

PENNON GROUP PLC
ANNUAL REPORT AND ACCOUNTS 2002

(Registered in England: No.2366640)



- A year of sound delivery
- Strategy clearly focused on water, sewerage and waste management
- Turnover £423.9 million
- Profit before tax £77.4 million*
- Earnings per share 54.3p*
- Dividend per share 37.5p

*after exceptional item

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The sound performance of the water and sewerage services and waste management activities, allied to the successful disposal of Viridor Instrumentation and restructuring of Head Office services, have underpinned the focused strategy outlined by the Board last year.

Financial overview

Group turnover reduced by 3% primarily reflecting the disposals of Viridor Instrumentation Limited and T J Brent Limited. However, this masks an increase of 8% to £381.0 million in the turnover of the Group's continuing operations.

Profit before tax in continuing operations was up £0.8 million to £69.3 million and, after incorporating discontinued businesses, Group profit before tax (including exceptional items) increased by 4% to £77.4 million. Earnings per share before exceptional items rose by 17% to 50.6p and after exceptional items increased 31% to 54.3p. In line with its previously stated policy of pursuing a progressive dividend policy, the Board is recommending a final dividend of 25.4p per share which, with the interim dividend of 12.1p, will result in a full year dividend of 37.5p – a 4.2% increase.

South West Water Limited

The water and sewerage business continued to perform well and produced very high levels of drinking water and bathing water compliance. The latter was especially pleasing in a year when the tourism industry in the South West was seeking to re-establish itself in the wake of the downturn caused by the outbreak of foot and mouth disease in 2001. The company is confident of continuing outperformance of the regulatory contract for the period to 2004/05, albeit that the opportunities to extract further efficiencies become ever more difficult to identify after many years of pursuing cost reductions.

Viridor Limited

As foreshadowed last year, the sale of Viridor Instrumentation has been completed and has enabled Viridor to focus on the waste management business.

Viridor Waste Limited has been successful in growing its turnover and profit before tax by 18% and 15% respectively in the year. It is now well placed to pursue its strategy of exploiting to the

A year of
sound delivery

full its landfill assets and profitable opportunities afforded by the targets of the Government's waste and renewable energy strategies.

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

Prospects/future strategy

The year has involved much intensive scrutiny of a range of options which appeared to have the potential to deliver enhanced value to shareholders. Two prongs of the strategy outlined last year have now been delivered. The profitable sale of Viridor Instrumentation was concluded in February 2002 and that has enabled the Board to declare a special interim dividend of 70p per share which will be paid in October and which it is proposed should be accompanied by a consolidation of the Company's share capital which is designed to maintain comparability of the share price. The restructuring of Head Office services was also completed which will result in savings of around £1 million per annum going forward.

Last year, the Board indicated that it would also examine options to more efficiently structure the balance sheet. This resulted in an extensive review of financial restructuring options which included the possibility of a whole business securitisation of South West Water. The technical feasibility of securitising was established but, in view of the significant implementation costs associated with the proposal, the Board concluded that it would not deliver sufficient incremental shareholder value to outweigh the consequential costs and risks. This option will not therefore be pursued for the foreseeable future.

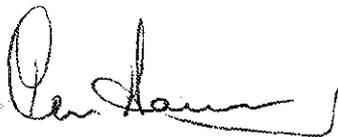
The immediate strategy will focus on adding value for shareholders through the planned outperformance of the regulatory contract by South West Water and continuing growth of Viridor Waste. Following a period of great change within the Group, it is important that a period of consolidation should now take place to enable that strategy to deliver results.

Board matters

Mr David Dupont was appointed Group Director of Finance on 2 March 2002 following the retirement of Mr Ken Hill from that role on 1 March. The Board is extremely grateful to Ken for his significant contribution to the development of the Group since privatisation and wishes him well in his retirement.

Employees

During my years as Chairman of the Group, many structural and organisational changes have taken place. Throughout those many changes employees have continued to demonstrate a high level of loyalty, commitment and professionalism and I thank them most sincerely for their efforts.



*K G HARVEY, Chairman
Pennon Group Plc
20 June 2002*

The Pennon Group continued to make strong progress during the year with good performance in all areas of the business.

South West Water Limited continued to deliver sound financial performance and to outperform the regulatory contract through the generation of additional efficiencies, while Viridor Limited delivered profitable growth in its waste operations and successfully disposed of its instrumentation business following a refocusing of strategy.

South West Water Limited

The company's turnover increased by 3.6% from £251.4 million to £260.4 million reflecting the impact of the tariff increase approved by the Director General of Water Services and other positive factors.

Operating costs increased by £9.3 million to £153.4 million, including £7.2 million for the operation of new capital schemes and efficiency savings of £4.0 million.

Operating profit showed a marginal decrease from £107.3 million to £107.0 million.

In September 2001 South West Water applied to the Director General of Water Services for an Interim Price Determination as, at the last Periodic Review, Ofwat had estimated that the number of customers who would switch from an unmeasured charging basis to a measured basis would be lower than that assumed by the company, producing a consequential adverse impact on turnover. In December 2001, based on the actual numbers at that time and revised projections, Ofwat confirmed revised price increases of 4.4% above inflation for each of the three years 2002/03 to 2004/05.

During the year a further 23,300 customers switched to a measured charging basis compared to 27,500 in the previous year.

Some three years ago a restructuring programme designed to significantly reduce overhead and operating costs was introduced. Its successful delivery has ensured South West Water currently outperforms the demanding operational and capital efficiency targets imposed by Ofwat and is on track to continue to do so for the remainder of the current regulatory period (K3).

the **best ever**

Since 1995 cost reductions totalling £37.4 million have been achieved by South West Water, demonstrating its excellent track record in the area of efficiency savings.

Exemplary levels of product and customer service remain one of the company's key objectives notwithstanding the Regulator's continued pressure to reduce operational expenditure. Market research carried out amongst South West Water's customers continues to confirm high levels of satisfaction with the overall service provided by the company, which is also continuing its high performance against Ofwat's prescribed 'Levels of Service Indicators' targets.

The region's water storage, treatment and distribution infrastructure has been significantly enhanced in order to fulfil the expectations of its customers for abundant supplies of high quality drinking water. The company's innovative and industry-leading leakage detection and reduction programme continues to deliver results in line with Ofwat's mandatory targets and there have been no restrictions on water usage since 1996.

During the K3 period, planned expenditure on water mains renovation will be in the order of £120 million with the length of mains scheduled for improvement more than double that achieved in the five year K2 period. Improvements in water supply have been matched with improvements to quality and during the year drinking water standards achieved the highest ever compliance level of 99.9%.

In November, the Department for Environment, Food and Rural Affairs (DEFRA) and the Environment Agency (EA) announced the best ever bathing water quality results for beaches and bathing waters along the West Country coastline. Almost 98% of the region's 140 bathing waters regularly monitored by the EA complied with the mandatory standards, compared with 96% the previous year and the results also confirmed a big increase in the number of bathing waters meeting the even more stringent guideline standards – 71% compared with 61% the previous year.

A rolling programme of updating and modernising inland waste water treatment works to ensure compliance with environmental standards continued throughout the year and the company's investment helped the region record more miles of high quality rivers than any other region in England.

As well as providing environmental benefits, the programme is enabling much needed commercial and residential property development to continue and contribute towards regional economic growth.

Capital expenditure for the year increased by £13.2 million to £167.6 million with £68.9 million invested in water supply improvements including water mains renovation, water treatment works enhancement and leakage control. Waste water services investment expenditure was £98.7 million of which £55.0 million was invested in the company's 'Clean Sweep' bathing water improvement programme.

bathing water quality results

Viridor Limited

Following a refocusing of strategy, the sale of Viridor Instrumentation Limited was successfully completed in February 2002. This has enabled Viridor to focus on the development of its waste management business.

Capital expenditure for the year was £18.3 million which was primarily invested by Viridor Waste in its continuing landfill operations.

Viridor Waste is one of the leading waste treatment and disposal businesses in the UK. In addition to its landfill disposal activities, it is a major generator of renewable energy utilising landfill gas and has transfer stations, recycling and collection operations in the South West, North West and East of England.

Turnover of Viridor Waste increased by 18% from £106.1 million to £125.3 million while operating profits (before goodwill amortisation) grew by 16% from £13.1 million to £15.2 million. There was a particularly strong performance in the first half of the year, mainly due to temporary contracts from a competitor who was short of capacity and activities arising from the foot and mouth outbreak.

There are two key elements in the Viridor Waste strategy. The first is fully to exploit the company's landfill assets. The UK is likely to face an increasing shortage of landfill disposal capacity due to planning constraints and, with 73 million cubic metres of consented landfill capacity, Viridor Waste is well positioned for the future. The second element is the pursuit of profitable opportunities to help deliver the targets of the Government's new waste and renewable energy strategies.

Landfill volumes increased by 6% (comprising 2% from existing business and 4% from acquisitions in the year) from 3.0 million tonnes to 3.2 million tonnes. There was also an increase of 3% in underlying gate fees, in part reflecting an awareness of the developing shortage of landfill capacity in the UK. The collection business also performed strongly, offsetting weaker performance in the areas of recycling and minerals.

delivered **profitable**

Two acquisitions were made during the year with a further taking place shortly after the year end. In October, The Suffolk Waste Disposal Company Limited, the recycling and disposal company owned by Suffolk County Council, was acquired for £8.7 million. This provided Viridor Waste with 4 million cubic metres of additional consented landfill together with associated contracts and significant recycling and composting capabilities. The acquisition also provided an ideal strategic fit with Viridor Waste's existing landfill and other contracts in Suffolk. In the same month, Lavelle & Sons Limited, a Manchester-based transfer station, recycling and collection company, was acquired for £3.4 million. This further strengthened Viridor Waste's position in the North West where it already operates two large landfills and enhanced its recycling capabilities.

After the year end, Viridor Waste completed the acquisition of Richardson Limited for £11.9 million. Richardson is the UK's leading reprocessor of flat glass from windows, windscreens and architectural uses. It is headquartered in St Helens, Lancashire, with a network of depots throughout the country. Government targets require substantial increases in glass recycling and Viridor Waste's activities elsewhere in the country will provide Richardson with access to further supplies of glass.

In May 2001, in view of the need to mitigate the impact of Ofwat's Final Determination on turnover and profitability for both South West Water and the Group, the Board announced it was undertaking a review of strategic options. As part of that review, it was decided to sell Viridor Instrumentation as the Group was no longer in a position to pursue planned growth in both the waste and instrumentation sectors.

As described in the previous Annual Report, Viridor had built up a strong position in the consolidating world-wide market for specialist environmental instrumentation. As part of the sale process, a formal auction was conducted which generated strong competition from a number of strategic buyers. The process was protracted due to the events of September 11 and the general softness in the world economy but the business was finally sold in February 2002 for a price, before costs of sale, of £105.5 million to a subsidiary of the Danaher Corporation, giving rise to a disposal profit of £5.1 million. In the period up to disposal, the company made an operating profit before goodwill amortisation of £3.7 million.



growth in its waste business...

Employees

Well motivated, highly skilled employees are fundamental to the continued success of the Pennon Group which supports them with the technology, infrastructure and opportunity for high level performance.

Throughout the Group, many well established and proven employee communications practices are used and include a monthly cascade team briefing system, use of the Group's intranet facility and an employee newspaper. Given the geographical diversity of the Group allied to the need to communicate quickly and effectively, e-communication continues to be a particularly useful medium.

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

UK employees are encouraged to become shareholders in the Company by participating in well-established all-employee share schemes. At last year's Annual General Meeting, approval was given by shareholders to the introduction of an All Employee Share Option Plan (now renamed Share Incentive Plan). That plan, when operated, is designed to assist in furthering the Group's policy of seeking to align the interests of employees with those of shareholders.

Changes to both the structure of the Group and working practices within it are vital for continued success in the market place and particular attention is given to the management of change via the Group's wide range of training and development programmes. An 'Investors in People' award was made to South West Water two years ago in recognition of the people management processes employed by the company.

