

SOUTHERN WATER CAPITAL LIMITED

**DIRECTORS' REPORT
AND ACCOUNTS FOR THE YEAR ENDED**

31 MARCH 2005

Registered Number 04608528



SOUTHERN WATER CAPITAL LIMITED

Directors' Report and Accounts for the year ended

31 March 2005

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SOUTHERN WATER CAPITAL LIMITED

REPORT OF THE DIRECTORS

The directors present their report and the audited accounts for the year ended 31 March 2005.

GROUP

The company acquired 80.1% of Southern Water Investments Limited (SWIL) on the 7 May 2003, with the remaining 19.9% held by Veolia Water UK plc. The major subsidiaries included within the Group are shown in note 27. The consolidated results cover the year ended 31 March 2005, the comparative consolidated results cover the period from 7 May 2003 until 31 March 2004.

RESULTS AND DIVIDENDS

The profit after taxation for the financial period for the Group amounted to £18.6million (2004: Loss of £5.1 million). The directors do not recommend a final dividend. The retained profit for the period of £13.9 million for the Group has been transferred to reserves.

PRINCIPAL ACTIVITIES AND REVIEW OF THE BUSINESS

The principal activities of the Group are the provision of water supply and wastewater services in the south-east of England.

The trading results largely reflect the performance of the major trading subsidiary Southern Water Services Limited (SWS).

The Company's principal activity is that of a holding company for SWIL and its subsidiaries.

FUTURE DEVELOPMENTS

The Directors anticipate that the Company will continue to act as a holding company to the Southern Water Group of companies.

The next year is the first of the new five-year regulatory period. During this period, the Group will focus on delivering its large investment programme, and achieving ongoing operational performance targets as detailed in its Monitoring Plan to OFWAT.

POST BALANCE SHEET EVENTS

In April 2005 the Group outsourced some of its key capital investment programme work to '4Delivery Limited', a joint venture vehicle owned by United Utilities (40%), Costain (40%) and Montgomery Watson Harza (20%). Under the contract, 4D is required to manage, design and deliver 255 schemes, which are all stand alone construction projects for the modification or extension of existing water mains, sewers, water supply works and wastewater treatment works. The total value of the contract is approximately £750m.

A Group company, Southern Water Services (Finance) Limited (SWSF), raised approximately £500m of additional finance in May 2005. The funds will be applied for its general corporate purposes or used to repay or service the issuer's financial indebtedness.

On the 21 November 2005 Veolia Water Investment Limited exercised its option and acquired a further 510,000 ordinary B shares of £1.00 each in SWIL, increasing their shareholding of ordinary B shares to 2,500,000. These shares were acquired at par.

The company has brought to the attention of OFWAT certain inconsistencies in its general levels of service procedures. These inconsistencies relate to the reporting and handling of response levels to customer enquiries and complaints, and were discovered in the course of a project to install a new customer billing system. Under a Guaranteed Standards Scheme Southern Water is obliged to make payments to customers if it does not reply to letters within certain timescales and the company is now identifying anyone who should have been paid and has not. It will then make them payments of £25 and in some circumstances £35 where there has been an exceptional delay. The investigation began on 24 October 2005 and is being carried out by an independent specialist team. Based on the results of the investigation to date, the directors do expect the amount of compensation to be material in the context of the consolidated results in the year to 31 March 2005, and so a provision of £5.7m has been made.

SOUTHERN WATER CAPITAL LIMITED

DIRECTORS AND THEIR INTERESTS

The directors during the period were:-

R Cullinan (resigned 7 September 2004)
S Dance
D Workman (appointed 7 September 2004)
R Thian (appointed 7 September 2004)

No director or person connected to directors had an interest in shares or debentures of the company or any other body corporate in the Group at both the beginning of the period (or date of appointment, if later) and the date of these financial statements.

DIRECTORS' RESPONSIBILITIES

Company law requires the directors to prepare Accounts for each financial period which give a true and fair view of the state of affairs of the Group as at the end of the financial period and of the profit or loss of the Group for that period.

Having assessed the future funding requirements of the Group, the directors are of the opinion that it is appropriate for the Accounts to be prepared on a going concern basis. The directors confirm that suitable accounting policies have been used and applied consistently as set out in note 1 to the Accounts (Accounting policies). They also confirm that reasonable and prudent judgements and estimates have been made in preparing the Accounts for the year ended 31 March 2005 and that applicable accounting standards have been followed, subject to any material departures disclosed and explained.

The directors are responsible for ensuring that the Accounts are published, and where they are published on the Internet, for the maintenance and integrity of the website. Uncertainty regarding legal requirements is compounded as information published on the Internet is accessible in many countries with different legal requirements relating to the preparation and dissemination of Accounts.

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

RESEARCH AND DEVELOPMENT

The improvement of existing services and processes, together with the identification and development of new technology and solutions, are important aspects of the Group's strategy to enhance the quality of service to customers and improve methods of working. Research and development expenditure for the year amounted to £1.5 million (2004: £1.5 million).

EMPLOYEES

Employee involvement

The Group recognises the importance of its employees and is committed to effective two-way communication and consultation.

The Group has established Business Involvement Groups to facilitate meaningful consultation between Company Management and employees through elected Employee Representatives. The Groups meet regularly at both functional and company-wide levels.

The Group also recognises the rights of every employee to join a trade union and participate in its activities. SWS has a single union agreement with Unison.

SOUTHERN WATER CAPITAL LIMITED

EMPLOYEES (continued)

Employee involvement

The Group publishes its own in-house newspaper, 'Southern Water News' on a regular basis, and also produces, 'Waterline', a county newsletter at a more local level. General information is posted on the Group Intranet and regular team briefing sessions are also held.

Equal opportunity

Group policy is to promote equality of opportunity in recruitment, employment continuity, training and career development. The policy is designed to ensure that equal opportunity in these areas extends as far as practicable to people with disabilities. The Group is a member of the Employers' Forum on Disability, which supports the efforts to meet the needs of the disabled for employment and access to the Group and its buildings.

Health and safety

The Group recognises its duties to make proper provision for the health, safety and welfare at work of its employees.

Every employee receives a copy of the corporate policy statement on health and safety. There are regular meetings of employee representatives and managers to consider all aspects of health and safety, and there is a health and safety management review group which ensures that there is an adequate system for meeting the company's responsibilities for health and safety to its staff, customers and members of the public.

The Group provides an internal occupational health service for employees, including the provision of physiotherapy. These services have been developed and are continuously reviewed to ensure they meet the needs of the business and our employees at work.

CREDITOR PAYMENT POLICY AND PRACTICE

The Group's current policy and practice concerning the payment of its trade creditors is to follow the Better Payment Practice Code to which it is a signatory. Copies of the Code may be obtained from the Department of Trade and Industry or from the website www.payontime.co.uk.

The Group's policy and practice is to settle terms of payment when agreeing the terms of the transaction, to include the terms in contracts and to pay in accordance with its contractual and legal obligations. The Group's trade creditor days at 31 March 2005 were 36 days (2004: 44 days).

ENVIRONMENTAL ISSUES

The Group is committed to meeting or improving upon legislative and regulatory environmental requirements and codes of practice, and aims to contain the environmental impact of its activities to a practicable minimum.

The Group's environmental performance is reported in its annual Sustainability Report. The Group recognises its responsibility to operate within a framework that supports sustainable development and has established, where possible, indicator targets which are measurable. Performance against these targets is monitored and reported regularly.

CHARITABLE DONATIONS

The Group made donations of £53,000 (2004: £25,000) to a variety of charities over the year.

No political donations were made.

SOUTHERN WATER CAPITAL LIMITED

AUDITORS

The auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office and a resolution that they be reappointed will be proposed at the annual general meeting.

