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SOUTH WEST WATER PLC

Annual Report & Accounts
1996

South West Water Plc operates and invests primarily in the fields of water and waste engineering, waste management and environmental instrumentation.

The principal subsidiary, South West Water Services Limited, holds the water and sewerage appointments for the South West region.

The non-regulated businesses include one of the top five waste disposal companies in the UK, a specialist environmental instrumentation company with leading positions in its key segments worldwide, and a leading regional construction services company.

The Group has assets of £1.6 billion and currently employs over 3,000 people.

Contents

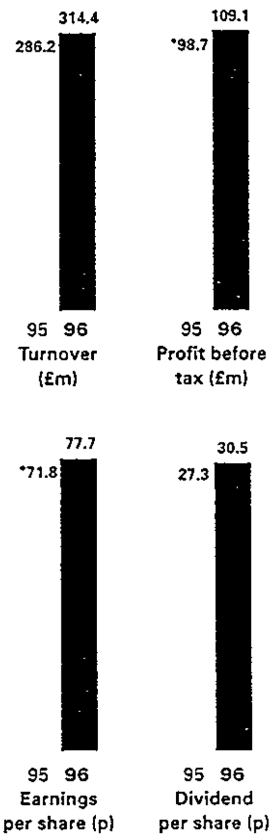
Highlights of the year

Strong profitable improvements in regulated and non-regulated businesses

- profit before tax up 10.5% to £109.1 million

Significant benefits for shareholders and customers

- earnings up 8.2% to 77.7 pence per share
- dividend up 11.7% to 30.5 pence
- customer rebate of £10 per customer payable in July 1996



Financial summary

Year ended 31 March	1996 £m	1995 £m	% change
Turnover	314.4	286.2	9.9
Operating profit	134.1	121.7*	10.2
Profit before taxation	109.1	98.7*	10.5
Net assets	840.1	844.3	(0.5)
Capital expenditure	110.3	159.4	(30.8)
Earnings per share	77.7p	71.8p*	8.2
Dividend per share			
interim	9.8p	9.1p	7.7
final	20.7p	18.2p	13.7
total	30.5p	27.3p	11.7

* Before exceptional restructuring charge of £35.5 million

Chairman's statement

Keith W Court

This year I am delighted to be able to report excellent financial results and significant strategic progress. This marked advance stems from the successful restructuring of the water and sewerage utility and the growth of the non-regulated businesses.

Progress in water services

Last year I emphasised the fundamental role of the huge capital investment programme in modernising the water and sewerage infrastructure of the South West region. I also outlined the strategic re-assessment of the structure and business processes in South West Water Services Limited and its outcome: the initiation in 1995 of changes to achieve a lower cost, leaner utility that could adjust its focus from capital works engineering to delivering the benefits of that investment to customers and to shareholders.

What brought about the need for this change? Immediately after privatisation the public policy imperative was to make quantum changes in drinking water quality and waste water pollution control on an unprecedented scale and, in our case, at an accelerating pace. The inevitable consequence of prices rising rapidly to pay for this modernisation and to pay the cost of the necessary borrowings not surprisingly caused tensions with customers and the public generally.

The need to try to reconcile the meeting of the long term quality goals and the cost impact on the present generation of customers was put to the test through the Periodic Review process conducted by the Director General of Water Services in 1994 and the referral process at the Monopolies and Mergers Commission (MMC) in 1995.

'Squaring the circle' between the need for continued, accelerated modernisation and the pressure for strong price constraints has been a formidable problem. We concluded that the major part, if not all, of the solution would lie with us. Hence we laid the plans to transform the water services utility.

Our aims were clear: to become more responsive to changing customer, regulatory and shareholder expectations and aspire to excellence in service and efficiency.

During the year these explicit intentions started to be realised; the seeds of change resulted in breakthroughs. Firstly the renewed pursuit of efficiency led, last summer, to a reduction from three to two operating divisions, from five to three management tiers, and a lowering of employment costs unavoidably involving the loss of 500 people.

This put us in a good position to deal with the MMC conclusion that the restraint on price increases should be contributed to by moving South West Water Services Limited to the forefront of efficiency. The efficiency actions generated cost savings of £6.7 million in 1995/96 and the targets set by the MMC for the year were exceeded.

Secondly, we instigated moves to improve customer relations. These have been set out in detail in the operating reviews that follow and make clear that we have taken a progressive position, the clearest signal of which is the paying of the special rebate of £10 per customer, shared out from the benefits of the markedly improved performance in 1995/96.

The benefits of the capital investment are manifold. In the very trying circumstances of last summer's drought, with the hottest and driest weather for 200 years, the £400 million spent since 1989 in improving reservoirs, enlarging water treatment works capacity and improving the water distribution system proved vital. There were no restrictions on supply or usage for nearly half of the region's residents and the many holiday visitors; elsewhere the restrictions were for non-essential use only. This was indeed a great improvement on previous drought years. Further investment has taken place over the last autumn and winter to reinforce water supplies this summer to meet the higher levels of customers' demand.

It can now be seen that the £1,100 million which has been expended since privatisation on capital and renewal work has successfully regenerated the neglected and decaying infrastructure which South West Water inherited. It provides a much sounder base for economic development in our region, as well as contributing to the quality of life and the protection of the environment. This has been made possible through the re-investment of profits and significant borrowings.

In a short period it has literally been a 'clean sweep'; permanent gains for the region and its people have been made.

Progress in non-regulated businesses

The careful development of the non-regulated businesses within a focused strategy is paying off, with improved margins and the early benefits of expansion.

Our decision in earlier years to widen and develop the sources of earnings for the Group in related businesses has been successful and in this last financial year the performance has leapt forward, with operating profit more than doubling and profit before tax increasing by over 75%. External turnover contributed almost a quarter of the Group's total turnover.

Keith Court at the announcement of our unique fire safety partnership with the Devon Fire and Rescue Service.

This step change arose both from the acquisition and successful integration of the UK landfill and landfill gas activities of Blue Circle Industries Plc and of Great Lakes Instruments Inc., and also through efficiencies and development of the existing businesses. All three key businesses – waste management, environmental instrumentation and specialist construction services – maintained competitive positions and showed profitable growth to provide a good basis for further progress.

Group results

The strong outcome reflects the intensive and continuing efforts of our staff, managers and directors in both the regulated and non-regulated businesses to renew and improve the performance of the Group and propel it to a higher potential.

All the financial numbers show substantial uplift. Turnover and operating profit went up by 10%. Profit before tax rose by 10.5% to £109.1 million and earnings per share by

Chairman's statement

continued

8.2% to 77.7p. The Directors are recommending a final dividend of 20.7p per share which, with the interim dividend, will provide a full year dividend of 30.5p – an increase of 11.7% over last year.

Board structure

In the light of the potential bids, I agreed to the Board's request not to retire at the end of April 1996 as previously announced, and to stay on as Chairman and Chief Executive. I was very pleased that the Board proceeded to appoint Mr Alan Fletcher as the non-executive Deputy Chairman with effect from 14 March and announced the intention that he will succeed as non-executive Chairman at an appropriate time in the future, when the Board would also appoint a group chief executive.

In January we announced that Mr Bill Fraser, Managing Director of South West Water Services Limited, had resigned from the Board, effective the end of February 1996, and the Board paid tribute to his contribution to the progress and achievements of the water and sewerage business.

The Group's two major operating and trading segments are each led by a managing director, who is also an executive member of the main Board. Mr Colin Drummond is the Managing Director of the non-regulated group of enterprise companies. I was especially pleased to be able to announce the appointment of Mr Bob Baty as the new Managing Director of the regulated business – South West Water Services Limited – with effect from 1 March this year. Bob, with over 36 years of experience in the water industry, was the utility company's Engineering Director until his new appointment and successfully managed the capital programme. We are well served by these two younger members of the Board.

Bid approaches

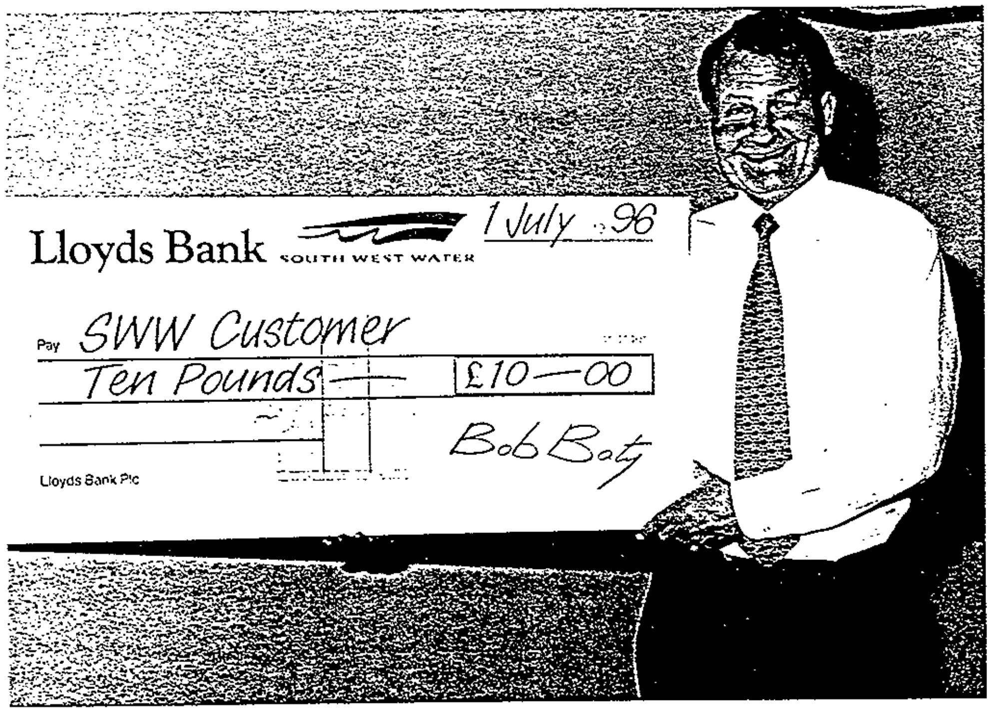
All shareholders have been advised of the take-over intentions announced by Wessex and Severn Trent in March this year which are now the subject of investigation by the Monopolies and Mergers Commission and with which body we are co-operating fully. The approaches made by Wessex and Severn Trent were not sought, and are not welcome. The momentum that we have established as an independent Group is clear evidence that we will not be diverted from our goals of improving performance and delivering value for the benefit of customers, shareholders and the South West region.

Employees

The strength and resilience of the Group comes from the capable professionalism and dedication of our staff, managers and directors who are very determined to see the enterprise prosper. Having set the challenge to the leaders and their teams in 1994 and 1995, I record my special appreciation of their exceptional efforts.

Keith Court

Keith W Court
Chairman



Bob Baty, Managing Director of South West Water Services Limited, announcing the £10 rebate for customers.

We are sharing the benefits of our improved financial and operational performance with water and sewerage customers by paying a special rebate for 1995/96 of £10 per customer.

Operating review

WATER AND SEWERAGE SERVICES

Successful efficiency drive delivers improved operational performance and enables enhancements to customer services.

Reshaping the business

In the six years following privatisation, great progress has been made in bringing about major improvements to the neglected treatment works, pipelines and sewers of the region.

The substantial reshaping of South West Water Services Limited from a capital works dominated company to one with a 'customer first' orientation, culminated last summer in the strengthening of our customer services structure, the dispersal of the headquarters operations control staff, and the reduction from three to two delayered and decentralised operating divisions each now led by a director. This change has already brought about the achievement of higher levels of customer related performance.

Most notably, we are sharing the benefits of our improved financial and operational performance with customers by paying a special rebate for 1995/96 of £10 per customer in July this year, the cost of which amounts to £6.9 million.

Financial progress

Improved profitability is essential to funding the continuing capital programme and delivering enhanced customer services.

Turnover of £239 million (net of the rebate treated as an exceptional item) increased by 1% on 1994/95. Operating profit increased by 6% to £125 million after meeting £5.9 million of additional costs necessary to deal with the unprecedented water demand during the exceptionally hot, dry summer, and making payments to customers who were advised to boil their water as a precaution following an outbreak of cryptosporidiosis in South Devon. Without these one-off costs, operating profit would have increased by 11%.

Manpower reductions approaching 500 have been achieved since the reshaping programme commenced in 1994/95. Manpower savings of £5.5 million were achieved in 1995/96. In addition, there were further procurement and power cost savings of £1.2 million.

Water and Sewerage Services

Year ended 31 March	1996 £m	1995 £m
Turnover	239.3	236.7
Operating profit	124.8	117.7*
Profit before tax	104.0	95.8*
Capital expenditure	100.0	152.9

*Before exceptional restructuring charge of £35.5 million.

Continuing capital investment

In a short period in which we invested over £1 billion in the business – almost £1,500 for every customer – we have, in the light of the Periodic Review process, moderated our capital expenditure programme from its peak in 1994.

Capital expenditure for water and sewerage services was reduced from £153 million in 1994/95, to £100 million in 1995/96.

During 1995/96, 64 major schemes were completed with a further 168 ongoing. £40 million was invested in water resources, treatment and distribution and £58 million in waste water treatment and disposal, of which £25 million related to coastal sewage treatment schemes.

Customer initiatives

As part of our drive to become a leading customer orientated service provider, we are placing the highest priority on developing and extending a number of customer initiatives. Last Autumn we published 'Towards 2000 – Customers First' which sets out in detail the investment plans following determinations made by the regulators. The company worked closely with Ofwat's Customer Services Committee in producing the publication.

In parallel, improvements to customer services were started.

To gain a better insight into our customers' views, we established two new Customer Relations Committees, one each for Devon and Cornwall. These committees are in addition to the Ofwat Customer Services Committee. The prime purpose of the committees is to provide a two-way communications channel between the company and representatives of our domestic and commercial customers. Membership includes representatives from the National Farmers Union, Citizens Advice Bureaux, Help the Aged and local councils.

