,948,508 ordinary shares of £1 each (2000 136,345,283)	136.9	136.3

	2001 Number	2000 Number
Ordinary shares allotted during the year		
For consideration of £0.8 million (2000 £0.8 million) under the Company's Executive Share Option Scheme to Directors and senior employees who exercised their options	153,300	176,600
For consideration of £2.5 million (2000 £1.0 million) to Pennon Trustee Limited on behalf of employees who exercised their options under the Company's Sharesave Scheme	449,925	100,106
	603,225	276,706

23. 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	
					2001	2000
Sharesave	2 July 1993	393p	–	1998 – 2000	–	34
	6 Jan 1995	373p	–	2000 – 2002	48	308
	8 July 1997	556p	–	2000 – 2004	242	530
	7 July 1998	775p	–	2001 – 2005	90	226
	6 July 1999	825p	–	2002 – 2006	81	219
	5 July 2000	461p	–	2003 – 2007	1,099	–
Executive	3 July 1992	418p	<i>a</i>	1995 – 2002	2	9
	5 July 1993	496p	<i>b</i>	1996 – 2003	4	45
	6 Jan 1995	503p	<i>c</i>	1998 – 2005	9	115
					1,575	1,486

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 2001 there were 1,391 participants in the Sharesave Scheme (2000 1,489) and 2 in the Executive Scheme (2000 24).

Options granted to Directors, included above, are shown in the report on remuneration policy and remuneration on pages 18 to 22.

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24. Reserves

	Group and Company share premium account £m	Other reserves		Profit and loss account	
		Group £m	Company £m	Group £m	Company £m
At 1 April 2000	148.6	-	3.1	658.4	248.5
Retained profit for year	-	-	-	24.8	22.6
Premium on shares issued	2.1	-	-	-	-
Adjustment for shares issued under the Sharesave Scheme through Employee Share Ownership Trust	0.6	-	-	(0.6)	(0.6)
Currency retranslation differences on foreign currency net investments	-	-	-	0.2	-
Goodwill written back on disposal	-	3.1	-	3.5	-
Other transfers	-	(3.1)	(3.1)	3.1	3.1
At 31 March 2001	151.3	-	-	689.4	273.6

Currency retranslation differences on foreign currency net investments is after a £1.2 million loss arising on a currency hedge (2000 £1.8 million gain).

The cumulative value of goodwill at 31 March 2001 resulting from acquisitions, which has been written off to reserves, is £166.8 million (2000 £173.4 million). Goodwill of £6.6 million was written back on the disposal of T J Brent Limited and the Copa Products division of that company (2000 nil).

The other reserves were established upon the acquisition of Copa Holdings Limited in 1992. Consequent upon the sale of the Copa Products business and the disposal loss which has been charged to profits, the other reserves have been transferred to the profit and loss accounts.

The Group and the Company have taken advantage of the exemption provided in Urgent Issues Task Force Abstract 17 not to recognise a cost arising from the award of discounted Company shares to employees under the Sharesave Scheme.

25. Statement of movements in shareholders' funds

	Group		Company	
	2001 £m	2000 £m	2001 £m	2000 £m
Profit on ordinary activities after taxation	74.2	116.6	72.0	74.6
Dividends	(49.4)	(65.1)	(49.4)	(65.1)
	24.8	51.5	22.6	9.5
Other recognised gains and losses for the year	0.2	(1.1)	-	-
Shares issued for cash consideration	3.3	1.8	3.3	1.8
Adjustment for shares issued under the Sharesave Scheme through Employee Share Ownership Trust	(0.6)	(0.6)	(0.6)	(0.6)
Goodwill written back on disposal	6.6	-	-	-
Shareholders' funds (equity interest):				
Addition for year	34.3	51.6	25.3	10.7
At 1 April	943.3	891.7	536.5	525.8
At 31 March	977.6	943.3	561.8	536.5

26. Loans and other borrowings

Loans

	Group		Company	
	2001 £m	2000 £m	2001 £m	2000 £m
Repayable:				
Over five years	156.6	171.2	150.0	150.0
Over two and up to five years	92.7	150.9	50.0	110.0
Over one and up to two years	72.8	22.1	60.0	10.0
Falling due after more than one year (note 20)	322.1	344.2	260.0	270.0
Falling due within one year (note 19)	42.4	32.4	50.4	33.2
	364.5	376.6	310.4	303.2

£0.9 million floating rate unsecured guaranteed loan stock notes, repayable at par in 2009 or on notice being given by the noteholders, were issued in December 2000 to satisfy contingent consideration payable in connection with the December 1997 acquisition of Terry Adams Limited (note 28).