Approved by the Board of Directors and signed on behalf of the Board.

A handwritten signature in black ink, appearing to read "D Workman". The signature is written in a cursive style with a long horizontal stroke at the end.

D Workman
Director

SOUTHERN WATER CAPITAL LIMITED

CONSOLIDATED PROFIT AND LOSS ACCOUNT

for the year ended 31 March 2005

	Notes	Year to 31 March 2005 £m	Period to 31 March 2004 £m
Turnover	1,2,3	475.0	408.6
Cost of sales	3	(264.4)	(226.7)
Gross profit		210.6	181.9
Administrative expenses	3	(31.6)	(24.9)
Other operating income	3	2.0	1.6
Operating profit and profit on ordinary activities before interest and taxation	4	181.0	158.6
Profit on disposal of fixed assets		3.0	3.8
Net interest and similar charges	7	(163.9)	(159.2)
Profit on ordinary activities before taxation		20.1	3.2
Tax on profit on ordinary activities	8	(1.5)	(8.3)
Profit/(loss) on ordinary activities after taxation		18.6	(5.1)
Equity Minority Interests		(4.7)	(0.0)
Retained profit/(loss) for the financial year / period	20	13.9	(5.1)

The above results relate entirely to continuing operations. The Group has no recognised gains and losses other than those included in the profit above and therefore no separate statement of total recognised gains and losses has been presented.

There was no difference between the profit on ordinary activities before taxation and the retained profit for the financial year stated above, and their historical cost equivalent.

The Notes on pages 8 to 34 form part of these accounts.

SOUTHERN WATER CAPITAL LIMITED

CONSOLIDATED BALANCE SHEET

as at 31 March 2005

	Notes	Group 2005 £m	Company 2005 £m	Group 2004 £m	Company 2004 £m
Fixed Assets					
Tangible assets	9	2,978.5	-	2,992.6	-
Investments	10,26	7.0	40.1	7.0	40.1
		<u>2,985.5</u>	<u>40.1</u>	<u>2,999.6</u>	<u>40.1</u>
Current assets					
Stocks	12	1.0	-	1.4	-
Debtors: amounts falling due within one year	13	105.9	4.0	108.6	3.9
Cash at bank and in hand	17	246.2	4.2	99.0	0.1
		<u>353.1</u>	<u>8.2</u>	<u>209.0</u>	<u>4.0</u>
Creditors: amounts falling due within one year	14	<u>(164.3)</u>	<u>(0.1)</u>	<u>(195.3)</u>	<u>(0.1)</u>
Net current assets		<u>188.8</u>	<u>8.1</u>	<u>13.7</u>	<u>3.9</u>
Total assets less current liabilities		<u>3,174.3</u>	<u>48.2</u>	<u>3,013.3</u>	<u>44.0</u>
Creditors: amounts falling due after one year	15	(2,741.7)	-	(2,614.0)	-
Provision for liabilities and charges	16	(327.3)	-	(312.8)	-
Grants and contributions	18	(43.7)	-	(42.5)	-
Net assets		<u>61.6</u>	<u>48.2</u>	<u>44.0</u>	<u>44.0</u>
Capital and reserves					
Called up share capital	19	40.1	40.1	40.1	40.1
Profit and loss account	20	8.8	8.1	(5.1)	3.9
Total shareholder's funds (including non-equity interests)		<u>48.9</u>	<u>48.2</u>	<u>35.0</u>	<u>44.0</u>
Equity minority interests		<u>12.7</u>	<u>-</u>	<u>9.0</u>	<u>-</u>
Capital employed		<u>61.6</u>	<u>48.2</u>	<u>44.0</u>	<u>44.0</u>

The accounts on pages 5 to 34 were approved by the Board on 25 January 2006 and signed on its behalf by:



D Workman
Director

SOUTHERN WATER CAPITAL LIMITED

CONSOLIDATED CASH FLOW STATEMENT

for the year ended 31 March 2005

	Notes	Year to 31 March 2005 £m	Period to 31 March 2004 £m
Net cash inflow from operating activities	21	300.0	228.9
Returns on investments and servicing of finance			
Issue costs of new loans		(0.7)	(53.7)
Interest paid		(166.2)	(153.1)
Interest received		13.6	5.9
Dividends paid to minority interests		(1.0)	-
Net cash outflow from returns on investments and servicing of finance		(154.3)	(200.9)
Taxation		2.8	-
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(189.5)	(203.1)
Sale of tangible fixed assets		4.5	4.1
Receipt of grants and contributions		10.0	7.5
Net cash outflow for capital expenditure and financial investment		(175.0)	(191.5)
Acquisitions			
Acquisition of Southern Water Investments Limited		-	(40.1)
Net cash acquired with subsidiary undertaking		-	341.8
		-	301.7
Net cash (outflow)/inflow before financing		(26.5)	138.2
Financing			
Premium arising on new loans		18.5	187.5
Payment of swap break costs		-	(187.8)
Redemption of preference shares		-	(370.0)
Repayment of short term loan		-	(2,074.7)
Issue of long term loans		156.6	2,103.2
Proceeds from preference share issue		-	260.0
Proceeds from share issue		-	40.1
Net cash inflow/(outflow) from financing		175.1	(41.7)
Increase in net cash		148.6	96.5
Reconciliation to net debt			
Net debt at beginning of year / period		(2,494.4)	-
Acquisition of net debt at 7 May 2004		-	(2,123.4)
Increase in net cash		148.6	96.5
Movement in borrowings		(156.6)	(288.5)
Bond Premium		(18.5)	(187.5)
Debt issue costs		0.6	52.0
Non-cash items		46.0	(43.5)
Net debt at end of year / period	21	(2,474.3)	(2,494.4)

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005

1 Accounting policies

Basis of accounting

The accounts have been prepared under the historical cost convention and in accordance with applicable accounting standards and, subject to the treatment of infrastructure grants and contributions described below, with the requirements of the Companies Act 1985.

Basis of consolidation

The Group accounts include the accounts of the company and all of its subsidiary undertakings. The results of the subsidiaries acquired during the period are included in the Profit and Loss Account from the date of acquisition. Intra group sales and profits are eliminated fully on consolidation. The acquisition method of accounting has been used to consolidate the subsidiaries.

Turnover

Turnover represents the income receivable (excluding value added tax) in the ordinary course of the business for goods and services provided and, in respect of unbilled charges, includes an accrual for measured and unmeasured income.

Measured income arises from customers who have meters fitted at their premises. Therefore amounts billed are based on actual water consumption. Unmeasured income bills are based on the rateable value of properties. The income accrual is an estimation of the amount of mains water and wastewater charges unbilled at the year end. The accrual is estimated using a defined methodology based upon weighted average tariffs and historical billing and consumption information.

Bad Debts

The bad debt provision is calculated by applying recovery rates to an aged debt profile to ensure that the age of debt not covered by the provision is an accurate reflection of the recoverability of debt.

Research and development

Expenditure on research and development is charged to the profit and loss account as it is incurred.

Capital Instruments

The Group has adopted the provisions of Financial Reporting Standard 4 'Capital instruments' ("FRS 4") which requires the amount of shareholders' funds attributable to equity and non-equity interests to be separately disclosed.

The issue costs of capital instruments have been amortised over the life of the financial instrument to which they relate. The interest rate swap payments on the hedging of the loans are paid, and expensed through the profit and loss account, in the year in which they occur.

Premiums received on issue of debt instruments are credited to the profit and loss account over the term of the debt at a constant rate on the carrying amount.

The carrying value of index-linked debt instruments is adjusted for the annual movement in the retail price index. The change in value arising from indexation is charged or credited to the profit and loss account in the year in which it arises.

