

PENNON GROUP PLC

COMPANY NUMBER 02366640

ANNUAL REPORT AND ACCOUNTS 2003

... A year of profitable growth

... Turnover £417.2 million

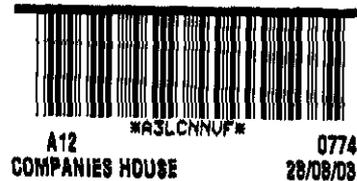
... Profit before tax £74.2 million

... Adjusted earnings per share 55.0p*

... Dividend per share 39.1p†

* Before deferred tax. Basic earnings per share are 44.3p

† Excluding the special interim dividend



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Ken Harvey : Chairman : Pennon Group Plc

Further profitable growth in the Group was achieved, affirming the strategy of focusing on the two key businesses, South West Water Limited and Viridor Waste Limited.

South West Water has maintained its improvement in customer service, delivered further efficiencies and remains confident of outperforming the regulatory contract to 2005. Viridor Waste shows continued growth in profits and is well placed to capitalise on its recent acquisitions. The Board is confident prospects for the Group remain favourable.

... Financial overview

Group turnover from continuing operations rose by 9.5% to £417.2 million. This rise includes a significant contribution by Viridor Waste and the Ofwat approved tariff increases in South West Water. Overall Group turnover reduced by £6.7 million as a consequence of the disposal of Viridor Instrumentation Limited, completed in February 2002.

Profit before tax was £74.2 million, £3.2 million down on 2001/02, which included an exceptional profit on disposal of £5.1 million. Underlying profit before tax from continuing operations was up 7.1%. Adjusted earnings per share (before deferred tax and exceptional item) increased by 3.8% to 55.0p.

The Directors are recommending a final dividend of 26.5p per share which, together with the interim dividend of 12.6p per share, will result in a full year cash dividend of 39.1p (excluding the special interim dividend referred to below) – an increase of 4.3% on the total dividend for 2001/02.

Following the sale of Viridor Instrumentation in February 2002, a special interim dividend for 2002/03 of 70.0p per share was paid on 1 October 2002 out of the sale proceeds, at a cost of £95.9 million. A share consolidation took place on 2 September 2002 in order to maintain comparability of the share price both before and after the payment of the special interim dividend.

This year the Board is proposing to re-introduce a scrip dividend alternative to replace the Dividend Reinvestment Plan which has been available to shareholders in recent years. The scrip dividend alternative will enable shareholders to acquire new shares issued by the Company.

... South West Water Limited

The utility business has maintained its improvement in customer service and quality of product. The company is one of the industry leaders in managing water leakage and continues to deliver results in line with Ofwat's mandatory leakage target. Drinking water quality and river water quality are at an all time high and the region features more miles of high quality rivers than any other region in England. Over 98% of the region's 140 bathing waters along the South West coastline complied with the European Union's mandatory standards. In addition, almost 85% of the region's bathing waters met the more stringent EU guideline standards, the best performance of any region in the UK. Independent market research carried out amongst South West Water's customers confirmed continued high levels of satisfaction with the overall service provided.

The company remains ahead of Ofwat's efficiency targets and is on track to deliver further efficiency savings to outperform the regulatory contract for the period to 2004/05.

... Viridor Waste Limited

Viridor Waste delivered strong financial performance. Underlying profit growth was around 10% after netting off the effect of acquisitions and the step increase in profitability arising from the new renewables pricing regime. This was achieved despite the generally tough market conditions and reflects the success of Viridor Waste's focused strategy.

Three acquisitions were made during the year with a fourth completed in June 2003. These reinforced the company's stated strategy of capitalising on its strong position in landfill disposal, exploiting opportunities in renewable energy and pursuing profitable opportunities in line with the Government's developing waste management strategy.

... Pensions

Pennon Group operates a defined benefit pension scheme for existing staff and new entrants to Pennon and South West Water and for existing employees in Viridor Waste. In line with recommendations from the scheme actuary, following a pension 'holiday' for a number of years, the Group resumed paying employer contributions in 2002/03. From 1 April 2003 these have been increased to 11.5% of pensionable pay. The pension fund position is being kept under review and the next triennial actuarial review is due in April 2004.

The Group is also putting in place a defined contribution scheme for employees from recently acquired waste companies and for new entrants to Viridor Waste. Whilst the introduction of the defined contribution scheme and increased funding for the defined benefit pension scheme will have some impact on the 2003/04 results, the new scheme will reduce Viridor Waste's exposure to any further adverse movements in the defined benefit pension scheme funding position.

The Financial review provides comprehensive details of the Group's pension position.

... Strategy

The Board will continue to focus on adding value for shareholders. This will be achieved by South West Water growing its regulatory asset value and outperforming the regulatory contract up to 2005 and Viridor Waste capitalising on the opportunities arising from its successful focused strategy.

... Board matters

Sir Geoffrey Chipperfield has been the Company's Deputy Chairman for the last three years and a Non-executive Director of Pennon for 10 years. Both he and Mr Alan Fletcher, who joined the Board in May 1993, are retiring as Non-executive Directors at the annual general meeting in July 2003. The Board is extremely grateful for their valuable contributions during their many years of service.

The Board is pleased to welcome Ms Dinah Nichols, who was appointed on 12 June 2003, as a Non-executive Director.

It is anticipated that a further Non-executive Director will shortly be appointed by the Board.

... Employees

I have been Chairman of the Group for six years now and have overseen many structural and organisational changes as the Group seeks to become more efficient and profitable. Our employees have consistently provided high levels of professionalism, loyalty and commitment throughout. My sincere thanks go to them.



K G Harvey, Chairman
Pennon Group Plc
26 June 2003

South West Water has maintained its improvement in services to customers whilst delivering further sound financial performance and additional efficiencies.

... **South West Water Limited**

The company's turnover increased by 3.8% from £260.4 million to £270.2 million primarily reflecting the impact of the tariff increase approved by the Director General of Water Services, together with 7,300 new customer connections.

Operating costs including depreciation charges increased by £5.3 million to £158.7 million, including £7.4 million for the operation of new capital schemes and efficiency savings of £4.5 million.

Operating profit rose by £4.5 million to £111.5 million. During the year a further 22,000 customers switched to a measured charging basis compared to 23,300 the previous year and this produced an adverse impact on operating profit of £5.0 million.

A restructuring and continuous improvement programme designed to significantly reduce overhead and operating costs was introduced some four years ago. Its successful delivery is ensuring South West Water continues to outperform 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, 2000 – 2005). South West Water's track record in the area of efficiency savings is excellent and since 1995 cost reductions totalling £41.9 million have been achieved.

In the drive to achieve further efficiencies, the benefit of three new recently launched major management information systems is being realised in the areas of asset management, human resources and customer service management.

Despite the regulatory pressure to reduce operational expenditure, first class levels of product and customer service have remained key company objectives. Independent 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 generally good performance against Ofwat's prescribed 'Levels of Service Indicators'. Plentiful supplies of high quality drinking water are an absolute priority for customers and, as a direct result of careful planning and capital expenditure, the region's water storage, treatment and distribution infrastructure has been progressively and significantly enhanced over the years.

There have been no water restrictions since 1996 and the company's innovative and industry leading leakage detection and reduction programme continues to deliver results in line with the mandatory leakage target set by Ofwat.

Planned expenditure on water mains renovation during the K3 period will be in the order of £120 million with the length of mains scheduled for improvement more than double that achieved in the K2 period (1995 – 2000). Over 400 kilometres of water mains were laid, replaced or refurbished during the year compared with 260 kilometres the previous year. Improvements in water supply have been matched with improvements to water quality and during the year the company achieved its highest ever drinking water compliance level of 99.92% with the quality standards set by the Drinking Water Inspectorate.

Progress has also been made in the area of waste water treatment and disposal. South West Water's massive coastal waste water treatment programme, 'Clean Sweep', was a vital factor in the region achieving the best ever bathing water quality results for beaches and bathing waters along the West Country coastline. Over 98% of the region's 140 bathing waters regularly monitored by the Environment Agency complied with EU mandatory standards. The results also confirmed a major increase in the number of bathing waters meeting the more stringent EU guideline standards – almost 85% compared with 71% the previous year. Inland waste water treatment works are also being updated and modernised as part of a rolling programme to ensure compliance with demanding environmental standards and the company's investment helped the region record more miles of high quality rivers than any other region in England.

In tandem with 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 £13.9 million to £181.5 million with £67.0 million invested in water supply improvements including water mains renovation, water treatment works enhancement and leakage control. Waste water services investment expenditure was £114.5 million of which £64.5 million was invested in the company's 'Clean Sweep' bathing water programme which is nearing completion.

A dedicated team within South West Water is managing the company's Periodic Review submission for the K4 period (2005 – 2010). South West Water will seek an outcome from Ofwat which strikes a realistic balance between investment and affordability and which benefits all the company's key stakeholders.

Viridor Waste delivered further growth both organically and by acquisition.

... Viridor Waste Limited

Viridor Waste made continued excellent progress within its focused strategy of:

capitalising on its strong position in landfill disposal;

exploiting opportunities in landfill gas power generation in line with the Government's target of increasing the proportion of electricity generated from renewable sources; and

pursuing profitable opportunities arising from the Government's developing waste management strategy.

Financial performance was significantly ahead of the previous year (which itself showed strong growth assisted by one-off gains). Turnover at £152.3 million was 21.5% up on the previous year. Operating profit before goodwill amortisation at £19.1 million was 25.7% up. Profit before tax, after taking account of goodwill amortisation and interest costs associated with recent acquisitions, was up 5.2% to £14.2 million. This financial performance was achieved despite generally tough market conditions and reflects the success of Viridor Waste's strategy.

The previous year's acquisitions, The Suffolk Waste Disposal Company Limited, now renamed Viridor Waste Suffolk Limited, and Lavelle & Sons Limited, are now fully integrated and performing well. They were earnings enhancing both before goodwill amortisation, as forecast at the time of acquisition, and after goodwill amortisation.

In 2002/03 Viridor Waste made three more acquisitions. In April it bought Richardson Limited for £11.9 million. This company, now renamed Viridor Richardson Limited, 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 are providing Viridor Richardson with access to further supplies of glass. In July, Viridor Waste bought Roseland Plant Co. Limited for £8.9 million. In addition to its collection and recycling operations, this company owns a large landfill with planning permission in Cornwall, an area of increasing shortage of waste disposal capacity and with significant synergies with Viridor Waste's other operations in the West Country. The landfill will be opened in due course when site licencing has been completed. In October, Viridor Waste bought Parkwood Holdings Limited for £20.6 million. This company, now renamed Viridor Parkwood Holdings Limited, is a Sheffield-based landfill, transfer station, liquid waste treatment and recycling operation. These activities tie in well with the strategy outlined above and have good synergies with Viridor Waste's existing operation at Erin in Derbyshire. In total these three acquisitions were already earnings enhancing before goodwill in 2002/03, at least a year earlier than projected at the time of acquisition.

After the year end, Viridor Waste completed the acquisition of Churngold Holdings Limited, a waste recycling and transfer station business, for £19.7 million. The acquisition complements Viridor Waste's existing activities in the South West and in Scotland.

Viridor Waste's total consented landfill void is now 80 million cubic metres compared to 73 million cubic metres at the previous year end. This increase arose from the acquisitions within the year, which brought an additional 6.2 million cubic metres and planning gains amounting to 5.1 million cubic metres, offset by usage during the year of 4.3 million cubic metres. Total landfill disposal volumes for the year, excluding cover, increased by 9% to 3.5 million tonnes. Excluding the effect of last year's non-recurring items and last and this year's acquisitions, volumes increased by 3%. Viridor Waste remains confident that landfill will be the key final waste disposal route for the UK for the medium term. The series of measures taken by the Government over the past five years to encourage recycling and minimise the amount of waste going to final disposal can be expected to slow the growth in total volumes going to landfill. However, with a waste industry average of only around six years' remaining landfill life in the UK (according to the Environment Agency's estimates) and new planning permissions being increasingly difficult to achieve, Viridor Waste's 80 million cubic metres of consented void space is expected to become an increasingly valuable resource.

Total power generation capacity increased from 28 MW to 37 MW in line with Viridor Waste's policy of exploiting its landfill gas for generation of electricity and benefiting from premium prices under the Government's system of renewable obligation certificates (ROCs). Again, Viridor Waste is exploiting the scarcity value of its asset base. With a Government target of 10% of electricity to be generated from renewable sources by the end of the decade compared to 3% currently, Viridor Waste expects this element of its business to continue to increase.

Total recycling volumes increased from 33 thousand tonnes (kt) to 183kt, through acquisitions, as the company continues to seek profitable opportunities arising from the Government's developing waste management strategy. Composting volumes of green waste in the year increased to 35kt from 21kt in 2001/02. Viridor Waste sees sustainability as key to its overall business and sets a high store by its environmental and social policies. These are covered more fully in Pennon's annual Environmental and Social Report. Viridor Waste is pleased to report that ISO 14001 accreditation was gained by Viridor Richardson and Viridor Waste Suffolk. After the end of the financial year, Viridor Waste's Warmwell site was awarded the Peel People's Cup by the Chartered Institute of Wastes Management for the best run landfill in the UK. This is the third time in the past five years that a Viridor Waste site has won this award.

Having reviewed practices in the waste industry, Pennon Group is putting in place a defined contribution scheme for employees from recently acquired waste companies and new entrants to Viridor Waste from 1 July 2003. In many instances this will be an enhancement of their current position. Profit growth in 2003/04 will be reduced because of the introduction of the defined contribution scheme and increased funding costs for the defined benefit pension scheme. However, this change will reduce Viridor Waste's exposure to any further adverse movements in the defined benefit scheme funding position.

In the longer term Viridor Waste is well placed to deliver continued steady profit growth with its carefully focused strategy.

... Employees

Highly skilled, well motivated employees are essential to the continued success of the Pennon Group, which supports them with the infrastructure, technology and opportunity to perform at the highest levels.

A number of well established and proven employee communication practices are used Group-wide and include use of the Group's intranet facilities, a staff team briefing system and employee newspapers, *'Flagstaff'* and *'Viridor Voice'*. Also, e-communication continues to be widely used, given the geographical diversity of the Group, coupled with the needs of the Group to communicate quickly and effectively with its employees.

The third survey by the Group on employee opinions and attitudes amongst staff in Pennon and South West Water on a variety of issues ranging from job satisfaction to communications, was carried out during the year. The findings indicated further improvements in staff attitudes and managers are focusing on those areas where even more effort needs to be concentrated. Viridor Waste also undertook an independent survey of communications among staff at all levels and is acting on the information provided.

Both South West Water and Viridor Waste have staff associations. South West Water employees elect representatives to the Staff Council which deals with areas of interest to all staff employees, both trade union and non-trade union alike. The Viridor Waste Management Staff Association, aligned with AMICUS, the second largest trade union in the UK, is also involved in a wide variety of staff issues, including looking at a number of communications initiatives.

The management of change, involving both the Group and work practices, continues to influence the wide range of training and development programmes offered by the Group. An 'Investors in People' (IIP) award was made to South West Water three years ago in recognition of the people management processes employed by the company and it will be applying for IIP reaccreditation during 2003.