To help domestic customers with genuine financial difficulties to pay their bills, we established a Special Assistance Fund. This was followed by a new approach to help such customers through a debt management counselling service. With these changes in place, we suspended disconnection of domestic water supplies for non-payment of water charges to remove an aspect which was of public and political concern. In addition we provided a range of flexible payment methods, including the introduction of 'Watercard', which allows customers to pay bills in a flexible manner at post offices, without incurring Girobank fees. A guaranteed standards scheme – above that required by Ofwat – was also introduced for services we provide, with enhanced compensation for customers if we do not meet those standards.

During the year, our domestic meter option scheme was improved. The installation charge was reduced to within a band of £17 to £67 for customers who choose to pay for water services on a measured basis; the meter is freely provided but remains a company asset.

The Ofwat annual report on our levels of customer service for the year 1994/95 identified six key areas out of seven where we have either maintained or provided improvements in levels of service to our customers. These achievements are directly attributable to the successful delivery of our capital programme, our investment in process technology and employee training.

Customers' drinking water

Drinking water quality in 1995 was maintained at a very high level of 99.6% compliance.

Because of the hottest, driest weather for 200 years, during which we supplied record amounts of water – over 50% more than

Operating review

continued

during the 1976 drought – it was necessary to apply limited water restrictions on non-essential use in some parts of the region. Nearly half of the region's customers, however, were not subject to any restrictions, and essential supplies were maintained throughout. This achievement was made possible by careful management of resources, specific measures taken during the summer, and infrastructure which has benefited from investment of over £400 million since privatisation on enhancement of our water storage, treatment and distribution capacity.

In December 1995 we announced a £20 million package of drought relief measures, which included the rephasing of schemes, to improve the amount of water available for customers' essential needs in the future. The package included new pumped storage schemes for two of our major reservoirs, Roadford in West Devon and Wimbleball on Exmoor, together with other schemes to enhance supplies in East Devon, Mid and West Cornwall. Many of these schemes have already been completed, and are helping to increase the amount of water available for customers. We worked closely with the Environment Agency in evolving these measures.

Supplies to 270,000 of our customers in Devon and Cornwall were further enhanced by the completion of improvements to water treatment works near Liskeard in Cornwall, and at works in Okehampton, Barnstaple, Buckfastleigh and Lynton in Devon. The supply network has also been strengthened by the duplication of the strategic spine main further into West Cornwall.

Progress in leakage reduction

During the past three years, we have developed one of the most comprehensive leakage monitoring and control programmes in Europe, supported by advanced computer technology. Leakage from the company's water mains has already been reduced from 26% to 22%, constituting a saving of almost five million gallons every day.

Progress towards reducing leakage continued with the announcement of a £99 million programme of work to renovate ageing pipelines, and to reduce leakage from 22% to 15% by the end of 1999.

The planned investment will enable the company to save the equivalent of enough water to supply all the domestic needs of Plymouth in Devon every day.

Progress in inland waste water treatment

At privatisation, after many years of under investment, almost 60% of our waste water treatment works were failing discharge consent standards, resulting in pollution of waterways and restrictions on local developments. By March 1996, 97% of our works met the stringent consent standards and over 300 planning embargoes have been lifted to allow much needed domestic and commercial building development to commence in both urban and rural communities throughout our region.

During the year we maintained the excellent progress already made in updating and improving our waste water treatment works, and many major schemes were completed at a total cost of £15 million.

"Clean Sweep is an immense step forward; it has helped to create jobs and is helping to generate hope." *David Bellamy, at the opening of 'Clean Sweep' for Teignmouth and Shaldon.*

Perranporth in Cornwall, one of 51 bathing waters benefiting from the successful delivery of our 'Clean Sweep' programme.

Drinking water quality last year was maintained at a very high level of 99.6% overall compliance.

Operating review

continued

Our aim is to achieve full compliance with the consent standards set by the Environment Agency within the next four years.

'Clean Sweep' – protecting bathing waters

The largest area of investment within our ten year £1.6 billion capital investment programme continued to be our 'Clean Sweep' coastal sewage treatment improvement initiative. During the year schemes were completed at Penzance/St Ives, Combe Martin, and Lyme Regis at a cost of £125 million.

By the end of the financial year, 30 of the original 33 schemes in our 'Clean Sweep' programme were completed or under construction including work at Dartmouth, Falmouth and Mevagissey, three of the four schemes deferred as part of the Periodic Review, by the Director General of Water Services. Work on improvements at the fourth location, Torbay, continues with major construction work being undertaken during 1996. Construction of the major improvement scheme for Plymouth is also underway.

Fifty-one bathing waters are now benefiting from the first class delivery of 'Clean Sweep'. In 1995, 94% of the 134 designated bathing waters complied with the European standards – this has helped the South West region to achieve the highest quality results ever recorded.

Phase one of the £100 million Penzance/St Ives scheme in Cornwall was completed on time providing clean bathing waters to Mounts Bay for the 1995 bathing season. This 'Clean Sweep' scheme was awarded the 'Top Civil Engineering Award' for 1995 by the British Construction Industry.

The second phase of the scheme – the St Ives transfer – was completed by the end of 1995, and is now in operation.

The 'Clean Sweep' scheme for Lyme Regis, completed in 1995, attracted a 'Special Commendation for Environmental Excellence' – a new award introduced by the Secretary of State for the Environment.

Research and development

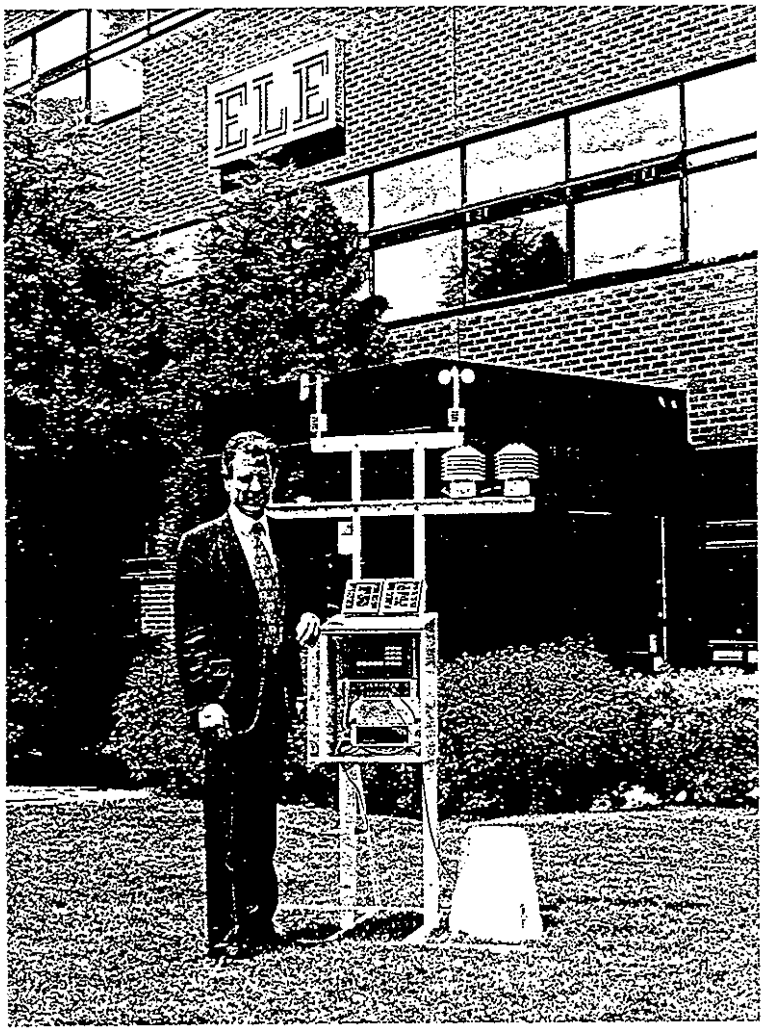
The company is determined to find practical ways of introducing new technology, particularly in water and waste processing, and investment in research and development continued.

The evaluation of our sludge treatment thermal drying plant at Ashford, North Devon is continuing, and the work is producing a high quality pelletised product which the agricultural community is using with great success.

Extensive trials of ultraviolet disinfection of final effluent at waste water treatment works have been conducted over the past five years. This technology is now being applied at five of our marine treatment schemes.

Following the outbreak of cryptosporidiosis in the community, development and evaluation of a fibre microfilter system was successfully carried out. This system has now been installed at Littlehempston Water Treatment Works in Devon.

R J Baty
Managing Director,
South West Water Services Limited



Colin Drummond, Managing Director of our Enterprise Division, alongside an ELE environmental monitoring station.

Through its subsidiaries, South West Water Plc is one of the top five waste disposal companies in the UK, a specialist environmental instrumentation company with leading positions in its key segments worldwide, and a leading regional specialist construction services company.

Operating review

NON-REGULATED BUSINESSES

We have achieved profitable growth in the three key business areas of waste management, environmental instrumentation and regional construction services.

A clear strategic focus

Our strategy for the non-regulated businesses targets growth markets which fit our overall Group skills, and offer the potential for competitive advantage and sustained profitability.

In particular we have concentrated on waste disposal, environmental instrumentation, and regional construction services.

Major progress was made in 1995/96 in each of these areas. Through our subsidiary companies, we are now one of the top five waste disposal companies in the UK, a specialist environmental instrumentation company with leading positions in its key segments worldwide, and a leading regional construction services company. We have also recently established, through an associate company, a position in the Italian water contracting and concessions market.

Major financial progress

Non-regulated turnover grew by 28% to £111.6 million, including acquisitions, during the year and operating profit by 114% to £10.5 million (133% and £9.3 million after consolidating out intra-group business). Profit before tax after all acquisition funding costs grew from £2.9 million to £5.1 million. The non-regulated businesses are now a significant contributor to Group financial performance and a basis for solid progress in coming years.

Non-regulated businesses

Year ended 31 March	1996 £m	1995 £m
Turnover		
- gross	111.6	87.3
- external	76.6	51.1
Operating profit		
- before consolidation adjustments	10.5	4.9
- after consolidation adjustments	9.3	4.0
Profit before tax	5.1	2.9

Waste management

In July 1995 we completed the acquisition of the landfill and landfill gas activities of Blue Circle Industries Plc, changing their name to Haul Waste Disposal Limited. These assets have been combined with our existing activities in Haul Waste Limited, giving a much broader base with strategic operational landfill sites throughout the South of England. The two businesses have been integrated and trade under the single name of Haul Waste.

Haul Waste has succeeded in obtaining an enhanced planning permission for its planned landfill site at Dunbar, Scotland and planning permissions for a new landfill at Warmwell in Dorset and an extension to its site at Ardley in Oxfordshire. Planning permissions were also achieved for new landfill gas power generation schemes (under NFFO contracts) at Ardley and Horton, West Sussex.

To exploit the increased commercial opportunities in recycling arising from the landfill tax to be introduced in October 1996, Haul Waste has also gained planning permission for a materials reclamation facility to be built and operated, in partnership with the relevant local authorities, at its Masons landfill site in Suffolk.

Haul Waste, including eight months' contribution from acquisitions, showed an operating profit of £5.3 million compared to the previous year's figure of £0.9 million.

Environmental instrumentation

In the ELE Group we have established one of the leading environmental instrumentation companies in the world in its specialist segments. The ELE Group's materials testing and environmental instrumentation businesses, based in Hertfordshire and Chicago, traded profitably in over 100 countries worldwide.

In August 1995 ELE Group's water quality instrumentation business was enhanced by the acquisition of Great Lakes Instruments Inc. of Milwaukee, an important player in the American market. This has been successfully integrated into the ELE Group with the strategy of capitalising on ELE's international distribution capability. In September 1995 we acquired Warren Jones Limited in Oxfordshire, a supplier of waste water flow and sampling equipment; this and our existing water quality instrumentation business, pHOX, have all been integrated under the overall GLI brand worldwide.

Whilst the ELE Group's performance in the first half year suffered from adverse trading conditions in Europe, the situation was fully recovered in the second half of the year and the ELE Group has started the new year with a strong order book. Operating profit for the ELE Group grew to £1.7 million in 1995/96 compared to £1.4 million in the previous year.

Specialist construction services

T J Brent Limited had another successful year. Last year's integration of our subsidiary company, Copa, into T J Brent has worked well. In February 1996 T J Brent extended its activities by the acquisition of Engineered Products Limited, a specialist mechanical and electrical contractor with whom it and Copa had been co-operating for a number of years. T J Brent has been successful in its strategy of increasing turnover outside the Group and external turnover now exceeds 30% of its total turnover.

Total operating profit rose from £0.1 million to £1.4 million.

Associated undertakings

Our minority investment in Westcountry Television Limited performed ahead of plan and made a useful contribution to pre-tax profit.

In October 1995, we purchased a 50% share in Elcar, an established Italian specialist water engineering company, subsequently renamed SIBA. SIBA made a small positive contribution to Group results and is entering the market for operating concessions expected to develop in Italy.

Operating review

continued

Part of Haul Waste's landfill disposal site at Heathfield in Devon, reinstated to provide an enhanced environment.

Other activities

The Group is also involved in pursuing best use and value from land and property holdings. This includes the provision of recreational facilities such as fishing, water sports and refreshments at our lakes and waterparks in Devon and Cornwall.

Research and development

Our non-regulated businesses continue to invest in research, development and innovation programmes geared towards product, service and environmental improvement at lower cost.

During the year, the ELE Group invested in a number of new product developments, including an organic pollution alarm, a colorimeter and a complete range of analysers for water quality monitoring. Their environmental monitoring system was upgraded to include a wider range of sensors and advanced communication facilities.

Haul Waste is a leading company in the field of design, construction and operation of containment landfill sites and is at the forefront of developments in advanced leachate control. Current research is taking place at our landfill site in Horton, West Sussex. Copa, a division of T J Brent, further developed their BAF sewage treatment plant for populations up to 3,000 and have supplied units throughout the UK and to the Yemen and Singapore.

C I J H Drummond
Managing Director, Enterprise Division

Financial review

The Group moved ahead with strong profitable improvements, delivering significant benefits for shareholders and customers.

Operating profit

Group turnover for the year increased by 10% to £314 million. External turnover of the water and sewerage services business was £238 million, up by 1% mainly influenced by tariff increases offset by the customer rebate.