Preference Shares

The preference shares issued by subsidiaries have been classified as loans in the consolidated financial statements as stated in FRS 4, since the Group taken as a whole has an obligation to transfer economic benefits in connection with the shares.

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005

1 Accounting policies (continued)

Foreign currencies

Individual transactions denominated in foreign currencies are translated into sterling at the actual exchange rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currency are translated at the exchange rates prevailing at the balance sheet date or at a contracted rate where appropriate. Profits and losses on both individual currency transactions settled during the year and unsettled monetary assets and liabilities are dealt with in the profit and loss account.

Tangible fixed assets

- i) Infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls) comprise a network of systems.

Expenditure on infrastructure assets relating to increases in capacity or enhancement of the network and on maintaining the operating capability of the network in accordance with defined standards of service, is treated as an addition to fixed assets and is stated at cost after deducting grants and contributions. Staff costs represent those costs directly related to the construction of a specific infrastructure asset and are capitalised as part of infrastructure assets on the basis of the amount of time spent by individuals on capital projects.

The depreciation charge for infrastructure assets is the estimated level of annualised expenditure required to maintain the operating capability of the network and is based on the asset management plan determined by the water industry regulator as part of the price regulation process. The asset management plan is developed from historical experience combined with a rolling programme of reviews of the condition of the infrastructure assets.

- ii) Other assets (including overground assets, plant and equipment) are stated at cost less accumulated depreciation. Other assets are depreciated on the straight-line method over their estimated operating lives which are principally as follows:

	Years
Buildings	10 - 60
Operational structures	15 - 80
Fixed plant	10 - 40
Vehicles, computers and mobile plant	3 - 10

Operational structures are assets used for wastewater and water treatment purposes. These include water tanks and similar assets.

- iii) Freehold land is not depreciated.

Assets in the course of construction are not depreciated until they are commissioned. Commissioning is deemed to occur when a new works is officially taken over from the contractor following completion of performance and take-over tests.

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005

1 Accounting policies (continued)

Grants and contributions

Capital grants and customer contributions in respect of additions to non-infrastructure fixed assets are treated as deferred income and released to the profit and loss account over the estimated operational lives of the related assets in accordance with the provisions of the Companies Act.

Grants and capital contributions received relating to infrastructure assets have been deducted from the cost of fixed assets. This is not in accordance with Schedule 4 of the Companies Act 1985 which requires fixed assets to be stated at their purchase price or production cost. The Act does not permit the deduction of contributions, hence these would have been accounted for as deferred income.

This departure from the requirements of the Act is, in the opinion of the directors, necessary for the accounts to give a true and fair view because infrastructure assets do not have determinable finite lives. Accordingly related capital contributions would not be recognised in the profit and loss account. The effect of this treatment on tangible fixed assets is disclosed in note 9.

Revenue grants and contributions are credited to the profit and loss account in the year to which they relate.

Leased assets

Fixed assets leased to the Group under finance leases are capitalised and depreciated in line with the Group's depreciation policy. The interest element of finance lease repayments is charged to the profit and loss account in proportion to the balance of the capital repayments outstanding.

Rentals payable under operating leases are charged to profit and loss account as incurred.

Fixed Asset Investments

Investments held as fixed assets are stated at cost, less provision, if appropriate, for any impairment in value other than a temporary impairment in value. The carrying values of fixed asset investments are reviewed for impairment in periods if events or changes in circumstances indicate the carrying value may not be recoverable

Stocks

Stocks are valued at the lower of cost and net realisable value.

Taxation

The taxation charge in the profit and loss account is based on the profit for the year as adjusted for disallowable and non-taxable items using current rates and takes into account tax deferred because of timing differences between the treatment of certain items for taxation and accounting purposes. Deferred taxation is provided on all timing differences that have originated but not reversed by the balance sheet date, calculated at the rate at which it is expected the tax will arise in accordance with Financial Reporting Standard 19 "Deferred Tax". ("FRS 19") Deferred taxation balances are not discounted. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005

1 Accounting policies (continued)

Pensions

Southern Water Services Limited operates pension schemes which cover the majority of the employees. A valuation of the defined benefits pension schemes is normally conducted by an independent actuary every three years. In accordance with Statement of Standard Accounting Practice (SSAP) 24, the regular cost of providing pensions and related benefits and any variations from regular cost arising from the actuarial valuations are charged to the profit and loss account over the expected remaining service lives of current employees following consultations with the actuary. Any difference between the charge to the profit and loss account and the actual contributions paid to the pension schemes is included as an asset or liability in the balance sheet. The Group has also adopted the disclosure requirements of FRS17.

Financial instruments

Derivative transactions include interest rate and currency swaps that are only used for non trading purposes. These derivatives are entered into for the purpose of matching or eliminating risk from potential movements in interest and currency rates associated with the long term borrowing requirements of the Group (see note 17). All non trading derivatives are accounted for on an accruals basis.

Provisions are made for losses, if appropriate, in the event that it is expected that any portion of a financial instrument will not be a hedge of the long term borrowing requirements of the Group.

Interest rate and currency swaps are used to manage interest rate profiles and mitigate exchange risks. When matched with primary financial instruments, the net position is measured at the hedge rate and presented within creditors on the balance sheet. Income, costs, gains, losses and expenses are recognised within net interest payable in the profit and loss account over the life of the instruments.

Provisions

An environmental provision is made in accordance with FRS12 for the costs relating to the decommissioning of abandoned sites. No reimbursement is expected. The period over which the provision will be utilised cannot be determined thus the provision is not discounted.

There is also a provision for guaranteed standard scheme payments relating to the ongoing investigation into the companies reporting and handling of customer enquiries. SWS is obliged to make payments to customers if it does not reply to letters within certain timescales and the company is now identifying anyone who should have been paid and has not. It will then make the payments due. The investigation is at its early stages and based on the results of the investigation to date, the directors at the time of signing the accounts have estimated the amount of compensation.

2 Segmental Analysis

The directors believe that the whole of Southern Water Capital Limited's activities constitute a single class of business. The Group's turnover is generated wholly from within the UK.

3 Classification of turnover and revenue costs

Turnover represents the income receivable for providing water supply and wastewater services and is generated wholly in the United Kingdom.

Cost of sales reflects the direct costs of providing water supply and wastewater services. Administrative expenses comprise the indirect costs of the business. Other operating income relates to rents receivable.

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005

4 Profit on ordinary activities before taxation

	Year to 31 March 2005 £m	Period to 31 March 2004 £m
Profit on ordinary activities before taxation is stated after charging/(crediting):		
Staff costs (note 6a)	45.6	41.8
Depreciation on		
- owned assets	121.2	101.1
- assets held under finance leases	0.3	0.4
	121.5	101.5
Rentals under operating leases – other	4.1	4.4
Research and development expenditure	1.5	1.5
Release of grants and contributions (note 18)	(2.1)	(1.7)
Provision for guaranteed standard scheme payments	5.7	-
Auditors' remuneration for audit work	0.2	0.2
Auditors' remuneration for non-audit services to the group	0.1	0.1

Auditors' remuneration for non-audit services of £1.4m was capitalised in the year to 31 March 2004 as part of the debt issue costs, in accordance with FRS 4, which have been offset against the loans (notes 14 and 15)

5 Profit of Parent Company

The company has not presented its own profit and loss account as permitted by section 230 of the Companies Act 1985. The profit for the financial year dealt with in the financial statements of the parent company is £4.2m (period to 31 March 2004: £3.9m).

