

Amending Document

**SOUTHERN WATER PLC**

**DIRECTORS' REPORT,**

**REPORT OF THE REMUNERATION**

**COMMITTEE AND**

**FINANCIAL STATEMENTS**

**1996**

**Registration number 2366620**



## REPORT OF THE DIRECTORS

The Directors have pleasure in presenting their report together with the audited financial statements for the year ended 31 March 1996. A Financial Review of the year appears below and the financial statements are set out on pages 15 to 34.

### Financial Review

#### Turnover

Group turnover in 1996 was £424.7m, 10.4% higher than in 1995. External sales in the regulated business of Southern Water Services were 7.6% higher at £363.5m. Water and sewerage charges increased by an average of 6.6% and the remaining increase in turnover of 1.0% mainly reflected additional income from new connections, higher levels of property occupation, and modest growth in measured supplies. The level of water charges continues to be heavily influenced by the company's massive capital programme to enhance services for customers.

Total sales in the non-regulated businesses, including sales to other Group companies, were £134.4m, an increase of 21.8% on the previous year. External turnover was 30.5% higher at £61.2m due to the continuing growth of existing businesses, notably Topmark Vehicle Contracts Ltd, Clinical Waste Ltd, ERG Group and Paperstream Ltd, together with a small contribution from companies acquired in 1995/96.

#### Profit

Group trading profit was £170.6m, an increase of 13.2% on the previous year or 15.3% higher if the 1995 gain of £2.7m on the sale of land in Hampshire is excluded. The trading profit in the regulated business was £159.4m, an underlying increase of 16.4%. Efficiency savings of £3.9m were achieved, which build on similar gains of £3m secured last year, and reflect ongoing firm control of costs. These savings helped to reduce the impact of higher costs associated with the commissioning of new capital schemes and the additional expenditure resulting from the very dry weather conditions which were experienced throughout the year. As a result cash operating expenses in the regulated business increased by only 1% in real terms in 1996. Depreciation decreased by £3.0m mainly due to certain assets originally acquired in 1974 reaching the end of their economic lives in 1995.

In the non-regulated businesses trading profit, excluding the land sale referred to above, increased by £0.1m to £11.2m, notwithstanding higher business development expenditure and subdued trading conditions in solid and liquid waste. Non-regulated trading profit represented 6.6% of the Group total.

Net interest payable at £5.0m was £2.3m below the previous year and reflected better returns on short term investments, and the replacement of £21m of loans from the European Investment Bank at significantly lower rates of interest. After accounting for the above movements, profit on ordinary activities before taxation increased by 15.5% to £165.6m.

The taxation charge of £20.8m (1995 £13.1m) comprised a mainstream corporation tax charge of £28.6m less adjustments of £2.9m relating to prior years and a net utilisation of advance corporation tax amounting to £4.9m. The effective rate of tax was 12.6% (1995 9.1%) and reflected the profile of capital expenditure and the final utilisation of available tax losses in the previous year. Advance corporation tax of £24.0m paid in respect of the 16.9m shares repurchased in December 1995 has been written off through the Statement of Total Recognised Gains and Losses in accordance with Financial Reporting Standard No. 3.

### Earnings and Dividends

Profit attributable to ordinary shareholders increased by 11.2% to £145.4m. However, after allowing for the beneficial effect of the shares repurchased, earnings per share rose by 13.8% to 88.3p. An interim dividend of £15.0m (9.8p per ordinary share) with a scrip alternative was paid on 9 April 1996. The Board is proposing a final dividend of £34.0m (21.8p per ordinary share) together with a scrip alternative. In the event of the recommended offer by Southern Electric plc being declared wholly unconditional, the proposed final dividend will not be paid. Dividend cover is unchanged at 3.0. The retained profit for the year, after allowing for dividends, amounted to £96.4m (£86.9m) and has been transferred to reserves.

### Shareholders' Funds

Capital and reserves decreased by £36.7m to £1022.4m. The retained profit for the year of £96.4m, together with a net increase of £4.6m from other movements as detailed in note 21 to the financial statements, were offset by expenditure of £137.7m on the shares repurchased during the year.

### Capital Structure

Following the share repurchase, the Group had net debt of £102.2m (1995 net cash £8.4) comprising cash and short term investments of £73.1m, less total borrowings of £175.3m. Gearing, which represents net debt as a percentage of shareholders' funds, amounted to 10.0%. It is Group policy to secure the majority of debt through fixed interest rate borrowings. Substantial bank facilities are in place with a number of U.K and international banks.

## Cash Flow

The Group cash flow statement appears on page 20. Operating activities generated a net cash inflow of £213.9m, an increase of £21.4m over 1995, resulting from increased profits and favourable movements in working capital. Returns on investment and servicing of finance gave rise to a net outflow of £42.1m, £3.9m higher than 1995. The increase was due to a £6.9m rise in dividend payments to shareholders partially offset by lower net interest payments. Taxation, representing the net mainstream corporation tax liability for 1995 and ACT on dividends paid, increased by £0.6m to £9.9m.

Investing activities gave rise to a net cash outflow was £89.2m compared with £98.6m in 1995. The decrease of £9.4m incorporated a reduction of £12.7m in the inflows related to short term investments maturing after three months. Additionally purchases of tangible fixed assets were £23.7m lower than in 1995 mainly due to the profile of expenditure of major capital schemes in the regulated business. Expenditure on fixed assets continued to reflect investment in new marine and inland wastewater treatment works and on improvements to water supply services and sewerage systems. Following the high level of activity in 1995 on Operation Seaclean, the company's huge programme of work to improve bathing water quality a number of major plants have been or soon will be commissioned, and feasibility studies have now begun on the massive schemes required under the Urban Waste Water Directive. Receipts from grants and contributions were £4.0m lower at £9.0m, following the reduction in infrastructure charges implemented by the Office of Water Regulation, whilst disposals of fixed assets increased by £3.6m in the year mainly due to land sales.

Financing activities resulted in cash outflow of £132.2m, principally due to the share repurchase which cost £137.7m. This was partly offset by net new long term loans of £4.0m and proceeds of £1.5m mainly from new shares issued under the Group's Sharesave and Executive Share Option schemes.

The above activities resulted in a net decrease in cash and cash equivalents of £59.5m. The total liquidity of the Group, comprising cash and short term investments, decreased by £102.9m to £73.1m. After deducting all borrowings, including short term borrowings of £12.0m, the Group ended the year with net debt of £102.2m (1995 net cash £8.4m).

## Creditor Payment Policy

The Group's payment policy is to (i) settle terms of payments with suppliers when agreeing the terms of transactions, (ii) ensure that suppliers are made aware of the terms of payment, and (iii) to comply with those contractual arrangements. Southern Water plc's policy is in accordance with the CBI's Prompt Payment Code (copies of the Code are available from the CBI, Centre Point, 103 New Oxford Street, London WC1A 1DU).

## Share Capital

The ordinary share capital of the Company decreased by £13.9m in the year. In order to enhance long term shareholder value, 16,932,618 ordinary shares of £1 each, representing 9.9% of the total share capital of the Company were repurchased for a consideration of £137.7m including advance corporation tax. Details of the shares issued in the year of £3.0m are given in Note 18. The issued share capital at 31 March 1996 was 155,356,221 Ordinary Shares of £1 each.

As far as the Directors are aware, no person had a beneficial interest in 3% or more of the issued ordinary share capital at 7 June 1996 except for the following:

Southern Electric plc	9.98%
Prudential Portfolio Managers Ltd	8.19%

## Investments

During the year the Company acquired the entire share capital of Nationwide Maintenance Ltd, Total Mailing Services Ltd and Vehicle Contract Hire and Leasing Ltd for a total consideration of £15.0m, £0.2m of which is deferred.

## Research and Development

Expenditure on research and development in 1996 amounted to £4.5m (1995 - £4.1m).

## Employment Policies

The Group is an equal opportunities employer and has a policy of non-discrimination in all forms of employment, with recruitment, selection and promotion for all jobs being based solely upon merit. Every effort, including the provision of special equipment, is made to enable disabled persons to be employed for all types of work. The Group is conscious of its responsibilities towards disabled persons in society and during the year joined the Employers' Forum on Disability.

