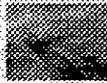
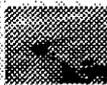
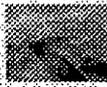


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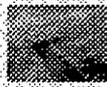
**The Group has consolidated on the rapid financial growth achieved in 1996/97.**

 Turnover up 11.2% to £382.1 million.

 Profit before tax up 2.5% to £121.6 million.\*

 Earnings per share up 2.0% to 82.8 pence.\*

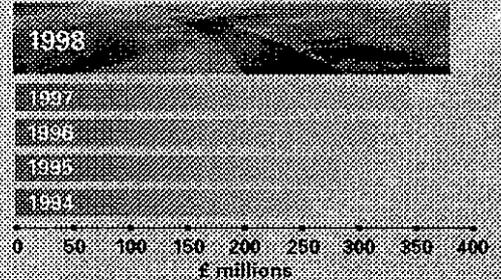
 Full year cash dividend up 11.7% to 41.0 pence.

 Customer rebate of £15 per customer paid in March 1998.

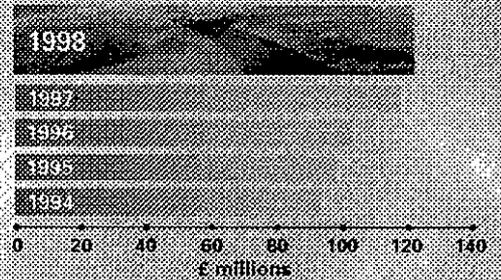
 Further strategic development of Haul Waste.

*\*Before exceptional items*

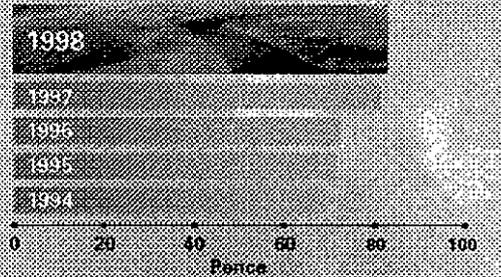
Turnover



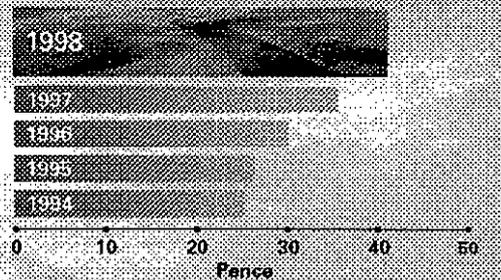
Profit before tax\*



Earnings per share\*



Dividend per share





“ The Board’s strategy is the delivery of an efficient customer oriented water and sewerage business, allied to non-regulated businesses which we expect to continue to grow profitably. ”

**I am very pleased to report another satisfactory year for the Group which has consolidated on the rapid financial growth achieved in 1996/97. The Board’s strategy is the delivery of an efficient customer oriented water and sewerage business, allied to non-regulated businesses which we expect to continue to grow profitably.**

#### Group results

Sound financial progress was made during the year with Group turnover rising by 11.2% to £382.1 million. Profit before tax and exceptional items rose by 2.5% to £121.6 million and earnings per share, excluding exceptional items, increased by 2.0% to 82.8p. The Directors are recommending a final cash dividend of 27.8p per share which will result in a full year dividend of 41.0p – an increase of 11.7% over last year. The Board is also recommending an enhanced scrip dividend alternative which it believes is in the best interest of shareholders as a whole.

#### Board matters

Reflecting the success of the Group’s strategy of building two different areas of focus – the regulated water and sewerage utility and the non-regulated group of environmental businesses within the Enterprise Division – the Board has decided to effect the following changes.

A recommendation will be made to shareholders at the annual general meeting that South West Water Plc changes its name to Pennon Group Plc. Consequent upon this the regulated utility will be re-named South West Water Limited. In addition the Enterprise Division businesses have been brought together under a newly formed company, Viridor Limited.

Subject to approval of the above name change at the annual general meeting, I will be Non-executive Chairman of Pennon Group Plc, South West Water Limited and Viridor Limited. Ken Hill will be Group Director of Finance of Pennon Group Plc; Bob Baty, previously Managing Director of the utility business, will become Chief Executive of South West Water Limited; and Colin Drummond, previously Managing Director of the Enterprise Division, has become Chief Executive of Viridor Limited. Both Chief Executives will be Executive Directors of Pennon Group Plc. In addition, Alan Fletcher, currently a Plc Non-executive Director, will also be a Non-executive Director of Viridor Limited.

Sir Simon Day will be retiring from the Board after many years sterling service as Non-executive Director. The Board thanks him for his significant contribution, particularly during the privatisation process and the proposed bids to acquire the Group in 1996.

#### Water and sewerage business

South West Water Services Limited delivered higher levels of product quality and customer service and was able, for the third successive year, to share the benefits of its improved financial and operational efficiencies with customers by way of a rebate of £15 on charges for 1998/99. The company has now returned by way of rebates a total of £40 to each of its customers, at a total cost of £27 million. The Director General of Water Services has confirmed that these rebates will be fully taken into account at the next Periodic Review.

During the year, the water and sewerage business initiated a major programme to streamline its structure to achieve even higher levels of customer service whilst significantly reducing overhead and operating costs. It is anticipated that the cost of implementing this restructuring will be paid back through lower operating costs within one year.

The successful delivery of the capital programme continued throughout the year, bringing benefits to customers, the environment and the economy of the region as a whole. The Operating Review describes in more detail the progress made during a year when there were no water restrictions in the region. It is pleasing to be able to state that no restrictions are anticipated during 1998/99.

#### Non-regulated businesses

The group of environmental businesses within the Enterprise Division continued to focus on the core activities of waste management and disposal; environmental instrumentation; and construction services. During the year selective acquisitions were completed, the most notable of which was the purchase of Terry Adams Limited which increased Haul Waste's total landfill void capacity by some 50%.

Greenhill Enterprises Limited was also acquired during the year, and with Terry Adams Limited, was fully integrated into Haul Waste, which is now one of the largest waste disposal companies in the UK.

Action has been taken to minimise the effects of difficult trading conditions in the international market place experienced by Environmental Instrumentation Group. The Hydrolab Corporation, acquired in July 1997, was fully integrated during the year and EI Group is well positioned for future growth capitalising on world wide environmental and infrastructure development trends.

T J Brent strengthened its market position during the year securing major contracts throughout the UK, and in the USA via its newly formed Copa MEICA division.

The non-regulated businesses are continuing to make a positive and growing contribution to Group

profitability and, as described in the Operating Review, turnover from these businesses now represents 35% of the Group total. It is anticipated that this figure will continue to grow in the future.

#### Business developments

During the year a joint venture company was established with Enviro-Logic Limited to build on and develop Enviro-Logic's expertise in promoting competition in the water and sewerage sector. The Group acquired a 50% stake in all Enviro-Logic's current and future interests including brokered water and sewerage facilities within the UK. 29 inset and similar applications are currently being considered by the Director General of Water Services, one of which has already been approved.

The Group made arrangements to dispose of its interest in Societa Italo Britannica dell'Acqua Srl, SIBA, during the year.

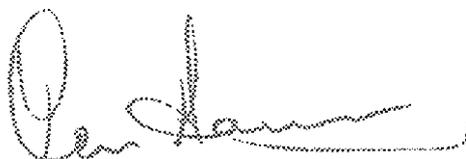
#### Prospects

The Director General's 1999 review of water and sewerage price limits is the most challenging issue facing the Group. A significant amount of time and energy is being expended prior to the water and sewerage company making its submission to Ofwat. It is vital that South West Water's business is adequately financed to carry out its legal and environmental obligations having regard to the special circumstances of the region which it serves.

Early action was taken to establish a high priority programme to address the impact of the Year 2000 information technology problem on all of the Group's businesses and substantial progress has been made. The programme is being controlled at main Board level and action is being taken with a view to ensuring that all business critical systems will be fully compliant by the end of December 1998 and all other systems compliant by the end of March 1999.

#### Employees

Throughout a challenging and demanding year, employees of the Group demonstrated their professionalism and dedication in the achievement of continued growth and the provision of significantly higher quality standards for our customers. I thank them most sincerely for their individual and collective efforts.



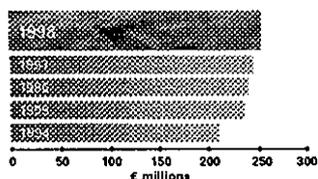
✻ K G HARVEY  
CHAIRMAN  
SOUTH WEST WATER PLC

WATER AND SEWERAGE SERVICES

Customer focus remains the key objective

**Significant progress has been made during the year by South West Water Services Limited. It has continued to transform from a capital works oriented company to a customer focused company delivering substantial efficiencies, enhanced levels of product and improved customer service.**

Water and sewerage services -- Turnover



For the past two years the company has been able to share the benefits of its improved financial and operational efficiencies with its customers by way of rebates which, together with a further rebate on charges for 1998/99, total £27 million. The company has now returned a total of £40 to each of its customers.

Financial progress

Water and sewerage services turnover increased by 2.7% to £251.2 million (net of the rebate). The underlying operating costs prior to depreciation, infrastructure renewals and the restructuring provision have been held at 1996/97 levels. The impact of operating new works and of inflation has been absorbed by further efficiency savings amounting to £4.7 million.

Operating profit, excluding the impact of exceptional items, increased by 3.2% to £125.2 million.

Net interest payable at £13.5 million, rose by £2.2 million, reflecting the need to fund the capital programme. Significant benefits from financing initiatives (predominantly finance leases) were achieved in 1997/98.

Profit before tax rose £1.7 million to £111.7 million excluding exceptional items.

Capital expenditure for the year increased by 2.2% to £154.7 million, with £69.2 million invested in water supply improvements, including water treatment works upgrading, leakage control and water mains rehabilitation. Waste water services benefited from an investment of £85.5 million of which £54.0 million was invested in the company's 'Clean Sweep' bathing water programme.

Reshaping the business for the future

During the year the water and sewerage services business initiated a major restructuring programme to achieve a streamlined structure targeted at customer services and to deliver significant reductions in overhead and operating costs to bring the company nearer to the forefront of efficiency.

The programme included a reduction in the number of South West Water Services Limited Executive Directors from six to four together with a realignment of their duties and responsibilities.

The programme also included the introduction of centralised functionally based operations management in place of two regional operating divisions. It will eventually see the replacement of the divisional offices in Exeter and St Austell with more accessible local customer service centres, coupled with the centralisation and integration of other aspects of the business.

A thorough review of the changing regulatory, customer, financial and economic circumstances facing the company has been carried out as part of the restructuring programme.

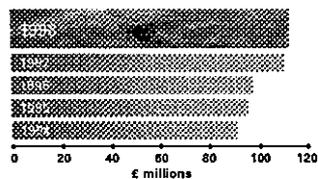
Throughout the planning and execution of the organisational restructuring, improved levels of customer service have remained the company's key priority and the appointment of a Customer Service Director to the Board of South West Water Services Limited signals its ongoing customer focus philosophy.

Unavoidably the changes will result in around 135 redundancies and it is for this reason a provision has prudently been set aside from this year's profits to deal with the associated costs.

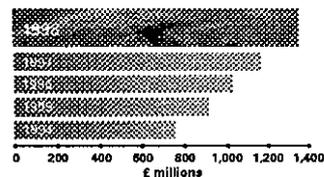
Customer initiatives

The extensive programme of customer benefits initiated three years ago has reflected the refocusing of the company. The Government Consultation Paper on water charges, published in April this year, recognised the importance of a number of customer initiatives the company has had in place for a considerable time. These include the policy of non-disconnection of water supplies for all domestic customers who cannot pay their water bills and the company's special assistance fund established over three years ago which provides financial support for customers who have genuine difficulties in paying their water bills.

Water and sewerage services -- Profit before tax (before exceptional items)



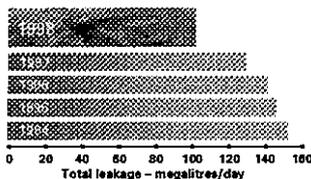
Water and sewerage services -- Cumulative capital expenditure (from 1990)



*Bob Kelly, Chief Executive of South West Water Services Limited, focusing on customers with Customer Service Personnel.*

“ The company continued to improve its levels of customer service ”

Leakage reduction



During the year the company introduced a free leakage detection and repair service for customers' underground household supply pipes, an initiative serving the dual purpose of being an additional customer benefit, whilst at the same time proving to be a practicable water conservation measure.

The company already has the lowest standing charges in the country for metered water and sewerage customers, helping reduce water bills for many low consumption customers. Again, this was an issue contained in the Consultation Paper.

The first edition of a new customer newspaper 'Waterlevel' was published during the year in response to many requests from customers for further information on the water and sewerage company. 'Waterlevel' was well received and will be published twice a year, in the Spring and the Autumn.

The company has continued to improve its levels of customer service and expects the improvements to be reflected in Ofwat's next annual report on levels of service published later this year.

Drinking water supplies

The company's effective management of water supplies in the region is based upon a three pronged approach - leakage reduction, further development of existing resources and a comprehensive programme to promote more efficient use of water.

The strategy takes account of environmental issues in liaison with the Environment Agency and its effectiveness was proven during a year when there were no water restrictions in any part of the region and none is anticipated for the remainder of this year.

A £200 million renovation programme has resulted in a total reduction in leakage levels of 35% between 1994 and 1998 to 101 megalitres per day. The company has met the leakage target set by Ofwat of 110 megalitres per day for 1997/98 and is well on track to meet the target for 1998/99.

The company has one of the most comprehensive water supply network monitoring systems in the industry. All of these

achievements demonstrate the excellent progress made in controlling the level of leakage from the company's pipes.

A series of measures costing more than £20 million has further reinforced the company's ability to supply customers with water. These measures include the strengthening of strategic water supply links across the region and the completion of a programme of new winter augmentation pumped storage schemes for all three of the strategic reservoirs - Colliford, Roadford and Wimbleball.

During the year the company published 'Making Every Drop Count', which outlined its plans to promote the efficient use of water resources. Customer response to the plans has been encouraging.

A free customer leakline was introduced where customers could also obtain water conservation advice and free 'Hippo' water saving devices were distributed to customers along with a home water check list to help save water.

Drinking water quality was maintained at the very high level of 99.7% overall compliance. Supplies to 150,000 customers in South Devon were enhanced following the completion of the new £6 million Tottiford water treatment works.

The company was found not guilty following a prosecution by the Secretary of State for the Environment following an outbreak of cryptosporidiosis in South Devon in 1995.

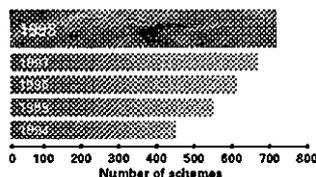
Protecting and enhancing the environment

The largest area of investment continues to be the company's £1 billion 'Clean Sweep' coastal sewage treatment improvement programme and during the year, schemes were completed at Porthleven, the Camel Estuary and Barnstaple at a cost of £28.6 million.

At privatisation in 1989 the company inherited 227 crude sewage discharges. Already more than 150 of those have been eliminated and replaced with modern sewage treatment schemes at a cost of over £500 million. 67 bathing waters have now been improved.

More than half of the ongoing bathing water schemes incorporate ultra violet disinfection and the company has so far provided 200,000 customers with sewage treatment for the first time.

Cumulative major capital scheme completions (from 1990)



*Constructing the pipeline for the  
Colliford winter augmentation  
pumped storage scheme.*



“ There were no  
water restrictions  
in any part of the  
region ”

The water at over 90% of the region's beaches now complies with the bathing water quality standards and 66 bathing waters now meet stringent European guideline standards. The improvements delivered are providing significant environmental and economic benefits.

The £50 million scheme for Plymouth is on schedule to be completed during the summer of 1998. The scheme includes ultra violet disinfection and will provide sewage treatment to 120,000 customers for the first time. Over £30 million has already been invested in improvements to the existing sewer network in Torbay, as part of a £95 million scheme – one of the largest in the 'Clean Sweep' programme.

Subject to receipt of the necessary planning permissions, projects for Newquay, Camborne and Redruth, Sidmouth and Dawlish will be completed for the new millennium.

Over 200 inland sewage treatment works have been modernised and upgraded since 1989 when only 60% complied with consent standards. Now over 97% of the works comply providing enhanced levels of environmental protection for inland waterways and, as a direct result of the company's investment, over 370 planning embargoes have been lifted during the past nine years.

