Subterra Limited

Annual report for the year ended 31 March 1998

Directors and advisers

Executive Directors

A J Whiteside
P O'Connell

Non-executive Directors

A Cooper
I Cooper

Registered Auditors

Coopers & Lybrand
Abacus Court
6 Minshull Street
Manchester
M1 3ED

Secretary and registered office

P O'Connell
Dullar Lane
Sturminster Marshall
Wimborne
Dorset
BH21 4DA

Bankers

National Westminster Bank Plc
City of London
P O Box 12258
1 Princess Street
London
EC2R 8PA

Solicitors

Ensor Byfield
Equity Court
73 - 75 Millbrook Road East
Southampton
SO15 1RJ

Directors' report
for the year ended 31 March 1998

The directors present their report and the audited financial statements for the year ended 31 March 1998.

Principal activities

The profit and loss account for the year is set out on page 6.

The company's principal activity during the year was pipeline renovation for the water and gas utilities. The company also supplied materials and machinery to the pipeline renovation industry.

Review of business

The company acquired the trade of Subterra (Scotland) Limited on 1 April 1997.

The level of business during the year has been satisfactory. As noted below and in note 19 to the financial statements, the company ceased to trade on 1 April 1998.

Post balance sheet events

On 1 April 1998, the company transferred its trade, assets and liabilities to Thames Waste Management Limited and then ceased to trade (see note 19 to the financial statements for further details).

Dividends

The directors recommend that no dividend be paid for the year.

Directors

The directors of the company at the date of this report, all of whom have been directors for the whole of the year ended on that date, are listed on page 1.

J Hackett was a director on 1 April 1997 and resigned on 31 December 1997.

B Hersee, who was a director throughout the year, resigned on 6 April 1998.

Directors' interests in shares of the company

No director held any interest in the shares of the company during the year.

The interests of A Cooper in other group companies is disclosed in the financial statements of Thames Water Environmental Services Limited.

A J Whiteside, P O'Connell and B Hersee have the following options to acquire shares in the ultimate holding company, under the Thames Water Plc Share Save Scheme, which were granted on 3 December 1997.

	1998 Number	1997 Number
A J Whiteside	**1,423**	-
P O'Connell	**1,423**	-
B Hersee	**1,423**	-

Millennium IT risk

The year 2000 issue, which stems from computer programs written using two digits rather than four to define the applicable year, could result in processing faults on the change of the century, producing a wide range of consequences.

The company has conducted an initial review of its computer systems and computer-controlled processes. Plans have been established to identify and address issues which may arise. These involve either replacement or repair of the affected systems, in close collaboration with system suppliers.

Costs incurred to date have been charged to the profit and loss account in accordance with UITF 20. No firm estimate has been established of the total cost which is likely to be incurred. The directors consider that these costs will not be significant compared with the activities of the company.

Statement of directors' responsibilities

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

The directors confirm that suitable accounting policies have been used and applied consistently and reasonable and prudent judgements and estimates have been made in the preparation of the financial statements for the year ended 31 March 1998. 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 and for taking reasonable steps to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

Employee involvement

The company, as part of its organisation structure, has lines of communication with all its employees, enabling them to be informed of matters of concern to them as employees and providing opportunities for them to express their views on such matters.

It is the policy of the company to maintain and develop these arrangements to encourage the involvement of employees in the company's performance and in achieving common awareness of the financial and economic factors affecting such performance.

Employment of disabled persons

The company supports the employment of disabled people whenever possible through recruitment, by retention of those who become disabled during their employment and generally through training, career development and promotion.

Creditor payment policy

The company's current policy concerning the majority of its trade creditors is to:

- settle the terms of payment with those suppliers when agreeing the terms of each transaction;

- ensure that those suppliers are made aware of the terms of payment by inclusion of the relevant terms in contracts; and

- pay in accordance with its contractual and other legal obligations.

The company's average creditor payment period at 31 March 1998 was 44 days (1997: 77 days).

Auditors

A resolution to reappoint Coopers & Lybrand as auditors will be proposed at the annual general meeting.

By order of the board

AJ Whiteside

A J Whiteside
Director
30 June 1998

Report of the auditors to the members of Subterra Limited

We have audited the financial statements on pages 6 to 17.