6 Employee information

	Year to 31 March 2005 £m	Period to 31 March 2004 £m
(a) Employee costs (including directors' emoluments):		
Wages and salaries	52.7	47.6
Social security costs	4.2	3.9
Pension costs	7.3	4.8
	64.2	56.3
Total employee costs	64.2	56.3
Less: charged as capital expenditure	(16.7)	(14.5)
Charged to the profit and loss account	47.5	41.8

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 2005

6 Employee information (continued)

	Year to 31 March 2005 No.	Period to 31 March 2004 No.
(b) Average number of persons employed		
Operations	1,142	1,177
Project Delivery	65	66
Customer Services	528	516
Corporate Centre	327	336
	2,062	2,095

The prior year numbers are the average for the Group from the date of acquisition of SWIL to the 31 March 2004.

7 Net interest and similar charges

	Year to 31 March 2005 £m	Period to 31 March 2004 £m
Interest payable		
Interest payable on bank loans and overdraft	-	0.7
Interest payable on other loans	145.3	117.5
Interest rate swap payments	5.3	21.1
Indexation	19.0	8.7
Interest on pension fund deficit	3.0	3.0
Amortisation of issue costs	2.5	7.6
Preference share appropriation	(2.9)	2.9
Amortisation of bond premium	(8.4)	(7.2)
Interest on preference shares	13.7	10.7
Total interest payable	177.5	165.0
Interest receivable		
Other interest receivable	13.6	5.8
	13.6	5.8
Net interest charge	163.9	159.2

SOUTHERN WATER CAPITAL LIMITED

**NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED
31 MARCH 2005**

8 Tax on profit on ordinary activities

	Year to 31 March 2005 £m	Period to 31 March 2004 £m
Current tax:		
UK corporation tax on profits of the period	-	-
Adjustment in respect of prior years	(10.1)	-
	<u>(10.1)</u>	<u>-</u>
Deferred tax:		
Origination and reversal of timing differences	10.4	8.3
Adjustment in respect of prior years	1.2	-
Total deferred tax	<u>11.6</u>	<u>8.3</u>
Total tax on profit on ordinary activities	<u>1.5</u>	<u>8.3</u>

The rate of current tax charge on profit on ordinary activities varied from the standard rate of corporation tax due to the following factors:

	2005 £m	2004 £m
Current tax:		
UK corporation tax rate at 30% on profit for the period	6.0	1.0
Adjustment in respect of prior years	(10.1)	-
Other differences	0.7	0.7
Utilisation of capital losses	-	(1.2)
Permanent differences	3.7	7.8
Tax charge on ordinary activities	<u>0.3</u>	<u>8.3</u>
Effect of deferred tax	(10.4)	(8.3)
Current tax charge for period	<u>(10.1)</u>	<u>-</u>

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005

9 Fixed assets and capital commitments

The Group tangible assets are shown below. The Company has no tangible assets.

(a) Group tangible assets

	Freehold land & buildings £m	Plant & Machinery £m	Infra- structure assets £m	Assets in the course of const- ruction £m	Other £m	Total £m
Cost:						
At 1 April 2004	820.9	704.7	1,171.9	243.5	139.4	3,080.4
Additions	5.9	7.9	8.5	140.9	5.5	168.7
Transfers	37.0	63.2	45.7	(169.3)	23.4	-
Fair Value adjustment	-	-	(54.6)	-	-	(54.6)
Grants & contributions	-	-	(6.7)	-	-	(6.7)
Disposals	-	-	(1.0)	-	(9.8)	(10.8)
At 31 March 2005	863.8	775.8	1,163.8	215.1	158.5	3,177.0
Depreciation:						
At 1 April 2004	23.2	31.7	23.0	-	9.9	87.8
Charge for the period	27.9	38.6	29.5	-	25.5	121.5
Disposals	-	-	(1.0)	-	(9.8)	(10.8)
At 31 March 2005	51.1	70.3	51.5	-	25.6	198.5
Net book value:						
At 31 March 2005	812.7	705.5	1,112.3	215.1	132.9	2,978.5
At 31 March 2004	797.7	673.0	1,148.9	243.5	129.5	2,992.6

Of the additions to infrastructure assets, the amount spent on infrastructure renewals during the year ended 31 March 2005 was £21.2m (2004: £28.9m). Of the grants and contributions set against infrastructure assets during the year ended 31 March 2005, £3.0m (2004: £3.5m) relates to infrastructure renewals.

The fair value adjustment relates to the revisions in value of assets in the year to 31 March 2005 as described in note 11.

For the year ended 31 March 2005, the net book value of infrastructure assets is stated after deducting grants and contributions of £139.0m (2004: £132.3m).

Freehold land is stated at a cost of £63.7m (2004: £62.4m) at 31 March 2005, and is not depreciated.

Other assets relate primarily to computer equipment and meter reading devices.

Assets held under finance leases are capitalised and included in plant and machinery:

	Group 2005 £m	Group 2004 £m
Cost	11.7	11.7
Aggregate depreciation	(7.8)	(7.5)
Net book amount	<u>3.9</u>	<u>4.2</u>
(b) Group Capital Commitments	2005	2004
	£m	£m
In respect of contracts placed	<u>69.1</u>	<u>105.7</u>
The company has no capital commitments		

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005

10 Fixed asset investments

	Group 2005 £m	Company 2005 £m	Group 2004 £m	Company 2004 £m
SWIL	-	40.1	-	40.1
Other external investments (see below)	7.0	-	7.0	-
	7.0	40.1	7.0	40.1

Other Group external investments are stated below.

Company	Class of share capital	Proportion of shares held	Activity
Folkestone & Dover Water Services Ltd	Ordinary	25.1%	Water treatment and supply
	Preference	21.8%	
	Deferred	12.2%	

The undertaking principally operates in its country of incorporation. The investment is held by a subsidiary of Southern Water Capital Limited. Folkestone & Dover Water Services Ltd had retained profits of £0.8m for the year ended 31 March 2005 (2004: £0.6m) and net assets of £16.4m at 31 March 2005 (2004: £15.4m).

The Company acquired on 7 May 2003 8,010,000 Ordinary Shares of £1 of Southern Water Investments Limited (being 80.1% of its issued capital), a company incorporated in the United Kingdom. Southern Water Investments Limited itself owns the entire issued capital of Southern Water Services Group Limited and Southern Water NR Holdings Limited.

11 Acquisition of Southern Water Investments Limited

The net assets acquired by Southern Water Capital Limited on 7 May 2003 (the date of acquisition) have been adjusted during the year to 31 March 2005 as below:-

	Book value £m	Adjustments £m	Provisional Fair value £m	Adjustments to Fair value £m	Final Fair value £m
Fixed assets	2671.6	258.4	2,930.0	(54.6)	2,875.4
Stock	1.7	-	1.7	-	1.7
Debtors	201.2	-	201.2	-	201.2
Cash	412.3	-	412.3	-	412.3
Creditors	(2,849.7)	(299.7)	(3,149.4)	54.6	(3,094.8)
Provisions	(371.3)	66.7	(304.6)	-	(304.6)
Borrowings	(41.1)	-	(41.1)	-	(41.1)
Net assets / (liabilities) acquired	24.7	25.4	50.1	-	50.1
80.1% of assets acquired			40.1		40.1
Goodwill		-	-		-
Consideration			40.1		40.1

Hindsight period adjustments have been made to the fair values of the assets and liabilities acquired in the prior period. The fair values were originally based on estimates, for which further evidence has become available in the year. The principal adjustments relate to net present value of preference shares based on the terms of the preference share agreement, and the fair values of infrastructure assets.

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005

12 Stocks

	Group 2005 £m	Group 2004 £m
Raw materials	0.7	1.2
Work in progress	0.3	0.2
	1.0	1.4

The Company does not hold any stock.