The Group regularly reviews its health and safety policy and performance standards in order to provide its employees with a safe working environment. Innovative risk assessment and control programmes have been introduced over the years as part of the Group's constantly evolving health and safety strategy which has helped to ensure low levels of work-related accidents and attendant reductions in operating costs. In particular, South West Water has been commended by the Health & Safety Executive for its 'world-class' risk management systems.

Ethical employment practices are encouraged by the adoption of key policies with Group-wide application. A non-discriminatory employment policy operates within the Group and every reasonable effort is made to ensure that no current or future employee is disadvantaged because of gender, age, religion, colour, ethnic origin, marital status, sexual orientation or disability. A 'Whistleblowing' policy has also been adopted throughout the Group, as have family-friendly policies.

World-cla

Caring for the environment

The Group plays a leading role in enhancing and maintaining the quality of the environment. This role is underscored as one of the three key goals set out in the Group's mission statement.

The two principal operating 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. Both companies recognise the importance of environmental sustainability and have taken steps to ensure that their operations are carried out in a sustainable manner having due regard to their environmental impacts.

An environmental policy has been in place since the early days of the Company's life and is regularly reviewed by the Environment Committee of the Board. That policy aims to achieve continuous improvement in environmental performance. Recognition of enhanced performance came recently when the Group again improved its ranking in the Business in the Environment 2001 survey.

South West Water achieved its highest ever performance in clean water compliance at the very high level of 99.9%. Allowing for the exceptional effects of the foot and mouth crisis on the company's operation of its sewage treatment assets, compliance was maintained at around 98%, but should be viewed in the context of the company inheriting a situation where only 60% compliance was being achieved.

South West Water's massive coastal waste water treatment improvement programme 'Clean Sweep' was the key factor in the region being able to boast some of the finest beaches in the UK. This good news provided a welcome tonic for the South West tourism industry following the ravages of the foot and mouth outbreak.

Reflecting its continuing commitment to high environmental standards, Viridor Waste has already achieved ISO 14001, the international environmental management standard, at most of its key sites. South West Water is currently reviewing its business processes as a precursor to the introduction of a formal environmental management system.

The Group is a major producer of renewable energy. Viridor Waste's capacity for power generation from landfill gas is 28MW while South West Water generates 7MW from hydro-electric and combined heat and power plants. In total, the Group generates the equivalent of over 113% of its own electricity consumption from renewable sources. In line with the Government's Renewables Obligations order which was approved by Parliament in March 2002 and which sets the price framework to achieve the Government's target of 10% of electricity generated from renewable energy by 2010, Viridor Waste is developing a number of schemes to increase its landfill gas generation capacity by a further 8MW over the next two years.

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 contact continues to be maintained with the local community via formal liaison groups to discuss and, wherever possible, mitigate potential problems. This underlines the approach of the Group in its determination to be a good neighbour.

The foot and mouth epidemic had a major impact on a number of the communities in which Viridor Waste operates. The safe disposal of carcasses was a major challenge for the whole country and, at the request of the Government, certain of the company's landfills were nominated by the Environment Agency as suitable to take carcasses arising from precautionary culls. Viridor Waste worked closely with the Government in developing codes of practice for carcass handling and sought to minimise the impact on its neighbours whilst playing its part in managing the crisis. Particular praise is due to those employees who worked so hard in such distressing circumstances on the safe transport and disposal of the carcasses.

The Group's environmental performance will be more fully reported in the Social and Environmental Report '*Enhancing the Environment 2002*'.

...over

£7 million

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.

Community involvement is channelled through a number of initiatives and over £7 million was donated by the Group during the year as follows:

- *Charitable donations* – charitable donations amounting to £46,000 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 £50,000 were awarded during the year across a wide spectrum of activities.
- *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 £28.6 million to Environmental Bodies which has provided support for a wide range of environmental and local amenity projects across the country. Funds of £7.3 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 voluntarily adopted a target whereby 50% of its landfill tax credits is directed towards such initiatives. It aims to achieve the Government target of 65% in the coming year.
- *Pennon Environmental Fund Committee* – the Committee was established with the aim of utilising some of Viridor Waste's landfill tax credits for the specific benefit of the West Country. 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.

was donated during the year

The Group's financial results showed growth in both turnover and profit before tax in continuing operations.

The financial statements for 2000/01 have been restated to reflect changes required by the adoption of FRS 19 'Deferred Tax' and FRS 18 'Accounting Policies'. The changes, including the impact on earnings per share for 2000/01, are set out in note 12 to the financial statements.

Operating profit

The turnover of continuing operations rose by 7.9%. Water and sewerage business turnover was £260.4 million, up 3.6% on 2000/01 principally resulting from the increase in tariffs approved by the Regulator. Turnover for Viridor Waste Limited at £125.3 million was 18.1% up on 2000/01 primarily resulting from increased trading, together with the impact of acquisitions made in October 2001 and increased landfill tax. Overall, Group turnover for the year reduced by 2.6% to £423.9 million, principally as a consequence of the disposals of Viridor Instrumentation Limited and T J Brent Limited.

Operating profit from continuing operations reduced by £1.3 million to £119.1 million, after charging £2.1 million of costs related to testing the feasibility of balance sheet restructuring. The water and sewerage business achieved a £107.0 million operating profit, down £0.3 million on 2000/01. Viridor Waste contributed £14.9 million, up £1.8 million on 2000/01 and representing 12.5% of the operating profit of the Group's continuing operations in 2001/02.

After disposals and restructuring, overall Group operating profit fell £6.3 million to £121.8 million.

Finance costs

Net interest payable was £49.0 million, which was 2.5 times covered by Group operating profits, compared with £51.4 million (2.5 times covered) in 2000/01.

Gross interest payable was £61.2 million arising on borrowings, predominantly denominated in sterling. Gross interest receivable of £12.2 million was derived from the investment of temporarily surplus funds.

Net interest payable represents a rate of 6.5% when measured against average net debt (2000/01 7.1%, as restated).

Turnover for Viridor Waste
showed an

18.1%

Profit before tax

Profit before tax was £77.4 million, £3.2 million up on 2000/01, after exceptional items.

In respect of continuing operations there was an increase of £0.8 million, from £68.5 million to £69.3 million, supported by profitable growth by Viridor Waste.

The return on investment achieved for waste management in 2001/02 was 7% (2000/01 6%), representing profit before tax expressed as a percentage of acquisition cost.

An exceptional profit of £5.1 million resulted from the sale of Viridor Instrumentation in February 2002 (2000/01 – exceptional loss of £2.1 million from the sale of T J Brent).

Taxation

Excluding deferred tax, there was no taxation charge for the year. As a result of FRS 19, full discounted provision for deferred tax has been made. A charge of £3.3 million arose in the year and a prior year adjustment resulted in the charge for 2000/01 being restated at £17.6 million.

Earnings per share

Earnings per share, before exceptional items, increased by 17.4% to 50.6p and, after exceptional items, increased 30.8% to 54.3p. Last year's earnings per share of 56.0p has been restated at 43.1p following the prior year adjustment in respect of deferred tax (see note 12 to the financial statements).

10% increase

Dividends and retained earnings

The Directors recommend the payment of a final dividend of 25.4p per share for the year ended 31 March 2002. Together with the interim dividend of 12.1p per share paid on 8 April 2002 this makes a total dividend for the year of 37.5p per share, an increase of 4.2% on the dividend for 2000/01. The dividend of 37.5p is paid out of earnings per share of 50.6p before the exceptional item. The cover for payment of dividends is 1.3 times.

The total cost of the interim and recommended final dividend of the Company is £51.4 million. The retained profit of £22.7 million has been transferred to reserves.

The dividend payable by South West Water Limited to the Company for 2001/02 amounted to £66.7 million.

Investment

Capital expenditure by the Group on tangible fixed assets was £186.4 million (2000/01 £166.5 million) of which £167.6 million arose in the water and sewerage business (2000/01 £154.4 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 net cash inflow from operating activities was £196.2 million (2000/01 £205.0 million). Capital expenditure and financial investment cash outflow increased from £153.2 million in 2000/01 to £182.3 million in 2001/02. The net inflow from acquisitions and disposals was £85.0 million (2000/01 £12.0 million). Taxation cash inflow was £0.4 million (2000/01 £0.3 million outflow). Equity dividends paid and servicing of net debt involved a cash outflow of £93.7 million (2000/01 £105.2 million).

Overall, the net cash inflow of the Group, before the use of liquid resources and financing, was £5.6 million (2000/01 £41.7 million outflow).

Financing during the year included £45.6 million of finance lease facilities.

At 31 March 2002, loans and finance lease obligations were £1,043.3 million and the Group held current asset investments and cash of £292.0 million. Net borrowings, which reduced by £0.5 million during the year from £751.8 million, as restated, to £751.3 million, represent 77% of shareholders' funds (2000/01 83%, as restated).

goodberfo

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 2002 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.

Payments to suppliers

It is the Company's payment policy for the year ending 31 March 2003 to follow the Code of The Better Payment Practice Group on supplier payments. Information about the Code can be obtained from www.payontime.co.uk. The Company will agree payment terms with individual suppliers in advance and abide by such terms. The ratio, expressed in days, between the amount invoiced to the Company by its suppliers during 2001/02 and the amount owed to its trade creditors at 31 March 2002 was 20 days.

Share capital

During the year the issued ordinary share capital increased from £136.9 million to £137.0 million. The value of net assets per share at book value, at 31 March 2002, was 713p.

Permission was obtained from shareholders at the annual general meeting in July 2001 to purchase up to 10% of the Company's ordinary share capital. Renewal of the authority will be sought at the July 2002 annual general meeting.

Performance in all areas of the business

Board of Directors

Kenneth George Harvey

BSc, CEng, FIEE (61)

Non-executive Chairman

Sir Geoffrey Howes Chipperfield

KCB, DCL (69)

Non-executive Deputy Chairman

Robert John Baty

OBE, CEng, FEng, FICE, FCIWEM, MIMgt, ACIArb (58)

Chief Executive, South West Water Limited

Colin Irwin John Hamilton Drummond

MA, MBA (51)

Chief Executive, Viridor Waste Limited

David Jeremy Dupont

MA, MBA (48)

Group Director of Finance

Alan Thomas Fletcher

MA (67)

Non-executive Director

Katharine Mary Hope Mortimer

MA, BPhil (56)

Non-executive Director

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.

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 Heliodynamics Limited and pro-chancellor of University of Kent.

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.

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. He is a member of the Government's Advisory Committee for Business in the Environment.

was appointed on 2 March 2002. He was formerly regulatory and finance director of South West Water Limited, having joined Pennon Group Plc (then South West Water Plc) in 1992 as strategic planning manager. Previously he held business planning and development roles with Gateway Corporation.

was appointed on 26 May 1993. He is managing partner of Rubicon Partners, chairman of Vector Industries Limited and 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.

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, 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 Hewett (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

D J Dupont

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

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

Executive Directors

The remuneration package of the Executive Directors comprises:

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

ii Performance related bonus – annual performance related bonuses are awarded in accordance with an incentive bonus scheme for Executive Directors and based on the achievement of overall corporate and individual objectives established by the Committee. The maximum cash bonus achievable under the scheme for Executive Directors is 40% of basic salary which can be matched by an award of shares of an equivalent amount. Shares awarded usually have to be held for a period of three years, conditional upon continuous service with the Company.

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 2001 has been one share for every four shares awarded. The eventual number of shares, if any, which participants may receive is dependent upon the achievement of the performance conditions of the Plan over a three year period. 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, no shares vested under either of these awards.

Report on remuneration policy and remuneration

Executive Directors *continued*

For awards made in the period 1999 to 2001 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 to the three awards made in 1999 to 2001 because the Committee had regard to current market practice and the impact of the Final Determination by the Director General of Water Services in respect of price limits for South West Water Limited.

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

In addition, at the annual general meeting in 2001, shareholders approved the introduction of a share option scheme which, in the normal course of events, it is intended should operate in any given year as an alternative to the Restricted Share Plan. To date, the new option scheme has not been operated.

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).