External turnover of non-regulated businesses was £25 million higher at £76 million, including £21 million from 1995/96 acquisitions.

Operating costs for the year of £181 million increased by 10% (on 1995 before the exceptional item) influenced largely by acquisitions and non-regulated business growth. Within the water and sewerage services business, a reduction in underlying operating costs was achieved (before exceptional items and depreciation and infrastructure renewals charges). Efficiency savings of £6.7 million were achieved in the regulated business, mainly as a result of the restructuring commenced last year. Safeguarding water supplies, following the exceptional 1995 summer and the cryptosporidiosis incident, involved £5.9 million of additional operating costs.

The Group's two major pension schemes have substantial surpluses and an employer pension contribution holiday, likely to last for the forseeable future, commenced in 1995/96. Items treated as exceptional operating costs in 1995/96 comprised a £7.5 million release from the water and sewerage services business restructuring provision established in 1995, and £0.7 million for costs associated with the proposed takeover bids.

Operating profit (before exceptional item of £35.5 million in 1995) increased by 10% to £134 million. The water and sewerage services business contributed an operating profit of £125 million, up 6% on 1995. Non-regulated businesses contributed an operating profit of £9.3 million, more than double the profit of the previous year; a major step forward in the Group's non-regulated business development programme.

Finance costs

Net interest payable was £27 million for the year, £2 million higher than in 1995, reflecting utilisation of cash for capital investment purposes, and benefiting from a well-established financing strategy. Capital investment on tangible fixed assets and acquisitions totalled £213 million in 1995/96. Net interest payable was five times covered by operating profit.

Interest payable totalled £49 million, of which £30 million was at fixed interest rates on long term loans. Substantially all borrowings are sterling denominated. Interest receivable is derived from investment of temporarily surplus funds in financial investments, and on the money market, predominantly in sterling.

Profit before tax

Profit before tax at £109 million was 11% ahead of 1995 before exceptional items. The improvement in operating profit was marginally restrained by increased interest payable.

Financial review

continued

Profit before tax includes the Group's share of net profits in associated undertakings of £1.6 million compared with £1.2 million in 1995.

Non-regulated businesses contributed a profit before tax of £5.1 million, which compares with £2.9 million in 1995, and has helped to provide improved returns to shareholders.

Taxation

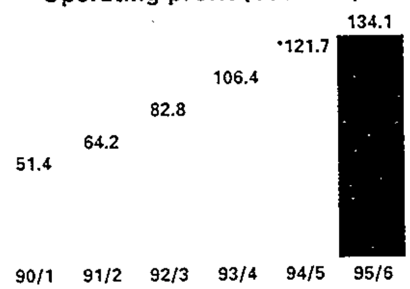
The Group's capital investment programme continues to generate substantial capital allowances. Included for the first time is a mainstream UK corporation tax charge, though the major part remains a net write-off of currently non-recoverable advance corporation tax. The Group's taxation charge for the year was £10 million.

Dividends and retained earnings

Group profit on ordinary activities after taxation was £99 million (1995 £91 million before the exceptional item).

The Directors recommend the payment of a final dividend of 20.7p per share for the year ended 31 March 1996. Together with the interim dividend of 9.8p per share paid on 9 April 1996, this makes a total dividend for the year of 30.5p per share, an increase of 11.7% on the dividends for 1995.

Operating profit (1991–96)



*Before exceptional restructuring charge of £35.5 million.

The increased dividend for 1995/96 signifies the introduction of an enhanced dividend policy. The Directors intend, in the absence of unforeseen circumstances, to continue with this policy in future years.

Payment of the interim and recommended final dividends will cost £39 million. This year £60 million, or 61% of profit after tax, has been transferred to reserves and retained in the business to help fund the investment programme.

The dividend paid by South West Water Services Limited to the Company for 1995/96 amounted to £46.5 million. The total cost of the interim and recommended final dividend of the Company is £48.6 million (including advance corporation tax).

Investment

Capital expenditure by the Group on tangible fixed assets was £110 million (1995 £159 million) of which £100 million was for the water and sewerage business. Acquisitions during the year involved expenditure of £103 million (1995 £0.2 million). After placing fair values on the underlying assets and liabilities acquired, a £68 million value for goodwill resulted, which has been charged against shareholders' funds.

In the opinion of the Directors the current market value of land and buildings is not significantly different from the book value shown in the financial statements.

Financing

Cash flow from operating activities has improved to £143 million (1995 £134 million). During the year £6 million of finance lease facilities were drawn down, net of repayments, to contribute to the funding of the capital investment programme.

£35 million short-term borrowings were undertaken and £5 million of borrowing repayments were made.

At 31 March 1996 loan and finance lease obligations were £546 million and the Group held current asset investments of £200 million. During the year £150 million of current asset investments were offset against finance lease obligations in order to generate improved investment returns. Net borrowings, which increased by £115 million during the year, represent 41% of shareholders' funds (1995 27%). At 31 March 1996 the Group had finance lease facilities in place and undrawn totalling £77 million and uncommitted short-term borrowing facilities of over £250 million.

The balance between fixed and floating rate debt and current assets is varied by means of interest rate swaps and is aimed at minimising interest rate exposure and ensuring that at least 50% of net debt is at fixed interest rates. The debt maturity profile is shown in note 25 to the financial statements. Borrowings to fund regulated activities are ring-fenced from the rest of the Group. Current asset investments derived therefrom are similarly ring-fenced.

Treasury activities are governed by policies and procedures approved by the Board. The Group's treasury policy reflects the need to secure funds at affordable costs, to finance the substantial long-term investment programme of the water and sewerage services business and the development and expansion of non-regulated activities. Investment of liquid funds seeks to minimise the Group's interest rate exposure and investments are placed with counter-parties who are highly rated by major credit rating agencies.

The borrowing powers of the Directors are limited to two and a half times capital and reserves, as defined in the Company's Articles of Association. At 31 March 1996 the limit was £2.1 billion. The Directors confirm that the Group can meet its short-term requirements from the existing borrowing facilities without breaching covenants or other borrowing restrictions.

Share capital

During the year the issued ordinary share capital increased from £126.5 million to £127.4 million as a result of shares issued under the Company's scrip dividend alternative and the Sharesave and Executive Share Option Schemes.

In common with other companies in the water sector, the Company is seeking powers from its shareholders at the annual general meeting to make market purchases of its ordinary shares. This is in order to increase the Company's flexibility to optimise the long-term financial and tax efficiency of its capital structure. The Board has no specific plans to exercise such powers in the immediate future but will keep the option under review.

Shareholders' return

The dividend of 30.5p is paid out of earnings per share of 77.7p. On a net basis, the cover for payment of dividends is 2.5 times. There would be no significant dilution of earnings per share if the outstanding shares which might be issued in respect of the Company's share option schemes had been in issue during the year.

The Company's share price started the year at 492p, and had risen to 677p at 31 March 1996. The value of net assets per share, at book value, at 31 March 1996 was 659p.

K L Hill
Group Director of Finance

Environmental review

Protection and enhancement of the environment is one of the Group's key goals.

Our environmental role

Modern society depends on the exploitation of natural resources to sustain economic development and quality of life. The Group plays a major role in safely treating, disposing and recycling the waste this produces.

South West Water Services Limited treats the waste water from 534,000 domestic and 46,000 business properties. Each day this amounts to 55 million gallons which is returned to the natural water cycle through 580 waste water treatment works. 97% of the inland works now comply with their consent standards – a dramatic improvement from the 60% seven years ago and a major contribution to improved river water quality across the South West region.

'Clean Sweep' helped produce record bathing water quality in 1995.

Treating our customers' waste water produces 13,000 tons of solid waste a year. Much of this is recycled to improve agricultural land.

For the forseeable future, carefully managed landfill will remain a major option for dealing with domestic waste. Haul Waste is at the forefront of landfill technology with fully contained lining systems and sophisticated leachate recirculation.

Group companies generate 14 megawatts of non-fossil fuel electricity from six landfill gas sites, seven hydrogeneration sites and five sewage biogas sites.

ELE Group's environmental monitoring instruments are playing a role in environmental protection in over 100 countries worldwide.

Conservation and access

The gathering grounds of South West Water Services' reservoirs provide a valuable recreational resource, as well as providing important areas for conservation. We have continued to enhance and manage sensitively the land around the reservoirs, providing access appropriate to the location whilst protecting and conserving habitats for flora and fauna. We work closely with external conservation bodies to ensure that the land in our ownership is managed in the most sensitive way.

We have recently created new ponds at the northern end of our largest reservoir at Roadford in West Devon to improve the habitat for wildlife in periods when the water level in the reservoir is reduced. Following negotiations with Dartmoor National Park we have reached a 21 year access agreement which guarantees public access to over 4,000 acres of moorland and forest walks surrounding Burrator Reservoir near Plymouth in Devon.

Environmental initiatives

The Group will produce its first Environmental Report in 1996. This will highlight our key impacts on the environment and show the framework in which they are managed, as well as demonstrating the balances and priorities that need to be considered and how we deal with them. It will also provide a medium for monitoring our performance against objectives and targets.

Our annual Environmental Award is designed to promote environmental awareness amongst employees throughout the Group. In 1995 it was awarded for a project that demonstrated a wide ranging concern for the environmental impact of a service reservoir in the Raddon Hills near Crediton in Devon. The Awards for 1996 are being expanded to include grants for proposed environment enhancing projects.

Our environmental newspaper 'The Pennant' has continued to cover many aspects related to the business of the Group. Highlights from the past year included the award winning Lyme Regis 'Clean Sweep' scheme where the main pumping station and underground storage tanks were combined with new sea defences.

B A O Hewett
Director of Technical and Environmental Affairs

Board of Directors

Keith William Court
B.A, FIPM (61)
Executive Chairman
was appointed on 1 September 1989 and was chairman and chief executive of South West Water Authority from 1 August 1987. Previously 17 years at Ford Motor Company where he held a number of senior management appointments including employee affairs director of Ford of Europe Inc. He joined Blue Circle Industries as assistant works director in 1975, became a main board director from 1978 and was chief executive of the UK cement and related operations from 1983 to 1987.

Alan Thomas Fletcher
MA (61)
Non-executive Deputy Chairman
was appointed on 26 May 1993. He is managing partner of Rubicón Partners, chairman of Vector Industries Limited and a director of Shepherd Building Group and several other companies. Formerly he was chairman and chief executive of the Wilkinson Sword Group and chief operating officer of Swedish Match.

Robert John Baty
CEng, FICE, FCIWEM, MIMgt, ACIArb, FIWO (52)
Managing Director, South West Water Services Limited
was appointed on 1 March 1996. He was formerly engineering and scientific director of South West Water Services Limited having joined South West Water Authority in 1988. Previously he held engineering and operational appointments with North West Water Authority.

Colin Irwin John Hamilton Drummond
MA, MBA (45)
Managing Director, Enterprise Division
was appointed on 1 April 1992. Prior to joining the Company he was a divisional chief executive of Coats Viyella, having previously been corporate development director of Renold plc, a strategy consultant with the Boston Consulting Group and an official of the Bank of England.

Bruce Alexander Ogston Hewett
BSc(Eng), MSc, EurIng, CEng, FICE, FCIWEM, FIMgt (60)
Director of Technical and Environmental Affairs
was appointed on 1 April 1993. He has over 30 years' experience in the water industry, including nine years with international consulting engineers on dams, water supply and waste water schemes in the UK and overseas. Prior to joining the Company he held senior appointments with Southern Water Plc, including managing director of Southern Water Services from 1988 to 1992. He is a member of the American Society of Civil Engineers, and the British Committee of the International Water Supply Association.

Kenneth Leslie Hill
CPFA (55)
Group Director of Finance
was appointed on 21 September 1989. He is a chartered public finance accountant with wide experience in the water industry. Prior to joining the Company he was finance director of Severn Trent Water. He is a City Disputes panellist.

Sir Geoffrey Howes Chipperfield
KCB (63)
Non-executive Director
was appointed on 1 October 1993. He was the permanent secretary and chief executive of PSA Services from 1991 and previously he was permanent secretary in the Department of Energy. He is Chairman of the Energy Advisory Panel of the Department of Trade and Industry and Chairman of the British Cement Association.

Simon James Day
MA (61)
Non-executive Director
was appointed on 1 September 1989 and was a member of South West Water Authority from October 1983. He was vice chairman of the Association of County Councils and is a member of the Committee of the Regions of the European Union. He is a member and former leader of Devon County Council and is chairman of governors of Bicton College of Agriculture.

Timothy Charles Leader
B.A, MIMechE, CIMgt (68)
Non-executive Director
was appointed on 1 September 1989. He had held senior positions in the engineering industry including chief executive of Simon Engineering from 1985 to 1989.

Stanislas Michael Yassukovich
CBE (61)
Non-executive Director
was appointed on 16 November 1992. He is chairman of Hemingway Properties Plc and of Flextech Plc, vice chairman of Cragnotti & Partners Group and Bristol & West Building Society, director of Henderson Administration Group and of several other companies. He was formerly chairman of Merrill Lynch Europe and Middle East. He has been a deputy chairman of the Stock Exchange and from 1988 to 1991 was chairman of the Securities Association.

Committees of the Board

Audit
T C Leader (Chairman)
Sir Geoffrey H Chipperfield
S J Day
A T Fletcher

Finance
K W Court (Chairman)
S J Day
A T Fletcher
K L Hill
T C Leader
S M Yassukovich

Nomination
A T Fletcher (Chairman)
Sir Geoffrey H Chipperfield
K W Court
S M Yassukovich

Remuneration
A T Fletcher (Chairman)
Sir Geoffrey H Chipperfield
T C Leader

Company secretary and registered office
R C Milligan
Peninsula House, Rydon Lane
Exeter EX2 7HR
Registered in England No 2366640

Auditors
Price Waterhouse, Chartered Accountants
31 George Street, Bristol BS1 5QD

Registrars
Lloyds Bank Registrars
54 Pershore Road South
Birmingham B30 3EP

Report of the Directors

The Directors of South West Water Plc ('the Company') present their seventh Annual Report, in respect of the year ended 31 March 1996, together with the audited Financial Statements of the Company for that year.

