

SOUTH WEST WATER LIMITED

ANNUAL REPORT AND FINANCIAL STATEMENTS 2004



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



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CHIEF EXECUTIVE'S REVIEW

South West Water continued to deliver sound financial performance, to outperform the regulatory contract and to maintain improvements in services to customers. The company's turnover increased by 8% from £270.3 million to £292.0 million, primarily reflecting the impact of the tariff increase approved by the Director General of Water Services, together with 6,900 new customer connections.

Operating costs increased by £13.4 million to £172.9 million, including £8.6 million for the operation of new capital schemes, inflation of £3.4 million and £5.5 million of other cost increases, mainly pensions, direct cost of sales and bad debts. These costs were offset by efficiency savings of £4.1 million achieved during the year.

Operating profit increased by £8.3 million to £119.1 million. During the year a further 31,000 customers switched to a measured charging basis compared to 22,000 the previous year.

Some five years ago a restructuring and continuous improvement programme specifically designed to reduce significantly overhead and operating costs was introduced. 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).

Since 1995, cost reductions totalling £46.0 million have been achieved by South West Water demonstrating its excellent track record in the area of efficiency saving.

In the constant drive to achieve further efficiencies, the company has also successfully launched new major management information systems in the areas of asset management, human resources and customer service management and is currently reviewing its organisational structure to ensure that improved levels of efficiency continue to be delivered in the future.

Exemplary levels of product and customer service remain one of the company's key objectives. 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' targets.

The region's water storage, treatment and distribution infrastructure has been progressively and significantly enhanced over the years and as a direct result of careful planning and focused capital expenditure, the company has been able to fulfil the expectations of its customers for abundant supplies of high quality drinking water. The company's innovative and industry-leading leakage detection and control programme continues to deliver results in line with Ofwat's mandatory leakage targets and there have been no water restrictions since 1996. During the K3 period, planned expenditure on water mains renovation will be in the order of £135.0 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. Improvements in water supply have been matched with improvements to water quality and during the year the company matched its highest ever drinking water compliance level of 99.92% with the quality standards set by the Drinking Water Inspectorate.

In November 2003, the Department for Environment, Food and Rural Affairs (DEFRA) and the Environment Agency (EA) announced the best ever bathing water quality results for beaches and bathing waters along the West Country coastline. Only one of the 141 designated bathing waters in the region regularly monitored by the EA failed to comply with the European Union (EU) mandatory standards, with Devon achieving 100% compliance for the first time ever. The results also confirmed that 115 bathing waters met the more stringent EU guideline standards, one of the best performances of any region in the UK.



CHIEF EXECUTIVE'S REVIEW (continued)

South West Water's £1 billion 'Clean Sweep' bathing water improvement programme has been pivotal in achieving these record levels of compliance and the associated financial and environmental benefits for the region. Its successful delivery is great testament to the endeavours of South West Water employees, its contractors and regional key stakeholders including customers who have all contributed to the completion of the biggest environmental improvement programme of its kind in Europe.

A rolling programme of updating and modernising inland waste water treatment works to ensure compliance with environmental standards continued throughout the year and played a major role in helping the region achieve the highest percentage length of high quality rivers in England.

In line with Regulatory requirements, capital expenditure for the year reduced by £42.4 million to £139.1 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 £72.3, million of which £30.8 million was invested in the company's 'Clean Sweep' bathing water improvement programme.

South West Water's Periodic Review submission for the K4 period (2005 – 2010) is being progressed in accordance with the required timescales ahead of Ofwat's Draft Determination on price limits due to be published in August this year. Ofwat will make a Final Determination in December 2004 of the prices customers will pay from 1st April 2005.

Whilst acknowledging that further price increases will be inevitable, South West Water will be endeavouring to strike a realistic balance between value for money investment, financeability and customer affordability.

R J Baty
Chief Executive

DIRECTORS, REGISTERED OFFICE AND AUDITORS

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

NOTICE OF MEETING

The fifteenth Annual General Meeting of South West Water Limited will be held at Peninsula House, Rydon Lane, Exeter on 20 July 2004 at 9.30 am 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 2004.
- Resolution 2 To re-appoint PricewaterhouseCoopers LLP as auditors of the Company to hold office until the conclusion of the next general meeting at which accounts are laid before the Company 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

28 June 2004

For the purposes of the appointment of auditors (Resolution 2 in this notice), Special notice in accordance with Sections 379 and 388(3), Companies Act 1985 of the intention to move Resolution 2 as an ordinary resolution has been received by the Company.

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 2004.

PRINCIPAL ACTIVITIES

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

FINANCIAL RESULTS

Turnover for the year increased by £21.7m, 8.0%, to £292.0m, primarily reflecting the tariff increases for main water and sewerage charges as determined in the Director General's review of price limits for the five year period 2001 to 2005, revised by an interim determination in December 2001.

Total operating costs rose by £13.4m to £172.9m, reflecting an increase in depreciation of £4.5m, to £65.4m (2003 £60.9m). Additional costs incurred in the operation of commissioned new capital schemes totalled £8.2m, and inflation caused costs to rise by £3.4m. The charge for bad & doubtful debts was increased to £6.9m (2003 £4.4m). Offsetting savings of £4.1m were achieved from the Company's continuing restructuring and cost reduction programmes.