*Research and development*

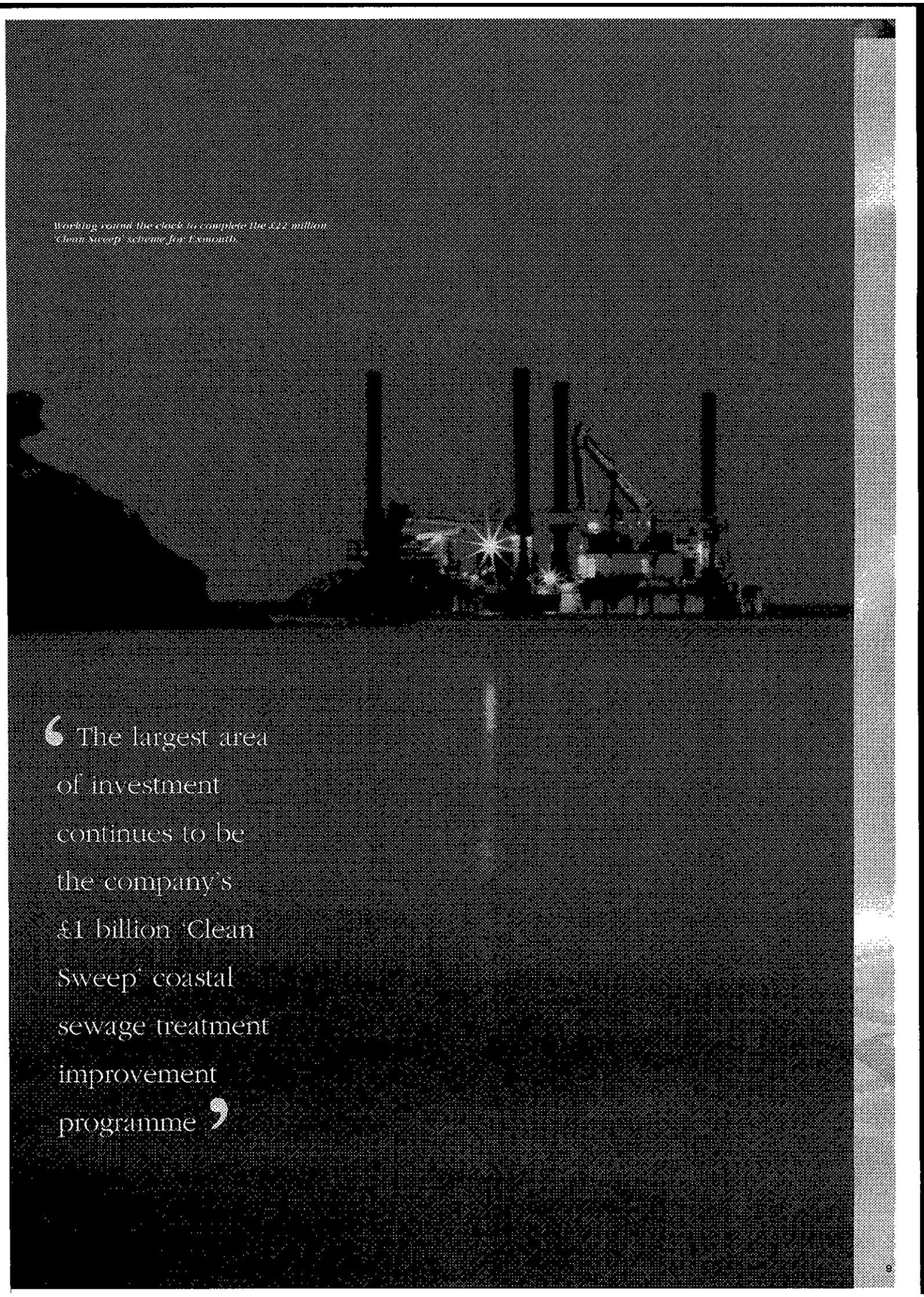
Research and technological development initiatives continue to add value to the company's capital investment programme and the cost effective operation of clean and waste water processes.

Developments in the improvement of drinking water quality within the water distribution system have been continued as part of a national initiative.

The company continues to focus its research on a collaborative basis through national programmes. It is currently supporting projects undertaken by WRc plc, the Construction Industry Research and Information Association (CIRIA) and UK Water Industry Research Ltd (UKWIR).

As part of the company's involvement with UKWIR it project managed nine contracts, four of which have been collaborative contracts with the Department of the Environment, Transport and the Regions and the Environment Agency.

✻ R J BATY  
 CHIEF EXECUTIVE  
 SOUTH WEST WATER SERVICES LIMITED



*Working round the clock to complete the £22 million 'Clean Sweep' scheme for Exmouth.*

“ The largest area of investment continues to be the company’s £1 billion ‘Clean Sweep’ coastal sewage treatment improvement programme ”

NON-REGULATED BUSINESSES

Continued success of strategic focus

**Through organic growth and strategic acquisition, South West Water Plc has created a successful group of related environmental businesses – operating as the Enterprise Division – which individually are among the leading companies within their respective national and international markets. 1997/98 saw further progress.**

The Group has now established the Enterprise Division as a separate company in order better to reflect the importance of these major businesses to the future of the Group. The name for the new company, Viridor Limited – from the Latin *to make green* – was chosen to reflect the business's environmental focus.

Viridor will continue to concentrate on the core activities of waste management – especially disposal – environmental instrumentation and construction services. During the year selective acquisitions were completed, the most notable of which was the purchase of Terry Adams Limited which increased Haul Waste's landfill void by some 50%.

The non-regulated businesses have grown substantially during the year and are well positioned to make a significant contribution to the Group in the future.

Financial progress

Total non-regulated turnover increased by 22.1% to £178.1 million during the year, with almost 75% generated outside the Group. Non-regulated businesses now account for 35% of Group external turnover. Operating profit, before exceptional items, rose by 17.7% to £16.6 million buoyed by a particularly strong performance in waste management and in spite of difficult market conditions for some of the environmental instrumentation products.

Profit before tax and exceptional items rose by £1.3 million to £9.9 million, after taking account of the cost of funding acquisitions and further capital investment.

During the year the Group made arrangements to dispose of its shareholding in Societa Italo Britannica dell'Acqua Srl. This was in line with the Group's strategy of focusing on a limited number of attractive businesses.

Waste management

Haul Waste is one of the largest waste disposal businesses in the United Kingdom and is a leading collector of waste in the South West of England.

During the year two major acquisitions strengthened Haul Waste's position in the market. These were the purchase of Terry Adams

Limited, an Exeter based waste disposal company, for £76.6 million (with a further £28 million contingent upon certain planning permissions) and the acquisition of Greenhill Enterprises Limited, the waste disposal and quarrying subsidiary of Southern Water Plc for £7.1 million. The acquisitions provide the Group with a nationwide network of landfill sites and both companies have been fully integrated into Haul Waste.

A further 4.2 million cubic metres of planning permissions have been achieved for two landfill extensions at Pilsforth near Manchester and 7.5 million cubic metres for a new site at Erin in Derbyshire.

Haul Waste's strategic landfill at Dunbar in Scotland was opened as planned in September 1997. With a capacity of 13 million cubic metres, the site is contracted to take a minimum of 150,000 tonnes of waste each year from the City of Edinburgh. The one million cubic metre Wamwell site in Dorset was also opened on schedule during the year.

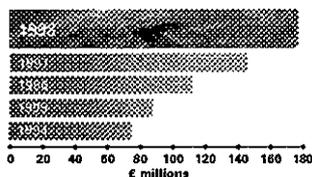
The Environment Agency has now granted a site licence for Haul Waste's fully engineered site at Broadpath near Uffculme in Devon. Engineering is now underway and the site is due to open later this year as is the site at Astley, west of Manchester and Squabb Wood in Hampshire.

The acquisitions, allied to the planning successes achieved, increase Haul Waste's consented landfill void to 69 million cubic metres with a further 59 million cubic metres of unconsented void. Consequently, Haul Waste is one of the largest waste disposal companies in the United Kingdom and is strongly positioned to capitalise on the increasing shortage of landfill disposal capacity.

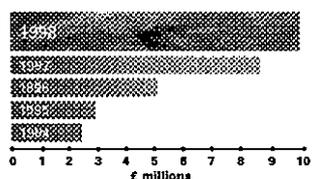
Under NFF04 contracts awarded in 1997, which have electricity prices guaranteed, the business will increase its landfill gas power generation capacity from 14 to 30 megawatts. The increased capacity will see the Group as a whole generating the equivalent of around 80% of its electricity needs in 1998/99 compared with less than half in 1995/96.

In line with its environmental strategy, Haul Waste has further increased its ISO 14001 environmental accreditation. This now covers ten

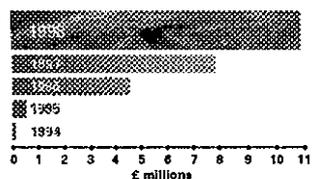
Non-regulated businesses -- Turnover



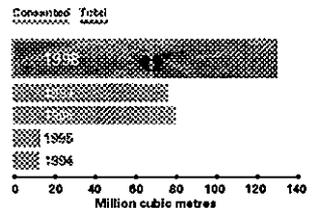
Non-regulated businesses -- Profit before tax (before exceptional items)

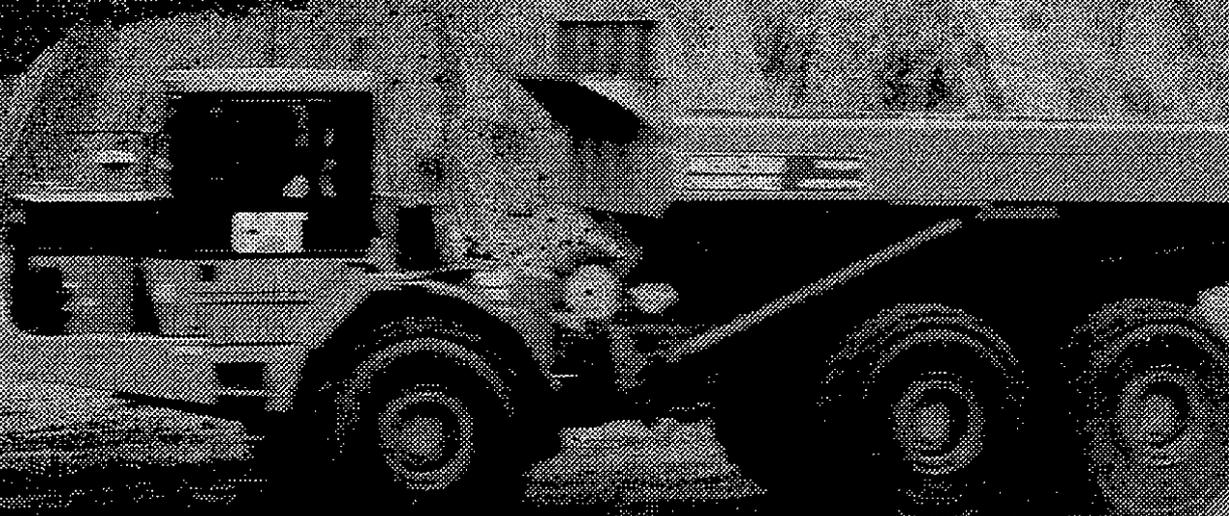


Waste management -- Profit before tax (before exceptional items)



Landfill void



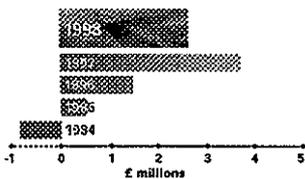
A large, white haul truck is the central focus of the upper half of the image. It is parked on a dirt road at a waste disposal site. In the background, there are several other vehicles, including a smaller truck and a larger piece of machinery, and a large, dark, textured mound of waste material. The overall scene is industrial and somewhat desolate.

“ Haul Waste is one of  
the largest waste disposal  
businesses in the United  
Kingdom ”

A man in a white shirt, dark tie, and white hard hat is standing in the lower right quadrant of the image. He is holding a large sheet of paper, likely a blueprint or site plan, and looking towards the camera. The background is a dark, textured surface, possibly a pile of waste or a large container.

*Colin Drimmond, Chief Executive of  
Viridor Limited, at Haul Waste's  
Broadpath, Devon site.*

Environmental instrumentation -- Profit before tax (before exceptional items)



of its sites in recognition of the high standard of its environmental management systems. These complement their existing ISO 9001 accreditations for quality management systems.

Turnover in Haul Waste rose by 43.4% to £60.1 million. Operating profit rose by 36.3% to £10.9 million and profit before tax and exceptional items rose by 39.7% to £10.9 million.

Environmental instrumentation

Environmental Instrumentation Group is a leading international specialist in environmental instrumentation equipment with a share of up to 20% of the world market in key product areas. The group trades in over 150 countries with development, manufacturing and assembly facilities in the UK and USA.

During the first half of the year the group's UK operations suffered from difficult trading conditions in its materials testing business in certain Far East markets and the rapid escalation in the strength of sterling which affected many exporting businesses. Its GLI water quality instrumentation business in the USA continued to show profit growth.

By re-focussing attention into areas with a better growth potential, the overall performance in the second half of the year has been improved considerably. However, it is recognised that short term prospects in certain Far East markets remain uncertain and that sterling and dollar exchange rates may stay at current high levels. Action is therefore also being taken to further minimise fixed costs by accelerating planned rationalisation of manufacturing facilities in the UK and USA. As a result, the group is well positioned for future growth, capitalising on the world wide environmental and infrastructure development trends.

Hydrolab Corporation, a Texas based world leader in the manufacture and supply of multi-parameter water quality monitoring instruments, was acquired in July 1997 for £9.4 million and has been fully integrated into the group. Hydrolab's products complement those of the group and are well suited to its world wide distribution network.

Despite the difficult overseas trading conditions which prevailed, the group secured a number of major orders including a £1.6 million World Bank funded contract - with payment guaranteed - for the supply of instrumentation to the Nigerian Environmental Agency. The group was also awarded contracts for the supply of soil testing

equipment in Libya and Latvia valued at £350,000 and £200,000 respectively.

EI Group's positive reaction to adverse trading conditions saw them recover ground in the second half of the year. Full year operating profit was £2.9 million on turnover of £41.8 million (1997 £4.0 million on £40.0 million). Profit before tax was £2.6 million (1997 £3.7 million).

Construction services

T J Brent is a market leader in construction services in the South West of England and during the year it continued to make considerable progress in all areas of the business. Turnover with companies outside the Group continues to grow strongly.

Two of T J Brent's operating divisions, Copa and Engineered Products were merged to form a new division - Copa MEICA - serving utility companies and industry and the division is already making excellent progress through its distributor in the USA.

In line with its strategy, T J Brent won a number of significant contracts with companies outside the Group. The proportion rose to 37% in 1997/98 and is expected to grow substantially in 1998/99.

During the year T J Brent was awarded an Institution of Civil Engineers Merit Award for an outstanding example of civil engineering work - a combined sewer overflow project in Paignton, Devon - and a British Safety Council National Safety Award in recognition of the company's commitment to health and safety.

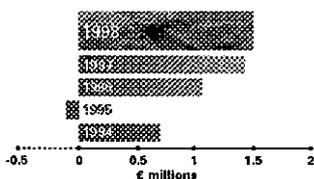
T J Brent's successful year culminated in turnover increasing by 9.8% to £56.9 million, with external turnover rising by 12.3% to £21.0 million. Operating profit rose by 11.8% to £1.9 million with profit before tax, before exceptional items, up 7.1% to £1.5 million.