In order to provide its employees with a safe working environment, the Group regularly reviews its health and safety policy and performance standards and undertakes innovative risk assessment and control programmes. The Group's constantly evolving health and safety strategy has helped to ensure that considerable progress has been made towards the Group's goal to reduce the number of days lost through ill health and ensure low levels of work-related accidents. South West Water is progressing well towards its aim to reduce the number of days lost through ill health by 30% by November 2010. The Chief Executive of South West Water is the Programme Director for an innovative health and safety water industry initiative known as 'Clear Water 2010'. Viridor Waste subscribes to the high profile Environmental Services Association's Accident Reduction Charter and the company's accident rate amongst its employees is consistently below the average of the waste industry as a whole.

The Group operates a non-discriminatory employment policy and, in addition to its 'Whistleblowing' and family-friendly policies, continues to adapt its employment policies to ensure full compliance with new 'Flexible Working' legislation although in many areas, the Group already offers benefits which are above the statutory minimum.

... Caring for the environment

The Group plays a major role in enhancing and maintaining the quality of the environment. This role is 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 acknowledge the importance of environmental sustainability and have taken measures to ensure that their operations are undertaken in a sustainable manner which has regard to their environmental impact. For example, South West Water recognises that its suppliers can have a major environmental impact in the manner in which they conduct their business and has consequently adopted an environmental objective to obtain goods and services through suppliers and contractors whose environmental practices correspond with its own.

An environmental policy has been in place since the early days of the Group's life and is reviewed by the Environment Committee of the Board. The policy aims to achieve continuous improvement in environmental performance. This was reflected by a further improvement in the Group's ranking in the Business in the Environment 2002 survey, with the Group's overall ranking rising to 55th out of 204 (mainly FTSE 350) companies, compared to 61st out of 192 companies in the 2001 survey.

South West Water achieved its highest ever performance in drinking water compliance of 99.92% with the quality standards set by the Drinking Water Inspectorate.

South West Water's coastal waste water treatment improvement programme, 'Clean Sweep', has been a key contributor to the

region having some of the finest bathing waters and beaches in the UK. The region achieved over 98% compliance with the EU mandatory standards and almost 85% compliance with the more stringent EU guideline standards. The Environment Agency has also stated that the region has more miles of high quality rivers than any other region in England. South West Water continues to remain focused on improving its performance for waste water compliance and additional resources have, and are being, directed to this area.

Both South West Water and Viridor Waste remain committed to achieving high environmental standards. Viridor Waste has already achieved ISO 14001, the international environmental management standard, at most of its key sites and has a policy of gaining accreditation in its acquired companies as noted above. Key functions within South West Water have ISO 9001 accreditation, the international quality management system standard, and the company is currently reviewing its business processes as a precursor to the introduction of a formal environmental system, building on the achievements of its ISO 9001 accreditation.

The Group is a major producer of renewable energy. Viridor Waste's capacity for power generation from landfill gas is 37 MW, while South West Water generates the equivalent of over 6.5 MW from hydro-electric and combined heat and power plants. In total, the Group generates the equivalent of 110% of its own electricity from renewable resources. In line with The Renewable Obligations Order 2002, which sets the price framework to achieve the Government's target of 10% of electricity generated from renewable energy by 2010, Viridor Waste has substantially increased its landfill gas generation capacity.

Construction activity associated with the Group's water, sewerage and waste management activities can have a significant impact on the neighbourhood as well as on the natural habitat. The Group is committed to working closely with planners and interested parties to minimise such impacts and to ensure that the sites blend in with the natural environment. As an example of this approach, South West Water won an award from the Country Land and Business Association under their 'Farm and Country Buildings Award Scheme 2002' for the care in siting its Dawlish waste water treatment works within a sensitive landscape. At most landfill sites and on many construction projects, close contact continues to be maintained with the local community through formal liaison groups to discuss and, whenever possible, mitigate potential problems. This underlines the approach of the Group in its determination to be a good neighbour.

The Group's environmental and social performance will be more fully reported in the Environmental and Social Report 'Enhancing the Environment 2003'.

... Involvement with the community

The Group is committed to satisfying its customers and this is another of the key goals set out in the Group's mission statement. South West Water acknowledges that understanding its customers' views assists it to provide levels of product and services in line with customer expectations. To facilitate this, South West Water has carried out regular customer research on the quality of its services and in March 2003 it became the first water company to provide an on-line customer consultation service.

Viridor Waste actively encourages its employees to become involved with the widespread local communities in which the company operates and liaises regularly with interest groups around its landfill sites.

As one of the few large Plcs headquartered in the region, the Pennon Group 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.

The Group's financial community involvement is channelled through a number of initiatives:

Charitable Donations – charitable donations made by Pennon Group amounting to £46,000 were made during the year. These donations were primarily to charities operating in Devon and Cornwall, where the average size of donation of around £500 can make a significant impact on the services provided by these organisations.

South West Water Community Sponsorship Programme – funds amounting to £50,000 were awarded during the year across a wide range of activities.

Landfill Tax Credit Scheme – this Scheme allows Viridor Waste to demonstrate its commitment to environmental improvements, particularly in areas near its landfill operations. Since the inception of the Scheme, Viridor Waste has made a total contribution of £36.9 million to environmental bodies, which has provided support for a wide range of environmental and local amenity projects across the country. Funds of £8.3 million were awarded in the year.

In November 2002, the Government announced changes to the Landfill Tax Credit Scheme which, with effect from 1 April 2003, resulted in two thirds of the available funding generated via landfill tax being removed from the Scheme and put into a programme of public spending to encourage sustainable waste management. The remaining one third of funding will continue to be made available through a reformed Landfill Tax Credit Scheme for spending on local community, environmental and amenity projects. The actual nature of the reforms will be determined by further consultation to be undertaken during the summer of 2003. The changes to the Scheme will significantly reduce the amount of contributions that will be available in future for Viridor Waste to make to environmental bodies.

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. The changes to the Landfill Tax Credit Scheme will also significantly reduce the amount of funds available to the Committee to allocate next year.

South West Water Special Assistance Fund – the Fund was established to provide help to customers trying to pay their water and sewerage bills but who, for reasons of severe financial or personal difficulties, were having problems paying the full amount. Although South West Water provides administrative support to the Fund, the decisions on applications for help are made by a panel drawn from the South West Water Customer Consultative Group.

... Ethics

To help achieve the Group's stated objectives, its aim is to establish and preserve a reputation for integrity and fair dealing. It believes that such a reputation is essential to the long term well-being of the Group itself, its shareholders, employees, customers, suppliers and the community in which it operates.

To facilitate these ethical employment practices, the Group has adopted key ethical policies which are applied Group-wide. It operates a non-discriminatory employment policy and every reasonable effort is made to ensure that no current or future employee is disadvantaged because of age, gender, religion, colour, ethnic origin, marital status, sexual orientation, or disability.

The Group also has a 'Whistleblowing' policy which supports its approach to ethics in business by encouraging employees to raise in accordance with a formalised procedure, concerns which relate to potential unlawful conduct, financial malpractice, dangers to the public or damage to the environment. This policy also protects employees who raise such concerns from victimisation or harassment.

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

... **Operating profit**

The turnover of continuing operations rose by 9.5% to £417.2 million. South West Water Limited turnover was £270.2 million, up 3.8% on 2001/02, principally resulting from the additional increase in tariffs approved by the Regulator. Turnover for Viridor Waste Limited at £152.3 million was 21.5% up on 2001/02. Acquisitions accounted for £14.2 million, increased existing business £9.3 million and increased landfill tax £3.5 million. Overall Group turnover for the year reduced by 1.6% to £417.2 million, as a consequence of the disposal of Viridor Instrumentation Limited in February 2002.

Operating profit from continuing operations increased by £7.9 million to £127.0 million. South West Water achieved a £111.5 million operating profit, up £4.5 million on 2001/02. Viridor Waste contributed £17.6 million (after goodwill amortisation of £1.5 million), up £2.7 million on 2001/02 and representing 13.9% of the operating profit of the Group's continuing operations in 2002/03 (2001/02 12.5%).

Overall Group operating profit increased £5.2 million to £127.0 million.

Group earnings from continuing operations, before interest, taxation, depreciation and goodwill amortisation (EBITDA) amounted to £206.3 million, (2001/02 £191.7 million) including South West Water £170.7 million (2001/02 £162.9 million) and Viridor Waste £38.2 million (2001/02 £32.1 million).

Total Group operating costs of £290.2 million (2001/02 £261.9 million) for continuing operations included the following major categories of expenditure:

	£ million
Depreciation and goodwill amortisation	81.3
Landfill tax	42.7
Manpower	46.1
Property costs	15.2
Transport	10.3
Power	9.6
Raw materials and consumables	9.1
Abstraction and discharge consent costs	7.1
Statutory operating licences and royalties	4.7
Lease rentals – plant and machinery	3.1

Offsetting the above power costs was revenue from power generation of £10.3 million.

... Finance costs

Net interest payable was £52.1 million, which was 2.42 times covered by Group operating profits, compared with £49.0 million (2.48 times covered) in 2001/02.

Gross interest payable was £62.1 million. Gross interest receivable of £10.0 million was derived from the investment of temporarily surplus funds, including the sale proceeds of Viridor Instrumentation in the first half of 2002/03.

Net interest payable represents a rate of 6.0% when measured against average net debt (2001/02 6.5%).

... Profit before tax

Profit before tax was £74.2 million, £3.2 million down on 2001/02, which included an exceptional profit of £5.1 million from the sale of Viridor Instrumentation in February 2002.

Underlying profit before tax from continuing operations was up 7.1%, with profit growth in both South West Water and Viridor Waste. In addition there was an interest benefit of circa £2.0 million in the first half of 2002/03 from the cash received from the sale of Viridor Instrumentation.

Viridor Waste achieved a pre-tax return on investment in 2002/03 of 7.4% (2001/02 7.0%).

... Taxation

The corporation taxation charge for the year was £3.4 million (2001/02 nil). The deferred tax charge for the year was £13.7 million (2001/02 £3.3 million), principally as a result of lower discount factors.

... Earnings per share

Earnings per share, before deferred tax and the 2001/02 exceptional item, increased by 3.8% to 55.0p. Basic earnings per share fell 18.4% to 44.3p, as a result of the increased deferred tax charge and the exceptional item in 2001/02.

... Dividends and retained earnings

The Directors recommend the payment of a final dividend of 26.5p per share for the year ended 31 March 2003. Together with the interim dividend of 12.6p per share paid on 7 April 2003 this makes a total dividend for the year (excluding the special interim dividend of 70.0p per share) of 39.1p per share, an increase of 4.3% on the dividend for 2001/02.

The dividend of 39.1p is paid out of adjusted earnings per share of 55.0p before deferred tax, giving a cash dividend cover of 1.4 times.

The total cost of the interim and recommended final dividend of the Company is £48.4 million. The cost of the special interim dividend was £95.9 million. The retained deficit of £87.2 million has been transferred from reserves.

... Investment

Capital expenditure by the Group on tangible fixed assets was £204.6 million (2001/02 £186.4 million). The major categories of expenditure comprised:

South West Water

£ million

Water mains renovation	28.0
Water supply leakage control	7.6
Water treatment works	6.6
Sewage treatment works	60.1
Sewerage	37.8
Sewage sludge treatment	8.1

Viridor Waste

£ million

Landfill	12.2
Power generation	4.9
Collection	2.5

Other expenditure included information systems, metering and transport.

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 £198.9 million (2001/02 £196.2 million). Capital expenditure cash outflow increased from £184.4 million in 2001/02 to £201.7 million in 2002/03. The net outflow for acquisitions was £37.2 million (2001/02 net inflow with disposals £85.0 million). Taxation cash inflow was nil (2001/02 £0.4 million). Equity dividends paid and servicing of net debt involved a cash outflow of £190.2 million (2001/02 £93.7 million).

Overall, the net cash outflow of the Group, before the use of liquid resources and financing, was £226.7 million (2001/02 £5.6 million inflow).

Financing during the year included £62.6 million drawdown of finance lease facilities (2001/02 £45.6 million).

At 31 March 2003 loans and finance lease obligations were £1,179.6 million and the Group held current asset investments and cash of £191.0 million. Net borrowings increased by £237.3 million during the year from £751.3 million to £988.6 million, principally as a result of the payment of dividends, the cost of acquisitions of £37.2 million and capital expenditure of £201.7 million.

Net borrowings represent 111% of shareholders' funds compared with 77% in 2001/02 (allowing for the impact of the special interim dividend, pro forma gearing at 31 March 2002 was 96%).

The Group uses financial derivatives, usually interest rate swaps, to manage the mix of fixed and floating rate debt, to ensure that at least 50% of net debt is at fixed rate. To take advantage of current historically low interest rates and reduce the risk of adverse movements over the next few years, South West Water has entered into swap arrangements to fix the interest rate on the majority of its debt for the period up to the next Periodic Review.

The notional principal amounts of the interest rate swaps are used to determine settlement under those swaps and are not, therefore, an exposure for the Group. These instruments are analysed in more detail in note 27 to the financial statements.

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 2003 the limit was £2.2 billion. The Directors confirm that the Group can meet its short-term requirements from the existing borrowing facilities without breaching covenants or other borrowing restrictions.

... Pensions

Pennon operates defined benefit pension schemes for existing staff and new entrants to Pennon and South West Water and for existing employees in Viridor Waste. The last actuarial valuation in April 2001 indicated a scheme surplus, enabling a continuation of the employer contribution 'holiday' in 2001/02. However, in response to deteriorating stock market conditions, the Company resumed employer contributions of 4.8% of pensionable pay in 2002/03, in line with the recommendation from the scheme actuary.

Under Financial Reporting Standard 17 'Retirement Benefits', the Group pension schemes had net liabilities at 31 March 2003 of £59.4 million. This represents circa 7% of total market capitalisation. From 1 April 2003, employer contributions have been increased to 11.5%. The pension fund position is being kept under review and the next triennial actuarial review is due in April 2004.

From 1 July 2003, Pennon Group is introducing a defined contribution pension scheme for employees of Viridor Waste. Details are contained in the Business review on page 7.

... Payments to suppliers

It is the Company's payment policy for the year ending 31 March 2004 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 2002/03 and the amount owed to its trade creditors at 31 March 2003 was 27 days.

... Share capital

During the year the Company's issued ordinary share capital increased from £137.0 million to £137.2 million. The weighted average number of shares in issue during the year was 128.8 million (2001/02 136.5 million). The reduction is as a result of the share capital consolidation undertaken in September 2002.

The value of net assets per share at book value at 31 March 2003 was 720p.

Permission was obtained from shareholders at the annual general meeting in July 2002 to purchase up to 10% of the Company's ordinary share capital. Renewal of the authority will be sought at the July 2003 annual general meeting.

Kenneth George Harvey BSc, CEng, FIEE (62)

Non-executive Chairman

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

Sir Geoffrey Howes Chipperfield KCB, DCL (70)

Non-executive Deputy Chairman

Was appointed on 1 October 1993 and became Deputy Chairman on 1 May 2000. He was the permanent secretary and chief executive of PSA Services from 1991 and previously he was permanent secretary in the Department of Energy. He is also chairman of Heliodynamics Limited and pro-chancellor of University of Kent. He will retire at the conclusion of the annual general meeting on 31 July 2003.

