

SOUTH WEST WATER LIMITED

ANNUAL REPORT AND FINANCIAL STATEMENTS 2000



REGISTERED OFFICE: Peninsula House, Rydon Lane, Exeter EX2 7HR
REGISTERED IN ENGLAND NO 2366665

ANNUAL REPORT AND FINANCIAL STATEMENTS 2000

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DIRECTORS, REGISTERED OFFICE AND AUDITORS

Chairman	K G Harvey
Chief Executive	R J Baty
Operations Director	S C Bird
Customer Service Director	P J Briens
Regulatory and Finance Director	D J Dupont
Secretary	K D Woodier
Registered Office	Peninsula House Rydon Lane Exeter EX2 7HR
Auditors	PricewaterhouseCoopers Chartered Accountants 31 Great George Street Bristol BS1 5QD

NOTICE OF MEETING

The eleventh Annual General Meeting of South West Water Limited will be held at Peninsula House, Rydon Lane, Exeter on 20 July 2000 at 2.00 pm for the transaction of the following business:-

- Resolution 1 To receive the Report of the Directors and the audited financial statements for the year ended 31 March 2000.
- Resolution 2 To re-appoint PricewaterhouseCoopers as auditors and to authorise the Directors to fix their remuneration.

By Order of the Board



K D Woodier
Secretary
Peninsula House
Rydon Lane
Exeter EX2 7HR

23 June 2000

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

REPORT OF THE DIRECTORS

The Directors submit their annual report and the audited financial statements of South West Water Limited for the year ended 31 March 2000.

PRINCIPAL ACTIVITIES

The principal activities of the Company are the provision of water-care and waste water services. The Company holds the water and sewerage appointments for Cornwall and Devon and small areas of Somerset and Dorset.

FINANCIAL RESULTS

Turnover

Turnover for the year increased by 4.2% to £281.4m. Turnover from main water and sewerage charges was £270.5m (1999 £262.1m) primarily reflecting increases in tariffs and new customers.

Operating Costs

Total operating costs rose by £3.2m to £134.6m, principally reflecting the impact of inflation and the additional costs of operating new capital schemes, including an increase in depreciation charged to profits of £2.7m, to £44.6m (1999 £41.9m).

Profit

Operating profit was £146.8m (1999 £138.7m). Net interest payable increased to £38.8m (1999 £32.5m), mainly due to the utilisation of cash for capital expenditure and a lower gain on defeasance of finance leases. Net profit before taxation amounted to £108.0m (1999 £106.2m).

The Company's taxation position results in a charge to mainstream corporation tax of £11.4m (1999 £40.6m) for the year. The reduction reflects the benefit delivered from the policy of disclaiming capital allowances in order to utilise surplus advance corporation tax.

Dividends and Retained Profit

An interim dividend of £64.0m (1999 £60.0m) was declared to the parent undertaking. The Directors do not recommend payment of a final dividend.

The Company has established a dividend policy which involves two components:

- a sustainable level of base dividend growth, determined by a number of factors including the shareholders' investment and the cost of capital: and
- a further level of growth funded by efficiency out-performance.

Dividend payments ensure that key financial ratios are not prejudiced and that the ability of the Appointee to finance its Appointed Business is not impaired. In the light of the Director General's Final Determination, it is anticipated that the dividend for 2001 will be reduced from current levels.

Retained profit of £32.6m was transferred to reserves (1999 £5.6m).

REPORT OF THE DIRECTORS (Continued)

FINANCIAL RESULTS (Continued)

Cash Flow

Net cash inflow from operating activities increased to £189.4m (1999 £154.4m) mainly as a result of reduced working capital funding requirements.

FINANCIAL NEEDS AND RESOURCES

Capital expenditure on tangible fixed assets during the year was £133.6m, a significant increase from the 1999 level of £105.2m, reflecting the programme of work on a number of major sewage treatment schemes. Capital scheme work-in-progress at 31 March 2000 increased to £70.1m (1999 £38.5m). The Company continues to focus its investment programme upon targeted improvements to meet customer needs.

The capital works programme comprises nearly 100 on-going projects at 31 March 2000 with 43 major projects completed during the year. Further progress on the "Clean Sweep" bathing water schemes was achieved.

During the year the Company increased its authorised share capital to £500.0m and £85.0m Ordinary shares were allotted to finance the Company's medium term capital investment needs.

Significant funding facilities are also in place to cover both medium and long term requirements, including finance leasing and loans from the European Investment Bank and a long term loan from Pennon Group Plc. In addition short term facilities are in place with a range of financial institutions.

At 31 March 2000 loans and finance lease obligations amounted to £561.6m compared with £584.0m at 31 March 1999. Current asset investments of £36.8m (1999 £22.8m) were held at the Balance Sheet date. Total facilities in place but not utilised totalled £170.0m at 31 March 2000.

As part of the Company's risk management policy, interest rate swaps are used to achieve a balance between fixed and floating rate debt. During the year, interest rate swaps with a notional principal amount of £200.0m, commencing from April 2006 and maturing in March 2030, were entered into and link interest payments to European rates. The settlement of £18.2m, received when these swaps were entered into, has been deferred 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 do not, therefore, constitute an exposure for the Company.

The Directors confirm that the Company can meet its short term requirements from existing facilities without breaching covenants or other borrowing restrictions.