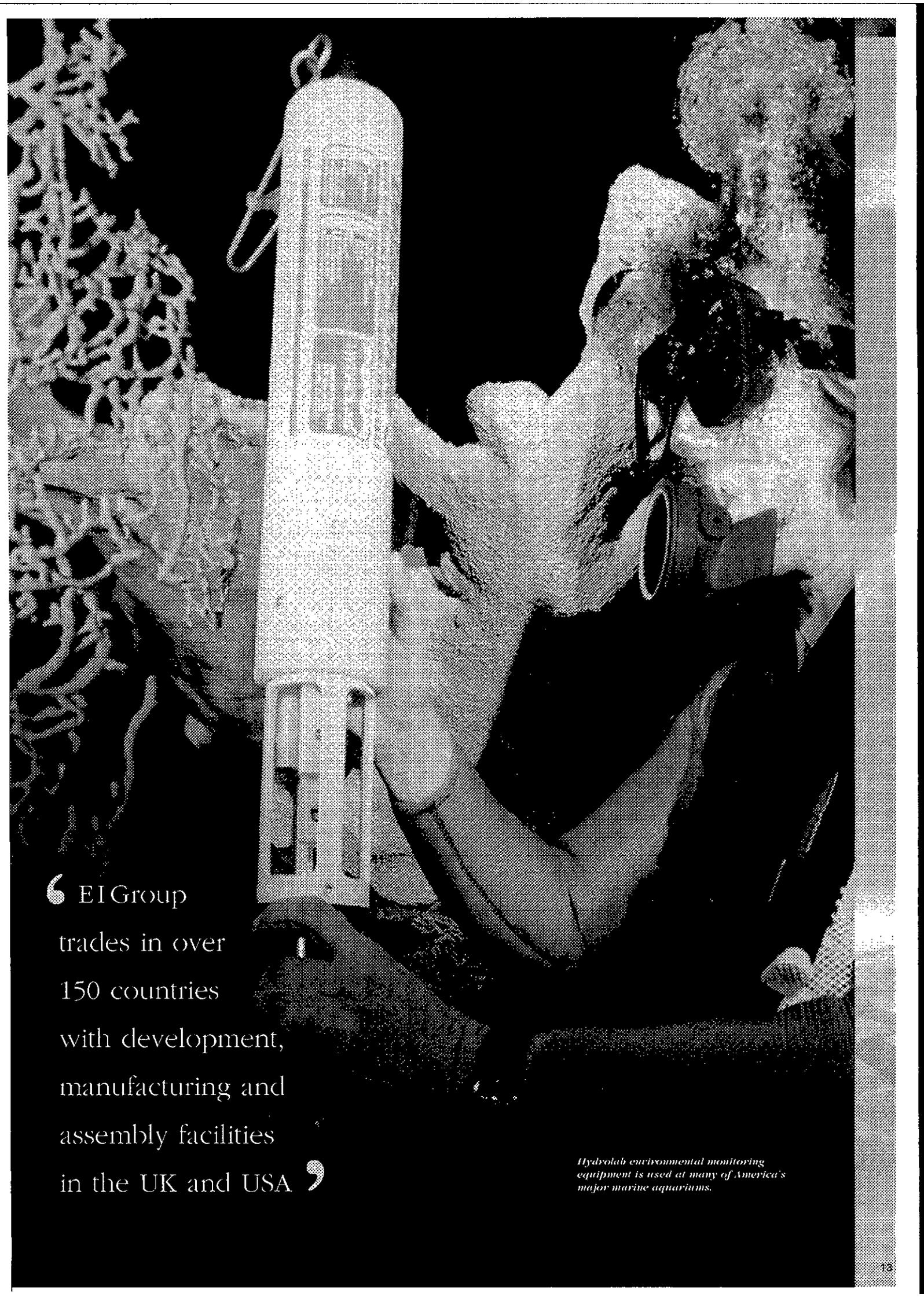
Property

In line with the Group's overall strategy, a number of further profitable disposals were made during the year, including the Ballard House office building in Plymouth. Over the past two years, the sale of property has realised £21.8 million of cash for the Group.

✻ C I J H DRUMMOND  
CHIEF EXECUTIVE  
VIRIDOR LIMITED

Construction services -- Profit before tax (before exceptional items)





“ EI Group  
trades in over  
150 countries  
with development,  
manufacturing and  
assembly facilities  
in the UK and USA ”

*Hydrolab environmental monitoring  
equipment is used at many of America's  
major marine aquariums.*

## FINANCIAL REVIEW

## Summary

**The financial results for the year were dominated by the impact of the windfall tax charge of £104 million.**

Trading from continuing operations increased, producing a £4.6 million improvement in operating profit before exceptional items.

Substantial acquisitions were made in accordance with the longer term strategy of the Group.

The impact from exceptional items was significant, with the disposal of the Group's interest in SIBA producing a loss of £7.5 million in 1998 together with a £7.5 million water and sewerage business restructuring charge. In contrast, exceptional profits, principally from the disposal of the Group's interest in Westcountry Television Limited, totalled £14.0 million in 1997.

## Operating profit

Group turnover for the year increased by 11.2% to £382.1 million. Total turnover of the water and sewerage services business was £251.2 million, up by 2.7% on 1997. This was broadly in line with the approved tariff increase, whilst being impacted adversely by customers moving to the measured usage tariff. Total turnover (including intra-group trading) for the non-regulated businesses reached £178.1 million, including £60.1 million from waste management, £41.8 million from environmental instrumentation, £56.9 million from the construction services business, and £10.8 million from property development disposals.

Operating costs for the year of £241.0 million (before exceptional items) increased by £32.1 million influenced largely by non-regulated business growth.

Operating profit was £141.8 million for 1997/98, before exceptional items. The water and sewerage services business contributed an operating profit of £125.2 million, up £3.9 million on 1997. Non-regulated businesses contributed an operating profit of £16.6 million, up £2.5 million on the profit of 1997, including £1.8 million from companies acquired during the year.

## Finance costs

Gross interest payable totalled £46.5 million. Substantially all borrowings are sterling denominated. Interest receivable of £14.5 million is derived from investment of temporarily surplus funds in financial investments and on the money market, predominantly in sterling.

The Group crystallised a further benefit, of £12.2 million in 1998, from the utilisation of finance lease facilities linked to standby letters of credit counter-indemnified by cash deposits.

Net interest payable was £19.8 million for the year, £1.8 million higher than in 1997, which incorporates financing costs arising from the need to finance the ongoing water and sewerage business improvement programme, from funding the Group's £93.9 million acquisitions during the year, and the first of two £52.0 million windfall tax payments.

## Profit before tax

Profit before tax, and before exceptional items, was £121.6 million, 2.5% up on the 1997 comparative.

Non-regulated businesses contributed a profit before tax, and exceptional items, of £9.9 million, which compares with £8.6 million in 1997. The companies acquired during 1998 are expected to become earnings enhancing during 1999.

## Taxation

The Group's ordinary business taxation charge for the year was £13.0 million. This includes a mainstream UK corporation tax charge, though the major part remains a write-off of currently non-recoverable advance corporation tax on the current year dividends. The Group's capital investment programme continues to generate substantial capital allowances to be set against taxable profits.

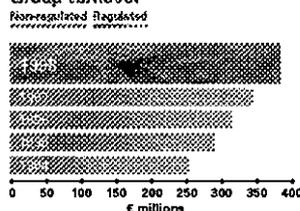
The results include provision of £104.0 million for the full cost of the windfall tax.

## Dividends and retained earnings

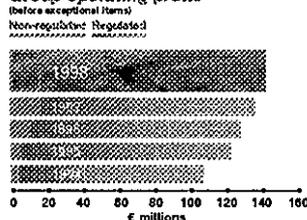
The Directors recommend the payment of a final cash dividend of 27.8p per share for the year ended 31 March 1998. Together with the interim dividend of 13.2p per share paid on 6 April 1998 this makes a total cash dividend for the year of 41.0p per share, an increase of 11.7% on the dividend for 1997.

In respect of the final dividend for the year, the Board is proposing an Enhanced Scrip Dividend Alternative worth 30.0p per share – an enhancement of nearly 8%. Details of the option, and a cash offer alternative, are contained in the circular posted to shareholders with this Annual Report. The arrangement is subject to approval at the annual general meeting.

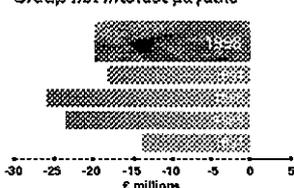
## Group turnover



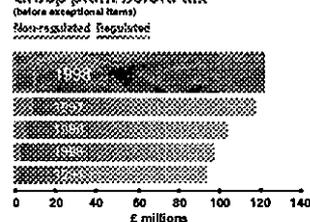
## Group operating profit

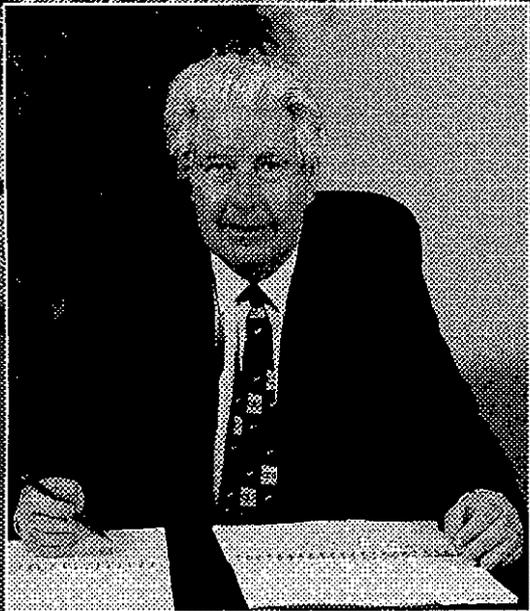


## Group net interest payable



## Group profit before tax

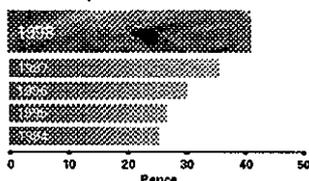




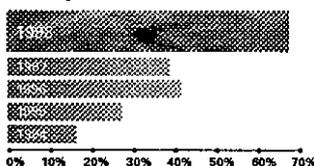
*Ken Hill, Group Director of Finance,  
South West Water Plc*

*The 'Clean Sweep' scheme for Plymouth  
features a new waste water treatment works  
substantially funded through finance leasing.*

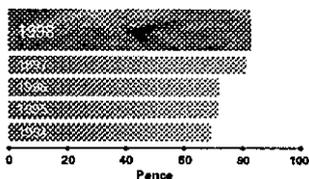
Dividend per share



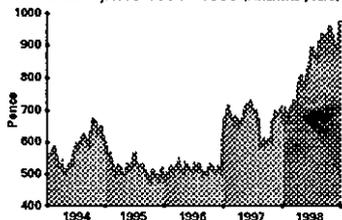
Gearing



Earnings per share  
(before exceptional items)



South West Water  
Share price 1994-1998 (Financial years)



The total cost of the interim and recommended final dividend of the Company is £67.6 million (including advance corporation tax).

This year a retained loss, of £64.5 million, has been transferred from reserves.

The dividend paid by South West Water Services Limited to the Company for 1997/98, for ordinary business purposes, amounted to £61.1 million.

Investment

Capital expenditure by the Group on tangible fixed assets was £174.6 million (1997 £157.2 million) of which £154.7 million was for the water and sewerage business.

Business acquisitions during the year involved an investment of £93.9 million. After placing fair values on the underlying assets and liabilities acquired, a £71.2 million value for goodwill resulted, which has been charged against shareholders' funds. Further payments, up to a maximum of £28.0 million, may become payable dependent upon landfill planning approvals.

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

Financing

Cash inflow from operating activities has improved to £188.6 million (1997 £155.9 million). Capital expenditure and financial investment cash outflow increased from £141.6 million in 1997 to £175.7 million in 1998. Taxation cash outflows of £61.2 million (1997 £11.0 million) included the first windfall tax instalment. Acquisitions and disposals moved from a cash inflow of £28.0 million in 1997, reflecting the successful business disposals, to a cash outflow of £20.8 million in 1998 arising mainly from business expansion in the waste management segment. Overall cash outflow by the Group, before the use of liquid resources and financing, was £123.1 million (1997 £22.7 million).

During the year £90.9 million of finance lease facilities were drawn down, and £75.2 million of cash was placed on deposit with financial institutions, as part of the financing initiative referred to in note 6 to the financial statements. £75.0 million of finance leases, previously collateralised by cash deposits, were included at 31 March 1998. £68.5 million of loan stock was issued in connection with the acquisition of Terry Adams Limited. During February 1998 £85.0 million Sterling notes were repaid at maturity. These were partially refinanced by £50.0 million medium term borrowings from banks.

At 31 March 1998 loan and finance lease obligations were £642.6 million and the Group held current asset investments and cash of £98.1 million. Net borrowings, which increased by £188.7 million during the year to £544.5 million, represent 68% of shareholders' funds (1997 39%).

At 31 March 1998 the Group had uncommitted short-term borrowing facilities of around £300 million.

The balance between fixed and floating rate debt and current asset investments 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 26 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.

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 1998 the limit was £2.0 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 £129.1 million to £131.4 million largely as a result of shares issued under the Company's scrip dividend alternative and the Sharesave and Executive Share Option Schemes.

Permission was obtained from shareholders at the annual general meeting in July 1997 to purchase up to 10% of the Company's Ordinary share capital. Renewal of the authority will be sought at the 1998 annual general meeting.

Shareholders' return

The dividend of 41.0p is paid out of earnings per share, before exceptional items, of 82.8p. On a net basis, the cover for payment of dividends is 2.0 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 662.5p and was 978.5p at 31 March 1998. The value of net assets per share at book value, at 31 March 1998, was 613.6p.

✻ K L HILL  
GROUP DIRECTOR OF FINANCE  
SOUTH WEST WATER PLC

**Kenneth George Harvey**  
BSc, CEng, FIEE (57)

**Chairman**

was appointed on 1 March 1997. He was formerly chairman and chief executive of Norweb Plc. He was chairman of National Grid Holdings in 1995 and was previously deputy chairman of London Electricity and earlier its engineering director. He is a non-executive director of several other companies.

**Stanislas Michael Yassukovich**  
CBE (63)

**Non-executive Deputy Chairman**

was appointed on 16 November 1992 and became Deputy Chairman on 13 November 1996. He is chairman of Easdaq SA and Hemingway Properties Plc, deputy chairman of Bristol & West Plc and a director 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.

**Robert John Baty**  
CEng, FICE, FCIWEM, MIMgt, ACI Arb, FIWO (54)

**Chief Executive, 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 (47)

**Chief Executive, Viridor Limited**

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.

**Kenneth Leslie Hill**  
CPFA (57)

**Group Director of Finance**

was appointed on 21 September 1989. He is a 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 (65)

**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, chairman of the British Cement Association and deputy pro-chancellor of University of Kent.

**Sir Simon James Day**  
MA (63)

**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. He is also a director of Exeter and Devon Airport Limited.

**Alan Thomas Fletcher**  
MA (63)

**Non-executive Director**

was appointed on 26 May 1993. He is managing partner of Rubicon Partners, chairman of Vector Industries Limited, deputy chairman of Shepherd Building Group and a director of several other companies. Formerly he was chairman and chief executive of the Wilkinson Sword Group and chief operating officer of Swedish Match.

**Bruce Alexander Ognou Hewett**  
BSc(Eng), MSc, EurIng, CEng, FICE, FCIWEM (62)

**Non-executive Director**

was appointed on 1 April 1993 as Director of Technical and Environmental Affairs. On his retirement from this executive position on 31 March 1997 he became a Non-executive Director. He has over 30 years' experience in the water industry, including nine years with international consulting engineers and has held senior appointments with Southern Water Plc, including managing director of Southern Water Services Limited. He is a member of Eureau Commission 3 and the British Committee of the International Water Supply Association.

*Constituents of the Board*

**Audit**

*Sir Geoffrey H. Chipperfield (Chairman)*  
*Sir Simon J. Day*  
*A. T. Fletcher*

**Environment**

*B. A. O. Hewett (Chairman)*  
*R. J. Baty*  
*C. J. H. Drummond*

**Nomination**

*S. M. Yassukovich (Chairman)*  
*Sir Geoffrey H. Chipperfield*  
*A. T. Fletcher*  
*K. G. Harvey*

**Remuneration**

*A. T. Fletcher (Chairman)*  
*Sir Geoffrey H. Chipperfield*  
*K. G. Harvey*

*Company secretary and registered office*

*K. D. Woodier*  
*Peninsula House, Rydon Lane,*  
*Exeter EX2 7HR*  
*Registered in England*  
*No. 2366640*

*auditors*

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

*registrars*

*Lloyds Bank Registrars*  
*54 Parkside Road South,*  
*Birmingham B30 3EP*

## REPORT OF THE DIRECTORS

The Directors of South West Water Plc ('the Company') present their ninth Annual Report, in respect of the year ended 31 March 1998, together with the audited Financial Statements of the Company for that year.

The Financial Statements will be laid before the shareholders at the ninth annual general meeting of the Company, to be held on 30 July 1998, notice of which is given on pages 58 to 60.

