

FINANCIAL STATEMENTS
NORTHUMBRIAN WATER LIMITED
FOR THE NINE MONTHS ENDED 31 DECEMBER 1997

Registered no: 2366703



**FINANCIAL STATEMENTS
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DIRECTORS' REPORT

For the nine months ended 31 December 1997

The directors present their report and the audited financial statements for the nine months ended 31 December 1997.

The company has changed the end date of their financial reporting period from 31 March to 31 December to bring it in line with the financial reporting period of the ultimate parent company, Suez Lyonnaise des Eaux S.A.

Results and dividends

The group's profit for the nine months ended 31 December 1997 after taxation amounts to £98.4m. An analysis of turnover and profits for the operating segments of the group is shown in note 2 to the financial statements. The directors propose a final dividend of £14.8m which, together with the interim dividend of £29.5m, makes a total for the nine months of £44.3m.

Principal activities and review of business

The principal activities of the business comprises supply of potable water, and collection, treatment and disposal of sewage throughout the region.

The company has enjoyed a period of impressive achievement following the merger of its activities with those of North East Water plc in April 1996. Compliance levels remain high, the investment programme reached an all time peak and operating efficiencies as a result of the merger were ahead of schedule allowing for a further increase in the 'merger discount' to a 2% reduction in customers' water bills during the period.

The final stages of the merger are now complete and these gave rise to a further charge of £2.5m during the period.

The future focus of the company remains on improving efficiency levels and driving down operating costs while maintaining the high standards our customers demand.

Going concern

After a budgetary review, analysis of projected cash flow balances and an overview of expected financial and operational performance, the directors conclude that the company and the group will generate adequate resources for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

Research and development

The company places a high priority on research and technological innovation to serve the needs of customers. Research and development expenditure is charged to the profit and loss account in the year in which it is incurred, as disclosed in note 3(d) to the financial statements.

Northumbrian Water Limited payment policy

The company's policy is to settle terms of payment with suppliers when agreeing the terms of each transaction, also ensuring that suppliers are made aware of the terms of payment and abide by the terms of payment. The period end trade creditors expressed as a number of days of purchases made during the period is 37 days (March 1997: 29 days). This has been calculated by dividing the period end trade creditors balance of £4.4m by the aggregate of the average daily amounts invoiced by suppliers during the period.

DIRECTORS' REPORT (continued)

Millennium

The Northumbrian Water Group recognises the year 2000 implications. A Group project team supported by individual company project teams is currently assessing the impact and developing action plans to ensure that the Group and its subsidiaries, including the company, will be millennium compliant before the year 2000.

Post Balance Sheet Event

On 6 February 1998 Northumbrian Water Group plc issued £200m Guaranteed Eurobonds maturing 6 February 2023, with an annual coupon of 6.875%. The issue was guaranteed by the company who received the issue proceeds by way of an inter company loan.

Directors

The directors who served during the period were as follows:

H D M Speed	(Chairman)
P Babin	
J A Cuthbert	
J Graham	(Appointed 24 June 1997)
A J Harding	(Managing Director)
A F Jones	
H A Lacy	(Resigned 1 June 1997)
G Neave	
Dr A C Price	

Non executive directors were as follows:

P Babin (39)
HEC MBA

Managing Director, Northumbrian Water Group plc, January 1996; Corporate Director (Finance), Lyonnaise des Eaux S.A., 1993; Finance Director, Essex & Suffolk Water plc and Lyonnaise Europe plc, 1990 – 1992. Patrick Babin joined Lyonnaise des Eaux S.A. in 1987, following several years in the oil industry.

J A Cuthbert (44)
BSc ACA MBA

Non Executive Director, 1996; Managing Director, Essex & Suffolk Water plc, 1996; Board Member, Managing Director, North East Water plc, 1993 – 1996; Finance Director and Deputy Managing Director, 1991 – 1993; Financial Controller, North Eastern Co-operative Society, 1986 – 1990.

H Speed (61)
BSc MEng FICE FIWEM CBIM

Chairman, Northumbrian Water Limited and Executive Director, Northumbrian Water Group plc, 1996; Vice President, Lyonnaise International Water Division, 1993; Board Director, Essex & Suffolk Water plc; formerly Board Director and Managing Director of North East Water plc; Managing Director, Newcastle & Gateshead Water plc, 1986.

D J Watson acted as company secretary during the period.

Directors' interests are disclosed in note 5 to the financial statements.

DIRECTORS' REPORT (continued)

Employees

The company recognises its responsibilities towards disabled people and to their training, career development and promotion and gives full and fair consideration to applications for employment where suitable work is available. Every effort is made to find appropriate alternative jobs for those who become disabled while working for the company.

The board of directors recognises that it is important to continue to recruit and develop a successful team. This is achieved by promoting opportunities for decentralised decision making, individual accountability, teamwork and successful communication. Continuous development is promoted to enable employees to realise their full potential. It is the board's aim to develop a company where people are committed to achieving the best for the business and are confident to use their skills and initiatives to add maximum value.

The company's policy is to consult and discuss with employees, through the Company Council, matters likely to affect employees' interests. Information on matters of concern to employees is given through regular Team Briefs, which seek to achieve a common awareness on the part of all employees of the financial and economic factors affecting the performance of the company and the group.

Employees are represented on the Trustee Boards of the group pension schemes in which the company participates.

Charitable and Political Contributions

During the period the company made charitable donations of £45,752 (March 1997: £66,100). The company made no donations to any political party during the period (March 1997: Nil).

Auditors

The company has appointed Arthur Andersen as its auditors and has, by elective resolution pursuant to section 386 of the Companies Act 1985, dispensed with the obligation to appoint auditors annually.

Directors' Responsibilities

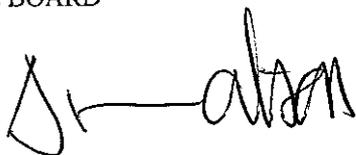
The directors are required by United Kingdom company law to prepare financial statements for each financial period that give a true and fair view of the state of affairs of the company and of the group as at the end of the financial period and of the profit or loss of the group for that period.