The continued growth of the Group, particularly in the areas of non-regulated business, requires that our employees develop the correct skills to meet its future needs. A great deal of work has been undertaken to enhance the management competencies required at all levels. Internal management programmes, based upon developing these core competencies have continued in conjunction with Henley Management College. This year has also seen a new development programme for first line supervisors, which will be implemented in 1996/97. The continuation of apprentice training and graduate recruitment are seen as key to the future success of the Group. The system of linking pay to individual performance operates in all companies in the Group.

The Group is committed to applying best practices in health and safety, and in 1996 implemented a major initiative on health and safety training. The programme of Well Man and Well Woman health screening continues to offer staff the benefit of health advice from our Occupational Health Advisers. Arrangements have also been made for the Blood Transfusion Service to visit offices with their mobile unit to encourage staff to donate blood for the benefit of others.

### Directors

The Directors of the Company at the date of this report are W J W Courtney (Chairman), M R Webster, R King, K Tozzi, J Cullen, A M Fry, J M Westhead and T Blackler. Mr F N Midmer retired as a Director on 31 December 1995, and Mr V Thomas resigned on 9 May 1996. The Director retiring by rotation at the Annual General Meeting in accordance with Article 106 is Mr R King, who being eligible, offers himself for re-election. Mr King has a service contract terminable on not less than 36 months notice.

Under Article 89 Mr J Cullen has been appointed to the Board as an Executive Director with effect from 1 April 1996, and Mr T Blackler has been appointed to the Board as a Non-Executive Director with effect from 1 June 1996. They will resign and offer themselves for election at the Annual General Meeting. Mr Cullen has a service agreement terminable on not less than 24 months notice. Mr T Blackler does not have a service contract.

### Directors' Share Interests

The share interests of the Directors shown in the register maintained under the provisions of the Companies Act 1985 as at 31 March 1996 are set out in the Report of the Remuneration Committee together with their interests as at the date of this report. None of the Directors holds shares beneficially in any subsidiary company.

### Directors' Interests in Contracts

The Board is not aware of any contract of significance (other than service contracts) in relation to the Company or its subsidiaries in which any Director has or has had a material interest. Service contracts are held by Mr W J W Courtney, Mr M R Webster, Mr R King, Mr K Tozzi, and Mr J Cullen.

### Corporate Governance

The Board remains committed to the highest standards of integrity and professionalism in the conduct of the Group's business and considers that during the year the Group complied with the Code of Best Practice on the Financial Aspects of Corporate Governance, published by the Cadbury Committee in December 1992.

## Internal Control

The system of internal control has developed over a number of years, particularly in the period since privatisation in 1989. Minor improvements are implemented from time to time, as part of the evolutionary process. The current system is set out below.

The Board meets regularly throughout the year and has formally adopted a schedule of matters which are specifically reserved for its decision, and retains full control over key strategic, financial and organisational issues within the Group. The Board acknowledges its responsibility for the system of internal controls and during the year has, through the Audit Committee, reviewed the effectiveness of the internal financial controls of the Group.

The Board has established standing committees, each of which operates within defined terms of reference.

Day-to-day management of the Group is delegated to an Executive Committee comprising all of the Executive Directors. Nominations for new Directors are considered by a Nomination Committee, consisting of the whole Board, which meets as required.

There is an Audit Committee composed entirely of Non-Executive Directors which normally meets three times a year to monitor the adequacy of the Group's internal controls and to review the external and internal audit activities. The Committee also reviews the interim and annual financial statements before submission to the Board. The external auditors and the Finance Director are invited to attend all Audit Committee meetings, although an opportunity is provided for the Non-Executive Directors and the Auditors to meet in private.

The composition and role of the Remuneration Committee, is explained in the Report of the Remuneration Committee on pages 9 to 13.

Internal financial control is exercised within the Group through a formal organisational structure put in place by the Board. This involves clearly defined lines of authority and responsibility, including limits for authorisation of transactions and appropriate division of duties. In view of the significance of the Group capital programme, specifically designed investment appraisal and approval procedures have been put in place for all Group companies. Implementation reviews are carried out to ensure that the most efficient solutions and practices are always applied throughout the Group.

Operating units consist of individual businesses and also the central functional departments which have responsibility for legal, finance and administrative issues. The development of each business is controlled within a strategy approved by the Board. There are comprehensive budgeting and financial reporting systems throughout the Southern Water Group. The Board approves an annual budget for each business and for the Group. Monthly management accounts and forecasts are also prepared and are reviewed by the Board. Regular performance reviews of each business are undertaken.

The Group's treasury activities are centrally controlled in accordance with policies laid down by the Board. Cash is invested according to strictly defined criteria to limit risk, and performance is reported monthly to the Board. The Group does not have material foreign exchange exposures and has not made significant use of financial derivatives.

The Group internal controls are reviewed by the Group Internal Audit department which has a broad remit covering both internal financial controls and wider aspects of business efficiency and compliance. Audit coverage is drawn up to reflect the nature of the business risks within the Group. The Group Audit Manager and the external auditors, Coopers & Lybrand, report regularly to the Audit Committee on the performance of the internal financial control environment. The Group internal financial controls are designed to provide reasonable but not absolute assurance against material misstatement or loss.

### Going Concern

The Directors, having made appropriate enquiries, are satisfied that Southern Water plc, as an autonomous Group, have adequate resources to continue in operational existence for the foreseeable future and that, therefore, it is appropriate to adopt the going concern basis in preparing the financial statements.

### Auditors' Review

Our auditors have reported to the Company that in their opinion the Directors' comments on internal financial control and on going concern set out above provide the disclosures required by paragraphs 4.5 and 4.6 of the Code (as supplemented by the related guidance) and are not inconsistent with the information of which they are aware from their audit work on the financial statements, and the above statement appropriately reflects the Company's compliance with the other paragraphs of the Code specified by the London Stock Exchange for their review. They have not carried out the additional work necessary to, and do not, express any opinion on the effectiveness of either the Group's system of internal financial control or its corporate governance procedures, nor the ability of the Company and the Group to continue in operational existence.

### Donations

Charitable donations during the year amounted to £30,000. No political donations were made either by the Company or its subsidiaries.

### Close Company Status

The close company provisions of the Income and Corporation Taxes Act 1988 do not apply to the Company.

## Auditors

A resolution to re-appoint Coopers & Lybrand as auditors and to authorise the Directors to fix their remuneration will be proposed at the Annual General Meeting.

## Annual General Meeting

The Agenda for the Annual General Meeting will include, as items of special business, a renewal of the authorities for the Company to purchase up to 10% of its issued share capital and for the Directors to allot shares up to 5% of the issued share capital on a non-pre-emptive basis. A special resolution is also included to amend the Articles of Association in order to delete the provisions relating to the 'Special Share', which has now been redeemed, to permit the Company's shares to be held in uncertified form for the purposes of the CREST settlement system, and to update the Articles to reflect current legislation and Stock Exchange practices. It is the Company's present intention to hold the Annual General Meeting on 15 August 1996. Shareholders will be advised if circumstances arising from the current offers for the Company require the arrangements for the meeting to be changed.



By Order of the Board  
John Cullen  
Secretary  
7 June 1996

## REPORT OF THE REMUNERATION COMMITTEE

The Remuneration Committee is appointed by the Board and is responsible for determining the service contracts and emoluments of the Executive Directors. The membership of the Committee is composed entirely of Non-Executive Directors. The remuneration of Non-Executive Directors is decided by the whole Board; however, each Director abstains from decisions affecting his own remuneration.

The Remuneration Committee confirms that the Company complies with those listing rules of the London Stock Exchange which were introduced following the publication of the Code of Best Practice by the Study Group on Directors' Remuneration, chaired by Sir Richard Greenbury. The Committee has given full consideration to Section B of the Best Practice Conditions annexed to the listing rules and has complied with the Study Group recommendation that the privatised water and energy companies should review comprehensively their existing remuneration packages.

### Remuneration Policy

The objective of the Company's remuneration policy is to ensure that the remuneration offered to Executive Directors and Senior Managers is competitive in order to attract, retain and motivate high calibre individuals. Remuneration is tailored to provide incentives which are closely aligned with corporate and personal performance. In determining appropriate levels of reward, the Committee regards the overall value of remuneration to be of much greater importance than the individual elements. Regular use is made of external advisers and in 1996 a comprehensive review of Directors' terms and conditions was carried out with the assistance of the Hay Group.