Robert John Baty OBE, FREng, CEng, FICE, FCIWEM, CCMI, ACI Arb (59)

Chief Executive, South West Water Limited

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

Colin Irwin John Hamilton Drummond MA, MBA, CCMI, LTCL (52)

Chief Executive, Viridor Waste Limited

Was appointed on 1 April 1992. Prior to joining the Company he was a divisional chief executive of Coats Viyella Plc, having previously been corporate development director of Renold Plc, a strategy consultant with the Boston Consulting Group Limited and an official of the Bank of England. He is a member of the Government's Advisory Committee for Business in the Environment.

David Jeremy Dupont MA, MBA (49)

Group Director of Finance

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 Plc.

Aian Thomas Fletcher MA (58)

Non-executive Director

Was appointed on 26 May 1993. He is managing partner of Rubicon Partners, chairman of Helix Industries Limited and of Shepherd Building Group and a director of a number of subsidiary companies within those groups. He was formerly chairman and chief executive of the Wilkinson Sword Group and chief operating officer of Swedish Match. He will retire at the conclusion of the annual general meeting on 31 July 2003.

Katharine Mary Hope Mortimer MA, BPhil (57)

Non-executive Director

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

Dinah Alison Nichols CB, BA Hons (59)

Non-executive Director

Was appointed on 12 June 2003. She was formerly Director General (Environment) at the Department for Environment, Food and Rural Affairs and previously held various senior appointments within Government departments including being Head of the Water Directorate during the period of water privatisation. She is also a Crown Estates Commissioner, a non-executive director of Shires Smaller Companies Plc, a board member of Toynbee Housing Association and the chairman of Toynbee Partnership Association.

Committees of the Board

Audit

Sir Geoffrey H Chipperfield (Chairman)
A T Fletcher
Ms K M H Mortimer
*Ms D A Nichols

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
† Ms K M H Mortimer
* Ms D A Nichols

Remuneration

A T Fletcher (Chairman)
Sir Geoffrey H Chipperfield
Ms K M H Mortimer
* Ms D A Nichols

Company secretary and registered office

K D Woodier
Peninsula House, Rydon Lane, Exeter EX2 7HR
Registered in England No 2368640

Auditors

PricewaterhouseCoopers LLP
Chartered Accountants
31 Great George Street, Bristol BS1 5QD

Registrars

Lloyds TSB Registrars
The Causeway, Worthing, West Sussex BN99 6DA

* appointed 12 June 2003 † appointed 24 April 2003

This report is made in compliance with Schedule 7A of the Companies Act 1985 as introduced by the Directors' Remuneration Report Regulations 2002, Section B of the Best Practice Provisions on Directors' Remuneration annexed to the Listing Rules of the UK Listing Authority and the Listing Rules.

1. Consideration by the Directors of matters relating to Directors' remuneration

The Remuneration Committee ('the Committee') of the Board of Directors is responsible for determining the remuneration and terms of employment of the Executive Directors and senior management of the Group. During the year the Committee comprised three Non-executive Directors, these being Mr A T Fletcher, who chairs the Committee, Sir Geoffrey Chipperfield and Ms K M H Mortimer. The Committee met on eight occasions and received advice, or services, that materially assisted the Committee in their consideration of remuneration matters from Mr K G Harvey (Chairman of the Company), Mr K D Woodier (Company Secretary), the Monks Partnership, remuneration consultants, (not appointed by the Committee) and Meis, remuneration consultants (appointed by the Committee). The Monks Partnership market data on Non-executive Directors' fees has been considered by the Executive Directors in determining the fees of the Non-executive Directors (Section 5 refers on page 20).

2. Statement of the Company's policy on Directors' remuneration

The policy of the Group which will be applied in 2003/04 and is also currently intended to be applied in subsequent years, 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.

3. Elements of remuneration

The remuneration package of the Executive Directors is summarised below. It comprises salary, annual bonus, long term incentives, pensions, car benefit and health cover. The total package is regularly reviewed by the Committee to ensure that it is consistent with overall policy. In 2003/04 (subject to fluctuations in the Company's share price) it is expected that nearly 60% of Directors' potential direct remuneration (i.e. excluding

pensions, car benefit and health cover) will again be performance related. It is intended that this balance between performance related remuneration and non performance related remuneration will continue.

(i) Basic salary and benefits – These are set out on page 21 for each Executive Director and are not related to performance. However, the Committee determines revised salaries, usually on an annual basis, for Executive Directors based upon surveys conducted by external consultants (being the Monks Partnership during 2002/03) and the performance of the individual Executive Directors which they assess with the advice of Mr K G Harvey, Chairman. Other benefits, not mentioned below, include a fully expensed car and health cover which are not related to performance.

(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. (See page 18 for a summary of the performance objectives for each Executive Director which the Committee determined as appropriate having regard to the activities of the Group that each individual Director could most influence and also to the overall performance of the Group, all of which seeks to align the interests of the Directors with those of shareholders). 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 in the Company of an equivalent value. Any shares awarded usually have to be held for a period of three years, conditional upon continuous service with the Group. During this period the Directors, in respect of these shares, are entitled to receive any dividends declared by the Company. No additional performance conditions applicable to the release of these shares were considered appropriate by the Committee in view of the performance conditions applicable to the initial award of the shares.

The corporate and individual objectives of the Executive Directors applicable to the cash bonus and to the matched deferred share award set during the year under the Incentive Bonus Scheme are:

R J Baty

- 1% bonus for each 1% that Group earnings per share exceeds budget up to a maximum of 10%;
- Up to 30% bonus calculated by reference to the average bonus earned by the Directors of South West Water, consisting of 2% bonus for each 0.5% outperformance of South West Water against its operating costs budget up to a maximum of 10% bonus; 1% bonus for every 1% that profit before tax of South West Water is higher than budget up to a maximum of 5%; and 0.5% bonus up to a maximum bonus of 5% for each position above tenth South West Water achieves in the overall performance assessment of water and sewerage companies established by the Director General of Water Services; and up to a maximum of 10% bonus for the achievement of a range of customer service standards based upon those set by the Director General of Water Services for South West Water.

C I J H Drummond

- 1% bonus for each 1% that Group earnings per share exceeds budget up to a maximum of 10%;
- 2% bonus up to a maximum of 20% bonus for every 1% above budget of operating profit before goodwill amortisation of Viridor Waste;
- up to a maximum of 10% bonus for personal objectives relating to corporate and profit growth activities of Viridor Waste.

D J Dupont

- 1% bonus for each 1% that Group earnings per share exceeds budget up to a maximum of 10%;
- 1% bonus up to a maximum of 5% bonus for every 1% that net interest payable of the Group is less than budget;
- 1% bonus up to a maximum of 5% for every 1% that corporation tax of the Group is less than budget;
- 1% bonus up to a maximum of 5% for every 2% that profit before tax of South West Water exceeds budget;
- 1% bonus up to a maximum of 5% for every 2% that profit before tax of Viridor Waste exceeds budget;
- up to a maximum of 10% bonus for developing an appropriate capital structure for the Group.

(The previous references to a percentage bonus relate to a percentage of the annual basic salary of each Executive Director). The achievements of the Executive Directors against their

individual performance objectives are assessed by the Remuneration Committee following the financial year end when the audited results of the Company and performance against standards set are known. This enables the Committee to apply largely objective criteria in determining the level of bonus (if any) that should be awarded, with the advice of Mr K G Harvey, Chairman.

(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. The Executive Directors received an award of shares in the Company (in respect of which they are entitled to any dividends declared by the Company) up to a value of 75% of their basic salary on the basis that they provided a matching investment in shares of the Company (by way of shares they already hold or which they purchased) in the ratio of one investment share for every four shares awarded. The eventual number of shares, if any, which the Directors may receive is dependent upon the achievement of the performance condition(s) of the Plan over a three year period. In respect of the awards made to the Directors for the years 1997, 1998 and 1999, no shares were received by the Directors at the end of each successive three year period because the performance criteria had not been met on each occasion. For the year 2000 it is expected that all of the shares awarded to Directors will vest at the end of the three year period in September 2003 because the performance condition has been met in full. For each of the years 2000, 2001 and 2002 the performance condition was:

The total shareholder return (TSR) 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.

The comparator group for the awards made during the year to 31 March 2003 is as follows:

AWG Plc
Bristol Water Holdings Plc
British Energy Plc
Centrica Plc
Dee Valley Group Plc
East Surrey Holdings Plc
International Power Group Plc
Kelda Plc
Lattice Plc (now part of National Grid Transco Plc)
National Grid Group Plc (now National Grid Transco Plc)
Pennon Group Plc
Scottish & Southern Energy Plc
Scottish Power Plc
Severn Trent Plc
South Staffordshire Water Holdings Plc
(now South Staffordshire Group Plc)
United Utilities Plc
Viridian Plc

The total shareholder return performance condition was applied by the Committee because, based upon advice from Meis, it believed that this was an appropriate measure to align the interests of the Executive Directors with those of shareholders. In addition, the Committee believed that comparing the total shareholder return of the Company to the other companies in the comparator group was appropriate because the other companies carried on business in a sector similar to that of the Company and, therefore, it was possible to demonstrate superior performance by the Company if its total shareholder return was at least higher than half of the other companies in the comparator group.

If the performance condition was met then 50% of an award for the year in question would vest with 100% of an award vesting if the Company achieved a position greater than that of the company equal or closest to but not above the 75th percentile position of the comparator group. The achievement of a position between the 50th percentile position and the 75th percentile position would result in vesting in steps reflecting the number of companies within that third quartile of the comparator group.

The TSR of each company in the comparator group is measured by an independent remuneration consultant (Hewitt Bacon & Woodrow) and is calculated by taking the average market value during March at the beginning and the end of each three year performance period, to avoid any distortion of the TSR values from any significant daily share price movement during the month.

(iv) Sharesave Scheme – Executive Directors are entitled to participate in this Scheme. It is an all-employee plan to which performance conditions do not apply.

(v) Service agreements – In accordance with Company policy, all Executive Directors have service agreements which are subject to one year's notice and which expire when Directors reach their normal retirement age. No provision is made for termination payments under the service agreements. In the event of termination by the Company of any Executive Director's service agreement, the Board would determine what payments, if any, should be made to the Director depending upon the circumstances of the termination. The dates of the agreements are:

Mr R J Baty	26 February 1996
Mr C I J H Drummond	5 March 1992
Mr D J Dupont	2 January 2003

(vi) Provision for pension – Executive Directors participate in the Pennon Group Pension Scheme and the Pennon Group Executive Pension Scheme. These are funded defined benefit

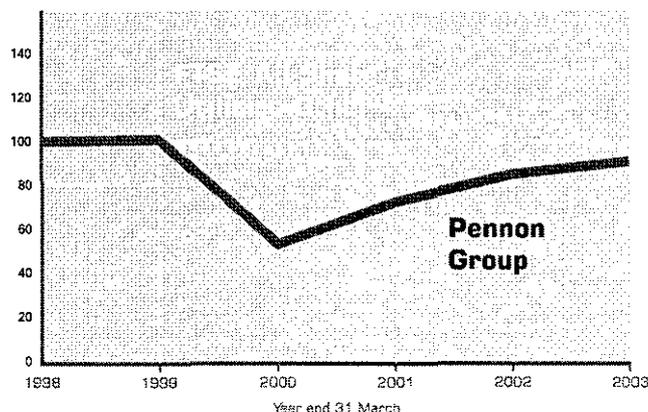
schemes. Through membership of these schemes Executive Directors will be provided with a pension which, dependent on length of service, at normal retirement date (age 60 or 62) will normally amount to two thirds of final pensionable pay (subject to any restriction in respect of the Earnings Cap).

Mr C I J H Drummond and Mr D J Dupont are 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 a 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 received 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 the costs of providing individual pension arrangements.

4. Performance graph

The graph shows a comparison of the total shareholder return for the Company's shares for each of the last five years against the TSR for the companies comprised in the FTSE All Share Utilities-Other Index which is considered appropriate as it is a broad equity market index of which the Company is a constituent.



This graph has been produced in accordance with Schedule 7A of the Companies Act 1985 as introduced by the Directors' Remuneration Report Regulations 2002.

5. Non-executive Directors

Non-executive Directors' (excluding the Chairman, Mr K G Harvey) remuneration consisting of fees only as set out on page 21 is determined by the Board of Directors (in the absence of the Non-executive Directors and the Chairman) and is usually reviewed biennially although in 2003 they will be reviewed after 12 months to take account of any market changes in Non-executive Directors' fees arising from the impact of the Higgs Review on Non-executive Directors. In reviewing the fees, the Executive Directors take account of market information on Non-executive Directors fees, most recently from the Monks Partnership as presented to them by the Company Secretary. The policy is to set fees around the median level compared to the market, which the Executive Directors believe is appropriate to attract and retain suitably experienced Non-executive Directors. The Chairman's remuneration is set by the Executive Directors in the same manner having regard to the same considerations, but, in addition, the Chairman receives car benefit and health cover. No other benefits or remuneration are received by the Chairman.

The fees of the Non-executive Directors (excluding the Chairman) for the year were made up as follows:

	Basic fee £000	Committee membership fee (£2,500 per Committee) £000	Chairman of Committee fee £000	Deputy Chairmanship fee £000	Second Board fee £000	Total £000
Non-executive Directors						
Sir Geoffrey H Chipperfield	22	5	2	5	–	34
A T Fletcher	22	5	2	–	12*	41
Ms K M H Mortimer	22	5	–	–	–	27

* Mr A T Fletcher is also a Non-executive Director of the Viridor Waste Board.

The Non-executive Directors (excluding the Chairman) have contracts for services which are subject to the Articles of Association of the Company and which may be extended by agreement between the Non-executive Directors and the Company. No provision is made for any termination payments under these contracts.

The dates of their contracts are:

	Date of contract	Expiry of current contract
Sir Geoffrey H Chipperfield	14 July 1993	31 July 2003
A T Fletcher	14 May 1993	31 July 2003
Ms K M H Mortimer	2 May 2000	30 April 2006

The Chairman, Mr K G Harvey, has a contract for services dated 30 September 1998 which is subject to 12 months' notice. No provision is made for any termination payments under this contract.

Emoluments of Directors

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

	Salary/fees £000	Performance-related bonuses Payable £000	Deferred** £000	Estimated value of other emoluments £000	Payments related to supplementary pension £000	Total 2003 £000	Total 2002 £000
Chairman:							
K G Harvey	130	–	–	21	–	151	146
Executive Directors:							
R J Baty	158	42	42	18	–	260	277
C I J H Drummond	158	59*	59*	19	37	332	296
D J Dupont (appointed 2 March 2002)	125	40	40	11	20	236	17
†K L Hill (retired 1 March 2002)	–	–	–	–	–	–	204
Non-executive Directors:							
Sir Geoffrey H Chipperfield	34	–	–	–	–	34	34
A T Fletcher	41	–	–	–	–	41	44
Ms K M H Mortimer	27	–	–	–	–	27	27
	673	141	141	69	57	1,081	1,045

*Includes £7,000 in each category for additional bonus awarded in respect of performance for the previous year, 2001/02.

Other emoluments are car benefit and health cover.

No expense allowances chargeable to tax or termination/compensation payments were made during the year.