13 Debtors: amounts falling due within one year

	Group 2005 £m	Company 2005 £m	Group 2004 £m	Company 2004 £m
Trade debtors	56.9	-	59.0	-
Unbilled income	37.2	-	35.9	-
Amounts owed by group undertakings	-	4.0	-	3.9
Prepayments	2.0	-	2.0	-
Other debtors	9.8	-	11.7	-
	105.9	4.0	108.6	3.9

14 Creditors: amounts falling due within one year

	Group 2005 £m	Company 2005 £m	Group 2004 £m	Company 2004 £m
Bank overdraft	1.1	-	2.5	-
Trade creditors	11.0	-	18.9	-
Capital creditors and capital accruals	69.2	-	90.0	-
Corporation tax	-	-	7.3	-
Other taxation and social security	1.4	-	1.5	-
Other accruals and deferred revenue	73.1	0.1	67.3	0.1
Bond premium deferred	10.0	-	9.3	-
Debt issue costs	(2.5)	-	(2.5)	-
Dividends payable to minority interest	1.0	-	1.0	-
	164.3	0.1	195.3	0.1

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED MARCH 2005

15 Creditors: amounts falling due after one year

	Group 2004 £m	Company 2004 £m	Group 2004 £m	Company 2004 £m
Long term borrowings	2,547.5	-	2,429.4	-
Debt issue costs	(47.7)	-	(49.5)	-
Bond premium deferred	212.1	-	204.2	-
Pension deficit (note 22)	29.8	-	29.9	-
	<u>2,741.7</u>	<u>-</u>	<u>2,614.0</u>	<u>-</u>

	2005 £m	2004 £m
Repayments fall due as follows:		
Between two and five years	300.0	300.0
After five years not by instalments	<u>2,308.4</u>	<u>2,129.4</u>
	<u>2,608.4</u>	<u>2,429.4</u>

An analysis of the external loans is shown below: -

Loans	Group 2005 £m	Group 2004 £m
Class A £350m 6.192% fixed rate 2029	350.0	350.0
Class A £150m 3.706% index linked 2034	157.2	152.6
Class A £35m 3.706% index linked 2034	36.7	35.6
Class A \$483m USD LIBOR plus 0.40% floating rate 2007 - (i)	300.0	300.0
Class A £350m 6.640% fixed rate 2026	350.0	350.0
Class A £150m 3.816% index linked 2023	157.3	152.9
Class A £120m 6.925% fixed rate 2013 - (ii)	120.0	120.0
Class B £250m 7.869% fixed rate 2038 - (iii)	250.0	250.0
Artesian £165m 4.076% index linked 2033	173.0	167.6
Artesian £156.5m 3.635% index linked 2032	160.1	-
Senior mezzanine £127.2m 11.96% fixed rate 2038 - (iv)	127.2	127.2
Junior mezzanine £106m 16.0% fixed rate 2038	106.0	106.0
Debt issue costs	(47.7)	(49.5)
Premium on issue	212.1	204.2
Class A1 Preference shares -(v)	150.0	150.0
Class B Preference shares -(v)	110.0	110.0
Class A2 Preference shares-(v & vi)	-	57.5
	<u>2,711.9</u>	<u>2,584.1</u>

In July 2004 SWSF raised £175m in the financial markets which included a premium of £18.5m. The debt has then been on-lent to SWS. Issue costs of £1.3m were incurred during the year.

Floating interest rates have been hedged to fixed and US dollar currency have been hedged to sterling.

Notes :

- (i) The class A \$483m loan has been hedged to a £300m loan with interest at sterling LIBOR plus 0.43% this loan is then hedged to a fixed rate of 6.175%.
- (ii) The interest rate on the class A £120m is hedged to a fixed rate of 6.925% until March 2009 when it reverts to LIBOR plus 2.95%.
- (iii) The interest rate on the class B £250m is fixed at 7.869% until March 2014 when it steps up to LIBOR plus 4.75%.
- (iv) The interest rate on the senior mezzanine £125m loan is fixed at 11.96% until March 2022 when it reverts to LIBOR plus 6.25%. For the remaining senior mezzanine loan of £2.2m the interest rate is LIBOR plus 6.25%.

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED MARCH 2005

15 Creditors: amounts falling due after one year (continued)

These loans are guaranteed and secured pursuant to a guarantee and security agreement (the Security Agreement). The agreement is over the entire property, assets, rights and undertaking of each of Southern Water Services Limited, Southern Water Services (Finance) Limited, SWS Holdings Limited, and SWS Group Holdings Limited. In the case of Southern Water Services Limited, this is to the extent permitted by the Water Industry Act 1991 and Licence.

(v) The preference shares issued by subsidiaries have been classified as loans in the consolidated financial statements as stated in FRS 4, since the Group taken as a whole has an obligation to transfer economic benefits in connection with the shares. All shares are redeemable at the companies' option at any time.

The Class A1 and B shares preference shares, which do not carry voting rights, were issued on the 23 July 2003, and are redeemable at their nominal value plus the share premium paid, on 31 March 2038. Class A1 and B shares were issued at £1,000 per share and the amounts received totalled £260.0m for both classes of shares. Class A2 were issued for £0.01 per share on the 7 May 2003 and the amount received totalled £1,500 and are redeemable at nominal value. Shareholders are entitled to receive dividends annually as follows: -

Class A1

- £40 per share

Class A2

- the base value dividend plus an amount for company outperformance and any savings arising from any refinancing of the mezzanine debt. The base value is £nil per share increasing by £15 every five years. (Outperformance from 1 April 2005 onwards is the difference between Southern Water Services Limited's audited 'profit before interest and taxation' and the targeted 'profit before interest and taxation' as determined by OFWAT in the periodic review. Outperformance for the current year is measured against numbers agreed as part of the refinancing).

Class B

- £70 per share

These dividends are payable on the 31 March and 30 September each year. On winding up the preference shareholders rank above ordinary shareholders with the preference shareholders being paid in order of Class A1, Class A2 then Class B.

(vi) The class A2 preference shares have been included in the balance sheet at their fair value on acquisition at the 7 May 2003. The valuation is based on the present value of the total expected payments up to the first possible redemption date. Since the shares are redeemable at any time at the option of the company, they are reflected at the nominal value of £1,500.

Debt issue costs represent issue fees which are being amortised over the weighted-average life of the loan advances noted above. As at 31 March 2005 debt issue costs amounted to £50.2m of which £2.5m represents the short-term amount which is disclosed separately in note 14.

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005

16 Provision for liabilities and charges

	Group 2005 £m	Group 2004 £m
(a) Environmental obligations		
Provision brought forward	3.9	-
Provision acquired at 7 May 2003	-	4.0
Written back in year/period	(1.2)	-
Utilised in year/period	(0.4)	(0.1)
Provision at 31 March	2.3	3.9
(b) Deferred taxation		
Accelerated capital allowances	392.7	383.4
Other timing differences	(73.4)	(74.5)
Deferred taxation	319.3	308.9
(c) Provision for guaranteed standard scheme payments	5.7	-
Total	327.3	312.8

The environmental provision relates to costs for the decommissioning of abandoned sites. No reimbursement is expected. As the period over which the provision will be utilised cannot be determined the provision is not discounted.

The provision for guaranteed standard scheme payments relates to the ongoing investigation into the companies reporting and handling of customer enquiries. SWS is obliged to make payments to customers if it does not reply to letters within certain timescales and the company is now identifying anyone who should have been paid and has not. It will then make the payments due. The investigation is at its early stages and based on the results of the investigation to date, the directors at the time of signing the accounts have estimated the amount of compensation to be £5.7m.

	Group 2005 £m	Group 2004 £m
Movement in deferred tax provision:		
Deferred tax provision brought forward	308.9	-
Deferred tax provision acquired at 7 May	-	300.6
Deferred tax charge in Profit and Loss Account	10.4	8.3
Deferred tax provided at 31 March	319.3	308.9

The Company has no provisions for liabilities and charges.