Operating profit was £119.1m (2003 £110.8m). Net interest payable increased to £48.6m (2003 £44.4m), reflecting higher borrowings to fund the capital expenditure programme.

Net profit before taxation amounted to £70.5m (2003 £66.4m).

The Company's taxation position results in a charge to mainstream corporation tax of £3.2m (2003 credit of £2.0m) for the year. This position reflects the continuing substantial capital allowances generated by the capital expenditure programme and the continuing benefits delivered from the policy of disclaiming capital allowances in order to utilise surplus advance corporation tax. A discounted provision for deferred tax has been made resulting in a charge of £4.5m in the year (2003 £17.0m).

Dividends and Retained Profit

An interim dividend of £75.6m (2003 £72.7m) 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 the following components:

- a sustainable level of base dividend growth, determined by a number of factors including the shareholders' investment and the cost of capital.
- a further level of growth funded by efficiency out-performance.
- consistency with the assumptions made by Ofwat in setting prices for the five year period 2001 to 2005.

Dividend payments are designed to ensure that key financial ratios are not prejudiced and that the ability of the Appointee to finance its Appointed Business is not impaired.

A deficit of £12.8m was transferred from reserves (2003 £21.3m), after charging the interim dividend.

REPORT OF THE DIRECTORS (Continued)

FINANCIAL RESULTS (Continued)

Investment

Capital expenditure on tangible fixed assets during the year was £139.1m, a 23.4% reduction from the 2003 level of £181.5m, reflecting the programme of work on a number of major waste water treatment schemes, water mains rehabilitation and other improvement initiatives. Capital scheme work-in-progress at 31 March 2004 decreased to £76.0m (2003 £83.8m). The Company continues to focus its investment programme upon targeted improvements to meet customer needs and regulatory requirements.

The capital works programme comprises approximately 100 on-going projects at 31 March 2004 with 128 significant projects completed during the year. Major projects commissioned in the year included sewage treatment works at Croyde, Plymouth Camels Head and Lynmouth (secondary treatment). Major sewers and water mains commissioned included Torbay Brixham sewer improvements and Tottiford-Torquay water main. Other significant areas of capital expenditure were water mains rehabilitation, combined storm overflows, leakage control, and metering.

Financing

Net cash inflow from operating activities increased by £3.5m, to £177.4m (2003 £173.9m) mainly as a result of the cash impact of the increase in operating profit offset by working capital increases.

Significant funding facilities are in place to cover both medium and long term requirements, including finance leasing, 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.

Net debt increased by £86.3m to £955.6m (9.9%).

Short-term uncommitted facilities totalled £147.0m at 31 March 2004.

Derivatives, usually interest rate swaps, are used to manage the mix of fixed and floating rate debt. 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. Major submissions have been completed in support of the Director General's review of price limits. The outcome of this review is due to be published in late 2004 and will be important to the financial position of the Company from 1st April 2005.

RISK MANAGEMENT

The Directors have established a formal framework for the identification and monitoring of both operational and financial risks arising from the Company's activities. The effectiveness of this framework is regularly reviewed by the Board.

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.

DIRECTORS

The current Directors of the Company are shown on page 5.

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 increased slightly during the year from 1,339 to 1,341.

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's people management processes have been recognised via an "Investor in People" award. Whilst the external accreditation is most welcome, the Company is not complacent and will continue its drive for industry-leading best practice in the future. Changes to both structure and working practices are vital for continued success and particular attention is given to the management of change via a wide range of training and development programmes.

The Company is a recognised leader in health and safety management and a safe working environment is of paramount importance. The Company's innovative and low-cost management systems have been introduced for the protection of employees, contractors and the public. These systems have helped to ensure a low level of work-related accidents and attendant reductions in operating costs. The Company has been commended by the Health & Safety Executive for its "world class" risk management systems.

The Company remains committed to a non-discriminatory employment policy, making every reasonable effort to ensure that no current or future employee is disadvantaged because of age, gender, religion, colour, ethnic origin, marital status, sexual orientation or disability. In addition, a "whistleblowing" policy has been adopted, as have "family friendly" policies.

PAYMENTS TO SUPPLIERS

It is the Company's payment policy for the year ending 31 March 2005 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 2004 represented 34 days of the amount invoiced by suppliers during the year.

REPORT OF THE DIRECTORS (Continued)

PARENT COMPANY

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

STATEMENT OF DIRECTORS' RESPONSIBILITIES

Company law requires the directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. The directors are required to prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the company will continue in business.

The directors confirm that suitable accounting policies have been used and applied consistently. They also confirm that reasonable and prudent judgements and estimates have been made in preparing the financial statements for the year ended 31 March 2004 and that applicable accounting standards have been followed.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities

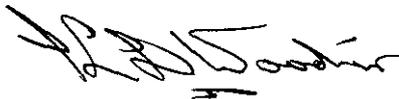
AUDITORS

A resolution to re-appoint PricewaterhouseCoopers LLP as auditors to the Company will be proposed at the annual general meeting. PricewaterhouseCoopers LLP have indicated their willingness to continue as auditors.