The directors confirm that suitable accounting policies have been used and applied consistently, and reasonable, prudent judgements and estimates have been made in the preparation of the financial statements for the nine months ended 31 December 1997. The directors also confirm that applicable accounting standards have been followed and that the financial statements have been prepared on the going concern basis.

The directors are responsible for keeping proper accounting records as required by United Kingdom company law, for taking reasonable steps to safeguard the assets of the group, and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

BY ORDER OF THE BOARD

D J Watson
Company Secretary



24 March 1998

REPORT OF THE AUDITORS

To the shareholders of Northumbrian Water Limited:

We have audited the financial statements on pages 5 to 31, which have been prepared under the historical cost convention and the accounting policies set out on pages 9 to 11.

Respective responsibilities of directors and auditors

As described on page 3 the company's directors are responsible for the preparation of the financial statements. It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion to you.

Basis of opinion

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

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material mis-statement, 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 of the group at 31 December 1997 and of the group's profit and cash flows for the period then ended and have been properly prepared in accordance with the Companies Act 1985.



Arthur Andersen
Chartered Accountants and Registered Auditors
Pearl Assurance House
7 New Bridge Street
Newcastle Upon Tyne
NE1 8BQ

24 March 1998

GROUP PROFIT AND LOSS ACCOUNT
For the nine months ended 31 December 1997

	Note	9 months ended December 1997	12 months ended March 1997
		£'m	£'m
Turnover	2	260.6	329.3
Operating costs	3	(93.2)	(127.6)
Exceptional operating costs	3	(2.5)	(10.0)
Capital maintenance costs	3	(32.6)	(40.1)
OPERATING PROFIT	2	132.3	151.6
Net interest payable	4	(18.5)	(17.7)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION		113.8	133.9
Taxation	8	(15.4)	(20.2)
PROFIT FOR THE FINANCIAL PERIOD		98.4	113.7
Dividends	9	(44.3)	(55.7)
PROFIT RETAINED FOR THE PERIOD	24	54.1	58.0

All turnover and operating profit derive from continuing operations.

The movement on reserves is shown in note 24.

The group has no recognised gains or losses other than the profits above and therefore no separate statement of total recognised gains or losses has been presented.

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

The accompanying notes are an integral part of this consolidated profit and loss account.

GROUP BALANCE SHEET

At 31 December 1997

	Note	December 1997 £'m	March 1997 £'m
FIXED ASSETS			
Tangible assets	10	1,374.3	1,209.6
CURRENT ASSETS			
Stocks	12	3.9	3.2
Debtors: amounts falling due within one year	13	61.4	56.9
Debtors: amounts falling due after one year	13	16.6	18.7
Investments	14	5.2	38.2
Cash at bank and in hand		4.5	-
		<u>91.6</u>	<u>117.0</u>
CREDITORS			
Amounts falling due within one year	15	(201.3)	(153.1)
NET CURRENT LIABILITIES			
		<u>(109.7)</u>	<u>(36.1)</u>
TOTAL ASSETS LESS CURRENT LIABILITIES			
		<u>1,264.6</u>	<u>1,173.5</u>
CREDITORS: Amounts falling due after more than one year			
	16	(373.1)	(329.6)
PROVISIONS FOR LIABILITIES AND CHARGES			
	21	(15.3)	(22.4)
ACCRUALS AND DEFERRED INCOME			
	22	(28.8)	(28.2)
		<u>(417.2)</u>	<u>(380.2)</u>
NET ASSETS			
		<u>847.4</u>	<u>793.3</u>
CAPITAL AND RESERVES			
Called up share capital	23	122.7	122.7
Profit and loss account	24	724.7	670.6
EQUITY SHAREHOLDERS' FUNDS			
	25	<u>847.4</u>	<u>793.3</u>

The accompanying notes are an integral part of this consolidated balance sheet.

Approved by the board on 24 March 1998

A J Harding
A F Jones



COMPANY BALANCE SHEET

At 31 December 1997

	Note	December 1997	March 1997
		£'m	£'m
FIXED ASSETS			
Tangible assets	10	1,374.3	1,209.6
Investments	11	47.2	47.2
		1,421.5	1,256.8
CURRENT ASSETS			
Stocks	12	3.9	3.2
Debtors: amounts falling due within one year	13	61.4	56.9
Debtors: amounts falling due after one year	13	16.6	18.7
Investments	14	5.2	38.2
Cash at bank and in hand		4.5	-
		91.6	117.0
CREDITORS			
Amounts falling due within one year	15	(201.3)	(153.1)
NET CURRENT LIABILITIES			
		(109.7)	(36.1)
TOTAL ASSETS LESS CURRENT LIABILITIES			
		1,311.8	1,220.7
CREDITORS: Amounts falling due after more than one year			
	16	(420.3)	(376.8)
PROVISIONS FOR LIABILITIES AND CHARGES			
	21	(15.3)	(22.4)
ACCRUALS AND DEFERRED INCOME			
	22	(28.8)	(28.2)
		(464.4)	(427.4)
NET ASSETS			
		847.4	793.3
CAPITAL AND RESERVES			
Called up share capital	23	122.7	122.7
Profit and loss account	24	724.7	670.6
EQUITY SHAREHOLDERS' FUNDS			
	25	847.4	793.3

The accompanying notes are an integral part of this balance sheet.

Approved by the board on 24 March 1998

A J Harding
A F Jones

GROUP CASH FLOW STATEMENT

At 31 December 1997

	Note	9 months ended December 1997	12 months ended March 1997
		£'m	£'m
NET CASH INFLOW FROM CONTINUING OPERATING ACTIVITIES	26	167.7	164.3
Returns on investments and servicing of finance	27	(16.9)	(11.6)
Taxation	27	0.6	(10.2)
Capital expenditure and financial investment	27	(179.2)	(120.6)
Equity dividend paid		(58.0)	(121.5)
CASH OUTFLOW BEFORE MANAGEMENT OF LIQUID RESOURCES AND FINANCING		(85.8)	(99.6)
Management of liquid resources	27	33.0	62.0
Financing	27	66.1	25.7
INCREASE/(DECREASE) IN CASH IN THE PERIOD	28	13.3	(11.9)

The accompanying notes are an integral part of this consolidated cash flow statement.