### Remuneration

Remuneration for Executive Directors consists of annual pay and benefits, a longer term incentive principally in the form of a restricted share scheme and a pension. The Company also maintains an approved executive share option scheme; however, individuals who in any year are invited to participate in the restricted share scheme will not be eligible to receive an award of options.

#### *Annual pay and benefits*

The *salary* of Executive Directors is set having regard to their role and performance, the overall remuneration structure in the Company and after benchmarking against market data and the remuneration of individuals performing similar functions in other comparable organisations. The main *benefits*, all of which are taxable, comprise a company car and private medical insurance for the Director and his immediate family. *Annual bonus* is available subject to corporate performance in the year satisfying criteria established by the Remuneration Committee at the beginning of the year. In 1995/6 the bonus was linked to the growth in the Company's earnings per share and gave rise to a payment of 22% of salary, compared with a maximum possible bonus level of 30%.

#### *Longer term incentive*

The Company's main long term incentive arrangement takes the form of a restricted share scheme which was introduced in 1994/5. The scheme provides for the notional award of shares in the Company to Directors and Senior Managers which will be released to the individual after a qualifying period of three years, only if pre-determined performance targets have been achieved at the end of that same period. In order to align the interests of customers and shareholders, the performance

targets relate to both the maintenance of high customer service levels in the regulated business and increases in the Group's earnings per share relative to the average performance of comparable companies over the three year period. The shares to be allocated are reduced on a sliding scale if growth in earnings per share falls below 105% of the average of the group of comparable companies. No shares are allocated if growth is below 95% of the average of the comparator group or if the customer service standards are not achieved. The shares required to operate the scheme are purchased in the market and held in trust until the performance criteria have been met. When shares are released from the trust, participants in the scheme will be expected to retain them for a further year, subject to the requirement to sell shares in order to settle a taxation liability arising under the scheme.

Under the terms of the Finance Act 1996, the executive share option scheme will remain an approved scheme and therefore no individual will be eligible to receive a future award of options unless the total market value of shares held under option is less than £30,000.

### *Pension*

The only post retirement benefit provided by the Company is a pension and all Executive Directors are members of the Southern Water Executive Pension Scheme. This is an Inland Revenue approved, non-contributory scheme, which having regard to the overall value of the remuneration package the Committee considers to be appropriate and competitive. Members of the scheme can earn a maximum pension of two thirds of salary, annual bonus and benefits on retirement at 60, subject to qualifying service and the Company currently contributes to the scheme at a rate of 27.2%. The Greenbury Study Group has recommended disclosure of pension entitlements earned by each director, calculated on an actuarial basis. The Company will provide this information when the Stock Exchange confirms the principles to be used to calculate the entitlement.

Mr R King is affected by the earnings cap on pensions payable from approved schemes and a separate provision has been made in the financial statements to reflect the cost of providing him with a pension which is not reduced by the cap.

### Directors' Service Contracts

As part of the comprehensive review of remuneration packages, the Committee had considered the question of a reduction in the notice period of the existing Directors' contracts from three years to two years. The Committee believe however that, until the uncertainties arising from the recent offers to acquire the Company have been resolved, it would be inappropriate to review the terms and conditions of the Directors' service contracts.

The Chairman's current service contract expires on 31 December 1996 and Mr Cullen's existing service contract will retain a two years notice period.

The Committee endorse the principle of mitigation of damages on early termination of a service contract for unsatisfactory performance.

## Remuneration of Directors

The emoluments of the Executive and Non-Executive Directors were as follows:

	Salary		Benefits		Annual Bonus		Fees		Total	
	1996 £000	1995 £000								
<b>Executive Directors</b>										
WJW Courtney	151	144	18	18	34	21	-	-	203	183
M R Webster	129	124	13	13	29	18	-	-	171	155
R King	99	94	12	11	22	14	-	-	133	119
K Tozzi	91	86	7	7	20	12	-	-	118	105
	<u>470</u>	<u>448</u>	<u>50</u>	<u>49</u>	<u>105</u>	<u>65</u>	<u>-</u>	<u>-</u>	<u>625</u>	<u>562</u>
<b>Non-Executive Directors</b>										
A M Fry			-	-			18	13	18	13
V E Thomas			-	-			18	18	18	18
J M Westhead			-	-			18	18	18	18
F N Midmer			9	10			14	18	23	28
P A Girle			-	-			-	24	-	24
	<u>470</u>	<u>448</u>	<u>59</u>	<u>59</u>	<u>105</u>	<u>65</u>	<u>68</u>	<u>91</u>	<u>702</u>	<u>663</u>

Pension contributions for Executive Directors	155	142
	<u>857</u>	<u>805</u>

In addition to the pension contributions in the period, unfunded liabilities have been charged against profit in respect of (a) Mr W J W Courtney, £nil (1995 £96,000) and (b) Mr R King £18,000 (1995 £10,000).

Mr Midmer retired from the Board on 31 December 1995. Mr Girle retired on 31 December 1994, and Mr Fry was appointed to the Board on 1 July 1994.

The emoluments of the Chairman, who was also the highest paid Director were £203,000 (1995 £183,000). In addition, pension contributions paid in the period in respect of the Chairman were £55,000 (1995 £50,000).

**Only fifty per cent of Directors' emoluments are charged to the regulated water and wastewater business, the remainder being charged to the Group's non-regulated businesses.**

### Directors share interests

#### (1) Beneficial Interests

The interests of the Directors who held office at 31 March 1996, including family interests, shown on the register maintained under the provisions of the Companies Act 1985 as at 31 March 1996 and 31 March 1995 are set out below, together with their interests as at the date of this report. None of the Directors holds shares beneficially in any subsidiary company.

	Ordinary Shares		
	7 June 1996	31 March 1996	31 March 1995
W J W Courtney	67048	66348	58184
M R Webster	60888	58599	48693
R King	7098	9379	768
K Tozzi	21397	23909	20377
A M Fry	521	516	500
V E Thomas	250*	250	250
J M Westhead	621	613	587

\* Mr V E Thomas' holding is shown at the date he ceased to be a Director.

## (2) Long Term Incentive Scheme

The following notional allocation of shares was made during the year. These are eligible for award in July 1998, subject to compliance with the performance criteria described on pages 9 and 10:

M R Webster	7000
R King	5000
K Tozzi	5000

## (3) Share options

Details of the share options held by Directors and changes in the year are as follows:-

	31 March 1995	Granted	Exercised	31 March 1996	Exercise Price	Exercisable Dates
<b>W J W Courtney</b>						
Executive Scheme	50000	-	50000 †	-	310p	1995-2002
	16000	-	16000 ~	-	466p	1996-2003
	40000	-	-	40000	639p	1997-2004
	25000	-	-	25000	525p	1998-2005
		29500	-	29500	668p	2001-2008
Sharesave Scheme	3024	-	-	3024	248p	1997
	2269	-	-	2269	456p	2000
<b>M R Webster</b>						
Executive Scheme	25000	-	25000 †	-	310p	1995-2002
	12000	-	12,000 ~	-	466p	1996-2003
	35000	-	-	35000	639p	1997-2004
	25000	-	-	25000	525p	1998-2005
Sharesave Scheme	4766	-	-	4766	236p	1996
	3024	-	-	3024	248p	1997
	-	1927	-	1927	537p	2001
<b>R King</b>						
Executive Scheme	40000	-	19000 ~	21000	466p	1996-2003
	25000	-	-	25000	639p	1997-2004
	11500	-	-	11500	525p	1998-2005
Sharesave Scheme	4872	-	-	4872	372p	1998

**K Tozzi**

Executive Scheme	11000	-	11000 *	-	295p	1994-2001
	11000	-	11000 *	-	310p	1995-2002
	5000	-	5000	-	466p	1996-2003
	25000	-	-	25000	639p	1997-2004
	20000	-	-	20000	525p	1998-2005
Sharesave Scheme	3024	-	-	3024	248p	1997
	1948	-	-	1948	372p	1998
	4538	-	-	4538	456p	2000

There have been no changes in outstanding options held by the Directors between 31 March 1996 and 7 June 1996, except for the exercise of 4,766 shares by Mr Webster under the Sharesave Scheme.

