

# **SOUTH WEST WATER LIMITED**

## **ANNUAL REPORT AND FINANCIAL STATEMENTS 2005**

This report is published in accordance with the requirements of the  
Director General of Water Services

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



# ANNUAL REPORT AND FINANCIAL STATEMENTS 2005

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## CHIEF EXECUTIVE'S REVIEW

South West Water turnover rose by £18.0m to £310.0m. Approved tariff increases amounted to £21.2m. Customers switching from unmeasured to metered charging caused a reduction of £6.3m in turnover. Other factors contributed a net total of £3.1m, including 7,300 new customer connections and increased commercial sales offset by an estimated £2.4m reduction in measured demand, as the summer of 2004 did not match the high temperatures of the previous year.

South West Water's operating profit rose 2.1% to £121.6m before the exceptional charge of £3.4m. Operating costs, including depreciation, increased by £15.5m to £188.4m. Additional costs from new capital schemes of £5.7m, inflation of £4.4m and other cost increases of £9.5m (mainly pensions, direct cost of sales and bad debts) were offset by efficiency savings of £4.1m. Some six years ago, South West Water established a restructuring and continuous improvement programme to reduce significantly overhead and operating costs. Its successful delivery ensured that South West Water outperformed the demanding operational and capital efficiency targets imposed by Ofwat for the K3 regulatory period (2000-2005).

Since 1995, cost reductions totalling £50.1m have been achieved by South West Water demonstrating its excellent track record in the area of efficiency saving.

In December 2004, Ofwat announced its Final Determination on price level increases for the period 2005-2010, which confirmed an average annual household bill increase of 25% in real terms over the five year period. Throughout the Periodic Review process, South West Water endeavoured to strike the right balance between value for money, investment, financeability and customer affordability whilst acknowledging that further price increases were inevitable in order that the Company was able to meet the Governmental and regulatory demands.

The additional efficiencies required over the K4 regulatory period (2005-2010) include a £13m p.a. reduction in base operating costs by 2010, and the Company has already implemented a number of reorganisational and restructuring initiatives in order to attain the demanding efficiency targets imposed, including a manpower reduction programme which will see employee levels reduced by 100 over the period. An exceptional charge of £3.4m has been made in respect of the associated restructuring costs.

Capital expenditure increased by 2% to £141.9m. £66.1m was invested in water supply improvements, including water mains renovation, water treatment works enhancement and leakage control. Ofwat's latest report on leakage noted that South West Water continues to be one of the leading companies in managing water leakage and is delivering results in line with Ofwat's leakage target. Almost 570 kilometers of water mains were laid, replaced or refurbished during the year, a 55% increase on the previous year. Drinking water quality is at an all time high and the region features the highest proportion of high quality rivers in England.

Waste water investment expenditure totalled £75.8m for the year. Commissioning of the Ilsham Valley Pumping Station in Torbay commenced in early April 2004 and its operation signalled the completion of the final major project in the Company's fifteen year original 'Clean Sweep' coastal sewage treatment improvement programme. 'Clean Sweep' has transformed the coastal environment around the South West. 98% of bathing waters conform with EU mandatory standards and 81% of the region's bathing waters now meet the tougher EU guideline standards. This compares with only 47% of the region's bathing waters achieving the guideline standard five years ago.

A further measure of the Company's success has been its progress within the 2003/04 Ofwat 'Overall Performance Assessment' which has seen South West Water achieve one of the largest performance improvements during the year as capital expenditure, constrained while the coastal clean-up was delivered, has now been able to address other areas. It is anticipated a further significant improvement will have been achieved in 2004/05.

R J Baty  
Chief Executive

## **DIRECTORS, REGISTERED OFFICE AND AUDITORS**

Chairman	K G Harvey
Chief Executive	R J Baty
Operations Director	S C Bird
Finance & Regulatory Director	R M P Hughes
Customer Service Director	M S Read
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 sixteenth Annual General Meeting of South West Water Limited will be held at Peninsula House, Rydon Lane, Exeter on 19 July 2005 at 10.00 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 2005.
- 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

30 June 2005

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 2005.

### 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 £18.0m, 6.2%, to £310.0m, 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.

Operating costs before exceptional item rose by £15.5m to £188.4m, reflecting an increase in depreciation of £3.2m, to £68.6m (2004 £65.4m), additional costs incurred in the operation of commissioned new capital schemes totalling £5.7m, and inflation caused costs to rise by £4.4m. Other cost increases of £9.5m (mainly pensions, direct cost of sales and bad debts) were offset by savings of £4.1m achieved from the Company's continuing restructuring and cost reduction programmes.