NOTES TO THE FINANCIAL STATEMENTS
For the nine months ended 31 December 1997

1 STATEMENT OF ACCOUNTING POLICIES

The financial statements have been prepared in accordance with applicable Accounting Standards in the United Kingdom with the exception of capital grants and contributions to infrastructure assets which is not in accordance with the Companies Act 1985 ((e) below). A summary of the more important accounting policies, which have been applied consistently throughout the period and with the preceding year, is set out below.

(a) Basis of accounting

The financial statements have been prepared under the historic cost convention on a going concern basis.

(b) Basis of consolidation

The consolidated financial statements include the company and its subsidiary undertakings. The results of subsidiaries acquired during the year are included from the date of their acquisition. Intra-group sales and profits are eliminated fully on consolidation.

(c) Turnover

Turnover, which excludes Value Added Tax, represents the income receivable in the ordinary course of business for services provided within the United Kingdom.

(d) Tangible fixed assets and depreciation

Tangible fixed assets comprise:

(i) Infrastructure assets

Infrastructure assets comprise a network of systems which include water mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls.

Expenditure on infrastructure assets relating to increases in capacity or enhancements of the network is treated as additions which are included at cost after deducting grants and contributions.

Expenditure on maintaining the operating capability of the network in accordance with defined standards of service is charged as an operating cost.

No depreciation is charged on infrastructure assets because the network of systems is required to be maintained in perpetuity and therefore has no finite economic life.

(ii) Other assets

Other assets (including properties, overground plant and equipment) are included at cost less accumulated depreciation. Additions are included at cost.

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

Freehold buildings	30 – 60 years
Operational structures, plant and machinery	4 – 60 years
Fixtures, fittings, tools and equipment	4 – 10 years

1 STATEMENT OF ACCOUNTING POLICIES (continued)

(d) Tangible fixed assets and depreciation (continued)

(iii) Assets in the course of construction

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

(e) Government grants and contributions

Revenue grants are credited to the profit and loss account when received.

Grants and contributions relating to infrastructure assets have been deducted from the cost of those assets as permitted under Statement of Standard Accounting Practice No 4. This is not in accordance with the Companies Act 1985 which requires fixed assets to be stated at their purchase price or production cost without deduction of grants and contributions which are accordingly 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 as infrastructure assets are not depreciated, and it is therefore not appropriate to recognise related grants and contributions as deferred income. The effect of the departure on the value of tangible fixed assets is disclosed in note 10.

Capital grants and contributions relating to other assets are treated as deferred income and amortised in the profit and loss account over the expected useful economic lives of the qualifying assets.

(f) Hire purchase and leasing

Where assets are financed by hire purchase or leasing arrangements which transfer substantially all the risks and rewards of ownership to the company, the assets are treated as if they had been purchased and the corresponding capital cost is treated as a liability. Rentals or leasing payments are treated as consisting of a capital element and finance costs, the capital element reducing the outstanding liability and the finance costs being charged to the profit and loss account over the period of the hire purchase contract or lease in proportion to the reducing outstanding liability.

Rental costs arising under operating leases are charged to the profit and loss account in the period in which they are incurred.

(g) Stocks

Raw materials and consumables are stated at cost less any provision necessary to recognise damage and obsolescence. Work in progress is valued at the lower of cost and net realisable value. Cost includes labour, materials, transport and an element of overheads.

(h) Pension costs

The cost of providing pension benefits is charged to the profit and loss account so as to spread the cost over the expected average service lives of employees. Differences between the amounts funded and amounts charged to the profit and loss account are treated as prepayments or accruals in the balance sheet.

(i) Deferred taxation

Tax deferred or accelerated is accounted for in respect of all material timing differences to the extent that it is probable that a liability or asset will crystallise in the foreseeable future. Timing differences arise from the inclusion of items of income and expenditure in tax computations in periods different from those in which they are included in the accounts. Provision is made at the rate which is expected to apply when the liability or asset crystallises.

1 STATEMENT OF ACCOUNTING POLICIES (continued)

(j) **Foreign currency**

All transactions denominated in foreign currencies are translated into sterling at the actual rates of exchange ruling at the dates of the transactions. Foreign currency balances are translated into sterling at the rates of exchange ruling at the balance sheet date. Exchange gains or losses are recognised in the profit and loss account in the period incurred.

(k) **Research and development**

Research and development expenditure is charged to the profit and loss account in the period in which it is incurred.

(l) **Investments**

Fixed asset investments are stated at their purchase cost, less provision for permanent diminution in value.

2 TURNOVER AND OPERATING PROFIT

Turnover and operating profit are analysed as follows:

	9 months ended December 1997	12 months ended March 1997
	£'m	£'m
Measured	62.7	79.1
Unmeasured	172.1	217.8
Reception, treatment and disposal of trade effluent	5.2	6.4
Other sources:		
Rechargeable works	1.5	1.1
Other income	19.1	24.9
TURNOVER	260.6	329.3
Operating costs	(93.2)	(127.6)
Capital maintenance costs	(32.6)	(40.1)
OPERATING PROFIT BEFORE EXCEPTIONAL ITEMS	134.8	161.6
Exceptional items:		
Operating costs (note 3(b))	(2.5)	(10.0)
OPERATING PROFIT	132.3	151.6

3 OPERATING COSTS AND CAPITAL MAINTENANCE COSTS

(a) Operating costs comprise:

	9 months ended December 1997	12 months ended March 1997
	£'m	£'m
Materials and consumables	7.9	10.2
Other external charges	11.5	15.1
Manpower costs (note 7)	24.5	33.3
Other operating charges	49.3	69.2
Other operating income	-	(0.2)
	93.2	127.6
	93.2	127.6

(b) Exceptional operating costs comprise:

	9 months ended December 1997	12 months ended March 1997
	£'m	£'m
Reorganisation/restructuring costs	2.5	6.8
Provision for refinancing losses of subsidiary (note 11)	-	3.2
	2.5	10.0
	2.5	10.0

The reorganisation/restructuring costs represent exceptional amounts arising out of the merger of the activities of Northumbrian Water Limited and North East Water plc and anticipated severance payments from bringing the sewerage agencies in-house from April 1997. This includes costs of future severances which are expected to arise out of the revised voluntary severance scheme introduced to the business in March 1996, the costs of relocating staff and a recognition of the diminution in value of properties which are expected to become redundant in the merged business.