The Financial Statements will be laid before the shareholders at the seventh annual general meeting of the Company, to be held on 30 July 1996, notice of which is given on page 55.

Principal activities

The principal activities of the Company and its subsidiaries ('the Group') continued to be the provision of water and waste engineering, waste management and environmental instrumentation. The activities are described in more detail in the operating reviews.

Financial results and dividend

Group profit on ordinary activities after taxation was £98.8 million. The Directors recommend a final dividend of 20.7p per ordinary share, making a total for the year of 30.5p, the cost of which would be £38.9 million, leaving retained profit £59.9 million to be transferred into reserves.

The financial review on pages 15 to 17 analyses the results in more detail, and sets out other financial information.

Corporate governance

The Company complies fully with the provisions of the Cadbury Committee's Code of Best Practice.

Board of Directors

The Board of Directors comprises five Executive and five Non-executive Directors. The Board and the Audit, Finance and Remuneration Committees meet on a regular basis. The Nomination Committee meets when a vacancy occurs on the Board. Strategic and key operational decisions are determined by the Board. The Audit Committee reviews the audit plan, financial controls and procedures as well as regulatory compliance matters; the Finance Committee reviews dividend policy, financial statements and accounting policies and the Remuneration Committee reviews the remuneration and benefits of the Executive Directors and the overall remuneration and benefits policy for senior management. Details of membership of the Committees is given on page 19 and the Report of the Remuneration Committee is on pages 23 to 27.

A procedure has been estabished for Directors to take independent professional advice, if necessary, at the Company's expense.

Directors' responsibility statement

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

In preparing the financial statements appropriate accounting policies have been used and consistently applied and reasonable and prudent judgements and estimates have been made. All relevant accounting standards which the Directors consider to be applicable have been followed.

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

Internal control

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

There is an established internal control framework which comprises:

a a clearly defined structure which delegates authority, responsibility and accountability, including responsibility for internal financial control, to management of operating units;

b a comprehensive budgeting and reporting function, with an annual budget approved by the Board of Directors, which also monitors monthly achieved results and updated forecasts for the year against budget;

c documented financial control procedures; managers of operating units are required to confirm annually that they have adequate financial controls in operation, and to report all material areas of financial risk; compliance with procedures is reviewed by the Company's internal audit function; and

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

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

Going concern
The Directors consider, after making appropriate enquiries, that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the financial statements.

Directors

Details of the Directors at the date of this report are given on page 19. Lady Mary Holborow retired as a Director on 30 September 1995 and Mr W H Fraser left the Company on 29 February 1996. Mr R J Baty was appointed as an Executive Director on 1 March 1996.

Mr S J Day and Mr K L Hill are due to retire by rotation at the annual general meeting. Having been appointed by the Board during the year, Mr R J Baty is also due to retire at the annual general meeting. All of the Directors due to retire offer themselves for re-election and resolutions for their re-election will be proposed at the annual general meeting. Mr K L Hill and Mr R J Baty have service contracts which provide for not less than one year's notice of termination, by the Company or by the respective Director, expiring at any time. Mr S J Day does not have a service contract with the Company.

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.

Details of Directors' interests in shares of the Company are given on pages 26 and 27.

Employees

The Company is committed to effective communication with all employees. Employees in South West Water Services Limited elect representatives from all levels to a Staff Council, which deals with matters of concern to all staff employees, both trade union and non-trade union members alike. The Staff Council complements other forms of employee communication used throughout the Group, including a monthly employee briefing system, an employee newspaper and an employee ideas scheme.

Employees are encouraged to become shareholders in the Company through the employee share schemes.

Training and development of staff is a priority and particular attention is given to the management of change and training for revised working processes.

The Group operates a non-discriminatory employment policy and makes every reasonable effort to provide disabled people with equal opportunities for employment, training and development, having regard to their particular aptitudes and abilities.

Research and development

Research and development activities continued throughout the Group during the year, with expenditure of £1.7 million on research. Further information is included in the operating reviews.

Donations

During the year charitable donations amounting to £32,000 were made. No political donations were made.

Tax status

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

Payments to suppliers

The Company has a variety of payment terms with its suppliers. For the year ending 31 March 1997, the payment terms for its business transactions will be settled when agreeing the other terms negotiated with its suppliers. Payment will be made in line with these agreed terms, subject to the terms and conditions being met by the suppliers.

Substantial shareholdings

At 27 June 1996 interests in the issued share capital had been reported by:

	Shares	%
PDFM/UBS International	18,618,559	14.66
Norwich Union Life Insurance Society	7,489,980	5.95
Compagnie UAP	6,302,562	5.02

Future developments

Wessex Water Plc and Severn Trent Plc have each announced their possible intention to make an offer for the whole of the issued share capital of the Company, subject to obtaining appropriate regulatory clearances. These proposals, which did not contain any formal commitment to make an offer, have been referred to the Monopolies and Mergers Commission. The Board did not solicit these proposals nor were the proposals discussed with the Board in advance of the announcements. The Board will consider any serious proposals put to it which fully reflect the value of the South West Water Group's business. These announcements have not deflected the Company from continuing its programme of improving operational efficiencies and services to customers and developing its non-regulated businesses.

Auditors

Price Waterhouse were appointed auditors until the conclusion of the seventh annual general meeting and

Report of the Directors

continued

have indicated their willingness to continue in office. A resolution for their re-appointment will be proposed at the annual general meeting.

Appointed business

South West Water Services Limited is required to publish additional financial information relating to the 'Appointed Business' as water and sewerage undertaker in accordance with the Instrument of Appointment from the Secretary of State for the Environment. A copy of this information will be available from 30 September 1996 by application to the Secretary at Peninsula House, Rydon Lane, Exeter EX2 7HR.

Annual general meeting

The seventh annual general meeting will be held at The Great Hall, University of Exeter, Exeter, Devon on 30 July 1996 at 11.00 a.m.

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

Resolution 7 requests shareholder approval by way of a special resolution to renew until next year's annual general meeting the Directors' existing authority to allot equity securities for cash without first being required to offer such securities to existing shareholders. The share capital to which this authority relates represents approximately 5% of the issued share capital at the date of this report.

The Directors consider that they should have such authority in order to be able to take advantage of opportunities as they arise and to retain flexibility although they have no current plans to issue shares.

Resolution 8 requests shareholder approval by way of a special resolution for the Company to purchase up to 10% of its ordinary shares at or between the minimum and maximum prices specified in the resolution. The Directors have no present intention to make purchases under the proposed authority. Any decision in the future to do so will be made regardless of whether either or both of the possible bids from Wessex Water Plc and Severn Trent Plc proceed and only if such purchases would result in an increase in the Company's earnings per share and are in the best interests of the Company's shareholders generally.

By Order of the Board
R C Milligan, Company Secretary
Peninsula House, Rydon Lane, Exeter EX2 7HR
27 June 1996

Report by the Auditors on corporate governance matters

Report by the Auditors to the Directors of South West Water Plc on corporate governance matters

In addition to our audit of the financial statements we have reviewed your statements on pages 20 and 21 concerning the Group's compliance with the paragraphs of the Code of Best Practice specified for our review by the London Stock Exchange. The objective of our review is to draw attention to non-compliance with those paragraphs of the Code, if not otherwise disclosed.

Basis of opinion

We carried out our review having regard to the Bulletin 1995/1 'Disclosures relating to corporate governance' issued by the Auditing Practices Board. That Bulletin does not require us to perform the additional work necessary to, and we do not, express any opinion on the effectiveness of either the Group's system of internal financial control or corporate governance procedures nor on the ability of the Group to continue in operational existence.

Opinion

In our opinion, your statements on internal financial controls on page 20 and on going concern on page 21, have provided the disclosures required by paragraphs 4.5 and 4.6 of the Code (as supplemented by the related guidance for directors) and are consistent with the information which came to our attention as a result of our audit work on the financial statements.

In our opinion, based on enquiry of certain Directors and officers of the Company and examination of relevant documents, your statement on page 20 appropriately reflects the Group's compliance with the other paragraphs of the Code specified for our review.

Price Waterhouse
Chartered Accountants
27 June 1996

Report of the Remuneration Committee

Remuneration Committee

The Remuneration Committee consists of the Non-executive Deputy Chairman, Mr A T Fletcher, who is Chairman of the Committee, and two Non-executive Directors, Sir Geoffrey H Chipperfield and Mr T C Leader. The Executive Chairman is normally present at meetings but takes no part in the consideration of his own remuneration.

The Remuneration Committee operates within agreed terms of reference. These terms of reference were revised during the year to bring them fully into compliance with the Greenbury Code of Best Practice and with Section A of the Best Practice Provisions on Directors' Remuneration, annexed to the Stock Exchange Listing Rules.

The Remuneration Committee is responsible for the determination of the Company's policy for executive remuneration and for deciding the remuneration packages of Executive Directors which include salary, annual incentive bonus, pension entitlement and participation in employee share schemes and other benefits. All members of the Remuneration Committee have satisfied the criteria for Remuneration Committee membership laid down in both the Greenbury Code and the Best Practice Provisions and the intention is that they serve for a period of no less than three years, at which point they may be considered for re-election.

In reaching its decisions on the remuneration of other Executive Directors, the Remuneration Committee consults with the Executive Chairman on its proposals and receives and reviews his recommendations.

The fees and any other benefits received by Remuneration Committee members and other Non-executive Directors are determined by the Board, after taking external professional advice. Non-executive Directors do not vote on any resolution submitted as part of this process. The other benefits received by Non-executive Directors include reimbursement of reasonable travel and accommodation expenses. Non-executive Directors are also covered by the Company's insurance policy when on Company business.

The Remuneration Committee met on six occasions during the year under review.

Greenbury Code of Best Practice and Stock Exchange Best Practice Provisions

The Remuneration Committee considers that currently it complies fully with the Greenbury Code's requirements on remuneration committees and with Section A of the Stock Exchange's Best Practice Provisions and it intends to comply with these provisions for the next accounting period. The Chairman of the Remuneration Committee will attend the annual general meeting and be available to answer questions about the remuneration packages of Executive Directors.

Full consideration has been given to the Best Practice Provisions in respect of Directors' remuneration and the Remuneration Committee comprehensively reviewed, with appropriate external advice, the existing remuneration packages in the light of the Greenbury Report and adjusted them as necessary.

Service agreements

The period of notice provided by the Company was reduced to a rolling 12 month notice period, effective 1 July 1996. The notice period for any new appointments will be a rolling 12 months.

Remuneration policy

The policy of the Remuneration Committee is to provide for Executive Directors a remuneration package which is adequate to attract, retain and motivate good quality executives and which is commensurate with the remuneration packages provided by companies of similar size and complexity and in doing this makes use of the Arthur Andersen Complexity and Size (AACS™) methodology.

In ensuring that the value of that package is appropriate to the circumstances of the business, the Remuneration Committee also considers arrangements in other businesses within the water and sewerage sector within England and Wales. In making its judgements, the Remuneration Committee also takes full account of the wider scene, including the pay and employment conditions in other sectors and elsewhere within the Group, and in designing the elements of Executive Directors' remuneration, aims to align the interests of Directors as closely as possible with those of the Company's shareholders and customers, particularly with respect to the performance related elements of remuneration.

The remuneration package comprises salary, annual incentive bonus, pension benefits, participation in employee share schemes and other benefits consistent with those provided by other comparable companies. Regarding longer term incentives, share options are no longer being granted under the Company's Executive Share Option Scheme and no new long-term incentive arrangement has been instituted.

Salaries are normally reviewed annually; the most recent review took place on 1 October 1995.

In reaching its decisions, the Remuneration

Report of the Remuneration Committee

continued

Committee has access to internal and external advice and has taken this in the period under review to ensure that salaries and other benefits reflect the Executive Directors' responsibilities and are appropriate to the size, complexity and location of the Company. This year an external adviser, Arthur Andersen, comprehensively reviewed the remuneration package of the Executive Directors, as recommended by the Greenbury Committee.

Annual incentive bonus plan

Executive Directors and senior management participate in the annual incentive bonus plan. The continuation of this plan, its structure and its participants are reviewed by the Remuneration Committee on an annual basis. The plan is designed to reinforce the major aspects of performance which are particularly important to the Company in the short-term and provides rewards based on achievement of overall corporate and individual objectives as set by the Remuneration Committee.

In the case of Executive Directors, the maximum bonus achievable is 40% of base salary, 25% is related to corporate performance based on earnings per share and 15% to individual performance. Performance measures and objectives under the plan for the year are discussed and approved by the Committee. Awards are made after the year end, when the prior year's financial results are known. At this stage, the Committee may also take into account other factors, including any major changes in direction or circumstances that have arisen during the year. The awards for 1995/96 have not yet been determined.

Long-term incentive

Subsequent to the Board's decision that no further options will be granted under the Company's Executive Share Option Scheme, the Remuneration Committee has reviewed whether the Executive Directors should be eligible to receive benefits under a long-term incentive arrangement. As a result of this, the Remuneration Committee considers that, in due course, a new long-term incentive plan should be put in place, to reflect current competitive practice and to contribute to the alignment of the interests of the Executive Directors with those of the Company's shareholders and customers over the longer term. It is therefore envisaged that a new plan would be put before shareholders for their approval at an appropriate juncture. In line with the recommendations contained in the Best Practice Provisions, the Committee will ensure that awards under any new plan will be fully subject to challenging performance criteria, reflecting the Company's relative performance against comparators and will also ensure that awards made under the plan are phased over time.

Executive pension arrangements

Executive Directors and senior management participate in the South West Water Pension Scheme and the South West Water Executive Pension Scheme. These are funded defined benefit schemes. Through membership of these schemes Executive Directors will be provided with a pension which at normal retirement date will normally amount to two-thirds of final pensionable pay (subject to any restriction in respect of the Inland Revenue Earnings Cap) and dependent on length of service.

Messrs Drummond, Hewett and Hill are subject to the Earnings Cap and are provided with additional pension benefits under the unapproved, funded Supplementary Pension Scheme in order to bring their pension benefits up to the level which would have been provided under the other schemes if the Earnings Cap had not applied. Benefits were also provided under the Supplementary Pension Scheme in the period in respect of Mr K W Court. Executive Directors included in the unapproved pension arrangements receive payments equivalent to the tax liability which arises in respect of Company contributions to the Supplementary Pension Scheme.