Mr C I J H Drummond is, and Mr K L Hill was, subject to the Earnings Cap and both were provided with additional pension benefits under the unapproved funded Supplementary Pension Scheme in order to bring their pension benefits up to the level which would have been provided under the other schemes if the Earnings Cap had not applied. Executive Directors included in the unapproved pension arrangements receive payments equivalent to the tax liability which arises in respect of Company contributions to the Supplementary Pension Scheme.

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

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

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

Emoluments of Directors

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

	Salary/fees £000	Performance-related bonuses		Other emoluments £000	Payments related to supplementary pension £000	Total 2002 £000	Total 2001 £000
		Payable £000	Deferred £000				
<i>Chairman:</i>							
K G Harvey	130	-	-	16	-	146	134
<i>Executive Directors:</i>							
R J Baty	150	57	57	13	-	277	197
C I J H Drummond	150	80	40	16	10	296	211
D J Dupont (appointed 2 March 2002)	10	3	3	1	-	17	-
K L Hill (retired 1 March 2002)	143	47	-	10	4	204	215
<i>Non-executive Directors:</i>							
Sir Geoffrey H Chipperfield	34	-	-	-	-	34	30
A T Fletcher	44	-	-	-	-	44	40
Ms K M H Mortimer	27	-	-	-	-	27	22
	688	187	100	56	14	1,045	849

Other emoluments include car benefit and health cover.

Mr C I J H Drummond received a special bonus of £40,000, included within the amount payable above, which was not part of the performance-related bonus scheme. This bonus was awarded following the successful conclusion of the sale of Viridor Instrumentation Limited.

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 2001/02 are shown in the table below:

	Increase in accrued pension during 2002 (net of inflation) <i>a</i> £000	Increase in transfer value (net of inflation) <i>b</i> £000	Accrued pension entitlement <i>c</i> £000
R J Baty	6	92	103
C I J H Drummond	5	52	40
D J Dupont	-	2	26
K L Hill	5	79	101

Column *a* above is the increase in accrued pension during 2001/02 (net of inflation). It recognises:

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

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 31 March 2002, or on retirement if earlier, payable at normal retirement age.

Report on remuneration policy and remuneration

Directors' pensions *continued*

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 shown on the previous page.

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 2002 and 31 March 2001 (or date of appointment if later) were:

	2002	2001		2002	2001
R J Baty	26,011	23,132	A T Fletcher	1,506	1,424
Sir Geoffrey H Chipperfield	2,500	2,500	K G Harvey	2,482	2,350
C I J H Drummond	13,543	12,516	Ms K M H Mortimer	-	-
D J Dupont	13,990	13,990			

As a result of participation in the Company's Dividend Reinvestment Plan, Directors acquired additional shares on 8 April 2002 as follows:

R J Baty	1,054
K G Harvey	45
A T Fletcher	28

(b) Restricted Share Plan

In addition to the above beneficial interests, the following Directors have 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 criteria were met:

	Date of conditional award			2002 Total	2001 Total
	September 1999	September 2000	September 2001		
R J Baty	10,314	17,954	18,087	46,355	37,826
C I J H Drummond	10,314	17,954	18,087	46,355	37,826
D J Dupont	4,361	7,595	7,813	19,769	15,897

It is anticipated that no shares will vest under the 1999 awards as the performance criterion has not been met.

Directors' share interests *continued*

(c) Sharesave Scheme

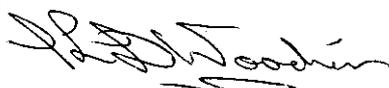
Options to subscribe for shares of the Company under the Sharesave Scheme as at 31 March 2002 and 31 March 2001 (or date of appointment if later) were:

	Grant date: Subscription price:	1997 556p	2000 461p	2001 489p	2002 Total	2001 Total
R J Baty		–	1,260	792	2,052	1,260
C I J H Drummond		–	2,101	–	2,101	2,101
D J Dupont		3,102	–	–	3,102	3,102

The exercise dates of the above options are shown in note 24 to the financial statements.

(d) Share price

The market price of the Company's shares at 31 March 2002 was 645p (2001 599p) and the range during the year was 580p to 660p (2001 465p to 775p).



By Order of the Board
K D WOODIER, Company Secretary
20 June 2002

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 current provisions of the Combined Code.

Board of Directors

The Board of Directors currently comprises three Executive Directors and four Non-executive Directors. Mr D J Dupont was appointed Group Director of Finance on 2 March 2002 following the retirement of Mr K L Hill from that role on 1 March. The Non-executive Directors are regarded as independent and Sir Geoffrey Chipperfield is the appointed senior Non-executive Director. The biographies on page 16 demonstrate a broad range of business and financial experience and there is a clear separation in the roles of the Chairman and the Chief Executives of South West Water Limited and Viridor Waste 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 reviewed critically. 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 17 to 21.

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.

Environment Committee

The Environment Committee is chaired by Mr B A O Hewett (a co-opted member and former Non-executive Director of the Company) and also comprises the Chief Executives of South West Water Limited and Viridor Waste 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 operated in the year under review, was chaired by the Company Secretary, Mr K D Woodier and comprised all of the Executive Directors and the Head of Personnel. It met five times during the year and was responsible for reviewing the systems to manage risk and the effectiveness of the Group's internal control procedures including financial, operational and compliance controls. In view of the Group's revised structure, it was decided to discontinue the Compliance Committee and, with effect from April 2002, the Boards of the two principal subsidiary companies have assumed responsibility for the review and management of risk within their businesses. Both Boards are accountable and report to the Board of Pennon Group Plc in that respect. The Board of Pennon Group is also responsible for the review and management of risk in Group functions.

Internal control

The Board confirms that, throughout the year and during the period up to the date of approval of the financial statements, it has operated procedures meeting the requirements of the Combined Code as set out in the guidance *'Internal Control : Guidance for Directors on the Combined Code'*. As part of these procedures the Board has a formalised risk management policy which provides for the identification of key risks in relation to the achievement of the business objectives of the Group.

Prior to the year under review, a full risk and control assessment was undertaken by the management of each business within the Group to identify financial and non-financial risks. During the year, 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 Compliance Committee received and reported on high level risk issues to the Board on a quarterly basis. As noted above, that role has now been assumed by the Boards of South West Water Limited and Viridor Waste Limited. 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 has reviewed corporate objectives and the key risks to the achievement of those objectives. In addition, the Board and the Audit and Compliance Committees have reviewed regularly internal control and risk management policies to ensure that they are appropriate to the Group. All of these activities and 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 control *continued*

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

There is an established internal control framework which comprises:

a a clearly defined structure which delegates authority, responsibility and accountability, including responsibility for internal financial control, to the 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; compliance with procedures is reviewed by the Company's internal audit function; and

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

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

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 during the year related to interest rate, exchange rate and counterparty risk. Further details of those instruments are included in note 28 to the financial statements.

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' responsibilities 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.

■ **Directors' responsibilities statement** continued

The Directors have responsibility for ensuring that proper 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
20 June 2002

Part of the Directors

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

Directors' report	1	Future developments	17
Directors' remuneration	15	Performance	18
Directors' interests	16	Share activities	19
Employment policies	20	Financial statements	20
Financial results and dividends	21	Related party transactions	21
		Substantial shareholding	22
		Side letter cover	61
		Implications	62

[Signature]
 By Order of the Board
 K D WOODIER, Company Secretary
 20 June 2002

Report by the auditors on the financial statements

Independent Auditors' report to the shareholders of Pannon Group Plc

We have audited the financial statements which comprise the Group profit and loss account, the Group balance sheet, the Company balance sheet, the Group cash flow statement, the Group statement of total recognised gains and losses, the accounting policies and the related notes.

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of Directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements, United Kingdom Auditing Standards issued by the Auditing Practices Board and the Listing Rules of the Financial Services Authority.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding Directors' remuneration and transactions 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. The other information comprises only the Chairman's Statement, the Business Review, the Financial Review, the report on remuneration policy and remuneration, the statement of compliance on corporate governance and the Report of the Directors.

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

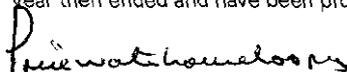
Basis of audit opinion

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 2002 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.



PRICEWATERHOUSECOOPERS

Chartered Accountants and Registered Auditors, Bristol

20 June 2002

Group profit and loss account

for the year ended 31 March 2002

	Notes	2002 £m	2001 Restated (note 12) £m
Turnover			
Continuing operations		374.8	353.2
Acquisitions		6.2	–
		381.0	353.2
Discontinued operations		42.9	81.9
Total turnover	2	423.9	435.1
Operating costs	3	(302.1)	(307.0)
Group operating profit			
Continuing operations		119.2	120.4
Acquisitions		(0.1)	–
		119.1	120.4
Discontinued operations		2.7	7.7
Total Group operating profit	2	121.8	128.1
Share of operating loss in:			
Joint venture		(0.1)	–
Associate		(0.4)	(0.4)
Total operating profit		121.3	127.7
Profit/(loss) on disposal of discontinued operation	4	5.1	(2.1)
Net interest payable	5	(49.0)	(51.4)
Profit on ordinary activities before taxation	2	77.4	74.2
Tax on profit on ordinary activities	6	(3.3)	(17.6)
Profit on ordinary activities after taxation		74.1	56.6
Dividends	8	(51.4)	(49.4)
Retained profit transferred to reserves	25	22.7	7.2
Earnings per share			
	9		
Before exceptional item:			
Basic earnings per share		50.6p	43.1p
Diluted earnings per share		50.5p	43.0p
After exceptional item:			
Basic earnings per share		54.3p	41.5p
Diluted earnings per share		54.2p	41.4p
Dividend per share	8	37.5p	36.0p

Statement of total recognised gains and losses

for the year ended 31 March 2002

	Notes	2002 £m	2001 Restated (note 12) £m
Profit on ordinary activities after taxation		74.1	56.6
Currency retranslation differences on foreign currency net investments	25	0.6	0.2
Total gains and losses recognised for the year		74.7	56.8
Prior year adjustments (note 12)		(50.9)	
Total gains and losses recognised since last Annual Report		23.8	

There were no recognised gains or losses for the Company, other than profit for the year, in 2002 or 2001.

The notes on pages 32 to 67 form part of these financial statements.

Balance sheets

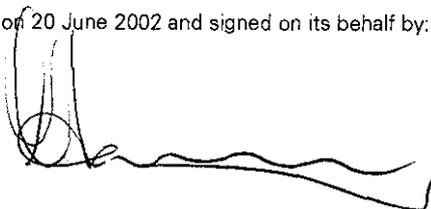
at 31 March 2002

	Notes	Group		Company	
		2002 £m	2001 Restated (note 12) £m	2002 £m	2001 Restated (note 12) £m
Fixed assets					
Intangible assets	13	11.7	24.7	-	-
Tangible assets	14	1,907.7	1,798.5	0.2	0.3
Investments	15	3.3	3.1	929.8	744.5
		1,922.7	1,826.3	930.0	744.8
Current assets					
Stocks	16	3.2	13.9	-	-
Debtors: amounts falling due after more than one year	17	5.4	7.1	179.9	162.2
Debtors: amounts falling due within one year	18	76.2	82.2	10.8	35.1
Investments	19	291.0	216.0	112.9	-
Cash at bank and in hand		1.0	3.7	-	-
		376.8	322.9	303.6	197.3
Current liabilities					
Creditors: amounts falling due within one year	20	(276.0)	(221.4)	(430.6)	(111.2)
Net current assets/(liabilities)		100.8	101.5	(127.0)	86.1
Total assets less current liabilities		2,023.5	1,927.8	803.0	830.9
Creditors: amounts falling due after more than one year	21	(932.3)	(911.7)	(208.7)	(268.7)
Provisions for liabilities and charges	22	(74.4)	(65.9)	(1.9)	-
Deferred income	23	(40.6)	(41.1)	-	-
Net assets	2	976.2	909.1	592.4	562.2
Capital and reserves					
Called-up share capital	24	137.0	136.9	137.0	136.9
Share premium account	25	151.6	151.3	151.6	151.3
Profit and loss account	25	687.6	620.9	303.8	274.0
Shareholders' funds	26	976.2	909.1	592.4	562.2

The notes on pages 32 to 67 form part of these financial statements.