† Mr K L Hill received £3,000 during the year in respect of consultancy provided on financing matters to the Company.

**The deferred bonus is used by the Company to purchase shares which are then held normally for three years before they are released to the Director provided he remains in employment at the release date. (Section (c) of the Directors' share interests on page 23 sets out details of the shares acquired).

Directors' pensions

Defined benefit pensions accrued and payable on retirement for Directors holding office during 2002/03 are shown in the table below:

	Increase in accrued pension during 2002/03 (net of inflation) £000 a	Increase in accrued pension during 2002/03 £000 b	Accrued pension at 31 March 2003 £000 c	Transfer value at 31 March 2003 £000 d	Transfer value at 31 March 2002 £000 e	Increase in transfer value (net of Directors' contributions) £000 f	Transfer value of Column a (net of Directors' contributions) £000 g
R J Baty	5	7	110	1,872	1,674	190	71
C I J H Drummond	5	6	49	572	526	39	49
D J Dupont	12	12	38	377	270	101	111

Column a above is the increase in accrued pension during 2002/03 (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) upon the accrued pension at the start of the year.

Column b is the actual increase in accrued pension during 2002/03.

Column c is the accrued pension at 31 March 2003 payable at normal retirement age.

Column d is the transfer value of the accrued pension set out in column c as at 31 March 2003.

Directors' pensions *continued*

Column *e* is the transfer value of the accrued pension at the end of the previous financial year on 31 March 2002.

Column *f* is the increase in the transfer value during the year (column *d* minus column *e*) after deducting Directors' contributions.

Column *g* is the transfer value of column *a* less Directors' contributions.

Columns *d*, *e*, *f* and *g* have been calculated in accordance with Actuarial Guidance Note GN11.

The Supplementary Pension Scheme, which mainly funds pension provision above the Earnings Cap, provides benefits in tax-paid lump sum form at retirement. The value of the additional pension benefit has been included in the accrued pension totals shown on page 21.

Directors have the option to pay additional voluntary contributions; neither the contributions nor the resulting benefits are included in the table shown on page 21.

Directors' share interests

(a) Shareholdings

The number of shares of the Company in which Directors held beneficial interests at 31 March 2003 and 31 March 2002 were:

	2003	2002		2003	2002
R J Baty	26,792	26,011	A T Fletcher	1,605	1,506
Sir Geoffrey H Chipperfield	2,252	2,500	K G Harvey	2,644	2,482
C I J H Drummond	12,270	13,543	Ms K M H Mortimer	256	–
D J Dupont	15,841	13,990			

As a result of participation in the Company's Dividend Reinvestment Plan, Directors acquired additional shares on 7 April 2003 as follows:

R J Baty	472
C I J H Drummond	34
D J Dupont	34
A T Fletcher	29

There have been no other changes in the beneficial interests or the non-beneficial interests of the Directors in the ordinary shares of the Company between 1 April 2003 and 28 May 2003.

(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:

Director and date of award	Conditional awards held at 1 April 2002*	Conditional awards made in year	Market price upon award in year	Vesting in year	Conditional awards held at 31 March 2003	Date of end of period for qualifying conditions to be fulfilled
R J Baty						
12/9/00	16,174	–	598p	–	16,174	11/9/03
11/9/01	16,294	–	622p	–	16,294	10/9/04
16/9/02	–	18,514	638p	–	18,514	15/9/05
C I J H Drummond						
12/9/00	16,174	–	598p	–	16,174	11/9/03
11/9/01	16,294	–	622p	–	16,294	10/9/04
16/9/02	–	18,514	638p	–	18,514	15/9/05
D J Dupont						
12/9/00	6,842	–	598p	–	6,842	11/9/03
11/9/01	7,038	–	622p	–	7,038	10/9/04
16/9/02	–	14,694	638p	–	14,694	15/9/05

Directors' share interests continued

*The number of shares in each of these awards was reduced to the number shown consequent upon the Company's share capital consolidation on 2 September 2002.

During the year the Directors received dividends on the above shares in accordance with the conditions of the Restricted Share Plan.

Details of the Restricted Share Plan may be found in the Directors' remuneration report on pages 18 and 19.

It is anticipated that all the shares will vest under the 2000 awards as the performance criterion has been met.

(c) Annual Incentive Bonus Plan – Deferred Shares

The following Directors also have a contingent interest in the number of shares shown to which they would become entitled if they remain employed by the Company for a further three years from the date of the award:

Director and date of award	Conditional awards held at 1 April 2002	Conditional awards made in year	Market price upon award in year	Vesting in year	Conditional awards held at 31 March 2003	Date of end of period for qualifying conditions to be fulfilled
R J Baty 26/7/02	–	7,885*	652p	–	7,885	25/7/05
C I J H Drummond 26/7/02	–	5,554*	652p	–	5,554	25/7/05
3/12/02	–	1,161	607p	–	1,161	2/12/05
D J Dupont 26/7/02	–	4,728*	652p	–	4,728	25/7/05

*The number of shares in each of these awards was reduced to the number shown consequent upon the Company's share capital consolidation on 2 September 2002.

During the year the Directors received dividends on the above shares in accordance with the conditions of the Bonus Plan, details of which may be found in the Directors' remuneration report on page 17.

(d) Sharesave Scheme

Details of options to subscribe for shares of the Company under the all-employee Sharesave Scheme were:

Director and date of grant	Options held at 1 April 2002	Granted in year	Exercised in year	Market price on exercising	Options held at 31 March 2003	Exercise price	Exercise period/maturity date
R J Baty 4/7/00	1,260	–	–	–	1,260	461p	1/9/03 – 1/3/04
10/7/01	792	–	–	–	792	489p	1/9/04 – 1/3/05
C I J H Drummond 4/7/00	2,101	–	–	–	2,101	461p	1/9/03 – 1/3/04
D J Dupont 24/7/97	3,102	–	3,102	635p	–	556p	–
9/7/02	–	2,924	–	–	2,924	566p	1/9/07 – 1/3/08

(e) Share price

The market price of the Company's shares at 31 March 2003 was 660p (2002 645p) and the range during the year was 585p to 760p (2002 580p to 660p).



By Order of the Board
K D Woodier, Company Secretary
26 June 2003

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.

The Board

During the year the Board of Directors comprised three Executive Directors and four Non-executive Directors. Ms D A Nichols was subsequently appointed a Non-executive Director on 12 June 2003. The Non-executive Directors are regarded as independent and Sir Geoffrey Chipperfield was the appointed senior Non-executive Director. Following the annual general meeting on 31 July 2003 Sir Geoffrey Chipperfield and Mr A T Fletcher will retire from the Board. The Board is to appoint a further Non-executive Director shortly. The biographies on page 16 demonstrate a broad range of business and financial experience and there is a clear separation in the roles of Chairman and the Chief Executives of South West Water Limited and Viridor Waste Limited. All Directors are subject to re-election at least every three years.

During the year the Board met monthly, (except in August and with an additional special meeting in April 2002) and at each meeting all Directors were present with the exception of Mr D J Dupont, Mr A T Fletcher and Ms K M H Mortimer each on one occasion. The Board has adopted a Group policy which includes a schedule of matters reserved for its decision and which recognises that the Board's capacity is limited. The Board has therefore delegated more detailed consideration of certain matters to Board Committees, to the subsidiary boards of South West Water Limited and Viridor Waste Limited and to the Executive Directors and Company Secretary as appropriate. Recognising this policy, the matters reserved to the Board 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. The Board operates by receiving written reports circulated in advance from the Executive Directors and the Company Secretary on matters within their respective business areas within the Group. Under the guidance of the Chairman, all matters before the Board are discussed openly, and if necessary, specialist advice is received on occasions from other senior executives within the Group, or external advisers. Directors have access to the advice and services of the Company Secretary and the Board has established a procedure whereby Directors, 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. In accordance with Group policy the tasks of giving detailed consideration to specified matters, to monitoring executive actions and to assessing reward are allocated to the Board Committees as follows:

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, met four times during the year. Ms D A Nichols was subsequently appointed a member of the Committee on 12 June 2003. Its Terms of Reference cover the points recommended by the Combined Code including, through the work undertaken by the external auditors and internal audit section of the Company, ensuring the adequacy and effectiveness of the financial and operating controls and reporting systems of the Group; considering overall budgetary controls and executive delegations; considering the annual review undertaken by the Group of the effectiveness of the system of internal control to ensure compliance by the Group with the Group Risk Management Policy; approving annually a rolling three year audit plan for the Group; considering and recommending to the Board the appointment and approving the remuneration of external auditors of the Company and subsidiaries; discussing with the external auditors the scope of their audit and considering the reports of the external auditors; and considering matters, including those relating to unethical or fiduciary activities, which Directors may wish to raise with the Chairman of the Committee. The Committee pays particular attention to the independence and objectivity of the auditors and has established a policy for the engagement of the auditors for non-audit work by the Group. In addition, the Company's current auditors ensure that the senior partner responsible for the external audit of the Group remains responsible for such audit for no more than seven years and that there is an independent concurring review partner of the auditors who is involved in planning and in the reviewing of the final accounts of the Company and also any critical matters that may be identified in the audit. (Details of audit and non-audit fees are contained in note 3 to the Financial statements on page 40).

The Group Director of Finance attends the Committee 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 comprised three Non-executive Directors during the year, these being Mr A T Fletcher, who chaired the Committee, Sir Geoffrey Chipperfield and Ms K M H Mortimer. Ms D A Nichols was subsequently appointed a member of the Committee on 12 June 2003. The Committee met on eight occasions during the year 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 Directors' remuneration report, which also provides more information on the activities of the Remuneration Committee, appears on pages 17 to 23.

Nomination Committee

The Nomination Committee was chaired by Mr K G Harvey and also comprised Sir Geoffrey Chipperfield and Mr A T Fletcher. Ms K M H Mortimer was subsequently appointed a member of the Committee on 24 April 2003 and Ms D A Nichols was appointed a member on 12 June 2003. It meets as and when required to select and recommend to the Board suitable candidates for appointment as Executive and Non-executive Directors. During the year it met on one occasion to consider the appointment of a Non-executive Director.

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 met four times during the year and is responsible for reviewing and monitoring the environmental and social policies of Group companies, their achievement of environmental and social objectives and targets and considering the Group's annual Environmental and Social Report.

Internal control

Wider aspects of internal control

The Board confirms that it continues to apply its established procedures which were introduced in 2000 to implement 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. All business units within the Group apply the policy in accordance with an annual timetable, which commences with the setting of objectives as part of the Group strategic planning process.

This is followed by a full risk and control assessment undertaken by the management of each business unit to identify financial and non-financial risks to achieve the objectives. Each business unit management committee then receives as part of its regular management reports an assessment of key risks against corporate objectives. The Board at each meeting receives from Executive Directors details of any new high level risks identified and how they are to be managed, together with details of any changes to existing risks and their management. The boards of South West Water and Viridor Waste also receive at each meeting similar reports in respect of their own areas of responsibility. Finally, all senior managers certify on an annual basis that they have established effective controls to manage risks and to operate in compliance with legislation and Group procedures. All of these processes serve to ensure that a culture of effective control and risk management is embedded within the organisation and that the Group is in a position to react appropriately to new risks as they arise.

Internal financial control

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

There is an established internal control framework which comprises:

- (a) a clearly defined structure which delegates authority, responsibility and accountability, including responsibility for internal financial control, to management of operating units;
- (b) a comprehensive budgeting and reporting function with an annual budget approved by the Board of Directors, which also monitors monthly achieved results and updated forecasts for the year against budget;
- (c) documented financial control procedures; managers of operating units are required to confirm annually that they have adequate financial controls in operation and to report all material areas of financial risk; 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 relate to interest rate and counterparty risk. Further details are included in note 27 to the financial statements on page 56.

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

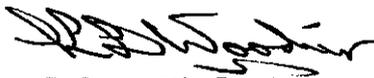
The Directors are required by the Companies Act 1985 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the profit or loss of the Group for the financial year.

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.

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

Relations with shareholders

The Company maintains a regular dialogue with its institutional shareholders and has a well developed investor relations programme. During the year meetings with institutional shareholders were attended by the Group Director of Finance and the Company's Investor Relations Manager and, on certain occasions, the Chairman, the Chief Executive of South West Water Limited and the Chief Executive of Viridor Waste Limited also attended. 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
26 June 2003

The Directors submit their report and audited financial statements for the year ended 31 March 2003.

Principal activity and business review

The principal activities of the Company and its subsidiaries ('the Group') continue to be the provision of water and sewerage services and waste management. Further information regarding the Group and its progress during the year and future developments is contained in the Chairman's statement, in the Business review and in the Financial review on pages 2 to 15.

The principal subsidiaries of the Company are listed in note 29 to the financial statements on page 62.

Financial results and dividend

Group profit on ordinary activities after taxation was £57.1 million. The Directors recommend a final dividend of 26.5p per ordinary share, making a total for the year of 39.1p (excluding the special interim dividend of 70.0p), the cost of which is £48.7 million, leaving a retained deficit of £87.2 million which has been transferred from reserves.

The Financial review on pages 12 to 15 analyses the results in more detail and sets out other financial information, including the Directors' opinion on asset values.

Directors

Sir Geoffrey Chipperfield and Mr A T Fletcher will retire from the Board at the conclusion of the annual general meeting on 31 July 2003. Ms D A Nichols was appointed as a Non-executive Director on 12 June 2003. Messrs K G Harvey and C I J H Drummond are due to retire by rotation at the annual general meeting and they offer themselves for re-election. Following her appointment by the Board, Ms D A Nichols is also due to retire and will offer herself for election at the annual general meeting. Resolutions for the (re)election of Messrs K G Harvey, C I J H Drummond and Ms D A Nichols will be proposed at the annual general meeting.

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

Further details relating to the Directors and their service contracts are set out on pages 17 to 20 and details of the Directors' interests in shares of the Company are given on pages 22 and 23.

Employment policies

Details are set out in the Business review on page 8.

Research and development

Research and development activities within the Group during the year amounted to £0.1 million compared with £2.6 million in 2001/02.

Charitable donations

During the year charitable donations amounting to £46,000 were made. No political donations were made.

Tax status

The Company is not a close company within the meaning of the Income and Corporation Taxes Act 1988.

Payments to suppliers

Details are set out in the Financial review on page 15.

Substantial shareholdings

Details are set out in the Shareholder information section on page 72.

Auditors

PricewaterhouseCoopers were appointed auditors until the conclusion of the fourteenth annual general meeting. However, following the conversion of PricewaterhouseCoopers to a Limited Liability Partnership (LLP) from 1 January 2003, PricewaterhouseCoopers resigned as the Company's auditors on 26 February 2003 and the Directors appointed its successor, PricewaterhouseCoopers LLP to fill the casual vacancy. A resolution for their re-appointment upon the recommendation of the Audit Committee of the Board will be proposed at the annual general meeting and the auditors have indicated their willingness to continue in office.

Appointed business

South West Water Limited is required to publish additional financial information relating to the 'appointed business' as water and sewerage undertaker in accordance with the Instrument of Appointment from the Secretary of State for the Environment. A copy of this information will be available from 15 July 2003 upon application to the Company Secretary at Peninsula House, Rydon Lane, Exeter EX2 7HR.