Obligations under finance leases

	Group		Company	
	2001 £m	2000 £m	2001 £m	2000 £m
Repayable:				
Over five years	374.5	297.6	-	-
Over two and up to five years	12.2	11.4	-	-
Over one and up to two years	18.7	10.8	-	-
Falling due after more than one year (note 20)	405.4	319.8	-	-
Falling due within one year (note 19)	13.2	9.7	-	-
	418.6	329.5	-	-

Included above are accrued finance charges arising on obligations under finance leases totalling £63.5 million (2000 £53.2 million), of which £6.1 million (2000 £6.9 million) is repayable within one year.

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	
	2001 £m	2000 £m	2001 £m	2000 £m
Loans	172.5	235.5	150.0	150.0
Obligations under finance leases	416.1	322.3	-	-
	588.6	557.8	150.0	150.0

The rates of interest payable on loans and other borrowings, any part of which is due after five years, range between 5.2% and 11.3% (2000 5.7% and 11.3%), and are repayable over the period 2002 to 2030.

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26. Loans and other borrowings *continued*

Borrowing facilities

Undrawn committed borrowing facilities of £30.0 million were available to the Group at 31 March 2001 and 31 March 2000 expiring between two and five years. In addition, the Group has short-term uncommitted bank facilities of over £160 million.

27. Financial instruments

Disclosures on financial and treasury policies are also included in the financial review on pages 12 to 16.

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	
	2001 £m	2000 £m	2001 £m	2000 £m
Floating rate	61.7	36.0	(365.8)	(318.8)
Fixed rate	4.7	4.7	(417.3)	(387.3)
On which no interest is paid	0.9	0.4	(19.9)	(19.9)
	67.3	41.1	(803.0)	(726.0)
Which is included in:				
Net debt	65.1	39.3	(783.1)	(706.1)
Provisions for liabilities and charges	-	-	(1.7)	(1.7)
Deferred income	-	-	(18.2)	(18.2)
Other long-term monetary assets/(liabilities)	2.2	1.8	-	-
	67.3	41.1	(803.0)	(726.0)
Floating rate financial assets and liabilities are denominated in:				
Sterling	57.2	31.7	(321.0)	(281.0)
US dollar	2.8	2.8	(16.5)	(12.4)
Swiss franc	0.4	1.0	(28.3)	(25.4)
Other currencies	1.3	0.5	-	-
	61.7	36.0	(365.8)	(318.8)
Fixed rate financial assets and liabilities:				
Weighted average interest rate	6.5%	6.3%	8.3%	8.7%
Weighted average period for which rate is fixed	2.6 years	1.6 years	5.9 years	6.8 years
Range of interest rates	3.5% to 8.0%	3.5% to 8.0%	5.1% to 11.3%	5.4% to 11.3%
Financial assets and liabilities on which no interest is paid:				
Weighted average period until maturity	-	-	17.2 years	17.9 years

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

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.

27. Financial instruments *continued*

Interest rate and currency profile of financial assets and liabilities *continued*

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 2001 was 5.0% to 6.7% (2000 3.8% to 8.0%).

The maturity profile of floating rate and fixed rate financial liabilities is shown in note 26. Other financial liabilities fall due for payment principally after 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 2001 interest rate swaps to hedge financial liabilities, with a notional principal value of £200.0 million, existed with a weighted average maturity of 2.4 years (2000 £160.0 million, with 3.6 years) to swap from floating to fixed rate; and

at 31 March 2001 floating rate interest rate swaps, to hedge financial liabilities, with a notional principal value of £200.0 million, existed to swap LIBOR to European Inter Bank Offered Rate (EURIBOR) with commencement dates between 1 April 2006 and 1 April 2010 and maturing on 31 March 2030 (2000 £200.0 million). A settlement of £18.2 million, shown in note 22, was received when these swaps were entered into during December 1999.