Approved by the Board on 20 June 2002 and signed on its behalf by:

K G HARVEY, Chairman



Group cash flow statement

for the year ended 31 March 2002

	Notes	2002 £m	2001 Restated (note 12) £m
Net cash inflow from operating activities	33(a)	196.2	205.0
Returns on investments and servicing of finance	33(b)	(44.3)	(39.9)
Taxation		0.4	(0.3)
Capital expenditure and financial investment	33(b)	(182.3)	(153.2)
Acquisitions and disposals		85.0	12.0
Equity dividends paid		(49.4)	(65.3)
Net cash inflow/(outflow) before use of liquid resources and financing		5.6	(41.7)
Management of liquid resources	33(b)	(27.0)	(24.2)
Financing	33(b)	38.2	64.6
Increase/(decrease) in cash in year	33(c)	16.8	(1.3)

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 2002, together with the attributable share of results and reserves of joint ventures and associated undertakings on the basis of their latest financial statements. The results of any 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.

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.

1. Accounting policies *continued*

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

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

Other assets are stated at cost less accumulated depreciation.

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

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

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

(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.

The adoption of Financial Reporting Standard 18 'Accounting Policies' has resulted in a change in the method of accounting for defeased finance leases. The effect of this change is disclosed in note 12.

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

1. Accounting policies *continued*

(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, 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 14.

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.

In respect of Financial Reporting Standard 17 'Retirement Benefits', the Company has adopted the disclosure requirements only, as set out in note 31.

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 in full. Where the effect of the time value of money is material the current amount of the reversals of tax deferred is discounted to its present value. The unwinding of the discount to present value is included in the tax charge.

Deferred tax assets are recognised to the extent that it is regarded as more likely than not that there will be suitable taxable profits against which the deferred tax asset can be recovered in future periods.

The adoption of Financial Reporting Standard 19 'Deferred Tax' has resulted in a change in the method of accounting for deferred tax. The effect of this change is disclosed in note 12.

(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

2. Segmental analysis

By class of business

	Turnover		Group operating profit		Profit before tax	
	2002 £m	2001 £m	2002 £m	2001 £m	2002 £m	2001 £m
Continuing operations						
Water and sewerage	260.4	251.4	107.0	107.3	66.8	67.0
Waste management	125.3	106.1	14.9	13.1	13.5	11.7
Other	6.6	6.1	(2.8)	-	(11.0)	(10.2)
Less intra-group trading	(11.3)	(10.4)	-	-	-	-
Total continuing operations	381.0	353.2	119.1	120.4	69.3	68.5
Discontinued operations						
Instrumentation	43.0	54.9	2.6	4.8	2.7	4.9
Construction services	-	37.1	-	0.5	-	0.4
Property	1.4	5.7	0.1	2.4	0.3	2.5
Less intra-group trading	(1.5)	(15.8)	-	-	-	-
Total discontinued operations	42.9	81.9	2.7	7.7	3.0	7.8
Exceptional item						
Discontinued operations disposal profit/(loss)	-	-	-	-	5.1	(2.1)
Group totals	423.9	435.1	121.8	128.1	77.4	74.2

	Net assets/(liabilities)		Employees (average number)	
	2002 £m	2001 Restated (note 12) £m	2002	2001
Continuing operations				
Water and sewerage	930.0	934.0	1,485	1,537
Waste management	94.2	88.1	605	453
Other, including intra-group trading	(48.0)	(165.8)	47	51
	976.2	856.3	2,137	2,041
Discontinued operations				
Instrumentation	-	49.6	421	495
Construction services	-	-	-	617
Property	-	3.2	4	4
	-	52.8	425	1,116
Group totals	976.2	909.1	2,562	3,157

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 continuing operations include parent company financing of business acquisitions. Profit before tax of other continuing operations is shown after interest arising thereon.

By geographical origin

	Turnover		Group operating profit	
	2002 £m	2001 £m	2002 £m	2001 £m
United Kingdom	386.7	388.4	118.4	122.7
Continental Europe	14.2	18.6	1.0	1.6
Americas	23.0	28.1	2.4	3.8
	423.9	435.1	121.8	128.1

By geographical destination

	Turnover		Group operating profit	
	2002 £m	2001 £m	2002 £m	2001 £m
United Kingdom	384.7	383.5	118.9	123.5
Continental Europe	4.7	7.6	0.2	0.3
Americas	25.0	32.3	2.4	3.9
Other	9.5	11.7	0.3	0.4
	423.9	435.1	121.8	128.1

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 327 working outside the United Kingdom (2001 382). These employees were all in the instrumentation segment.

Turnover and Group operating profit in 2002 and 2001 which arose in geographical locations outside the United Kingdom principally related to the instrumentation segment which was discontinued during the year.

The results of Viridor Instrumentation Limited up to the disposal date and the comparatives for the year ended 31 March 2001 are included under discontinued operations.

The comparatives for the year ended 31 March 2001 for discontinued operations also include the results of T J Brent Limited which was disposed of in December 2000.

3. Operating costs

	Continuing operations £m	Acquisitions £m	Discontinued operations £m	Total 2002 £m	Continuing operations £m	Discontinued operations £m	Total 2001 £m
Manpower costs (note 10)	44.8	2.0	12.9	59.7	41.6	22.3	63.9
Raw materials and consumables	22.1	1.8	15.2	39.1	20.4	24.5	44.9
Rentals under operating leases:							
Hire of plant and machinery	3.2	0.2	0.2	3.6	3.4	0.4	3.8
Other operating leases	2.9	–	0.4	3.3	1.3	0.7	2.0
Research and development expenditure	0.1	–	2.5	2.6	0.1	3.2	3.3
Auditors' remuneration	0.2	–	–	0.2	0.3	0.1	0.4
Other external charges	46.7	0.3	1.6	48.6	41.9	11.7	53.6
Amortisation of intangible fixed assets	–	0.3	1.3	1.6	–	1.4	1.4
Depreciation:							
On owned assets	57.3	0.3	0.9	58.5	51.9	1.7	53.6
On assets held under finance leases	16.9	0.1	–	17.0	16.5	0.3	16.8
Profit on disposal of tangible fixed assets	(1.1)	–	–	(1.1)	(0.4)	(0.3)	(0.7)
Deferred income released to profits	(1.2)	–	–	(1.2)	(1.2)	–	(1.2)
Other operating charges	63.7	1.3	5.2	70.2	57.0	8.2	65.2
	255.6	6.3	40.2	302.1	232.8	74.2	307.0

The depreciation on assets held under finance leases has been restated to include depreciation on defeased finance leases (previously separately disclosed) following the change of accounting policy set out in note 12.

Fees payable to the Company's auditors for non-audit work, mainly in connection with the potential balance sheet restructuring and the disposal of Viridor Instrumentation Limited, amounted to £0.2 million (2001 £0.2 million).

4. Profit/(loss) on disposal of discontinued operation

	2002 £m	2001 £m
Profit/(loss) on disposal of discontinued operation	5.1	(2.1)

The profit on the disposal of the discontinued operation in 2002 relates to the sale of the Company's interest in the ordinary share capital of Viridor Instrumentation Limited, which had comprised the Group's instrumentation segment. The profit on disposal, which is an exceptional item reported after operating profit, is after charging £43.5 million of goodwill previously written off to reserves on acquisition. An analysis of net assets sold is shown in note 33(f). The tax charge was not affected by the business disposal profit.

The loss on the disposal of the discontinued operation in 2001 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 £6.6million of goodwill previously written off to reserves on acquisition. An analysis of net assets sold is shown in note 33(f). The tax charge was not affected by the business disposal loss.

5. Net interest payable

	2002 £m	2001 Restated (note 12) £m
Interest payable:		
Bank loans and overdrafts	(15.5)	(16.9)
Other loans	(16.7)	(16.9)
Interest element of finance lease rentals	(27.8)	(28.7)
Other finance costs	(0.5)	(2.3)
	(60.5)	(64.8)
Interest receivable:		
Listed redeemable securities	0.2	0.6
Other investments (as defined in note 19)	12.0	13.4
	12.2	14.0
Unwinding of discount in provisions	(0.7)	(0.6)
Net interest payable	(49.0)	(51.4)

6. Tax on profit on ordinary activities

(a) Analysis of charge for the year

	2002 £m	2001 Restated (note 12) £m
Current tax:		
UK corporation tax at 30%:		
Current year	2.4	–
Prior year	(1.9)	–
	0.5	–
Overseas tax:		
Current year	0.3	–
Prior year	(0.8)	–
	(0.5)	–
Total current tax (note 6(b))	–	–
Deferred tax:		
Origination and reversal of timing differences	23.2	21.2
Increase in discount on undiscounted provision	(19.9)	(3.6)
Total deferred tax (note 22)	3.3	17.6
Tax on profit on ordinary activities	3.3	17.6

Notes to the financial statements

6. Tax on profit on ordinary activities *continued*

(b) Factors affecting tax charge for the year

	2002 £m	2001 Restated (note 12) £m
Profit on ordinary activities before tax	77.4	74.2
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK (30%)	23.2	22.3
Effects of:		
Capital profit/(loss) on disposal of discontinued operation	(1.5)	0.6
Expenses not deductible for tax purposes	1.8	1.9
Capital allowances for year in excess of depreciation	(22.5)	(21.2)
Other timing differences	1.7	(3.6)
Adjustments to tax charge in respect of prior year	(2.7)	-
Current tax charge for period (note 6(a))	-	-

7. Profit of parent company

	2002 £m	2001 Restated £m
Profit on ordinary activities after taxation dealt with in the accounts of the parent company	81.3	72.1

The profit on ordinary activities after taxation dealt with in the accounts of the parent company in 2001 has been restated to include a prior year adjustment of £0.1 million credit for deferred tax.

As permitted by section 320 of the Companies Act 1985, no profit and loss account is presented for the Company.

8. Dividends

	2002 £m	2001 £m
Interim dividend of 12.1p (2001 11.6p) per share paid 8 April 2002	16.6	15.9
Proposed final dividend of 25.4p (2001 24.4p) per share payable 1 October 2002	34.8	33.5
	51.4	49.4

9. Earnings per share

	Profit after tax £m	2002 Earnings per share		Profit after tax £m	2001 Restated (note 12) Earnings per share	
		Basic p	Diluted p		Basic p	Diluted p
Before exceptional item	69.0	50.6	50.5	58.7	43.1	43.0
Exceptional item:						
Discontinued operation disposal profit/(loss)	5.1	3.7	3.7	(2.1)	(1.6)	(1.6)
After exceptional item	74.1	54.3	54.2	56.6	41.5	41.4

Earnings per share before the exceptional item in 2002 and 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 136.5 million (2001 136.3 million).

All share options with an exercise price lower than the average market price of the Company's shares during the year have been included in the calculation of diluted earnings per share. The weighted average number of shares in issue during the year, taking account of the dilutive effect of share options, was 136.8 million (2001 136.6 million).

10. Employees and employment costs

The average number of persons (including Directors) employed by the Group was 2,562 (2001 3,157), including 425 for the discontinued operations (2001 1,116).

	Continuing operations £m	Acquisitions £m	Discontinued operations £m	Total 2002 £m	Continuing operations £m	Discontinued operations £m	Total 2001 £m
Employment costs comprise:							
Wages and salaries	47.1	1.8	12.2	61.1	45.2	25.4	70.6
Social security costs	3.3	0.1	2.3	5.7	3.5	3.2	6.7
Pension costs	2.7	0.1	0.3	3.1	1.2	0.4	1.6
Total employment costs	53.1	2.0	14.8	69.9	49.9	29.0	78.9
Charged as follows:							
Manpower costs (note 3)	44.8	2.0	12.9	59.7	41.6	22.3	63.9
Research and development expenditure	0.1	-	1.9	2.0	-	2.7	2.7
Restructuring provision	0.3	-	-	0.3	1.2	-	1.2
Capital schemes	7.9	-	-	7.9	7.1	4.0	11.1
	53.1	2.0	14.8	69.9	49.9	29.0	78.9

11. Directors' emoluments

	2002 £000	2001 £000
Executive Directors:		
Salary	453	435
Performance related bonus:		
Payable	187	105
Deferred	100	–
Other emoluments	40	42
Payments in respect of tax liability from supplementary pension arrangements	14	41
Non-executive Directors	251	226
Total emoluments	1,045	849

The emoluments of the highest paid Director, including gains on the exercise of share options, were £296,000 (2001 £215,000).