Annual general meeting

The fourteenth annual general meeting will be held at the Plymouth Pavilions, Millbay Road, Plymouth, Devon on 31 July 2003 at 11am.

In addition to routine business, resolutions will be proposed at the annual general meeting to:

- re-elect Mr K G Harvey and Mr C I J H Drummond and to elect Ms D A Nichols as Directors of the Company
- approve the Directors' remuneration report for the year as set out in pages 17 to 23 of the Annual Report
- renew the existing authorities to issue a limited number of shares and to purchase up to 10% of the issued share capital
- adopt new Articles of Association of the Company
- introduce a scrip dividend alternative for shareholders to replace the existing Dividend Reinvestment Plan

Details of the resolutions are set out in the Notice of Meeting which is circulated as a separate document with the Annual Report.



By Order of the Board
K D Woodier, Company Secretary
26 June 2003

Independent auditors' report to the members of Pennon Group Plc

We have audited the financial statements which comprise the Group profit and loss account, the Group statement of total recognised gains and losses, the Group balance sheet, the Company balance sheet, the Group cash flow statement, the accounting policies and the related notes. We have also audited the disclosures required by Part 3 of Schedule 7A to the Companies Act 1985 contained in the Directors' remuneration report ('the auditable part').

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 Directors' responsibilities statement on page 26. The Directors are also responsible for preparing the Directors' remuneration report.

Our responsibility is to audit the financial statements and the auditable part of the Directors' remuneration report in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

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

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 of the Financial Services Authority and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the Company's or Group's corporate governance procedures or its risk and control procedures.

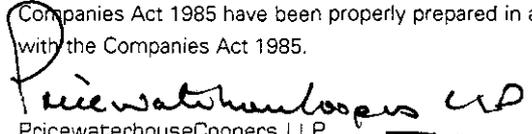
Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the auditable part of the Directors' remuneration report. 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 and the auditable part of the Directors' remuneration report 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 2003 and of the profit and cash flows of the Group for the year then ended, have been properly prepared in accordance with the Companies Act 1985 and those parts of the Directors' remuneration report required by Part 3 of Schedule 7A to the Companies Act 1985 have been properly prepared in accordance with the Companies Act 1985.


PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Bristol
26 June 2003

... Group profit and loss account

for the year ended 31 March 2003

	Notes	2003 £m	2002 £m
Turnover			
Continuing operations		403.0	381.0
Acquisitions		14.2	–
		417.2	381.0
Discontinued operations		–	42.9
Total turnover	2	417.2	423.9
Operating costs	3	(290.2)	(302.1)
Group operating profit			
Continuing operations		126.0	119.1
Acquisitions		1.0	–
		127.0	119.1
Discontinued operations		–	2.7
Total Group operating profit	2	127.0	121.8
Share of operating loss in:			
Joint venture		(0.1)	(0.1)
Associate		(0.6)	(0.4)
Total operating profit		126.3	121.3
Profit on disposal of discontinued operation	4	–	5.1
Net interest payable	5	(52.1)	(49.0)
Profit on ordinary activities before taxation	2	74.2	77.4
Tax on profit on ordinary activities	6	(17.1)	(3.3)
Profit on ordinary activities after taxation		57.1	74.1
Dividends	8	(144.3)	(51.4)
Retained (deficit)/surplus transferred (from)/to reserves	24	(87.2)	22.7
Earnings per share			
	9		
Before exceptional item and deferred tax:			
Adjusted basic earnings per share		55.0p	53.0p
Adjusted diluted earnings per share		54.8p	52.9p
After exceptional item and deferred tax:			
Basic earnings per share		44.3p	54.3p
Diluted earnings per share		44.2p	54.2p
Dividend per share	8	109.1p	37.5p

... Group statement of total recognised gains and losses

for the year ended 31 March 2003

	2003 £m	2002 £m
Profit on ordinary activities after taxation	57.1	74.1
Currency retranslation differences on foreign currency net investments	–	0.6
Total gains and losses recognised for the year	57.1	74.7
Prior year adjustments	–	(50.9)
Total gains and losses recognised since last Annual Report	57.1	23.8

There is no difference between the profits as reported and those profits on a historical basis.

The notes on pages 34 to 70 form part of these financial statements.

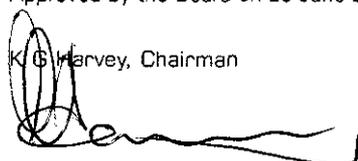
... Balance sheets

at 31 March 2003

	Notes	Group		Company	
		2003 £m	2002 £m	2003 £m	2002 £m
Fixed assets					
Intangible assets	12	37.6	11.7	-	-
Tangible assets	13	2,046.4	1,907.7	0.2	0.2
Investments	14	1.9	3.3	928.7	929.8
		2,085.9	1,922.7	928.9	930.0
Current assets					
Stocks	15	4.0	3.2	-	-
Debtors: amounts falling due after more than one year	16	5.5	5.4	175.4	179.9
Debtors: amounts falling due within one year	17	82.1	76.2	58.9	10.8
Investments	18	182.4	291.0	-	112.9
Cash at bank and in hand		8.6	1.0	-	-
		282.6	376.8	234.3	303.6
Current liabilities					
Creditors: amounts falling due within one year	19	(265.1)	(276.0)	(402.2)	(430.6)
Net current assets/(liabilities)		17.5	100.8	(167.9)	(127.0)
Total assets less current liabilities					
Creditors: amounts falling due after more than one year	20	(1,083.3)	(932.3)	(233.7)	(208.7)
Provisions for liabilities and charges	21	(90.6)	(74.4)	(0.3)	(1.9)
Deferred income	22	(39.4)	(40.6)	-	-
Net assets	2	890.1	976.2	527.0	592.4
Capital and reserves					
Called-up share capital	23	137.2	137.0	137.2	137.0
Share premium account	24	152.8	151.6	152.8	151.6
Profit and loss account	24	600.1	687.6	237.0	303.8
Shareholders' funds	25	890.1	976.2	527.0	592.4

The notes on pages 34 to 70 form part of these financial statements.

Approved by the Board on 26 June 2003 and signed on its behalf by:

K G Harvey, Chairman


... Group cash flow statement

for the year ended 31 March 2003

	Notes	2003 £m	2002 £m
Net cash inflow from operating activities	32(a)	198.9	196.2
Returns on investments and servicing of finance	32(b)	(42.9)	(44.3)
Taxation		-	0.4
Capital expenditure and financial investment	32(b)	(198.2)	(182.3)
Acquisitions and disposals	32(b)	(37.2)	85.0
Equity dividends paid		(147.3)	(49.4)
<hr/>			
Net cash (outflow)/inflow before use of liquid resources and financing		(226.7)	5.6
Management of liquid resources	32(b)	67.6	(27.0)
Financing	32(b)	140.7	38.2
<hr/>			
(Decrease)/increase in cash in year	32(c)	(18.4)	16.8

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).

(b) Basis of consolidation

The Group financial statements include the results of the Company and its subsidiary undertakings, each made up to 31 March 2003, 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

From 1 April 1998 goodwill arising from the acquisition of subsidiary, joint venture 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, joint venture 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.

1. Accounting policies continued

(f) Tangible fixed assets and depreciation

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

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

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

The depreciation charge on infrastructure assets represents the level of annual expenditure required to maintain the operating capacity of the network and is calculated from an independently certified asset management plan.

ii Landfill sites

Landfill sites are included at cost less 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.

The cost of assets includes directly attributable labour and overhead costs that are incremental to the Group.

(g) Leased assets

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

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

1. Accounting policies continued

(h) 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 13.

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

(i) Investments

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

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

(j) Fixed asset investment in own shares and impairment

Shares acquired under the Employee Share Ownership Plan, a discretionary trust, are recognised on the balance sheet at cost of acquisition less impairment, being the charge to profits over the period to which the employees' performance relates.

(k) Stocks

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

(l) Pension costs

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

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

The financial statements reflect, as set out in note 30, only the disclosure requirements of Financial Reporting Standard 17 'Retirement Benefits'.

(m) Research and development expenditure

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

1. Accounting policies *continued*

(n) 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.

(o) 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.

(p) Environmental and landfill restoration 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.

(q) Financial instruments

Derivative financial instruments are used to hedge interest rate risks. All such hedging instruments, including interest differentials which arise, are matched with their underlying hedged item.

2. Segmental analysis

By class of business

	Turnover		Group operating profit				Profit before tax	
	2003 £m	2002 £m	Before goodwill amortisation		After goodwill amortisation		2003 £m	2002 £m
			2003 £m	2002 £m	2003 £m	2002 £m		
Continuing operations								
Water and sewerage	270.2	260.4	111.5	107.0	111.5	107.0	67.1	66.8
Waste management	152.3	125.3	19.1	15.2	17.6	14.9	14.2	13.5
Other	5.2	6.6	(2.1)	(2.8)	(2.1)	(2.8)	(7.1)	(11.0)
Less intra-group trading	(10.5)	(11.3)	-	-	-	-	-	-
Total continuing operations	417.2	381.0	128.5	119.4	127.0	119.1	74.2	69.3
Discontinued operations								
Instrumentation	-	43.0	-	3.9	-	2.6	-	2.7
Property	-	1.4	-	0.1	-	0.1	-	0.3
Less intra-group trading	-	(1.5)	-	-	-	-	-	-
Total discontinued operations	-	42.9	-	4.0	-	2.7	-	3.0
Exceptional item								
Discontinued operations disposal profit	-	-	-	-	-	-	-	5.1
Group totals	417.2	423.9	128.5	123.4	127.0	121.8	74.2	77.4

	Net assets/(liabilities)		Employees (average number)	
	2003 £m	2002 £m	2003	2002
Continuing operations				
Water and sewerage	909.3	930.0	1,343	1,485
Waste management	95.7	94.2	685	605
Other, including intra-group trading	(114.9)	(48.0)	35	47
	890.1	976.2	2,063	2,137
Discontinued operations				
Instrumentation	-	-	-	421
Property	-	-	-	4
	-	-	-	425
Group totals	890.1	976.2	2,063	2,562

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	
	2003 £m	2002 £m	2003 £m	2002 £m
United Kingdom	417.2	386.7	127.0	118.4
Continental Europe	-	14.2	-	1.0
Americas	-	23.0	-	2.4
	417.2	423.9	127.0	121.8

By geographical destination

	Turnover		Group operating profit	
	2003 £m	2002 £m	2003 £m	2002 £m
United Kingdom	417.2	384.7	127.0	118.9
Continental Europe	-	4.7	-	0.2
Americas	-	25.0	-	2.4
Other	-	9.5	-	0.3
	417.2	423.9	127.0	121.8

Intra-group trading arose in the United Kingdom.

Profit before tax is not separately disclosed by geographical origin and destination since it is substantially located in the United Kingdom.

There are no employees working outside the United Kingdom (2002 327, all in the instrumentation segment).

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

The comparatives for the year ended 31 March 2002 for discontinued operations include the results of Viridor Instrumentation Limited which was disposed of in February 2002.

3. Operating costs

	Continuing operations £m	Acquisitions £m	Total 2003 £m	Continuing operations £m	Discontinued operations £m	Total 2002 £m
Manpower costs (note 10)	43.4	2.7	46.1	46.8	12.9	59.7
Raw materials and consumables	22.2	5.9	28.1	23.9	15.2	39.1
Rentals under operating leases:						
Hire of plant and machinery	3.0	0.1	3.1	3.4	0.2	3.6
Other operating leases	3.0	0.2	3.2	2.9	0.4	3.3
Research and development expenditure	0.1	–	0.1	0.1	2.5	2.6
Auditors' remuneration	0.3	–	0.3	0.2	–	0.2
Other external charges	52.4	0.5	52.9	47.0	1.6	48.6
Amortisation of intangible fixed assets	0.6	0.9	1.5	0.3	1.3	1.6
Depreciation:						
On owned assets	61.6	0.6	62.2	57.6	0.9	58.5
On assets held under finance leases	17.6	–	17.6	17.0	–	17.0
Profit on disposal of tangible fixed assets	(0.7)	(0.1)	(0.8)	(1.1)	–	(1.1)
Deferred income released to profits	(1.2)	–	(1.2)	(1.2)	–	(1.2)
Other operating charges	74.7	2.4	77.1	65.0	5.2	70.2
	277.0	13.2	290.2	261.9	40.2	302.1

Fees payable to the Group's auditors amounted to £271,000 (2002 £243,000) in respect of the Group audit, including £47,000 (2002 £53,000) for the Company's audit. In addition, fees of £137,000 (2002 £244,000) were payable to the Group's auditors for non-audit work mainly in connection with taxation advice and acquisitions.

4. Profit on disposal of discontinued operation

	2003 £m	2002 £m
Profit on disposal of discontinued operation	–	5.1

The profit on the disposal of the discontinued operation in 2002 related to the sale of the Company's interest in the entire ordinary share capital of Viridor Instrumentation Limited, which had comprised the Group's instrumentation segment. The profit on disposal, which was an exceptional item reported after operating profit, was after charging £43.5 million of goodwill previously written off to reserves on acquisition. The tax charge was not affected by the business disposal profit.

5. Net interest payable

	2003 £m	2002 £m
Interest payable:		
Bank loans and overdrafts	(16.5)	(15.5)
Other loans	(16.5)	(16.7)
Interest element of finance lease rentals	(28.1)	(27.8)
Other finance costs	(0.2)	(0.5)
	(61.3)	(60.5)
Interest receivable:		
Listed redeemable securities	0.3	0.2
Other investments (as defined in note 18)	9.7	12.0
	10.0	12.2
Unwinding of discount in provisions	(0.8)	(0.7)
Net interest payable	(52.1)	(49.0)

6. Tax on profit on ordinary activities

(a) Analysis of charge for the year

	2003 £m	2002 £m
Current tax:		
UK corporation tax at 30%:		
Current year	5.8	2.4
Prior year	(2.4)	(1.9)
	3.4	0.5
Overseas tax:		
Current year	–	0.3
Prior year	–	(0.8)
	–	(0.5)
Total current tax (note 6(b))	3.4	–
Deferred tax:		
Origination and reversal of timing differences	17.2	23.2
Increase in discount	(3.5)	(19.9)
Total deferred tax (note 21)	13.7	3.3
Tax on profit on ordinary activities	17.1	3.3

6. Tax on profit on ordinary activities *continued*

(b) Factors affecting tax charge for the year

	2003 £m	2002 £m
The tax assessed for the year is lower than the standard rate of corporation tax in the UK (30%). The differences are explained below:		
Profit on ordinary activities before tax	74.2	77.4
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK (30%)	22.3	23.2
Effects of:		
Capital loss on disposal of discontinued operation	-	(1.5)
Expenses not deductible for tax purposes	3.1	1.8
Capital allowances for year in excess of depreciation	(19.3)	(22.5)
Other timing differences	(0.3)	1.7
Adjustments to tax charge in respect of prior year	(2.4)	(2.7)
Current tax charge for year (note 6(a))	3.4	-

The discounted deferred tax liability and the amount charged to the profit and loss account are affected by changes in medium and long term interest rates.