Forward currency contracts are used to hedge the net investment in overseas subsidiaries. At 31 March 2001 forward currency sales of US dollar 22.0 million and Swiss franc 69.0 million existed for settlement in twelve months (2000 US dollar 18.5 million, and Swiss franc 65.0 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	Euro €m	Deutsche mark DM	Other £m	Total £m
Functional currency of Group operation:						
At 31 March 2001:						
Sterling	–	1.3	–	–	–	1.3
Swiss franc	0.7	0.3	0.9	0.8	0.4	3.1
	0.7	1.6	0.9	0.8	0.4	4.4
At 31 March 2000:						
Sterling	–	0.6	–	–	0.1	0.7
US dollar	(0.5)	–	–	–	–	(0.5)
Swiss franc	–	0.4	–	0.7	1.0	2.1
	(0.5)	1.0	–	0.7	1.1	2.3

Forward currency contracts which are used to hedge 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.

Notes to the financial statements

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27. Financial instruments continued

Fair values of financial assets and liabilities

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

	2001		2000	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Financial assets:				
Current asset investments	61.4	61.5	35.5	35.5
Cash at bank	3.7	3.7	3.8	3.8
Other	2.2	2.5	1.8	1.8
	67.3	67.7	41.1	41.1
Financial liabilities:				
Short-term debt	(42.4)	(42.6)	(32.4)	(32.5)
Long-term debt	(321.9)	(378.2)	(344.1)	(395.8)
Finance lease obligations	(418.6)	(418.6)	(329.5)	(329.5)
Other	(1.7)	(1.7)	(1.7)	(1.7)
	(784.6)	(841.1)	(707.7)	(759.5)
Derivative financial instruments (used to manage interest rate and currency profile):				
Interest rate swaps	(18.2)	(17.5)	(18.2)	(16.0)
Forward currency contracts	(0.2)	(0.3)	(0.1)	(0.5)
	(18.4)	(17.8)	(18.3)	(16.5)

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 as at 31 March or otherwise have been calculated by discounting cash flows at prevailing interest and exchange rates.

27. Financial instruments *continued*

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	2001 Total net gains £m	Gains £m	Losses £m	2000 Total net gains £m
Unrecognised gains and losses on hedges:						
At 1 April	2.9	(1.1)	1.8	–	(8.0)	(8.0)
Of which recognised in current year	0.8	(0.5)	0.3	–	(2.2)	(2.2)
	2.1	(0.6)	1.5	–	(5.8)	(5.8)
Arising and not recognised in current year	3.4	(4.3)	(0.9)	2.9	4.7	7.6
At 31 March	5.5	(4.9)	0.6	2.9	(1.1)	1.8
Expected to be recognised:						
In next year	0.8	(1.9)	(1.1)	0.8	(0.5)	0.3
Thereafter	4.7	(3.0)	1.7	2.1	(0.6)	1.5
	5.5	(4.9)	0.6	2.9	(1.1)	1.8

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

28. Acquisitions

The acquisition of Terry Adams Limited (now renamed Viridor Waste Exeter 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 £0.9 million of that contingent consideration was settled through the issue of loan stock notes (note 26). The contingent consideration matches the fair value of the tangible fixed asset acquired and the transaction was accounted for using the acquisition method.

During the year £1.4 million fair value acquisition accruals and provisions were utilised (2000 £2.3 million), £0.4 million were released (2000 £4.0 million), and at 31 March 2001 £10.4 million (2000 £12.2 million) were carried forward.