Total gains made by Directors on the exercise of share options were nil (2001 £4,000).

Total emoluments include £378,000 (2001 £263,000) payable to Directors for services as directors of subsidiary undertakings.

At 31 March 2002 and 31 March 2001 retirement benefits were accruing to three Directors under defined benefit pension schemes. The accrued pension entitlement at 31 March 2002 under defined benefit schemes of the highest paid Director was £40,000 (2001 £95,000). No pension contributions were payable to defined contribution schemes in 2002 or 2001.

More detailed information concerning Directors' emoluments, shareholdings and share options is shown in the report on remuneration policy and remuneration on pages 17 to 21.

12. Prior year adjustments

The Group's accounting policy on deferred taxation has changed following adoption of Financial Reporting Standard 19 'Deferred Tax' (FRS 19). The FRS requires full provision to be made for deferred taxation arising from timing differences between recognition of gains and losses in the financial statements and their recognition in a tax computation. The Group has adopted a policy of discounting deferred tax assets and liabilities to reflect the time value of money, as permitted by FRS 19. Previously, the Group's accounting policy was to provide for deferred taxation to the extent that it was likely to crystallise in the foreseeable future. The application of the previous accounting policy resulted in no provision for deferred taxation being recognised at 31 March 2001.

With the adoption of Financial Reporting Standard 18 'Accounting Policies' (FRS 18), the Directors have reviewed the accounting policies of the Group and decided that, in the current reporting environment which encourages increased clarity and transparency in accounting transactions, it is appropriate to present the Group's defeased lease arrangements in a manner that improves their understandability and comparability with other utilities. Accordingly, the rental obligations and cash deposits associated with these leases have now been recognised on the balance sheet separately and the net interest receivable arising from these transactions will now be recognised over the life of the leases.

12. Prior year adjustments *continued*

As a result of these changes in accounting policy the comparative year has been restated as follows:

Group and Company balance sheets

	Group Provisions for liabilities and charges 2001 £m	Group Deferred income 2001 £m	Group Profit and loss reserve 2001 £m	Company Profit and loss reserve 2001 £m
Previously reported	(22.8)	(49.0)	(689.4)	(273.6)
Deferred taxation (FRS 19)	(43.1)	-	43.1	(0.4)
Deceased leases (FRS 18)	-	7.9	25.4	-
Restated now reported	(65.9)	(41.1)	(620.9)	(274.0)

The restatement of the Group's profit and loss reserve at 31 March 2001 comprises a prior period adjustment of £50.9 million (£25.5 million FRS 19 and £25.4 million FRS 18) and a £17.6 million charge for the year (FRS 19).

	Group Creditors: amounts falling due within one year 2001 £m	Group Creditors: amounts falling due after more than one year 2001 £m	Group Current asset investments 2001 £m	Company Debtors: amounts falling due after more than one year 2001 £m
Previously reported	(217.3)	(727.9)	61.4	161.8
Deferred taxation (FRS 19)	-	-	-	0.4
Deceased leases (FRS 18)	(4.1)	(183.8)	154.6	-
Restated now reported	(221.4)	(911.7)	216.0	162.2

Group profit and loss account

	Net interest payable 2001 £m	Tax on profit on ordinary activities 2001 £m	Basic earnings per share 2001 p	Diluted earnings per share 2001 p
Previously reported	(51.4)	-	56.0	55.9
Deferred taxation (FRS 19)	-	(17.6)	(12.9)	(12.9)
Deceased leases (FRS 18)	-	-	-	-
Restated now reported	(51.4)	(17.6)	43.1	43.0

The changes arising within net interest payable from the adoption of FRS 18 relate to the recognition of £9.2 million interest receivable on investments and £8.6 million interest payable on finance leases, offset by the elimination of the previously reported gain on defeasance of finance leases of £0.6 million.

There is no material effect on the current year's results as a consequence of the change in accounting policy in respect of deceased leases. The effect of the change in accounting policy for deferred tax is the charge for deferred tax shown in note 22.

Depreciation on assets held under deceased finance leases has been reclassified as depreciation on assets held under finance leases.

Notes to the financial statements

12. Prior year adjustments *continued*

Group cash flow statement

	Management of liquid resources 2001 £m	Financing 2001 £m
Previously reported		
Defeased leases (FRS 18)	(25.2)	65.6
	1.0	(1.0)
Restated now reported	(24.2)	64.6

13. Intangible fixed assets

	Goodwill £m	Licences £m	Group Total 2002 £m
Cost:			
At 1 April 2001			
Additions	26.8	1.0	27.8
Business disposal	11.8	–	11.8
Currency retranslation	(27.8)	(1.0)	(28.8)
	1.0	–	1.0
At 31 March 2002	11.8	–	11.8
Amortisation:			
At 1 April 2001			
Charge for year	3.0	0.1	3.1
Business disposal	1.4	0.2	1.6
Currency retranslation	(4.4)	(0.3)	(4.7)
	0.1	–	0.1
At 31 March 2002	0.1	–	0.1
Net book value:			
At 31 March 2002	11.7	–	11.7
At 31 March 2001	23.8	0.9	24.7

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

14. 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 2002 £m	Company Total 2002 £m
Cost:							
At 1 April 2001	148.1	892.1	473.8	627.2	96.4	2,237.6	0.4
Arising on acquisitions	3.6	–	–	2.4	–	6.0	–
Additions	14.2	48.3	30.7	46.9	46.3	186.4	0.1
Grants and contributions	–	(1.1)	–	–	–	(1.1)	–
Business disposal	(3.8)	–	–	(7.0)	–	(10.8)	–
Disposals	–	(0.6)	(0.5)	(4.1)	–	(5.2)	(0.1)
Transfers/reclassifications	(8.2)	13.4	25.6	38.1	(68.9)	–	–
Currency retranslation	(0.1)	–	–	–	–	(0.1)	–
At 31 March 2002	153.8	952.1	529.6	703.5	73.8	2,412.8	0.4
Depreciation:							
At 1 April 2001	46.3	87.8	89.3	215.7	–	439.1	0.1
Charge for year	11.1	13.1	8.5	43.8	–	76.5	0.1
Business disposal	(0.9)	–	–	(5.2)	–	(6.1)	–
Disposals	–	(0.6)	–	(3.8)	–	(4.4)	–
Transfers/reclassifications	(2.2)	–	(5.5)	7.7	–	–	–
At 31 March 2002	54.3	100.3	92.3	258.2	–	505.1	0.2
Net book value:							
At 31 March 2002	99.5	851.8	437.3	445.3	73.8	1,907.7	0.2
At 31 March 2001	101.8	804.3	384.5	411.5	96.4	1,798.5	0.3
Assets held under finance leases included above:							
Cost: At 31 March 2002	–	105.8	309.4	188.1	15.7	619.0	–
Depreciation: Charge for year	–	1.5	5.4	10.1	–	17.0	–
Depreciation: At 31 March 2002	–	5.0	32.5	81.3	–	118.8	–

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

The cost of land and buildings and of operational properties includes non-depreciable land of £2.4 million (2001 £2.4 million) and £9.3 million (2001 £9.3 million) respectively.

Notes to the financial statements

14. Tangible fixed assets *continued*

The net book value of land and buildings comprises:

	2002 £m	2001 £m
Freehold	57.5	62.0
Long leasehold	-	0.8
Short leasehold	42.0	39.0
	99.5	101.8

The net book value of infrastructure assets is stated after deducting £45.4 million (2001 £44.3 million) grants and contributions.

The net book value of infrastructure assets includes £9.7 million (2001 £5.9 million) for the accumulated difference between expenditure on maintaining operating capacity and depreciation charges. Expenditure in the year was £16.9 million (2001 £14.8 million).

Out of the total depreciation charge for the Group of £76.5 million (2001 £72.1 million), the sum of £1.0 million (2001 £1.7 million) has been charged to capital projects and £75.5 million (2001 £70.4 million) against profits.

15. Fixed asset investments

	Subsidiary undertakings £m	Own shares £m	Other investments £m	Total investments 2002 £m
Group				
Cost:				
At 1 April 2001	-	2.0	1.1	3.1
Additions	-	0.5	-	0.5
Provision for impairment	-	(0.3)	-	(0.3)
At 31 March 2002	-	2.2	1.1	3.3
Company				
Cost:				
At 1 April 2001	743.1	0.9	0.5	744.5
Additions	274.6	0.3	-	274.9
Disposals	(87.1)	-	-	(87.1)
Provision for impairment	(2.5)	-	-	(2.5)
At 31 March 2002	928.1	1.2	0.5	929.8

All investments are in shares except other investments for the Group which includes £0.6 million loans at 31 March 2002 (2001 £0.6 million).

The additions and disposals of subsidiary undertakings by the Company primarily arose from the transfer of the ownership of Viridor Waste Limited and Viridor Instrumentation Limited from Viridor Limited and the subsequent disposal of Viridor Instrumentation Limited.

15. 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 17 to 21.

During the year the trustees of the Employee Share Ownership Plan purchased 74,000 of the Company's ordinary shares (2001 78,000) financed through non-interest bearing advances made by sponsoring Group companies. The market value of the 545,000 shares held as Group investments at 31 March 2002 was £3.5 million (2001 £2.8 million). 298,000 of those shares (2001 174,000) held as Company investments had a market value of £1.9 million at 31 March 2002 (2001 £1.0 million). The costs of the incentive scheme are recognised as a provision for impairment and are charged within employment costs to profits over the period of its operation.

Details of principal subsidiary and associated undertakings and a joint venture of the Group are set out in note 30.

16. Stocks

	Group		Company	
	2002 £m	2001 £m	2002 £m	2001 £m
Raw materials and consumables	3.2	7.8	-	-
Work in progress	-	0.6	-	-
Finished goods	-	5.5	-	-
	3.2	13.9	-	-

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

	Group		Company	
	2002 £m	2001 £m	2002 £m	2001 Restated (note 12) £m
Amounts owed by subsidiary undertakings	-	-	177.9	160.6
Other debtors	1.1	1.1	1.1	1.1
Prepayments for pension costs	4.3	6.0	0.7	0.1
Deferred taxation (note 22)	-	-	0.2	0.4
	5.4	7.1	179.9	162.2

18. Debtors: amounts falling due within one year

	Group		Company	
	2002 £m	2001 £m	2002 £m	2001 £m
Trade debtors	46.2	55.5	-	-
Amounts owed by subsidiary undertakings	-	-	9.6	34.7
Amounts owed by joint venture	0.3	-	-	-
Other debtors	9.4	6.7	0.6	0.2
Prepayments for pension costs	2.5	1.8	0.5	0.1
Other prepayments and accrued income	17.3	16.9	0.1	0.1
Tax recoverable	0.5	1.3	-	-
	76.2	82.2	10.8	35.1

19. Current asset investments

	Group		Company	
	2002 £m	2001 Restated (note 12) £m	2002 £m	2001 £m
Listed investments	4.8	7.1	-	-
Other investments:				
Overnight deposits	45.3	0.6	41.7	-
Other	240.9	208.3	71.2	-
	286.2	208.9	112.9	-
	291.0	216.0	112.9	-

At 31 March 2002 the market value of listed investments was £4.9 million (2001 £7.2 million).

Other investments include certificates of deposit, variable rate notes, commercial paper, other short-dated unlisted securities and deposits of £157.9 million (2001 £154.6 million) made to counter-indemnify letters of credit by financial institutions to lessors in order to secure rental obligations (note 27).