ANNUAL GENERAL MEETING

The fifteenth annual general meeting will be held at Peninsula House, Rydon Lane, Exeter on 20 July 2004 at 9.30 am.

By Order of the Board



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

28 June 2004

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SOUTH WEST WATER LIMITED

We have audited the financial statements which comprise the profit and loss account, the balance sheet, the cash flow statement and the related notes.

Respective Responsibilities of Directors and Auditors

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

Our responsibility is to audit the financial statements in accordance with the 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 are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law 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 the Chief Executive's Review, the Report of the Directors and the Directors' Responsibility Statement.

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 Company's affairs at 31 March 2004 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 LLP
Chartered Accountants
and Registered Auditors
Bristol

28 June 2004

PROFIT AND LOSS ACCOUNT
for the year ended 31 March 2004

	Notes	2004 £m	2003 £m
Turnover	2	292.0	270.3
Operating costs	3	(172.9)	(159.5)
Operating Profit	2	119.1	110.8
Net interest payable	4	(48.6)	(44.4)
Profit on Ordinary Activities Before Taxation	2	70.5	66.4
Tax on profit on ordinary activities	5	(7.7)	(15.0)
Profit on Ordinary Activities After Taxation		62.8	51.4
Dividends	6	(75.6)	(72.7)
Deficit Transferred From Reserves	20	(12.8)	(21.3)

All operating activities are continuing operations.

There were no recognised gains or losses for the Company, other than profit for the year, in 2004 or 2003.

The notes on pages 15 to 35 form part of these financial statements.

BALANCE SHEET
at 31 March 2004

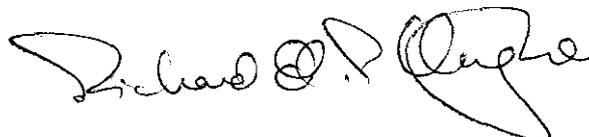
	Notes	2004 £m	2003 £m
Fixed Assets			
Tangible assets	10	1,982.4	1,911.6
Investments	11	4.5	4.3
		<u>1,986.9</u>	<u>1,915.9</u>
Current Assets			
Stocks	12	3.6	3.1
Debtors: amounts falling due after more than one year	13	4.4	30.6
Debtors: amounts falling due within one year	13	119.9	90.9
Investments	14	249.3	176.7
Cash at bank and in hand		1.3	0.6
		<u>378.5</u>	<u>301.9</u>
Current Liabilities			
Creditors: amounts falling due within one year	15	(170.1)	(155.7)
Net Current Assets		<u>208.4</u>	<u>146.2</u>
Total Assets Less Current Liabilities			
Creditors: amounts falling due after more than one year	16	(1,173.1)	(1,030.4)
Provisions for liabilities and charges	17	(73.7)	(69.7)
Deferred income	18	(38.7)	(39.4)
Net Assets	2	<u>909.8</u>	<u>922.6</u>
Capital and Reserves			
Called-up share capital	19	450.9	450.9
Profit and loss account	20	458.9	471.7
Shareholders' Funds	21	<u>909.8</u>	<u>922.6</u>

The notes on pages 15 to 35 form part of these financial statements.

Approved by the Board on 28 June 2004 and signed on its behalf by:-



R J Baty
 Chief Executive



R M P Hughes
 Finance & Regulatory Director

CASH FLOW STATEMENT
for the year ended 31 March 2004

	Notes	2004 £m	2003 £m
Net Cash Inflow from Operating Activities	25a	177.4	173.9
Returns on Investments and Servicing of Finance	25b	(36.1)	(35.4)
Taxation		2.0	(2.1)
Capital Expenditure and Financial Investment	25b	(146.0)	(177.0)
Acquisitions	25b	-	(0.1)
Equity Dividends Paid		(75.6)	(72.7)
		<hr/>	<hr/>
Cash Outflow Before Use of Liquid Resources and Financing		(78.3)	(113.4)
Management of Liquid Resources	25b	(63.5)	(3.5)
Financing	25b	156.6	136.1
		<hr/>	<hr/>
Increase in Cash in Year	25c	14.8	19.2
		<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(f) below.

(b) Consolidated Financial Statements

The Company is exempt under the provisions of Section 228 of the Companies Act 1985 from the requirement to produce group financial statements (as amended by Section 5 of the Companies Act 1989) as it is a wholly-owned subsidiary undertaking of Pennon Group Plc which is registered within the European Economic Area and which itself prepares consolidated financial statements. Accordingly consolidated financial statements have not been prepared and the financial information presented is for the Company as an individual undertaking.

(c) Turnover

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

(d) 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)

(e) 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.

The rental obligations and cash deposits associated with defeased leases are recognised on the balance sheet separately and the net interest arising from these transactions is recognised over the life of the leases.

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

(f) 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.

(g) 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.

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.

(h) Stocks

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

(i) 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 (or deficit) is released (or charged) to profits, using the straight line method, over the average remaining service lives of employees in the schemes.

(j) 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)

(k) Taxation

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 in full. Where the effect of the time value of money is material the current amount of the reversals of tax deferred or accelerated 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.