The market price of the shares at 31 March 1996 was 749p (1995 - 566p). The market price on the days that the executive scheme options were exercised were 580p\*, 699p†, and 745p~. During the year the market price ranged from 566p to 758p.

A M Fry  
7 June 1996

**Directors' responsibilities**

*for the preparation of the financial 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 and cash flows of the Group for the year. They are also required to prepare financial statements on a going concern basis unless this is inappropriate.

The Directors confirm that suitable accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, have been used in the preparation of the financial statements. All accounting standards which they consider to be applicable have been followed and the going concern basis has been applied.

The Directors have responsibility for ensuring that the Company keeps proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and which enable them to ensure that the financial statements comply with the Companies Act 1985. The Directors are also responsible for taking reasonable steps to safeguard the assets of the Group and to prevent or detect fraud and other irregularities.

---

**Report of the Auditors**

*to the members of Southern Water plc*

We have audited the financial statements on pages 15 to 34.

**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.

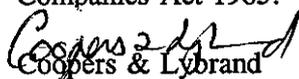
**Basis of opinion**

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 Company's circumstances, consistently applied and adequately disclosed.

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

**Opinion**

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

  
Coopers & Lybrand

*Chartered Accountants and Registered Auditors*  
London

## ACCOUNTING POLICIES

The financial statements have been prepared under the historical cost convention and in accordance with applicable UK accounting standards and, subject to the treatment of infrastructure grants and contributions described below, in accordance with the Companies Act 1985. The main accounting policies are set out below.

### **Basis of consolidation**

The consolidated Group financial statements include the accounts of the parent company and all its subsidiary undertakings. The accounting year end for all subsidiary undertakings is 31 March.

The results of businesses acquired or sold during the year are included in the Group financial statements from or to their respective dates of acquisition or disposal.

### **Turnover**

Turnover represents the invoice value of goods and services provided, excluding VAT.

### **Depreciation**

Fixed assets are depreciated on a straight line basis over their estimated useful lives, which are principally as follows:

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

Freehold land and infrastructure assets are not depreciated. Infrastructure assets, being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls are not depreciated 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.

### **Grants and contributions**

Grants and contributions received in respect of additions to non-infrastructure fixed assets are included in creditors and released to profit over the useful lives of the relevant assets in accordance with the Companies Act 1985. The treatment of grants and contributions relating to infrastructure assets differs, since these assets are not depreciated and therefore no basis exists on which to recognise infrastructure grants and contributions as deferred income. Accordingly, grants and contributions relating to infrastructure additions are deducted from the cost of infrastructure assets in order to show a true and fair view. This treatment is in accordance with SSAP4 and the effect on the value of tangible fixed assets is disclosed in note 8 .

### **Leased assets**

Assets leased to Southern Water Services Limited under finance leases are capitalised and depreciated in line with the Group depreciation policy. Assets leased to all other Group companies under finance leases are capitalised and depreciated over the shorter of their estimated useful lives and the lease period. The interest element of finance lease repayments is charged against profit in proportion to the balance of the capital repayments outstanding.

Rental costs under operating leases are charged against profit as incurred.

### **Fixed asset investments**

In the Group financial statements the Group share of the results of associated undertakings is included in the profit and loss account on the equity accounting basis, and the balance sheet includes the investment in associated undertakings at the Group share of their net assets.

Other investments held as fixed assets are stated at the lower of cost or market value or Directors' valuation where no market value is available. Dividends from other investments are accounted for on receipt.

### **Goodwill**

Goodwill, representing the excess of the acquisition cost of businesses or investments in associated undertakings over the fair value of the net assets acquired, is charged to reserves. On the subsequent disposal of a previously acquired business, the profit or loss on disposal is determined after charging related goodwill previously taken directly to reserves.

### **Stocks and work in progress**

Stocks used internally for operational purposes are stated at cost less provision for damage and obsolescence. Other stocks and work in progress are valued at the lower of cost and net realisable value. Cost includes labour, materials and relevant overheads.

### **Current asset investments**

Current asset investments are stated in the balance sheet at market value. Realised and unrealised gains and losses arising in the year are recognised in the profit and loss account.

### **Research and development**

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

### **Foreign currency**

Transactions denominated in foreign currencies are translated into sterling at the rate of exchange ruling at the transaction date, or at the forward cover rate where forward cover arrangements exist. Foreign currency balances are translated into sterling at the rate of exchange ruling at the balance sheet date or at the forward cover rate where forward cover arrangements exist.

All foreign currency gains and losses are taken to the profit and loss account.

### **Taxation**

Advance corporation tax in respect of dividends payable for the year is written off in the profit and loss account unless it can be recovered against mainstream corporation tax.

Provision is made for deferred taxation, relating to capital allowances and other timing differences, on the liability method, to the extent that it is considered probable that a liability to taxation will occur in the foreseeable future.

### **Pensions**

The Group operates defined benefit and defined contribution pension schemes. The expected costs of the defined benefit schemes are charged against profit over the period benefiting from the employees' service. Variations from the regular cost are charged against profit on a systematic basis over the expected remaining service lives of employees in each scheme. Contributions to the schemes are determined on the basis of professional actuarial advice in accordance with statutory requirements. Payments to defined contribution schemes are charged against profit as incurred.

**GROUP PROFIT AND LOSS ACCOUNT**  
**For the year ended 31 March 1996**

	Notes	1996 £m	1995 £m
Turnover - continuing operations	1	424.7	384.6
Trading profit - continuing operations	1,2	170.6	150.7
Net interest payable	3	(5.0)	(7.3)
<b>Profit on ordinary activities before taxation</b>		165.6	143.4
Taxation	4	(20.8)	(13.1)
<b>Profit on ordinary activities after taxation</b>		144.8	130.3
Minority interests		0.6	0.5
<b>Profit attributable to ordinary shareholders</b>		145.4	130.8
Dividends	5	(49.0)	(43.9)
<b>Retained profit for the year</b>	19	96.4	86.9
<b>Earnings per share</b>	7	88.3p	77.6p

There is no difference between the profit on ordinary activities before taxation and the retained profit for the year stated above and their historical cost equivalents.

	1996 £m	1995 £m
<b><u>Statement of Total Recognised Gains and Losses</u></b>		
Profit for the financial year attributable to shareholders	145.4	130.8
Advance corporation tax on share repurchase	(24.0)	-
<b>Total recognised gains and losses for the year</b>	121.4	130.8

**BALANCE SHEETS**  
**At 31 March 1996**

	Notes	Group		Company	
		1996 £m	1995 £m	1996 £m	1995 £m
<b>Fixed assets</b>					
Tangible assets	8	1290.9	1181.7	1.2	1.0
Investments	9	1.4	1.4	504.0	474.5
		<u>1292.3</u>	<u>1183.1</u>	<u>505.2</u>	<u>475.5</u>
<b>Current assets</b>					
Stocks	10	5.8	5.0	-	-
Debtors	11	78.8	72.3	176.7	122.9
Investments	12	54.7	94.7	50.7	91.2
Cash and deposits	12	18.4	81.3	17.2	91.0
		<u>157.7</u>	<u>253.3</u>	<u>244.6</u>	<u>305.1</u>
<b>Creditors due within one year</b>					
Short term borrowings	13	(12.0)	(33.5)	(60.0)	(21.0)
Other creditors	14	(218.6)	(177.1)	(75.7)	(65.7)
		<u>(230.6)</u>	<u>(210.6)</u>	<u>(135.7)</u>	<u>(86.7)</u>
<b>Net current (liabilities)/assets</b>		<u>(72.9)</u>	<u>42.7</u>	<u>108.9</u>	<u>218.4</u>
<b>Total assets less current liabilities</b>		<u>1219.4</u>	<u>1225.8</u>	<u>614.1</u>	<u>693.9</u>
<b>Creditors due after more than one year</b>					
Long term borrowings	15	(163.3)	(134.1)	(155.1)	(134.0)
Grants and contributions	16	(28.3)	(25.3)	-	-
		<u>(191.6)</u>	<u>(159.4)</u>	<u>(155.1)</u>	<u>(134.0)</u>
<b>Provision for liabilities and charges</b>	17	(5.4)	(6.7)	-	(0.2)
<b>Minority interests</b>		-	(0.6)	-	-
<b>Net assets</b>		<u>1022.4</u>	<u>1059.1</u>	<u>459.0</u>	<u>559.7</u>
<b>Capital and reserves</b>					
Called up share capital	18	155.4	169.3	155.4	169.3
Capital redemption reserve	19	16.9	-	16.9	-
Share premium account	19	11.8	2.9	11.8	2.9
Profit and loss account	19	838.3	886.9	274.9	387.5
<b>Equity shareholders' funds</b>	21	<u>1022.4</u>	<u>1059.1</u>	<u>459.0</u>	<u>559.7</u>