Respective responsibilities of directors and auditors

As described on page 3, 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 the company's affairs at 31 March 1998 and of its results for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Coopers & Lybrand.

Coopers & Lybrand

Chartered Accountants and Registered Auditors
Manchester
30 June 1998

Profit and loss account for the year ended 31 March 1998

	Notes	1998 £	1997 £
Turnover	2	**38,952,422**	25,250,043
Cost of sales		**(31,878,211)**	(19,135,274)
Gross profit		**7,074,211**	6,114,769
Distribution costs		**(674,133)**	(652,019)
Administrative expenses		**(6,020,635)**	(4,358,850)
Operating profit		**379,443**	1,103,900
Interest receivable and similar income		**4,853**	1,248
Interest payable and similar charges	5	**(278,076)**	(254,270)
Profit on ordinary activities before taxation	6	**106,220**	850,878
Tax on profit on ordinary activities	7	**(186,602)**	(218,624)
Retained (loss)/profit for the financial year	17	**(80,382)**	632,254

All results are derived from activities that have been discontinued on 1 April 1998, as explained in note 19 to the financial statements.

The company has no recognised gains and losses other than those included in the results above and therefore no separate statement of total recognised gains and losses has been presented.

Balance sheet
at 31 March 1998

	Notes	1998 £	1997 £
Fixed assets			
Intangible assets	8	**420,000**	510,000
Tangible assets	9	**2,217,441**	2,164,436
Investments	10	**335,629**	335,629
		2,973,070	3,010,065
Current assets			
Stocks	11	**2,040,711**	1,573,977
Debtors	12	**8,573,936**	6,233,963
Cash at bank and in hand		**44,350**	24,692
		10,658,997	7,832,632
Creditors: amounts falling due within one year	13	**(11,519,848)**	(8,650,096)
Net current liabilities		**(860,851)**	(817,464)
Net assets		**2,112,219**	2,192,601
Capital and reserves			
Called up share capital	16	**365,535**	365,535
Share premium account	17	**248,334**	248,334
Profit and loss account	17	**1,498,350**	1,578,732
Equity shareholders' funds	18	**2,112,219**	2,192,601

The financial statements on pages 6 to 17 were approved by the board of directors on 30 June 1998 and were signed on its behalf by:

AJ Whiteside

A J Whiteside
Director

Notes to the financial statements for the year ended 31 March 1998

1 Principal accounting policies

The financial statements have been prepared in accordance with applicable Accounting Standards in the United Kingdom. A summary of the more important accounting policies, which have been applied consistently, is set out below.

Basis of accounting

The financial statements are prepared in accordance with the historical cost convention.

Cash flow statement

The company is a wholly owned subsidiary of Thames Water Plc and the cash flows of the company are included in the consolidated group cash flow statement of Thames Water Plc. Consequently, the company has taken advantage of the exemptions under the terms of Financial Reporting Standard Number 1 (Revised), from publishing a cash flow statement.

Tangible and intangible fixed assets

The cost of fixed assets is their purchase cost, together with any incidental costs of acquisition.

Depreciation is calculated so as to write off the cost of tangible and intangible fixed assets, less their estimated residual values, on a straight line basis over the expected useful economic lives of the assets concerned, which are principally as follows:

Freehold buildings	100 years
Plant and equipment	4 years
Motor vehicles	3 - 4 years
Computers	4 years
Patents and licences	10 years

Freehold land is not depreciated.

Operating leases and hire purchase contracts

Costs in respect of operating leases are charged on a straight line basis over the lease term. Hire purchase agreements, which transfer to the company substantially all the benefits and risks of ownership of an asset, are treated as if the asset had been purchased outright. The assets are included in fixed assets and the capital element of the hire purchase commitments is shown as obligations under hire purchase contracts. The rentals are treated as consisting of capital and interest elements. The capital element is applied to reduce the outstanding obligations and the interest element is charged against profit in proportion to the reducing capital element outstanding. Assets held under hire purchase contracts are depreciated over the shorter of the lease terms and the useful lives of equivalent owned assets.

Stocks

Stocks of raw materials, finished goods and consumables are stated at the lower of cost and net realisable value.