20. Creditors: amounts falling due within one year

	Group		Company	
	2002 £m	2001 Restated (note 12) £m	2002 £m	2001 £m
Loans:				
Bank loans and overdrafts	29.1	3.9	18.2	24.0
Short-term loans	35.0	10.0	35.0	10.0
European Investment Bank loans	12.8	12.1	-	-
Unsecured loan stock notes	15.1	16.4	15.1	16.4
	92.0	42.4	68.3	50.4
Obligations under finance leases	19.2	17.8	-	-
Trade creditors	62.2	62.0	0.5	0.2
Amounts owed to subsidiary undertakings	-	-	301.2	3.6
Other creditors	16.3	16.7	7.3	6.6
Corporation tax	2.9	2.0	-	-
Foreign tax	-	0.9	-	-
Other taxation and social security	11.7	11.8	0.2	0.3
Accruals and deferred income	20.3	18.4	1.7	0.7
Interim dividend	16.6	15.9	16.6	15.9
Proposed final dividend	34.8	33.5	34.8	33.5
	276.0	221.4	430.6	111.2

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

	Group		Company	
	2002 £m	2001 Restated (note 12) £m	2002 £m	2001 £m
Loans:				
Sterling bond	150.0	150.0	150.0	150.0
European Investment Bank loans	49.2	62.0	-	-
Other bank loans	100.0	110.1	50.0	110.0
	299.2	322.1	200.0	260.0
Obligations under finance leases	632.9	589.2	-	-
Amounts owed to subsidiary undertakings	-	-	8.7	8.7
Other creditors	0.2	0.4	-	-
	932.3	911.7	208.7	268.7

22. Provisions for liabilities and charges

	Deferred tax £m	Environmental & landfill restoration £m	Restructuring £m	Other provisions £m	Group Total 2002 £m	Company Restructuring 2002 £m
At 1 April 2001	-	19.7	0.2	2.9	22.8	-
Prior year adjustment (note 12)	43.1	-	-	-	43.1	-
At 1 April 2001 (restated)	43.1	19.7	0.2	2.9	65.9	-
Charged against profits	3.3	2.9	1.4	0.1	7.7	1.2
Pension costs	-	-	0.8	-	0.8	0.8
Arising on acquisitions	-	3.7	-	-	3.7	-
Business disposal	(0.2)	-	-	-	(0.2)	-
Utilised during year	-	(3.0)	(0.4)	(0.1)	(3.5)	(0.1)
At 31 March 2002	46.2	23.3	2.0	2.9	74.4	1.9

Environmental and landfill restoration provisions will be utilised over the period from 2003 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, in both the Company and the Group, 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.

22. Provision for liabilities and charges continued

Deferred taxation

	Group		Company	
	2002 £m	2001 Restated (note 12) £m	2002 £m	2001 Restated (note 12) £m
Accelerated capital allowances	240.2	216.3	–	–
Other timing differences	(4.5)	(1.8)	(0.2)	(0.4)
Undiscounted provision/(asset) for deferred tax	235.7	214.5	(0.2)	(0.4)
Discount	(189.5)	(171.4)	–	–
Discounted provision/(asset) for deferred tax	46.2	43.1	(0.2)	(0.4)
Provision/(asset) at 1 April 2001 restated	43.1		(0.4)	
Business disposal	(0.2)		–	
Deferred tax charge in profit and loss account for year	3.3		0.2	
Provision/(asset) at 31 March 2002	46.2		(0.2)	

The Company deferred tax asset is included within debtors falling due after more than one year (note 17).

23. Deferred income

	Finance lease variations £m	Forward interest rate swaps (note 28) £m	Grants and contributions £m	Group Total 2002 £m	Finance lease variations £m	Forward interest rate swaps (note 28) £m	Grants and contributions £m	Group Total 2001 £m
At 1 April:								
Amount to be released:								
After more than one year	–	18.2	22.9	41.1	7.5	18.2	24.2	49.9
Prior year adjustment (note 12)	–	–	–	–	(7.5)	–	–	(7.5)
	–	18.2	22.9	41.1	–	18.2	24.2	42.4
Amount to be released within one year	–	–	1.3	1.3	–	–	1.2	1.2
Restated	–	18.2	24.2	42.4	–	18.2	25.4	43.6
Additions	–	–	0.7	0.7	–	–	–	–
Released to profits	–	–	(1.2)	(1.2)	–	–	(1.2)	(1.2)
At 31 March:	–	18.2	23.7	41.9	–	18.2	24.2	42.4
Amount to be released:								
Within one year	–	–	(1.3)	(1.3)	–	–	(1.3)	(1.3)
After more than one year	–	18.2	22.4	40.6	–	18.2	22.9	41.1

Finance lease variations at 1 April 2001 have been restated to include the prior year adjustment of £7.9 million (note 12). The restatement at 1 April 2000 is £7.5 million and additions for 2001 of £0.4 million have been expunged.

24. Called-up share capital

	2002 £m	2001 £m
<i>Authorised</i>		
175,000,000 ordinary shares of £1 each	175.0	175.0
<i>Allotted, called-up and fully paid</i>		
137,007,911 ordinary shares of £1 each (2001 136,948,508)	137.0	136.9

	2002 Number	2001 Number
<i>Ordinary shares allotted during the year</i>		
For consideration of nil (2001 £0.8 million) under the Company's Executive Share Option Scheme to Directors and senior employees who exercised their options	–	153,300
For consideration of £0.4 million (2001 £2.5 million) to Pennon Trustee Limited on behalf of employees who exercised their options under the Company's Sharesave Scheme	59,403	449,925
	59,403	603,225

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		
				2002	2001	
Sharesave	6 Jan 1995	373p	–	2000 – 2002	46	48
	8 July 1997	556p	–	2000 – 2004	201	242
	7 July 1998	775p	–	2001 – 2005	42	90
	6 July 1999	825p	–	2002 – 2006	54	81
	5 July 2000	461p	–	2003 – 2007	825	1,099
	4 July 2001	489p	–	2004 – 2008	209	–
Executive	3 July 1992	418p	a	1995 – 2002	2	2
	5 July 1993	496p	b	1996 – 2003	4	4
	6 Jan 1995	503p	c	1998 – 2005	9	9
					1,392	1,575

24. Called-up share capital *continued*

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 2002 there were 1,089 participants in the Sharesave Scheme (2001 1,391) and 2 in the Executive Scheme (2001 2).

Options granted to Directors, included above, are shown in the report on remuneration policy and remuneration on pages 17 to 21.

25. Reserves

	Group and Company share premium account £m	Profit and loss account Group £m	Company £m
At 1 April 2001	151.3	689.4	273.6
Prior year adjustments (note 12)	–	(68.5)	0.4
At 1 April 2001 (restated)	151.3	620.9	274.0
Retained profit for year	–	22.7	29.9
Premium on shares issued	0.2	–	–
Adjustment for shares issued under the Sharesave Scheme through Employee Share Ownership Trust	0.1	(0.1)	(0.1)
Currency retranslation differences on foreign currency net investments	–	0.6	–
Goodwill written back on disposal	–	43.5	–
At 31 March 2002	151.6	687.6	303.8

Currency retranslation differences on foreign currency net investments are after a £0.4 million gain arising on a currency hedge (2001 £1.2 million loss).

The cumulative value of goodwill at 31 March 2002 resulting from acquisitions, which has been written off to reserves, is £123.3 million (2001 £166.8 million). Goodwill of £43.5 million was written back on the disposal of Viridor Instrumentation Limited (2001 £6.6 million on disposal of T J Brent Limited).

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.

26. Statement of movements in shareholders' funds

	Group		Company	
	2002 £m	2001 £m	2002 £m	2001 £m
Profit on ordinary activities after taxation	74.1	56.6	81.3	72.1
Dividends	(51.4)	(49.4)	(51.4)	(49.4)
	22.7	7.2	29.9	22.7
Other recognised gains and losses for the year	0.6	0.2	-	-
Shares issued for cash consideration	0.4	3.3	0.4	3.3
Adjustment for shares issued under the Sharesave Scheme through Employee Share Ownership Trust	(0.1)	(0.6)	(0.1)	(0.6)
Goodwill written back on disposal	43.5	6.6	-	-
Shareholders' funds (equity interest):				
Addition for year	67.1	16.7	30.2	25.4
At 1 April (restated)	909.1	892.4	562.2	536.8
At 31 March	976.2	909.1	592.4	562.2

Group shareholders' funds at 1 April 2001 have been restated to include the prior year adjustment of £68.5 million (Company £0.4 million) as set out in note 12.

The restatement of Group shareholders' funds at 1 April 2000 is £50.9 million (Company £0.3 million) and the restated profit for the year 2001 has been reduced by £17.6 million (Company £0.1 million increase).

Notes to the financial statements

27 Loans and other borrowings

Loans

	Group		Company	
	2002 £m	2001 £m	2002 £m	2001 £m
Repayable:				
Over five years	152.2	156.6	150.0	150.0
Over two and up to five years	133.4	92.7	50.0	50.0
Over one and up to two years	13.6	72.8	-	60.0
Falling due after more than one year (note 21)	299.2	322.1	200.0	260.0
Falling due within one year (note 20)	92.0	42.4	68.3	50.4
	391.2	364.5	268.3	310.4

£0.2 million floating rate unsecured guaranteed loan stock notes, repayable at par in 2009 or on notice being given by the noteholders, were issued during the year to satisfy contingent consideration payable in connection with the December 1997 acquisition of Terry Adams Limited (note 29).

Obligations under finance leases

	Group		Company	
	2002 £m	2001 Restated (note 12) £m	2002 £m	2001 £m
Repayable:				
Over five years	576.5	554.5	-	-
Over two and up to five years	37.7	12.2	-	-
Over one and up to two years	18.7	22.5	-	-
Falling due after more than one year (note 21)	632.9	589.2	-	-
Falling due within one year (note 20)	19.2	17.8	-	-
	652.1	607.0	-	-

Included above are accrued finance charges arising on obligations under finance leases totalling £77.8 million (2001 £72.1 million as restated), of which £16.4 million (2001 £10.7 million as restated) 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.

Loans	Group		Company	
	2002 £m	2001 Restated £m	2002 £m	2001 £m
Obligations under finance leases	169.8	172.5	150.0	150.0
	650.4	603.6	-	-
	820.2	776.1	150.0	150.0

27 Loans and other borrowings continued

The rates of interest payable on loans and other borrowings, any part of which is due after five years, range between 3.9% and 11.3% (2001 5.2% and 11.3%), and are repayable over the period 2003 to 2030.

Within obligations under finance leases South West Water Limited has:

- a utilised finance lease facilities of £180.0 million at 31 March 2002 (2001 £180.0 million) for certain water and sewerage business tangible fixed assets;
- 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 2002 (2001 £144.9 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, or any Pennon Group company.

The rentals payable under the finance leases will vary if interest rates, or effective tax rates, change.

The separate recognition of these obligations under finance leases and the current asset investments on the Group balance sheet is a prior year adjustment following the change in accounting policy (note 12).

Borrowing facilities

Undrawn committed borrowing facilities of £130.0 million were available to the Group at 31 March 2002 which expire as follows:

	2002 £m	2001 £m
Within one year or less	100.0	-
Over two and up to five years	30.0	30.0
	130.0	30.0

In addition, the Group has short-term uncommitted bank facilities of over £210.0 million.

Notes to the financial statements

28. Financial instruments

Disclosures on financial and treasury policies are also included in the Corporate governance – statement of compliance on pages 22 to 25.