No provision has been made for potential deferred tax liability on fair value adjustments to the fixed assets recognised. Such tax would only become payable if a contract was entered into to sell the related assets.

The total amount unprovided for is £77.5m. At present it is not envisaged that any such tax will become payable in the foreseeable future.

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005

17 Financial instruments

Derivative activity is undertaken by a subsidiary in the Group, SWSF as determined by the Board, which considers the overall risk profile of the Group and enters into derivatives to mitigate or hedge any risks identified, as appropriate. No derivatives are undertaken for trading purposes, or to benefit from price fluctuations.

The SWSF business consists of lending to other group Companies and raising external finance. In the opinion of the Directors, the fair values of the financial assets and liabilities of the Group (apart from the specific financing loans and hedging instruments shown in the fair value table below) are not materially different from the book values and are not separately disclosed.

All fair values are based on arms length transactions in normal market conditions. Where available market values have been used to determine fair values.

The fair value of the Group's long term borrowings has been estimated based on quoted market prices for the same or similar debt where possible. Where prices did not exist, the fair value has been estimated based the calculations of the present value of future cash flows using the appropriate discount rates in effect at the balance sheet dates.

For foreign currency and interest rate swap agreements the fair value has been estimated based on market valuations at the balance sheet dates.

The Group has no material unhedged monetary assets and liabilities denominated in a currency different from the local currency of the particular operation.

The table below describes the main activities and risks which lead to the use of derivatives.

Activity	Risk	Type of hedge in place
Floating rate borrowing / financing	Increased interest expense due to increases in interest rates	Interest rate swaps which fix the amount of interest payable.
Currency rate borrowing / financing	Increased currency losses due to increases in exchange rates	Currency rate swaps which fix the exchange rates.

On 23 July 2003, the Group carried out a refinancing transaction and entered in to a series of derivative transactions for the purpose of hedging risk associated with the long term borrowing requirements of the Southern Water Capital Group.

For the purposes of the notes below, short term debtors and creditors have been excluded.

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED
31 MARCH 2005

17 Financial instruments (continued)

Interest Rate Risk profile of financial liabilities

Currency	Total £m	Index Linked financial liabilities £m	Fixed rate financial liabilities £m	Variable rate financial liabilities £m	Non equity fixed rate preference shares £m
GBP	2,429.4	508.7	1,601.0	2.2	317.5
At 31 March 2004	<u>2,429.4</u>	<u>508.7</u>	<u>1,601.0</u>	<u>2.2</u>	<u>317.5</u>
GBP	2,547.5	684.3	1,601.0	2.2	260.0
At 31 March 2005	<u>2,547.5</u>	<u>684.3</u>	<u>1,601.0</u>	<u>2.2</u>	<u>260.0</u>

The balance above includes the debt raised in external finance markets (described further in note 15).

Within the fixed rate financial liabilities of £1,601.0m, are loans of £670.0m that have a floating rate which have been fixed through the use of interest rate swaps.

Fixed rate financial liabilities

Currency	Weighted average interest rate %	Weighted average time for which rate is fixed Years
GBP	7.7	16.4
31 March 2004	<u>7.7</u>	<u>16.4</u>
GBP	7.7	15.4
31 March 2005	<u>7.7</u>	<u>15.4</u>

The Group held the following financial assets, as part of the financing arrangements at 31 March 2005.

	31 March 2005 £m	31 March 2004 £m
GBP Cash	245.7	97.2
GBP Restricted cash	0.5	1.8
	<u>246.2</u>	<u>99.0</u>

Restricted cash of £0.5m is held in a designated bank account in order to meet the interest requirements on the loan finance.

The above financial assets attract interest at floating rates.

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005

17 Financial instruments (continued)

Fair values of financial assets and financial liabilities

The following table provides a comparison by category of the carrying amounts and the fair values of the Group's financial assets and financial liabilities at 31 March 2005. Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties. Where available, market values have been used to determine fair values.

{PRIVATE }	Book value 2005 £m	Fair value 2005 £m	Book value 2004 £m	Fair value 2004 £m
Long term borrowings	(2,547.5)	(2,765.8)	(2,429.4)	(2,647.7)
Restricted Cash	0.5	0.5	1.8	1.8
Cash at Bank and in Hand	245.7	245.7	97.2	97.2
Overdraft (note 14)	(1.1)	(1.1)	(2.5)	(2.5)
Derivative financial instruments held to manage interest rate and currency profile				
Interest Rate Swaps	-	(18.5)	-	(20.9)
Currency Rate Swaps	-	(44.9)	-	(37.5)

HEDGES

The table below shows the extent to which the Group has off-balance sheet (unrecognised) and on-balance sheet (deferred) gains and losses in respect of financial instruments used as hedges at the beginning and end of the year. It also shows the amount of such gains and losses which have been included in the profit and loss account for the year and those gains and losses which are expected to be included in next year's or later profit and loss accounts.

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005

17 Financial instruments (continued)

All the gains and losses on the hedging instruments are expected to be matched by losses and gains on the hedged transactions or positions.

	Unrecognised Losses £m
Losses on hedges at 1 April 2004	(58.4)
Amount realised in the current year	-
Gains and (losses) not realised 2005	(5.0)
Losses on hedges at 31 March 2005	(63.4)
Of which:	
Gains and losses expected to be recognised within 2006 income	-
Gains and losses expected to be recognised within 2007 income or later	(63.4)

In 2003 derivatives were put into place to hedge the anticipated bond issue. The bonds were issued at the hedged rate on the 23 July 2003. The premium proceeds on the bond issue were used to finance the payment of the swap break costs on the same date.

The losses of £5.0m for the current period relate to instruments which will continue to hedge the Group's exposure to movements in interest and currency rates.

18 Grants and contributions

	Group £m
At 1 April 2004	42.5
Receivable in year	3.3
Released to profit and loss account	(2.1)
At 31 March 2005	43.7

Grants and Contributions relate to non-infrastructure assets.

19 Share capital

	Group and Company 2005 £m	Group and Company 2004 £m
Authorised		
5,000,000 ordinary A shares of £1 each	5.0	5.0
195,000,000 ordinary B shares of £1 each	195.0	195.0
	200.0	200.0
Allotted, called up and fully paid		
5,000,000 ordinary A shares of £1 each	5.0	5.0
35,050,000 ordinary B shares of £1 each	35.1	35.1
	40.1	40.1

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005

19 Share capital (continued)

The share capital of the Company was increased from £100 to £200,000,000 by a written resolution dated 6 May 2003 by the creation of 99,999,900 ordinary shares of £1 each and 100,000,000 redeemable shares of £1 each. By written resolution dated 14 October 2003 the share capital was redesignated into 5,000,000 A shares of £1 each and 195,000,000 B shares of £1 each. Class A shares only carry voting rights, in all respects the A and B shares rank pari passu as regards rights to income and capital.

On 7 May 2003 5,000,000 ordinary A shares were issued at £1 per share and £35,050,000 ordinary B shares were issued at £1 per share, the amounts received totalled £40.1m for both classes of shares.