(l) 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:-

	Water		Sewerage		Company	
	2004 £m	2003 £m	2004 £m	2003 £m	2004 £m	2003 £m
Turnover	124.0	111.8	168.0	158.5	292.0	270.3
Profit						
Segmental operating profit	40.1	32.7	79.0	78.1	119.1	110.8
Net interest payable	(19.2)	(18.9)	(29.4)	(25.5)	(48.6)	(44.4)
Profit on ordinary activities before taxation	20.9	13.8	49.6	52.6	70.5	66.4
Net Assets	431.8	393.7	478.0	528.9	909.8	922.6

“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

	2004 £m	2003 £m
Manpower costs (note 7)	30.0	26.8
Raw materials and consumables	10.8	9.4
Rentals under operating leases:-		
Hire of plant and machinery	0.6	0.7
Other operating leases	1.3	1.3
Research and development expenditure	0.1	0.1
Auditors' remuneration	0.2	0.1
Other external charges	55.4	51.7
Depreciation:-		
On owned non-infrastructure assets	35.1	31.6
On owned infrastructure assets	12.4	12.1
On assets held under finance leases	17.9	17.2
Provision for impairment of fixed asset investments	0.6	0.3
Profit on disposal of fixed assets	(1.5)	(0.5)
Deferred income released to profits	(1.2)	(1.2)
Other operating charges	11.2	9.9
	<u>172.9</u>	<u>159.5</u>

£0.1m fees were payable to the Company's auditors, PricewaterhouseCoopers LLP, for assurance work in connection with the regulatory price review for the year ended 31 March 2004 (2003 Nil).

4 Net Interest Payable

	2004 £m	2003 £m
Interest payable:-		
To parent undertaking	(16.0)	(16.3)
Bank loans and overdrafts	(14.5)	(9.3)
Interest element of finance lease rentals	(28.9)	(28.1)
Other finance costs	(0.6)	(0.2)
	<u>(60.0)</u>	<u>(53.9)</u>
Interest receivable:-		
From parent undertaking	3.3	1.8
From fellow subsidiaries	0.1	0.1
Other investments (as defined in note 14)	8.0	7.6
	<u>11.4</u>	<u>9.5</u>
Net interest payable	<u>(48.6)</u>	<u>(44.4)</u>

NOTES TO THE FINANCIAL STATEMENTS

5 Tax on Profit on Ordinary Activities

	2004 £m	2003 £m
(a) Analysis of charge for year		
Current tax :		
UK corporation tax at 30% :-		
Current year	6.3	-
Amounts (receivable from) / payable to Pennon Group companies in respect of surrender of taxable losses and advance corporation tax	(3.1)	(2.0)
Total current tax (note 5 (b))	<u>3.2</u>	<u>(2.0)</u>
Deferred tax :		
Origination and reversal of timing differences	17.3	20.7
Increase in discount	(12.8)	(3.7)
Total deferred tax (note 17)	<u>4.5</u>	<u>17.0</u>
Tax on profit on ordinary activities	<u>7.7</u>	<u>15.0</u>
	2004	2003
	£m	£m
(b) Factors affecting current tax charge for the year		
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	<u>70.5</u>	<u>66.4</u>
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK (30%)	21.2	19.9
Tax effects of:		
Expenses not deductible for tax purposes	0.9	1.6
Capital allowances for year in excess of depreciation	(15.7)	(20.1)
Other timing differences	(0.1)	(0.6)
Adjustments to tax charge in respect of prior year	(3.1)	(2.8)
Current tax charge for the year (note 5(a))	<u>3.2</u>	<u>(2.0)</u>

NOTES TO THE FINANCIAL STATEMENTS

6 Dividends

	2004 £m	2003 £m
Interim dividend of 16.76p (2003 16.12p) per Ordinary share paid 10 December 2003	<u>75.6</u>	<u>72.7</u>

7 Employees and Employment Costs

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

	2004	2003
Water services	700	697
Sewerage services	641	642
	<u>1,341</u>	<u>1,339</u>

	2004 £m	2003 £m
Employment costs comprise:-		
Wages and salaries	32.2	32.0
Social security costs	2.4	2.2
Pension costs	4.2	2.1
	<u>38.8</u>	<u>36.3</u>
Total employment costs		
Charged as follows:-		
Manpower costs (note 3)	30.0	26.8
Capital schemes	8.5	9.4
Restructuring provision	0.3	0.1
	<u>38.8</u>	<u>36.3</u>

NOTES TO THE FINANCIAL STATEMENTS

8 Directors' Emoluments

	2004 £000	2003 Restated £000
Total emoluments of the Directors of the Company:-		
Remuneration - salary	376	357
- performance bonus payable	<u>80</u>	<u>72</u>
	456	429
Other emoluments	<u>39</u>	<u>141</u>
	<u>495</u>	<u>570</u>

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

	2004 £000	2003 Restated £000
Remuneration - salary	136	126
- performance bonus payable	<u>39</u>	<u>34</u>
	175	160
Other emoluments	<u>12</u>	<u>14</u>
	<u>187</u>	<u>174</u>

The above performance related bonus payable represents the cash element. In addition, Directors received a conditional award of shares for a matching amount which is subject to a future service criterion. This is a change to the presentation previously adopted and 2003 has been restated accordingly.