(c) Capital maintenance costs comprise:

	9 months ended December 1997	12 months ended March 1997
	£'m	£'m
Depreciation:		
Owned tangible fixed assets	17.6	19.3
Tangible fixed assets held under finance leases	1.9	2.9
Infrastructure renewals:		
Infrastructure renewals expenditure	16.6	24.7
Infrastructure renewals prepaid	(1.9)	(6.0)
Profit on disposal of fixed assets	(1.6)	(0.8)
	32.6	40.1
	32.6	40.1

3 OPERATING COSTS AND CAPITAL MAINTENANCE COSTS (continued)

(d) Profit on ordinary activities before taxation

	9 months ended December 1997	12 months ended March 1997
	£'m	£'m
Profit on ordinary activities before taxation is stated after crediting:		
Amortisation of capital grants (note 22)	1.0	1.2
And after charging:		
Operating leases:		
Plant and machinery	0.6	1.2
Other assets	-	-
Costs of research and development	3.8	6.2
Directors' emoluments (note 5)	0.4	0.5
Non-audit services provided by the auditors and their associates	0.1	0.1

Auditors' remuneration for the audit amounted to £45,000 (1997: £44,000).

4 NET INTEREST

	9 months ended December 1997	12 months ended March 1997
	£'m	£'m
Net interest payable comprises:		
Interest payable:		
Bank loans and overdrafts	19.2	19.9
Debenture stock interest	0.7	1.0
Financing charges payable under finance leases	1.9	2.4
Total interest payable	21.8	23.3
Interest receivable	(3.3)	(5.6)
Net interest payable	18.5	17.7

The financing charges payable under finance leases include £0.1m (1997: £0.2m) owed to a fellow subsidiary.

5 DIRECTORS' EMOLUMENTS AND INTERESTS

Directors' remuneration

The remuneration of the directors of the company was as follows:

	9 months ended December 1997	12 months ended March 1997
	£'000	£'000
Emoluments (including benefits in kind)	361.4	498.5

Pensions

The number of directors who were members of group pension schemes was as follows:

	9 months ended December 1997	12 months ended March 1997
	No.	No.
Defined benefit schemes	5	5

Highest paid director

The above amounts for remuneration include the following in respect of the highest paid director:

	9 months ended December 1997	12 months ended March 1997
	£'000	£'000
Emoluments (including benefits in kind)	118.6	157.6

The accrued pension entitlement under the company's defined benefit scheme of the highest paid director at 31 December 1997 was £39,000 (31 March 1997: £33,000). In addition to the pension, there is a tax free lump sum at normal pension date of which the accrued entitlement at 31 December 1997 is £117,000 (31 March 1997: £99,000).

The directors who held office at 31 December 1997 had no interest in the shares of the company.

The directors who held office on 31 December 1997 had the following beneficial interests in the ordinary shares, other than share options, and debentures of the Company's ultimate parent company, Suez Lyonnaise des Eaux S.A.:

Name of Director	Description of Shares or debentures	31 December 1997	Start of Period or subsequent date of appointment
H D M Speed	Ordinary Shares of 60FF	251	240
P Babin	Ordinary Shares of 60FF	205	163
J A Cuthbert	Ordinary Shares of 60FF	39	-
J Graham	Ordinary Shares of 60FF	39	-
A J Harding	Ordinary Shares of 60FF	11	-
A F Jones	Ordinary Shares of 60FF	39	-
A C Price	Ordinary Shares of 60FF	39	-

5 DIRECTORS' EMOLUMENTS AND INTERESTS (continued)

The directors who held office on 31 December 1997 held the following options over ordinary shares of 60FF each in Suez Lyonnaise des Eaux S.A.:

Name of Director	Start of Period or subsequent date of appointment	Granted during period	31 December 1997	Exercise Price (FF)
H D M Speed	800	-	800	485
	1200	-	1200	493
	1200	-	1200	456
	-	1400	1400	573
P Babin	1000	-	1000	430
	1500	-	1500	485
	2000	-	2000	493
	2500	-	2500	456
	-	3500	3500	573
J A Cuthbert	500	-	500	485
	1200	-	1200	493
	1200	-	1200	456
	-	2200	2200	573
J Graham	-	300	300	573
A J Harding	500	-	500	485
	1500	-	1500	493
	1600	-	1600	456
	-	2500	2500	573
A F Jones	200	-	200	456
	-	500	500	573
G Neave	200	-	200	456
	-	500	500	573
A C Price	200	-	200	456
	-	500	500	573

No options have been exercised or lapsed during the period.

All options with an exercise price of 430FF were granted on 7 July 1993 and are exercisable between 7 July 1995 and 7 July 1998.

All options with an exercise price of 485FF were granted on 15 July 1994 and are exercisable between 15 July 1996 and 15 July 2002.

All options with an exercise price of 493FF were granted on 14 June 1995 and are exercisable between 14 June 1997 and 14 June 2003.

All options with an exercise price of 456FF were granted on 24 July 1996 and are exercisable between 24 July 1998 and 24 July 2004.

All options with an exercise price of 573FF were granted on 17 November 1997 and are exercisable between 17 November 2002 and 17 November 2005.

The highest and lowest prices of the Suez Lyonnaise des Eaux S.A. shares during the period were 716FF and 500FF respectively.

No other Director holds any interest required to be disclosed in accordance with Schedule 7 of the Companies Act 1985.

6 TRANSACTIONS WITH DIRECTORS AND OFFICERS

No transactions or arrangements which are disclosable under the provisions of the Companies Act 1985 have occurred during the year.

7 EMPLOYEE INFORMATION

(a) The total employment costs of all employees (including directors) were charged as follows:

	9 months ended December 1997	12 months ended March 1997
	£'m	£'m
Costs charged to the profit and loss account:		
Wages and salaries	21.3	26.9
Social security costs	1.7	2.4
Other pension costs	1.5	4.0
	<u>24.5</u>	<u>33.3</u>
Costs charged to capital schemes and infrastructure renewals:		
Wages and salaries	4.9	6.5
Social security costs	0.4	0.6
Other pension costs	0.6	0.9
	<u>5.9</u>	<u>8.0</u>

(b) The average monthly number of employees on the payroll during the financial period was as follows:

	9 months ended December 1997	12 months ended March 1997
	No.	No.
Average during the period	<u>1,848</u>	<u>1,808</u>
Total at December/March	<u>1,825</u>	<u>1,697</u>

On 1 April 1997, 219 Sewerage Agency staff were transferred to the company from the local councils.