20 Reconciliation of movement in shareholder's funds

Group

	Called up share capital £m	Profit and loss account £m	Total £m
On Incorporation	-	-	-
Shares issued	40.1	-	40.1
Loss for the period	-	(5.1)	(5.1)
At 31 March 2004	40.1	(5.1)	35.0
At 1 April 2004	40.1	(5.1)	35.0
Profit for the year	-	13.9	13.9
At 31 March 2005	40.1	8.8	48.9

Company

	Called up share capital £m	Profit and loss account £m	Total £m
On Incorporation	-	-	-
Shares issued	40.1	-	40.1
Profit for the period	-	3.9	3.9
At 31 March 2004	40.1	3.9	44.0
At 1 April 2004	40.1	3.9	44.0
Profit for the year	-	4.2	4.2
At 31 March 2005	40.1	8.1	48.2

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005

21 Notes to the cash flow statement

Cash flow from operating activities	2005	2004
	£m	£m
Continuing operations		
Operating profit and profit on ordinary activities before interest and taxation.	181.0	158.6
Increase / (Decrease) in provisions	4.1	(0.1)
Decrease in pension deficit	(0.1)	(0.2)
Depreciation charge	119.4	101.5
Decrease in stocks	0.4	0.3
Decrease in debtors	-	92.6
Decrease in creditors	(4.8)	(123.8)
Total net cash inflow from operating activities	300.0	228.9

Analysis of Net Debt:

	At 1 April 2004	Cash flows	Other non-cash	31 March 05
	£m	£m	£m	£m
Cash	99.0	147.2	-	246.2
Bank overdraft	(2.5)	1.4	-	(1.1)
	96.5	148.6	-	245.1
Debt due within one year	(6.8)		(0.7)	(7.5)
Debt due after one year	(2,584.1)	(174.4)	46.6	(2,711.9)
Net Debt	(2,494.4)	(25.8)	45.9	(2,474.3)

22 Pensions

The Group accounted for pension costs during the period under SSAP 24, but has also made the detailed disclosures required under the transitional arrangements under FRS 17. These disclosures show a net FRS 17 deficit (after deferred tax) of £98.0 million (2004 deficit: £104.4 million). The deficit has arisen mainly as a result of turbulence in the stock market and low interest rates.

Pension schemes operated

At 1 April 2004 the Group principally operated two schemes, details of which are shown below:

1. Southern Water Pension Scheme (SWPS), a funded defined benefit scheme, which was closed to new members in 31 December 1998 but re-opened in July 2003. This scheme has nine trustee directors.
2. Southern Water Executive Pension Scheme (SWEPS), which is a funded defined benefit scheme. This scheme has four trustee directors.

The assets of the schemes are held separately from those of the company. State Street Bank and Trust Company acts as custodian for the defined benefit schemes and asset management is delegated to external fund managers.

The two schemes were merged together as SWPS on 1 April 2005, at which point it was closed to new members.

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005

22 Pensions (Continued)

Pension schemes operated

A third company stakeholder scheme, which is a defined contribution scheme, is also available.

Members of all schemes receive an annual statement of their accrued benefits.

The latest actuarial valuations of the Southern Water Pension Scheme (SWPS) and Southern Water Services Executive Pension (SWEPS) schemes were carried out as at 31 March 2004 using the projected unit method. The assumptions which have the most significant effect on the results of the valuation are those relating to the rate of return on investments, the rate of future pensionable salary increases and the level of pension increases.

For closed schemes under this method the current service cost will increase as the members of the schemes approach retirement.

The principal assumptions made by the actuary in the valuation were as follows:

	2004 SWPS % pa	2004 SWEPS % pa
Return on investments	6.3	5.6
Salary growth	4.3	4.3
Pension increases on the excess over guaranteed minimum pensions	2.8	2.8

The assets of the scheme had a market value of £270.4m for the SWPS and £21.9m for the SWEPS at 31 March 2004. This was sufficient to cover 78% and 82% of the benefits of SWPS and SWEPS respectively, that had accrued to members at that date, after allowing for expected future increases in earnings.

Regular pension costs under SSAP 24

On acquisition of the Southern Water Investments Limited group, the fair value of the deficit in the pension schemes under SSAP24 was recognised, net of the related deferred tax asset £30.1m. The balance sheet at 31 March 2005 includes the opening deficit £29.9m, pension costs (including interest) of £10.3m (2004:£7.8m), and payments of £10.4m (2004:£8.0m), resulting in a closing deficit of £29.8m (2004:£29.9m).

FRS 17 - disclosures

The Company is following the transitional arrangements under FRS 17 and the required disclosures are made on the following page.

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 2005

22 Pensions (Continued)

FRS 17 - assumptions, asset, liability and reserves disclosures

Formal actuarial funding valuations of the two principal defined benefit schemes in the UK were carried out at 1 April 2004 and updated to 31 March 2005 by a qualified independent actuary. The following disclosures are combined for the SWPS and SWEPS. The major assumptions used by the actuary are set out in the table below.

	31 March 2005 % pa	31 March 2004 % pa	At 7 May 2003 % pa
Price inflation	2.9	2.9	2.5
Rate of increase in salaries (plus an age-related promotional scale)	4.4	4.4	4.0
Rate of increase of pensions in payment	2.9	2.9	2.5
Rate of increase for deferred pensions	2.9	2.9	2.5
Discount rate	5.5	5.6	5.5
Expected return on assets – SWPS	7.1	7.3	7.5
Expected return on assets – SWEPS	5.5	5.6	5.6

The assets and liabilities in the schemes and the expected rates of return at 31 March 2005, 31 March 2004 and 7 May 2003 were:

	Rate of return 2005 %	Rate of return 2004 %	Rate of return 7 May 2003 %	Value at 2005 £m	Value at 2004 £m	Value at 7 May 2003 £m
Equities	8.1%	8.4%	8.7%	223.5	192.6	173.5
Bonds	4.7%	4.8%	4.7%	94.1	87.9	80.4
Cash	3.9%	3.9%	4.0%	7.5	4.9	-
Total market value of Plan assets				325.1	285.4	253.9
Total value of Plan liabilities				(465.1)	(434.6)	(386.0)
Accrued deficit in the Plan				(140.0)	(149.2)	(132.1)
Related deferred tax asset				42.0	44.8	39.6
Net pension liability				(98.0)	(104.4)	(92.5)

If FRS 17 had been adopted and therefore the pension liabilities as discussed above were to be recognised, the Group's net assets and profit and loss account after taking account of the effect of both pension schemes would have been as follows:

	2005 £m	2004 £m
Shareholders' funds		
As reported (note 20)	48.9	35.0
Goodwill arising on acquisition on inclusion of FRS 17 deficit	-	47.6
SSAP 24 deficit in relation to SWPS and SWEPS net of related deferred tax.	29.8	29.9
FRS 17 net pension liability as above	(98.0)	(104.4)
As adjusted for FRS 17	(19.3)	8.1

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005

22 Pensions (Continued)

Shareholders' funds

If FRS17 had been adopted in 2004, the deficit on acquisition calculated under FRS17 would have been more than that calculated under SSAP24. This would have resulted in goodwill being created of £47.6m. Subsequent to 2004, when FRS17 is applied in full, the fair value of the deficit on acquisition will not be revisited. This means that goodwill will not arise in a future period on the full application of FRS17.

FRS 17 - assumptions, asset, liability and reserves disclosures

Profit and loss account	Year to 31 March 2005 £m	Period to 31 March 2004 £m
As reported (note 20)	8.8	(5.1)
Goodwill arising on acquisition on inclusion of FRS 17 deficit	-	47.6
SSAP 24 deficit as above	29.8	29.9
FRS 17 net pension liability as above	<u>(98.0)</u>	<u>(104.4)</u>
As adjusted for FRS 17	<u>(59.4)</u>	<u>(32.0)</u>

FRS 17 – profit and loss account disclosures

The following amounts would have been recognised in the profit and loss account for the year to 31 March 2005 under the requirements of FRS17.