The pensionable pay for participants in these arrangements consists of the highest basic salary in any consecutive twelve month period of service within five years of retirement, plus the average bonus paid over the previous five years. The Remuneration Committee is currently reviewing the links between the annual bonus plan and the pension arrangements and will report back to shareholders in due course.

In determining all remuneration arrangements for Executive Directors, the Remuneration Committee gives full consideration to the impact of these on the pension funds and costs of providing individual pension arrangements.

Board structure

In the light of the current circumstances, Mr K W Court, Executive Chairman, agreed to the Board's request to stay on in his present role and not retire at the end of April 1996 as previously announced. Mr A T Fletcher was appointed as Deputy Chairman, with effect from 14 March 1996, and it is intended that he will succeed Mr Court at an appropriate time in the future. Mr Fletcher's appointment will be as Non-executive Chairman and it is the Board's intention that at that time, on Mr Court's retirement, a Group chief executive will also be appointed. Mr Baty was appointed as Managing Director of South West Water Services Limited with effect from 1 March 1996 at a salary of £85,000 p.a.

Remuneration policy

In framing its policy and performing its functions over the period under review the Remuneration Committee has given full consideration to the Greenbury Code's requirements on remuneration and to Section B of the Stock Exchange's Best Practice Provisions and intends to give full consideration to these in the coming year.

Emoluments of Directors

The emoluments of individual Directors, and the cost to the Company of pension contributions, are shown in the table below:

	Emoluments							Pension contributions	
	Salary/ fees £000	1995 Salary/ fees £000	Performance bonus £000	Other emoluments £000	Payments related to supplementary pension £000	1996 Total £000	1995 Total £000	1996 £000	1995 £000
Executive Chairman									
K W Court	104	99	10	7	4	125	115	36	49
Executive Directors									
R J Baty (appointed 1 March 1996)	7	-	-	1	-	8	-	2	-
C I J H Drummond	82	77	12	8	11	113	88	39	25
W H Fraser (resigned 29 February 1996)	109	107	9	16	28	162	154	62	63
B A O Hewett	84	81	10	8	5	107	95	28	29
K L Hill	89	86	13	8	10	120	104	37	34
Non-executive Directors									
Sir Geoffrey H Chipperfield	18	17				18	17		
S J Day	18	18				18	18		
A T Fletcher	18	18				18	18		
Lady Mary Holborow (resigned 30 September 1995)	11	21				11	21		
T C Leader	26	26				26	26		
S M Yassukovich	17	17				17	17		
	583	567	54	48	58	743	673	204	200

Other emoluments include car benefit and health cover.

During the year, Mr W H Fraser, a Director of the Company and the previous Managing Director of South West Water Services Limited, left the Company. He had a service agreement terminable by the Company on three years' notice. The Company agreed to pay Mr Fraser compensation for loss of office with a total value approximately equal to 18 months' salary and benefits. The compensation comprised a payment of £226,000, additional pension contributions of £100,000 and non-cash benefits of £10,000. These payments are not included in the above table.

Mr Fraser is entitled to exercise share options over 106,000 shares up to 28 February 1997 and over 10,000 shares up to 6 July 1998.

In addition, Mr Fraser agreed to give the Company access to his international major capital projects experience through a consultancy for twelve months at a fee of £50,000.

Report of the Remuneration Committee

continued

Directors' share interests

a Shareholdings

The number of shares of the Company in which Directors held beneficial interests at 31 March 1996 and 31 March 1995 (or date of appointment if later) were:

	1996	1995		1996	1995
R J Baty	11,005	11,005	A T Fletcher	1,089	1,033
Sir Geoffrey H Chipperfield	1,500	1,500	B A O Hewett	1,141	1,084
K W Court	45,799	43,788	K L Hill	12,580	9,080
S J Day	1,500	1,500	T C Leader	1,368	1,296
C I J H Drummond	1,462	1,392	S M Yassukovich	–	–

As a result of electing for a scrip dividend alternative, the following Directors acquired additional shares on 9 April 1996:

R J Baty	165	A T Fletcher	22
K W Court	797	B A O Hewett	22
C I J H Drummond	1	T C Leader	26

R J Baty and C I J H Drummond acquired an additional 25 and 14 shares respectively on 9 April 1996 as a result of reinvestment of dividends in a Personal Equity Plan.

No Director had any interest in the shares of any subsidiary company during the year.

b Executive Share Option Scheme

Options to subscribe for shares of the Company under the Executive Share Option Scheme at 31 March 1996 and 31 March 1995 (or date of appointment if later) were:

					1996	1995
Grant date	1995	1993	1992	1991	Total	Total
Subscription price	503p	496p	418p	328p		
R J Baty	7,500	15,000	4,600	20,000	47,100	47,100
K W Court	10,000	40,000	23,000	40,000	113,000	113,000
C I J H Drummond	8,000	22,500	–	–	30,500	64,000
B A O Hewett	15,000	30,000	–	–	45,000	45,000
K L Hill	8,000	25,500	–	–	33,500	89,500

During the year, C I J H Drummond exercised options under the Scheme in respect of 33,500 shares at an exercise price of 418p per share. At the date of exercise, the market price of the shares was 514p. K L Hill also exercised options in respect of 30,000 shares and 26,000 shares at exercise prices of 328p and 418p respectively. At the date of exercise, the market price of the shares was 499p. No other Director exercised any options during the year and no options were granted or lapsed during the year in respect of Directors. The exercise dates of the above options and the performance targets in respect of exercise are shown in note 22 to the financial statements.

c Sharesave Scheme

Options to subscribe for shares of the Company under the Sharesave Scheme as at 31 March 1996 and 31 March 1995 (or date of appointment if later) were:

Grant date	1995	1993	1992	1991	**1996 Total**	1995 Total
Subscription price	373p	393p	332p	287p		
R J Baty	2,774	–	2,259	–	5,033	5,033
K W Court	–	–	2,259	1,567	3,826	3,826
B A O Hewett	–	4,389	–	–	4,389	4,389

No Directors exercised any options during the year and no options were granted or lapsed during the year in respect of Directors. The exercise dates of the above options are shown in note 22 to the financial statements.

d Share price

The market price of the Company's shares at 31 March 1996 was 677p (1995 492p) and the range during the year to that date was 489p to 678p (1995 462p to 578p).

A T Fletcher
Chairman, Remuneration Committee
27 June 1996

Report by the Auditors on the financial statements

Auditors' report to the shareholders of South West Water Plc

We have audited the financial statements on pages 28 to 53 (including the additional disclosures on pages 25 to 27 relating to the remuneration of the Directors specified for our review by the London Stock Exchange) which have been prepared under the historical cost convention and the accounting policies set out on pages 31 and 32.

Respective responsibilities of Directors and Auditors

As described on page 20 the Company's Directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of 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 circumstances of the Company and the Group, 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 misstatements, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and of the Group at 31 March 1996 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Price Waterhouse

Price Waterhouse
Chartered Accountants and Registered Auditors
27 June 1996

Group profit and loss account

for the year ended 31 March 1996

	Notes	1996 £m	1995 £m
Turnover			
Continuing operations		293.8	286.2
Acquisitions		20.6	–
Total turnover	2	314.4	286.2
Other operating income		0.6	0.6
Operating costs	3	(180.9)	(200.6)
Operating profit			
Continuing operations		129.0	86.2
Acquisitions		5.1	–
Total operating profit	2	134.1	86.2
Income from interests in associated undertakings		1.6	1.2
Net interest payable	5	(26.6)	(24.2)
Profit on ordinary activities before taxation	2	109.1	63.2
Tax on profit on ordinary activities	6	(10.3)	(8.2)
Profit on ordinary activities after taxation	7	98.8	55.0
Dividends	8	(38.9)	(34.5)
Retained profit transferred to reserves	23	59.9	20.5
Earnings per share	9	77.7p	43.7p
Earnings per share before exceptional items	9	77.8p	71.8p

The notes on pages 31 to 53 form part of these financial statements.

There were no recognised gains or losses for the Group or Company, other than the profit for the year, in 1996 or 1995.

A statement of movements in reserves is given in note 23.

Balance sheets

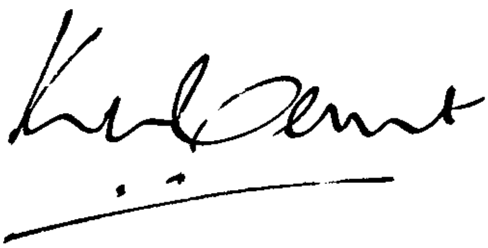
at 31 March 1996

	Notes	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Fixed assets					
Tangible assets	*12*	1,294.1	1,177.7	1.8	2.1
Investments	*13*	7.1	4.5	531.4	428.5
		1,301.2	1,182.2	533.2	430.6
Current assets					
Stocks	*14*	19.7	14.2	–	–
Debtors: amounts falling due after more than one year	*15*	5.4	4.3	188.3	192.5
Debtors: amounts falling due within one year	*16*	62.6	56.9	14.3	11.0
Investments	*17*	200.1	429.3	20.5	70.3
Cash at bank and in hand		0.9	3.1	–	–
		288.7	507.8	223.1	273.8
Current liabilities					
Creditors: amounts falling due within one year	*18*	(225.1)	(158.3)	(110.6)	(55.4)
Net current assets		63.6	349.5	112.5	218.4
Total assets less current liabilities		1,364.8	1,531.7	645.7	649.0
Creditors: amounts falling due after more than one year	*19*	(482.7)	(633.9)	(235.7)	(237.0)
Provisions for liabilities and charges	*20*	(18.8)	(29.7)	–	–
Deferred income	*21*	(23.2)	(23.8)	–	–
Net assets	*2*	840.1	844.3	410.0	412.0
Capital and reserves					
Called-up share capital	*22*	127.4	126.5	127.4	126.5
Share premium account	*23*	144.9	144.0	144.9	144.0
Other reserves	*23*	–	–	3.1	3.1
Profit and loss account	*23*	567.8	573.8	134.6	138.4
Shareholders' funds	*24*	840.1	844.3	410.0	412.0

The notes on pages 31 to 53 form part of these financial statements.

Approved by the Board on 27 June 1996 and signed on its behalf by:

K W Court, Chairman



Group cash flow statement

for the year ended 31 March 1996

	Notes	1996 £m	1995 £m
Net cash inflow from operating activities	*30a*	142.5	134.3
Returns on investments and servicing of finance			
Interest received		23.4	29.0
Interest paid		(39.3)	(37.8)
Interest element of finance lease rental payments		(4.7)	(10.0)
Dividends received from associated undertakings		0.4	0.1
Dividends paid		(32.5)	(29.6)
Net cash outflow from returns on investments and servicing of finance		(52.7)	(48.3)
Taxation			
Advance corporation tax paid		(7.8)	(6.8)
Investing activities			
Payments to acquire tangible fixed assets		(109.8)	(180.9)
Grants and contributions:			
Infrastructure assets		3.2	3.1
Non-infrastructure assets		0.7	5.2
Receipts from disposal of tangible fixed assets		0.8	1.0
Payments to acquire current asset investments		(672.0)	(1,056.6)
Receipts from disposal of current asset investments		693.5	1,147.0
Sale of investment in associated undertaking		0.4	–
Loan to associated undertaking		(1.2)	–
Acquisitions net outflow	*30b*	(93.4)	(0.2)
Net cash outflow from investing activities		(177.8)	(81.4)
Net cash outflow before financing		(95.8)	(2.2)
Financing			
Issue of shares for cash consideration		(1.8)	(1.6)
Short-term loans raised		(35.4)	–
Loans repaid		5.1	3.7
Amounts received under finance lease arrangements		(12.5)	(52.0)
Cash deposited against finance lease obligations		150.0	–
Capital element of finance lease rental payments		6.1	4.6
Net cash outflow/(inflow) from financing		111.5	(45.3)
(Decrease)/increase in cash and cash equivalents	*30d*	(207.3)	43.1
		(95.8)	(2.2)

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, the requirements of the London Stock Exchange 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 1f below.

b Basis of consolidation

The Group financial statements include the results of the Company and its subsidiary undertakings, each made up to 31 March 1996, together with the attributable share of results and reserves of associated undertakings on the basis of their latest financial statements. The results of subsidiary and associated undertakings acquired during the year are included for the periods of ownership.

c Turnover

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

d Tangible fixed assets and depreciation

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

Infrastructure assets comprise a network of systems. Expenditure on infrastructure assets relating to increases in capacity or enhancements of the network is treated as capital expenditure on tangible fixed assets and included at cost after deducting grants and contributions. No depreciation is charged on infrastructure assets because the network of systems is required to be maintained in perpetuity and therefore has no finite economic life.

Expenditure on maintaining the operating capability of the network is charged as an operating cost. Expenditure on the maintenance of infrastructure assets may vary significantly from the long term normal annual level. In such instances, the charge against profits is equalised by way of accruals or deferrals as appropriate to reflect the long term normal level of charges, in accordance with defined standards of service.

ii Landfill sites

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

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

Other assets are stated at cost less accumulated depreciation.

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

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

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

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 costs is charged against profits, using the actuarial method, over the period of the lease.

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

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 have been deducted from the cost

Notes to the financial statements

continued

1 Accounting policies continued

f Grants and contributions *continued*

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 no provision is made for depreciation and any grants and contributions relating to such assets would not be taken to the profit and loss account. The effect of this treatment on the value of tangible fixed assets is disclosed in note 12.

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.

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

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

j Research expenditure

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

k Taxation

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

l Goodwill

Goodwill, arising from the purchase of subsidiary and associated undertakings, representing the excess of the purchase consideration over the fair value of net assets acquired, is written off to Group reserves.

m Foreign currency

Assets and liabilities denominated in foreign currencies are translated into sterling at the rates ruling at the balance sheet date. Profit and loss accounts are translated at average rates for the relevant accounting period. Exchange differences arising from the retranslation of the opening net investment in overseas enterprises at closing rates, offset by translation differences on foreign currency loans which finance such investments, are dealt with in reserves.

n Landfill restoration and environmental costs

Provisions for restoration, aftercare and environmental control costs are made over the estimated operational life of landfill sites taking account of the usage of void space.