8 TAXATION

	9 months ended December 1997	12 months ended March 1997
	£'m	£'m
Tax on profit on ordinary activities		
United Kingdom corporation tax at 31% (March 1997:33%)		
- current year	3.5	9.8
- prior years	-	(1.0)
Payable in respect of group relief		
- current year	7.9	10.3
Payable in respect of advance corporation tax surrendered	4.0	1.1
Tax charge	<u>15.4</u>	<u>20.2</u>

- (a) The company has provisionally claimed tax losses from fellow subsidiaries in the current period of £25.6m (1997: £31.2m) for which payment will be made at the rate of 31%. The company has provisionally claimed advance corporation tax of £4.0m (1997: £1.1m) from Northumbrian Water Group plc for which payment shall be made at full value.
- (b) No deferred taxation has been provided in the financial statements since timing differences at 31 December 1997 are not expected to reverse in the foreseeable future (1997: £Nil). The effect of not providing for deferred taxation has been a reduction in the tax charge for the year of £21.7m (1997: £25.9m). The full potential amount of deferred taxation calculated at 31% (1997: 33%) on all timing differences is as follows:

	9 months ended December 1997	12 months ended March 1997
	£'m	£'m
Accelerated capital allowances	251.5	247.2
Other timing differences	(16.7)	(14.2)
	<u>234.8</u>	<u>233.0</u>

As infrastructure assets are not depreciated, deferred taxation will crystallise only in the event of a disposal of such assets at amounts in excess of their tax written down value. In the opinion of the directors, the likelihood of a liability crystallising in the foreseeable future is remote. The tax effect due to accelerated capital allowances on infrastructure assets which has been included in the amounts set out above is £158.7m assuming a tax rate of 31% (March 1997: £159.4m assuming a tax rate of 33%).

9 DIVIDENDS

	9 months ended December 1997	12 months ended March 1997
	£'m	£'m
Equity:		
Interim paid of 24.052p (March 1997: 22.176p) per share on an aggregated basis	29.5	27.2
Final proposed of 12.067p (March 1997: 23.236p) per share on an aggregated basis	14.8	28.5
	<u>44.3</u>	<u>55.7</u>

Dividends continue to be set at a level to ensure that the appointed business has sufficient financial resources to carry out its planned investment programme until 31 March 2000. Revised price limits to be determined by the Director General of Water Services will take effect from 1 April 2000 onwards.

In accordance with the principle of incentive based price cap regulation, rewards to shareholders will reflect company performance against Ofwat targets, in particular operating and investment targets.

10 TANGIBLE FIXED ASSETS – GROUP AND COMPANY

The net book value of infrastructure assets, including infrastructure assets in the course of construction, is stated after the deduction of grants and contributions amounting to £51.0m (1997: £48.2m) in order to give a true and fair view (note 1).

	Freehold land and buildings	Infra- structure assets	Operational structures, plant and machinery	Fixtures, fittings, tools and equipment	Assets in the course of construction	Total
	£'m	£'m	£'m	£'m	£'m	£'m
Cost:						
At 1 April 1997	42.7	650.5	511.7	44.4	122.3	1,371.6
Additions	-	-	-	-	187.0	187.0
Schemes commissioned	1.8	61.9	24.7	3.2	(91.6)	-
Disposals	-	-	(0.6)	-	-	(0.6)
Grants and contributions	-	(2.0)	-	-	(0.8)	(2.8)
Balance at 31 December 1997	44.5	710.4	535.8	47.6	216.9	1,555.2
Depreciation:						
At 1 April 1997	10.5	-	122.5	29.0	-	162.0
Provision for year	1.2	-	14.5	3.8	-	19.5
Disposals	-	-	(0.6)	-	-	(0.6)
At 31 December 1997	11.7	-	136.4	32.8	-	180.9
Net book value:						
At 31 December 1997	32.8	710.4	399.4	14.8	216.9	1,374.3
At 31 March 1997	32.2	650.5	389.2	15.4	122.3	1,209.6
Leased assets included above:						
Net book value						
At 31 December 1997	-	-	30.7	0.6	-	31.3
At 31 March 1997	-	-	31.9	0.8	0.5	33.2

11 FIXED ASSET INVESTMENTS – COMPANY

The company has a wholly-owned subsidiary undertaking, Newcastle and Gateshead Water plc, whose principal activity is the holding of a loan note due from the company. This investment equates to an investment in the ordinary share capital of Newcastle and Gateshead Water plc of £40.7m, the value of the net assets of this company, and a long term loan investment of £6.5m. Included in the net assets of Newcastle and Gateshead Water plc is a loan note due from Northumbrian Water Limited of £47.2m. It has been agreed by both companies that interest on the loan note will be 0%. The results of this subsidiary have been consolidated in these financial statements.

The non-appointed business holds an investment of £2 in the ordinary shares of a wholly owned subsidiary, Northumbrian Water Services Limited. This subsidiary is engaged in carrying out various commercial contracts. The results and balance sheet of this subsidiary have not been included in the consolidated financial statements as they are considered not to be material. The financial statements of Northumbrian Water Services Limited for the year ended 31 December 1997 show net liabilities amounting to £3.2m (1997: £3.2m) and profit after tax of £0.0m (1997: £0.1m loss). The effect of consolidating Northumbrian Water Services Limited on these financial statements would have been a decrease in cash and cash equivalents of £3.0m (1997: £3.1m). A provision of £3.2m (note 3b) was made for refinancing the losses of this subsidiary in the year ended March 1997.

12 STOCKS – GROUP AND COMPANY

	<u>December 1997</u>	<u>March 1997</u>
	£'m	£'m
Raw materials and consumables	3.9	3.2
	<u>3.9</u>	<u>3.2</u>

There is no material difference between the balance sheet value of stocks and their replacement costs.