FUTURE DEVELOPMENTS

Continuous improvement within the Company's operations has been maintained during the year, enabling further cost reduction and development of customer focus for the future.

The Director General's review of price limits was published in late 1999 and has been effected for 2000/01 customer bills, containing an overall reduction of 12.2% in main charges tariffs. Subsequent years to 2005 will reflect a profile of modest increases in real terms, to take account of further major capital investment spending.

YEAR 2000

As a direct result of careful planning, allied to an investment of £4.0m, including £0.4m during the year, the Company's business was not affected by potential year 2000 information technology problems.

REPORT OF THE DIRECTORS (Continued)

RESEARCH AND DEVELOPMENT

The development and testing of innovative techniques and processes will continue to play a role in the further improvement of cost effective provision of services.

The Company continues to commission pilot plants to test rigorously potential new processes in field conditions.

DIRECTORS

The current Directors of the Company are shown on page 5. R Furniss resigned from office on 29 February 2000. On 1 March 2000 S C Bird was appointed Operations Director and P J Briens' role changed from Operations and Engineering Director to Customer Service Director.

None of the Directors held any beneficial interest in the shares of the Company during the year. The interests of the Directors in shares of Pennon Group Plc are shown in note 9 of the Financial Statements. 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.

EMPLOYEES

Employee numbers decreased during the year through continued manpower efficiencies.

Industrial relations and negotiating arrangements designed to meet business needs are in place. Employee consultation is maintained through a staff council and supporting consultative committees, both chaired by Directors of the Company with representatives drawn from all functional areas.

A Performance Appraisal and Pay Related System exists for all non-manual staff and managers.

The Company is a recognised leader in health and safety management and during the year was described by the Health and Safety Commission as a "world class company". This description was a pleasing commentary on the Company's innovative and low-cost management systems which have been introduced for the protection of employees, contractors and the public. These systems have reduced the Company's accident frequency rate by a substantial amount.

The Company remains committed to a non-discriminatory employment policy, making every reasonable effort to provide disabled people with equal opportunities for employment, training and development.

PAYMENTS TO SUPPLIERS

It is the Company's payment policy for the year ending 31 March 2001 to follow the Code of The Better Payment Practice Group on supplier payments. The Company will agree payment terms with individual suppliers in advance and abide by such terms. Information about the Code may be obtained from The Better Payment Practice Group's website at www.payontime.co.uk. Trade creditors at 31 March 2000 represented 37 days (1999 49 days) of the amount invoiced by suppliers during the year.

PARENT COMPANY

The Company is a wholly owned subsidiary of Pennon Group Plc.

REPORT OF THE DIRECTORS (Continued)

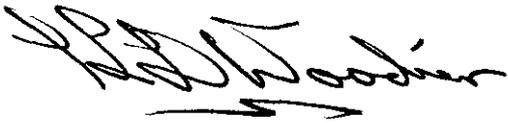
AUDITORS

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

ANNUAL GENERAL MEETING

The eleventh annual general meeting will be held at Peninsula House, Rydon Lane, Exeter on 20 July 2000 at 2.00 pm.

By Order of the Board

A handwritten signature in black ink, appearing to read 'K D Woodier', with a horizontal line underneath.

K D Woodier
Secretary
Peninsula House
Rydon Lane
Exeter EX2 7HR

23 June 2000

DIRECTORS' RESPONSIBILITY STATEMENT

The following statement, which should be read in conjunction with the Auditors' statement of responsibilities set out on page 12, is made with a view to distinguishing for shareholders the respective responsibilities of the Directors and Auditors in relation to the financial statements.

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 as at the end of the financial year and of the profit for the financial year.

The Directors consider that in preparing the financial statements on pages 13 to 35, the Company has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider to be applicable have been followed.

The Directors have responsibility for ensuring that the Company keeps accounting records which disclose with reasonable accuracy the financial position of the Company and which enable them to ensure that the financial statements comply with the Companies Act 1985.

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and hence to prevent and detect fraud and other irregularities.

AUDITORS' REPORT TO THE MEMBERS OF SOUTH WEST WATER LIMITED

We have audited the financial statements on pages 13 to 35 which have been prepared under the historical cost convention and the accounting policies set out on pages 16 to 18.

Respective Responsibilities of Directors and Auditors

The Directors are responsible for preparing the Annual Report. As described on page 11 this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and our profession's ethical guidance.

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

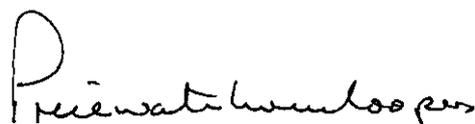
Basis of Audit Opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company at 31 March 2000 and of its profit and cash flows for the year then ended and have been properly prepared in accordance with the Companies Act 1985.



PricewaterhouseCoopers
Chartered Accountants
and Registered Auditors
Bristol

23 June 2000

PROFIT AND LOSS ACCOUNT
for the year ended 31 March 2000

	Notes	2000 £m	1999 £m
Turnover	2	281.4	270.1
Operating costs	3	(134.6)	(131.4)
Operating Profit	2	146.8	138.7
Net interest payable	4	(38.8)	(32.5)
Profit on Ordinary Activities			
Before Taxation	2	108.0	106.2
Tax on profit on ordinary activities	5	(11.4)	(40.6)
Profit on Ordinary Activities			
After Taxation		96.6	65.6
Dividends	6	(64.0)	(60.0)
Retained Profit Transferred to Reserves	20	32.6	5.6

There are no recognised gains or losses other than the profit on ordinary activities after taxation for the year, in 2000 or 1999.