7. Profit of parent company

	2003 £m	2002 £m
Profit on ordinary activities after taxation dealt with in the accounts of the parent company	77.8	81.3

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

8. Dividends

	2003 £m	2002 £m
Special interim dividend of 70.0p per share paid 1 October 2002	95.9	-
Interim dividend of 12.6p (2002 12.1p) per share paid 7 April 2003	15.6	16.6
Proposed final dividend of 26.5p (2002 25.4p) per share payable 1 October 2003	32.8	34.8
	144.3	51.4

9. Earnings per share

	2003			2002		
	Profit after tax £m	Earnings per share Basic p	Earnings per share Diluted p	Profit after tax £m	Earnings per share Basic p	Earnings per share Diluted p
Adjusted earnings:						
Before exceptional item and deferred tax	70.8	55.0	54.8	72.3	53.0	52.9
Exceptional item:						
Discontinued operation disposal profit	-	-	-	5.1	3.7	3.7
Deferred tax	(13.7)	(10.7)	(10.6)	(3.3)	(2.4)	(2.4)
Profit on ordinary activities after taxation	57.1	44.3	44.2	74.1	54.3	54.2

Adjusted earnings per share before the exceptional item and deferred tax have been calculated to exclude the impact of those items on the results, as such items can have a distorting effect on earnings from year to year and therefore warrant separate consideration.

The calculation of earnings per share is based on the profit after tax divided by the weighted average number of ordinary shares in issue during the year of 128.8 million (2002 136.5 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 129.3 million (2002 136.8 million).

10. Employees and employment costs

The average number of persons (including Directors) employed by the Group was 2,063 (2002 2,562), including, in 2002, 425 for the discontinued operations.

	Continuing operations £m	Acquisitions £m	Total 2003 £m	Continuing operations £m	Discontinued operations £m	Total 2002 £m
Employment costs comprise:						
Wages and salaries	46.4	2.5	48.9	48.9	12.2	61.1
Social security costs	3.3	0.2	3.5	3.4	2.3	5.7
Pension costs	3.2	-	3.2	2.8	0.3	3.1
Total employment costs	52.9	2.7	55.6	55.1	14.8	69.9
Charged as follows:						
Manpower costs (note 3)	43.4	2.7	46.1	46.8	12.9	59.7
Research and development expenditure	-	-	-	0.1	1.9	2.0
Restructuring provision	0.1	-	0.1	0.3	-	0.3
Capital schemes	9.4	-	9.4	7.9	-	7.9
	52.9	2.7	55.6	55.1	14.8	69.9

11. Directors' emoluments

	2003 £000	2002 £000
Executive Directors:		
Salary	441	453
Performance related bonus:		
Payable	141	187
Deferred	141	100
Other emoluments	48	40
Payments in respect of tax liability from supplementary pension arrangements	57	14
Non-executive Directors	253	251
Total emoluments	1,081	1,045

The emoluments of the highest paid Director were £332,000 (2002 £296,000).

Total gains made by Directors on the exercise of share options were £2,000 (2002 nil).

Total emoluments include £414,000 (2002 £378,000) payable to Directors for services as directors of subsidiary undertakings.

At 31 March 2003 and 31 March 2002 retirement benefits were accruing to three Directors under defined benefit pension schemes. The accrued pension entitlement at 31 March 2003 under defined benefit schemes of the highest paid Director was £49,000 (2002 £40,000). No pension contributions were payable to defined contribution schemes in 2003 or 2002.

More detailed information concerning Directors' emoluments, shareholdings and share options is shown in the Directors' remuneration report on pages 17 to 23.

12. Intangible fixed assets

	Goodwill 2003 £m
Cost:	
At 1 April 2002	11.8
Additions	27.4
At 31 March 2003	39.2
Amortisation:	
At 1 April 2002	0.1
Charge for year	1.5
At 31 March 2003	1.6
Net book value:	
At 31 March 2003	37.6
At 31 March 2002	11.7

All goodwill is amortised evenly over the Directors' estimate of its useful economic life, which is 20 years.

13. Tangible fixed assets

	Land and buildings £m	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers £m	Construction in progress £m	Group Total 2003 £m	Company Total 2003 £m
Cost:							
At 1 April 2002	153.8	952.1	529.6	703.5	73.8	2,412.8	0.4
Arising on acquisitions	14.6	–	–	3.1	–	17.7	–
Additions	16.3	64.4	32.1	48.9	42.9	204.6	0.1
Grants and contributions	–	(0.8)	–	–	–	(0.8)	–
Disposals	(0.3)	(0.6)	(0.5)	(5.4)	–	(6.8)	(0.2)
Transfers/reclassifications	(2.1)	15.2	6.2	13.6	(32.9)	–	–
At 31 March 2003	182.3	1,030.3	567.4	763.7	83.8	2,627.5	0.3
Depreciation:							
At 1 April 2002	54.3	100.3	92.3	258.2	–	505.1	0.2
Charge for year	12.6	13.9	9.6	45.3	–	81.4	0.1
Disposals	(0.1)	(0.5)	(0.4)	(4.4)	–	(5.4)	(0.2)
Transfers/reclassifications	1.3	–	–	(1.3)	–	–	–
At 31 March 2003	68.1	113.7	101.5	297.8	–	581.1	0.1
Net book value:							
At 31 March 2003	114.2	916.6	465.9	465.9	83.8	2,046.4	0.2
At 31 March 2002	99.5	851.8	437.3	445.3	73.8	1,907.7	0.2
Assets held under finance leases included above:							
Cost: At 31 March 2003	–	125.9	314.5	205.5	35.7	681.6	–
Depreciation: Charge for year	–	1.8	5.5	10.3	–	17.6	–
Depreciation: At 31 March 2003	–	6.9	38.0	91.3	–	136.2	–

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 £7.7 million (2002 £2.4 million) and £9.3 million (2002 £9.3 million) respectively.

13. Tangible fixed assets *continued*

The net book value of land and buildings comprises:

	2003 £m	2002 £m
Freehold	72.4	57.5
Short leasehold	41.8	42.0
	114.2	99.5

The net book value of infrastructure assets is stated after deducting £46.2 million (2002 £45.4 million) grants and contributions.

The net book value of infrastructure assets includes £11.6 million (2002 £9.7 million) for the accumulated difference between expenditure on maintaining operating capacity and depreciation charges. Expenditure in the year was £15.8 million (2002 £16.9 million).

Out of the total depreciation charge for the Group of £81.4 million (2002 £76.5 million), the sum of £1.6 million (2002 £1.0 million) has been charged to capital projects and £79.8 million (2002 £75.5 million) against profits.

14. Fixed asset investments

	Subsidiary undertakings £m	Joint venture £m	Own shares £m	Other investments £m	Total investments 2003 £m
Group					
Cost:					
At 1 April 2002	–	–	2.2	1.1	3.3
Addition	–	0.1	–	–	0.1
Loss for year	–	(0.1)	–	–	(0.1)
Provision for impairment	–	–	(0.9)	(0.5)	(1.4)
At 31 March 2003	–	–	1.3	0.6	1.9
Company					
Cost:					
At 1 April 2002	928.1	–	1.2	0.5	929.8
Disposals	–	–	(0.2)	–	(0.2)
Provision for impairment	–	–	(0.4)	(0.5)	(0.9)
At 31 March 2003	928.1	–	0.6	–	928.7

All investments are in shares except other investments for the Group which includes £0.6 million loans at 31 March 2003 (2002 £0.6 million).

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, are dependent upon performance conditions being met. Shares are also held as part of an Incentive Bonus Scheme operated for senior management of the Group. Awards under the Scheme involve the release of ordinary shares in the Company to participants usually conditional upon continuous service with the Group for a period of three years from the award. The shares described above are released out of an Employee Share Ownership Plan, a discretionary trust, established to facilitate the operation of the incentive schemes. More information on the operation of the incentive schemes is included in the Directors' remuneration report on pages 17 to 23.

14. Fixed asset investments continued

During the year the trustees of the Employee Share Ownership Plan did not purchase any of the Company's ordinary shares (2002 74,000 financed through non-interest bearing advances made by sponsoring Group companies).

The market value of the 485,000 ordinary shares held as Group investments at 31 March 2003 was £3.2 million (2002 £3.5 million). 170,000 of those shares (2002 298,000) held as Company investments had a market value of £1.1 million at 31 March 2003 (2002 £1.9 million). The costs of the Long Term Incentive Plan are recognised as a provision for impairment and are charged within employment costs to profits over the period of its operation. The costs of the Incentive Bonus Scheme are charged within employment costs in the year of the award.

Details of principal subsidiary, joint venture and associated undertakings of the Group are set out in note 29.

15. Stocks

	Group		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Raw materials and consumables	3.5	3.2	-	-
Work in progress	0.5	-	-	-
	4.0	3.2	-	-

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

	Group		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Amounts owed by subsidiary undertakings	-	-	173.9	177.9
Other debtors	1.2	1.1	1.1	1.1
Prepayments for pension costs	4.3	4.3	0.4	0.7
Deferred tax (note 21)	-	-	-	0.2
	5.5	5.4	175.4	179.9

17. Debtors: amounts falling due within one year

	Group		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Trade debtors	59.0	46.2	-	-
Amounts owed by subsidiary undertakings	-	-	58.1	9.6
Amounts owed by joint venture	1.7	0.3	-	-
Other debtors	1.7	9.4	0.5	0.6
Prepayments for pension costs	1.2	2.5	0.3	0.5
Other prepayments and accrued income	18.5	17.3	-	0.1
Tax recoverable	-	0.5	-	-
	82.1	76.2	58.9	10.8

18. Current asset investments

	Group		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Listed investments	4.1	4.8	-	-
Other investments:				
Overnight deposits	4.3	45.3	-	41.7
Other	174.0	240.9	-	71.2
	178.3	286.2	-	112.9
	182.4	291.0	-	112.9

At 31 March 2003 the market value of listed investments was £4.2 million (2002 £4.9 million).

Other investments include certificates of deposit, variable rate notes and deposits of £170.1 million (2002 £157.9 million) made to counter-indemnify letters of credit by financial institutions to lessors in order to secure rental obligations (note 26).

19. Creditors: amounts falling due within one year

	Group		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Loans:				
Bank loans and overdrafts	14.1	29.1	19.1	18.2
Short-term loans	30.0	35.0	-	35.0
European Investment Bank loans	13.6	12.8	-	-
Unsecured loan stock notes	14.4	15.1	14.4	15.1
	72.1	92.0	33.5	68.3
Obligations under finance leases	24.3	19.2	-	-
Trade creditors	60.6	62.2	0.1	0.5
Amounts owed to subsidiary undertakings	-	-	314.5	301.2
Amounts owed to joint venture	0.1	-	-	-
Other creditors	13.9	16.3	4.7	7.3
Corporation tax	8.1	2.9	-	-
Other taxation and social security	16.1	11.7	0.2	0.2
Accruals and deferred income	21.5	20.3	0.8	1.7
Interim dividend	15.6	16.6	15.6	16.6
Proposed final dividend	32.8	34.8	32.8	34.8
	265.1	276.0	402.2	430.6

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

	Group		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Loans:				
Sterling bond	150.0	150.0	150.0	150.0
European Investment Bank loans	135.6	49.2	-	-
Other bank loans	100.0	100.0	50.0	50.0
	385.6	299.2	200.0	200.0
Obligations under finance leases	697.6	632.9	-	-
Amounts owed to subsidiary undertakings	-	-	33.7	8.7
Other creditors	0.1	0.2	-	-
	1,083.3	932.3	233.7	208.7

21. Provisions for liabilities and charges

	Deferred tax £m	Environmental and landfill restoration £m	Restructuring £m	Other provisions £m	Group Total 2003 £m	Company Restructuring 2003 £m
At 1 April 2002	46.2	23.3	2.0	2.9	74.4	1.9
Charged against profits	13.7	3.8	0.6	0.1	18.2	-
Arising on acquisitions	0.1	3.6	-	-	3.7	-
Utilised during year	-	(3.6)	(1.8)	(0.3)	(5.7)	(1.6)
At 31 March 2003	60.0	27.1	0.8	2.7	90.6	0.3

Environmental and landfill restoration provisions will be utilised over the period from 2004 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 £1.0 million for the decommissioning of an operational site in the water and sewerage business in 2004.

21. Provision for liabilities and charges *continued*

Deferred taxation

	Group		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Accelerated capital allowances	257.4	240.2	-	-
Other timing differences	(4.4)	(4.5)	-	(0.2)
Undiscounted provision/(asset) for deferred tax	253.0	235.7	-	(0.2)
Discount	(193.0)	(189.5)	-	-
Discounted provision/(asset) for deferred tax	60.0	46.2	-	(0.2)
Provision/(asset) at 1 April 2002	46.2		(0.2)	
Arising on acquisitions	0.1		-	
Deferred tax charge in profit and loss account for year	13.7		0.2	
Provision at 31 March 2003	60.0		-	

The Company deferred tax asset is included within debtors falling due after more than one year (note 16).

22. Deferred income

	Forward interest rate swaps (note 27) £m	Grants and contributions £m	Group Total 2003 £m	Forward interest rate swaps (note 27) £m	Grants and contributions £m	Group Total 2002 £m
At 1 April 2002:						
Amount to be released:						
After more than one year	18.2	22.4	40.6	18.2	22.9	41.1
Within one year	-	1.3	1.3	-	1.3	1.3
	18.2	23.7	41.9	18.2	24.2	42.4
Additions	-	-	-	-	0.7	0.7
Released to profits	-	(1.2)	(1.2)	-	(1.2)	(1.2)
At 31 March 2003:	18.2	22.5	40.7	18.2	23.7	41.9
Amount to be released:						
Within one year	-	(1.3)	(1.3)	-	(1.3)	(1.3)
After more than one year	18.2	21.2	39.4	18.2	22.4	40.6

23. Called-up share capital

	2003 £m	2002 £m
Authorised		
157,657,600 Ordinary shares of £1.11 each	175.0	–
(2002 175,000,000 Ordinary shares of £1 each)	–	175.0
Allotted, called-up and fully paid		
123,629,373 Ordinary shares of £1.11 each	137.2	–
(2002 137,007,911 Ordinary shares of £1 each)	–	137.0
	2003 Number (Ordinary shares of £1.11 each)	2002 Number (Ordinary shares of £1 each)
Ordinary shares allotted during the year		
For consideration of £1.4 million (2002 £0.4 million) to Pennon Trustee Limited on behalf of employees who exercised their options under the Company's Sharesave Scheme	168,851	59,403

During the year, there was a return of capital to shareholders by way of a special interim dividend from the proceeds of the sale of Viridor Instrumentation Limited. This was accompanied by a consolidation of the Company's share capital in order to maintain comparability of the share price before and after the payment of the special interim dividend, which was approved at the last annual general meeting. The share capital consolidation resulted in every 111 existing ordinary shares of £1 each in the capital of the Company at the close of business on 30 August 2002 being replaced by 100 new ordinary shares of £1.11 each. These shares were admitted to trading on 2 September 2002.