Notes to the financial statements

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29. Principal subsidiary and associated undertakings

Subsidiary undertakings:

		Country of incorporation, registration and principal operations
<i>Water and sewerage</i>	South West Water Limited*	England
<i>Waste management</i>	Viridor Waste Limited†	England
	Viridor Waste Disposal Limited	England
	VWM (Scotland) Limited	Scotland
	Viridor Waste Exeter Limited	England
	Dragon Waste Limited	England
	Viridor Waste Wootton Limited	England
	Viridor Waste Hampshire Limited	England
	Viridor Waste Management Limited	England
<i>Instrumentation</i>	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
	Orbisphere Laboratories Japan Inc	United States
	Orbisphere Laboratories Overseas Corporation	United States
	Orbisphere Management Holding SA	Switzerland
	Orbisphere Laboratories Neuchâtel SA	Switzerland
	Orbisphere Canada Inc	Canada
	Orbisphere France Sarl	France
	Orbisphere GmbH	Germany
	Orbisphere Laboratories Geneve SA	Switzerland
	Orbisphere South Africa (Pty) Limited	South Africa
	Orbisphere UK Limited	England
<i>Property</i>	Viridor Properties Limited†	England
<i>Insurance services</i>	Peninsula Insurance Limited*	Guernsey
<i>Other companies</i>	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 Viridor Waste Exeter Limited.

Associated undertakings:

		Share capital in issue	Percentage held
<i>Water and sewerage concessions</i>	Enviro-Logic Limited	2,000 A ordinary shares 2,000 B ordinary shares	100% -
	Albion Water Limited	1 ordinary share	100%

Shares in Enviro-Logic Limited were held directly by the Company. The share in Albion Water Limited was held by Enviro-Logic Limited.

30. Pensions

The Group operates a number of pension schemes. The assets of the Group's pension schemes are held in separate trustee administered funds. During the prior year the two main funded defined benefit schemes were merged.

The latest actuarial valuations of the two main schemes were as at 31 March 1998 prior to their merger. 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 both 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 merged scheme's two sections is 12.2% and 15.9% of pensionable earnings (2000 12.2% and 15.9%). The net pension charge for the year ended 31 March 2001 was £1.6 million (2000 £1.4 million) which benefits from the actuarial surpluses, after allowing for benefit improvements implemented on the merger of the two main pension schemes. Following the actuarial valuations, employer contributions to the two main schemes ceased until the actuarial review of the merged scheme (which will be as at 31 March 2001).

Pension prepayments included as debtors of the Group amount to £7.8 million (2000 £8.8 million), representing the accumulated difference between the Group pension cost and employer contributions paid.

31. Commitments and contingent liabilities

	Group		Company	
	2001 £m	2000 £m	2001 £m	2000 £m
Capital commitments				
Contracted but not provided	77.3	85.4	14.9	24.0
Commitments under operating leases				
Rentals during the year following the balance sheet date:				
Land and buildings leases expiring:				
Within one year	0.4	0.3	-	-
Between one and five years	1.1	1.0	-	-
After five years	3.0	3.1	-	-
Other leases expiring:				
Within one year	0.1	0.1	-	-
Between one and five years	0.1	0.5	-	-
	4.7	5.0	-	-
Contingent liabilities				
Contractors' claims on capital schemes	0.7	0.8	-	-
Guarantees	27.8	25.9	441.6	442.1
	28.5	26.7	441.6	442.1

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.

Notes to the financial statements

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20. Notes to the Group cash flow statement

a Reconciliation of Group operating profit to net cash inflow from operating activities

	2001 £m	2000 £m
Group operating profit	128.1	167.1
Depreciation charge	70.4	60.9
Amortisation of intangible fixed assets	1.4	1.2
Provision for impairment of fixed asset investments	0.1	1.1
Deferred income released to profits	(1.2)	(1.2)
Decrease in provisions for liabilities and charges	(2.1)	(4.0)
(Increase)/decrease in stocks	(0.3)	0.1
Decrease/(increase) in debtors (amounts falling due within and over one year)	8.7	(8.6)
Increase in creditors (amounts falling due within and over one year)	0.6	0.4
Profit on disposal of tangible fixed assets	(0.7)	(0.7)
Net cash inflow from operating activities	205.0	216.3

There was no cash flow in 2001 from operating activities accounted for as exceptional items (2000 £1.7 million cash outflow in respect of the utilisation of the restructuring provision).