All operating activities are continuing operations.

The notes on pages 16 to 35 form part of these financial statements.

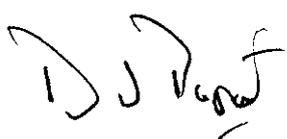
BALANCE SHEET
at 31 March 2000

	Notes	2000 £m	1999 £m
Fixed Assets			
Tangible assets	10	1,590.2	1,505.8
Investments	11	0.7	0.5
		<u>1,590.9</u>	<u>1,506.3</u>
Current Assets			
Stocks	12	3.4	3.2
Debtors: amounts falling due after more than one year	13	7.0	8.4
Debtors: amounts falling due within one year	13	53.2	52.4
Investments	14	36.8	22.8
Cash at bank and in hand		0.3	1.7
		<u>100.7</u>	<u>88.5</u>
Current Liabilities			
Creditors: amounts falling due within one year	15	(83.7)	(123.0)
		<u>17.0</u>	<u>(34.5)</u>
Net Current Assets/(Liabilities)			
		<u>1,607.9</u>	<u>1,471.8</u>
Total Assets Less Current Liabilities			
Creditors: amounts falling due after more than one year	16	(540.9)	(540.2)
Provisions for liabilities and charges	17	(3.4)	(3.4)
Accruals and deferred income	18	(49.9)	(32.1)
		<u>1,013.7</u>	<u>896.1</u>
Net Assets			
Capital and Reserves			
Called-up share capital	19	450.9	365.9
Profit and loss account	20	562.8	530.2
		<u>1,013.7</u>	<u>896.1</u>
Shareholders' Funds			
	21		

The notes on pages 16 to 35 form part of these financial statements.

Approved by the Board on 23 June 2000 and signed on its behalf by:-


R J Baty
Chief Executive


D J Dupont
Regulatory and Finance Director

CASH FLOW STATEMENT
for the year ended 31 March 2000

	Notes	2000 £m	1999 £m
Cash Inflow from Operating Activities	25a	189.4	154.4
Returns on Investments and Servicing of Finance	25b	(4.9)	(22.7)
Taxation		(30.1)	(39.4)
Capital Expenditure and Financial Investment	25b	(124.6)	(109.1)
Equity Dividends Paid		(64.0)	(112.0)
		<hr/>	<hr/>
Cash Outflow Before Use of Liquid Resources and Financing		(34.2)	(128.8)
Management of Liquid Resources	25b	(4.6)	33.6
Financing	25b	46.0	92.1
		<hr/>	<hr/>
Increase/(Decrease) in Cash in Year		7.2	(3.1)
		<hr/>	<hr/>

NOTES TO THE FINANCIAL STATEMENTS

1 Accounting Policies

The following paragraphs describe the main policies:-

(a) Accounting Convention

The financial statements have been prepared under the historical cost convention and in compliance with all applicable accounting standards 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 1(e) below.

(b) Turnover

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

(c) Tangible Fixed Assets and Depreciation

Tangible fixed assets comprise:-

- (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 enhancements of the network, in accordance with defined standards of service, and to the maintenance of the operating capacity of the network, is treated as capital expenditure on tangible fixed assets 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) 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:-

Buildings	30-60 years
Operational properties	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.

NOTES TO THE FINANCIAL STATEMENTS

1 Accounting Policies (Continued)

(d) 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 cost 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.

(e) 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 are 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 10.

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

(f) 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.

(g) Stocks

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

(h) Pension Costs

The expected cost of pensions in respect of the Company's employees (who are members of the Pennon Group Plc'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 is released to profits, using the straight line method, over the average remaining service lives of employees in the schemes.

(i) Research and Development Expenditure

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

NOTES TO THE FINANCIAL STATEMENTS

1 Accounting Policies (Continued)

(j) Taxation

Corporation tax payable is provided on taxable profits at current rates. Tax deferred or accelerated as a result of timing differences between the treatment of certain items for taxation and for accounting purposes is provided for to the extent that it is probable that a material liability or asset will crystallise in the foreseeable future.

(k) Goodwill

From 1 April 1998 goodwill, arising from the acquisition of subsidiary undertakings, representing the excess of the purchase consideration over the fair value of the net assets acquired, is capitalised and classified as an asset on the balance sheet, and amortised evenly according to its finite economic life. Previously such goodwill, arising on the purchase of a business undertaking, has been written off directly to reserves.

(l) Financial Instruments

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

2 Segmental Analysis

By class of business:-

	Water		Sewerage		Company	
	2000 £m	1999 £m	2000 £m	1999 £m	2000 £m	1999 £m
Turnover	111.3	112.4	170.1	157.7	281.4	270.1
Profit						
Segmental operating profit	39.9	42.5	106.9	96.2	146.8	138.7
Net interest payable	(14.9)	(11.9)	(23.9)	(20.6)	(38.8)	(32.5)
Profit on ordinary activities before taxation	25.0	30.6	83.0	75.6	108.0	106.2
Net Assets	463.3	424.5	550.4	471.6	1,013.7	896.1

“Water” includes the provision of water resources, treatment and distribution services and “Sewerage” includes the transfer of sewage, its treatment and disposal.