13 DEBTORS – GROUP AND COMPANY

	<u>December 1997</u>	<u>March 1997</u>
	£'m	£'m
(a) Amounts falling due within one year:		
Trade debtors	22.6	27.7
Amounts owed by other group companies	2.6	2.4
Other debtors	5.4	5.1
Prepayments and accrued income	27.3	20.2
Infrastructure renewals prepayment (note 21)	3.5	1.5
	<u>61.4</u>	<u>56.9</u>
(b) Amounts falling due after one year:		
Amounts owed by other group companies	<u>16.6</u>	<u>18.7</u>

Included in amounts owed by other group companies are loans of £18.5m repayable by instalments of which £12.0m (March 1997: £10.7m) falls due in less than five years and £6.5m (March 1997: £9.0m) falls due after more than five years.

No amounts are owed by other group companies in respect of tax losses (March 1997: £Nil).

14 INVESTMENTS – GROUP AND COMPANY

	December 1997	March 1997
	£'m	£'m
Short term deposits	5.2	38.2

15 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	December 1997	March 1997
	Company/Group	Company/Group
	£'m	£'m
Obligations under finance leases (note 19)	0.5	2.7
Bank overdraft	-	8.8
Loans (note 17)	34.0	7.7
Trade creditors	4.4	3.8
Amounts owed to other group companies	44.0	22.0
Taxation and social security	1.6	0.8
Other creditors	73.2	70.5
Accruals and deferred income	28.8	8.3
Dividend payable	14.8	28.5
	201.3	153.1

Other creditors includes creditors related to capital projects of £36.9m (March 1997: £35.3m).

Included in other creditors is £6.8m (March 1997: £8.1m) in respect of corporation tax payable.

Included in amounts owed to other group companies is £18.2m (March 1997: £10.6m) payable in respect of tax losses surrendered by fellow subsidiaries; £5.0m (March 1997: £1.1m) payable in respect of advance corporation tax surrendered from Northumbrian Water Group plc; and £6.2m (March 1997: £0.4m) payable in respect of advance corporation tax surrendered by Lyonnaise Europe plc.

16 CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR – GROUP AND COMPANY

	December 1997		March 1997	
	Group	Company	Group	Company
	£'m	£'m	£'m	£'m
Obligations under hire purchase contracts and finance leases (note 19)	44.0	44.0	42.6	42.6
Loans (note 17)	189.3	189.3	148.3	148.3
Debenture stocks (note 18)	8.7	8.7	8.7	8.7
Amounts owed to other group companies (note 20)	129.5	176.7	129.5	176.7
Other creditors	1.6	1.6	0.5	0.5
	<u>373.1</u>	<u>420.3</u>	<u>329.6</u>	<u>376.8</u>

At 31 December 1997 the group and company had entered into the following interest swap arrangements: £17.0m (March 1997: £17.0m) over a seven year period commencing on 28 August 1992 under which the group and company is required to pay interest at 9.43% and will receive interest at a rate linked to LIBOR; £15.0m (March 1997: £15.0m) over a ten year period commencing on 10 May 1994 under which the group and company is required to pay interest at a rate linked to LIBOR and will receive interest at 9.00%, and £10.0m (March 1997: £10.0m) over a seven year period commencing on 16 December 1996 under which the group and company is required to pay interest at a rate linked to LIBOR and will receive interest at 7.45%.

17 LOANS – GROUP AND COMPANY

	December 1997	March 1997
	£'m	£'m
Loans are repayable as follows:		
Within one year	34.0	7.7
Between one and two years	26.7	9.0
Between two and five years	38.9	47.4
After five years	123.7	91.9
	<u>223.3</u>	<u>156.0</u>

Loans repayable by instalments not wholly repayable within 5 years amount to £191.3m (March 1997: £124.0m) and bear interest rates in the range of 6.0% to 11.1% of which £82.6m (March 1997: £47.1m) falls due in less than 5 years and £108.7m (March 1997: £76.9m) falls due after more than 5 years.

Loans repayable otherwise than by instalments which fall due in less than 5 years amount to £17.0m (March 1997: £17.0m) and bear interest at 0.2% below LIBOR.

Loans repayable otherwise than by instalments which fall due after more than 5 years amount to £15.0m (March 1997: £15.0m) and bear interest at 7.95%.

18 DEBENTURE STOCKS – GROUP AND COMPANY

	<u>December 1997</u>	<u>March 1997</u>
	£'m	£'m
Debenture stocks are repayable as follows:		
In five years or more:		
£1, 12.0% Redeemable 2004	5.0	5.0
£1, 12.0% Redeemable 2005	2.0	2.0
£1, 3.75% Redeemable 2012	0.3	0.3
£1, 4.25% Redeemable 2012	0.7	0.7
£1, 5.25% Redeemable 2012	0.7	0.7
	<u>8.7</u>	<u>8.7</u>

All debenture stocks are redeemable at par on maturity. The debenture stocks are secured by a floating charge on the company's business undertaking and on its assets.

19 OBLIGATIONS UNDER FINANCE LEASES – GROUP AND COMPANY

Obligations under hire purchase contracts and finance leases are as follows:

	<u>December 1997</u>	<u>March 1997</u>
	£'m	£'m
Amounts due:		
Within one year	0.5	2.7
Between one and two years	0.8	0.5
Between two and five years	4.5	3.4
After five years	91.3	93.2
	<u>97.1</u>	<u>99.8</u>
Less:		
Finance charge allocated to future periods	(52.6)	(54.5)
	<u>44.5</u>	<u>45.3</u>
Disclosed as due:		
Within one year (note 15)	0.5	2.7
After more than one year (note 16)	44.0	42.6
	<u>44.5</u>	<u>45.3</u>

20 AMOUNTS DUE TO OTHER GROUP COMPANIES

Amounts due to other group companies relate to loans repayable as follows:

	December 1997		March 1997	
	Group	Company	Group	Company
	£'m	£'m	£'m	£'m
Between two and five years	1.8	1.8	1.0	1.0
After five years	127.7	174.9	128.5	175.7
	<u>129.5</u>	<u>176.7</u>	<u>129.5</u>	<u>176.7</u>

£47.2m is owed to a subsidiary undertaking in the form of an unsecured loan note repayable, at par, otherwise than by instalments after more than five years and is subject to interest at an agreed rate of 0%. The company may exercise an option to repay the loan note at any time, also at par, subject to three months notice in writing. At present there is no intention to repay, therefore it has been classified as being due in five years or more.