2 Segmental analysis

By class of business:	Turnover 1996 £m	Turnover 1995 £m	Operating profit 1996 £m	Operating profit 1995 £m	Profit before tax 1996 £m	Profit before tax 1995 £m	Net assets/(liabilities) 1996 £m	Net assets/(liabilities) 1995 £m
Water and sewerage services	239.3	236.7	124.8	82.2	104.0	60.3	907.4	850.1
Less: Intra-group trading	(1.5)	(1.6)	–	–	–	–	(5.2)	(5.2)
	237.8	235.1	124.8	82.2	104.0	60.3	902.2	844.9
Non-regulated businesses:								
Waste management	34.1	22.0	5.3	0.9	4.5	0.5	38.5	8.6
Environmental instrumentation	31.5	26.1	1.7	1.4	1.4	0.5	11.2	3.1
Construction services	31.7	24.1	1.4	0.1	1.1	(0.1)	0.6	1.1
Other	14.3	15.1	2.1	2.5	(0.6)	3.0	(107.9)	(10.2)
	111.6	87.3	10.5	4.9	6.4	3.9	(57.6)	2.6
Less: Intra-group trading	(35.0)	(36.2)	(1.2)	(0.9)	(1.3)	(1.0)	(4.5)	(3.2)
	76.6	51.1	9.3	4.0	5.1	2.9	(62.1)	(0.6)
	314.4	286.2	134.1	86.2	109.1	63.2	840.1	844.3

The segmental analysis has been expanded to provide extended disclosure of business classes in view of their increasing significance and comparatives have been amended accordingly.

Water and sewerage services comprise the regulated water and waste water business.

The exceptional items set out in note 4 are wholly attributable to water and sewerage services.

Net liabilities of Other includes parent company financing of the acquisition of non-regulated businesses, and profit before tax of Other is shown after interest arising thereon.

The analyses presented above include the following amounts for the operations acquired during the year:

	Turnover £m	Operating profit £m	Profit before tax £m	Net assets/ (liabilities) £m
Waste management	11.2	4.0	4.0	30.1
Environmental instrumentation	8.6	1.1	1.2	8.1
Construction services	0.8	–	–	(1.1)
	20.6	5.1	5.2	37.1

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

Notes to the financial statements

continued

3 Operating costs

	Continuing operations 1996 £m	Acquisitions 1996 £m	Total 1996 £m	Total 1995 £m
Manpower costs (note 10)	33.8	3.7	37.5	65.2
Raw materials and consumables	26.1	4.5	30.6	24.2
Rentals under operating leases:				
Hire of plant and machinery	1.9	0.1	2.0	2.4
Other operating leases	1.4	–	1.4	1.0
Research expenditure	1.0	0.7	1.7	1.6
Auditors' remuneration	0.2	–	0.2	0.2
Other external charges	49.1	0.6	49.7	45.6
Depreciation:				
On owned assets	15.9	2.9	18.8	15.5
On assets held under finance leases	12.9	–	12.9	10.5
Provision for diminution in value	–	–	–	8.3
Deferred income released to profits	(0.8)	–	(0.8)	(0.6)
Infrastructure renewals charge	6.9	–	6.9	6.1
Other operating charges	17.0	3.0	20.0	20.6
	165.4	15.5	180.9	200.6

Fees payable to the Company's auditors for non-audit work amounted to £0.5m (1995 £0.5m).

Operating costs include the exceptional items set out in note 4.

4 Exceptional items

	1996 £m	1995 £m
Operating profit is after charging/(crediting) the following exceptional items:		
Turnover:		
Water and sewerage business customer charges rebate	6.9	–
Operating costs:		
Water and sewerage business restructuring provision (release)/charge	(7.5)	35.5
Costs associated with the proposed takeover bids	0.7	–
	(6.8)	35.5
	0.1	35.5

The restructuring provision charge in 1995 comprised manpower costs £20.1m, provision for diminution in value of tangible fixed assets £8.3m, and other operating charges of £7.1m. The restructuring provision release in 1996, relating to continuing operations, comprised manpower costs, and included £7.3m for pension costs.

5 Net interest payable

	1996 £m	1995 £m
Interest payable:		
Bank loans and overdrafts	(15.9)	(13.8)
Other loans	(23.0)	(22.9)
Interest element of finance lease rentals	(10.2)	(11.5)
Other finance costs	(0.1)	(0.8)
	(49.2)	(49.0)
Interest receivable:		
Listed redeemable securities	4.3	7.6
Other investments (as defined in note 17)	18.3	17.2
	22.6	24.8
Net interest payable	(26.6)	(24.2)

Interest element of finance lease rentals is shown after £6.4m (1995 nil) interest receivable on cash deposited against finance lease obligations (note 25).

6 Tax on profit on ordinary activities

	1996 £m	1995 £m
United Kingdom taxation:		
Corporation tax at 33%	2.7	–
Advance corporation tax:		
Current year dividends	8.9	8.2
Previous year utilisation	(1.4)	–
Overseas taxation	0.1	–
	10.3	8.2

The corporation tax charge for the year has been reduced by the availability of capital allowances for which no deferred tax has been provided (note 20).

Notes to the financial statements

continued

7 Profit of parent company

	1996 £m	1995 £m
Profit on ordinary activities after taxation dealt with in the accounts of the parent company	32.7	139.2

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

8 Dividends

	1996 £m	1995 £m
Interim dividend of 9.8p (1995 9.1p) per share paid 9 April 1996	12.5	11.5
Proposed final dividend of 20.7p (1995 18.2p) per share payable 1 October 1996	26.4	23.0
	38.9	34.5

9 Earnings per share

	Profit on ordinary activities after taxation		Earnings per share	
	1996 £m	1995 £m	1996	1995
After exceptional items	98.8	55.0	77.7p	43.7p
Exceptional items (note 4)	0.1	35.5	0.1p	28.1p
Before exceptional items	98.9	90.5	77.8p	71.8p

Earnings per share before exceptional items have been calculated to show the impact of such items on the results, as they can have a distorting effect on earnings from year to year and therefore warrant separate consideration.

Earnings per share for 1996, calculated in accordance with the guidelines issued by the Institute of Investment Management and Research, were 77.7p (1995 50.2p).

Earnings per share on the nil distribution basis was 84.7p (1995 50.2p). This has been calculated by eliminating the taxation charge of £8.9m (1995 £8.2m) in respect of irrecoverable advance corporation tax on the interim and proposed final dividends.

The above earnings per share figures have been calculated by dividing the profit on ordinary activities by 127.1 million being the weighted average number of shares in issue during the year (1995 126.0 million). There would have been no significant dilution of earnings per share if the outstanding shares which might be issued in respect of the Company's share option schemes, referred to in note 22, had been in issue during the year.

10 Employees and employment costs

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

	1996	1995
Water and sewerage services	1,815	2,084
Waste management	322	271
Environmental instrumentation	357	255
Construction services	398	339
Other businesses	113	134
	3,005	3,083

The manpower analysis has been expanded to provide extended disclosure of business classes in view of their increasing significance and comparatives have been amended accordingly.

Employment costs comprise:	Continuing operations 1996 £m	Acquisitions 1996 £m	Total 1996 £m	Total 1995 £m
Wages and salaries:				
excluding exceptional items	51.5	3.4	54.9	53.6
exceptional items	(0.2)	–	(0.2)	9.5
Social security costs	4.4	0.7	5.1	4.7
Pension costs (note 28):				
excluding exceptional items	(1.0)	0.2	(0.8)	4.2
exceptional items	(7.3)	–	(7.3)	10.6
Total employment costs	47.4	4.3	51.7	82.6
Charged as follows:				
Manpower costs (note 3):				
excluding exceptional items	41.3	3.7	45.0	45.1
exceptional items	(7.5)	–	(7.5)	20.1
	33.8	3.7	37.5	65.2
Research expenditure	0.6	0.6	1.2	0.6
Capital schemes and infrastructure renewals expenditure	11.9	–	11.9	16.8
Restructuring provision	1.1	–	1.1	–
	47.4	4.3	51.7	82.6

Notes to the financial statements

continued

11 Directors' emoluments

	1996 £000	1995 £000
Executive Directors:		
Remuneration – salary	475	450
– performance bonus	54	–
Other emoluments	48	47
Pension contributions	204	200
Payments in respect of tax liability from supplementary pension arrangements	58	59
Non-executive Directors:		
Fees	108	117
	947	873
Compensation in respect of a service agreement	336	–
Total emoluments of Directors of the Company	1,283	873

Total emoluments include £206,000 (1995 £168,000) payable to Directors for services as directors of subsidiary undertakings.

The emoluments of the Chairman, excluding pension contributions, were £125,000 (1995 £115,000) and the emoluments of the highest paid Director, excluding pension contributions and compensation payment, were £162,000 (1995 £154,000).

The following table shows the number of other Directors whose emoluments, excluding pension contributions, fell within each band of £5,000:

Range (£)	1996	1995	Range (£)	1996	1995
5,001 – 10,000	1	–	95,001 – 100,000	–	1
10,001 – 15,000	1	–	100,001 – 105,000	–	1
15,001 – 20,000	4	4	105,001 – 110,000	1	–
20,001 – 25,000	–	1	110,001 – 115,000	1	–
25,001 – 30,000	1	1	120,001 – 125,000	1	–
85,001 – 90,000	–	1			

Performance bonuses for 1995 have been disclosed in 1996 numbers above. The bonuses payable for 1996 performance have not yet been determined and will be disclosed in the 1997 financial statements.

More detailed information concerning Directors' emoluments, shareholdings and share options is shown in the Report of the Remuneration Committee on pages 25 to 27.

12 Tangible fixed assets

Group

	Land and buildings £m	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers £m	Construction in progress £m	Total 1996 £m
Cost:						
At 1 April 1995	48.8	442.3	316.0	312.2	222.2	1,341.5
Additions	4.4	22.6	23.0	26.1	34.2	110.3
Grants and contributions		(2.7)				(2.7)
Arising on acquisitions	35.1	–	–	7.4	–	42.5
Disposals	(4.2)	–	–	(4.0)	–	(8.2)
Transfers	0.3	71.6	50.4	38.7	(161.0)	–
At 31 March 1996	84.4	533.8	389.4	380.4	95.4	1,483.4
Depreciation:						
At 1 April 1995	13.3		58.5	92.0		163.8
Charge for year	3.1		7.3	22.8		33.2
Disposals	(4.4)		–	(3.3)		(7.7)
At 31 March 1996	12.0		65.8	111.5		189.3
Net book value:						
At 31 March 1996	72.4	533.8	323.6	268.9	95.4	1,294.1
At 31 March 1995	35.5	442.3	257.5	220.2	222.2	1,177.7
Assets held under finance leases included above:						
Cost: At 31 March 1996			179.4	112.7	10.9	303.0
Depreciation: Charge for year			3.6	9.3		12.9
Depreciation: At 31 March 1996			7.3	30.0		37.3

Notes to the financial statements

continued

12 Tangible fixed assets continued

Group *continued*

The cost of land and buildings and of operational properties includes non-depreciable land of £3.9m (1995 £4.2m) and £7.6m (1995 £6.4m) respectively.

Net book value of land and buildings comprises:

	1996 £m	1995 £m
Freehold	65.1	28.8
Long leasehold	0.2	0.2
Short leasehold	7.1	6.5
	72.4	35.5

Included within freehold land and buildings is £2.5m (1995 £2.5m) for an investment property that has been valued by an employee of the Group who is a Chartered Surveyor.

The net book value of infrastructure assets is stated after deducting £30.9m (1995 £28.2m) grants and contributions.

Out of the total depreciation charge for the Group of £33.2m (1995 £27.9m), the sum of £1.5m (1995 £1.9m) has been charged to capital projects and £31.7m (1995 £26.0m) against profits.

Company

	Freehold land and buildings £m	Fixed and mobile plant, vehicles and computers £m	Total 1996 £m
Cost:			
At 1 April 1995	2.0	1.2	3.2
Additions	–	0.2	0.2
Disposals	(0.1)	(0.2)	(0.3)
At 31 March 1996	1.9	1.2	3.1
Depreciation:			
At 1 April 1995	0.6	0.5	1.1
Charge for year	–	0.2	0.2
At 31 March 1996	0.6	0.7	1.3
Net book value:			
At 31 March 1996	1.3	0.5	1.8
At 31 March 1995	1.4	0.7	2.1

13 Fixed asset investments

	Group Shares £m	Group Loans £m	Group Total 1996 £m	Company Shares £m	Company Loans £m	Company Total 1996 £m
Subsidiary undertakings						
Cost:						
At 1 April 1995				423.7	–	423.7
Additions				108.8	–	108.8
Provisions				(5.5)	–	(5.5)
At 31 March 1996				527.0	–	527.0
Associated undertakings						
Cost (Company) or share of net assets (Group):						
At 1 April 1995	1.5	3.0	4.5	1.8	3.0	4.8
Additions	6.5	1.2	7.7	–	–	–
Goodwill written off	(5.1)	–	(5.1)			
Sale of investment	(0.4)	–	(0.4)	(0.4)	–	(0.4)
Profit for year	0.8	–	0.8			
Dividends received	(0.4)	–	(0.4)			
At 31 March 1996	2.9	4.2	7.1	1.4	3.0	4.4
Total investments						
At 31 March 1996	2.9	4.2	7.1	528.4	3.0	531.4
At 31 March 1995	1.5	3.0	4.5	425.5	3.0	428.5

Profit for year of £0.8m (1995 £1.0m) comprised income from interests in associated undertakings at £1.6m (1995 £1.2m), disclosed in the profit and loss account, less £0.8m (1995 £0.2m) included elsewhere in the balance sheet.

Details of principal subsidiary and associated undertakings of the Group are set out in note 27.