An analysis by geographical origin and destination is not appropriate as the Company’s activity is substantially located in the United Kingdom.

NOTES TO THE FINANCIAL STATEMENTS

3 Operating Costs

	2000 £m	1999 £m
Manpower costs (note 7)	29.4	27.2
Raw materials and consumables	7.8	8.2
Rentals under operating leases:-		
Hire of plant and machinery	0.7	1.2
Other operating leases	1.2	1.1
Research and development expenditure	0.1	0.1
Auditors' remuneration	0.1	0.1
Other external charges	43.8	42.5
Depreciation:-		
On owned non infrastructure assets	23.1	20.9
On owned infrastructure assets	6.8	6.6
On assets held under finance leases	11.1	11.2
On assets held under defeased finance leases	3.6	3.2
Profit on disposal of fixed assets	(0.3)	(0.2)
Deferred income (note 18)	(1.2)	(1.3)
Other operating charges	8.4	10.6
	134.6	131.4

No fees were payable to the Company's auditors, PricewaterhouseCoopers, for non-audit work for the year ended 31 March 2000 (1999 £0.2m).

4 Net Interest Payable

	2000 £m	1999 £m
Interest payable:-		
To parent undertaking	(17.9)	(17.7)
Bank loans and overdrafts	(8.2)	(9.6)
Interest element of finance lease rentals	(14.3)	(13.1)
Other finance costs	(0.1)	(1.0)
	(40.5)	(41.4)
Interest receivable:-		
From parent undertaking	0.1	0.7
Listed redeemable securities	0.1	1.1
Other investments (as defined in note 14)	1.1	3.2
	1.3	5.0
Gain on defeasance of finance leases	0.4	3.9
Net interest payable	(38.8)	(32.5)

NOTES TO THE FINANCIAL STATEMENTS

4 Net Interest Payable (Continued)

The gain on defeasance of finance leases results from the in-substance early settlement (defeasance) of obligations under finance leases. The Company has:

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

These deposited funds, which totalled £145.9m at 31 March 2000 (1999 £143.8m), 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 the Company.

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

A gain of £0.4m (1999 £3.9m) has been recognised, equivalent to the difference between the finance lease drawdowns and the funds deposited with financial institutions to cover rentals arising therefrom, after deferring income in recognition of possible rental variations and costs as follows:

	2000 £m	1999 £m
Gain on defeasance of finance leases	0.5	5.1
less income deferred for finance lease rental variations (note 18)	(0.1)	(1.2)
	<u>0.4</u>	<u>3.9</u>

5 Tax on Profit on Ordinary Activities

	2000 £m	1999 £m
UK corporation tax at 30% (1999 31%) for :-		
the current year	-	13.2
prior years	6.6	7.4
Amounts payable to Pennon Group companies in respect of surrender of taxable losses and advance corporation tax	4.8	20.0
	<u>11.4</u>	<u>40.6</u>

The corporation tax charge is reduced by the availability of capital allowances for which no deferred tax has been provided (note 17).

NOTES TO THE FINANCIAL STATEMENTS

6 Dividends

	2000 £m	1999 £m
Interim dividend of 17.49p (1999 16.4p) per Ordinary share paid on 10 December 1999	<u>64.0</u>	<u>60.0</u>
	64.0	60.0

7 Employees and Employment Costs

The average number of persons (including Directors) employed by the Company was:-

	2000	1999
Water services	945	947
Sewerage services	693	753
	<u>1,638</u>	<u>1,700</u>

	2000 £m	1999 £m
Employment costs comprise:-		
Wages and salaries	34.1	32.8
Social security costs	2.4	2.5
Pension costs (note 23)	0.7	0.2
	<u>37.2</u>	<u>35.5</u>
Charged as follows:-		
Manpower costs	29.4	27.2
Capital schemes	6.1	6.8
Restructuring provision	1.7	1.5
	<u>37.2</u>	<u>35.5</u>

NOTES TO THE FINANCIAL STATEMENTS

8 Directors' Emoluments

	2000	1999
	£000	£000
Total emoluments of the Directors of the Company:-		
Remuneration - salary	333	298
- performance bonus	17	22
	350	320
Other emoluments	35	34
Compensation for loss of office	133	-
	518	354

The emoluments of the highest paid Director, included above, are:-

	2000	1999
	£000	£000
Remuneration - salary	112	104
- performance bonus	6	12
	118	116
Other emoluments	10	10
	128	126

Other emoluments include car benefit and health care.

The emoluments of South West Water Limited Directors are determined by the Remuneration Committee of Pennon Group Plc which consists of non-executive Directors. The Remuneration Committee takes external professional advice in determining the level of emoluments.

Payments under the incentive performance bonus plan are related to the achievement of Company profit and individual performance targets as determined by the Remuneration Committee of Pennon Group Plc.

At 31 March 2000 retirement benefits were accruing to 4 Directors (1999 4 Directors) under defined benefit pension schemes, operated by the parent company.

The highest paid Director participated in defined benefit pension schemes, with an accrued annual pension of £73,000 at 31 March 2000 (1999 £62,000).