£119.5m is owed to a fellow subsidiary in the form of an unsecured loan note repayable, at par, otherwise than by instalments after more than 5 years and is subject to an interest rate linked to LIBOR. The company may exercise an option to repay the loan note at any time, also at par, subject to three months notice in writing. At present there is no intention to repay, therefore it has been classified as being due in five years or more.

By way of a novation agreement dated 5 August 1996, Northumbrian Water Limited (NWL) took over the obligations of Lyonnaise Europe plc (LEP) in respect of a £33m loan agreement from the European Investment Bank (EIB) to LEP, dated July 1990 and known as Lyonnaise Water UK I Project (UK I). LEP had subsequently on-lent the £33m to its subsidiaries, North East Water plc, £13m, and Essex & Suffolk Water plc (E&S), £20m, with the agreement of EIB. By way of an on-lending agreement dated 30 August 1996, E&S agreed to indemnify NWL for the principal and interest due on the £20m borrowed by E&S in respect of UK I agreement.

By way of a novation agreement dated 5 August 1996, E&S took over the obligations of LEP in respect of, a £65m loan agreement from the EIB to LEP dated 7 July 1995 and known as Lyonnaise Water UK II Project (UK II). LEP had subsequently on-lent £25m of the loan facility to its subsidiaries, North East Water plc, £10m and E&S, £15m, with the agreement of EIB. By way of an on-lending agreement dated 30 August 1996, NWL agreed to indemnify E&S for the principal and interest due on the £10m borrowed by NWL in respect of the UK II agreement. On 3 October and 18 November 1996, E&S drew down from the EIB the outstanding £40m available under the UK II facility.

The £10m borrowed by NWL in respect of the UK II agreement is repayable by instalments, £1.8m falls due in less than five years and £8.2m falls due after more than 5 years. The loan bears interest at 8.55%.

21 PROVISIONS FOR LIABILITIES AND CHARGES – GROUP AND COMPANY

	<u>December 1997</u>	<u>March 1997</u>
	£'m	£'m
Infrastructure renewals:		
At 1 April	(1.0)	5.0
Transferred from profit and loss account	14.7	18.7
Utilised during the period	(16.6)	(24.7)
	<u>(2.9)</u>	<u>(1.0)</u>
Reorganisation/restructuring provision:		
At 1 April	21.9	24.1
Utilised during the period	(9.7)	(9.0)
Provided in the period (note 3(b))	2.5	6.8
	<u>14.7</u>	<u>21.9</u>
At December/March	<u>11.8</u>	<u>20.9</u>
Closing Balance		
Disclosed as:		
Infrastructure renewals prepayment (note 13)	(3.5)	(1.5)
Provisions for liabilities and charges	15.3	22.4
	<u>11.8</u>	<u>20.9</u>

The provision for liabilities and charges includes a £0.6m provision in respect of Infrastructure renewals in the Non-Appointed business (March 1997: £0.5m).

22 ACCRUALS AND DEFERRED INCOME – GROUP AND COMPANY

	<u>December 1997</u>	<u>March 1997</u>
	£'m	£'m
Non infrastructure capital grants and contributions:		
At 1 April	28.2	26.8
Additions	1.6	2.6
Amortised during the period	(1.0)	(1.2)
	<u>28.8</u>	<u>28.2</u>
At December/March		

23 CALLED UP SHARE CAPITAL – GROUP AND COMPANY

	<u>December 1997</u>	<u>March 1997</u>
	£'m	£'m
Authorised: 122,650,000 Ordinary Shares at £1 each (March 1997: 122,650,000)	122.7	122.7

	<u>December 1997</u>	<u>March 1997</u>
	£'m	£'m
Allotted, called up and fully paid: 122,650,000 Ordinary Shares of £1 each (March 1997: 122,650,000)	122.7	122.7

24 PROFIT AND LOSS ACCOUNT – GROUP AND COMPANY

	<u>9 months ended December 1997</u>	<u>12 months ended March 1997</u>
	£'m	£'m
At 1 April	670.6	612.6
Profit retained for the year	54.1	58.0
At 31 December/(March)	724.7	670.6

As permitted by Section 230 of the Companies Act 1985, the company's profit and loss account has not been included in these financial statements. A profit of £98.4m (March 1997: £113.7m) relates to the operations of the company.

25 RECONCILIATION OF MOVEMENTS IN EQUITY SHAREHOLDERS' FUNDS – GROUP AND COMPANY

	9 months ended December 1997	12 months ended March 1997
	£'m	£'m
Profit for the financial period	98.4	113.7
Dividends	(44.3)	(55.7)
Net additions to equity shareholders' funds	54.1	58.0
Opening equity shareholders' funds	793.3	735.3
Closing equity shareholders' funds	847.4	793.3

26 RECONCILIATION OF OPERATING PROFIT TO CASH FLOWS

	9 months ended December 1997	12 months ended March 1997
	£'m	£'m
Operating profit	132.3	151.6
Depreciation on tangible fixed assets	19.5	22.2
Infrastructure renewals expenditure	(16.6)	(24.7)
Provision for infrastructure renewals	14.7	18.7
Amortisation of grants	(1.0)	(1.2)
Profit on sale of fixed assets	(1.6)	(0.8)
Increase in stock	(0.7)	(0.4)
Increase in debtors	(2.0)	(22.1)
Increase in creditors	30.3	23.2
Restructuring provision	(7.2)	(2.2)
Net cash inflow from operating activities	167.7	164.3