Other emoluments include car benefit, health care and in the prior year a payment of £100,000 to the Pennon Group Executive Pension Scheme in order to augment the pension entitlement of Mr P Briens, who resigned on 31 August 2002.

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.

The maximum cash bonus achievable under the scheme is 40% of basic salary, which can be matched by an award of shares of an equivalent amount. Shares awarded usually have to be held for a period of three years, conditional upon continuous service with the Company.

At 31 March 2004 retirement benefits were accruing to 4 Directors (2003 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 £98,000 at 31 March 2004 (2003 £88,000).

NOTES TO THE FINANCIAL STATEMENTS

9 Directors' Interests

The beneficial interests of Directors holding office at 31 March 2004 in the shares of Pennon Group Plc at 31 March 2004 and 31 March 2003 were as follows:-

	Ordinary Shares		Scheme	Options over Ordinary Shares				
	31 March 2004	31 March 2003		31 March 2004	Granted in Period	Exercised in Period	Lapsed In Period	31 March 2003
S C Bird	3,322	2,235	Sharesave	1,510	523	504	-	1,491
R M P Hughes	6,321	4,220	Sharesave	1,745	1,745	2,101	-	2,101
M S Read	6,760	5,986	Sharesave	3,369	-	-	-	3,369

In addition, Directors had a contingent interest in the 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 2004	31 March 2003
	<u>Shares</u>	<u>Shares</u>
S C Bird	9,007	9,007
R M P Hughes	14,918	14,918
M S Read	8,197	8,197

The above represent the maximum number of shares to which Directors would become entitled if all relevant criteria are met. With regard to the year 2000 award, all of the shares awarded to Directors were due to vest at the end of the three year period in September 2003 because the performance condition had been met in full. However, because of the existence of unpublished price sensitive information relating to the parent company, Pennon Group plc, at this time these shares did not vest until 27 May 2004. It is also anticipated that the shares awarded in 2001 to Directors will vest at the end of the three year period in September 2004 because the performance condition has been met.

Directors also had a contingent interest in the shares of Pennon Group Plc under the terms of the Pennon Group Incentive Bonus Scheme, described in note 11, as follows :

	31 March 2004	31 March 2003
	<u>Shares</u>	<u>Shares</u>
S C Bird	5,715	3,454
R M P Hughes	3,987	2,051
M S Read	2,103	685

The above represent the number of shares to which Directors would usually become entitled if they remain employed by the Pennon Group Plc Group for a period of three years from the date of the award. During the year the Directors received dividends on the above shares in accordance with the conditions of the Bonus Plan.

A further conditional award of shares will be made in 2004/05 to match the amount of the cash bonus shown in Note 8.

NOTES TO THE FINANCIAL STATEMENTS

9 Directors' Interests (Continued)

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.

No Director has had any interest in the shares of the Company during the year.

In respect of the current Directors there have been the following changes since 31 March 2004 in the Directors' interests in shares of Pennon Group Plc:

On 8 April 2004, as a result of participation in a dividend reinvestment plan, Dr Bird and Mrs Read acquired additional interests in 67 and 252 shares respectively. On the same date, Mrs Read re-invested 33 shares from the April 2004 dividend into an ISA.

Dr Bird sold 659 shares on 4 June 2004 and Mr Hughes sold 1,000 and 1,900 shares on 7 June and 14 June 2004 respectively.

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 2003	10.4	1,030.3	575.4	697.2	83.8	2,397.1
Additions	0.4	51.1	6.1	25.4	56.1	139.1
Grants and contributions	-	(0.8)	-	-	-	(0.8)
Transfers / reclassifications	2.9	23.6	(15.9)	53.3	(63.9)	-
Disposals	(0.1)	(0.7)	-	(2.4)	-	(3.2)
At 31 March 2004	13.6	1,103.5	565.6	773.5	76.0	2,532.2
Depreciation:-						
At 1 April 2003	5.5	113.7	103.0	263.3	-	485.5
Charge for year	0.2	14.2	10.3	42.3	-	67.0
Disposals	-	(0.7)	-	(2.0)	-	(2.7)
At 31 March 2004	5.7	127.2	113.3	303.6	-	549.8
Net Book Value:-						
At 31 March 2004	7.9	976.3	452.3	469.9	76.0	1,982.4
At 31 March 2003	4.9	916.6	472.4	433.9	83.8	1,911.6

Out of the total depreciation charge for the Company of £67.0m (2003 £62.4m), the sum of £1.6m (2003 £1.6m) has been charged to capital projects, and £65.4m (2003 £60.8m) against profits.

The cost of freehold land and buildings and operational properties includes non-depreciable land of £1.9m (2003 £1.7m) and £9.3m (2003 £9.3m) respectively.