*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*

The Group loss on ordinary activities after taxation was £10.4 million. The Directors recommend a final cash dividend of 27.8p per ordinary share, making a total for the year of 41.0p, the cost of which would be £54.1 million, leaving a retained loss of £64.5 million to be transferred from reserves.

The Financial Review on pages 14 to 16 analyses the results in more detail, and sets out other financial information.

*Corporate governance*

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

*Board of Directors*

The Board of Directors comprises three Executive and six Non-executive Directors. The Board and the Audit, Remuneration and Environment Committees meet on a regular basis. The Nominations 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, accounting policies, financial controls and procedures as well as regulatory compliance matters; the Environment Committee keeps under review the environmental performance of the Group 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 17 and the report of the Remuneration Committee is on pages 21 to 24.

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

A statement of the Directors' responsibilities in respect of the financial statements is set out on page 25.

*Internal financial control*

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

There has been no change in the membership of the Board during the year but Sir Simon J Day will retire as a Director of the Company at the end of the annual general meeting.

Sir Geoffrey H Chipperfield and Mr S M Yassukovich are due to retire by rotation at the annual general meeting. Both Directors offer themselves for re-election and resolutions for their re-election will be proposed at the annual general meeting. Neither of the Directors offering themselves for re-election has 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 23 and 24.

## 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 profit sharing and Sharesave 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.

## Year 2000

Many computer and related digital storage systems express dates using only the last two digits of the year. Such systems require modification to accommodate the year 2000 in order to avoid malfunction and commercial disruption. The operations of the Group depend not only on in-house computer and related systems, but also to some degree, on those of other parties, including key suppliers.

A programme, to address the impact of the Year 2000 on the Group's businesses, has been established and substantial progress has been made. A risk analysis has been undertaken to determine how the change will affect each business, and has been developed to address key risks in advance of critical dates. Priority has been given to those computer systems which could cause a significant impact on the Group's business if Year 2000 failures arise. This programme includes a requirement for the testing of future computer systems changes. The risk analysis also considers the impact on the Group's business of Year 2000 failures by other parties, including key suppliers, who have participated in a formal Year 2000 compliance confirmation process.

Action is being taken with a view to ensuring that all business critical systems will be fully compliant by the end of December 1998 and all other systems compliant by the end of March 1999.

The Year 2000 compliance programme is designed to avoid computer systems failure from a year change. However, that work cannot provide an absolute assurance. The Directors will provide resources to deal promptly in the event that there are residual failures.

The total cost of modifications to the Group's computer hardware and software is estimated at £5.6 million, of which £2.0 million is for new equipment that will be capitalised. The remainder will be charged against profits in the year it is incurred, including £1.0 million in 1997/98.

## Research and development

Research and development activities continued throughout the Group during the year, with expenditure of £2.1 million on research. Further information is included in the Operating Reviews.

## Donations

During the year charitable donations amounting to £38,000 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

It is the Company's payment policy for the year ending 31 March 1999 to follow the Confederation of British Industry (CBI) Code of Practice on supplier payments. The Company will agree payment terms with individual suppliers in advance and abide by such terms. Information about the Code, and copies thereof, may be obtained from the CBI at Centre Point, 103 New Oxford Street, London WC1A 1DU. The ratio, expressed in days, between the amount invoiced to the Company by its suppliers during 1998 and the amount owed to its trade creditors at 31 March 1998, was 53 days.

## Substantial shareholdings

At 25 June 1998 interests in the issued share capital had been reported by:

	Shares	%
PDFM/UBS International	13,264,217	10.04
Norwich Union Life Insurance Society	8,484,180	6.56
AXA Group	7,966,434	6.19

## REPORT OF THE DIRECTORS

## Future developments

The Director General of Water Services' 1999 review of water and sewerage price limits is the most challenging issue facing the Group. A significant amount of time and energy is being expended prior to South West Water Services Limited making its submission to Ofwat. It is vital that South West Water's business is adequately financed to carry out its legal and environmental obligations having regard to the special circumstances of the region it serves.

## Auditors

Price Waterhouse were appointed auditors until the conclusion of the ninth annual general meeting and have indicated their willingness to continue in office. A resolution for their re-appointment, which reflects their proposed merger with Coopers & Lybrand, will be proposed at the annual general meeting.

## Appointed Business

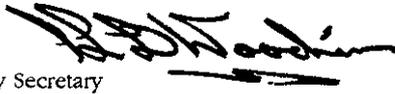
South West Water Services Limited is required to publish additional financial information relating to the 'Appointed Business' as water and sewerage undertaker in accordance with the Instrument of Appointment from the Secretary of State for the Environment. A copy of this information will be available from 15 July 1998 by application to the Company Secretary at Peninsula House, Rydon Lane, Exeter EX2 7HR.

## Annual general meeting

The ninth annual general meeting will be held at The Great Hall, University of Exeter, Exeter, Devon on 30 July 1998 at 11.00 a.m.

In addition to routine business, resolutions will be proposed at the annual general meeting to change the name of the Company, to renew the existing authorities to issue a limited number of shares and to purchase up to 10% of the existing share capital; to request authority to make changes to the Company's Articles of Association and to offer an enhanced scrip dividend alternative. Details are set out in the notice of meeting on pages 58 to 60 and in the accompanying circular to shareholders.

By Order of the Board

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

25 June 1998

## REPORT BY THE AUDITORS ON COMPANY'S COMPLIANCE WITH LISTING RULES

## 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 page 18 concerning the Group's compliance with the paragraphs of the Cadbury Code of Best Practice specified for our review by the London Stock Exchange and the adoption of the going concern basis in preparing the financial statements. The objective of our review is to draw attention to non-compliance with Listing Rules 12.43(j) and 12.43(v) if not otherwise disclosed.

## Basis of opinion

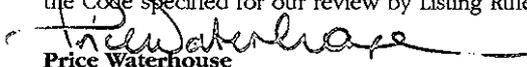
We carried out our review having regard to guidance issued by the Auditing Practices Board. That guidance does not require us to perform the additional work necessary to, and we do not, express any opinion on the effectiveness of either the Group's system of internal financial control or corporate governance procedures nor

on the ability of the Group to continue in operational existence.

## Opinion

In our opinion, your statements on internal financial controls and on going concern on page 18 have provided the disclosures required by the Listing Rules referred to above 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 18 appropriately reflects the Group's compliance with the other aspects of the Code specified for our review by Listing Rule 12.43(j).

  
Price Waterhouse  
Chartered Accountants  
25 June 1998

The Remuneration Committee ("the Committee") is an appointed committee of the Board which determines the remuneration and terms of employment of the Executive Directors and senior management of the Group. The Committee is comprised solely of Non-executive Directors being Mr A T Fletcher, who is Chairman of the Committee, Sir Geoffrey H Chipperfield and Mr K G Harvey, Chairman of the Company.

The constitution and operation of the Committee complies with Section A of the Best Practice Provisions on Directors' Remuneration, annexed to the Stock Exchange Listing Rules. In determining remuneration policy, service contracts and compensation, the Committee has given full consideration to Section B of the Best Practice Provisions.

#### Remuneration policy

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

#### Board structure

The Board does not believe at the present time that there is a need for a Group chief executive. The Chief Executives of the two businesses, the Group Director of Finance and the six Non-executive Directors jointly direct the Group.

#### Executive Directors

The remuneration package of the Executive Directors comprises:

- i* Salary and benefits – these are based on surveys conducted by external consultants and reviewed annually by the Committee;
- ii* Performance related bonus – annual performance related bonuses are awarded in accordance with an incentive bonus scheme for Executive Directors and senior management and on the achievement of overall corporate and individual objectives established by the Committee. The maximum bonus achievable under the scheme for Executive Directors is 40% of basic salary;
- iii* Long-Term Incentive Plan – a restricted share plan for Executive Directors and senior management was operated by the Company during the year following approval by shareholders at the annual general meeting on 29 July 1997. In line with the recommendations contained in the Best Practice Provisions, the Committee ensures that awards under the Plan are subject to challenging performance criteria which are reflected in the Company's

relative performance against comparators and it also ensures that awards made under the Plan are phased over time. The eventual number of shares, if any, which participants may receive is dependent upon the achievement of the performance conditions of the Plan over a three year period. These are:

- a* the Company's growth in earnings per share, calculated in accordance with IIMR guidelines, must be equal to at least 2.5% per annum above the Retail Price Index; and
- b* the Company's total shareholder return (share price growth and dividends paid) must be at least equal to that of the company ranked at the 13th position (reading from the bottom) of the list of 25 companies in the FT-SE classified as 'Utilities'.

The ranked performance of the Company, as described in *b* above, will determine the proportion of the awards to which participants will be entitled;

*iv* Provision for pension – 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, dependent on length of service, at normal retirement date will normally amount to two-thirds of final pensionable pay (subject to any restriction in respect of the Earnings Cap).

Messrs Drummond 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. 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 consists of the highest basic salary in any consecutive twelve month period of service within five years of retirement.

Until 1998 the average bonuses paid to Executive Directors over the previous five years were also included in pensionable pay. As recommended by the Best Practice Provisions, bonuses are no longer included in pensionable pay.

In determining remuneration arrangements for Executive Directors, the Committee gives full consideration to their impact on the pension funds and costs of providing individual pension arrangements; and

- v* Service agreements – all Executive Directors have one year rolling service agreements.

## REPORT OF THE REMUNERATION COMMITTEE

## Emoluments of Directors

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

	Salary /fees £000	Performance bonuses £000	Other emoluments £000	Payments related to supplementary pension £000	<b>Total 1998 £000</b>	Total 1997 £000
<i>Chairman</i>						
K G Harvey (appointed 1 March 1997)	80		11		<b>91</b>	7
<i>Executive Directors</i>						
R J Baty	93	36*	8		<b>137</b>	107
C I J H Drummond	93	36*	10	12	<b>151</b>	133
K L Hill	101	79*	10	8	<b>198</b>	138
<i>Non-executive Directors</i>						
Sir Geoffrey H Chipperfield	21				<b>21</b>	19
Sir Simon J Day	21				<b>21</b>	19
A T Fletcher	23				<b>23</b>	24
B A O Hewett (Executive Director to 31 March 1997)	19	22			<b>41</b>	129
S M Yassukovich	25				<b>25</b>	19
<i>Directors resigned in 1996/97</i>						
Executive Directors						172
Non-executive Directors						21
	476	173	39	20	<b>708</b>	788

Other emoluments include car benefit and health cover.

\* The performance bonuses for the Executive Directors disclosed above include the application of the annual incentive bonus plan for the two years 1997 and 1998.

In addition to the sums included in the above table, Mr K W Court, the former Chairman, received an £83,000 performance bonus in respect of 1997. As a consequence, the defined benefit pension accrued at 31 March 1997 was modified to £49,000.

The performance bonuses of Mr K W Court and Mr K L Hill disclosed above had regard to the annual incentive bonus plan and to payments received by the Company under the Westcountry Television Limited Long-Term Incentive Plan upon the successful sale of the Company's shareholding in that company in 1997.

The performance bonus of Mr B A O Hewett, disclosed above, is in respect of his 1997 executive directorship.

The remuneration of Non-executive Directors is determined by the Board taking account of independent surveys of comparable appointments. Non-executive Directors do not vote on any resolutions submitted as part of this process.

#### Directors' pensions

Defined benefit pensions accrued and payable on retirement for Directors holding office during 1998 are shown in the table below:

	Increase in accrued pension during 1998 (net of inflation)	Increase in transfer value (net of inflation)	Accrued pension entitlement at 31 March 1998
	<i>a</i>	<i>b</i>	<i>c</i>
	£000	£000	£000
R J Baty	6	82	59
C I J H Drummond	3	30	13
K L Hill	6	91	66

Column *a* above is the increase in accrued pension during 1998 (net of inflation). It recognises:

- i* the accrual rate for the additional year's service based upon the pensionable pay at the end of the year; and
- ii* the effect of pay changes in real terms (net of inflation) based upon the accrued pension at the start of the year.

Column *b* is the increase in the transfer value of column *a*. This has been calculated in accordance with Actuarial Guidance Note GN11 less, where paid, directors' contributions.

Column *c* is the accumulated total pension at the end of the year payable at normal retirement age.

The Supplementary Pension Scheme, which mainly funds pension provision above the Earnings Cap, provides benefits in tax-paid lump sum form at retirement. Appropriate figures have been included in the above accrued pension totals.

Directors have the option to pay additional voluntary contributions; neither the contributions nor the resulting benefits are included in the above table.

#### Directors' share interests

##### *a Shareholdings*

The number of shares of the Company in which Directors held beneficial interests at 31 March 1998 and 31 March 1997 were:

	1998	1997		1998	1997
R J Baty	4,643	11,562	K G Harvey	2,000	—
Sir Geoffrey H Chipperfield	1,500	1,500	B A O Hewett	12,068	11,493
Sir Simon J Day	1,500	1,500	K L Hill	13,816	13,043
C I J H Drummond	2,189	1,556	S M Yassukovich	—	—
A T Fletcher	1,211	1,146			

As a result of electing for a scrip dividend alternative the following Directors acquired additional shares on 6 April 1998:

R J Baty	282	K G Harvey	29
C I J H Drummond	118	B A O Hewett	129
A T Fletcher	18	K L Hill	294

As a result of reinvestment of dividends in a Personal Equity Plan, R J Baty, C I J H Drummond and B A O Hewett acquired an additional 30, 20 and 4 shares respectively on 7 April 1998, and an additional 11, 7 and 2 shares respectively on 23 June 1998.

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

## REPORT OF THE REMUNERATION COMMITTEE

Directors' share interests continued

**b Restricted Share Plan**

In addition to the above beneficial interests, the following Directors have a contingent interest in the number of shares shown below, representing the maximum number of shares to which they would become entitled under the Group's Long-Term Incentive Plan if all of the relevant criteria are met:

R J Baty	7,949
C I J H Drummond	7,949
K L Hill	8,532

These awards, which were the first to be made under the Restricted Share Plan following its approval by shareholders in July 1997, were made on 12 September 1997.

**c Executive Share Option Scheme**

Options to subscribe for shares of the Company under the Executive Share Option Scheme at 31 March 1998 and 31 March 1997 were:

Grant date	1995	1993	1992	1991	1998 Total	1997 Total
Subscription price	503p	496p	418p	328p		
R J Baty	7,500	15,000	4,600	20,000	47,100	47,100
C I J H Drummond	8,000	22,500	-	-	30,500	30,500
B A O Hewett	15,000	-	-	-	15,000	15,000
K L Hill	8,000	25,500	-	-	33,500	33,500

No 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 23 to the financial statements.

**d Sharesave Scheme**

Options to subscribe for shares of the Company under the Sharesave Scheme as at 31 March 1998 and 31 March 1997 were:

Grant date	1997	1995	1998 Total	1997 Total
Subscription price	556p	373p		
R J Baty	701	2,774	3,475	5,033
C I J H Drummond	1,753	-	1,753	-
B A O Hewett	-	-	-	4,389
K L Hill	1,241	-	1,241	-

During the year, Mr R J Baty exercised an option under the Scheme in respect of 2,259 shares at an exercise price of 332p per share and Mr B A O Hewett exercised an option under the Scheme in respect of 3,311 shares at an exercise price of 393p per share. At the date of these exercises, the market price of the shares was 813.5p and 832.5p per share respectively. Options over 1,078 shares held by Mr B A O Hewett lapsed during the year. The options to subscribe at 556p were granted during the year.

The exercise dates of the above options are shown in note 23 to the financial statements.

**e Share price**

The market price of the Company's shares at 31 March 1998 was 978.5p (1997 669.0p) and the range during the year to that date was 662.5p to 991.5p (1997 575.0p to 729.0p).

A T Fletcher, Chairman  
Remuneration Committee  
25 June 1998



## DIRECTORS' RESPONSIBILITY STATEMENTS

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

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

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

## 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 26 to 56 (including the additional disclosures on pages 22 to 24 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 29 and 30.