A restructuring charge of £3.8m (2004 £0.5m) has been made to cover costs incurred on a number of reorganisational and restructuring initiatives undertaken to attain the efficiency targets for the K4 regulatory period (2005-2010). Of the total, £3.4m (manpower cost element £3.0m) is considered to be exceptional arising largely from voluntary severance arrangements.

Operating profit, before exceptional costs, was £121.6m (2004 £119.1m). Net interest payable increased to £51.4m (2004 £48.6m), reflecting higher borrowings to fund the capital expenditure programme.

Net profit before taxation and exceptional item amounted to £70.2m (2004 £70.5m).

The Company's taxation position results in a charge to mainstream corporation tax of £2.1m (2004 £3.2m) 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 £10.0m in the year (2004 £4.5m).

### Dividends and Retained Profit

An interim dividend of £79.5m (2004 £75.6m) 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 £24.8m was transferred from reserves (2004 £12.8m), after charging the interim dividend.

## **REPORT OF THE DIRECTORS (Continued)**

### **FINANCIAL RESULTS (Continued)**

#### **Investment**

Capital expenditure on tangible fixed assets during the year was £141.9m, a 2% increase on the 2004 level of £139.1m, 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 2005 decreased to £71.5m (2004 £76.0m). The Company continues to focus its investment programme upon targeted improvements to meet customer needs and regulatory requirements.

The capital works programme comprises approximately 85 major on-going projects at 31 March 2005 with 91 significant projects completed during the year. Major projects commissioned in the year included sections of Okehampton, Bude, Bideford and South Molton water main rehabilitation schemes, Torquay sewage transfer (Ilsham Valley section), Totnes STW compliance, Truro STW nitrification improvements, Ernesettle permanent lime stabilisation, Dunkerswell STW screening, Falmouth Queen Mary Gardens sewage pumping station and Torbay STW sludge holding tank. Other significant areas of capital expenditure were combined storm overflows, leakage control, and metering.

#### **Financing**

Net cash inflow from operating activities increased by £20.8m, to £198.2m (2004 £177.4m) mainly as a result of working capital decreases.

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 £74.2m to £1,029.8m (7.8%).

Short-term uncommitted facilities totalled £115.0m at 31 March 2005.

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.

The current Periodic Review was completed in December 2004 when Ofwat set water company charges for the years 2005-2010 giving 'K' price increases of 12.5%, 9.8%, 9.8%, 1.7%, 1.4% for 2005-2010 (an average of 6.9% p.a. over the five years).

The Company is implementing plans for restructuring to contribute towards the additional efficiencies required over the period.

## **REPORT OF THE DIRECTORS (Continued)**

### **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.

### **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 4.

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 10 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 slightly during the year from 1,341 to 1,336.

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 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 2006 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](http://www.payontime.co.uk). Trade creditors at 31 March 2005 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 2005 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 sixteenth annual general meeting will be held at Peninsula House, Rydon Lane, Exeter on 19 July 2005 at 10.00 am.

By Order of the Board



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

30 June 2005

# **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.

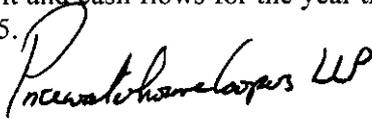
## **Basis of Audit Opinion**

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 2005 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

15 July 2005

## **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 2005 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

30 June 2005

**PROFIT AND LOSS ACCOUNT**  
for the year ended 31 March 2005

	Notes	Before exceptional item 2005 £m	Exceptional item 2005 £m	Total 2005 £m	2004 £m
Turnover	2	310.0	-	310.0	292.0
Operating costs	3	(188.4)	(3.4)	(191.8)	(172.9)
<b>Operating Profit</b>	2	121.6	(3.4)	118.2	119.1
Net interest payable	5	(51.4)	-	(51.4)	(48.6)
<b>Profit on Ordinary Activities Before Taxation</b>	2	70.2	(3.4)	66.8	70.5
Tax on profit on ordinary activities	6	(13.1)	1.0	(12.1)	(7.7)
<b>Profit on Ordinary Activities After Taxation</b>		57.1	(2.4)	54.7	62.8
Dividends	7	(79.5)	-	(79.5)	(75.6)
<b>Deficit Transferred From Reserves</b>	21	(22.4)	(2.4)	(24.8)	(12.8)

All operating activities are continuing operations.

There were no recognised gains or losses for the Company, other than profit for the year, in 2005 or 2004.

The notes on pages 14 to 34 form part of these financial statements.