The operating cash flows are all from continuing operations

27 ANALYSIS OF CASH FLOWS

	9 months ended December 1997	12 months ended March 1997
	£'m	£'m
Return on investments and servicing of finance		
Interest received	3.4	7.5
Interest paid	(20.0)	(18.5)
Interest element of finance lease rentals	(0.3)	(0.6)
Net cash outflow	<u>(16.9)</u>	<u>(11.6)</u>
Taxation		
UK corporation tax repaid/(paid)	0.6	(20.0)
Tax relief received	-	9.8
Net cash inflow/outflow	<u>0.6</u>	<u>(10.2)</u>
Capital expenditure and financial investment		
Purchase of tangible fixed assets	(185.4)	(127.6)
Sale of tangible fixed assets	1.6	0.8
Grants, contributions and connection charges	4.6	6.2
Net cash outflow	<u>(179.2)</u>	<u>(120.6)</u>
Management of liquid resources		
Purchase of short term deposits	(139.9)	(392.6)
Sale of short term deposits	172.9	454.6
Net cash inflow	<u>33.0</u>	<u>62.0</u>
Financing		
Redemption of debentures	-	(3.0)
New loans	75.0	35.0
Loan repayment receipts from other Group company	1.2	0.3
Loan repayments	(7.7)	(4.0)
Capital element of finance lease rental payments	(2.4)	(2.6)
Net cash inflow	<u>66.1</u>	<u>25.7</u>

ANALYSIS AND RECONCILIATION OF NET DEBT

	1 April 1997	Cash Flow	Other non-cash changes	31 December 1997
	£'m	£'m	£'m	£'m
Cash in hand and at bank	-	4.5	-	4.5
Overdrafts	(8.8)	8.8	-	-
		<u>13.3</u>		
Debt due after 1 year	(286.5)	(50.0)	9.0	(327.5)
Debt due within 1 year	(7.7)	(18.5)	(7.8)	(34.0)
Finance leases	(45.3)	2.4	(1.6)	(44.5)
		<u>(66.1)</u>		
Current asset investments	38.2	(33.0)	-	5.2
Net debt	<u>(310.1)</u>	<u>(85.8)</u>	<u>(0.4)</u>	<u>(396.3)</u>

Reconciliation of cash flow movement to net debt:

	9 months ended December 1997
	£'m
Increase in cash in the year	13.3
Cash inflow from increase in debt and lease financing	(66.1)
Cash inflow from decrease in liquid resources	(33.0)
Change in net debt resulting from cash flows	<u>(85.8)</u>
Finance lease interest capitalised	(1.6)
Movement in loan acquired from debt reorganisation (note 20)	1.2
Movement in net debt in year	(86.2)
Net debt at 1 April 1997	(310.1)
Net debt at 31 December 1997	<u>(396.3)</u>

29 COMMITMENTS AND CONTINGENT LIABILITIES – GROUP AND COMPANY

(a) Capital expenditure	9 months ended December 1997	12 months ended March 1997
	£'m	£'m
Expenditure contracted for	72.2	64.5

(b) Lease commitments:

The company and group has entered into non-cancellable operating leases in respect of land and buildings, plant, machinery and motor vehicles. The total amount payable under these leases in the next year is as follows:-

	9 months ended December 1997	12 months ended March 1997
	£'m	£'m
Land and buildings:		
Leases which expire:		
Between two and five years	-	0.1
In five years or more	0.1	0.1
	0.1	0.2
Other:		
Leases which expire:		
Within one year	0.3	0.2
Between two and five years	0.6	0.7
	0.9	0.9

30 PENSIONS

As a subsidiary of Northumbrian Water Group plc, the company participates in group pension schemes. The group operates three defined benefit final salary schemes: the Water Pension Scheme (WPS), the Water Mirror Image Pension Scheme (MIS), and the Lyonnaise UK Pension Scheme (LUKPS).

The employer's contributions to WPS and MIS and pension costs have been assessed in accordance with the advice of the consulting actuaries, William M Mercer Limited, and in the case of LUKPS, Sedgwick Noble Lowndes. The last actuarial valuation of WPS and MIS was carried out as at 31 March 1996 and for LUKPS as at 1 November 1996.

Full details of the Schemes are disclosed in the accounts of Northumbrian Water Group plc.

31 RELATED PARTY DISCLOSURES

The company is a wholly owned subsidiary of Northumbrian Water Group plc which produces publicly available financial statements which includes the company. Consequently the company is exempt under the terms of Financial Reporting Standard No 8 "Related Party Disclosures" from disclosing transactions with other members of the group headed by Northumbrian Water Group plc.

Transactions during the year and balances outstanding at the year end with other members of the group headed by Suez Lyonnaise des Eaux S.A. were as follows:

	9 months ended December 1997	12 months ended March 1997
	£'m	£'m
Suez Lyonnaise des Eaux S.A.		
Management charge in respect of the company's directors and staff paid by Suez Lyonnaise	0.2	0.3
Management charge in respect of Suez Lyonnaise staff paid by the company	(0.2)	(0.3)
Group research and development costs	3.4	4.9
Maintenance fee in respect of a software agreement	0.1	0.2
Creditor outstanding at 31 December/March	1.3	5.2
Debtor outstanding at 31 December/March	0.1	-
Degremont UK		
Services provided in respect of capital contracts	2.0	1.0
Creditor outstanding at 31 December/March	-	0.3
Lyonnaise Europe plc		
Interest paid/payable on EIB loans	-	0.6
Creditor outstanding at 31 December/March	-	-
Fastflow Pipeline Services Limited		
Sale of materials to Fastflow Pipeline Services	0.1	-
Services in respect of operating and capital contracts	4.6	6.1
Debtor outstanding at 31 December/March	0.1	-
Creditor outstanding at 31 December/March	1.6	1.0

Through a Research Sharing and Technical Assistance Agreement, the Company has full access to, and has full use of, the intensive programme carried out by Suez Lyonnaise des Eaux S.A.

32 ULTIMATE PARENT COMPANY

The ultimate parent company and controlling party of the company is Suez Lyonnaise des Eaux S.A., incorporated in France. The largest group which consolidates the results of the company is Suez Lyonnaise des Eaux S.A. and copies of the consolidated accounts are available to the public from Suez Lyonnaise des Eaux S.A., 72 Avenue de la Liberte, 92753 Nanterre, France.

The smallest group which consolidates the results of the company is that of which Northumbrian Water Group plc is the parent. Copies of the consolidated accounts may be obtained from Northumbrian Water Group plc, Northumbria House, Regent Centre, Gosforth, Newcastle upon Tyne NE3 3PX. Northumbrian Water Group plc is registered in England and Wales.