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	
	2002 £m	2001 Restated (note 12) £m	2002 £m	2001 Restated (note 12) £m
Floating rate	289.2	216.3	(636.6)	(554.2)
Fixed rate	4.4	4.7	(406.7)	(417.3)
On which no interest is paid	0.6	0.9	(19.9)	(19.9)
	294.2	221.9	(1,063.2)	(991.4)
Which is included in:				
Net debt	292.0	219.7	(1,043.3)	(971.5)
Provisions for liabilities and charges	–	–	(1.7)	(1.7)
Deferred income	–	–	(18.2)	(18.2)
Other long-term monetary assets	2.2	2.2	–	–
	294.2	221.9	(1,063.2)	(991.4)
Floating rate financial assets and liabilities are denominated in:				
Sterling	289.2	211.8	(636.6)	(509.4)
US dollar	–	2.8	–	(16.5)
Swiss franc	–	0.4	–	(28.3)
Other currencies	–	1.3	–	–
	289.2	216.3	(636.6)	(554.2)
Fixed rate financial assets and liabilities:				
Weighted average interest rate	6.6%	6.5%	8.3%	8.3%
Weighted average period for which rate is fixed	0.9 years	2.6 years	4.9 years	5.9 years
Range of interest rates	3.5% to 8.0%	3.5% to 8.0%	5.1% to 11.3%	5.1% to 11.3%
Financial assets and liabilities on which no interest is paid:				
Weighted average period until maturity	–	–	16.2 years	17.2 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.

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 Offer Rate (LIBOR) or equivalent. The range of interest rates applying at 31 March 2002 was 3.3% to 5.3% (2001 5.0% to 6.7%)

The maturity profile of floating rate and fixed rate financial liabilities is shown in note 27. Other financial liabilities fall due for payment principally after five years.

28. Financial instruments *continued*

Interest rate and currency profile of financial assets and liabilities continued

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 2002 54% of net debt was at fixed rate (2001 55% as restated);

at 31 March 2002 interest rate swaps to hedge financial liabilities, with a notional principal value of £200.0 million, existed with a weighted average maturity of 1.4 years (2001 £200.0 million, with 2.4 years) to swap from floating to fixed rate; and

at 31 March 2002 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 Offer Rate (EURIBOR) with commencement dates between 1 April 2006 and 1 April 2010 and maturing on 31 March 2030 (2001 £200.0 million). The settlement of £18.2 million which was received when these swaps were entered into during December 1999 has been deferred (note 23) and will be matched with interest charges on the underlying hedged debt over the period 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 to the Group.

Forward currency contracts were used to hedge the net investment in overseas subsidiaries. At 31 March 2002 no forward currency contracts existed (2001 forward currency sales of US dollar 22.0 million, and Swiss franc 69.0 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. Following the disposal of Viridor Instrumentation Limited there were no net foreign monetary assets or liabilities at 31 March 2002. Net foreign monetary assets and liabilities at 31 March 2001 comprised:

	Sterling £m	US dollar £m	Euros £m	Deutsche mark £m	Other £m	Total £m
Functional currency of Group operation:						
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

Forward currency contracts which were 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

28. Financial instruments continued

Fair values of financial assets and liabilities

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

	2002		2001	
	Book value £m	Fair value £m	Book value Restated (note 12) £m	Fair value Restated (note 12) £m
Financial assets:				
Current asset investments	291.0	291.1	216.0	216.1
Cash at bank	1.0	1.0	3.7	3.7
Other	2.2	2.2	2.2	2.5
	294.2	294.3	221.9	222.3
Financial liabilities:				
Short-term debt	(92.0)	(92.2)	(42.4)	(42.6)
Long-term debt	(299.2)	(358.6)	(321.9)	(378.2)
Finance lease obligations	(652.1)	(652.1)	(607.0)	(607.0)
Other	(1.7)	(1.7)	(1.7)	(1.7)
	(1,045.0)	(1,104.6)	(973.0)	(1,029.5)
Derivative financial instruments				
<i>(used to manage interest rate and currency profile):</i>				
Interest rate swaps	(18.2)	(16.1)	(18.2)	(17.5)
Forward currency contracts	-	-	(0.2)	(0.3)
	(18.2)	(16.1)	(18.4)	(17.8)

Floating rate debt, short-dated unlisted current asset investments and cash at bank are 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.

28. Financial instruments *continued*

Hedging interest rate and currency exposures

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	2002 Total net gains £m	Gains £m	Losses £m	2001 Total net gains £m
Unrecognised gains and losses						
on hedges:						
At 1 April	5.5	(4.9)	0.6	2.9	(1.1)	1.8
Of which recognised in current year	0.8	(1.9)	(1.1)	0.8	(0.5)	0.3
	4.7	(3.0)	1.7	2.1	(0.6)	1.5
Arising and not recognised in current year	1.1	(0.7)	0.4	3.4	(4.3)	(0.9)
At 31 March	5.8	(3.7)	2.1	5.5	(4.9)	0.6
Expected to be recognised:						
in next year	0.2	(2.1)	(1.9)	0.8	(1.9)	(1.1)
Thereafter	5.6	(1.6)	4.0	4.7	(3.0)	1.7
	5.8	(3.7)	2.1	5.5	(4.9)	0.6

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

28. Acquisitions

On 5 October 2001 the entire issued share capital of Lavelle & Sons Limited was purchased by Viridor Waste Management Limited for a cash consideration of £3.4 million, including costs of £0.6 million. The acquisition was accounted for using the acquisition method, and goodwill arising on the acquisition, amounting to £3.4 million, has been capitalised and will be amortised over 20 years.

The profit after tax of Lavelle & Sons Limited in the immediate pre-acquisition accounting periods was not material.

Notes to the financial statements

29. Acquisitions continued

The operating asset and liabilities of the acquisition were:

	Book value £m	Accounting policy harmonisation £m	Other adjustments £m	Fair value to the Group £m
Tangible fixed assets	3.4	(0.6)	–	2.8
Debtors: amounts falling due within one year	1.3	–	–	1.3
Creditors: amounts falling due within one year	(2.4)	–	(0.1)	(2.5)
Creditors: amounts falling due after more than one year	(1.6)	–	–	(1.6)
	0.7	(0.6)	(0.1)	–

Accounting policy harmonisation in respect of tangible fixed assets related to the alignment of vehicle asset lives with Group policy.

On 16 October 2001 the entire issued share capital of The Suffolk Waste Disposal Company Limited (now renamed Viridor Waste Suffolk Limited) was purchased by Viridor Waste Limited for a cash consideration of £8.7 million, including costs of £0.1 million. The acquisition was accounted for using the acquisition method and goodwill arising on the acquisition, amounting to £8.4 million, has been capitalised and will be amortised over 20 years.

The loss after tax of The Suffolk Waste Disposal Company Limited amounted to £0.4 million for the period from 2 April 2001 to 15 October 2001 (profit after tax of £0.2 million in the year ended 1 April 2001).

The operating assets and liabilities of the acquisition were:

	Book value £m	Accounting policy harmonisation £m	Revaluation adjustment £m	Other adjustments £m	Fair value to the Group £m
Tangible fixed assets	2.4	(0.1)	0.9	–	3.2
Debtors: amounts falling due within one year	1.6	(0.2)	–	–	1.4
Cash at bank and in hand	3.0	–	–	–	3.0
Creditors: amounts falling due within one year	(2.9)	(0.3)	–	(0.4)	(3.6)
Provisions for liabilities and charges	(1.9)	(1.8)	–	–	(3.7)
	2.2	(2.4)	0.9	(0.4)	0.3

Accounting policy harmonisation in respect of provisions for liabilities and charges was in respect of environmental and landfill restoration costs.

During the year £2.6 million fair value acquisition accruals and provisions were established (2001 nil), £0.4 million were utilised (2001 £1.4 million), £2.5 million in respect of tax were released (2001 £0.4 million), and at 31 March 2002 £10.1 million (2001 £10.4 million) were carried forward.

30. Principal subsidiary, joint venture and associated undertakings

Subsidiary undertakings

		Country of incorporation, registration and principal operations
Water and sewerage	South West Water Limited*	England
	Peninsula Leasing Limited	England
	Peninsula Properties (Exeter) Limited	England
Waste management	Viridor Waste Limited*	England
	Viridor Waste Disposal Limited	England
	WWM (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
	Lavelle & Sons Limited	England
Viridor Waste Suffolk Limited	England	
Insurance services	Peninsula Insurance Limited*	Guernsey

* Indicates the shares were held directly by the Company

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

Joint venture

	Share capital in issue	Percentage held	Activity
Echo South West Limited	A ordinary share	100%	Customer contact management
	B ordinary share	–	

Shares in Echo South West Limited were held by South West Water Limited.

Associated undertakings

	Share capital in issue	Percentage held	Activity
Enviro-Logic Limited	2000 A ordinary shares	100%	Water and sewerage concessions
	2000 B ordinary shares	–	
Albion Water Limited	1 ordinary share	100%	Water and sewerage concessions

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

31. Pensions

The Group operates a number of pension schemes. The assets of the Group's pension schemes are held in separate trustee administered funds.

The latest actuarial valuation of the main scheme was as at 31 March 2001. At that date, the market value of the scheme's assets was £215.1 million, and this was sufficient to cover 109% of the value of benefits that had accrued to members, after allowing for assumed future increases in earnings. The assumptions which have the most significant effect on the results of the valuation are those relating to the rate of return on investments and the rates of increase in earnings and pensions. The valuation assumes that the investment return would be 5.75% per annum for past service and 6.75% per annum for future service, pensionable pay increases would average 3.5% per annum and that present and future pensions would both increase at a rate of 2.5% per annum.

The pension cost of the defined benefit scheme has been determined on the advice of independent qualified actuaries using the projected unit method. The employers' regular pension cost for the year is 11.5% of pensionable earnings (2001 12.2% and 15.9% for the two sections of the now merged scheme). The net pension charge for the year ended 31 March 2002 for the main scheme was £2.9 million (2001 £1.3 million) which benefits by £1.8 million from the amortisation of the actuarial surplus (2001 £3.6 million). Based on advice of independent qualified actuaries contributions recommenced in April 2002 at 4.8% of pensionable earnings.

Pension prepayments included as debtors of the Group amount to £6.8 million (2001 £7.8 million), representing the accumulated difference between the Group pension cost and employer contributions paid.

The Group accounts for pension benefits in accordance with Statement of Standard Accounting Practice 24 'Accounting for Pension Costs'. Financial Reporting Standard 17 'Retirement Benefits' (FRS 17) changes the basis of accounting for pension benefits from 2003/04. Under transitional arrangements applying to FRS 17, certain additional disclosures are now required and these are given below.

The full actuarial valuation at 31 March 2001 was updated at 31 March 2002 by independent qualified actuaries using the projected unit method, as required by FRS 17. The value of the assets of the scheme have been updated to market value as at 31 March 2002. The demographic assumptions used in calculating the scheme liabilities under FRS 17 remain unchanged from those used in the 31 March 2001 actuarial valuation. The financial assumptions at the year end under FRS 17 were as follows:

Rate of increase in pensionable pay	3.75%
Rate of increase for present and future pensions	2.75%
Rate used to discount scheme liabilities	6.00%
Inflation	2.75%

The assets in the scheme and the expected long-term rate of return at the year end were:

	31 March 2002	
	Return %	Value £m
Equities	7.75	151.6
Bonds	5.25	42.5
Other	5.00	15.6
Total market value of assets		209.7
Present value of scheme liabilities		(216.8)
Deficit in scheme		(7.1)
Related deferred tax asset		2.1
Net pension liabilities		(5.0)

Had FRS 17 been adopted for the year ended 31 March 2002, the net assets and reserves of the Group would be reduced from £976.2 million by the net pension liabilities of £5.0 million and by £6.8 million in respect of prepayments for pension costs under SSAP 24, to £964.4 million.

32. Commitments and contingent liabilities

	Group		Company	
	2002 £m	2001 £m	2002 £m	2001 £m
Capital commitments				
Contracted but not provided	86.5	77.3	14.5	14.9
Commitments under operating leases				
Rentals during the year following the balance sheet date:				
Land and buildings leases expiring:				
Within one year				
Between one and five years	0.1	0.4	-	-
After five years	0.1	1.1	-	-
Other leases expiring:	2.8	3.0	-	-
Within one year				
Between one and five years	0.1	0.1	-	-
	0.3	0.1	-	-
	3.4	4.7	-	-
Contingent liabilities				
Contractors' claims on capital schemes				
Guarantees	-	0.7	-	-
	29.2	27.8	443.0	441.6
	29.2	28.5	443.0	441.6

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.