**BALANCE SHEET**  
**at 31 March 2005**

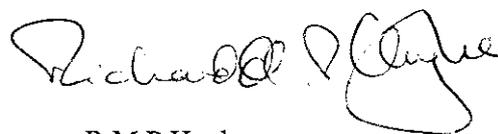
	Notes	2005 £m	2004 £m
<b>Fixed Assets</b>			
Tangible assets	11	2,051.1	1,982.4
Investments	12	4.6	4.5
		<u>2,055.7</u>	<u>1,986.9</u>
<b>Current Assets</b>			
Stocks	13	3.6	3.6
Debtors: amounts falling due after more than one year	14	1.0	4.4
Debtors: amounts falling due within one year	14	46.8	119.9
Investments	15	237.6	249.3
Cash at bank and in hand		1.1	1.3
		<u>290.1</u>	<u>378.5</u>
<b>Current Liabilities</b>			
Creditors: amounts falling due within one year	16	(122.1)	(170.1)
		<u>168.0</u>	<u>208.4</u>
<b>Net Current Assets</b>			
		<u>168.0</u>	<u>208.4</u>
<b>Total Assets Less Current Liabilities</b>			
Creditors: amounts falling due after more than one year	17	(1,220.8)	(1,173.1)
Provisions for liabilities and charges	18	(83.8)	(73.7)
Deferred income	19	(34.1)	(38.7)
		<u>885.0</u>	<u>909.8</u>
<b>Net Assets</b>			
	2	<u>885.0</u>	<u>909.8</u>
<b>Capital and Reserves</b>			
Called-up share capital	20	450.9	450.9
Profit and loss account	21	434.1	458.9
		<u>885.0</u>	<u>909.8</u>
<b>Shareholders' Funds</b>			
	22	<u>885.0</u>	<u>909.8</u>

The notes on pages 14 to 34 form part of these financial statements.

Approved by the Board on 30 June 2005 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 2005**

	Notes	2005 £m	2004 £m
<b>Net Cash Inflow from Operating Activities</b>	26a	198.2	177.4
<b>Returns on Investments and Servicing of Finance</b>	26b	(46.5)	(36.1)
<b>Taxation</b>		(3.2)	2.0
<b>Capital Expenditure and Financial Investment</b>	26b	(134.8)	(146.0)
<b>Equity Dividends Paid</b>		(79.5)	(75.6)
		<hr/>	<hr/>
Cash Outflow Before Use of Liquid Resources and Financing		(65.8)	(78.3)
<b>Management of Liquid Resources</b>	26b	19.0	(63.5)
<b>Financing</b>	26b	52.8	156.6
		<hr/>	<hr/>
<b>Increase in Cash in Year</b>	26c	6.0	14.8
		<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, 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 11.

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 of Pennon Group Plc 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) Bad Debt Provision

A provision for bad and doubtful debts is calculated by applying expected recovery rates to debts outstanding at the end of the accounting period. The expected recovery rates take into account age of the debt, payment history and credit characteristics.

## NOTES TO THE FINANCIAL STATEMENTS

### 1 Accounting Policies (Continued)

#### (j) 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.

#### (k) Research and Development Expenditure

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

#### (l) 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.

#### (m) 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	
	2005 £m	2004 £m	2005 £m	2004 £m	2005 £m	2004 £m
<b>Turnover</b>	<b>133.4</b>	124.0	<b>176.6</b>	168.0	<b>310.0</b>	292.0
<b>Profit</b>						
Segmental operating profit	<b>40.0</b>	40.1	<b>78.2</b>	79.0	<b>118.2</b>	119.1
Net interest payable	<b>(20.3)</b>	(19.2)	<b>(31.1)</b>	(29.4)	<b>(51.4)</b>	(48.6)
Profit on ordinary activities before taxation	<b>19.7</b>	20.9	<b>47.1</b>	49.6	<b>66.8</b>	70.5
<b>Net Assets</b>	<b>429.0</b>	431.8	<b>456.0</b>	478.0	<b>885.0</b>	909.8

"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

	2005 £m	2004 £m
Manpower costs (note 8)	38.0	30.0
Raw materials and consumables	11.6	10.8
Rentals under operating leases:-		
Hire of plant and machinery	0.8	0.6
Other operating leases	1.3	1.3
Research and development expenditure	0.1	0.1
Auditors' remuneration	0.2	0.2
Other external charges	60.4	55.4
Depreciation:-		
On owned non-infrastructure assets	36.7	35.1
On owned infrastructure assets	12.9	12.4
On assets held under finance leases	19.0	17.9
Provision for impairment of fixed asset investments	0.2	0.6
Profit on disposal of fixed assets	(1.2)	(1.5)
Deferred income released to profits	(1.3)	(1.2)
Other operating charges	13.1	11.2
	<u>191.8</u>	<u>172.9</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 2005 (2004 £0.1m).  
Operating costs include the exceptional item set out in note 4.