### Respective responsibilities of Directors and Auditors

As described above, 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

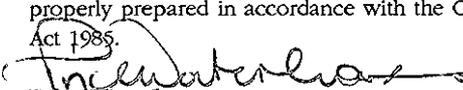
We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements 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 1998, and of the loss 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**

Chartered Accountants and Registered Auditors  
25 June 1998

## GROUP PROFIT AND LOSS ACCOUNT

for the year ended 31 March 1998

	Notes	Before exceptional items 1998 £m	Exceptional items 1998 £m	Total 1998 £m	Before exceptional items 1997 £m	Exceptional items 1997 £m	Total 1997 £m
<b>Turnover</b>							
Continuing operations		370.5	–	370.5	343.6	–	343.6
Acquisitions		11.6	–	11.6	–	–	–
Total turnover	2	382.1	–	382.1	343.6	–	343.6
Other operating income		0.7	–	0.7	0.7	–	0.7
Operating costs	3	(241.0)	(7.5)	(248.5)	(208.9)	(5.2)	(214.1)
<b>Operating profit</b>							
Continuing operations		140.0	(7.5)	132.5	135.4	(5.2)	130.2
Acquisitions		1.8	–	1.8	–	–	–
Total operating profit	2	141.8	(7.5)	134.3	135.4	(5.2)	130.2
Business disposal (loss)/profit	5	–	(7.5)	(7.5)	–	19.2	19.2
(Loss)/income from interests in associated undertakings		(0.4)	–	(0.4)	1.2	–	1.2
Net interest payable	6	(19.8)	–	(19.8)	(18.0)	–	(18.0)
<b>Profit/(loss) on ordinary activities before taxation</b>							
	2	121.6	(15.0)	106.6	118.6	14.0	132.6
Tax on profit on ordinary activities	7	(13.0)	(104.0)	(117.0)	(14.3)	–	(14.3)
<b>Profit/(loss) on ordinary activities after taxation</b>							
	8	108.6	(119.0)	(10.4)	104.3	14.0	118.3
Dividends	9	(54.1)	–	(54.1)	(47.4)	–	(47.4)
<b>Retained profit/(loss) transferred to/(from) reserves</b>							
	24	54.5	(119.0)	(64.5)	56.9	14.0	70.9
<b>Earnings per share</b>							
	10	82.8p	(90.7)p	(7.9)p	81.2p	10.9p	92.1p

The notes on pages 29 to 56 form part of these financial statements.

There were no recognised gains or losses for the Group or the Company, other than the profit/(loss) for the year, in 1998 or 1997.

A statement of movements in reserves is given in note 24.

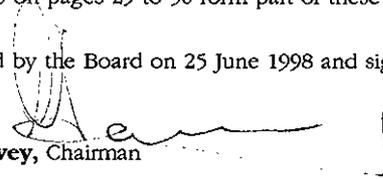
## BALANCE SHEETS

at 31 March 1998

	Notes	Group		Company	
		1998 £m	1997 £m	1998 £m	1997 £m
<b>Fixed assets</b>					
Tangible assets	13	1,555.3	1,396.4	0.3	0.9
Investments	14	3.0	1.4	609.6	533.6
		<b>1,558.3</b>	<b>1,397.8</b>	<b>609.9</b>	<b>534.5</b>
<b>Current assets</b>					
Stocks	15	16.2	19.6	–	–
Debtors: amounts falling due after more than one year	16	12.3	10.8	175.3	171.6
Debtors: amounts falling due within one year	17	79.4	70.8	82.5	23.2
Investments	18	95.2	185.3	25.7	60.9
Cash at bank and in hand		2.9	2.4	–	–
		<b>206.0</b>	<b>288.9</b>	<b>283.5</b>	<b>255.7</b>
<b>Current liabilities</b>					
Creditors: amounts falling due within one year	19	(372.0)	(331.8)	(238.6)	(208.7)
<b>Net current (liabilities)/assets</b>		<b>(166.0)</b>	<b>(42.9)</b>	<b>44.9</b>	<b>47.0</b>
<b>Total assets less current liabilities</b>					
Creditors: amounts falling due after more than one year	20	(523.2)	(395.1)	(200.5)	(150.3)
Provisions for liabilities and charges	21	(37.3)	(21.5)	–	–
Deferred income	22	(25.5)	(22.4)	–	–
<b>Net assets</b>	2	<b>806.3</b>	<b>915.9</b>	<b>454.3</b>	<b>431.2</b>
<b>Capital and reserves</b>					
Called-up share capital	23	131.4	129.1	131.4	129.1
Share premium account	24	149.0	148.5	149.0	148.5
Other reserves	24	–	–	3.1	3.1
Profit and loss account	24	525.9	638.3	170.8	150.5
<b>Shareholders' funds</b>	25	<b>806.3</b>	<b>915.9</b>	<b>454.3</b>	<b>431.2</b>

The notes on pages 29 to 56 form part of these financial statements.

Approved by the Board on 25 June 1998 and signed on its behalf by:

  
K G Harvey, Chairman

## GROUP CASH FLOW STATEMENT

*for the year ended 31 March 1998*

	Notes	1998 £m	1997 £m
<b>Cash inflow from operating activities</b>	32a	<b>188.6</b>	155.9
<b>Returns on investments and servicing of finance</b>	32b	<b>(18.8)</b>	(18.6)
<b>Taxation</b>	32b	<b>(61.2)</b>	(11.0)
<b>Capital expenditure and financial investment</b>	32b	<b>(175.7)</b>	(141.6)
<b>Acquisitions and disposals</b>	32b	<b>(20.8)</b>	28.0
<b>Equity dividends paid</b>		<b>(35.2)</b>	(35.4)
Cash outflow before use of liquid resources and financing		<b>(123.1)</b>	(22.7)
<b>Management of liquid resources</b>	32b	<b>90.4</b>	18.9
<b>Financing</b>	32b	<b>32.7</b>	10.3
<b>Increase in cash in year</b>		<b>—</b>	6.5

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 1998, 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 or disposed of during the year are included for the periods of ownership.

**c Turnover**

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

**d 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 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

**f Grants and contributions** continued

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 13.

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 scheme.

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

**j Research and development expenditure**

Research and development 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. When a previously acquired subsidiary or associated undertaking is sold the profit or loss on disposal is determined after including the attributable amount of goodwill previously 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.

**o Financial instruments**

Derivative financial instruments are used to hedge interest rate risks. Interest differentials on derivatives are charged against profits in the year in which they are incurred.

## 2 Segmental analysis

By class of business:

	Turnover		Operating profit		Profit before tax	
	1998	1997	1998	1997	1998	1997
	£m	£m	£m	£m	£m	£m
Water and sewerage business:						
Before exceptional items	<b>251.2</b>	244.6	<b>125.2</b>	121.3	<b>111.7</b>	110.0
Less: Intra-group trading	<b>(1.2)</b>	(1.7)	–	–	–	–
	<b>250.0</b>	242.9	<b>125.2</b>	121.3	<b>111.7</b>	110.0
Exceptional items:						
Restructuring provision	–	–	<b>(7.5)</b>	–	<b>(7.5)</b>	–
Business disposal profit	–	–	–	–	–	1.7
After exceptional items	<b>250.0</b>	242.9	<b>117.7</b>	121.3	<b>104.2</b>	111.7
Non-regulated businesses:						
Before exceptional items:						
Waste management	<b>60.1</b>	41.9	<b>10.9</b>	8.0	<b>10.9</b>	7.8
Environmental instrumentation	<b>41.8</b>	40.0	<b>2.9</b>	4.0	<b>2.6</b>	3.7
Construction services	<b>56.9</b>	51.8	<b>1.9</b>	1.7	<b>1.5</b>	1.4
Other	<b>19.3</b>	12.2	<b>1.6</b>	1.5	<b>(4.4)</b>	(3.2)
	<b>178.1</b>	145.9	<b>17.3</b>	15.2	<b>10.6</b>	9.7
Less: Intra-group trading	<b>(46.0)</b>	(45.2)	<b>(0.7)</b>	(1.1)	<b>(0.7)</b>	(1.1)
	<b>132.1</b>	100.7	<b>16.6</b>	14.1	<b>9.9</b>	8.6
Exceptional items:						
Proposed bids costs	–	–	–	(5.2)	–	(5.2)
Business disposal (loss)/profit	–	–	–	–	<b>(7.5)</b>	17.5
After exceptional items	<b>132.1</b>	100.7	<b>16.6</b>	8.9	<b>2.4</b>	20.9
Group totals	<b>382.1</b>	343.6	<b>134.3</b>	130.2	<b>106.6</b>	132.6

	Net assets/(liabilities)		Employees (average number)	
	1998	1997	1998	1997
	£m	£m		
Water and sewerage services	<b>877.2</b>	948.3	<b>1,734</b>	1,765
Non-regulated businesses:				
Waste management	<b>78.2</b>	47.1	<b>312</b>	297
Environmental instrumentation	<b>15.5</b>	13.4	<b>443</b>	411
Construction services	<b>2.4</b>	1.6	<b>838</b>	567
Other	<b>(160.2)</b>	(88.2)	<b>93</b>	113
	<b>(64.1)</b>	(26.1)	<b>1,686</b>	1,388
Intra-group trading	<b>(6.8)</b>	(6.3)	–	–
	<b>806.3</b>	915.9	<b>3,420</b>	3,153

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

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.

## NOTES TO THE FINANCIAL STATEMENTS

**2 Segmental analysis** continued

By geographical origin:

	Turnover		Operating profit		Profit before tax	
	1998 £m	1997 £m	1998 £m	1997 £m	1998 £m	1997 £m
United Kingdom	<b>358.6</b>	325.2	<b>131.7</b>	128.2	<b>104.0</b>	130.6
Americas	<b>23.5</b>	18.4	<b>2.6</b>	2.0	<b>2.6</b>	2.0
	<b>382.1</b>	343.6	<b>134.3</b>	130.2	<b>106.6</b>	132.6

By geographical destination:

	Turnover		Operating profit		Profit before tax	
	1998 £m	1997 £m	1998 £m	1997 £m	1998 £m	1997 £m
United Kingdom	<b>344.8</b>	309.4	<b>131.3</b>	126.6	<b>104.1</b>	129.0
Continental Europe	<b>2.5</b>	4.8	<b>0.3</b>	0.4	<b>(0.1)</b>	0.4
Americas	<b>19.6</b>	16.8	<b>2.2</b>	2.2	<b>2.2</b>	2.2
Other	<b>15.2</b>	12.6	<b>0.5</b>	1.0	<b>0.4</b>	1.0
	<b>382.1</b>	343.6	<b>134.3</b>	130.2	<b>106.6</b>	132.6

Intra-group trading arose in the United Kingdom.

The exceptional items set out in notes 4 and 5 arose in the United Kingdom.

Net assets are not separately disclosed by geographic origin and destination since they are substantially located in the United Kingdom.

The employee numbers include 258 working outside the United Kingdom (1997 211).

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	Location
Waste management	8.5	1.8	1.8	31.6	United Kingdom
Environmental instrumentation	3.1	—	—	0.9	Americas
Other	—	—	—	0.2	United Kingdom
	<b>11.6</b>	<b>1.8</b>	<b>1.8</b>	<b>32.7</b>	

### 3 Operating costs

	Continuing operations 1998 £m	Acquisitions 1998 £m	Total 1998 £m	Total 1997 £m
Manpower costs (note 11)	51.9	1.9	<b>53.8</b>	45.4
Raw materials and consumables	35.3	1.7	<b>37.0</b>	37.1
Rentals under operating leases:				
Hire of plant and machinery	1.8	0.4	<b>2.2</b>	1.9
Other operating leases	3.3	–	<b>3.3</b>	1.7
Research and development expenditure	1.7	0.4	<b>2.1</b>	2.0
Auditors' remuneration	0.3	–	<b>0.3</b>	0.2
Other external charges	60.8	0.4	<b>61.2</b>	59.3
Depreciation:				
On owned assets	27.2	0.9	<b>28.1</b>	25.4
On assets held under finance leases	12.9	–	<b>12.9</b>	9.7
On assets held under defeased finance leases	1.2	–	<b>1.2</b>	0.4
Provision for diminution in value	3.9	–	<b>3.9</b>	–
Deferred income released to profits	(1.0)	–	<b>(1.0)</b>	(1.2)
Infrastructure renewals charge	7.0	–	<b>7.0</b>	6.8
Other operating charges	32.4	4.1	<b>36.5</b>	25.4
	<b>238.7</b>	<b>9.8</b>	<b>248.5</b>	<b>214.1</b>

Fees payable to the Company's auditors for non-audit work, mainly in connection with taxation advice and acquisitions, amounted to £0.3m (1997 £0.8m).

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

### 4 Exceptional items

	1998 £m	1997 £m
Operating profit is after charging the following exceptional items:		
Water and sewerage business restructuring provision:		
Manpower costs	<b>2.9</b>	–
Provision for diminution in value	<b>3.9</b>	–
Other operating charges	<b>0.7</b>	–
Proposed bids costs:		
Other external charges	–	5.2
	<b>7.5</b>	<b>5.2</b>

## NOTES TO THE FINANCIAL STATEMENTS

**5 Business disposal (loss)/profit**

	1998 £m	1997 £m
During the year the Group realised a (loss)/profit from the disposal of an interest in:		
Societa Italo Britannica dell'Acqua Srl	(7.5)	–
Westcountry Television Limited	–	14.8
Other businesses	–	4.4
	<b>(7.5)</b>	<b>19.2</b>

The business disposal (loss)/profit is after charging £7.1m of acquisition goodwill previously written off to reserves (1997 £0.6m).

The tax charge was not affected by the business disposal (loss)/profit.

The income arising from the operation of the business disposed of during the year was not material to the profits of the Group.

**6 Net interest payable**

	1998 £m	1997 £m
Interest payable:		
Bank loans and overdrafts	(15.1)	(13.8)
Other loans	(23.2)	(23.0)
Interest element of finance lease rentals	(7.9)	(7.6)
Other finance costs	(0.3)	(0.3)
	<b>(46.5)</b>	<b>(44.7)</b>
Interest receivable:		
Listed redeemable securities	1.7	2.3
Other investments (as defined in note 18)	12.8	15.7
	<b>14.5</b>	<b>18.0</b>
Gain on defeasance of finance leases	<b>12.2</b>	<b>8.7</b>
Net interest payable	<b>(19.8)</b>	<b>(18.0)</b>

Interest element of finance lease rentals is shown after netting £8.5m (1997 £7.2m) interest receivable on cash deposited against collateralised finance lease obligations (note 26).

The gain on defeasance of finance leases results from the in-substance early extinguishment (defeasance) of obligations under finance leases. South West Water Services Limited has:

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

These deposited funds, which totalled £127.9m at 31 March 1998 (1997 £52.7m), together with interest earned thereon, may be used to settle the rental obligations under those finance leases. If the finance leases terminate due to the insolvency of the financial institutions which have issued the letters of credit no liability will fall on South West Water Services Limited, or any South West Water Group company.

## 6 Net interest payable continued

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

A gain of £12.2m (1997 £8.7m) has been recognised, equivalent to the difference between the finance lease proceeds and the funds deposited with financial institutions to cover rentals arising therefrom, after making provision for possible rental variations and costs as follows:

	1998 £m	1997 £m
Gain on defeasance of finance leases	15.7	12.7
less: provision for finance lease rental variations (note 21)	(3.3)	(2.9)
less: costs	(0.2)	(1.1)
	<b>12.2</b>	8.7

## 7 Tax on profit on ordinary activities

	1998 £m	1997 £m
United Kingdom taxation:		
Corporation tax at 31% (1997 33%):		
Current year	12.8	12.7
Prior year	(2.3)	(2.9)
Advance corporation tax:		
Current year dividends	9.4	10.7
Previous year utilisation	(6.9)	(6.3)
Overseas taxation	–	0.1
	<b>13.0</b>	14.3
Exceptional item:		
United Kingdom taxation:		
Windfall tax	104.0	–
	<b>117.0</b>	14.3

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 21).

The windfall tax arises under the Finance (No. 2) Act 1997. The first of two equal instalments of £52.0m was paid on 1 December 1997. The second instalment is payable on 1 December 1998.