NOTES TO THE FINANCIAL STATEMENTS

9 Directors' Interests

The beneficial interests of Directors holding office at 31 March 2000 in the shares of Pennon Group Plc at 31 March 2000 and 31 March 1999, or date of appointment, were as follows:-

	Share Interests		Options				
	31 March 2000	31 March 1999, or date of appointment	Scheme	31 March 2000	Granted in Period	Exercised in Period	31 March 1999, or date of appointment
S C Bird	441	441	Sharesave	854	-	-	854
P J Briens	3,129	5,111	-	-	-	-	-
D J Dupont	13,990	13,972	Executive Sharesave	4,000 3,102	- -	- -	4,000 3,102

In addition a contingent interest was held in shares of Pennon Group Plc under the terms of the Pennon Group Plc Long Term Incentive Plan, described in note 11, as follows :

	31 March 2000 Shares	31 March 1999, or date of appointment Shares
S C Bird	4,516	4,516
P J Briens	12,165	7,686
D J Dupont	12,469	8,108

The above represent the maximum number of shares to which Directors would become entitled if all relevant criteria are met. On the basis of the financial results for the year ended 31 March 2000, it is not anticipated that any of the shares from the 1997 award will vest.

No Director has had any interest in shares of the Company during the year. The interests in shares of Pennon Group Plc of Messrs K G Harvey and R J Baty are disclosed in the financial statements of that company.

In respect of the current Directors there have been the following changes since 31 March 2000 in the Directors' interests in shares of the Company or of Pennon Group Plc:

On 6 April 2000, as a result of participation in a dividend reinvestment plan, Messrs Bird and Briens acquired additional share interests of 145 and 448 respectively.

On 12 April 2000, the sharesave options held by S C Bird over 234 shares lapsed.

NOTES TO THE FINANCIAL STATEMENTS

10 Tangible Fixed Assets

	Freehold land and buildings	Infra- structure assets	Opera- tional properties	Fixed & mobile plant, vehicles and computers	Construc- tion in progress	Total
	£m	£m	£m	£m	£m	£m
Cost:-						
At 1 April 1999	11.4	780.7	491.2	511.0	38.5	1,832.8
Additions	-	44.3	7.8	38.2	43.3	133.6
Grants and contributions		(1.9)	-	-	-	(1.9)
Reclassifications/ transfers	(0.6)	20.0	(26.0)	18.3	(11.7)	-
Disposals	-	(0.3)	(0.1)	(3.5)	-	(3.9)
At 31 March 2000	<u>10.8</u>	<u>842.8</u>	<u>472.9</u>	<u>564.0</u>	<u>70.1</u>	<u>1,960.6</u>
Depreciation:-						
At 1 April 1999	6.0	68.3	91.7	161.0		327.0
Charge for year	0.2	7.5	9.4	29.1		46.2
Disposals	-	(0.3)	-	(2.5)		(2.8)
At 31 March 2000	<u>6.2</u>	<u>75.5</u>	<u>101.1</u>	<u>187.6</u>		<u>370.4</u>
Net Book Value:-						
At 31 March 2000	<u>4.6</u>	<u>767.3</u>	<u>371.8</u>	<u>376.4</u>	<u>70.1</u>	<u>1,590.2</u>
At 31 March 1999	<u>5.4</u>	<u>712.4</u>	<u>399.5</u>	<u>350.0</u>	<u>38.5</u>	<u>1,505.8</u>

Out of the total depreciation charge for the Company of £46.2m (1999 £43.3m), the sum of £1.6m (1999 £1.4m) has been charged to capital projects, and £44.6m (1999 £41.9m) against profits.

The cost of freehold land and buildings and operational properties includes non-depreciable land of £1.3m (1999 £1.3m) and £8.9m (1999 £8.8m) respectively.

The net book value of infrastructure assets is stated after deducting £42.5m (1999 £40.6m) grants and contributions.

NOTES TO THE FINANCIAL STATEMENTS

10 Tangible Fixed Assets (Continued)

Maintenance of the operating capability of the infrastructure network:-

	£m
Excess of expenditure over depreciation on maintaining the operating capability of the network at 1 April 1999	2.8
Expenditure in the year on maintaining operating capability	8.7
Less depreciation for the year	(7.5)
	<hr/>
Excess of expenditure over depreciation at 31 March 2000	4.0
	<hr/>

Assets held under finance leases included above:-

	Infra- structure assets	Opera- tional properties	Fixed & mobile plant, vehicles and computers	Construc- tion in progress	Total
	£m	£m	£m	£m	£m
Cost:- At 31 March 2000	-	193.9	102.5	-	296.4
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Depreciation:- Charge for year	-	3.4	7.7	-	11.1
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Depreciation:- At 31 March 2000	-	19.5	51.7	-	71.2
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

Assets held under defeased finance leases also included above:-

Cost:- At 31 March 2000	75.3	69.2	32.5	3.0	180.0
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Depreciation:- Charge for year	0.7	1.2	1.7	-	3.6
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Depreciation:- At 31 March 2000	2.2	2.5	4.5	-	9.2
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

NOTES TO THE FINANCIAL STATEMENTS

11 Fixed Asset Investments

	2000 £m	1999 £m
Listed Investments:-		
At 1 April	0.5	0.4
Addition during year	0.5	0.4
Provision for impairment	(0.3)	(0.3)
At 31 March	<u>0.7</u>	<u>0.5</u>

The listed investments relate to a Long Term Incentive Plan which is operated for senior management of the Company. Awards under the Plan, involving the release of ordinary shares in Pennon Group Plc to participants, are dependent upon performance conditions being met. These shares are released out of an Employee Share Ownership Plan, a discretionary trust, established to facilitate the operation of the incentive scheme.