### 4 Exceptional item

	2005 £m	2004 £m
Operating profit is after charging:-		
Non-recurring restructuring costs	(3.4)	-
	<u>(3.4)</u>	<u>-</u>

### 5 Net Interest Payable

	2005 £m	2004 £m
Interest payable:-		
To parent undertaking	(15.9)	(16.0)
Bank loans and overdrafts	(16.5)	(14.5)
Interest element of finance lease rentals	(32.2)	(28.9)
Other finance costs	(0.4)	(0.6)
	<u>(65.0)</u>	<u>(60.0)</u>
Interest receivable:-		
From parent undertaking	2.1	3.3
From fellow subsidiaries	0.1	0.1
Other investments (as defined in note 15)	11.4	8.0
	<u>13.6</u>	<u>11.4</u>
Net interest payable	<u>(51.4)</u>	<u>(48.6)</u>

## NOTES TO THE FINANCIAL STATEMENTS

### 6 Tax on Profit on Ordinary Activities

	2005 £m	2004 £m
(a) Analysis of charge for year		
Current tax :		
UK corporation tax at 30% :-		
Current year	5.6	6.3
Prior year	(3.5)	-
Amounts receivable from Pennon Group companies in respect of surrender of taxable losses and advance corporation tax	-	(3.1)
Total current tax (note 6 (b))	<u>2.1</u>	<u>3.2</u>
Deferred tax :		
Origination and reversal of timing differences	17.4	17.3
Increase in discount	(7.4)	(12.8)
Total deferred tax (note 18)	<u>10.0</u>	<u>4.5</u>
Tax on profit on ordinary activities	<u>12.1</u>	<u>7.7</u>

	2005 £m	2004 £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>66.8</u>	<u>70.5</u>
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK (30%)	20.0	21.2
Tax effects of:		
Expenses not deductible for tax purposes	0.3	0.9
Capital allowances for year in excess of depreciation	(16.0)	(15.7)
Other timing differences	1.3	(0.1)
Adjustments to tax charge in respect of prior year	(3.5)	(3.1)
Current tax charge for the year (note 6(a))	<u>2.1</u>	<u>3.2</u>

## NOTES TO THE FINANCIAL STATEMENTS

### 7 Dividends

	2005 £m	2004 £m
Interim dividend of 17.62p (2004 16.76p) per Ordinary share paid 14 December 2004	<u>79.5</u>	<u>75.6</u>

### 8 Employees and Employment Costs

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

	2005	2004
Water services	686	700
Sewerage services	650	641
	<u>1,336</u>	<u>1,341</u>

	2005 £m	2004 £m
Employment costs comprise:-		
Wages and salaries	33.4	32.2
Social security costs	2.5	2.4
Pension costs	11.9	4.2
	<u>47.8</u>	<u>38.8</u>
Total employment costs		
Charged as follows:-		
Manpower costs (note 3)		
Before exceptional costs	35.0	30.0
Exceptional costs (note 4)	3.0	-
	<u>38.0</u>	<u>30.0</u>
Restructuring provision	-	0.3
Capital schemes	9.8	8.5
	<u>47.8</u>	<u>38.8</u>

## NOTES TO THE FINANCIAL STATEMENTS

### 9 Directors' Emoluments

	2005 £000	2004 £000
Total emoluments of the Directors of the Company:-		
Remuneration - salary	428	376
- performance related bonus payable	<u>131</u>	<u>80</u>
	559	456
Other emoluments	<u>42</u>	<u>39</u>
	<u>601</u>	<u>495</u>

The above performance related bonus payable represents the cash element. Mr Baty has elected to waive his cash element of his performance related bonus which amounts to £59,000. In addition, Directors received a conditional award of shares for a matching amount which is subject to a future service criterion.

Other emoluments include car benefit and health care.

The emoluments of the highest paid Director were £231,000 (2004 £187,000). In the current year this includes a bonus of £59,000 on which an election to waive has been made.

The emoluments of South West Water Limited Directors are determined by the Remuneration Committee of Pennon G Plc which consists of non-executive Directors. The Remuneration Committee takes external professional advice 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 on continuous service with the Company.

At 31 March 2005 retirement benefits were accruing to 4 Directors (2004 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 £118,000 at 31 March 2005 (2004 £98,000).

## NOTES TO THE FINANCIAL STATEMENTS

### 10 Directors' Interests

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

Messrs K G Harvey and R J Baty are Directors of Pennon Group Plc and their interests in the shares of Pennon Group Plc are disclosed in the financial statements of that company.