The net book value of infrastructure assets is stated after deducting £47.0m (2003 £46.2m) 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 2003	11.6
Expenditure in the year on maintaining operating capability	16.4
Less depreciation for the year	(14.2)
	<hr/>
Excess of expenditure over depreciation at 31 March 2004	13.8
	<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 2004	147.6	315.0	203.5	32.6	698.7
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Depreciation:- Charge for year	1.8	5.5	10.6	-	17.9
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Depreciation:- At 31 March 2004	8.7	43.5	90.7	-	142.9
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

11 Fixed Asset Investments

	Joint Venture	Subsidiary Undertakings	Listed Investments	Total Investments 2004
	£m	£m	£m	£m
At 1 April 2003	0.1	3.3	0.9	4.3
Additions during year			0.8	0.8
Provision for impairment			(0.6)	(0.6)
	<hr/>	<hr/>	<hr/>	<hr/>
At 31 March 2004	0.1	3.3	1.1	4.5
	<hr/>	<hr/>	<hr/>	<hr/>

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. Shares are also held as part of an Incentive Bonus Scheme operated for senior management of the Company. Awards under the Scheme involve the release of ordinary shares in Pennon Group Plc to participants usually conditional upon continuous service with the Pennon Group Plc 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.

NOTES TO THE FINANCIAL STATEMENTS

11 Fixed Asset Investments (Continued)

During the year the trustees of the Employee Share Ownership Plan purchased 82,312 of Pennon Group Plc's ordinary shares (2003 46,963) through a non-interest bearing advance made by the Company. The market value of the shares held at 31 March 2004 was £1.6m (2003 £1.4m). The costs of the Long Term Incentive Plan are recognised as a provision for impairment and are charged within employment costs over the period of its operation. The costs of the Incentive Bonus Scheme are charged within employment costs in the year of the award.

The Company holds 99,999 (100%) A ordinary shares in Echo South West Limited, a joint venture engaged in customer contact management, established between the Company and Echo Managed Services Limited, a subsidiary of South Staffordshire Group Plc. The proportion of the nominal value of ordinary shares held by the Company remains at 50%.

The Company has two wholly-owned subsidiaries, Peninsula Properties (Exeter) Limited and Peninsula Leasing Limited. Both companies are incorporated, registered and have their operation in England.

Consolidated financial statements have not been prepared, as explained in note 1(b).

In the opinion of the Directors the total value of investments in subsidiary and joint venture undertakings is not less than the amount at which they are shown in the balance sheet.

12 Stocks

	2004 £m	2003 £m
Raw materials and consumables	3.6	3.1

13 Debtors

	2004 £m	2003 £m
Amounts falling due after more than one year:-		
Amounts owed by parent undertaking	-	25.0
Amounts owed by fellow subsidiary undertakings	0.7	1.7
Prepayments for pension costs (note 23)	3.7	3.9
	<u>4.4</u>	<u>30.6</u>
Amounts falling due within one year:-		
Trade debtors	30.3	30.2
Amounts owed by parent undertaking	62.4	37.7
Amounts owed by fellow subsidiary undertakings	3.6	4.0
Amounts owed by joint venture	1.3	1.7
Other debtors	4.3	0.9
Prepayments for pension costs (note 23)	0.7	1.2
Other prepayments and accrued income	17.3	15.2
	<u>119.9</u>	<u>90.9</u>

NOTES TO THE FINANCIAL STATEMENTS

14 Current Asset Investments

	2004 £m	2003 £m
Other investments:-		
Overnight deposits	13.3	4.2
Other	236.0	172.5
	<u>249.3</u>	<u>176.7</u>

Other investments include certificates of deposit, variable rate notes and deposits of £173.6m (2003 £170.1m) made to counter-indemnify letters of credit by financial institutions to lessors in order to secure rental obligations (note 22).

15 Creditors: Amounts Falling Due Within One Year

	2004 £m	2003 £m
Loans:- (note 22)		
European Investment Bank loans	14.5	13.6
Bank loans and overdrafts	61.8	41.9
	<u>76.3</u>	<u>55.5</u>
Obligations under finance leases (note 22)	18.4	23.4
Trade creditors	10.6	10.6
Capital creditors	27.0	40.0
Other amounts owed to parent undertaking	2.4	3.0
Other amounts owed to joint venture	0.2	-
Amounts owed to fellow subsidiary undertakings	1.1	2.7
Other creditors	11.2	6.3
Corporation Tax	6.3	-
Other taxation and social security	1.0	0.9
Accruals and deferred income	15.6	13.3
	<u>170.1</u>	<u>155.7</u>

16 Creditors: Amounts Falling Due After More Than One Year

	2004 £m	2003 £m
Loans:- (note 22)		
European Investment Bank loans	181.1	135.6
Other loans	105.0	50.0
Amounts owed to parent undertaking	150.0	150.0
	<u>436.1</u>	<u>335.6</u>
Obligations under finance leases (note 22)	737.0	694.8
	<u>1,173.1</u>	<u>1,030.4</u>

NOTES TO THE FINANCIAL STATEMENTS

17 Provisions for Liabilities and Charges

	Restruc- turing £m	Deferred Tax £m	Other £m	Total £m
At 1 April 2003	2.1	66.6	1.0	69.7
Charged against profits	0.7	4.5	0.1	5.3
Utilised during year	(1.2)	-	(0.1)	(1.3)
At 31 March 2004	<u>1.6</u>	<u>71.1</u>	<u>1.0</u>	<u>73.7</u>

The restructuring provision relates 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 to 2017.