14 Stocks

	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Raw materials and consumables	4.5	2.7	–	–
Work in progress	11.0	8.2	–	–
Finished goods	4.2	3.3	–	–
	19.7	14.2	–	–

15 Debtors: amounts falling due after more than one year

	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Amounts owed by subsidiary undertakings			187.3	191.9
Amounts owed by associated undertakings	–	0.6	–	0.6
Other debtors	–	0.1	–	–
Prepayments for pension costs	5.4	–	1.0	–
Other prepayments and accrued income	–	3.6	–	–
	5.4	4.3	188.3	192.5

Notes to the financial statements

continued

16 Debtors: amounts falling due within one year

	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Trade debtors	40.7	34.9	–	–
Amounts owed by subsidiary undertakings			13.5	10.3
Amounts owed by associated undertakings	0.8	0.4	0.5	0.3
Other debtors	3.1	0.4	0.1	–
Prepayments and accrued income	17.9	21.1	0.2	0.4
Advance corporation tax recoverable	0.1	0.1	–	–
	62.6	56.9	14.3	11.0

17 Current asset investments

	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Listed investments	57.5	64.2	–	–
Other investments	142.6	365.1	20.5	70.3
	200.1	429.3	20.5	70.3
Market value of listed investments	57.7	64.3	–	–

Other investments include certificates of deposit, variable rate notes, commercial paper and other short-dated unlisted securities.

£150.0m (1995 nil) deposited against finance lease obligations (note 25) is not included in the Group numbers.

18 Creditors: amounts falling due within one year

	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Loans:				
Bank loans and overdrafts	2.2	4.8	15.4	2.4
Short-term loans	35.4	–	35.0	–
Sterling notes	0.5	0.5	0.5	0.5
European Investment Bank loans	7.8	4.7	–	–
Series B unsecured loan stock notes	4.4	4.8	4.4	4.8
	50.3	14.8	55.3	7.7
Obligations under finance leases	15.5	13.8	–	–
Trade creditors	63.3	56.0	6.2	4.3
Amounts owed to associated undertakings	0.5	1.0	–	–
Other creditors	7.8	2.0	1.2	0.4
Advance corporation tax	9.8	9.0	9.8	8.9
Corporation tax	2.4	–	–	–
Other taxation and social security	4.3	2.6	–	–
Accruals and deferred income	33.2	25.1	0.1	0.1
Interim dividend	11.6	11.0	11.6	11.0
Proposed final dividend	26.4	23.0	26.4	23.0
	225.1	158.3	110.6	55.4

19 Creditors: amounts falling due after more than one year

	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Loans:				
Sterling bond	150.0	150.0	150.0	150.0
Sterling notes	85.4	85.9	85.4	85.9
European Investment Bank loans	115.6	123.4	–	–
Other loans	0.3	0.3	–	–
	351.3	359.6	235.4	235.9
Obligations under finance leases	128.7	272.5	–	–
Amounts owed to subsidiary undertakings			0.2	0.1
Other creditors	2.7	1.8	0.1	1.0
	482.7	633.9	235.7	237.0

20 Provisions for liabilities and charges

	Infrastructure renewals £m	Environmental and landfill restoration £m	Restructuring costs £m	Group Total £m
At 1 April 1995	3.7	0.6	25.4	29.7
Charged against profits	6.9	1.0	–	7.9
Arising on acquisitions	–	10.3	–	10.3
Utilised during year	(8.5)	(0.9)	(12.2)	(21.6)
Released to profits	–	–	(7.5)	(7.5)
At 31 March 1996	2.1	11.0	5.7	18.8

Deferred taxation

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

	Group 1996 £m	Group 1995 £m
Tax effect of timing differences due to:		
Accelerated capital allowances	61.8	54.5
Other timing differences	(5.4)	(10.8)
	56.4	43.7
Advance corporation tax recoverable	(34.1)	(26.5)
Maximum potential liability	22.3	17.2

As infrastructure assets are not depreciated, deferred taxation will crystallise in the event of their disposal at amounts in excess of their tax written-down value. The tax effect (at 33%) due to accelerated capital allowances on infrastructure assets which has been excluded above amounts to £128.1m (1995 £110.4m). Advance corporation tax of £8.8m, additional to the amount set out in the table above, is available to be set against this liability (1995 £9.9m). In the opinion of the Directors, the likelihood of a liability crystallising in the foreseeable future is remote.

Notes to the financial statements

continued

21 Deferred income

	Group 1996 £m	Group 1995 £m
At 1 April	24.5	19.9
Additions	0.5	5.2
Released to profits	(0.8)	(0.6)
At 31 March	24.2	24.5
To be released within one year	(1.0)	(0.7)
To be released after more than one year	23.2	23.8

22 Called-up share capital

	1996 £m	1995 £m
Authorised		
175,000,000 ordinary shares of £1 each	175.0	175.0
Allotted, called-up and fully paid		
127,421,387 ordinary shares of £1 each (1995 126,503,786)	127.4	126.5

	1996	1995
Ordinary shares allotted during year		
In lieu of £2.1m cash (1995 £2.3m) under scrip dividend alternative	405,681	439,826
For consideration of £1.4m (1995 £0.8m) under South West Water Executive Share Option Scheme to Directors and senior employees who exercised their options	365,100	231,700
For consideration of £0.4m (1995 £0.8m) under South West Water Sharesave Scheme to employees who exercised their options	146,820	455,689
	917,601	1,127,215

Share options

Outstanding options to subscribe for shares of £1 each under the Company's share option schemes are:

Nature of scheme	Date granted	Subscription price fully paid	Performance targets	Period when options normally exercisable	Thousands of shares in respect of which options outstanding at 31 March 1996	1995
Sharesave	12 Dec 1989	176p	–	1995 – 1997	206	269
	5 July 1991	287p	–	1996 – 1998	358	426
	3 July 1992	332p	–	1997 – 1999	257	312
	2 July 1993	393p	–	1998 – 2000	177	205
	6 Jan 1995	373p	–	2000 – 2002	426	475
Executive	18 Jan 1990	293p	*a*	1993 – 2000	–	13
	5 July 1991	328p	*a*	1994 – 2001	273	390
	3 July 1992	418p	*a*	1995 – 2002	256	438
	5 July 1993	496p	*b*	1996 – 2003	455	512
	6 Jan 1995	503p	*c*	1998 – 2005	313	338
					2,721	3,378

22 Called-up share capital continued

Share options continued

The performance targets for exercise of Executive Scheme options are:

a gross dividend yield of 9.68% on the 1989 water share offer price;

b increase in earnings per share in excess of the Retail Price Index movement over the period March 1993 to date of exercise;

c increase in earnings per share in excess of the Retail Price Index movement over the period March 1994 to date of exercise.

At 31 March 1996 there were 992 participants in the Sharesave Scheme (1995 1,182) and 80 in the Executive Scheme (1995 93).

Options granted to Directors, included above, are included in the Report of the Remuneration Committee on pages 26 and 27.

23 Reserves

	Group and Company share premium account £m	Company other reserves £m	Group profit and loss account £m	Company profit and loss account £m
At 1 April 1995	144.0	3.1	573.8	138.4
Retained profit/(loss) for year			59.9	(6.2)
Premium on shares issued	1.3			
Adjustment for shares issued under the scrip dividend alternative	(0.4)		2.4	2.4
Goodwill arising on acquisitions			(68.3)	
At 31 March 1996	144.9	3.1	567.8	134.6

The cumulative value of goodwill at 31 March 1996 resulting from acquisitions, which has been written off to reserves, is £108.6m (1995 £40.3m).

24 Statement of movements in shareholders' funds

	Group		Company	
	1996 £m	1995 £m	**1996 £m**	1995 £m
Profit on ordinary activities after taxation	98.8	55.0	32.7	139.2
Dividends	(38.9)	(34.5)	(38.9)	(34.5)
	59.9	20.5	(6.2)	104.7
Adjustment for shares issued under the scrip dividend alternative	2.4	2.0	2.4	2.0
Shares issued for cash consideration	1.8	1.6	1.8	1.6
Goodwill written off	(68.3)	(1.1)		
Shareholders' funds (equity interest):				
(Reduction)/addition for year	(4.2)	23.0	(2.0)	108.3
At 1 April	844.3	821.3	412.0	303.7
At 31 March	840.1	844.3	410.0	412.0

Notes to the financial statements

continued

25 Loans and other borrowings

Loans	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Repayable:				
After five years	224.1	235.5	150.0	150.0
Between two and five years	117.7	115.8	84.9	85.4
Between one and two years	9.5	8.3	0.5	0.5
Falling due after more than one year (note 19)	351.3	359.6	235.4	235.9
Falling due within one year (note 18)	50.3	14.8	55.3	7.7
	401.6	374.4	290.7	243.6

Obligations under finance leases	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Repayable:				
After five years	113.4	257.8	–	–
Between two and five years	9.1	10.6	–	–
Between one and two years	6.2	4.1	–	–
Falling due after more than one year (note 19)	128.7	272.5	–	–
Falling due within one year (note 18)	15.5	13.8	–	–
	144.2	286.3	–	–

Included above are finance charges arising on obligations under finance leases which are repayable within one year and amount to £9.8m (1995 £8.4m).

Obligations under finance leases of £150.0m (1995 nil) are not included above because cash of an equal amount has been deposited with the lessor's bank group; South West Water Services Limited can insist this cash is utilised to meet the finance lease obligations as they fall due. Such cash deposits are likewise not shown on the balance sheet. South West Water Services Limited has no present plans to withdraw the cash deposits but, in the event that some, or all, of the deposits were withdrawn, an equivalent amount of finance lease obligations would require to be reinstated as a liability in the balance sheet.

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:

	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Loans	265.7	273.6	150.0	150.0
Obligations under finance leases	122.4	265.4	–	–
	388.1	539.0	150.0	150.0

Loans and other borrowings are predominantly denominated in sterling and are repayable over the period 1996 to 2018. The rates of interest payable on loans and other borrowings, any part of which is due after five years, range between 4% and 12%.

26 Acquisitions

During the year the Group acquired interests in the following:

	Consideration and costs £m	Fair value acquired £m	Goodwill written off to reserves £m
Blue Circle Waste Management Limited	70.7	27.8	42.9
Great Lakes Instruments Inc.	24.1	6.6	17.5
Other:			
Warren Jones Limited	0.7	–	0.7
Elcar Srl	6.5	1.4	5.1
Engineered Products Limited	1.0	(1.1)	2.1
	103.0	34.7	68.3

All acquisitions were accounted for using the acquisition method.

On 19 July 1995 the entire issued share capital of Blue Circle Waste Management Limited (now renamed Haul Waste Disposal Limited) was purchased by South West Water Plc and Peninsula Waste Technology Limited (a 100% owned Group company) for a cash and contingent consideration of £70.7m, including costs of £1.0m. A contingent consideration of £2.0m is linked to development of a landfill site. Prior to 1 April 1995 the activities of Blue Circle Waste Management Limited were carried out as a division of Blue Circle Industries Plc. For the period from 1 April 1995 to 19 July 1995 the profit after tax amounted to £0.6m.

On 31 August 1995 the entire issued share capital of Great Lakes Instruments Inc. was purchased by GLI Acquisition Inc. (a 100% owned Group company) for a cash consideration of £24.1m, including costs of £0.8m. The profit after tax of the company for the eleven months ended 31 August 1995 was £0.4m.

On 29 September 1995 the entire issued share capital of Warren Jones Limited was purchased by ELE International Limited (a 100% owned Group company) for a cash consideration of £0.7m.

On 4 October 1995 a 50% interest in Elcar Srl (now renamed Societa Italo Britannica del'Acqua Srl) was purchased by Exe Continental Limited (a 100% owned Group company) for a cash and contingent consideration of £6.5m, including costs of £0.5m. The contingent consideration of £4.8m is linked to net asset warranties and post-acquisition profit achievement, and an initial £3.0m was paid on 3 May 1996.

On 14 February 1996 the entire issued share capital of Engineered Products Limited was purchased by T J Brent Limited (a 100% owned Group company) for a cash and contingent consideration of £1.0m. A contingent consideration of £0.4m is linked to post-acquisition profit achievement.

Notes to the financial statements

continued

26 Acquisitions continued

The operating assets and liabilities of the above acquisitions were:

	Book value				Fair value adjustments	Fair value total
	Blue Circle Waste Management Limited £m	Great Lakes Instruments Inc. £m	Other £m	Total £m	£m	£m
Tangible fixed assets	11.8	3.8	0.5	16.1	26.4	42.5
Associated undertakings	–	–	4.0	4.0	(2.5)	1.5
Stocks	0.1	1.8	0.8	2.7	0.1	2.8
Debtors due within one year	4.8	0.6	2.3	7.7	(1.9)	5.8
Cash at bank and in hand	–	2.7	–	2.7	–	2.7
Bank overdraft	(0.4)	–	(0.3)	(0.7)	–	(0.7)
Creditors due within one year	(3.1)	(1.9)	(2.7)	(7.7)	(1.4)	(9.1)
Creditors due after more than one year	–	(0.1)	(0.4)	(0.5)	0.1	(0.4)
Finance lease obligations	–	(0.1)	–	(0.1)	–	(0.1)
Provisions for liabilities and charges	(2.0)	–	–	(2.0)	(8.3)	(10.3)
	11.2	6.8	4.2	22.2	12.5	34.7

The following fair value adjustments were made to the book value of the assets and liabilities of the above acquisitions:

	Blue Circle Waste Management Limited £m	Great Lakes Instruments Inc. £m	Other £m	Total £m
Revaluation of tangible fixed assets	26.4	0.2	(0.2)	26.4
Accounting policy harmonisation:				
Provisions	(8.3)	–	–	(8.3)
Other	–	(0.3)	(3.7)	(4.0)
Other adjustments	(1.5)	(0.1)	–	(1.6)
	16.6	(0.2)	(3.9)	12.5

Other adjustments comprise planning appeal and pension costs.

Elcar Srl fair value adjustments, included in other, are provisional.

During the year £9.6m fair value acquisition accruals and provisions were established (1995 nil), £0.8m were utilised (1995 £1.3m) and at 31 March 1996 £10.5m (1995 £1.7m) was carried forward.