The financial statements on pages 15 to 34 were approved by the Board on 7 June 1996 and signed on its behalf by:

W J W Courtney CBE



Chairman

R King



Group Finance Director

**GROUP CASH FLOW STATEMENT**  
**For the year ended 31 March 1996**

	Notes	1996 £m	1995 £m
<b>Net cash inflow from operating activities</b>	26	213.9	192.5
		—	—
<b>Returns on investment and servicing of finance:</b>			
Interest received		13.5	10.9
Interest paid		(17.6)	(18.1)
Dividends received		0.4	0.5
Dividends paid		(38.4)	(31.5)
		—	—
Net cash outflow from returns on investment and servicing of finance		(42.1)	(38.2)
		—	—
<b>Taxation paid</b>		(9.9)	(9.3)
		—	—
<b>Investing activities:</b>			
Purchase of tangible fixed assets		(137.2)	(160.9)
Sale of tangible fixed assets		5.1	1.5
Purchase of subsidiary undertakings	20	(1.5)	(0.3)
Grants and capital contributions received		9.0	13.0
Decrease in current asset investments and deposits maturing after three months		35.4	48.1
		—	—
Net cash outflow from investing activities		(89.2)	(98.6)
		—	—
<b>Net cash inflow before financing</b>		72.7	46.4
		—	—
<b>Financing:</b>			
Issue of new shares less expenses of issue		1.4	0.1
Shares repurchased	18	(137.7)	-
New loans		25.0	-
Repayment of loans		(21.0)	-
New finance leases		0.6	-
Capital element of finance lease payments		(0.5)	(0.1)
		—	—
Net cash outflow from financing		(132.2)	-
		—	—
<b>(Decrease)/increase in cash and cash equivalents</b>	29	(59.5)	46.4
		—	—
<b>Movement in net cash balances</b>	30	(110.6)	(1.6)
		—	—

# NOTES TO THE FINANCIAL STATEMENTS

## 1 Segmental information

	Regulated Business		Non-Regulated Businesses		Group	
	1996 £m	1995 £m	1996 £m	1995 £m	1996 £m	1995 £m
Gross turnover	363.8	338.1	134.4	110.3	498.2	448.4
Less inter company	(0.3)	(0.4)	(73.2)	(63.4)	(73.5)	(63.8)
External turnover	<u>363.5</u>	<u>337.7</u>	<u>61.2</u>	<u>46.9</u>	<u>424.7</u>	<u>384.6</u>
Profits	<u>159.4</u>	<u>136.9</u>	<u>11.2</u>	<u>11.1</u>	<u>170.6</u>	<u>148.0</u>
Profit on sale of land in Hampshire					-	2.7
Trading profit					<u>170.6</u>	<u>150.7</u>
Net interest payable					(5.0)	(7.3)
Profit on ordinary activities before taxation					<u>165.6</u>	<u>143.4</u>
Net Assets					<u>1996</u>	<u>1995</u>
					£m	£m
Regulated business					1051.5	989.3
Non regulated businesses					70.7	59.1
Unallocated assets					2.4	2.3
Cash and short term investments less short term and long term borrowings					(102.2)	8.4
					<u>1022.4</u>	<u>1059.1</u>

All material activities were conducted in the United Kingdom.

## 2 Analysis of trading profit

	Group	
	1996 £m	1995 £m
Turnover	424.7	384.6
Cost of sales	(211.0)	(195.5)
Gross profit	<u>213.7</u>	<u>189.1</u>
Administration expenses	(46.7)	(44.0)
Other operating income	3.6	5.6
Trading profit	<u>170.6</u>	<u>150.7</u>
Trading profit is stated after charging/(crediting):		
Depreciation on:		
Own fixed assets	39.1	40.2
Fixed assets held under finance leases	<u>1.0</u>	<u>0.6</u>
	40.1	40.8
Infrastructure renewals expenditure	17.9	17.3
Rentals under operating leases	0.8	0.6
Research and development	4.5	4.1
Grants and contributions	(1.1)	(1.0)

Audit fees charged in the Group financial statements for the year ended 31 March 1996 were £0.2m (1995 £0.2m), of which £40,000 (1995 £40,000) related to the Company. Fees payable to the auditors for services other than statutory audit were £0.2m (1995 £0.1m).

NOTES TO THE FINANCIAL STATEMENTS continued

3 Interest

	Group	
	1996 £m	1995 £m
Interest payable on bank loans, overdrafts and other loans:		
Repayable wholly within five years	(7.0)	(7.5)
Repayable after five years	(10.2)	(10.4)
Finance lease obligations	(0.2)	(0.1)
	<u>(17.4)</u>	<u>(18.0)</u>
Interest receivable	12.4	10.7
	<u>(5.0)</u>	<u>(7.3)</u>

4 Taxation

	Group	
	1996 £m	1995 £m
United Kingdom taxation:		
Corporation tax in respect of the current year	28.6	10.0
Corporation tax provision in respect of prior years no longer required	(2.9)	-
	<u>25.7</u>	<u>10.0</u>
Advance corporation tax utilised relating to prior years	(15.5)	(6.1)
Advance corporation tax on dividends for the year	10.6	9.2
	<u>20.8</u>	<u>13.1</u>

The corporation tax charge for the year of £28.6m has been reduced by £28.4m (1995 £39.5m) in respect of the excess of tax allowances over depreciation and other timing differences.

5 Dividends

	Group	
	1996 £m	1995 £m
Interim dividend of 9.8p (1995 8.45p) per ordinary share paid 9 April 1996	15.0	14.3
Proposed final dividend of 21.8p (1995 17.45p) per ordinary share	34.0	29.6
	<u>49.0</u>	<u>43.9</u>

A scrip alternative was offered for the interim dividend and will be offered for the final dividend. In the event of the recommended offer by Southern Electric plc being declared wholly unconditional, the proposed final dividend will not be paid.

**6 Directors and employees**

	Group	
	1996	1995
	£m	£m
<b>Employee costs</b>		
<b>(including Directors' emoluments)</b>		
Wages and salaries	77.8	72.7
Social security costs	6.4	5.9
Pension contributions	8.0	7.1
	<u>92.2</u>	<u>85.7</u>
	—	—
	Number	Number
<b>Average number of persons employed</b>		
Regulated business	2,243	2,371
Non-regulated businesses	1,642	1,357
	<u>3,885</u>	<u>3,728</u>
	—	—

**Directors' Remuneration**

Details of Directors' Remuneration are contained within the Report of the Remuneration Committee on pages 9 to 13.

**7 Earnings per share**

Earnings per share were 88.3p (1995 77.6p), based on profit attributable to ordinary shareholders of £145.4m (1995 £130.8m) and the weighted average number of shares in issue during the year of 164.7m (1995 168.6m).

Earnings per share on the nil basis were 85.3p (1995 79.4p) and are calculated on profit attributable to ordinary shareholders, adjusted by the net amount of advance corporation tax written back of £4.9m (1995 £3.1m written off).

There would be no significant dilution of earnings if the outstanding share options were exercised.