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

Deferred Taxation

	2004 £m	2003 £m
Accelerated capital allowances	278.7	261.2
Other timing differences	(1.6)	(1.4)
Undiscounted provision for deferred tax	<u>277.1</u>	<u>259.8</u>
Discount	(206.0)	(193.2)
Discounted provision for deferred tax	<u>71.1</u>	<u>66.6</u>
Provision at 1 April 2003	66.6	
Deferred tax charge in profit and loss account for year	<u>4.5</u>	
Provision at 31 March 2004	<u>71.1</u>	

NOTES TO THE FINANCIAL STATEMENTS

18 Deferred Income

	Forward interest rate swap £m	Grants and contributions £m	Total £m
At 1 April 2003:			
Amount to be released :			
after more than one year	18.2	21.2	39.4
within one year	-	1.3	1.3
	<hr/>	<hr/>	<hr/>
	18.2	22.5	40.7
Additions		0.5	0.5
Released to profits		(1.2)	(1.2)
	<hr/>	<hr/>	<hr/>
At 31 March 2004:	18.2	21.8	40.0
Amount to be released:			
within one year	-	(1.3)	(1.3)
	<hr/>	<hr/>	<hr/>
after more than one year	18.2	20.5	38.7
	<hr/>	<hr/>	<hr/>

19 Called-up Share Capital

	2004 £m	2003 £m
Authorised, 500,000,000 Ordinary shares of £1 each	500.0	500.0
	<hr/>	<hr/>
Allotted, called-up and fully paid:- 450,950,000 Ordinary shares of £1 each	450.9	450.9
	<hr/>	<hr/>

20 Reserves

	Profit and loss account £m
At 1 April 2003	471.7
Retained deficit for year	(12.8)
	<hr/>
At 31 March 2004	458.9
	<hr/>

The cumulative value of goodwill at 31 March 2004 resulting from acquisitions, which has been written off against reserves, is £1.4m (2003 £1.4m).

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

NOTES TO THE FINANCIAL STATEMENTS

21 Statement of Movements in Shareholders' Funds

	2004 £m	2003 £m
Profit on ordinary activities after taxation	62.8	51.4
Dividends	(75.6)	(72.7)
Shareholders' Funds (equity interest) :-		
Deficit for year	(12.8)	(21.3)
At 1 April	922.6	943.9
At 31 March	909.8	922.6

22 Loans and Other Borrowings

	2004 £m	2003 £m
Loans		
Repayable:-		
Over five years	281.8	240.9
Over two and up to five years	139.6	30.2
Over one and up to two years	14.7	64.5
Falling due after more than one year (note 16)	436.1	335.6
Falling due within one year (note 15)	76.3	55.5
	512.4	391.1
	2004 £m	2003 £m
Obligations under finance leases		
Repayable:-		
Over five years	663.3	629.4
Over two and up to five years	51.7	42.9
Over one and up to two years	22.0	22.5
Falling due after more than one year (note 16)	737.0	694.8
Falling due within one year (note 15)	18.4	23.4
	755.4	718.2

Included above are accrued finance charges arising on obligations under finance leases totalling £96.0m (2003 £88.0m), of which £15.6 m (2003 £20.5m) is repayable within one year.

NOTES TO THE FINANCIAL STATEMENTS

22 Loans and Other Borrowings (Continued)

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:-

	2004 £m	2003 £m
Loans	310.0	250.0
Obligations under finance leases	754.2	717.1
	<u>1,064.2</u>	<u>967.1</u>

Loans and finance leases are denominated in sterling and are repayable over the period 2004 - 2035. The rates of interest payable on loans, any part of which is due after five years, vary from 4% to 11%.

Within obligations under finance leases the company has :

a utilised finance lease facilities of £180.0m at 31 March 2004 (2003 £180.0m) for 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 United Kingdom financial institutions, to counter-indemnify letters of credit issued by those institutions to the lessors in order to secure those rental obligations.

These deposited funds, which totalled £144.9m at 31 March 2004 (2003 £144.9m), 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 finance leases vary as interest rates, or effective tax rates, change.

At 31 March 2004 floating interest rate to fixed interest rate swaps existed, to hedge financial liabilities and achieve a balance between fixed and floating rate debt, with a notional principal value of £440.0m.

The Company has entered into an agreement to swap the interest to hedge financial liabilities, with a notional principal value of £200.0m, from London Inter Bank Offer Rate (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. The settlement of £18.2m which was received when these swaps were entered into during December 1999 has been deferred (note 18) 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 Company.

NOTES TO THE FINANCIAL STATEMENTS

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 Company is unable to separately identify its share of the underlying assets and liabilities on either a consistent or reasonable basis. The overall pension funding deficit and its implications are shown in the financial statements of Pennon Group Plc.

The net pensions charge for the Company for the year ended 31 March 2004 was £4.2m (2003 £2.1m). 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 (note 13) amount to £4.4m (2003 £5.1m), representing the accumulated difference between the Company pension charge and employer contributions paid.

24 Commitments and Contingent Liabilities

	2004 £m	2003 £m
Capital commitments		
Contracted but not provided	53.8	52.7
Commitments under operating leases		
Rentals during the year following the balance sheet date		
Land and buildings leases expiring:-		
within one year	0.1	0.1
after five years	2.2	2.2
	2.3	2.3
Contingent Liabilities		
Contractors' claims on capital schemes	0.3	1.5
Guarantee of borrowings of the parent undertaking	150.0	150.0
	150.3	151.5

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.