27 Principal subsidiary and associated undertakings

Subsidiary undertakings (wholly owned):	Country of incorporation, registration and principal operations	Activity
South West Water Services Limited*	England	Water and sewerage services
Peninsula Waste Technology Limited*	England	Holding company
Haul Waste Limited	England	Waste management
Haul Waste Disposal Limited	England	Waste management
ELE Group Limited*	England	Holding company
ELE International Limited	England	Instrumentation
ELE International Inc.	United States	Instrumentation
GLI International Limited	England	Instrumentation
Water West Limited*	England	Holding company
Exe International Inc.	United States	Holding company
Great Lakes Instruments Inc.	United States	Instrumentation
T J Brent Limited*	England	Construction services
Exe Continental Limited*	England	Holding company
Peninsula Insurance Limited*	Guernsey	Insurance
Peninsula Properties (Exeter) Limited*	England	Property development
Rydon Properties Limited*	England	Property investment

Shares of those undertakings marked with an asterisk (*) were held directly by the Company. Otherwise, except for Haul Waste Disposal Limited, the shares of subsidiary undertakings were held by the immediately preceding holding company in the list above. All shares in issue are ordinary shares except those of Haul Waste Disposal Limited.

Haul Waste Disposal Limited has ordinary, preference and deferred shares in issue. The ordinary and deferred shares are held by Peninsula Waste Technology Limited and the preference shares are held by South West Water Plc.

Associated undertakings:	Share and loan capital in issue	Percentage held	Activity
Pell Frischmann Water Limited*	6,666 ordinary £1	25%	Engineering
	3,334 ordinary £1 (non-voting)	100%	consultancy
Westcountry Television Limited*	1,030,000 ordinary 10p	23%	Television
	£5m subordinated loan stock	60%	broadcasting
Societa Italo Britannica del'Acqua Srl	6 billion lire share capital	50%	Construction
(shares held by Exe Continental Limited)	6 billion lire subordinated		and operating
	loan stock	50%	concessions

Shares of those companies marked with an asterisk (*) were held directly by the Company.
On 12 June 1996 the Company sold its interest in Pell Frischmann Water Limited.

Notes to the financial statements

continued

28 Pensions

The Group operates a number of pension schemes. The two major schemes are funded defined benefit schemes and the assets of the schemes are held in separate trustee administered funds.

The latest actuarial valuations of the two main schemes were at 31 March 1996. At that date, the market value of the schemes' assets was £140.2m, and the actuarial value of those assets represented 135% and 146% of the benefits that had accrued to members, after allowing for expected future increases in earnings. The assumptions which have the most significant effect on the results of the valuations are those relating to the rate of return on investments and the rates of increase in earnings and pensions. The valuations assume that the investment return would be 9% per annum and pensionable pay increases would average 7% per annum and that present and future pensions would increase at a rate of 4.5% and 5% per annum for the two main schemes.

For accounting purposes, the results of these valuations have also been used to estimate the two main schemes' position as at 1 April 1995 and because of the actuarial surpluses the net pension credit for the Group for the year ended 31 March 1996 was £0.8m (1995 £4.2m charge) before exceptional items. The pension cost of the defined benefit schemes has been determined on the advice of independent qualified actuaries using the projected unit method. The employers' regular pension cost for the year of the two main schemes is 10.3% and 13.8% of pensionable earnings (1995 10.5% and 14.9%). The actuarial surpluses for the two main schemes are being recognised using the straight line method of amortisation over the average remaining service lives of the current members of each scheme. Following the actuarial valuations, employer contributions to the two main schemes have ceased until the next actuarial review (which is expected to be in 1999).

Pension prepayments included in debtors of the Group amount to £5.4m (1995 nil), representing the difference between the Group pension credit and employer contributions paid.

In 1995, a provision of £10.6m was made in respect of additional employer pension contributions which were expected as a result of the restructuring of the water and sewerage business. During 1995/96, £3.3m of this provision was utilised and, as set out in note 10, £7.3m has been released to profits.

29 Commitments and contingent liabilities

	Group 1996 £m	Group 1995 £m	Company 1996 £m	Company 1995 £m
Capital commitments				
Contracted but not provided	28.6	17.9	–	–
Commitments under operating leases				
Rentals during the year following the balance sheet date:				
Land and buildings – leases expiring:				
Within one year	0.1	0.3	–	–
Between one and five years	0.2	0.8	–	–
After five years	0.4	0.7	–	–
Other-leases expiring:				
Between one and five years	–	0.1	–	–
	0.7	1.9	–	–
Contingent liabilities				
Contractors' claims on capital schemes	18.8	18.9	–	–
Guarantees	4.9	1.9	292.5	422.9
	23.7	20.8	292.5	422.9

Guarantees by the Company are principally in respect of borrowing facilities of subsidiary undertakings.

Notes to the financial statements

continued

30 Notes to the Group cash flow statement

a Reconciliation of operating profit to net cash inflow from operating activities	1996 £m	1995 £m
Operating profit	134.1	86.2
Depreciation charge	31.7	26.0
Provision for diminution in value	–	8.3
Deferred income released to profits	(0.8)	(0.6)
(Decrease)/increase in provisions for liabilities and charges	(21.1)	25.4
Increase in stocks	(2.7)	(8.0)
Increase in debtors (amounts falling due within and over one year)	(6.9)	(3.4)
Increase in creditors (amounts falling due within and over one year)	8.5	0.5
Profit on disposal of tangible fixed assets	(0.3)	(0.1)
Net cash inflow from operating activities	142.5	134.3

Cash outflows from operating activities accounted for as exceptional items, included above, were £11.8m (1995 £1.8m).

b Net outflow of cash and cash equivalents in respect of acquisitions	1996 £m	1995 £m
Cash consideration	95.4	0.2
Cash at bank and in hand acquired	(2.7)	–
Bank overdraft acquired	0.7	–
	93.4	0.2

c Acquisitions comprised	1996 £m	1995 £m
Tangible fixed assets	42.5	(0.6)
Associated undertakings	1.5	–
Stocks	2.8	–
Debtors: amounts falling due within one year	5.8	0.4
Cash at bank and in hand	2.7	–
Bank overdraft	(0.7)	–
Creditors: amounts falling due within one year	(9.1)	(0.3)
Creditors: amounts falling due after more than one year	(0.4)	(0.1)
Provisions for liabilities and charges	(10.3)	–
Finance lease obligations and loans	(0.1)	(0.3)
Fair value of net assets acquired	34.7	(0.9)
Goodwill	68.3	1.1
	103.0	0.2
Satisfied by:		
Cash consideration	95.4	0.2
Loan stock	0.4	–
Contingent consideration	7.2	–
	103.0	0.2

The subsidiary undertakings acquired during the year contributed an inflow of £9.7m to the Group's net operating cashflow, received £0.1m in respect of net returns on investments and servicing of finance, and utilised £5.8m for investing activities. The subsidiary undertaking acquired during 1995 did not contribute materially to the Group's cashflow in that year.

30 Notes to the Group cash flow statement continued

d Balances of cash and cash equivalents

	1996 £m	1995 £m	Change in 1996 £m	Change in 1995 £m
Current asset investments	200.1	429.3	(229.2)	(50.3)
Deduct investments not within three months of maturity when purchased	(143.7)	(165.2)	21.5	90.4
	56.4	264.1	(207.7)	40.1
Cash at bank and in hand	0.9	3.1	(2.2)	1.3
Bank overdrafts	(2.2)	(4.8)	2.6	1.7
Cash and cash equivalents	55.1	262.4	(207.3)	43.1

e Changes in financing during the year

	Share capital (including premium)		Loans and finance lease obligations	
	1996 £m	1995 £m	1996 £m	1995 £m
At 1 April	270.5	268.9	647.5	604.0
Cash inflows/(outflows) from financing	1.8	1.6	(113.3)	43.7
Release of premium on sterling notes			(0.5)	(0.5)
Loans and finance lease obligations of subsidiary undertakings acquired			0.1	0.3
At 31 March	272.3	270.5	533.8	647.5

Five year financial summary

Profit and loss account	1996 £m	1995 £m	1994 £m	1993 £m	1992 £m
Turnover	314.4	286.2	251.6	194.4	166.5
Operating profit	134.1	86.2	106.4	82.8	64.2
Income/(loss) from interests in associated undertakings	1.6	1.2	0.7	(2.0)	(0.1)
Net interest (payable)/receivable	(26.6)	(24.2)	(14.1)	11.9	25.9
Profit on ordinary activities before taxation	109.1	63.2	93.0	92.7	90.0
Tax on profit on ordinary activities	(10.3)	(8.2)	(7.1)	(8.5)	(8.9)
Profit on ordinary activities after taxation	98.8	55.0	85.9	84.2	81.1
Dividends	(38.9)	(34.5)	(32.0)	(29.5)	(26.8)
Retained profit transferred to reserves	59.9	20.5	53.9	54.7	54.3
Earnings per share:					
Before exceptional items	77.8p	71.8p	68.5p	67.9p	66.1p
After exceptional items	77.7p	43.7p			
Dividend per share	30.5p	27.3p	25.5p	23.7p	21.7p

Capital expenditure	£m	£m	£m	£m	£m
Acquisitions and investment	103.0	0.2	17.9	32.1	4.8
Tangible fixed assets	110.3	159.4	203.4	203.7	172.4

Balance sheet	£m	£m	£m	£m	£m
Fixed assets	1,301.2	1,182.2	1,063.0	882.1	679.5
Net current assets	63.6	349.5	375.9	394.0	402.1
Non-current liabilities	(524.7)	(687.4)	(617.6)	(496.6)	(343.4)
Net assets	840.1	844.3	821.3	779.5	738.2

Number of employees (average for year)					
Water and sewerage services	1,815	2,084	2,141	2,144	2,084
Waste management	322	271	242	35	-
Environmental instrumentation	357	255	244	119	144
Construction services	398	339	291	111	81
Other business	113	134	142	147	140
	3,005	3,083	3,060	2,556	2,449

Notice of meeting

The seventh annual general meeting of South West Water Plc will be held at The Great Hall, University of Exeter, Exeter, Devon on 30 July 1996 at 11.00 am for the transaction of the following business:

Resolution 1
To receive the Report of the Directors and the financial statements for the year ended 31 March 1996.

Resolution 2
To declare a final dividend for the year ended 31 March 1996.

Resolution 3
To re-elect Mr S J Day as a Director.

Resolution 4
To re-elect Mr K L Hill as a Director.

Resolution 5
To re-elect Mr R J Baty as a Director.

Resolution 6
To re-appoint Price Waterhouse as auditors until the conclusion of the next annual general meeting at which financial statements are laid before the Company and to authorise the Directors to fix their remuneration.

Resolution 7
To propose the following as a special resolution:

That, in accordance with Article 6 of the Company's Articles of Association, a) the Directors be given power to allot equity securities for cash, b) that for the purpose of paragraph (A)(ii) of that Article, the nominal amount to which this power is limited is £6,391,000 and c) this power shall expire on 30 October 1997 or, if earlier, at the conclusion of the next annual general meeting of the Company.

Resolution 8
To propose the following as a special resolution:

That the Company is generally and unconditionally authorised to make market purchases (within the meaning of section 163 of the Companies Act 1985) of ordinary shares of £1 each in the capital of the Company ("ordinary shares") on such terms and in such manner as the Directors of the Company may from time to time determine provided that:

(a) the maximum number of ordinary shares that may be purchased under this authority is 12,783,000 (being 10% of the current issued share capital of the Company);

(b) the maximum price which may be paid for an ordinary share purchased under this authority is an amount equal to 105% of the average of the middle market quotations for ordinary shares, as derived from the London Stock Exchange Daily Official List for the 10 business days immediately preceding the day on which that share is purchased, and the minimum price which may be paid is £1 per ordinary share; and

(c) this authority will, unless previously varied, revoked or renewed, expire at the conclusion of the next annual general meeting of the Company, but the Company may make a contract to purchase ordinary shares under this authority before its expiry which will or may be executed wholly or partly after the expiry of this authority and may make purchases of ordinary shares pursuant to such a contract.

By order of the Board

R C Milligan, Company Secretary
Peninsula House, Rydon Lane, Exeter EX2 7HR
27 June 1996

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

A Form of Proxy is enclosed and, if used, should be lodged with the Company's Registrars, Lloyds Bank Registrars, not less than 48 hours before the time fixed for the meeting.

The Register of Directors' Interests and copies of the Directors' service contracts will be available for inspection during normal business hours at the Company's registered office from the date of this notice until the date of the meeting, and at the place of the meeting from 10.00 a.m. until the conclusion of the meeting.

Shareholder information

Financial calendar

Financial year end	31 March
Seventh annual general meeting	30 July 1996
1996 Final dividend payable	1 October 1996
1997 Interim results announcement	November 1996
1997 Interim dividend payable	April 1997
1997 Preliminary results announcement	May 1997
Eighth annual general meeting	July 1997
1997 Final dividend payable	October 1997

Shareholders' analysis at 31 March 1996

	Number of shareholders	Percentage of total shareholders	Percentage of ordinary shares
1–100	4,303	12.9	0.2
101–1,000	24,889	74.6	7.9
1,001–5,000	3,384	10.1	4.2
5,001–50,000	482	1.4	7.6
50,001–100,000	116	0.4	6.8
Over 100,000	186	0.6	73.3
	33,360	100.0	100.0
Individuals	30,757	92.2	11.4
Companies	494	1.4	6.0
Trust companies (pension funds, etc)	18	0.1	1.5
Banks and nominees	2,056	6.2	75.1
Insurance companies	35	0.1	6.0
	33,360	100.0	100.0

Shareholder services

Share dealing service
The low-cost share dealing service enables investors to buy and sell shares in the Company on a low-cost basis and to make regular investments in the Company.

Personal equity plans
By holding their shares in the Company in the general or the single company personal equity plan, shareholders may gain tax advantages.

Scrip dividend alternative
The scrip dividend alternative enables shareholders to receive their dividends in the form of shares instead of cash.

Details of the scrip dividend alternative are enclosed and details of the other shareholder services are available from the Company Secretary's Department (telephone: (01392) 446688).

CREST
CREST is the new computerised system for settling sales and purchases of shares which will begin in July 1996. A leaflet giving general guidance about what CREST will mean for private shareholders is enclosed with this report.

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