**8 Tangible fixed assets**

	Group				Total	Company
	Freehold land and buildings	Plant and machinery	Infra- structure assets	Other	£m	Other
	£m	£m	£m	£m	£m	£m
<b>Cost</b>						
Balance at 1 April 1995	476.7	328.0	495.6	152.6	1,452.9	2.3
Acquisition of subsidiaries	0.4	19.0	-	0.3	19.7	-
Additions and transfers	13.6	82.9	32.8	14.4	143.7	0.8
Grants and contributions	-	-	(4.6)	-	(4.6)	-
Disposals	-	(6.5)	-	-	(6.5)	(0.3)
	<u>490.7</u>	<u>423.4</u>	<u>523.8</u>	<u>167.3</u>	<u>1605.2</u>	<u>2.8</u>
Balance at 31 March 1996	490.7	423.4	523.8	167.3	1605.2	2.8
	—	—	—	—	—	—

8 (cont'd)

**Depreciation**

Balance at 1 April 1995	88.8	114.5	-	67.9	271.2	1.3
Acquisition of subsidiaries	-	7.3	-	0.2	7.5	-
Charge for the year	9.6	19.4	-	11.1	40.1	0.5
Disposals	-	(4.5)	-	-	(4.5)	(0.2)
Balance at 31 March 1996	<u>98.4</u>	<u>136.7</u>	<u>-</u>	<u>79.2</u>	<u>314.3</u>	<u>1.6</u>
<b>Net book value at 31 March 1996</b>	<u>392.3</u>	<u>286.7</u>	<u>523.8</u>	<u>88.1</u>	<u>1290.9</u>	<u>1.2</u>
<b>Net book value at 31 March 1995</b>	<u>387.9</u>	<u>213.5</u>	<u>495.6</u>	<u>84.7</u>	<u>1181.7</u>	<u>1.0</u>

Tangible fixed assets include £171.0m (1995 £224.8m) of assets in the course of construction which are not depreciated until commissioning.

The net book value of tangible fixed assets held under finance leases was £18.9m (1995 £7.9m).

The net book value of infrastructure assets is stated after deducting grants and contributions since privatisation of £71.1m (1995 £66.5m).

Included above are assets leased to customers under operating leases with a cost of £27.7m (1995 £14.1m) and accumulated depreciation of £8.9m (1995 £3.9m).

9 Fixed asset investments

	1996		1995	
(a) Group	£m		£m	
Cost at 1 April	2.3		2.3	
Amounts provided at 1 April	(0.9)		(0.9)	
Balance at 31 March	<u>1.4</u>		<u>1.4</u>	
 (b) Company	Shares in subsidiary undertakings	Loans to subsidiary undertakings	Other investments	Total
	£m	£m	£m	£m
Balance at 1 April 1995	63.9	409.2	1.4	474.5
Net investment	17.0	12.5	-	29.5
Balance at 31 March 1996	<u>80.9</u>	<u>421.7</u>	<u>1.4</u>	<u>504.0</u>

The principal subsidiary undertakings and fixed asset investments of the Group are listed on pages 33 and 34.

NOTES TO THE FINANCIAL STATEMENTS continued

10 Stocks

	Group	
	1996	1995
	£m	£m
Materials and consumables	3.3	3.6
Work in progress	1.8	1.1
Finished goods and goods for resale	0.7	0.3
	<u>5.8</u>	<u>5.0</u>
	—	—

11 Debtors

	Group		Company	
	1996	1995	1996	1995
	£m	£m	£m	£m
Trade debtors	69.6	58.7	-	-
Amounts owed by subsidiary undertakings	-	-	174.4	119.4
Other debtors	5.4	8.5	0.3	1.1
Prepayments	3.8	5.1	2.0	2.4
	<u>78.8</u>	<u>72.3</u>	<u>176.7</u>	<u>122.9</u>
	—	—	—	—

12 Cash and short term investments

	Group		Company	
	1996	1995	1996	1995
	£m	£m	£m	£m
Current asset investments:				
Listed on recognised investment exchanges	0.4	18.4	-	17.1
Other investments	51.5	76.3	47.9	74.1
Own shares held, at cost (note 18)	2.8	-	2.8	-
	<u>54.7</u>	<u>94.7</u>	<u>50.7</u>	<u>91.2</u>
Cash and deposits	18.4	81.3	17.2	91.0
	<u>73.1</u>	<u>176.0</u>	<u>67.9</u>	<u>182.2</u>
	—	—	—	—

Current asset investments include Government bonds, floating rate notes and commercial paper and are stated at market value.

13 Short term borrowings

	Group		Company	
	1996	1995	1996	1995
	£m	£m	£m	£m
Bank loans and overdrafts	4.4	12.4	56.1	-
Obligations under finance leases	3.7	0.1	-	-
Long term borrowings repayable within 12 months	3.9	21.0	3.9	21.0
	<u>12.0</u>	<u>33.5</u>	<u>60.0</u>	<u>21.0</u>
	—	—	—	—

14 Other creditors

	Group		Company	
	1996 £m	1995 £m	1996 £m	1995 £m
Trade creditors	23.1	15.1	0.2	0.1
Capital creditors and accruals	39.4	32.9	-	-
Amounts owed to subsidiary undertakings	-	-	3.3	0.4
Corporation tax	26.2	15.1	11.9	10.9
Other taxation and social security	4.0	1.6	0.2	-
Other accruals and deferred income	76.6	68.3	10.8	10.2
Dividends payable	49.3	44.1	49.3	44.1
	<u>218.6</u>	<u>177.1</u>	<u>75.7</u>	<u>65.7</u>

15 Long term borrowings

	Group		Company	
	1996 £m	1995 £m	1996 £m	1995 £m
Bank loans	159.0	155.0	159.0	155.0
Obligations under finance leases	11.9	0.2	-	-
Less amounts repayable within 12 months	(7.6)	(21.1)	(3.9)	(21.0)
	<u>163.3</u>	<u>134.1</u>	<u>155.1</u>	<u>134.0</u>
Repayable as follows:				
Between one and two years	11.9	4.0	8.7	3.9
Between two and five years	37.7	29.7	32.8	29.7
After five years	113.7	100.4	113.6	100.4
	<u>163.3</u>	<u>134.1</u>	<u>155.1</u>	<u>134.0</u>

Bank loans are unsecured and repayable by instalments for periods up to 15 years. The rates of interest payable on loans due after 5 years range from 7.1% to 11.05%. The Group's main borrowing facilities are subject to review in certain circumstances following a change of control of the Company.

16 Grants and contributions

	Group £m
Balance at 1 April 1995	25.3
Receivable in year	4.1
Released to profit and loss account	(1.1)
Balance at 31 March 1996	<u>28.3</u>

Grants and contributions relate to non-infrastructure fixed assets.

NOTES TO THE FINANCIAL STATEMENTS continued

17 Provision for liabilities and charges	Infra structure renewal	Share schemes	Group Other	Total	Company Share schemes
	£m	£m	£m	£m	£m
Balance at 1 April 1995	3.4	0.2	3.1	6.7	0.2
Provided in year	17.9	-	0.3	18.2	-
Utilised in year	(19.3)	(0.2)	-	(19.5)	(0.2)
Balance at 31 March 1996	2.0	-	3.4	5.4	-

The full potential deferred taxation liability, for which no provision is considered necessary, calculated under the liability method at a tax rate of 33% is:

	Group	
	1996 £m	1995 £m
Accelerated capital allowances (non-infrastructure assets)	127.7	107.9
Other timing differences	(13.3)	(11.8)
Advance corporation tax	(61.0)	(41.9)
	53.4	54.2

18 Called-up share capital	1996	1995
Authorised	£m	£m
225,000,000 ordinary shares of £1 each	225.0	225.0
1 special rights redeemable preference share of £1	-	-
	225.0	225.0
<b>Allotted, called-up and fully paid</b>		
Ordinary shares of £1 each:		
At 1 April	169.3	167.8
Issued during the year	3.0	1.5
Share repurchase	(16.9)	-
At 31 March	155.4	169.3

Allotments in the year were in respect of acquisitions 1,586,000, scrip dividends 927,000, executive share options exercised 400,000 and sharesave scheme 50,000.

On 14 December 1995, the company purchased, and subsequently cancelled, 16.9 million ordinary shares at an average price of £6.65p per share. The total cost of the purchase including advance corporation tax of £24.0m and expenses was £137.7m and has been charged against distributable reserves.