Analysis of amounts charged to operating profit:

	Year to 31 March 2005 £m	Period to 31 March 2004 £m
Employer's current service cost	10.0	7.2
Employer's past service costs	0.3	0.2
Total charged to operating profit	<u>10.3</u>	<u>7.4</u>

Analysis of other amounts credited to the profit and loss account:

	Year to 31 March 2005 £m	Period to 31 March 2004 £m
(Gain) on settlements	-	(0.2)
Net gain credited to profit and loss account	<u>-</u>	<u>(0.2)</u>

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005

22 Pensions (continued)

FRS 17 – profit and loss account disclosures

Analysis of the amount charged to other finance income:

	Year to 31 March 2005 £m	Period to 31 March 2004 £m
Interest on pension scheme liabilities	24.3	21.1
Expected return on pension scheme assets	(20.3)	(17.0)
Net charge to other finance income	4.0	4.1
Total charge before tax	14.3	11.3

Analysis of the amounts recognised in STRGL:

	Year to 31 March 2005 £m	Period to 31 March 2004 £m
Actuarial return less expected return on pension scheme assets	19.2	33.4
Experience gain/(loss) arising on scheme liabilities	1.8	(6.8)
Loss on change of assumptions (financial and demographic)	(7.9)	(27.5)
Total gain/(loss) recognised in STRGL before Adjustment for tax	13.1	(0.9)

Analysis of the movement in the schemes' deficits during the year

	2005 £m	2004 £m
Deficit in the scheme at 1 April / 7May 2003	(149.2)	(132.1)
Employer's contributions	10.4	7.0
Employer's current service cost	(10.0)	(6.6)
Employer's past service cost	(0.3)	(0.2)
Settlement gain	-	0.2
Acquisitions loss	-	(2.2)
Other finance income	(4.0)	(2.4)
Actuarial gain/(loss)	13.1	(12.9)
Deficit in the scheme at end of year	(140.0)	(149.2)

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005

22 Pensions (continued)

Details of experience gains and losses for the year to 31 March 2005 are as follows:

	Year to 31 March 2005	Period to 31 March 2004
a. Actuarial (gain) on scheme assets		
Amount (£m)	(19.2)	(34.0)
Percentage of the scheme assets	5.9%	11.9%
b. Experience (gain)/loss on scheme liabilities		
Amount (£m)	(1.8)	6.8
Percentage of the present value of the scheme liabilities	0.4%	1.6%
c. Total actuarial (gain)/loss recognised in STRGL		
Amount (£m)	(13.1)	0.3
Percentage of the present value of the scheme liabilities	2.9%	0.1%

23 Contingent liabilities

	Group 2005 £m	Group 2004 £m
Contractors' claims	8.7	21.9

Contractors' submit claims to the Group for the estimated final cost of their works. These claims are reviewed by Southern Water, who assess where the liability for the costs rests and the amount that will actually be settled. The expected amount is included within capital creditors and a further sum is identified as a contingent liability, representing a proportion of the difference between the contractor's claim and Southern Water's valuation.

24 Financial commitments

	Group 2005 £m	Group 2004 £m
Annual commitments under other operating leases:		
Expiring within one year	0.4	1.0
Expiring between two and five years	2.7	2.8
	3.1	3.8

Operating leases are charged to the Profit and Loss Account over the lease term. The Company has no such commitments.

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005

25 Directors' emoluments

	2005 £000	2004 £000
Aggregate emoluments (including benefits in kind)	254.1	129.5

Directors' emoluments relate to amounts paid by Southern Water Services Limited for their services to that company.

No payments were made to the directors of Southern Water Capital Limited by the company as they are deemed to be of a non-executive nature.

26 Related party transactions and ultimate controlling party

The major shareholders in Southern Water Capital Limited are Royal Bank Investments Limited and PPI Investments SP, Inc. Southern Water Capital owns 80.1% of the share capital of Southern Water Investments Limited. The remaining 19.9% is owned by Veolia Water Investment Limited.

The transactions and balances with the Group's related parties, as defined by Financial Reporting Standard 8 and the extent of the transactions with them are summarised below.

	2005 £m	2004 £m
Costs		
Royal Bank Investments Limited		
– fees in respect of the securitisation transaction	-	34.2
– fees in respect of the debt issued	0.9	-
Veolia Water UK plc		
- fees paid for tax consultancy	-	0.1
- preference dividends paid	1.6	1.1
- ordinary dividends paid	1.0	-
Renex Limited		
- consultancy fees for R Thian	0.1	-
Creditors		
Ordinary dividend payable to Veolia Water UK plc	1.0	1.0
Management charges payable to Veolia Water Investment Limited and Royal Bank Investments Limited	0.5	-
Loans greater than one year		
Loan from Royal Bank Investments Limited (mezzanine debt)	233.2	233.2

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005

27 Principal subsidiaries

As of 31 March 2005 the Company held 80.1% of the ordinary share capital of Southern Water Investments Limited. Southern Water Investments Limited principal subsidiaries are listed below.

Company	Class of share capital	Proportion of shares held	Activity
Southern Water(NR) Holdings Limited	Ordinary	100%	Non-trading activities
Southern Water(NR) Limited (formerly Aspen 4 Limited)	Ordinary	100%	Non-trading activities
SWS Group Holdings Limited	Ordinary	100%	Non-trading activities
SWS Holdings Limited	Ordinary	100%	Non-trading activities
Southern Water Limited (formerly Southern Water plc)	Ordinary	100%	Intermediate parent company for Southern Water(NR) Group
Southern Water Services Limited	Ordinary	100%	Supply of Water and Wastewater Services
Southern Water Services Finance Limited	Ordinary	100%	To raise debt finance
Southern Water Services Group Limited	Ordinary	100%	Non-trading activities
Southern Water Industries Limited	Ordinary	100%	Commercial Services
Southern Water Services Finance plc	Ordinary	100%	Financial Services
Bowsprit Holdings Limited	Ordinary	100%	Property Investment
Monk Rawling Limited	Ordinary	100%	Estate Management
Bowsprit Property Development Limited	Ordinary	100%	Property Development
James Leppard & Sons Limited	Ordinary	100%	Landfill Operator
Taylor Plant & Haulage Limited	Ordinary	100%	Landfill Operator
EcoClear Limited	Ordinary	100%	Dormant
Southern Water Executive Pension Scheme Trustees Limited	Ordinary	100%	Corporate Trustee of Executive Pension Scheme
Southern Water Pension Trustees Limited	Ordinary	100%	Corporate Trustee of Company Pension Scheme

All subsidiaries have been included in Southern Water Capital Limited's consolidated accounts.

Associate Company

Coastal Wastewater Consultants Limited	Ordinary	50%	Marine treatment, engineering design and consultancy
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This company has not been consolidated in the financial statements due to immateriality.

SOUTHERN WATER CAPITAL LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2005

28 Post Balance sheet events

Since the year end, Southern Water Services Limited has brought to the attention of OFWAT certain inconsistencies in its general levels of service procedures. These inconsistencies relate to the reporting and handling of response levels to customer enquiries and complaints, and were discovered in the course of a project to install a new customer billing system. Under a Guaranteed Standards Scheme Southern Water is obliged to make payments to customers if it does not reply to letters within certain timescales and the company is now identifying anyone who should have been paid and has not. It will then make the payments due. The investigation began on 24 October 2005 and is being carried out by an independent specialist team. Based on the results of the investigation to date, the directors do expect the amount of compensation to be material in the context of the consolidated results in the year to 31 March 2005, and so a provision of £5.7m has been made.

SOUTHERN WATER CAPITAL LIMITED

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SOUTHERN WATER CAPITAL LIMITED

We have audited the financial statements which comprise the Group consolidated profit and loss account, the Group and Company balance sheet, the consolidated cash flow statement and the related notes which have been prepared under the historical cost convention and the accounting policies set out in the accounting policy note.

Respective responsibilities of directors and auditors

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

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for and only for the Group's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the Group has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the directors' report.

Basis of audit opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of the affairs of the company and the Group at 31 March 2005 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London

25 January 2006