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

	2001 £m	2000 £m
<i>i Returns on investments and servicing of finance</i>		
Interest received	4.8	4.8
Interest paid	(34.5)	(35.1)
Interest element of finance lease rentals	(10.2)	1.9
Gain on currency hedge	–	0.1
Forward interest rate swap settlements (note 22)	–	18.2
Net cash outflow for returns on investments and servicing of finance	(39.9)	(10.1)

	2001 £m	2000 £m
<i>ii Capital expenditure and financial investment</i>		
Purchase of intangible fixed assets	(1.0)	–
Purchase of tangible fixed assets	(156.2)	(144.1)
Grants and contributions:		
Infrastructure assets	1.2	1.9
Non-infrastructure assets	–	0.6
Receipts from disposal of tangible fixed assets	3.9	2.0
Purchase of Company shares by Employee Share Ownership Plan	(0.6)	(1.4)
(Purchase)/disposal of other investments	(0.5)	0.4
Net cash outflow for capital expenditure and financial investment	(153.2)	(140.6)

32. Notes to the Group cash flow statement *continued*

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

	2001 £m	2000 £m
<i>iii Acquisitions and disposals</i>		
Sale of businesses	11.4	0.5
Overdraft disposed with business sale	0.6	-
Net cash inflow for acquisitions and disposals	12.0	0.5

	2001 £m	2000 £m
<i>iv Management of liquid resources</i>		
Purchase of current asset investments	(245.0)	(186.7)
Sale of current asset investments	219.8	207.5
Net cash (outflow)/inflow from management of liquid resources	(25.2)	20.8

Liquid resources comprise readily disposable current asset investments.

	2001 £m	2000 £m
<i>v Financing</i>		
Issue of ordinary share capital	3.3	1.8
Adjustment for shares issued under the Sharesave Scheme through Employee Share Ownership Trust	(0.6)	(0.6)
	2.7	1.2
Reduction in debt due within one year (other than bank overdrafts)	(14.5)	(16.2)
Reduction in debt due after more than one year	-	(10.1)
Cash (outflow)/inflow from currency hedge	(3.3)	1.8
Cash inflow/(outflow) in connection with deposits with financial institutions (note 5)	1.0	(2.1)
Defeased finance lease drawdowns (note 5)	-	2.6
Other finance lease drawdowns	89.0	-
Capital element of finance lease rental payments	(9.3)	(4.6)
	62.9	(28.6)
Net cash inflow/(outflow) from financing	65.6	(27.4)

Notes to the financial statements

Pannon Group Plc 2001

32. Notes to the Group cash flow statement *continued*

c Analysis of net debt

	At 1 April 2000 £m	Cash flow £m	Acquisition (excluding cash items) £m	Disposal (excluding cash items) £m	Non-cash movements £m	Exchange movements £m	At 31 March 2001 £m
Cash at bank and in hand	3.8	(0.4)	–	–	–	0.3	3.7
Current asset investments:							
Overnight deposits	0.1	0.5	–	–	–	–	0.6
Bank overdrafts	(2.4)	(1.4)	–	–	–	(0.1)	(3.9)
	1.5	(1.3)	–	–	–	0.2	0.4
Debt due within one year							
(other than bank overdrafts)	(30.0)	14.5	(0.9)	–	(22.1)	–	(38.5)
Debt due after more than one year	(344.2)	3.3	–	–	22.1	(3.3)	(322.1)
Finance lease obligations	(329.5)	(80.7)	–	0.9	(9.3)	–	(418.6)
	(703.7)	(62.9)	(0.9)	0.9	(9.3)	(3.3)	(779.2)
Current asset investments:							
Other than overnight deposits	35.4	25.2	–	–	–	0.2	60.8
	(666.8)	(39.0)	(0.9)	0.9	(9.3)	(2.9)	(718.0)

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 5).