The beneficial interests of the other Directors holding office at 31 March 2005 in the shares of Pennon Group Plc at 31 March 2005 and 31 March 2004 were as follows:-

	Ordinary Shares		Scheme	Options over Ordinary Shares				
	31 March 2005	31 March 2004		31 March 2005	Granted in Period	Exercised in Period	Lapsed In Period	31 March 2004
S C Bird	4,590	3,322	Sharesave	1,664	470	316	-	1,510
R M P Hughes	6,753	6,321	Sharesave	1,745	-	-	-	1,745
M S Read	6,276	6,760	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 Restricted Share Plan, described in note 12, as follows :

	31 March 2005	31 March 2004
	<u>Shares</u>	<u>Shares</u>
S C Bird	16,906	9,007
R M P Hughes	21,605	14,918
M S Read	14,970	8,197

The above represent the maximum number of shares to which Directors would become entitled if all relevant criteria are met. During the year, all the shares awarded to the Directors under the 2000 and 2001 awards vested on 27 May 2004 and 13 September 2004 respectively. It is anticipated that some (but not all) of the shares awarded in 2002 to Directors will vest because the performance condition has been partially met.

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

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 12, as follows :

	31 March 2005	31 March 2004
	<u>Shares</u>	<u>Shares</u>
S C Bird	7,723	5,715
R M P Hughes	5,784	3,987
M S Read	3,541	2,103

The above represent the number of shares to which Directors would usually become entitled if they remain employed by the Pennon Group for a period of three years from the date of the award. It is anticipated that all the shares will vest under the 2002 awards as the criterion is expected to be met.

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

## **NOTES TO THE FINANCIAL STATEMENTS**

### **10 Directors' Interests (Continued)**

A further conditional award of shares will be made in 2005/06 to match the amount of the cash bonus shown in Note 9.

The changes in the Directors' interests in the shares of Pennon Group Plc since 31 March 2005 are as follows:

On 7 April 2005, as a result of participation in the scrip dividend alternative offered by Pennon Group Plc, Dr Bird and Mrs Read acquired additional interests in 240 and 302 shares respectively. On the same day, Mrs Read re-invested 21 shares from the April 2005 dividend into an ISA. On 14 June 2005 Mr Hughes sold 500 shares.

## NOTES TO THE FINANCIAL STATEMENTS

### 11 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
<b>Cost:-</b>						
At 1 April 2004	13.6	1,103.5	565.6	773.5	76.0	2,532.2
Additions	0.5	46.6	0.6	31.1	63.1	141.9
Grants and contributions	-	(2.8)	-	-	-	(2.8)
Transfers / reclassifications	0.6	16.5	2.7	47.8	(67.6)	-
Disposals	(2.0)	(0.7)	(0.9)	(5.6)	-	(9.2)
At 31 March 2005	<b>12.7</b>	<b>1,163.1</b>	<b>568.0</b>	<b>846.8</b>	<b>71.5</b>	<b>2,662.1</b>
<b>Depreciation:-</b>						
At 1 April 2004	5.7	127.2	113.3	303.6	-	549.8
Charge for year	0.2	14.9	10.2	44.7	-	70.0
Transfers / reclassifications	-	-	(0.5)	0.5	-	-
Disposals	(2.0)	(0.7)	(0.9)	(5.2)	-	(8.8)
At 31 March 2005	<b>3.9</b>	<b>141.4</b>	<b>122.1</b>	<b>343.6</b>	<b>-</b>	<b>611.0</b>
<b>Net Book Value:-</b>						
At 31 March 2005	<b>8.8</b>	<b>1,021.7</b>	<b>445.9</b>	<b>503.2</b>	<b>71.5</b>	<b>2,051.1</b>
At 31 March 2004	7.9	976.3	452.3	469.9	76.0	1,982.4

Out of the total depreciation charge for the Company of £70.0m (2004 £67.0m), the sum of £1.4m (2004 £1.6m) has been charged to capital projects, and £68.6m (2004 £65.4m) against profits.

The cost of freehold land and buildings and operational properties includes non-depreciable land of £2.2m (2004 £1.9m) and £9.3m (2004 £9.3m) respectively.

The net book value of infrastructure assets is stated after deducting £49.8m (2004 £47.0m) grants and contributions.

## NOTES TO THE FINANCIAL STATEMENTS

### 11 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 2004	13.8
Expenditure in the year on maintaining operating capability	14.9
Less depreciation for the year	(14.9)
	<hr/>
Excess of expenditure over depreciation at 31 March 2005	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 2005	155.8	315.0	217.2	59.0	747.0
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Depreciation:- Charge for year	2.0	5.5	11.5	-	19.0
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Depreciation:- At 31 March 2005	10.7	49.0	102.0	-	161.7
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

### 12 Fixed Asset Investments

	Joint Venture	Subsidiary Undertakings	Listed Investments	Total Investments 2005
	£m	£m	£m	£m
At 1 April 2004	0.1	3.3	1.1	4.5
Additions during year	-	-	1.0	1.0
Provision for impairment	-	-	(0.9)	(0.9)
	<hr/>	<hr/>	<hr/>	<hr/>
At 31 March 2005	0.1	3.3	1.2	4.6
	<hr/>	<hr/>	<hr/>	<hr/>

The listed investments relate to a Restricted Share 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

### 12 Fixed Asset Investments (Continued)

During the year the trustees of the Employee Share Ownership Plan purchased 114,499 of Pennon Group Plc's ordinary shares (2004 82,312) through a non-interest bearing advance made by the Company. The market value of the shares held at 31 March 2005 was £2.4m (2004 £1.6m). The costs of the Restricted Share 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.