During the year the trustees of the Employee Share Ownership Plan purchased 55,462 of Pennon Group Plc's ordinary shares (1999 38,100) through a non-interest bearing advance made by the Company. The market value of those shares, which were held at 31 March 2000, was £720,000 (1999 £963,000). The costs of the incentive scheme are recognised as a provision for impairment and are charged to profits over the period of its operation, and are included in employment costs.

12 Stocks

	2000 £m	1999 £m
Raw materials and consumables	<u>3.4</u>	<u>3.2</u>

13 Debtors

	2000 £m	1999 £m
Amounts falling due after more than one year:-		
Prepayments for pension costs (note 23)	<u>7.0</u>	<u>8.4</u>
Amounts falling due within one year:-		
Trade debtors	31.6	29.9
Amounts owed by fellow subsidiary undertakings	1.0	0.3
Other debtors	4.2	6.8
Prepayments for pension costs (note 23)	1.3	0.5
Prepayments and accrued income	14.8	14.9
Mainstream corporation tax	0.3	-
	<u>53.2</u>	<u>52.4</u>

NOTES TO THE FINANCIAL STATEMENTS

14 Current Asset Investments

	2000 £m	1999 £m
Listed investments	3.8	9.7
Other investments:-		
Overnight deposits	9.4	-
Other	23.6	13.1
	<u>36.8</u>	<u>22.8</u>
Market value of listed investments	<u>3.8</u>	<u>9.7</u>

Other investments include certificates of deposit, variable rate notes, commercial paper and other short dated unlisted securities. Overnight deposits of £9.4m represent an amount owed by the parent undertaking, arising from the pooling of short-term funds within the Pennon Group.

15 Creditors: Amounts Falling Due Within One Year

	2000 £m	1999 £m
Loans:- (note 22)		
European Investment Bank loans	11.5	10.8
Amounts owed to parent undertaking	-	26.1
Bank loans and overdrafts	0.8	-
	<u>12.3</u>	<u>36.9</u>
Obligations under finance leases (note 22)	8.4	6.9
Trade creditors	10.2	12.7
Capital creditors	28.4	23.7
Other amounts owed to parent undertaking	3.7	14.9
Amounts owed to fellow subsidiary undertakings	3.5	3.1
Other creditors	5.1	5.5
Corporation tax	-	7.0
Taxation and social security	0.9	0.8
Accruals and deferred income	11.2	11.5
	<u>83.7</u>	<u>123.0</u>

NOTES TO THE FINANCIAL STATEMENTS

16 Creditors: Amounts Falling Due After More Than One Year

	2000 £m	1999 £m
Loans:- (note 22)		
European Investment Bank loans	74.1	85.6
Amounts owed to parent undertaking	150.0	150.0
	<hr/> 224.1	<hr/> 235.6
Obligations under finance leases (note 22)	316.8	304.6
	<hr/> 540.9	<hr/> 540.2

17 Provisions for Liabilities and Charges

	Restruc- turing £m	Other £m	Total £m
At 1 April 1999	3.4	-	3.4
Additions	1.0	1.2	2.2
Utilised during year	(2.2)	-	(2.2)
	<hr/> 2.2	<hr/> 1.2	<hr/> 3.4
At 31 March 2000	2.2	1.2	3.4

The restructuring provision relates principally to severance costs to be utilised over the next twelve months, together with costs for property restructuring which will be utilised over the remaining lease period.

Other provisions relate to anticipated costs of de-commissioning an operational site at the end of its useful life.

Deferred Taxation

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

	2000 £m	1999 £m
Tax effect of timing differences due to:-		
Accelerated capital allowances	200.6	180.1
Other timing differences, including pensions	11.3	9.1
	<hr/> 211.9	<hr/> 189.2

NOTES TO THE FINANCIAL STATEMENTS

18 Accruals and Deferred Income

	Finance lease variations	Forward interest rate swap	Grants and contribu- tions	Total
Deferred Income	£m	£m	£m	£m
At 1 April 1999				
Amount to be released :				
after more than one year	7.4	-	24.7	32.1
within one year	-	-	1.2	1.2
	<u>7.4</u>	<u>-</u>	<u>25.9</u>	<u>33.3</u>
Additions	0.1	18.2	0.7	19.0
Released to profits	-	-	(1.2)	(1.2)
	<u>7.5</u>	<u>18.2</u>	<u>25.4</u>	<u>51.1</u>
At 31 March 2000				
Amount to be released within one year	-	-	(1.2)	(1.2)
Amount to be released after more than one year	7.5	18.2	24.2	49.9
	<u>7.5</u>	<u>18.2</u>	<u>24.2</u>	<u>49.9</u>
At 1 April 1998 (restated)				
Amount to be released :				
after more than one year	-	-	25.5	25.5
after more than one year - restated	6.2	-	-	6.2
within one year	-	-	1.2	1.2
	<u>6.2</u>	<u>-</u>	<u>26.7</u>	<u>32.9</u>
Additions	1.2	-	0.5	1.7
Released to profits	-	-	(1.3)	(1.3)
	<u>7.4</u>	<u>-</u>	<u>25.9</u>	<u>33.3</u>
At 31 March 1999				
Amount to be released within one year	-	-	(1.2)	(1.2)
Amount to be released after more than one year	7.4	-	24.7	32.1
	<u>7.4</u>	<u>-</u>	<u>24.7</u>	<u>32.1</u>

At 1 April 1998 the provision for finance lease variations was reclassified as deferred income arising from the application of FRS 12.