## 8 Profit of parent company

	1998 £m	1997 £m
Profit on ordinary activities after taxation dealt with in the accounts of the parent company	<b>58.2</b>	60.6

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

## NOTES TO THE FINANCIAL STATEMENTS

**9 Dividends**

	1998 £m	1997 £m
Interim dividend of 13.2p (1997 11.8p) per share paid 6 April 1998	17.4	15.1
Proposed final dividend of 27.8p (1997 24.9p) per share payable 17 August 1998	36.7	32.3
	<b>54.1</b>	47.4

**10 Earnings per share**

	Profit on ordinary activities after taxation		Earnings per share	
	1998 £m	1997 £m	1998 p	1997 p
Before exceptional items	<b>108.6</b>	104.3	<b>82.8</b>	81.2
Exceptional items:				
Water and sewerage restructuring provision	(7.5)	-	(5.7)	-
Proposed bids costs	-	(5.2)	-	(4.0)
Business disposal (loss)/profit	(7.5)	19.2	(5.7)	14.9
Windfall tax	(104.0)	-	(79.3)	-
	<b>(119.0)</b>	14.0	<b>(90.7)</b>	10.9
After exceptional items	<b>(10.4)</b>	118.3	<b>(7.9)</b>	92.1

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 1998, calculated in accordance with the guidelines issued by the Institute of Investment Management and Research, were a loss of 2.2p (1997 77.2p). This has been calculated by eliminating the business disposal loss, equivalent to 5.7p per share (1997 business disposal profit equivalent to 14.9p per share), and is provided for clarification purposes for users of the financial statements. The 1998 figure includes the impact of the windfall tax, equivalent to 79.3p per share.

Earnings per share before exceptional items on the nil distribution basis were 89.9p (1997 89.6p). This has been calculated by eliminating the taxation charge of £9.4m (1997 £10.7m) in respect of irrecoverable advance corporation tax on the interim and proposed final dividends. Earnings per share after exceptional items on the nil distribution basis were a loss of 0.8p (1997 100.5p).

The above earnings per share figures have been calculated by dividing the profit/(loss) figures by 131.2 million being the weighted average number of shares in issue during the year (1997 128.4 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 23, had been in issue during the year.

## 11 Employees and employment costs

The average number of persons (including Directors) employed by the Group was 3,420 (1997 3,153).

Employment costs comprise:

	Continuing operations 1998 £m	Acquisitions 1998 £m	<b>Total 1998 £m</b>	Total 1997 £m
Wages and salaries:				
Before exceptional items	61.8	1.7	<b>63.5</b>	57.7
Exceptional items	2.9	-	<b>2.9</b>	-
After exceptional items	64.7	1.7	<b>66.4</b>	57.7
Social security costs	5.8	0.2	<b>6.0</b>	5.4
Pension costs (note 30)	(1.7)	-	<b>(1.7)</b>	(2.0)
<b>Total employment costs</b>	<b>68.8</b>	<b>1.9</b>	<b>70.7</b>	<b>61.1</b>

Charged as follows:

	Continuing operations 1998 £m	Acquisitions 1998 £m	<b>Total 1998 £m</b>	Total 1997 £m
Manpower costs (note 3):				
Before exceptional items	49.0	1.9	<b>50.9</b>	45.4
Exceptional items	2.9	-	<b>2.9</b>	-
After exceptional items	51.9	1.9	<b>53.8</b>	45.4
Research and development expenditure	1.2	-	<b>1.2</b>	1.5
Capital schemes and infrastructure renewals expenditure	15.7	-	<b>15.7</b>	14.2
	<b>68.8</b>	<b>1.9</b>	<b>70.7</b>	<b>61.1</b>

## NOTES TO THE FINANCIAL STATEMENTS

**12 Directors' emoluments**

	<b>1998</b>	1997
	<b>£000</b>	£000
Executive Directors:		
Remuneration – salary	<b>287</b>	480
– performance bonuses	<b>173</b>	126
Other emoluments	<b>28</b>	41
Payments in respect of tax liability from supplementary pension arrangements	<b>20</b>	32
Non-executive Directors	<b>200</b>	109
<b>Total emoluments</b>	<b>708</b>	788
Compensation in respect of a service agreement	–	29

The emoluments of the highest paid Director, including gains on the exercise of share options, were £198,000 (1997 £316,000).

Total gains made by Directors on the exercise of share options were £25,000 (1997 £201,000). The highest paid Director did not exercise any share options in 1998 (1997 gain £144,000).

Total emoluments include £185,000 (1997 £112,000) payable to Directors for services as directors of subsidiary undertakings.

At 31 March 1998 retirement benefits were accruing to three Directors under defined benefit pension schemes (1997 four). The accrued pension entitlement at 31 March 1998 under defined benefit pension schemes of the highest paid Director was £66,000 (1997 £55,000). No pension contributions were payable to defined contribution schemes (1997 £6,000, all for the highest paid Director).

Performance bonuses for 1997 and 1998 have been disclosed in 1998 numbers above.

More detailed information concerning Directors' emoluments, shareholdings and share options is shown in the Report of the Remuneration Committee on pages 21 to 24.

### 13 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 1998 £m
Cost:						
At 1 April 1997	72.5	574.2	431.6	424.5	112.8	<b>1,615.6</b>
Additions	11.9	42.0	19.4	47.7	53.6	<b>174.6</b>
Grants and contributions		(3.4)				<b>(3.4)</b>
Arising on acquisitions	37.7	-	-	1.8	-	<b>39.5</b>
Disposals	(6.0)	-	-	(4.8)	-	<b>(10.8)</b>
Transfers	0.2	36.1	25.0	13.9	(75.2)	-
At 31 March 1998	116.3	648.9	476.0	483.1	91.2	<b>1,815.5</b>
Depreciation:						
At 1 April 1997	13.6		73.7	131.9		<b>219.2</b>
Charge for year	5.3		8.5	30.4		<b>44.2</b>
Provision for diminution in value	3.2		-	0.7		<b>3.9</b>
Disposals	(3.4)		-	(3.7)		<b>(7.1)</b>
At 31 March 1998	18.7		82.2	159.3		<b>260.2</b>
Net book value:						
At 31 March 1998	97.6	648.9	393.8	323.8	91.2	<b>1,555.3</b>
At 31 March 1997	58.9	574.2	357.9	292.6	112.8	1,396.4
Assets held under finance leases included above:						
Cost: At 31 March 1998	-	-	193.9	119.1	-	<b>313.0</b>
Depreciation: Charge for year	-		3.2	9.7		<b>12.9</b>
Depreciation: At 31 March 1998	-		12.9	45.9		<b>58.8</b>
Assets held under defeased finance leases included above:						
Cost: At 31 March 1998	-	56.7	48.2	24.3	27.1	<b>156.3</b>
Depreciation: Charge for year	-		0.2	1.0		<b>1.2</b>
Depreciation: At 31 March 1998	-		0.3	1.3		<b>1.6</b>

## NOTES TO THE FINANCIAL STATEMENTS

**13 Tangible fixed assets** continued**Group** continued

The cost of land and buildings and of operational properties includes non-depreciable land of £2.1m (1997 £1.6m) and £7.4m (1997 £7.2m) respectively.

The net book value of land and buildings comprises:

	1998 £m	1997 £m
Freehold	57.6	52.3
Long leasehold	0.2	0.2
Short leasehold	39.8	6.4
	<b>97.6</b>	<b>58.9</b>

The net book value of infrastructure assets is stated after deducting £37.1m (1997 £33.7m) grants and contributions.

Out of the total depreciation charge for the Group of £44.2m (1997 £37.3m), the sum of £2.0m (1997 £1.8m) has been charged to capital projects and £42.2m (1997 £35.5m) against profits. The provision for diminution in value of £3.9m (1997 nil) has been included in the exceptional water and sewerage business restructuring provision (note 4).

**Company**

	Freehold land and buildings £m	Fixed and mobile plant, vehicles and computers £m	Total 1998 £m
Cost:			
At 1 April 1997	1.0	1.0	2.0
Additions	-	0.3	0.3
Disposals	(1.0)	(0.9)	(1.9)
At 31 March 1998	-	0.4	0.4
Depreciation:			
At 1 April 1997	0.5	0.6	1.1
Charge for year	-	0.1	0.1
Disposals	(0.5)	(0.6)	(1.1)
At 31 March 1998	-	0.1	0.1
Net book value:			
At 31 March 1998	-	0.3	0.3
At 31 March 1997	0.5	0.4	0.9

## 14 Fixed asset investments

	Shares	Loans	Group Total 1998 £m	Company Total (Shares) 1998 £m
	£m	£m	£m	£m
<i>Subsidiary undertakings</i>				
Cost:				
At 1 April 1997				533.6
Additions				154.6
Disposals				(72.4)
Provisions				(7.3)
At 31 March 1998				608.5
<i>Associated undertakings</i>				
Cost (Company) or share of net assets (Group):				
At 1 April 1997	–	1.4	1.4	–
Additions	0.8	–	0.8	0.8
Loss for year	–	(0.4)	(0.4)	–
Disposals	(4.6)	(3.2)	(7.8)	–
Goodwill	4.3	2.2	6.5	–
Transfer	(0.3)	–	(0.3)	–
At 31 March 1998	0.2	–	0.2	0.8
<i>Own shares</i>				
Cost:				
Additions	1.3	–	1.3	0.5
Provisions	(0.4)	–	(0.4)	(0.2)
At 31 March 1998	0.9	–	0.9	0.3
<i>Other investments</i>				
Cost:				
Additions	–	0.4	0.4	–
Arising on acquisitions	–	1.2	1.2	–
Transfer	0.3	–	0.3	–
At 31 March 1998	0.3	1.6	1.9	–
<i>Total investments</i>				
At 31 March 1998	1.4	1.6	3.0	609.6
At 31 March 1997	–	1.4	1.4	533.6

Investments made by the Company during the year in subsidiary undertakings included the acquisition of Terry Adams Limited, subsequently sold to a Group company, and the subscription for shares to facilitate expansion.

Goodwill includes £7.1m written back on the disposal of Societa Italo Britannica dell'Acqua Srl (note 5) offset by £0.6m arising on the acquisition of Enviro-Logic Limited (note 28). In 1997 goodwill of £2.0m arising on acquisitions was offset by £0.2m on a business disposal.

## NOTES TO THE FINANCIAL STATEMENTS

**14 Fixed asset investments continued**

A Long-Term Incentive Plan is operated for senior management of the Group. Awards under the Plan, involving the release of ordinary shares in the Company to participants, is dependent upon performance conditions being met. These shares are released out of an Employee Share Ownership Plan, a discretionary trust, established to facilitate the operation of the incentive scheme. More information on the operation of the incentive scheme is included in the Report of the Remuneration Committee on pages 21 to 24.

During the year the trustees of the Employee Share Ownership Plan purchased 155,000 of the Company's ordinary shares (1997 nil) financed through non-interest bearing advances made by sponsoring Group companies. The market value of those shares, which are disclosed as Group investments at 31 March 1998, was £1.5m (1997 nil). 53,000 of those shares (1997 nil) are disclosed as Company investments, having a market value of £0.5m at 31 March 1998 (1997 nil). The costs of the incentive scheme are charged to profits over the period of its operation, and are included in employment costs.

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

**15 Stocks**

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Raw materials and consumables	6.4	5.5	–	–
Work in progress	5.5	10.0	–	–
Finished goods	4.3	4.1	–	–
	<b>16.2</b>	<b>19.6</b>	<b>–</b>	<b>–</b>

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

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Amounts owed by subsidiary undertakings			172.8	168.0
Prepayments for pension costs	10.3	8.2	0.7	1.0
Other prepayments and accrued income	2.0	2.6	1.8	2.6
	<b>12.3</b>	<b>10.8</b>	<b>175.3</b>	<b>171.6</b>

**17 Debtors: amounts falling due within one year**

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Trade debtors	52.3	46.1	–	–
Amounts owed by subsidiary undertakings			80.6	20.2
Other debtors	3.1	8.1	0.2	0.9
Prepayments and accrued income	22.6	16.4	1.7	2.1
Advance corporation tax recoverable	1.4	0.2	–	–
	<b>79.4</b>	<b>70.8</b>	<b>82.5</b>	<b>23.2</b>

## 18 Current asset investments

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Listed investments	21.1	31.3	–	–
Other investments:				
Overnight deposits	5.0	4.7	–	–
Other	69.1	149.3	25.7	60.9
	74.1	154.0	25.7	60.9
	95.2	185.3	25.7	60.9
Market value of listed investments	21.2	31.4	–	–

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

£75.0m (1997 £150.0m) deposited against collateralised finance lease obligations (note 26) is not included in the Group numbers.

## 19 Creditors: amounts falling due within one year

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Loans:				
Bank loans and overdrafts	2.1	1.3	17.7	18.9
Short-term loans	25.2	35.7	25.0	35.0
Sterling notes	–	85.4	–	85.4
European Investment Bank loans	10.3	9.0	–	–
Unsecured loan stock notes	72.4	4.2	72.4	4.2
	110.0	135.6	115.1	143.5
Obligations under finance leases	11.6	15.1	–	–
Trade creditors	64.6	72.6	0.8	1.2
Amounts owed to subsidiary undertakings			0.4	–
Other creditors	17.3	13.4	10.0	5.5
Advance corporation tax	12.4	11.9	12.2	11.9
Corporation tax	11.5	3.6	–	–
Windfall tax	52.0	–	52.0	–
Other taxation and social security	14.1	5.7	–	–
Accruals and deferred income	30.4	27.7	–	0.4
Interim dividend	11.4	13.9	11.4	13.9
Proposed final dividend	36.7	32.3	36.7	32.3
	372.0	331.8	238.6	208.7

## NOTES TO THE FINANCIAL STATEMENTS

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

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Loans:				
Sterling bond	150.0	150.0	150.0	150.0
European Investment Bank loans	96.3	106.7	–	–
Other loans	50.1	0.1	50.0	–
	<b>296.4</b>	256.8	<b>200.0</b>	150.0
Obligations under finance leases	224.6	136.0	–	–
Amounts owed to subsidiary undertakings			0.4	0.2
Other creditors	2.2	2.3	0.1	0.1
	<b>523.2</b>	395.1	<b>200.5</b>	150.3

**21 Provisions for liabilities and charges**

	At 1 April 1997	Charged against profits	Arising on acquisitions	Utilised during year	Group At 31 March 1998
	£m	£m	£m	£m	£m
Environmental and landfill restoration	13.7	5.0	10.1	(3.6)	25.2
Finance lease rental variations (note 6)	2.9	3.3	–	–	6.2
Infrastructure renewals	2.4	7.0	–	(10.0)	(0.6)
Restructuring costs	2.5	7.5	–	(6.2)	3.8
Other provisions	–	1.5	1.3	(0.1)	2.7
	21.5	24.3	11.4	(19.9)	37.3

*Deferred taxation*

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

	Group	
	1998 £m	1997 £m
Tax effect of timing differences due to:		
Accelerated capital allowances	78.8	72.3
Other timing differences	(3.5)	(4.3)
	<b>75.3</b>	68.0
Advance corporation tax recoverable	(47.1)	(41.2)
Maximum potential liability	<b>28.2</b>	26.8

As infrastructure assets are not depreciated, deferred taxation will only crystallise in the event of their disposal at amounts in excess of their tax written-down value. The tax effect at 31% (1997 33%) due to accelerated capital allowances on infrastructure assets which has been excluded above amounts to £147.9m (1997 £144.8m). No advance corporation tax is available to be set against this liability (1997 £4.4m additional to the amount set out in the table above). In the opinion of the Directors, the likelihood of a liability crystallising in the foreseeable future is remote.

## 22 Deferred income

	Group	
	1998 £m	1997 £m
At 1 April	23.4	24.2
Additions	4.3	0.4
Released to profits	(1.0)	(1.2)
At 31 March	26.7	23.4
To be released within one year	(1.2)	(1.0)
To be released after more than one year	25.5	22.4

## 23 Called-up share capital

	1998 £m	1997 £m
<i>Authorised</i>		
175,000,000 ordinary shares of £1 each	175.0	175.0
<i>Allotted, called-up and fully paid</i>		
131,372,809 ordinary shares of £1 each (1997 129,137,651)	131.4	129.1
<i>Ordinary shares allotted during year</i>		
	<b>1998</b>	1997
	<b>Number</b>	Number
In lieu of £12.0m cash (1997 £3.5m) under scrip dividend alternative	1,794,638	585,817
For consideration of £1.1m (1997 £2.6m) under South West Water Executive Share Option Scheme to Directors and senior employees who exercised their options	239,800	608,850
For consideration of £0.7m under South West Water Sharesave Scheme to employees who exercised their options in 1997	–	218,100
For consideration of £1.7m (1997 £1.1m) to SWW Trustees Limited on behalf of employees who exercised their options under the South West Water Sharesave Scheme	200,720	164,906
For consideration of £0.9m to SWW Share Schemes Trustees Limited on behalf of participants in the Profit Sharing Scheme in 1997	–	138,591
	<b>2,235,158</b>	1,716,264

### 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	
					1998	1997
Sharesave	12 Dec 1989	176p	–	1995 – 1997	–	25
	5 July 1991	287p	–	1996 – 1998	142	159
	3 July 1992	332p	–	1997 – 1999	94	242
	2 July 1993	393p	–	1998 – 2000	140	160
	6 Jan 1995	373p	–	2000 – 2002	352	391
	8 July 1997	556p	–	2000 – 2004	782	–
Executive	5 July 1991	328p	a	1994 – 2001	20	63
	3 July 1992	418p	a	1995 – 2002	41	97
	5 July 1993	496p	b	1996 – 2003	182	257
	6 Jan 1995	503p	c	1998 – 2005	188	266
					<b>1,941</b>	1,660

## NOTES TO THE FINANCIAL STATEMENTS

**23 Called-up share capital 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; and
- 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 1998 there were 1,542 participants in the Sharesave Scheme (1997 923) and 56 in the Executive Scheme (1997 64).