### 13 Stocks

	2005 £m	2004 £m
Raw materials and consumables	3.6	3.6

### 14 Debtors

	2005 £m	2004 £m
Amounts falling due after more than one year:-		
Amounts owed by fellow subsidiary undertakings	0.8	0.7
Amounts owed by joint venture	0.2	-
Prepayments for pension costs (note 24)	-	3.7
	<u>1.0</u>	<u>4.4</u>
Amounts falling due within one year:-		
Trade debtors	22.6	30.3
Amounts owed by parent undertaking	-	62.4
Amounts owed by fellow subsidiary undertakings	0.9	3.6
Amounts owed by joint venture	1.2	1.3
Other debtors	3.8	4.3
Prepayments for pension costs (note 24)	-	0.7
Other prepayments and accrued income	18.3	17.3
	<u>46.8</u>	<u>119.9</u>

## NOTES TO THE FINANCIAL STATEMENTS

### 15 Current Asset Investments

	2005 £m	2004 £m
Other investments:-		
Overnight deposits	20.4	13.3
Other	217.2	236.0
	<u>237.6</u>	<u>249.3</u>

Other investments include deposits of £177.1m (2004 £173.6m) made to counter-indemnify letters of credit by financial institutions to lessors in order to secure rental obligations (note 23).

### 16 Creditors: Amounts Falling Due Within One Year

	2005 £m	2004 £m
Loans:- (note 23)		
European Investment Bank loans	14.7	14.5
Bank loans and overdrafts	7.8	61.8
	<u>22.5</u>	<u>76.3</u>
Obligations under finance leases (note 23)	25.2	18.4
Trade creditors	11.8	10.6
Capital creditors	29.8	27.0
Other amounts owed to parent undertaking	2.4	2.4
Other amounts owed to joint venture	0.2	0.2
Amounts owed to fellow subsidiary undertakings	0.8	1.1
Other creditors	7.7	11.2
Corporation Tax	2.1	6.3
Other taxation and social security	1.0	1.0
Accruals and deferred income	18.6	15.6
	<u>122.1</u>	<u>170.1</u>

### 17 Creditors: Amounts Falling Due After More Than One Year

	2005 £m	2004 £m
Loans:- (note 23)		
European Investment Bank loans	166.4	181.1
Other loans	120.0	105.0
Amounts owed to parent undertaking	150.0	150.0
	<u>436.4</u>	<u>436.1</u>
Obligations under finance leases (note 23)	784.4	737.0
	<u>1,220.8</u>	<u>1,173.1</u>

## NOTES TO THE FINANCIAL STATEMENTS

### 18 Provisions for Liabilities and Charges

	Restruc- turing £m	Deferred Tax £m	Other £m	Total £m
At 1 April 2004	1.6	71.1	1.0	73.7
Charged against profits	3.2	10.0	(0.5)	12.7
Utilised during year	(2.1)	-	(0.5)	(2.6)
At 31 March 2005	<u>2.7</u>	<u>81.1</u>	<u>-</u>	<u>83.8</u>

The restructuring provision relates to severance costs to be utilised over the next eighteen months.

#### Deferred Taxation

	2005 £m	2004 £m
Accelerated capital allowances	297.5	278.7
Other timing differences	(3.0)	(1.6)
Undiscounted provision for deferred tax	<u>294.5</u>	<u>277.1</u>
Discount	(213.4)	(206.0)
Discounted provision for deferred tax	<u>81.1</u>	<u>71.1</u>
Provision at 1 April 2004	71.1	
Deferred tax charge in profit and loss account for year	<u>10.0</u>	
Provision at 31 March 2005	<u>81.1</u>	

## NOTES TO THE FINANCIAL STATEMENTS

### 19 Deferred Income

	Forward interest rate swap £m	Grants and contributions £m	Total £m
At 1 April 2004:			
Amount to be released :			
after more than one year	18.2	20.5	38.7
within one year	-	1.3	1.3
	<hr/>	<hr/>	<hr/>
	18.2	21.8	40.0
Additions / (repayments)	(3.4)	0.1	(3.3)
Released to profits	-	(1.3)	(1.3)
	<hr/>	<hr/>	<hr/>
At 31 March 2005:	14.8	20.6	35.4
Amount to be released:			
within one year	-	(1.3)	(1.3)
	<hr/>	<hr/>	<hr/>
after more than one year	14.8	19.3	34.1
	<hr/>	<hr/>	<hr/>

### 20 Called-up Share Capital

	2005 £m	2004 £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/>

### 21 Reserves

	Profit and loss account £m
At 1 April 2004	458.9
Retained deficit for year	(24.8)
	<hr/>
At 31 March 2005	434.1
	<hr/>

The cumulative value of goodwill at 31 March 2005 resulting from acquisitions, which has been written off against reserves, is £1.4m (2004 £1.4m).