NOTES TO THE FINANCIAL STATEMENTS continued

Outstanding options to subscribe for ordinary shares in the Company at 31 March 1996 were as follows:

	Date of grant	Number of shares '000	Price per share
Executive share option scheme	January 1991	70	295p
	January 1992	83	310p
	January 1993	192	466p
	January 1994	273	639p
	February 1995	254	525p
	January 1996	29	668p
Sharesave scheme	December 1989	435	176p
	January 1991	664	236p
	February 1992	683	248p
	January 1993	527	372p
	January 1994	287	519p
	January 1995	580	456p
	January 1996	430	537p

In normal circumstances, the executive share options may be exercised between three and ten years from the date of grant. During the year 400,000 ordinary shares of £1 each were allotted under the scheme for a consideration of £1.4m.

Options under the sharesave scheme may be exercised after either five or seven years from the date of grant. During the year 50,000 ordinary shares of £1 each were allotted under the scheme for a consideration of £0.1m.

Southern Water plc has established an Employee Share Ownership Plan Trust (ESOP) for the benefit of its employees. This is a discretionary employee trust under which the trust fund is held for the benefit of those existing and future employees of the Company and its subsidiaries which the trustees may in their discretion select. Dividends relating to shares held under the ESOP have been waived until the shares become allocated to employees. During the year the ESOP purchased 405,000 shares in the market at a cost of £2.8m to satisfy certain outstanding options. At 31 March 1996 the market value of these 405,000 shares held by the ESOP amounted to £3m. In April 1996 282,000 of these shares were transferred to employees on the exercise of their options.

19 Share premium account and reserves	<u>Group &amp; Company</u>		<u>Group</u>	<u>Company</u>
	Capital Redemption Reserve	Share Premium Account	Profit & Loss Account	Profit & Loss Account
	£m	£m	£m	£m
At 1 April 1995	-	2.9	886.9	387.5
Retained profit for the year	-	-	96.4	19.7
Premium on allotments	-	10.0	-	-
Movements relating to scrip dividends:				
Capitalisation of shares	-	(0.9)	-	-
Value of dividends	-	-	5.4	5.4
Expenses of issue	-	(0.2)	-	-
Goodwill on acquisition	-	-	(12.7)	-
Shares repurchased	16.9	-	(113.7)	(113.7)
Advance corporation tax thereon	-	-	(24.0)	(24.0)
At 31 March 1996	<u>16.9</u>	<u>11.8</u>	<u>838.3</u>	<u>274.9</u>

19 (contd)

The cumulative amount of goodwill charged direct to reserves in respect of the acquisition of existing subsidiaries is £25.2m (1995 £12.5m).

The profit of the Company attributable to shareholders for the financial year was £68.7m (1995 £70.3m). No separate profit and loss account is presented as permitted by S230 of the Companies Act 1985.

20 Acquisitions

On 13 July 1995 Southern Water plc acquired the entire issued share capital of Nationwide Maintenance Limited, a company specialising in facilities management services for a total consideration of £1,354,000 in cash.

On 11 December 1995 Southern Water plc acquired the entire issued share capital of Total Mailing Services Limited, a company specialising in mailing and printing services for a total consideration of £350,000 in cash and shares.

On 16 February 1996 Southern Water plc acquired the entire issued share capital of Vehicle Contract Hire & Leasing Limited for a total consideration of £13,135,000 in cash and shares.

The group has used acquisition accounting to account for the purchases.

	Fixed Assets £m	Current Assets £m	Current Liabilities £m	Long Term Liabilities £m	Total £m
Book value of assets acquired	11.9	5.6	(6.4)	(7.8)	3.3
Accounting policy alignments	0.3	-	(1.1)	(0.2)	(1.0)
	—	—	—	—	—
Fair value of assets acquired	12.2	5.6	(7.5)	(8.0)	2.3
Goodwill charged to reserves					12.7
					15.0
Consideration					
Cash					4.3
Shares					10.5
Deferred consideration					0.2
					15.0
Total consideration					15.0

The deferred consideration represents an estimate of the amounts payable under agreements to meet minimum financial performance targets. The maximum payable is £0.7m.

The net outflow of cash and cash equivalents in respect of the purchase of subsidiary undertakings was as follows:-

	£m
Cash consideration	4.3
Cash acquired	(2.8)
	—
Net outflow	1.5
	—

One acquisition was made during the year ended 31 March 1995 for a cash consideration of £0.3m

21 Reconciliation of movements in shareholders' funds	Group	
	1996 £m	1995 £m
Profit attributable to ordinary shareholders	145.4	130.8
Dividends for the year	(49.0)	(43.9)
Retained profit for the year	96.4	86.9
Allotments for cash - executive and sharesave option schemes	1.5	0.3
Shares issued relating to acquisitions (note 20)	10.5	-
Value of dividends taken as scrip shares	5.4	7.2
Expenses of scrip dividend issues	(0.1)	(0.2)
Goodwill charged	(12.7)	(0.1)
Share repurchase	(137.7)	-
Net (reduction)/addition to shareholders' funds	(36.7)	94.1
Shareholders' funds at 1 April	1059.1	965.0
Shareholders' funds at 31 March	1022.4	1059.1

22 Contingent liabilities

	Group	
	1996 £m	1995 £m
Contractors' claims	3.3	2.4
Bank guarantees	0.6	0.3
	3.9	2.7

All wholly owned Group companies registered in England have provided mutual cross guarantees for borrowings from National Westminster Bank Plc which at 31 March 1996 amounted to £4.4m (1995: £12.4m).

23 Capital commitments

	Group		Company	
	1996 £m	1995 £m	1996 £m	1995 £m
Outstanding contracts placed for capital expenditure	97.3	65.2	-	-

24 Other financial commitments

	Group		Company	
	1996 £m	1995 £m	1996 £m	1995 £m
Annual commitments under non-cancellable operating leases:				
Expiring within one year	0.2	-	-	-
Expiring between two and five years	0.4	0.2	-	-
Expiring after five years	0.3	0.2	-	-
	0.9	0.4	-	-

**25 Pensions**

The Group has a number of pension schemes. The principal defined benefit scheme, which covers over 70% of the Group's employees, has six Trustee Directors - Mr William Courtney and five other members who are not Directors of the Company. The power of appointment of new Trustee Directors is vested in Southern Water plc.

The assets of all schemes are held separately from those of the Group. The Bank of Scotland acts as custodian trustee for the defined benefit schemes and asset management is delegated to an external fund manager. On 31 March 1996, the principal scheme held shares in Southern Water plc which represented 2.89% of the investment portfolio.

Members of the schemes receive an annual statement of their accrued benefits and a copy of the trustees' annual report. The accounts of all schemes are audited annually by Coopers & Lybrand.

The Group's defined benefit schemes are valued by independent consulting actuaries using either the 'projected unit' method or the 'attained age' method. The last completed actuarial valuation of the principal scheme was carried out as at 31 March 1995. At that date, the market value of the scheme's assets was £148.3m, and the actuarial value of these assets represented approximately 102% of the benefits accrued to members, after allowing for expected increases in earnings. The employers' average contribution has been increased to 12.7% of pensionable pay with members paying standard contributions of 6%, 5% or 3%.

The most recent actuarial valuations of the other defined benefit schemes indicated that the market values of their assets covered the estimated value of members' accrued benefits, after allowing for a special contribution paid into one of the schemes. On 1 April 1996 one of these defined benefit schemes was merged with the principal scheme.

The principal assumptions used in all actuarial valuations are those related to the differentials between the rates of return on investments and the rates of increases in earnings and pensions. In the main scheme, it has been assumed that the investment return per annum will be 2% higher than wage and salary increases and 3.5% higher than pension increases (4% higher where limited price indexation applies).

Total pension costs for the year were £8.0m (1995 £7.1m)

**26 Reconciliation of trading profit to net cash flow from operating activities**

	1996	1995
	£m	£m
Trading profit	170.6	150.7
Depreciation charge	40.1	40.8
Other items	(1.8)	(1.9)
Movement in provisions	(1.3)	0.9
(Increase) in stocks	(0.8)	(0.5)
(Increase) in debtors	(7.9)	(7.4)
Increase in other creditors	15.0	9.9
	<u>213.9</u>	<u>192.5</u>
Net cash inflow from operating activities	213.9	192.5

27 Changes in financing during the year	Capital	Long term loans	Finance leases	Total
	£m	£m	£m	£m
At 1 April 1995	172.2	155.0	0.2	327.4
Cash inflows	1.4	25.0	0.6	27.0
Cash outflows	-	(21.0)	(0.5)	(21.5)
Acquisition of subsidiaries	10.5	-	11.6	22.1
At 31 March 1996	184.1	159.0	11.9	355.0

Capital comprises called up share capital, capital redemption reserve and share premium account.