Options granted to Directors, included above, are shown in the Report of the Remuneration Committee on pages 21 to 24.

**24 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 1997	148.5	3.1	638.3	150.5
Retained (loss)/profit for year			(64.5)	4.1
Premium on shares issued	1.3			
Adjustment for shares issued under the scrip dividend alternative	(1.8)		17.2	17.2
Adjustment for shares issued under the Sharesave Scheme through Employee Share Ownership Trust	1.0		(1.0)	(1.0)
Goodwill arising on acquisitions			(71.2)	
Goodwill written back on disposal			7.1	
<b>At 31 March 1998</b>	<b>149.0</b>	<b>3.1</b>	<b>525.9</b>	<b>170.8</b>

The cumulative value of goodwill at 31 March 1998 resulting from acquisitions, which has been written off to reserves, is £175.8m (1997 £111.7m).

**25 Statement of movements in shareholders' funds**

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
(Loss)/profit on ordinary activities after taxation	(10.4)	118.3	58.2	60.6
Dividends	(54.1)	(47.4)	(54.1)	(47.4)
	(64.5)	70.9	4.1	13.2
Adjustment for shares issued under the scrip dividend alternative	17.2	3.6	17.2	3.6
Shares issued for cash consideration	2.8	5.3	2.8	5.3
Adjustment for shares issued under the Sharesave Scheme through Employee Share Ownership Trust	(1.0)	(0.9)	(1.0)	(0.9)
Goodwill arising on acquisitions	(71.2)	(3.7)	—	—
Goodwill written back on disposals	7.1	0.6	—	—
Shareholders' funds (equity interest):				
(Reduction)/addition for year	(109.6)	75.8	23.1	21.2
At 1 April	915.9	840.1	431.2	410.0
<b>At 31 March</b>	<b>806.3</b>	<b>915.9</b>	<b>454.3</b>	<b>431.2</b>

## 26 Loans and other borrowings

<i>Loans</i>	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Repayable:				
After five years	211.7	212.0	162.5	150.0
Between two and five years	73.8	34.4	37.5	–
Between one and two years	10.9	10.4	–	–
Falling due after more than one year (note 20)	296.4	256.8	200.0	150.0
Falling due within one year (note 19)	110.0	135.6	115.1	143.5
	406.4	392.4	315.1	293.5

On 12 December 1997 £68.5m floating rate unsecured guaranteed loan stock notes, repayable at par in 2004 or on notice being given by the noteholders, were issued as part consideration for the acquisition of Terry Adams Limited (note 28).

<i>Obligations under finance leases</i>	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Repayable:				
After five years	205.2	118.4	–	–
Between two and five years	7.7	7.0	–	–
Between one and two years	11.7	10.6	–	–
Falling due after more than one year (note 20)	224.6	136.0	–	–
Falling due within one year (note 19)	11.6	15.1	–	–
	236.2	151.1	–	–

Included above are accrued finance charges arising on obligations under finance leases totalling £26.6m (1997 £15.2m), of which £6.2m (1997 £8.8m) is repayable within one year.

In addition, obligations under finance leases of £75.0m (1997 £150.0m) have been offset against cash of an equal amount which has been deposited with the lessor's bank group (collateralisation); South West Water Services Limited can insist this cash is utilised to meet the finance lease obligations as they fall due. During the year South West Water Services Limited withdrew £75.0m (1997 nil) of the cash deposits placed with the lessor's bank group. Accordingly, a finance lease obligation of £75.0m (1997 nil) is included above.

### *Loans and obligations under finance leases*

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

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Loans	256.7	265.6	150.0	150.0
Obligations under finance leases	219.2	133.6	–	–
	475.9	399.2	150.0	150.0

Loans and other borrowings are predominantly denominated in sterling and are repayable over the period 1998 to 2021. The rates of interest payable on loans and other borrowings, any part of which is due after five years, range between 6% and 11%.

## NOTES TO THE FINANCIAL STATEMENTS

**27 Financial instruments and risk management**

The principal financial risk faced by the Group arises from interest rate movements.

The Group uses derivative financial instruments to manage and adjust its exposure to market risk from changes in interest rates including, inter alia, ensuring that at least 50% of net debt is at fixed rate. The precise mix is at times adjusted to reflect anticipated movements in short-term interest rates.

The Board approves treasury policies and procedures relating to the use of financial instruments. Transactions involving derivative financial instruments are permitted for hedging purposes only. Major transactions are individually approved by the Board.

The principal interest rate swap agreements in place during the year and outstanding at 31 March 1998 covered a notional amount of £149.8m. Of this, £49.8m aligned the basis of interest receivable from current asset investments with that payable on certain finance lease obligations; and £100.0m, with maturities of between five and seven years, converts floating rate interest payable on underlying borrowings to a fixed rate of 7.3%.

The notional principal amounts are used to determine settlements under interest rate swaps and are not, therefore, an exposure of the Group.

**28 Acquisitions**

During the year the Group acquired interests in the following:

	Consideration and costs	Fair value acquired	Goodwill written off to reserves
	£m	£m	£m
Hydrolab Corporation	9.4	0.9	8.5
Greenhill Enterprises Limited	7.1	0.7	6.4
Terry Adams Limited	76.6	20.9	55.7
Enviro-Logic Limited	0.8	0.2	0.6
	93.9	22.7	71.2

All acquisitions were accounted for using the acquisition method.

On 16 July 1997 the entire issued share capital of Hydrolab Corporation was purchased by H-Lab Acquisition Inc. (a 100% owned Group company) for a cash consideration of \$9.4m, including costs of \$0.4m. Results of the company for the immediate pre-acquisition periods were not material.

On 3 November 1997 the entire issued share capital of Greenhill Enterprises Limited was purchased by Haul Waste Group Limited (a 100% owned Group company) for a cash consideration of £7.1m. For the period 1 April 1997 to 3 November 1997 the profit after tax amounted to £0.1m; and £0.7m for the year ended 31 March 1997.

On 12 December 1997 the entire issued share capital of Terry Adams Limited, and a related asset, were purchased by South West Water Plc for £76.6m, including costs of £0.7m, comprised £4.2m cash, £68.5m loan stock notes (note 26), and £3.9m contingent consideration. Further contingent consideration with a maximum payment of £28.0m, linked to planning approval of landfill sites, has not been included in view of the inherent uncertainties. Any difference between the additional contingent consideration payable and the fair value of the landfill sites will be taken to reserves as goodwill in the year that planning approval arises. For the period 1 April 1997 to 12 December 1997 the profit after tax amounted to £1.3m; and £2.9m for the year ended 31 March 1997.

On 23 December 1997 a 50% interest in Enviro-Logic Limited was purchased by South West Water Plc for a cash consideration of £0.8m. Results of the company for the immediate pre-acquisition period were not material.

## 28 Acquisitions continued

The operating assets and liabilities of the above acquisitions were:

	Book value				Total £m	Fair value adjust- ments £m	Fair value total £m
	Hydrolab Corporation £m	Greenhill Enterprises Limited £m	Terry Adams Limited £m	Enviro- Logic Limited £m			
Tangible fixed assets	0.3	3.7	12.0	–	16.0	23.5	39.5
Fixed asset investments:							
Associated undertakings	–	–	–	0.2	0.2	–	0.2
Other	–	–	1.2	–	1.2	–	1.2
Stocks	0.4	–	0.1	–	0.5	(0.1)	0.4
Debtors due within one year	0.7	0.6	10.9	–	12.2	(0.2)	12.0
Cash at bank and in hand	0.4	–	3.4	–	3.8	–	3.8
Bank overdrafts	–	–	(2.2)	–	(2.2)	–	(2.2)
Creditors due within one year	(0.5)	(0.6)	(12.6)	–	(13.7)	(3.5)	(17.2)
Loans	–	(3.6)	–	–	(3.6)	–	(3.6)
Provisions for liabilities and charges	–	(0.1)	(2.4)	–	(2.5)	(8.9)	(11.4)
	1.3	–	10.4	0.2	11.9	10.8	22.7

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

	Hydrolab Corporation £m	Greenhill Enterprises Limited £m	Terry Adams Limited £m	Total £m
Revaluation of tangible fixed assets	–	2.1	21.6	23.7
Accounting policy harmonisation:				
Provisions for liabilities and charges	–	(1.2)	(6.4)	(7.6)
Other	–	(0.2)	–	(0.2)
Other adjustments:				
Taxation	–	–	(3.2)	(3.2)
Provisions for liabilities and charges	–	–	(1.3)	(1.3)
Other	(0.4)	–	(0.2)	(0.6)
	(0.4)	0.7	10.5	10.8

Accounting policy harmonisation for provisions for liabilities and charges was in respect of environmental and landfill restoration costs.

Within Other adjustments the increase in the taxation creditor principally arises from a re-assessment of the taxation affairs of acquired businesses for pre-acquisition periods. The additional provisions for liabilities and charges relate to commitments existing to progress planning applications on certain landfill sites.

During the year £12.4m fair value acquisition accruals and provisions were established (1997 £1.0m), £0.6m were utilised (1997 £0.9m) and at 31 March 1998 £22.4m (1997 £10.6m) was carried forward.

## NOTES TO THE FINANCIAL STATEMENTS

**29 Principal subsidiary, associated and other undertakings**

<i>Subsidiary undertakings:</i>	Country of incorporation, registration and principal operations	Activity
South West Water Services Limited*	England	Water and sewerage services
Haul Waste Group Limited*	England	Holding company
Greenhill Enterprises Limited	England	Waste management
Haul Waste Limited	England	Waste management
Haul Waste Disposal Limited	England	Waste management
Terry Adams Limited	England	Waste management
Sandspinnners Limited (shares held by Terry Adams Limited)	England	Waste management
Dragon Waste Limited (shares held by Terry Adams Limited)	England	Waste management
Environmental Instrumentation Group Limited*	England	Holding company
ELE International Limited	England	Environmental instrumentation
GLI International Limited (shares held by ELE International Limited)	England	Environmental instrumentation
Water West Limited*	England	Holding company
Exe International Inc.	United States	Holding company
ELE International Inc.	United States	Environmental instrumentation
GLI International Inc.	United States	Environmental instrumentation
Hydrolab Corporation	United States	Environmental 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

In May 1998 Viridor Limited was registered and was subsequently established as a wholly owned subsidiary of the Company.

Shares of those undertakings marked with an asterisk (\*) were held directly by the Company. Otherwise, except where indicated, all the shares of subsidiary undertakings were held by the immediately preceding holding company in the list above. All shares in issue are ordinary shares. The subsidiary undertakings are wholly owned, except for Dragon Waste Limited where 81% of the ordinary shares are held by Terry Adams Limited.

<i>Associated undertaking:</i>	Share capital in issue	Percentage held	Activity
Enviro-Logic Limited	2,000 A ordinary shares 2,000 B ordinary shares	100% —	Water and sewerage concessions

Shares were held directly by the Company.

<i>Other undertaking:</i>	Share capital in issue	Percentage held	Activity
Societa Italo Britannica dell'Acqua Srl (Incorporated in Italy)	20 billion lire	20%	Construction and operating concessions

Shares were held by Exe Continental Limited.

### 30 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, the rate of dividend growth, and the rates of increase in earnings and pensions. The valuations assume that the investment return would be 9% per annum, the dividend growth would be 4.5% per annum, 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.

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 11.0% and 14.2% of pensionable earnings (1997 11.0% and 14.2%). 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. Because of the actuarial surpluses the net pension credit for the year ended 31 March 1998 was £1.7m (1997 £2.0m). Following the actuarial valuations, employer contributions to the two main schemes have ceased until the next actuarial review (which is expected to be at 31 March 1999).

The changes, from 2 July 1997, to the tax treatment of United Kingdom dividend income received by pension schemes are expected to affect adversely the income of the Group's defined benefit pension schemes. In view of the actuarial surpluses, and after taking actuarial advice, the Directors consider it appropriate to recognise the impact of those changes at the time of the next actuarial valuation.

Pension prepayments included as debtors of the Group amount to £10.3m (1997 £8.2m), representing the accumulated difference between the Group pension credits and employer contributions paid.

### 31 Commitments and contingent liabilities

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
<i>Capital commitments</i>				
Contracted but not provided	56.0	59.4	28.5	—
<i>Commitments under operating leases</i>				
Rentals during the year following the balance sheet date:				
Land and buildings leases expiring:				
Within one year	0.2	0.1	—	—
Between one and five years	0.6	0.4	—	—
After five years	2.2	1.7	—	—
Other leases expiring:				
Within one year	0.1	0.2	—	—
Between one and five years	0.2	0.2	—	—
	3.3	2.6	—	—
<i>Contingent liabilities</i>				
Contractors' claims on capital schemes	8.1	16.7	—	—
Guarantees	16.7	4.9	363.5	274.7
	24.8	21.6	363.5	274.7

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

## NOTES TO THE FINANCIAL STATEMENTS

**32 Notes to the Group cash flow statement***a Reconciliation of operating profit to net cash inflow from operating activities*

	1998 £m	1997 £m
Operating profit	134.3	130.2
Depreciation charge	42.2	35.5
Provision for diminution in value:		
Tangible fixed assets	3.9	–
Fixed asset investment	0.4	0.4
Deferred income released to profits	(1.0)	(1.2)
Increase/(decrease) in provisions for liabilities and charges	1.1	(1.2)
Decrease in stocks	6.2	1.1
Increase in debtors (amounts falling due within and over one year)	(1.6)	(14.3)
Increase in creditors (amounts falling due within and over one year)	3.5	5.8
Profit on disposal of tangible fixed assets	(0.4)	(0.4)
<b>Net cash inflow from operating activities</b>	<b>188.6</b>	<b>155.9</b>

Cash outflows from operating activities accounted for as exceptional items, included above, were £1.9m (1997 £9.0m). These relate to the utilisation of the water and sewerage restructuring provision (and also proposed bids costs in 1997).

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

<i>i Returns on investments and servicing of finance</i>	1998 £m	1997 £m
Interest received	24.7	23.9
Interest paid	(39.3)	(38.4)
Interest element of finance lease rentals	(4.3)	(4.4)
Costs associated with defeased leases (note 6)	(0.2)	(0.6)
Gain on currency hedge	0.3	0.7
Dividends received	–	0.2
<b>Net cash outflow for returns on investments and servicing of finance</b>	<b>(18.8)</b>	<b>(18.6)</b>

<i>ii Taxation</i>	1998 £m	1997 £m
Windfall tax	(52.0)	–
Other taxes	(9.2)	(11.0)
<b>Net cash outflow for taxation</b>	<b>(61.2)</b>	<b>(11.0)</b>

The windfall tax is accounted for as an exceptional item. The cash outflow in 1998 is the first of two instalments of £52.0m. The second instalment is payable on 1 December 1998.

<i>iii Capital expenditure and financial investment</i>	1998 £m	1997 £m
Purchase of tangible fixed assets	(179.3)	(147.5)
Grants and contributions:		
Infrastructure assets	3.5	3.7
Non-infrastructure assets	0.2	0.6
Receipts from disposal of tangible fixed assets	1.6	1.6
Loan to associated undertaking	–	(3.0)
Repayment of loan from associated undertaking	–	3.0
Purchase of Company shares by Employee Share Ownership Plan	(1.3)	–
Other investment	(0.4)	–
<b>Net cash outflow for capital expenditure and financial investment</b>	<b>(175.7)</b>	<b>(141.6)</b>

### 32 Notes to the Group cash flow statement continued

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

<i>iv Acquisitions and disposals</i>	1998 £m	1997 £m
Purchase of businesses	(22.7)	(0.9)
Purchase of interest in associated undertaking	(0.8)	(3.0)
Net cash acquired with businesses	1.6	-
Sale of businesses:		
Associated undertakings	0.3	17.8
Other businesses	0.8	14.1
<b>Net cash (outflow)/inflow for acquisitions and disposals</b>	<b>(20.8)</b>	<b>28.0</b>

<i>v Management of liquid resources</i>	1998 £m	1997 £m
Purchase of current asset investments	(316.8)	(353.5)
Sale of current asset investments	407.2	372.4
<b>Net cash inflow from management of liquid resources</b>	<b>90.4</b>	<b>18.9</b>

Liquid resources comprise readily disposable current asset investments.