d Reconciliation of net cash flow to movement in net debt

	2001 £m	2000 £m
Decrease in cash in year	(1.3)	(5.1)
Cash (inflow)/outflow from (increase)/reduction in debt and finance leasing	(62.9)	28.6
Cash outflow/(inflow) from increase/(decrease) in liquid resources	25.2	(20.8)
(Increase)/reduction in net debt arising from cash flows	(39.0)	2.7
Acquisition (excluding cash items):		
Loan stock notes issued as part consideration for business acquired	(0.9)	–
Disposal (excluding cash items):		
Finance leases disposed with business sale	0.9	–
Non-cash movements:		
In-substance extinguishment of finance lease obligations (note 5)	1.0	0.5
Increase in accrued finance charges on finance lease obligations	(10.3)	(16.3)
Exchange movements	(2.9)	1.4
Increase in net debt in the year	(51.2)	(11.7)
Net debt at 1 April	(666.8)	(655.1)
Net debt at 31 March	(718.0)	(666.8)

32. Notes to the Group cash flow statement *continued*

e Purchase of business

	2001 £m	2000 £m
Fair value of tangible fixed asset acquired	0.9	-

The asset acquired was satisfied by the issue of loan stock notes (note 26).

The asset acquired did not materially contribute to the Group's cash flow for the year.

f Sale of business

	2001 £m	2000 £m
Net assets sold:		
Tangible fixed assets	3.4	-
Net current assets	3.8	-
Bank overdrafts	(0.6)	-
Finance lease obligations	(0.9)	-
Goodwill written back on disposal	6.6	-
	12.3	-
Accruals for liabilities under sale agreement	0.7	-
	13.0	-
Loss on disposal	(2.1)	-
	10.9	-

The sale was satisfied by cash consideration.

The business sold during the year did not materially contribute to the Group's cash flows in 2001 or 2000.

During the year £0.5 million of deferred consideration, arising from a business sold in an earlier year, was received (2000 £0.5 million).

33. Related party transactions

On 15 December 2000 the Company disposed of its interest in T J Brent Limited, having previously sold the Copa Products division of that company. Sales to the Pennon Group between the respective dates of disposal and 31 March 2001 were £5.2 million.

During the year the Company advanced £0.5 million to Enviro-Logic Limited, an associated undertaking, to finance business development costs (2000 £0.4 million). The £0.9 million advance was outstanding at 31 March 2001 and the Company had fully provided against the debt.

There were no related party transactions involving Directors during the year (2000 – a transaction by Mr R J Baty involving the acquisition of a surplus property for a consideration of £78,500).

Five year financial summary

Pennon Group Plc 2001

<i>Profit and loss account</i>	2001 £m	2000 £m	1999 £m	1998 £m	1997 £m
Turnover	435.1	467.0	437.1	382.4	343.6
Group operating profit	128.1	167.1	167.7	134.8	130.2
Share of operating (loss)/profit in associates	(0.4)	(0.4)	(0.2)	(0.4)	1.2
Business disposal (loss)/profit	(2.1)	-	-	(7.5)	19.2
Net interest payable	(51.4)	(45.1)	(40.9)	(20.3)	(18.0)
Profit on ordinary activities before taxation	74.2	121.6	126.6	106.6	132.6
Tax on profit on ordinary activities*	-	(5.0)	(17.5)	(117.0)	(14.3)
Profit/(loss) on ordinary activities after taxation	74.2	116.6	109.1	(10.4)	118.3
Dividends	(49.4)	(65.1)	(61.9)	(54.1)	(47.4)
Retained profit/(loss) transferred to/(from) reserves	24.8	51.5	47.2	(64.5)	70.9
Earnings per share (basic):					
Before exceptional items	56.0p	85.8p	77.9p	83.3p	81.2p
Exceptional items	(1.6)p	-	3.8p	(91.3)p	10.9p
After exceptional items	54.4p	85.8p	81.7p	(8.0)p	92.1p
Dividend per share	36.0p	47.8p	45.6p	41.0p	36.7p

* including £104.0 million windfall tax in 1998

<i>Capital expenditure</i>	2001 £m	2000 £m	1999 £m	1998 £m	1997 £m
Acquisitions	0.9	-	37.1	93.9	0.9
Tangible fixed assets	166.5	153.8	125.3	184.6	157.2