**28 Analysis of the balances of cash and cash equivalents as shown in the Balance Sheet**

	1996 £m	1995 £m
Current asset investments	54.7	94.7
Cash and short term deposits	18.4	81.3
	73.1	176.0
Bank loans and overdrafts	(4.4)	(12.4)
Investments and deposits exceeding three months to maturity when acquired	(49.9)	(85.3)
Cash and cash equivalents	18.8	78.3

**29 Analysis of changes in cash and cash equivalents**

	1996 £m	1995 £m
Cash and cash equivalents at 1 April	78.3	31.9
Net cash (outflow)/inflow	(59.5)	46.4
Cash and cash equivalents at 31 March (see note 28)	18.8	78.3

**30 Analysis of movements in net cash balances**

	1996 £m	1995 £m
(Decrease)/increase in cash and short term investments	(102.9)	1.7
Decrease/(increase) in short term borrowing	21.5	(24.3)
(Increase)/decrease in long term borrowings	(29.2)	21.0
	(110.6)	(1.6)

**SUBSIDIARY UNDERTAKINGS AND INVESTMENTS IN OTHER COMPANIES**

At 31 March 1996

**Subsidiary undertakings**

The Company's principal subsidiary undertakings at 31 March 1996 are listed below.

<b>Company</b>	<b>Class of capital</b>	<b>Proportion of class held</b>	<b>Nature of business</b>
Southern Water Services Limited	Ordinary	100%	Provision of water supply and wastewater services
Pipeworks Limited	Ordinary	100%	Pipework, mainlaying, plumbing, heating and ventilation services
Nationwide Maintenance Limited*	Ordinary	100%	Facilities management services
Southern Water Industries Limited	Ordinary	100%	Industrial and commercial services
McDowells Limited*	Ordinary	100%	Civil and structural engineering design and consultancy
IT Southern Limited*	Ordinary	100%	Information technology services
Paperstream Limited*	Ordinary	100%	Mailing, remittance processing and printing services
Total Mailing Services Limited*	Ordinary	100%	Mailing and printing services
Tynemarch Systems Engineering Limited	Ordinary	100%	Process control and engineering software services
Sectron Systems Limited*	Ordinary	100%	Security services
Southern Science Limited*	Ordinary	100%	Laboratory analysis and environmental assessment
GMSS Limited	Ordinary	75%	Laboratory services
Aquaclear Limited*	Ordinary	100%	Commercial water systems consultancy
Eco-clear Limited	Ordinary	100%	Liquid waste management
Taylor Plant & Haulage Limited	Ordinary	100%	Waste disposal services
James Leppard & Son Limited	Ordinary	100%	Landfill operation
ERG Environmental Resource Group plc	Ordinary	100%	Effluent and odour treatment services
Greenhill Enterprises Limited	Ordinary	100%	Waste management
Clinical Waste Limited	Ordinary	55%	Clinical waste management
Topmark Vehicle Contracts Limited*	Ordinary	100%	Vehicle contract hire sales and rentals
Vehicle Contract Hire & Leasing* Limited	Ordinary	100%	Vehicle contract hire, sales and rentals
Pipestock Plus Limited	Ordinary	100%	Materials, purchasing and distribution

**Subsidiary undertakings and investments in other companies** continued  
at 31 March 1996

<b>Company</b>	<b>Class of capital</b>	<b>Proportion of class held</b>	<b>Nature of business</b>
Hazeley Down Mineral Water Company Limited*	Ordinary	100%	Bottled mineral water
Bowsprit Holdings Limited	Ordinary	100%	Property investment
Monk Rawling Limited	Ordinary	100%	Estates management and property consultancy
Bowsprit Property Development Limited	Ordinary	100%	Property development
Moreton & Padmore Limited *	Ordinary	100%	Quantity surveying
Waterline Insurance Company Limited	Ordinary	100%	Insurance
Southern Water Technologies Limited*	Ordinary	100%	Technology marketing services
Southern Water Global Limited*	Ordinary	100%	Overseas engineering and environmental consultancy and operations
Water and Waste Water Projects (Philippines) Inc (incorporated in the Philippines)	Ordinary	100%	Civil and structural engineering design and consultancy

\* These companies act as agents of Southern Water Industries Limited.

**Fixed asset investments**

<b>Company</b>	<b>Class of capital</b>	<b>Proportion of class held</b>	<b>Nature of business</b>	<b>Total capital and reserves</b> £m	<b>Profit for the period</b> £m
<b>Associated undertaking</b>					
Coastal Wastewater Consultants Limited	Ordinary	50.0%	Marine treatment engineering design and consultancy	nil	-
<b>Other investments</b>					
Folkestone & Dover Water Services Ltd	Ordinary Preference Deferred	25.1% 21.8% 12.2%	Water supply	9.2	3.7

Both companies are registered in England

**GROUP FIVE YEAR SUMMARY**

	1996 £m	1995 £m	1994 £m	1993 £m	1992 £m
<b>Turnover</b>	424.7	384.6	347.7	319.2	290.7
<b>Trading profit -</b>					
Regulated	159.4	136.9	123.5	111.0	99.1
Non-regulated	11.2	11.1	10.1	8.4	7.0
Sale of land in Hampshire	-	2.7	-	-	-
	<u>170.6</u>	<u>150.7</u>	<u>133.6</u>	<u>119.4</u>	<u>106.1</u>
Exceptional items	-	-	-	-	6.0
Net interest	(5.0)	(7.3)	(6.1)	(0.2)	3.0
	<u>165.6</u>	<u>143.4</u>	<u>127.5</u>	<u>119.2</u>	<u>115.1</u>
<b>Profit on ordinary activities before taxation</b>					
Taxation	(20.8)	(13.1)	(10.2)	(9.8)	(9.8)
	<u>144.8</u>	<u>130.3</u>	<u>117.3</u>	<u>109.4</u>	<u>105.3</u>
<b>Profit on ordinary activities after taxation</b>					
Minority interests	0.6	0.5	0.2	-	-
	<u>145.4</u>	<u>130.8</u>	<u>117.5</u>	<u>109.4</u>	<u>105.3</u>
<b>Profit attributable to ordinary shareholders</b>					
Dividends	(49.0)	(43.9)	(38.8)	(35.3)	(32.1)
	<u>96.4</u>	<u>86.9</u>	<u>78.7</u>	<u>74.1</u>	<u>73.2</u>
<b>Retained profit for the year</b>					
	p	p	p	p	p
<b>Earnings per share</b>	88.3	77.6	70.3	66.3	64.2
<b>Earnings per share before exceptional items</b>	-	-	-	-	60.5
<b>Dividends per ordinary share</b>	31.6	25.9	23.1	21.3	19.5
	£m	£m	£m	£m	£m
<b>Assets employed</b>					
Fixed assets	1292.3	1183.1	1070.5	957.2	893.8
Net current (liabilities)/assets	(72.9)	42.7	78.0	98.6	59.5
Long term creditors	(191.6)	(159.4)	(176.6)	(167.1)	(142.8)
Provision for liabilities and charges	(5.4)	(6.7)	(5.8)	(6.2)	(6.4)
Minority interests	-	(0.6)	(1.1)	(1.0)	-
	<u>1022.4</u>	<u>1059.1</u>	<u>965.0</u>	<u>881.5</u>	<u>804.1</u>
<b>Net assets</b>					
<b>Capital and reserves</b>					
Called up share capital	155.4	169.3	167.8	165.8	164.3
Capital redemption reserve	16.9	-	-	-	-
Share premium account	11.8	2.9	4.3	2.1	1.6
Profit and loss account	838.3	886.9	792.9	713.6	638.2
	<u>1022.4</u>	<u>1059.1</u>	<u>965.0</u>	<u>881.5</u>	<u>804.1</u>
<b>Equity Shareholders' Funds</b>					