33. Notes to the Group cash flow statement

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

	2002 £m	2001 £m
Group operating profit		
Depreciation charge	121.8	128.1
Amortisation of intangible fixed assets	75.5	70.4
Provision for impairment of fixed asset investments	1.6	1.4
Deferred income released to profits	0.3	0.1
Increase/(decrease) in provisions for liabilities and charges	(1.2)	(1.2)
Increase in stocks	1.0	(2.1)
(Increase)/decrease in debtors (amounts falling due within and over one year)	(0.6)	(0.3)
Increase in creditors (amounts falling due within and over one year)	(4.0)	8.7
Profit on disposal of tangible fixed assets	2.9	0.6
Net cash inflow from operating activities	(1.1)	(0.7)
	196.2	205.0

Notes to the financial statements

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

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

<i>i Returns on investments and servicing of finance</i>	2002 £m	2001 Restated £m
Interest received	9.3	10.4
Interest paid	(32.7)	(34.5)
Interest element of finance lease rentals	(20.9)	(15.8)
Net cash outflow for returns on investments and servicing of finance	(44.3)	(39.9)

Interest received and the interest element of finance lease rentals paid in 2001 have each been restated by £5.6 million reflecting the adoption of FRS 18 (note 12).

<i>ii Capital expenditure and financial investment</i>	2002 £m	2001 £m
Purchase of intangible fixed assets	-	(1.0)
Purchase of tangible fixed assets	(184.4)	(156.2)
Grants and contributions: Infrastructure assets	0.7	1.2
Receipts from disposal of tangible fixed assets	1.9	3.9
Purchase of Company shares by Employee Share Ownership Plan	(0.5)	(0.6)
Purchase of other investments	-	(0.5)
Net cash outflow for capital expenditure and financial investment	(182.3)	(153.2)

<i>iii Acquisitions and disposals</i>	2002 £m	2001 £m
Purchase of businesses	(12.1)	-
Net cash acquired with businesses	3.0	-
Sale of businesses	103.6	11.4
Cash disposed of with business sale	(9.5)	0.6
Net cash inflow for acquisitions and disposals	85.0	12.0

<i>iv Management of liquid resources</i>	2002 £m	2001 Restated (note 12) £m
Purchase of current asset investments	(159.3)	(244.0)
Sale of current asset investments	132.3	219.8
Net cash outflow from management of liquid resources	(27.0)	(24.2)

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

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

<i>v</i> Financing	2002 £m	2001 Restated (note 12) £m
Issue of ordinary share capital	0.4	3.3
Adjustment for shares issued under the Sharesave Scheme through Employee Share Ownership Trust	(0.1)	(0.6)
	0.3	2.7
Reduction in debt due within one year (other than bank overdrafts)	(13.5)	(14.5)
Increase in debt due after more than one year	15.0	–
Cash outflow from currency hedge	(0.2)	(3.3)
Finance lease drawdowns	45.6	89.0
Capital element of finance lease rental payments	(9.0)	(9.3)
	37.9	61.9
Net cash inflow from financing	38.2	64.6

(c) Analysis of net debt

	At 1 April 2001 £m	Restated (note 12) £m	At 1 April 2001 restated £m	Cash flow £m	Acquisitions (excluding cash items) £m	Non-cash movements £m	At 31 March 2002 £m
Cash at bank and in hand	3.7	–	3.7	(2.7)	–	–	1.0
Current asset investments:							
Overnight deposits	0.6	–	0.6	44.7	–	–	45.3
Bank overdrafts	(3.9)	–	(3.9)	(25.2)	–	–	(29.1)
	0.4	–	0.4	16.8	–	–	17.2
Debt due within one year (other than bank overdrafts)	(38.5)	–	(38.5)	13.5	(0.2)	(37.7)	(62.9)
Debt due after more than one year	(322.1)	–	(322.1)	(14.8)	–	37.7	(299.2)
Finance lease obligations	(418.6)	(188.4)	(607.0)	(36.6)	(2.8)	(5.7)	(652.1)
	(779.2)	(188.4)	(967.6)	(37.9)	(3.0)	(5.7)	(1,014.2)
Current asset investments:							
Other than overnight deposits	60.8	154.6	215.4	27.0	–	3.3	245.7
	(718.0)	(33.8)	(751.8)	5.9	(3.0)	(2.4)	(751.3)

Non-cash movements include transfers between categories of debt for changing maturities, increased accrued finance charges within finance lease obligations and increased accrued interest on cash deposits to secure rental obligations.

Notes to the financial statements

33. Notes to the Group cash flow statement *(continued)*

(d) Reconciliation of net cash flow to movement in net debt

	2002 £m	2001 Restated (note 12) £m
Increase/(decrease) in cash in year	16.8	(1.3)
Cash inflow from increase in debt and finance leasing	(37.9)	(62.9)
Cash outflow from increase in liquid resources	27.0	25.2
Increase/(reduction) in net debt arising from cash flows	5.9	(39.0)
Acquisition (excluding cash items):		
Loan stock notes issued as part consideration for business acquired	(0.2)	(0.9)
Finance leases acquired with business purchase	(2.8)	–
Finance leases disposed with business sale	–	0.9
Non-cash movements:		
Increase in accrued finance charges on finance lease obligations	(5.7)	(13.3)
Increase in accrued interest on cash deposits to secure rental obligations	3.3	2.8
Exchange movements	–	(2.9)
Decrease/(increase) in net debt in the year	0.5	(52.4)
Net debt at 1 April (restated)	(751.8)	(699.4)
Net debt at 31 March	(751.3)	(751.8)

(e) Purchase of businesses

	2002 £m	2001 £m
Net assets acquired:		
Tangible fixed assets	6.0	0.9
Debtors: amounts falling due within one year	2.7	–
Cash at bank and in hand	3.0	–
Creditors: amounts falling due within one year	(6.1)	–
Creditors: amounts falling due after more than one year	(1.6)	–
Provisions for liabilities and charges	(3.7)	–
Fair value of net assets acquired	0.3	0.9
Goodwill	11.8	–
	12.1	0.9
Satisfied by:		
Cash consideration	12.1	–
Loan stock notes	–	0.9
	12.1	0.9

The businesses acquired during the year did not materially contribute to the Group's cash flow in 2002.

33. Notes to the Group cash flow statement continued

(f) Sale of businesses

	2002 £m	2001 £m
Net assets sold:		
Intangible fixed assets	24.1	–
Tangible fixed assets	4.7	3.4
Net current assets	15.9	3.8
Cash/(bank overdrafts)	9.5	(0.6)
Finance lease obligations	–	(0.9)
Goodwill written back on disposal	43.5	6.6
	97.7	12.3
Provision for liabilities under sale agreement	0.8	0.7
	98.5	13.0
Profit/(loss) on disposal	5.1	(2.1)
Sale proceeds, net of costs	103.6	10.9

The sales were satisfied by cash consideration.

The business sold during the year contributed £3.5 million to the Group's net cash inflow from operating activities, in 2002.

In 2001 £0.5 million of deferred consideration, arising from a business sold in an earlier year, was received.

34. Related party transactions

On 4 February 2002 the Company disposed of its interest in Viridor Instrumentation Limited. Sales to Pennon Group companies between the date of disposal and 31 March 2002 were not material.

On 15 December 2000 the Company disposed of its interest in T J Brent Limited. Sales to Pennon Group companies between the date of disposal and 31 March 2001 were £2.1 million.

During the year the Company advanced £0.8 million to Enviro-Logic Limited, an associated undertaking, to finance business development costs (2001 £0.5 million). Advances of £1.7 million were outstanding at 31 March 2002 and the Company had fully provided against the debt.

On his retirement as a Director on 1 March 2002, the Company sold a car to Mr K L Hill at its fair market value of £15,500.

Five year financial summary

Profit and loss account

	2002 £m	2001 £m	2000 £m	1999 £m	1998 £m
Turnover	423.9	435.1	467.0	437.1	382.4
Group operating profit	121.8	128.1	167.1	167.7	134.6
Share of operating loss in joint venture and associates	(0.5)	(0.4)	(0.4)	(0.2)	(0.4)
Business disposal profit/(loss)	5.1	(2.1)	-	-	(7.5)
Net interest payable	(49.0)	(51.4)	(45.0)	(44.3)	(35.2)
Profit on ordinary activities before taxation	77.4	74.2	121.7	123.2	91.5
Tax on profit on ordinary activities*	(3.3)	(17.6)	(5.0)	(17.5)	(117.0)
Profit/(loss) on ordinary activities after taxation	74.1	56.6	116.7	105.7	(25.5)
Dividends	(51.4)	(49.4)	(65.1)	(61.9)	(54.1)
Retained profit/(loss) transferred to/(from) reserves	22.7	7.2	51.6	43.8	(79.6)
Earnings per share (basic):					
Before exceptional items	50.6p	43.1p	85.9p	75.4p	71.7p
Exceptional items	3.7p	(1.6)p	-	3.8p	(91.3)p
After exceptional items	54.3p	41.5p	85.9p	79.2p	(19.6)p
Dividend per share	37.5p	36.0p	47.8p	45.6p	41.0p

* Including £104.0 million windfall tax in 1998

Capital expenditure

	2002 £m	2001 £m	2000 £m	1999 £m	1998 £m
Acquisitions	12.1	0.9	-	37.1	93.9
Tangible fixed assets	186.4	166.5	153.8	125.3	184.6

Balance sheet

	2002 £m	2001 £m	2000 £m	1999 £m	1998 £m
Fixed assets	1,922.7	1,826.3	1,736.6	1,652.4	1,558.9
Net current assets/(liabilities)	100.8	101.5	92.8	118.5	(37.7)
Non-current liabilities	(1,047.3)	(1,018.7)	(918.7)	(911.9)	(740.6)
Net assets	976.2	909.1	910.7	859.0	780.6

Number of employees (average for year)

	2002	2001	2000	1999	1998
Water and sewerage business	1,485	1,537	1,638	1,700	1,734
Waste management	605	453	438	441	312
Instrumentation	421	495	556	437	443
Construction services	-	617	837	875	838
Other businesses	51	55	57	55	93
	2,562	3,157	3,526	3,508	3,420

The adoption of Financial Reporting Standard (FRS) 12 'Provisions, Contingent Liabilities and Contingent Assets', FRS 14 'Earnings per Share', FRS 15 'Tangible Fixed Assets' and FRS 18 'Accounting Policies' required the revised presentation of certain numbers which have been incorporated for the periods 2001 to 1998 above. The adoption of FRS 19 'Deferred Tax' has resulted in a restatement of 2001 but earlier periods have not been restated.

Financial calendar

Financial year end	31 March
Thirteenth annual general meeting	25 July 2002
2002 Final dividend payable	1 October 2002
2003 Interim results announcement	November 2002
2003 Interim dividend payable	April 2003
2003 Preliminary results announcement	May 2003
Fourteenth annual general meeting	July 2003
2003 Final dividend payable	October 2003

Shareholders' analysis at 31 March 2002

	Number of shareholders	Percentage of total shareholders	Percentage of ordinary shares
1 - 100	5,470	18.7	0.2
101 - 1,000	19,872	67.9	6.2
1,001 - 5,000	3,315	11.3	4.3
5,001 - 50,000	386	1.3	4.5
50,001 - 100,000	75	0.3	4.1
Over 100,000	156	0.5	80.7
	29,274	100.0	100.0
Individuals	26,242	89.7	9.5
Companies	302	1.0	2.2
Trust companies (pension funds, etc)	9	-	0.1
Banks and nominees	2,716	9.3	87.3
Insurance companies	5	-	0.9
	29,274	100.0	100.0

Substantial shareholdings

At 19 June 2002, interests in the issued share capital had been notified by:

Cater Allen International Limited	5.50%
AXA Investment Managers	5.20%
AEGON UK Plc	4.87%
Morley Fund Management	3.97%
Standard Life Group	3.96%
Legal & General Investment Management	3.01%

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.