<i>vi Financing</i>	1998 £m	1997 £m
Issue of ordinary share capital	2.8	5.3
Adjustment for shares issued under the Sharesave Scheme through Employee Share Ownership Trust	(1.0)	(0.9)
	<b>1.8</b>	<b>4.4</b>
Debt due within one year (other than bank overdrafts): reduction	(104.8)	(8.2)
Debt due after more than one year: increase/(reduction)	46.3	(0.1)
Cash withdrawn from deposit against finance lease obligations (note 26)	75.0	-
Cash placed on deposit with financial institutions (note 6)	(75.2)	(52.7)
Defeased finance lease drawdowns (note 6)	90.9	65.4
Other finance lease drawdowns	5.0	8.1
Capital element of finance lease rental payments	(6.3)	(6.6)
	<b>30.9</b>	<b>5.9</b>
<b>Net cash inflow from financing</b>	<b>32.7</b>	<b>10.3</b>

## NOTES TO THE FINANCIAL STATEMENTS

**32 Notes to the Group cash flow statement** continued*c Analysis of net debt*

	At 1 April 1997 £m	Cash flow £m	Acquisitions (excluding cash items) £m	Non-cash movements £m	At 31 March 1998 £m
Cash at bank and in hand	2.4	0.5	–	–	<b>2.9</b>
Current asset investments: overnight deposits	4.7	0.3	–	–	<b>5.0</b>
Bank overdrafts	(1.3)	(0.8)	–	–	<b>(2.1)</b>
	5.8	–	–	–	<b>5.8</b>
Debt due within one year (other than bank overdrafts)	(134.3)	104.8	(68.5)	(9.9)	<b>(107.9)</b>
Debt due after more than one year	(256.8)	(46.3)	(3.6)	10.3	<b>(296.4)</b>
Finance lease obligations	(151.1)	(89.4)	–	4.3	<b>(236.2)</b>
	(542.2)	(30.9)	(72.1)	4.7	<b>(640.5)</b>
Current asset investments: other than overnight deposits	180.6	(90.4)	–	–	<b>90.2</b>
	(355.8)	(121.3)	(72.1)	4.7	<b>(544.5)</b>

Non-cash movements include transfers between categories of debt for changing maturities, increased finance charges within finance lease obligations, and the in-substance extinguishment of finance lease obligations (note 6).

*d Reconciliation of net cash flow to movement in net debt*

	1998 £m	1997 £m
Increase in cash in the year	–	6.5
Cash inflow from increase in debt and finance leasing	<b>(30.9)</b>	(5.9)
Cash inflow from decrease in liquid resources	<b>(90.4)</b>	(18.9)
Increase in net debt arising from cash flows	<b>(121.3)</b>	(18.3)
Non-cash movements:		
In-substance extinguishment of finance lease obligations	<b>15.7</b>	12.7
Increase in accrued finance charges on finance lease obligations	<b>(11.4)</b>	(5.4)
Other	<b>0.4</b>	0.4
Acquisitions (excluding cash items):		
Loans acquired with businesses	<b>(3.6)</b>	–
Loan stock notes issued as part consideration for businesses acquired (note 26)	<b>(68.5)</b>	(0.4)
Increase in net debt in the year	<b>(188.7)</b>	(11.0)
Net debt at 1 April	<b>(355.8)</b>	(344.8)
Net debt at 31 March	<b>(544.5)</b>	(355.8)

**32 Notes to the Group cash flow statement** continued*e Purchase of businesses*

	1998 £m	1997 £m
Net assets acquired:		
Tangible fixed assets	39.5	0.2
Fixed assets investments:		
Associated undertakings	0.2	-
Other	1.2	-
Stocks	0.4	-
Debtors due within one year	12.0	-
Cash at bank and in hand	3.8	-
Bank overdrafts	(2.2)	-
Creditors due within one year	(17.2)	-
Loans	(3.6)	-
Provisions for liabilities and charges	(11.4)	(1.0)
Fair value of net assets/(liabilities) acquired	22.7	(0.8)
Goodwill	71.2	1.7
	93.9	0.9
Satisfied by:		
Cash consideration	21.5	0.9
Loan stock notes	68.5	-
Contingent consideration	3.9	-
	93.9	0.9

During the year £2.0m of the contingent consideration, arising on businesses purchased in 1996, was paid (1997 £3.0m).

The businesses acquired during the year contributed £4.5m to the Group's net cash inflow from operating activities, utilised £1.3m for taxation and utilised £1.3m for capital expenditure and financial investment. The business acquired during 1997 did not contribute materially to the Group's cash flow in that year.

## NOTES TO THE FINANCIAL STATEMENTS

**32 Notes to the Group cash flow statement** continued*f Sale of businesses*

	1998 £m	1997 £m
Net assets disposed of:		
Tangible fixed assets	–	13.1
Associated undertakings	0.7	–
Goodwill written back to reserves	7.1	0.4
	7.8	13.5
Business disposal (loss)/profit	(7.5)	4.1
	0.3	17.6
Satisfied by:		
Cash consideration	0.3	14.1
Deferred consideration	–	3.5
	0.3	17.6

During the year £0.8m of the deferred consideration, arising on a business sold in 1997, was received (1997 nil).

In addition, in 1997, a sale of the Group's investment in associated undertakings for a cash consideration of £17.8m realised a business disposal profit of £15.1m.

The businesses sold during 1998 and 1997 did not materially contribute to the Group's cash flows.

**33 Related party transaction**

On 6 February 1998 Exe Continental Limited, a 100% owned Group company, made arrangements to dispose of its investment in unsubordinated loan stock in Societa Italo Britannica dell'Acqua Srl, an associated undertaking. The disposal loss, as set out in note 5, includes a £3.2m provision for this loan stock, a substantial element of which had previously been written off to reserves as goodwill.

FIVE YEAR FINANCIAL SUMMARY

	1998	1997	1996	1995	1994
	£m	£m	£m	£m	£m
<b>Profit and loss account</b>					
Turnover	382.1	343.6	314.4	286.2	251.6
Operating profit	134.3	130.2	134.1	86.2	106.4
Business disposal (loss)/profit	(7.5)	19.2	-	-	-
(Loss)/income from interests in associated undertakings	(0.4)	1.2	1.6	1.2	0.7
Net interest payable	(19.8)	(18.0)	(26.6)	(24.2)	(14.1)
Profit on ordinary activities before taxation	106.6	132.6	109.1	63.2	93.0
Tax on profit on ordinary activities *	(117.0)	(14.3)	(10.3)	(8.2)	(7.1)
(Loss)/profit on ordinary activities after taxation	(10.4)	118.3	98.8	55.0	85.9
Dividends	(54.1)	(47.4)	(38.9)	(34.5)	(32.0)
Retained (loss)/profit transferred (from)/to reserves	(64.5)	70.9	59.9	20.5	53.9

Earnings per share:

Before exceptional items	82.8p	81.2p	72.4p	71.8p	68.5p
Exceptional items	(90.7)p	10.9p	5.3p	(28.1)p	-
After exceptional items	(7.9)p	92.1p	77.7p	43.7p	68.5p
Dividend per share	41.0p	36.7p	30.5p	27.3p	25.5p

\* including £104.0m windfall tax in 1998

<b>Capital expenditure</b>	£m	£m	£m	£m	£m
Acquisitions and investment	93.9	0.9	103.0	0.2	17.9
Tangible fixed assets	174.6	157.2	110.3	159.4	203.4

<b>Balance sheet</b>	£m	£m	£m	£m	£m
Fixed assets	1,558.3	1,397.8	1,301.2	1,182.2	1,063.0
Net current (liabilities)/assets	(166.0)	(42.9)	63.6	349.5	375.9
Non-current liabilities	(586.0)	(439.0)	(524.7)	(687.4)	(617.6)
Net assets	806.3	915.9	840.1	844.3	821.3

**Number of employees** (average for year)

Water and sewerage services	1,734	1,765	1,815	2,084	2,141
Waste management	312	297	322	271	242
Environmental instrumentation	443	411	357	255	244
Construction services	838	567	398	339	291
Other businesses	93	113	113	134	142
	3,420	3,153	3,005	3,083	3,060

**RESOLUTIONS TO BE PASSED**

The ninth annual general meeting of South West Water Plc will be held at The Great Hall, University of Exeter, Exeter, Devon on 30 July 1998 at 11.00 a.m. 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 1998.

**Resolution 2**

To declare a final dividend for the year ended 31 March 1998.

**Resolution 3**

To re-elect Sir Geoffrey H Chipperfield as a Director.

**Resolution 4**

To re-elect Mr S M Yassukovich as a Director.

**Resolution 5**

To appoint auditors and, in particular, to consider a resolution that Price Waterhouse be re-appointed as auditors until the conclusion of the next general meeting at which financial statements are laid before the Company and to authorise the Directors to fix their remuneration or, if at the date of the meeting, Price Waterhouse has merged with Coopers & Lybrand, a resolution that Pricewaterhouse-Coopers be appointed or re-appointed as auditors, to hold office until the conclusion of the next general meeting at which financial statements are laid before the Company and to authorise the Directors to fix their remuneration.

**Resolution 6**

To propose the following as a special resolution:

That the name of the Company be changed to "Pennon Group Plc".

**Resolution 7**

To propose the following as an ordinary resolution:

That, in accordance with Article 5 of the Company's Articles of Association, the Directors be authorised to allot relevant securities up to a maximum nominal amount of £43,577,000, that such authority shall expire on the day five years after the passing of this resolution and that all previous authorities under section 80 of the Companies Act 1985 be revoked.

**Resolution 8**

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* for the purpose of paragraph (A)(ii) of that Article, the nominal amount to which this power is limited is £6,602,000; and

*c* this power shall expire on 30 October 1999 or, if earlier, at the conclusion of the next annual general meeting of the Company.

**Resolution 9**

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 13,205,000 (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 5 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.

**Resolution 10**

To propose the following as a special resolution:

That the Articles of Association of the Company be altered by the following amendments:

*a* Article 1 (A) be amended by deleting the existing definition of "The Stock Exchange" and replacing it with the following definition: "The Stock Exchange" means the London Stock Exchange Limited; and "

*b* Article 86 be amended by deleting the first sentence and substituting the following: "Until otherwise determined by the Company by Ordinary Resolution, there shall be paid to the Directors (other than alternate directors) such fees not exceeding £400,000 per annum in aggregate for their services as Directors and the

Directors may decide the amount of fees payable to each individual Director within that aggregate amount."

- c Article 135 (ii) be amended by deleting the existing sub-paragraph (ii) and adding a new sub-paragraph (ii) as follows:

"(ii) The entitlement of each holder of Ordinary Shares to new Ordinary Shares shall be such that the relevant value of the entitlement shall be as nearly as possible equal to (but no greater than) the cash amount (disregarding any tax credit) of the dividend that such holder elects to forego and may not (unless authorised by a special resolution of the Company) exceed an amount equal to the cash amount (disregarding any tax credit) of the dividend. For this purpose the "relevant value" shall be calculated either (1) by reference to the average of the middle market quotations (less the relevant dividend unless the Ordinary Shares are already quoted ex such dividend) on The Stock Exchange (derived from the Daily Official List) on at least five consecutive dealing days selected by the Directors, but commencing no earlier than the day upon which the proposed relevant dividend is announced by the Directors, or (2) in such other manner as may be determined by the Directors."

#### Resolution 11

To propose the following as an ordinary resolution:

That the Directors be authorised to offer any holders of Ordinary Shares in the capital of the Company the right to elect to receive Ordinary Shares, credited as fully paid, instead of cash, in respect of any dividend (or any part thereof) of the Company declared before the beginning of the annual general meeting of the Company to be held in 2003 including the final dividend for the year ended 31 March 1998.

#### Resolution 12

To propose the following as a special resolution:

That in addition to the authority proposed in Resolution 11 but subject to and conditional on the passing of Resolution 10 above:

- a the Directors be authorised, in accordance with the provisions of Article 135 of the Company's Articles of Association (as amended pursuant to Resolution 10), to permit holders of Ordinary Shares to elect to receive new Ordinary Shares in the capital of the Company, credited as fully paid instead of cash in respect of any dividend (or any part thereof) of the Company declared before the beginning of the annual general meeting of the Company to be held in 1999 including the final dividend for the year ended 31 March 1998;

- b the Directors may determine that such additional Ordinary Shares may or shall have a value greater than the cash amount which holders of Ordinary Shares would receive by way of dividend in the absence of an election to receive such additional shares;

- c elections in force at the date of this meeting made by holders of Ordinary Shares providing for such holders to receive on a regular basis Ordinary Shares instead of cash dividends shall (unless and until revoked) operate as valid elections for the purpose of paragraph (a) of this resolution; and

- d the Directors be authorised to capitalise out of the amount standing to the credit of the reserves, as the Directors may determine, a sum equal to the aggregate nominal amount of the additional Ordinary Shares to be allotted pursuant to elections made and apply it in paying up in full the appropriate number of unissued Ordinary Shares and to allot such Ordinary Shares to the members of the Company who have validly so elected.

By Order of the Board

  
**K D Woodier**, Company Secretary  
Peninsula House, Rydon Lane, Exeter EX2 7HR  
25 June 1998

#### Notes

Pursuant to Regulation 34 of the Uncertificated Securities Regulations 1995, only those shareholders registered in the register of members as at 6.00 p.m. on 28 July 1998 will be entitled to attend or vote at the meeting in respect of the number of shares registered in their name at that time. Changes to entries on the register after 6.00 p.m. on 28 July 1998 will be disregarded in determining the rights of any person to attend or vote at the meeting.

A person entitled to attend and vote at this 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.

*Explanatory notes on certain business of the annual general meeting*

#### **Authority to allot shares**

Resolution 7 requests shareholder approval by way of an ordinary resolution to renew for a period not exceeding five years the Directors' existing general and unconditional authority to allot securities in accordance with the

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Companies Act 1985 and the Articles of Association of the Company. This authority would continue that granted in July 1997. The share capital to which this authority relates of 43,577,000 Ordinary Shares represents approximately 33% of the issued share capital at the date of this report.

Resolution 8 requests shareholder approval by way of a special resolution to renew until next year's annual general meeting the Director's 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 the above authorities 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 other than under the enhanced scrip dividend alternative in respect of the final dividend for the year ended 31 March 1998.

***Authority to purchase Ordinary Shares of the Company***

Resolution 9 requests shareholder approval by way of a special resolution to renew the Company's authority to purchase up to 10% of its Ordinary Shares at or between the minimum and maximum prices specified in the resolution. This authority is requested in order to increase the Company's flexibility to optimise the long-term financial and tax efficiency of its capital structure. The Directors have no specific plans to exercise such powers in the immediate future but will keep the matter under review and will only make such purchases if they would result in an increase in the Company's earnings per share and are in the best interests of the Company's shareholders generally.

***Amendments to Articles of Association***

Resolution 10 requests shareholder approval by way of a special resolution to amend the Articles of Association of the Company. The proposed amendment to Article 86 removes the cap on the level of fees payable to individual Directors and replaces it with a limit on the aggregate fees payable. This is designed to provide greater flexibility in the setting of fees for Directors and is in accord with ABI guidelines.

The proposed amendment to Article 135(ii) is required to enable the Company to offer an enhanced scrip dividend alternative as proposed in Resolution 12.

***Enhanced Scrip Dividend Alternative***

Resolution 11 requests shareholder approval by way of an ordinary resolution to offer a scrip dividend alternative in respect of any dividend declared before the annual general meeting in 2003.

Resolution 12 requests shareholder approval by way of a special resolution to offer an enhanced scrip dividend alternative in respect of any dividend declared before the annual general meeting in 1999 including the final dividend for the year ended 31 March 1998. Details of the enhanced scrip dividend alternative are contained in the separate circular enclosed with this report.