<i>Balance sheet</i>	2001 £m	2000 £m	1999 £m	1998 £m	1997 £m
Fixed assets	1,826.3	1,736.6	1,652.4	1,558.9	1,397.8
Net current liabilities	(49.0)	(54.6)	(26.2)	(166.0)	(42.9)
Non-current liabilities	(799.7)	(738.7)	(734.5)	(584.2)	(439.0)
Net assets	977.6	943.3	891.7	808.7	915.9

<i>Number of employees (average for year)</i>	2001	2000	1999	1998	1997
Water and sewerage business	1,537	1,638	1,700	1,734	1,765
Waste management	453	438	441	312	297
Instrumentation	495	556	437	443	411
Construction services	617	837	875	838	567
Other businesses	55	57	55	93	113
	3,157	3,526	3,508	3,420	3,153

The adoption of Financial Reporting Standard 12 'Provisions, Contingent Liabilities and Contingent Assets', Financial Reporting Standard 14 'Earnings per Share', and Financial Reporting Standard 15 'Tangible Fixed Assets', required the revised presentation of certain numbers which have been incorporated for the periods 2001 to 1998 above. Comparatives for 1997 have not been restated.

Shareholder information

Pennon Group Plc 2001

Financial calendar

Financial year end	31 March
Twelfth annual general meeting	26 July 2001
2001 Final dividend payable	1 October 2001
2002 Interim results announcement	November 2001
2002 interim dividend payable	April 2002
2002 Preliminary results announcement	May 2002
Thirteenth annual general meeting	July 2002
2002 Final dividend payable	October 2002

Shareholders' analysis at 31 March 2001

	Number of shareholders	Percentage of total shareholders	Percentage of ordinary shares
1 - 100	5,297	18.5	0.2
101 - 1,000	19,654	68.8	6.0
1,001 - 5,000	2,993	10.5	3.7
5,001 - 50,000	407	1.4	5.3
50,001 - 100,000	71	0.2	3.7
Over 100,000	160	0.6	81.1
	28,582	100.0	100.0
Individuals	26,486	92.7	9.4
Companies	248	0.9	1.7
Trust companies (pension funds, etc)	11	-	0.1
Banks and nominees	1,830	6.4	87.8
Insurance companies	7	-	1.0
	28,582	100.0	100.0

Substantial shareholdings

At 21 June 2001, interests in the issued share capital had been notified by:

Prudential Plc	10.15%
Morley Fund Management	6.80%
AXA Investment Managers	5.20%
Standard Life Group	3.96%
AEGON UK Plc	3.37%

Shareholder services

Share dealing service

The low-cost share dealing service offered by Hoare Govett 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 (ISA), shareholders may gain tax advantages. The corporate ISA is administered by Lloyds TSB Registrars.

Dividend Reinvestment Plan

The Dividend Reinvestment Plan (DRIP) enables shareholders to reinvest their dividends to purchase additional shares in the Company. If you would like to participate in the Plan, an explanatory brochure and mandate form can be obtained from the Registrar.

Details of these shareholder services are available from the Company Secretary's Department, telephone: 01392 446677.

Shareholder information

Pennon Group Plc 2001

Shareholder services continued

Dividend history

In order to assist shareholders with the completion of their tax returns, a dividend history is set out below:

Payment number	Date	Net amount per share	Scrip/DRIP - Price of new share
1	1 October 1990	11.62p	-
2	4 March 1991	6.7p	-
3	1 October 1991	13.3p	-
4	4 March 1992	7.1p	-
5	1 September 1992	14.6p	412p
6	4 March 1993	7.8p	493p
7	1 September 1993	15.9p	571p
8	6 April 1994	8.4p	592p
9	1 September 1994	17.1p	508p
10	6 April 1995	9.1p	470p
11	1 September 1995	18.2p	518p
12	9 April 1996	9.8p	677p
13	1 October 1996	20.7p	642p
14	7 April 1997	11.8p	588p
15	1 October 1997	24.9p	806p
16	6 April 1998	13.2p	897.5p
17	17 August 1998	27.8p (30.0p)*	981p
18	17 February 1999	15.85p*	983p
	6 April 1999	14.7p	-
19	1 October 1999	30.9p	1029p
20	6 April 2000	15.4p	519.05p
21	2 October 2000	32.4p	681.23p

* denotes value of enhanced scrip dividend.