NOTES TO THE FINANCIAL STATEMENTS

25 Notes to the Cash Flow Statement

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

	2004	2003
	£m	£m
Operating profit	119.1	110.8
Depreciation charge	65.4	60.8
Provision for impairment of fixed asset investments	0.6	0.3
Deferred income released to profits	(1.2)	(1.2)
(Decrease) / increase in provisions for liabilities and charges	(0.8)	0.2
Increase in stocks	(0.5)	(0.3)
(Increase) / decrease in debtors (amounts falling due within and over one year)	(4.0)	2.9
Increase in creditors (amounts falling due within and over one year)	0.3	0.8
Profit on disposal of tangible fixed assets	(1.5)	(0.4)
	<hr/>	<hr/>
Net cash inflow from operating activities	177.4	173.9
	<hr/>	<hr/>

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

	2004	2003
	£m	£m
(i) Returns on Investments and Servicing of Finance		
Interest received	11.3	9.5
Interest paid	(29.1)	(25.9)
Interest element of finance lease rentals	(18.3)	(19.0)
	<hr/>	<hr/>
Net cash outflow for returns on investments and servicing of finance	(36.1)	(35.4)
	<hr/>	<hr/>

	2004	2003
	£m	£m
(ii) Capital Expenditure and Financial Investment		
Purchase of tangible fixed assets	(149.6)	(179.3)
Grants and contributions: Infrastructure assets	1.4	1.2
: Non-infrastructure assets	1.0	0.1
Receipts from disposal of tangible fixed assets	2.0	1.3
Purchase of fixed asset investments	(0.8)	(0.3)
	<hr/>	<hr/>
Net cash outflow for capital expenditure and financial investment	(146.0)	(177.0)
	<hr/>	<hr/>

	2004	2003
	£m	£m
(iii) Acquisitions		
Purchase of interest in joint venture	-	(0.1)
	<hr/>	<hr/>
	-	(0.1)
	<hr/>	<hr/>

NOTES TO THE FINANCIAL STATEMENTS

25 Notes to the Cash Flow Statement (Continued)

(iv) Management of Liquid Resources	2004 £m	2003 £m
Purchase of current asset investments	(338.2)	(14.6)
Sale of current asset investments	274.7	11.1
	<hr/>	<hr/>
Net cash outflow from management of liquid resources	(63.5)	(3.5)

(v) Financing	2004 £m	2003 £m
Increase in debt due within one year (other than bank overdrafts)	11.3	17.2
Increase in debt due after more than one year	115.0	100.0
Finance lease drawdowns	32.6	58.1
Capital element of finance lease rental payments	(3.4)	(1.5)
Loans to parent undertaking	1.1	(37.7)
	<hr/>	<hr/>
Net cash inflow from financing	156.6	136.1

(c) Analysis of Net Debt

	At 1 April 2003 £m	Cash flow £m	Non-cash movements £m	At 31 March 2004 £m
Cash at bank and in hand	0.6	0.7	-	1.3
Current asset investments:-				
Overnight deposits	4.2	9.1	-	13.3
Bank overdrafts	(11.9)	5.0	-	(6.9)
	<hr/>	<hr/>	<hr/>	<hr/>
	(7.1)	14.8	-	7.7
Debt due within one year (other than bank overdrafts)	(43.6)	(11.3)	(14.5)	(69.4)
Debt due after more than one year	(185.6)	(115.0)	14.5	(286.1)
Finance lease obligations	(718.2)	(29.2)	(8.0)	(755.4)
Amounts owed to parent undertaking	(87.3)	(1.1)	-	(88.4)
	<hr/>	<hr/>	<hr/>	<hr/>
	(1,034.7)	(156.6)	(8.0)	(1,199.3)
Current asset investments:- other than overnight deposits	172.5	63.5	-	236.0
	<hr/>	<hr/>	<hr/>	<hr/>
	(869.3)	(78.3)	(8.0)	(955.6)

NOTES TO THE FINANCIAL STATEMENTS

25 Notes to the Cash Flow Statement (Continued)

Non-cash movements include transfers between categories of debt for changing maturities and increased accrued finance charges within finance lease obligations.

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

	2004	2003
	£m	£m
Increase in cash in year	14.8	19.2
Cash inflow from increase in debt and finance leasing	(156.6)	(136.1)
Cash outflow from increase in liquid resources	63.5	3.5
Increase in net debt arising from cash flows	(78.3)	(113.4)
Non-cash movements:-		
Increase in accrued finance charges on finance lease obligations	(8.0)	(9.9)
Increase in net debt in the year	(86.3)	(123.3)
Net debt at 1 April	(869.3)	(746.0)
Net debt at 31 March	(955.6)	(869.3)

26 Related Party Transactions

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

During the year the Company purchased services in the ordinary course of business from Echo South West Limited, a joint venture undertaking, at a cost of £7.8m (2003 £7.5m) and sold services to Echo South West Limited of £2.5m (2003 £1.9m). The Company was owed £1.3m by Echo South West Limited at 31 March 2004 (2003 £1.7m), as shown in note 13 and owed £0.2m (2003 £Nil), as shown in note 15.

There were no related party transactions involving Directors during the year.

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.