The Company has taken advantage of the exemption provided in Urgent Issues Task Force Abstract 17 (revised 2003) 'Employee Share Schemes' 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

### 22 Statement of Movements in Shareholders' Funds

	2005 £m	2004 £m
Profit on ordinary activities after taxation	54.7	62.8
Dividends	(79.5)	(75.6)
Shareholders' Funds (equity interest) :-		
Deficit for year	(24.8)	(12.8)
At 1 April	909.8	922.6
At 31 March	885.0	909.8

### 23 Loans and Other Borrowings

	2005 £m	2004 £m
<b>Loans</b>		
Repayable:-		
Over five years	267.7	281.8
Over two and up to five years	124.5	139.6
Over one and up to two years	44.2	14.7
Falling due after more than one year (note 17)	436.4	436.1
Falling due within one year (note 16)	22.5	76.3
	458.9	512.4
	2005 £m	2004 £m
<b>Obligations under finance leases</b>		
Repayable:-		
Over five years	708.7	663.3
Over two and up to five years	51.6	51.7
Over one and up to two years	24.1	22.0
Falling due after more than one year (note 17)	784.4	737.0
Falling due within one year (note 16)	25.2	18.4
	809.6	755.4

Included above are accrued finance charges arising on obligations under finance leases totalling £104.6m (2004 £96.0m), of which £22.6 m (2004 £15.6m) is repayable within one year.

## NOTES TO THE FINANCIAL STATEMENTS

### 23 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:-

	<b>2005</b>	2004
	<b>£m</b>	£m
Loans	<b>310.0</b>	310.0
Obligations under finance leases	<b>808.9</b>	754.2
	<b><u>1,118.9</u></b>	<u>1,064.2</u>

Loans and finance leases are denominated in sterling and are repayable over the period 2005 - 2035. The rates of interest payable on loans, any part of which is due after five years, vary from 3.7% to 10.6%.

Within obligations under finance leases the company has :

a utilised finance lease facilities of £180.0m at 31 March 2005 (2004 £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 2005 (2004 £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 2005 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 £565.0m.

At 31 March 2004 floating rate interest swaps, to hedge financial liabilities with a notional principal of £200.0m, existed to swap LIBOR to European Inter Bank Offer Rate (EURIBOR) with commencement dates between 1 April 2006 and 1 April 2010, and maturing on 31 March 2030. A settlement of £18.2m which was received when these swaps were entered into during December 1999 was deferred (note 19). In May 2004 these interest rate swaps were terminated through the payment of £3.4m. The net balance of monies received remains deferred and will be matched with interest charges on the underlying hedged debt over the period of the original 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

### 24 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 2005 was £11.9m (2004 £4.2m), including £2.0m for early retirement costs included in the exceptional restructuring charge (note 4). Full details of the valuations and actuarial assumptions are given in the financial statements of Pennon Group Plc.

Pension accruals included as creditors of the Company (note 16) amount to £2.0m (2004 prepayment of £4.4m – note 14), representing the accumulated difference between the Company pension charge and employer contributions paid. In addition, £1.6m of the restructuring provision (note 18) relates to amounts that will become payable to the pension scheme in respect of funding early retirements.

### 25 Commitments and Contingent Liabilities

	2005 £m	2004 £m
<b>Capital commitments</b>		
Contracted but not provided	44.2	53.8
<b>Commitments under operating leases</b>		
Rentals during the year following the balance sheet date		
Land and buildings leases expiring:-		
within one year	0.1	0.1
after five years	1.2	2.2
	1.3	2.3
<b>Contingent Liabilities</b>		
Contractors' claims on capital schemes	-	0.3
Guarantee of borrowings of the parent undertaking	150.0	150.0
	150.0	150.3

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

### 26 Notes to the Cash Flow Statement

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

	2005	2004
	£m	£m
Operating profit	118.2	119.1
Depreciation charge	68.6	65.4
Provision for impairment of fixed asset investments	0.9	0.6
Deferred income released to profits	(1.3)	(1.2)
Increase / (decrease) in provisions for liabilities and charges	0.6	(0.8)
Increase in stocks	-	(0.5)
Decrease / (increase) in debtors (amounts falling due within and over one year)	11.4	(4.0)
Increase in creditors (amounts falling due within and over one year)	1.0	0.3
Profit on disposal of tangible fixed assets	(1.2)	(1.5)
	<hr/>	<hr/>
Net cash inflow from operating activities	198.2	177.4
	<hr/>	<hr/>