Long term contracts

Long term contracts are stated at cost, plus attributable profit, less foreseeable losses and progress payments received and receivable. The principal accounting basis used for determining profit on long term contracts is the percentage of completion method based on management's estimate of work completed to date and after providing for all known and anticipated future losses. The amount by which turnover exceeds payments on account is shown under debtors as amounts recoverable on contracts.

Foreign currencies

Trading transactions denominated in foreign currencies are translated into sterling at the exchange rate ruling on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the exchange rates ruling at the balance sheet date. Exchange gains or losses are included in operating profit where appropriate.

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.

Pension scheme arrangements

The company operates a defined benefit pension scheme. The fund is valued every three years by a professionally qualified independent actuary, the rates of contribution payable being determined by the actuary. In the intervening years the actuary reviews the continuing appropriateness of the rates. Pension costs are accounted for on the basis of charging the expected cost of providing pensions over the period during which the company benefits from the employees' services. The effects of variations from regular cost are spread over the expected average remaining service lives of members of the scheme.

Turnover

Turnover, which excludes value added tax, represents the invoiced value of goods and services supplied and the value of long-term contract work done.

2 Turnover

The geographical analysis of turnover by destination is as follows:

	1998 £	1997 £
United Kingdom	**38,240,455**	24,901,252
Europe	**389,452**	252,601
United States of America	**322,515**	96,190
	38,952,422	25,250,043

3 Directors' emoluments

	1998 £	1997 £
Aggregate emoluments and benefits	**194,728**	274,788
Compensation for loss of office	**30,000**	-
	224,728	274,788

Retirement benefits are accruing to three directors under a defined benefit scheme.

4 Employee information

The average weekly number of persons (including executive directors) employed by the company during the year was:

	1998 Number	1997 Number
Production	**318**	187
Research and development	**15**	9
Administration and management	**160**	113
	493	309

	£	£
Staff costs (for the above persons)		
Wages and salaries	**10,339,002**	6,533,352
Social security costs	**983,285**	568,740
Other pension costs (see note 15)	**230,159**	147,356
	11,552,446	7,249,448

5 Interest payable and similar charges

	1998	1997
	£	£
On bank loans and overdrafts	**133,329**	246,018
On loans from group companies	**144,747**	-
On hire purchase contracts	**-**	8,252
	278,076	254,270

6 Profit on ordinary activities before taxation

	1998	1997
	£	£
Profit on ordinary activities before taxation is stated after crediting:		
Profit on disposal of tangible fixed assets	**64,332**	40,801
And after charging:		
Depreciation charge for the year:		
Intangible fixed assets	**90,000**	90,000
Tangible owned fixed assets	**924,533**	668,521
Tangible fixed assets held under hire purchase contracts	**-**	21,210
Auditors' remuneration for audit	**25,000**	16,500
Hire of plant and machinery	**4,661,165**	3,139,997
Operating lease rentals on land and buildings	**134,114**	105,954

7 Tax on profit on ordinary activities

The charge/(credit) is as follows:

	1998	1997
	£	£
United Kingdom corporation tax at 31% (1997: 33%):		
Current	**-**	282,398
Consideration for group relief at 31% (1997: 33%)	**180,000**	-
Under/(over)provision in respect of prior years		
Current	**6,602**	(63,774)
	186,602	218,624

The high charge to taxation, by way of group relief, arises from the impact of short term timing differences.

8 Intangible fixed assets

	Patents and licences £
Cost	
At 1 April 1997 and 31 March 1998	**900,000**
Depreciation	
At 1 April 1997	390,000
Charge for year	90,000
At 31 March 1998	**480,000**
Net book value	
At 31 March 1998	**420,000**
Net book value	
At 31 March 1997	510,000

9 Tangible fixed assets

	Freehold land and buildings £	Motor vehicles £	Plant and equipment £	Computer £	Total £
Cost					
At 1 April 1997	164,924	950,236	3,327,594	223,831	4,666,585
Additions	-	389,674	549,159	71,534	1,010,367
Disposals	-	(172,718)	(27,957)	(6,350)	(207,025)
At 31 March 1998	**164,924**	**1,167,192**	**3,848,796**	**289,015**	**5,469,927**
Depreciation					
At 1 April 1997	13,165	385,929	2,026,152	76,903	2,502,149
Charge for year	1,648	311,130	551,846	59,909	924,533
Disposals	-	(134,822)	(38,767)	(607)	(174,196)
At 31 March 1998	**14,813**	**562,237**	**2,539,231**	**136,205**	**3,252,486**
Net book value					
At 31 March 1998	**150,111**	**604,955**	**1,309,565**	**152,810**	**2,217,441**
Net book value					
At 31 March 1997	151,759	564,307	1,301,642	146,928	2,164,436