23. Called-up share capital *continued*

Share options

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

Nature of scheme	Date granted and subscription price fully paid		Period when options normally exercisable	Thousands of shares in respect of which options outstanding at 31 March	
				2003 (Ordinary shares of £1.11 each)	2002 (Ordinary shares of £1 each)
Sharesave	6 Jan 1995	373p	2000 – 2002	–	46
	8 July 1997	556p	2000 – 2004	59	201
	7 July 1998	775p	2001 – 2005	34	42
	6 July 1999	825p	2002 – 2006	23	54
	5 July 2000	461p	2003 – 2007	738	825
	4 July 2001	489p	2004 – 2008	186	209
	9 July 2002	566p	2005 – 2009	246	–
Executive	3 July 1992	418p	1995 – 2002	–	2
	5 July 1993	496p	1996 – 2003	–	4
	6 Jan 1995	503p	1998 – 2005	6	9
				1,292	1,392

A performance target applies to the exercise of the Executive Scheme options whereby an increase in earnings per share in excess of the Retail Prices Index movement over the period March 1994 to date of exercise must be achieved.

At 31 March 2003 there were 1,146 participants in the Sharesave Scheme (2002 1,089) and 1 in the Executive Scheme (2002 2).

Options granted to Directors, included above, are shown in the Directors' remuneration report on pages 17 to 23.

24. Reserves

	Group and Company share premium account £m	Profit and loss account Group £m	Company £m
At 1 April 2002	151.6	687.6	303.8
Retained deficit for year	–	(87.2)	(66.5)
Premium on shares issued	0.9	–	–
Adjustment for shares issued under the Sharesave Scheme through Employee Share Ownership Trust	0.3	(0.3)	(0.3)
At 31 March 2003	152.8	600.1	237.0

The cumulative value of goodwill at 31 March 2003 resulting from acquisitions, which has been written off to reserves, is £123.3 million (2002 £123.3 million).

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

25. Statement of movements in shareholders' funds

	Group		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Profit on ordinary activities after taxation	57.1	74.1	77.8	81.3
Dividends	(144.3)	(51.4)	(144.3)	(51.4)
	(87.2)	22.7	(66.5)	29.9
Other recognised gains and losses for the year	–	0.6	–	–
Shares issued for cash consideration	1.4	0.4	1.4	0.4
Adjustment for shares issued under the Sharesave Scheme through Employee Share Ownership Trust	(0.3)	(0.1)	(0.3)	(0.1)
Goodwill written back on disposal	–	43.5	–	–
Shareholders' funds (equity interest):				
(Reduction)/addition for year	(86.1)	67.1	(65.4)	30.2
At 1 April	976.2	909.1	592.4	562.2
At 31 March	890.1	976.2	527.0	592.4

26. Loans and other borrowings

Loans

	Group		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Repayable:				
Over five years	240.9	152.2	150.0	150.0
Over two and up to five years	30.2	133.4	–	50.0
Over one and up to two years	114.5	13.6	50.0	–
Falling due after more than one year (note 20)	385.6	299.2	200.0	200.0
Falling due within one year (note 19)	72.1	92.0	33.5	68.3
	457.7	391.2	233.5	268.3

£1.2 million floating rate unsecured loan stock notes, repayable at par in 2009 or on notice being given by the noteholders, were issued during the year in settlement of accrued consideration payable in connection with the December 1997 acquisition of Terry Adams Limited.

Obligations under finance leases

	Group		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Repayable:				
Over five years	629.7	576.5	–	–
Over two and up to five years	44.9	37.7	–	–
Over one and up to two years	23.0	18.7	–	–
Falling due after more than one year (note 20)	697.6	632.9	–	–
Falling due within one year (note 19)	24.3	19.2	–	–
	721.9	652.1	–	–

Included above are accrued finance charges arising on obligations under finance leases totalling £88.0 million (2002 £77.8 million), of which £20.5 million (2002 £16.4 million) is repayable within one year.

Loans and obligations under finance leases

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

	Group		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Loans	250.0	169.8	150.0	150.0
Obligations under finance leases	721.3	650.4	–	–
	971.3	820.2	150.0	150.0

26. 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 3.5% and 11.3% (2002 3.9% and 11.3%), and are repayable over the period 2004 to 2035.

Within obligations under finance leases South West Water Limited has:

- a utilised finance lease facilities of £180.0 million at 31 March 2003 (2002 £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 2003 (2002 £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.

Borrowing facilities

Undrawn committed borrowing facilities of £30.0 million were available to the Group at 31 March 2003 which expire as follows:

	2003	2002
	£m	£m
Within one year or less	30.0	100.0
Over one and up to two years	-	30.0
	30.0	130.0

In addition, the Group has short-term uncommitted bank facilities of over £250.0 million.

27. Financial instruments

Disclosures on financial and treasury policies are also included in the Corporate governance – statement of compliance on pages 24 to 26.

Interest rate and currency profile of financial assets and liabilities

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

	Financial assets		Financial liabilities	
	2003 £m	2002 £m	2003 £m	2002 £m
Floating rate	187.7	289.2	(549.2)	(636.6)
Fixed rate	4.3	4.4	(630.4)	(406.7)
On which no interest is paid	0.8	0.6	(19.9)	(19.9)
	192.8	294.2	(1,199.5)	(1,063.2)
Which is included in:				
Net debt	191.0	292.0	(1,179.6)	(1,043.3)
Provisions for liabilities and charges	–	–	(1.7)	(1.7)
Deferred income	–	–	(18.2)	(18.2)
Other long-term monetary assets	1.8	2.2	–	–
	192.8	294.2	(1,199.5)	(1,063.2)
Fixed rate financial assets and liabilities:				
Weighted average interest rate	6.3%	6.6%	6.7%	8.3%
Weighted average period for which rate is fixed	1.1 years	0.9 years	3.9 years	4.9 years
Range of interest rates	3.5% to 8.0%	3.5% to 8.0%	4.3% to 11.3%	5.1% to 11.3%
Financial assets and liabilities on which no interest is paid:				
Weighted average period until maturity	–	–	15.2 years	16.2 years

All financial assets and liabilities 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 2003 was 3.2% to 4.9% (2002 3.3% to 5.3%).

The maturity profile of floating rate and fixed rate financial liabilities is shown in note 26. Other financial liabilities fall due for payment principally after five years.

27. Financial instruments continued

Interest rate and currency profile of financial assets and liabilities continued

Interest rate swaps are used to manage the mix of fixed and floating rates to ensure that at least 50% of net debt is at fixed rate:

at 31 March 2003 63% of net debt was at fixed rate (2002 54%);

at 31 March 2003 interest rate swaps to hedge financial liabilities, with a notional principal value of £435.0 million, existed with a weighted average maturity of 2.2 years (2002 £200.0 million, with 1.4 years) to swap from floating to fixed rate; and

at 31 March 2003 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 (2002 £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 22) 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 for the Group.

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

27. Financial instruments *continued*

Fair values of financial assets and liabilities

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

	2003		2002	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Financial assets:				
Current asset investments	182.4	182.5	291.0	291.1
Cash at bank	8.6	8.6	1.0	1.0
Other	1.8	1.8	2.2	2.2
	192.8	192.9	294.2	294.3
Financial liabilities:				
Short-term debt	(72.1)	(72.4)	(92.0)	(92.2)
Long-term debt	(385.6)	(448.7)	(299.2)	(358.6)
Finance lease obligations	(721.9)	(721.9)	(652.1)	(652.1)
Other	(1.7)	(1.7)	(1.7)	(1.7)
	(1,181.3)	(1,244.7)	(1,045.0)	(1,104.6)
Derivative financial instruments (used to manage interest rate profile):				
Interest rate swaps	(18.2)	(16.6)	(18.2)	(16.1)

Floating rate debt, floating rate 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 rates.

27. Financial instruments *continued*

Hedging interest rate exposures

The Group uses derivative financial instruments to manage certain interest rate risks.

The unrecognised gains and losses on such instruments are:

	Gains £m	Losses £m	2003 Total net gains £m	Gains £m	Losses £m	2002 Total net gains £m
Unrecognised gains and losses on hedges:						
At 1 April	5.8	(3.7)	2.1	5.5	(4.9)	0.6
Of which recognised in current year	0.2	(2.1)	(1.9)	0.8	(1.9)	(1.1)
	5.6	(1.6)	4.0	4.7	(3.0)	1.7
Arising and not recognised in current year	6.8	(9.2)	(2.4)	1.1	(0.7)	0.4
At 31 March	12.4	(10.8)	1.6	5.8	(3.7)	2.1
Expected to be recognised:						
In next year	0.4	(5.8)	(5.4)	0.2	(2.1)	(1.9)
Thereafter	12.0	(5.0)	7.0	5.6	(1.6)	4.0
	12.4	(10.8)	1.6	5.8	(3.7)	2.1

Gains and losses on hedging instruments are matched with their underlying hedged item.

28. Acquisitions

On 8 April 2002 the entire issued share capital of Richardson Limited (now renamed Viridor Richardson Limited) was purchased by Viridor Waste Management Limited for a cash consideration of £11.9 million, including costs of £0.1 million. The acquisition was accounted for using the acquisition method and goodwill arising on the acquisition, amounting to £9.4 million, has been capitalised and will be amortised over 20 years.

The profit after tax of Richardson Limited amounted to £0.7 million for the period from 1 August 2001 to 7 April 2002 (profit after tax of £0.5 million in the year ended 31 July 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	2.5	(0.1)	(0.4)	–	2.0
Debtors: amounts falling due within one year	1.8	–	–	–	1.8
Cash at bank and in hand	0.7	–	–	–	0.7
Creditors: amounts falling due within one year	(1.5)	–	–	(0.2)	(1.7)
Provisions for liabilities and charges	(0.1)	(0.2)	–	–	(0.3)
	3.4	(0.3)	(0.4)	(0.2)	2.5

28. Acquisitions *continued*

Accounting policy harmonisation in respect of tangible fixed assets related to the alignment of asset lives with Group policy and, for provisions for liabilities and charges, the recognition of environmental obligations. The revaluation adjustment recognises the value of acquired tangible fixed assets to the Group.

On 12 July 2002 the entire issued share capital of Roseland Plant Co. Limited was purchased by Viridor Waste Management Limited for a cash consideration of £8.9 million, including costs of £0.1 million. The acquisition was accounted for using the acquisition method and no goodwill arises.

The profit after tax of Roseland Plant Co. Limited amounted to £0.2 million for the period from 1 October 2001 to 11 July 2002. Profit in the previous accounting period was not material.

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	2.9	(0.2)	7.3	–	10.0
Debtors: amounts falling due within one year	0.4	–	–	–	0.4
Cash at bank and in hand	0.2	–	–	–	0.2
Creditors: amounts falling due within one year	(1.2)	–	–	(0.1)	(1.3)
Creditors: amounts falling due after more than one year	(0.2)	–	–	–	(0.2)
Provisions for liabilities and charges	(0.1)	–	–	(0.1)	(0.2)
	2.0	(0.2)	7.3	(0.2)	8.9

Accounting policy harmonisation in respect of tangible fixed assets related to the alignment of asset lives with Group policy. The revaluation adjustment recognises the value to the Group of the landfill acquired, based on projected discounted cash flows.

28. Acquisitions continued

On 24 October 2002 the entire issued share capital of Parkwood Holdings Limited (now renamed Viridor Parkwood Holdings Limited) was purchased by Viridor Waste Management Limited for a cash consideration of £20.6 million, including costs of £0.1 million. The acquisition was accounted for using the acquisition method and goodwill arising on the acquisition, amounting to £17.7 million, has been capitalised and will be amortised over 20 years.

The profit after tax of Parkwood Holdings Limited amounted to £0.9 million for the period from 1 April 2002 to 23 October 2002 (profit after tax of £1.5 million in the year ended 31 March 2002).

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	14.4	(1.3)	(7.4)	–	5.7
Debtors: amounts falling due within one year	4.2	–	–	(0.2)	4.0
Cash at bank and in hand	3.7	–	–	–	3.7
Creditors: amounts falling due within one year	(6.0)	–	–	(1.3)	(7.3)
Provisions for liabilities and charges	(0.5)	(2.8)	0.3	(0.2)	(3.2)
	15.8	(4.1)	(7.1)	(1.7)	2.9

Accounting policy harmonisation in respect of tangible fixed assets related to the alignment of asset lives with Group policy and, for provisions for liabilities and charges, the recognition of environmental and landfill restoration obligations. The revaluation adjustment recognises the value in use of the acquired landfill site and treatment plant together with the associated deferred tax. Other adjustments arise principally from a re-assessment of the taxation affairs of the company for pre-acquisition periods.

During the year £0.3 million was invested by Viridor Waste Management Limited in the acquisition for cash of an unincorporated business. Goodwill arising on the acquisition, amounting to £0.3 million, has been capitalised.

On 7 May 2002 South West Water Limited subscribed for a further 99,999 A ordinary shares in Echo South West Limited, a joint venture company, for a cash consideration of £0.1 million.

During the year £5.1 million fair value acquisition accruals and provisions were established (2002 £2.6 million), £1.5 million were utilised (2002 £0.4 million), none were released (2002 £2.5 million in respect of tax), and at 31 March 2003 £13.7 million (2002 £10.1 million) were carried forward.

29. 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 Hampshire Limited	England
	Viridor Waste Management Limited	England
	Roseland Plant Co. Limited	England
	Viridor Parkwood Holdings Limited	British Virgin Islands [†]
	Parkwood Group Limited	England
	Viridor Richardson Limited	England
Viridor Waste Suffolk Limited	England	
Insurance services	Peninsula Insurance Limited*	Guernsey

* indicates the shares were held directly by the Company † operations are carried out in England

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	100,000 A ordinary shares	100%	Customer contact management
	100,000 B ordinary shares	–	

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.

* The terms of the agreement with the other shareholders of Enviro-Logic Limited provided for Pennon Group Plc to acquire full ownership of the company after five years. The option was taken up by the Company on 6 May 2003.

30. Pensions

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

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 main defined benefit scheme has been determined on the advice of the independent qualified actuary using the projected unit method. The employers' regular pension cost for the year is 11.5% of pensionable earnings (2002 11.5%). The net pension charge for the year ended 31 March 2003 for the main scheme was £3.1 million (2002 £2.9 million) which benefits by £1.9 million from the amortisation of the actuarial surplus (2002 £1.8 million). Based on advice of the independent qualified actuary, employers' contributions recommenced in April 2002 at 4.8% of pensionable earnings and have been further increased in April 2003 to 11.5% of pensionable earnings.

Pension prepayments included as debtors of the Group amount to £5.5 million (2002 £6.8 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) was originally intended to change the basis of accounting for pension benefits from 2003/04, but full implementation has been deferred. Under transitional arrangements applying to FRS 17, certain additional disclosures are still required and these are given below.