19 Called-up Share Capital

	2000 £m	1999 £m
Authorised, 500,000,000 (1999 365,950,000) Ordinary shares of £1 each	<u>500.0</u>	<u>365.9</u>
Allotted, called-up and fully paid:-		
450,950,000 (1999 365,950,000) Ordinary shares of £1 each	<u>450.9</u>	<u>365.9</u>

NOTES TO THE FINANCIAL STATEMENTS

19 Called-up Share Capital (Continued)

On 21 March 2000 the authorised share capital of the Company was increased from £365,950,000 to £500,000,000 by the creation of 134,050,000 Ordinary shares of £1 each. On 31 March 2000, 85,000,000 Ordinary shares were allotted to Pennon Group Plc for cash at par.

20 Reserves

	Profit and loss account £m
At 1 April 1999	530.2
Retained profit for year	32.6
	<hr/>
At 31 March 2000	562.8
	<hr/>

The cumulative value of goodwill at 31 March 2000 resulting from acquisitions, which has been written off against reserves, is £1.4m (1999 £1.4m).

21 Statement of Movements in Shareholders' Funds

	2000 £m	1999 £m
Profit on ordinary activities after taxation	96.6	65.6
Dividends	(64.0)	(60.0)
	<hr/>	<hr/>
Shareholders' Funds (equity interest) :-		
Addition for year	32.6	5.6
Shares issued for cash consideration	85.0	-
At 1 April	896.1	890.5
	<hr/>	<hr/>
At 31 March	1,013.7	896.1
	<hr/>	<hr/>

22 Loans and Other Borrowings

	2000 £m	1999 £m
Loans		
Repayable:-		
After five years	171.1	185.6
Between two and five years	40.9	38.5
Between one and two years	12.1	11.5
	<hr/>	<hr/>
Falling due after more than one year (note 16)	224.1	235.6
Falling due within one year (note 15)	12.3	36.9
	<hr/>	<hr/>
	236.4	272.5
	<hr/>	<hr/>

Loans are denominated in sterling and are repayable over the period 2000-2012. The rates of interest payable on loans, any part of which is due after five years, vary from 5% to 11%.

NOTES TO THE FINANCIAL STATEMENTS

22 Loans and Other Borrowings (Continued)

	2000 £m	1999 £m
Obligations under finance leases		
Repayable:-		
After five years	297.6	293.5
Between two and five years	10.2	5.9
Between one and two years	9.0	5.2
	<hr/>	<hr/>
Falling due after more than one year (note 16)	316.8	304.6
Falling due within one year (note 15)	8.4	6.9
	<hr/>	<hr/>
	325.2	311.5
	<hr/>	<hr/>

Included above are finance charges arising on obligations under finance leases totalling £53.2m (1999 £36.9m), of which £6.9m (1999 £4.2m) is repayable within one year.

Loans and obligations under finance leases

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

	2000 £m	1999 £m
Loans	235.5	246.3
Obligations under finance leases	322.3	305.4
	<hr/>	<hr/>
	557.8	551.7
	<hr/>	<hr/>

At 31 March 2000 floating interest rate swaps, to hedge finance lease liabilities and achieve a balance between fixed and floating rate debt existed, with a notional principal value of £260.0m. During the year the Company has entered into an agreement to swap the interest on a notional principal value of £200.0m from LIBOR to European Inter Bank Offered Rate (EURIBOR) with commencement dates between 1 April 2006 and 1 April 2010, and maturing on 31 March 2030. A settlement of £18.2m, shown in note 25, was received when these swaps were entered into during December 1999.

23 Pensions

The Company's employees are eligible to participate in funded defined benefit schemes, operated by the parent Company. Contributions are based upon pension costs across the Pennon Group Plc as a whole.

The net pensions charge for the Company for the year ended 31 March 2000 was £0.7m (1999 £0.2m). Full details of the valuations and actuarial assumptions are given in the financial statements of Pennon Group Plc.

Pension prepayments included as debtors of the Company amount to £8.3m (1999 £8.9m), representing the accumulated difference between the Company pension charge (or credit) and employer contributions paid.

NOTES TO THE FINANCIAL STATEMENTS

24 Commitments and Contingent Liabilities

	2000 £m	1999 £m
Capital commitments		
Contracted but not provided	64.8	29.5
Commitments under operating leases		
Rentals during the year following the balance sheet date		
Land and buildings leases expiring:- after five years	2.1	2.0
Contingent Liabilities		
Contractors' claims on capital schemes	0.8	1.1
Guarantee of borrowings of the parent undertaking	150.0	150.0
	150.8	151.1

The Company has guaranteed the principal and interest on a £150.0m Bond issued by Pennon Group Plc, which is to be redeemed on 5 February 2012. The full amount of the Bond has been loaned to the Company, with the same repayment date.