Included within the net cash inflow from operating activities is a cash outflow of £1.0m relating to the exceptional restructuring costs (note 4)

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

	2005	2004
	£m	£m
(i) Returns on Investments and Servicing of Finance		
Interest received	13.9	11.3
Interest paid	(35.3)	(29.1)
Interest element of finance lease rentals	(25.1)	(18.3)
	<hr/>	<hr/>
Net cash outflow for returns on investments and servicing of finance	(46.5)	(36.1)
	<hr/>	<hr/>
(ii) Capital Expenditure and Financial Investment		
Purchase of tangible fixed assets	(138.3)	(149.6)
Grants and contributions: Infrastructure assets	2.8	1.4
: Non-infrastructure assets	0.1	1.0
Receipts from disposal of tangible fixed assets	1.6	2.0
Purchase of fixed asset investments	(1.0)	(0.8)
	<hr/>	<hr/>
Net cash outflow for capital expenditure and financial investment	(134.8)	(146.0)
	<hr/>	<hr/>

## NOTES TO THE FINANCIAL STATEMENTS

### 26 Notes to the Cash Flow Statement (Continued)

	2005 £m	2004 £m
(iii) Management of Liquid Resources		
Purchase of current asset investments	(304.6)	(338.2)
Sale of current asset investments	323.6	274.7
Net cash inflow / (outflow) from management of liquid resources	<u>19.0</u>	<u>(63.5)</u>
(iv) Financing	2005 £m	2004 £m
(Decrease) / Increase in debt due within one year (other than bank overdrafts)	(69.4)	11.3
Increase in debt due after more than one year	15.0	115.0
Finance lease drawdowns	48.5	32.6
Capital element of finance lease rental payments	(2.9)	(3.4)
Loans to parent undertaking	61.6	1.1
Net cash inflow from financing	<u>52.8</u>	<u>156.6</u>

### (c) Analysis of Net Debt

	At 1 April 2004 £m	Cash flow £m	Non-cash movements £m	At 31 March 2005 £m
Cash at bank and in hand	1.3	(0.2)	-	1.1
Current asset investments:-				
Overnight deposits	13.3	7.1	-	20.4
Bank overdrafts	(6.9)	(0.9)	-	(7.8)
	<u>7.7</u>	<u>6.0</u>	<u>-</u>	<u>13.7</u>
Debt due within one year (other than bank overdrafts)	(69.4)	69.4	(14.7)	(14.7)
Debt due after more than one year	(286.1)	(15.0)	14.7	(286.4)
Finance lease obligations	(755.4)	(45.6)	(8.6)	(809.6)
Amounts owed to parent undertaking	(88.4)	(61.6)	-	(150.0)
	<u>(1,199.3)</u>	<u>(52.8)</u>	<u>(8.6)</u>	<u>(1,260.7)</u>
Current asset investments:- other than overnight deposits	236.0	(19.0)	0.2	217.2
	<u>(955.6)</u>	<u>(65.8)</u>	<u>(8.4)</u>	<u>(1,029.8)</u>

## NOTES TO THE FINANCIAL STATEMENTS

### 26 Notes to the Cash Flow Statement (Continued)

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

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

	2005	2004
	£m	£m
<b>Increase in cash in year</b>	<b>6.0</b>	<b>14.8</b>
Cash inflow from increase in debt and finance leasing	(52.8)	(156.6)
Cash (inflow) / outflow from (decrease) / increase in liquid resources	<u>(19.0)</u>	<u>63.5</u>
<b>Increase in net debt arising from cash flows</b>	<b>(65.8)</b>	<b>(78.3)</b>
Non-cash movements:-		
Increase in accrued finance charges on finance lease obligations	(8.6)	(8.0)
Other	<u>0.2</u>	<u>-</u>
<b>Increase in net debt in the year</b>	<b>(74.2)</b>	<b>(86.3)</b>
<b>Net debt at 1 April</b>	<b>(955.6)</b>	<b>(869.3)</b>
<b>Net debt at 31 March</b>	<b><u>(1,029.8)</u></b>	<b><u>(955.6)</u></b>

### 27 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 £8.0m (2004 £7.8m) and sold services to Echo South West Limited of £2.5m (2004 £2.5m). The Company was owed £1.4m by Echo South West Limited at 31 March 2005 (2004 £1.3m), as shown in note 14 and owed £0.2m (2004 £0.2m), as shown in note 16.

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

### 28 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.