The full actuarial valuation at 31 March 2001 was updated at 31 March 2003 by the independent qualified actuary using the projected unit method, as required by FRS 17. The value of the assets of the schemes has been updated to market value as at 31 March 2003. The demographic assumptions used in calculating the schemes' liabilities under FRS 17 remain unchanged from those used in the 31 March 2001 actuarial valuation. The financial assumptions at each year end under FRS 17 were as follows:

	2003	2002
	%	%
Rate of increase in pensionable pay	3.50	3.75
Rate of increase for present and future pensions	2.50	2.75
Rate used to discount scheme liabilities	5.50	6.00
Inflation	2.50	2.75

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

	2003		2002	
	Return %	Value £m	Return %	Value £m
Equities	7.00	119.0	7.75	151.6
Bonds	4.50	31.9	5.25	42.5
Other	3.50	8.4	5.00	15.6
Total market value of assets		159.3		209.7
Present value of schemes' liabilities		(244.2)		(216.8)
Deficit in schemes		(84.9)		(7.1)
Related deferred tax asset		25.5		2.1
Net pension liabilities		(59.4)		(5.0)

30. Pensions continued

Had FRS 17 been adopted in the financial statements, the Group's net assets and profit and loss account reserve at 31 March would have been as follows:

	2003 £m	2002 £m
Net assets including prepayments for pension costs and excluding net pension liabilities	890.1	976.2
Prepayments for pension costs	(5.5)	(6.8)
Net pension liabilities	(59.4)	(5.0)
Net assets including net pension liabilities	825.2	964.4
Profit and loss account reserve including prepayments for pension costs and excluding net pension liabilities	600.1	687.6
Prepayments for pension costs	(5.5)	(6.8)
Net pension liabilities	(59.4)	(5.0)
Profit and loss account including net pension liabilities	535.2	675.8

The following amounts would have been recognised in the financial statements for the year ended 31 March 2003:

	2003 £m
Operating profit	
Current service cost	6.6
Past service cost	1.7
Total operating charge	8.3
Other finance income	
Expected return on pension schemes' assets	14.3
Interest on pension schemes' liabilities	(13.0)
Net return	1.3
Statement of total recognised gains and losses (STRGL)	
Actual return less expected return on pension schemes' assets	(61.0)
Experience gains and losses arising on schemes' liabilities	(1.4)
Changes in assumptions underlying the present value of schemes' liabilities	(12.6)
Actuarial loss to be recognised in STRGL	(75.0)

30. Pensions continued

	2003 £m
Movement in net deficit in schemes during the year	
Net deficit at 1 April 2002	(7.1)
Movement in year:	
Current service cost	(6.6)
Contributions	4.2
Past service cost	(1.7)
Other finance income	1.3
Actuarial loss	(75.0)
Net deficit at 31 March 2003	(84.9)

Details of experience gains and losses for the year to 31 March 2003

Difference between the expected and actual return in schemes' assets:	
Amount (£m)	(61.0)
Percentage of schemes' assets	(38.3)%
Experience gains and losses on schemes' liabilities:	
Amount (£m)	(1.4)
Percentage of the present value of the schemes' liabilities	(0.6)%
Total amount recognised in statement of total recognised gains and losses:	
Amount (£m)	(75.0)
Percentage of the present value of the schemes' liabilities	(30.7)%

31. Commitments and contingent liabilities

	Group		Company	
	2003 £m	2002 £m	2003 £m	2002 £m
Capital commitments				
Contracted but not provided	58.3	72.0	-	-
Commitments under operating leases				
Rentals during the year following the balance sheet date:				
Land and buildings leases expiring:				
Within one year	0.3	0.1	-	-
Between one and five years	0.2	0.1	-	-
After five years	3.2	2.8	-	-
Other leases expiring:				
Within one year	0.3	0.1	-	-
Between one and five years	0.5	0.3	-	-
	4.5	3.4	-	-
Contingent liabilities				
Contractors' claims on capital schemes	1.5	-	-	-
Guarantees	35.4	29.2	533.0	443.0
Other	14.5	14.5	14.5	14.5
	51.4	43.7	547.5	457.5

Guarantees by the Company are principally in respect of borrowing facilities of subsidiary undertakings. Guarantees by the Group are principally in respect of performance bonds entered into in the normal course of business. No liability is expected to arise in respect of the guarantees. Other contingent liabilities relate to a possible obligation to pay further consideration in respect of a previously acquired business when the outcome of planning applications is known (this is a reclassification for 2002).

32. Notes to the Group cash flow statement

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

	2003 £m	2002 £m
Group operating profit	127.0	121.8
Depreciation charge	79.8	75.5
Amortisation of intangible fixed assets	1.5	1.6
Provision for impairment of fixed asset investments	1.4	0.3
Deferred income released to profits	(1.2)	(1.2)
(Decrease)/increase in provisions for liabilities and charges	(2.0)	1.0
Increase in stocks	(0.8)	(0.6)
Decrease/(increase) in debtors (amounts falling due within and over one year)	1.1	(4.0)
(Decrease)/increase in creditors (amounts falling due within and over one year)	(7.1)	2.9
Profit on disposal of tangible fixed assets	(0.8)	(1.1)
Net cash inflow from operating activities	198.9	196.2

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

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

i Returns on investments and servicing of finance	2003 £m	2002 £m
Interest received	10.1	9.3
Interest paid	(33.8)	(32.7)
Interest element of finance lease rentals	(19.2)	(20.9)
Net cash outflow for returns on investments and servicing of finance	(42.9)	(44.3)

ii Capital expenditure and financial investment	2003 £m	2002 £m
Purchase of tangible fixed assets	(201.7)	(184.4)
Grants and contributions:		
Infrastructure assets	1.2	0.7
Non-infrastructure assets	0.1	-
Receipts from disposal of tangible fixed assets	2.2	1.9
Purchase of Company shares by Employee Share Ownership Plan	-	(0.5)
Net cash outflow for capital expenditure and financial investment	(198.2)	(182.3)

iii Acquisitions and disposals	2003 £m	2002 £m
Purchase of businesses	(41.7)	(12.1)
Purchase of interest in joint venture	(0.1)	-
Net cash acquired with businesses	4.6	3.0
Sale of business	-	103.6
Cash disposed of with business sale	-	(9.5)
Net cash (outflow)/inflow for acquisitions and disposals	(37.2)	85.0

iv Management of liquid resources	2003 £m	2002 £m
Purchase of current asset investments	(68.0)	(159.3)
Sale of current asset investments	135.6	132.3
Net cash inflow/(outflow) from management of liquid resources	67.6	(27.0)

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

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

v Financing	2003 £m	2002 £m
Issue of ordinary share capital	1.4	0.4
Adjustment for shares issued under the Sharesave Scheme through Employee Share Ownership Trust	(0.3)	(0.1)
	1.1	0.3
Reduction in debt due within one year (other than bank overdrafts)	(19.7)	(13.5)
Increase in debt due after more than one year	100.0	15.0
Cash outflow from currency hedge	-	(0.2)
Finance lease drawdowns	62.6	45.6
Capital element of finance lease rental payments	(3.3)	(9.0)
	139.6	37.9
Net cash inflow from financing	140.7	38.2

(c) Analysis of net debt:

	At 1 April 2002 £m	Cash flow £m	Acquisitions (excluding cash items) £m	Non-cash movements £m	At 31 March 2003 £m
Cash at bank and in hand	1.0	7.6	-	-	8.6
Current asset investments:					
Overnight deposits	45.3	(41.0)	-	-	4.3
Bank overdrafts	(29.1)	15.0	-	-	(14.1)
	17.2	(18.4)	-	-	(1.2)
Debt due within one year (other than bank overdrafts)	(62.9)	19.7	-	(14.8)	(58.0)
Debt due after more than one year	(299.2)	(100.0)	-	13.6	(385.6)
Finance lease obligations	(652.1)	(59.3)	(0.3)	(10.2)	(721.9)
	(1,014.2)	(139.6)	(0.3)	(11.4)	(1,165.5)
Current asset investments:					
Other than overnight deposits	245.7	(67.6)	-	-	178.1
	(751.3)	(225.6)	(0.3)	(11.4)	(988.6)

Non-cash movements include transfers between categories of debt for changing maturities, increased accrued finance charges within finance lease obligations and loan notes issued in settlement of accrued consideration in respect of a previously acquired business.

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

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

	2003 £m	2002 £m
(Decrease)/increase in cash in year	(18.4)	16.8
Cash inflow from increase in debt and finance leasing	(139.6)	(37.9)
Cash (inflow)/outflow from (decrease)/increase in liquid resources	(67.6)	27.0
(Increase)/decrease in net debt arising from cash flows	(225.6)	5.9
Acquisitions (excluding cash items):		
Loan stock notes issued as part consideration for business acquired	–	(0.2)
Finance lease obligations acquired with business purchase	(0.3)	(2.8)
Non-cash movements:		
Loan stock notes issued in settlement of accrued consideration	(1.2)	–
Increase in accrued finance charges on finance lease obligations	(10.2)	(5.7)
Increased accrued interest on cash deposits to secure rental obligations	–	3.3
(Increase)/decrease in net debt in the year	(237.3)	0.5
Net debt at 1 April	(751.3)	(751.8)
Net debt at 31 March	(988.6)	(751.3)

(e) Purchase of businesses

	2003 £m	2002 £m
Net assets acquired:		
Tangible fixed assets	17.7	6.0
Fixed asset investments: joint venture	0.1	–
Debtors: amounts falling due within one year	6.2	2.7
Cash at bank and in hand	4.6	3.0
Creditors: amounts falling due within one year	(10.3)	(6.1)
Creditors: amounts falling due after more than one year	(0.2)	(1.6)
Provisions for liabilities and charges	(3.7)	(3.7)
Fair value of net assets acquired	14.4	0.3
Goodwill	27.4	11.8
	41.8	12.1
Satisfied by:		
Cash consideration	41.8	12.1

The businesses acquired during the year contributed £2.5 million to the Group's net cash inflow from operating activities, utilised £0.5 million for taxation and utilised £0.6 million for capital expenditure. In 2002 the businesses acquired during that year did not materially contribute to the Group's cash flow in 2002.

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

(f) Sale of business

	2003 £m	2002 £m
Net assets sold:		
Intangible fixed assets	-	24.1
Tangible fixed assets	-	4.7
Net current assets	-	15.9
Cash	-	9.5
Goodwill written back on disposal	-	43.5
	-	97.7
Provision for liabilities under sale agreement	-	0.8
	-	98.5
Profit on disposal	-	5.1
	-	103.6
Sale proceeds, net of costs	-	103.6

The sale was satisfied by cash consideration.

33. Related party transactions

During the year the Group purchased services in the ordinary course of business from Echo South West Limited, a joint venture undertaking, at a cost of £7.5 million (2002 nil) and sold services to Echo South West Limited at a value of £1.9 million (2002 nil). Amounts owed by and to joint venture undertakings are disclosed in notes 17 and 19. These amounts relate to trading balances except for short term loans of £0.1 million (2002 nil) included in debtors falling due within one year, note 17.

During the year the Company advanced £0.7 million to Enviro-Logic Limited, an associated undertaking, to finance business development costs (2002 £0.8 million). The advances of £2.4 million were outstanding at 31 March 2003 (2002 £1.7 million) and the Company had fully provided against the debt.

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

There were no related party transactions involving Directors during the year (2002 – the sale to Mr K L Hill of a car upon retirement for a consideration of £15,500).

Profit and loss account

	2003 £m	2002 £m	2001 £m	2000 £m	1999 £m
Turnover	417.2	423.9	435.1	467.0	437.1
Group operating profit	127.0	121.8	128.1	167.1	167.7
Share of operating loss in joint venture and associate	(0.7)	(0.5)	(0.4)	(0.4)	(0.2)
Business disposal profit/(loss)	-	5.1	(2.1)	-	-
Net interest payable	(52.1)	(49.0)	(51.4)	(45.0)	(44.3)
Profit on ordinary activities before taxation	74.2	77.4	74.2	121.7	123.2
Tax on profit on ordinary activities	(17.1)	(3.3)	(17.6)	(5.0)	(17.5)
Profit on ordinary activities after taxation	57.1	74.1	56.6	116.7	105.7
Dividends	(144.3)	(51.4)	(49.4)	(65.1)	(61.9)
Retained (deficit)/surplus transferred (from)/to reserves	(87.2)	22.7	7.2	51.6	43.8
Earnings per share (basic):					
Before exceptional items and deferred tax	55.0p	53.0p	56.0p	85.9p	75.4p
Exceptional items	-	3.7p	(1.6)p	-	3.8p
Deferred tax	(10.7)p	(2.4)p	(12.9)p	-	-
After exceptional items and deferred tax	44.3p	54.3p	41.5p	85.9p	79.2p
Dividend per share	109.1p	37.5p	36.0p	47.8p	45.6p

Capital expenditure

	2003 £m	2002 £m	2001 £m	2000 £m	1999 £m
Acquisitions	41.8	12.1	0.9	-	37.1
Tangible fixed assets	204.6	186.4	166.5	153.8	125.3

Balance sheet

	2003 £m	2002 £m	2001 £m	2000 £m	1999 £m
Fixed assets	2,085.9	1,922.7	1,826.3	1,736.6	1,652.4
Net current assets	17.5	100.8	101.5	92.8	118.5
Non-current liabilities	(1,213.3)	(1,047.3)	(1,018.7)	(918.7)	(911.9)
Net assets	890.1	976.2	909.1	910.7	859.0

Number of employees (average for year)

	2003	2002	2001	2000	1999
Water and sewerage business	1,343	1,485	1,537	1,638	1,700
Waste management	685	605	453	438	441
Instrumentation	-	421	495	556	437
Construction services	-	-	617	837	875
Other businesses	35	51	55	57	55
	2,063	2,562	3,157	3,526	3,508

The adoption of Financial Reporting Standard 19 'Deferred Tax' in 2002 resulted in a restatement of 2001 but earlier periods have not been restated. Earnings per share in 2002 and 2001 have been adjusted to separately show the impact of deferred tax.

Financial calendar

Financial year end	31 March
Fourteenth annual general meeting	31 July 2003
2003 Final dividend payable	1 October 2003
2004 Interim results announcement	November 2003
2004 Interim dividend payable	April 2004
2004 Preliminary results announcement	May 2004
Fifteenth annual general meeting	July 2004
2004 Final dividend payable	October 2004

Shareholders' analysis at 31 March 2003

	Number of shareholders	Percentage of total shareholders	Percentage of ordinary shares
1 – 100	6,283	22.2	0.2
101 – 1,000	18,225	64.6	6.5
1,001 – 5,000	3,083	10.9	4.4
5,001 – 50,000	420	1.5	5.4
50,001 – 100,000	65	0.2	3.8
Over 100,000	156	0.6	79.7
	28,232	100.0	100.0
Individuals	25,762	91.3	10.1
Companies	237	0.8	1.8
Trust companies (pension funds, etc)	8	–	–
Banks and nominees	2,219	7.9	87.2
Insurance companies	6	–	0.9
	28,232	100.0	100.0

Substantial shareholdings

At 19 June 2003, interests in the issued share capital had been notified by:

AXA Investment Managers	5.20%
AEGON UK Pic	4.87%
Standard Life Group	3.96%
Legal & General Investment Management	3.01%
Zurich Financial Services	3.00%

Further shareholder information may be found at

Shareholder services

Share Dealing Service

The low-cost share dealing services offered by Stocktrade and Hoare Govett enable shareholders 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.

Scrip Dividend Alternative

Directors propose to introduce a scrip dividend alternative to enable shareholders to receive their dividends in the form of shares instead of cash. Resolutions requesting shareholder approval will be submitted to the annual general meeting on 31 July 2003.

Details of the above shareholder services are available from the Company Secretary's Department, telephone: 01392 257977.

Online Portfolio Service

The online portfolio service provided by Lloyds TSB Registrars gives shareholders access to more information on their investments. Details of the portfolio service are available from Lloyds TSB Registrars online at www.shareview.co.uk