25 Notes to the Cash Flow Statement

(a) Reconciliation of Operating Profit to Net Cash Inflow from Operating Activities

	2000 £m	1999 £m
Operating profit	146.8	138.7
Depreciation charge	44.6	41.9
Provision for impairment:-		
Fixed asset investments	0.3	0.3
Deferred income released to profits	(1.2)	(1.3)
Decrease in provisions for liabilities and charges	-	(2.9)
(Increase)/decrease in stocks	(0.2)	0.3
Decrease/(increase) in debtors (amounts falling due within and over one year)	1.4	(11.2)
Decrease in creditors (amounts falling due within and over one year)	(2.0)	(11.2)
Profit on disposal of tangible fixed assets	(0.3)	(0.2)
Net cash inflow from operating activities	189.4	154.4

Cash outflows from operating activities accounted for in previous years as exceptional items, included above, were £1.7m (1999 £1.8m). These relate to the utilisation of the restructuring provision.

NOTES TO THE FINANCIAL STATEMENTS

25 Notes to the Cash Flow Statement (Continued)

(b) Analysis of Cash Flows for Headings Netted in the Cash Flow Statement

	2000 £m	1999 £m
(i) Returns on Investments and Servicing of Finance		
Interest received	1.3	9.7
Interest paid	(26.8)	(27.2)
Interest element of finance lease rentals	2.4	(5.1)
Costs associated with defeased leases (note 4)	-	(0.1)
Forward interest rate swap settlements (note 22)	18.2	-
Net cash outflow for returns on investments and servicing of finance	<u>(4.9)</u>	<u>(22.7)</u>
(ii) Capital Expenditure and Financial Investment		
Purchase of tangible fixed assets	(128.0)	(113.9)
Grants and contributions:-		
Infrastructure assets	1.9	3.6
Non-infrastructure assets	0.6	0.8
Receipts from disposal of tangible fixed assets	1.4	0.8
Purchase of fixed asset investments	(0.5)	(0.4)
Net cash outflow for capital expenditure and financial investment	<u>(124.6)</u>	<u>(109.1)</u>
(iii) Management of Liquid Resources		
Purchase of current asset investments	(63.2)	(184.5)
Sale of current asset investments	58.6	218.1
Net cash (outflow)/inflow from management of liquid resources	<u>(4.6)</u>	<u>33.6</u>
Liquid resources comprise readily disposable current asset investments.		
(iv) Financing		
Issue of ordinary share capital	85.0	-
Debt due within one year (other than bank overdrafts): (reduction)/increase	(36.9)	15.8
Reduction in cash deposited against finance lease obligations	-	75.0
Cash placed on deposit with financial institutions (note 4)	(2.1)	(15.9)
Defeased finance lease drawdowns (note 4)	2.6	21.0
Capital element of finance lease rental payments	(2.6)	(3.8)
Net cash inflow from financing	<u>46.0</u>	<u>92.1</u>

NOTES TO THE FINANCIAL STATEMENTS

25 Notes to the Cash Flow Statement (Continued)

(c) Analysis of Net Debt

	At 1 April 1999 £m	Cash flow £m	Non-cash movements £m	At 31 March 2000 £m
Cash at bank and in hand	1.7	(1.4)	-	0.3
Current asset investments:- overnight deposits	-	9.4	-	9.4
Bank overdrafts	-	(0.8)	-	(0.8)
	1.7	7.2	-	8.9
Debt due within one year (other than bank overdrafts)	(36.9)	36.9	(11.5)	(11.5)
Debt due after more than one year	(85.6)	-	11.5	(74.1)
Finance lease obligations	(311.5)	2.1	(15.8)	(325.2)
Amounts owed to parent undertaking	(150.0)	-	-	(150.0)
	(584.0)	39.0	(15.8)	(560.8)
Current asset investments:- other than overnight deposits	22.8	4.6	-	27.4
	(559.5)	50.8	(15.8)	(524.5)

(d) Reconciliation of Net Cash Flow to Movement in Net Debt

	2000 £m	1999 £m
Increase/(decrease) in cash in the period	7.2	(3.1)
Cash outflow/(inflow) from decrease/(increase) in debt and finance leasing	39.0	(92.1)
Cash outflow/(inflow) from increase/(decrease) in liquid resources	4.6	(33.6)
Change in net debt arising from cash flows	50.8	(128.8)
Non-cash movements:-		
In-substance extinguishment of finance lease obligations	0.5	5.1
Increase in accrued finance charges on finance lease obligations	(16.3)	(10.6)
Decrease/(Increase) in net debt in the year	35.0	(134.3)
Net debt at 1 April	(559.5)	(425.2)
Net debt at 31 March	(524.5)	(559.5)

NOTES TO THE FINANCIAL STATEMENTS

26 Related Party Transactions

Under FRS8, transactions with other members of the Pennon Group Plc are not required to be set out herein since the Company is a wholly owned subsidiary within that group.

In September 1999, Mr R J Baty acquired a surplus property from the Company for a consideration of £78,500, which was the valuation of the property as determined by an independent property valuer.

27 Parent Company

The parent company, and ultimate controlling party, is Pennon Group Plc which is registered in England. Group financial statements are included in the Annual Report of Pennon Group Plc which is available from Peninsula House, Rydon Lane, Exeter, EX2 7HR.