10 Fixed asset investments

	Interest in subsidiary undertaking £
Cost and net book value at 31 March 1997 and at 31 March 1998	**335,629**

The company holds 100% of the equity share capital of the following companies:

Subsidiary company	**Country of registration**	**Class of shares held**	**Nature of business**
A J Whiteside & Company Limited	Great Britain	Ordinary	Dormant
Subterra Contracts Limited	Great Britain	Ordinary	Dormant
Subterra Developments Limited	Great Britain	Ordinary	Dormant
Subterra (Scotland) Limited	Great Britain	Ordinary	Dormant

The financial statements for A J Whiteside & Company Limited for the year ended 31 March 1998 show neither profit nor loss. The capital and reserves of the subsidiary at 31 March 1998 amount to £385,257.

The financial statements for Subterra (Scotland) Limited for the year ended 31 March 1998 show neither a profit nor loss. The capital and reserves of the subsidiary at 31 March 1998 are in deficit to an amount of £10,354.

Subterra Contracts Limited and Subterra Developments Limited are not material to Subterra Limited.

In the opinion of the directors, the value of investments in the subsidiaries is not less than the amount included in the balance sheet.

Under section 228 of the Companies Act 1985, the company is exempt from preparing consolidated financial statements.

11 Stocks

	1998 £	1997 £
Raw materials and consumables	**2,040,711**	1,573,977

12 Debtors

	1998	1997
	£	£
Amounts falling due within one year		
Trade debtors	**1,111,759**	1,236,669
Amounts owed by group undertakings:		
Amounts recoverable on contracts	**1,767,173**	221,488
Other	**10,354**	11,033
Other debtors	**222,721**	164,703
Amounts recoverable on contracts	**5,408,678**	4,535,977
Deferred expenditure	**53,251**	64,093
	8,573,936	6,233,963

13 Creditors: amounts falling due within one year

	1998	1997
	£	£
Bank loans and overdrafts	**1,808,714**	2,902,308
Obligations under hire purchase contracts	**-**	20,819
Trade creditors	**4,448,358**	3,357,988
Amounts owed to group undertakings	**586,530**	393,917
Corporation tax	**-**	295,547
Other taxation and social security	**852,500**	518,430
Accruals and deferred income	**1,323,746**	1,161,087
Loan from other group company	**2,500,000**	-
	11,519,848	8,650,096

14 Provisions for liabilities and charges

Deferred taxation

No deferred taxation has been recognised in the financial statements. The total potential (asset)/liability is as follows:

	Amount unprovided	
	1998	1997
	£	£
Tax effect of timing differences because of:		
Excess of capital allowances over depreciation	**(12,810)**	22,385
Other	**(106,333)**	(12,515)
	(119,143)	9,870

15 Pension and similar obligations

The company operates a defined benefit scheme for its eligible permanent employees. The scheme is funded by contributions from the company and the employees in accordance with the recommendations of the scheme's independent professionally qualified actuary in order to maintain full funding of the scheme. The contributions made by the company are charged to the profit and loss account as incurred. The total pension cost for the company for the year was £230,159 (1997: £147,356).

The latest actuarial valuation was at 5 April 1997 and was based on the Attained Age Valuation method. Whilst this method differs from the Prospective Benefit method, it is not expected to produce a significantly different result from that recommended by the Statement of Standard Accounting Practice 24.

The assumptions which have the most significant effect on the results of the valuation are those relating to the rate of return on investments and the rates of increase in salaries. It was assumed that the investment return would be 8.5% per annum and that salary increases would average 6.5% per annum. At the valuation date the market value of the assets was £1,052,680. The actuarial value of the assets was sufficient to cover 122% of the value of the accrued benefits, assuming that all benefits are eventually taken at age 65. A small actuarial surplus on discontinuance was estimated.

16 Called up share capital

	1998	1997
	£	£
Authorised		
1,000,000 ordinary shares of £1 each	**1,000,000**	1,000,000
Allotted, called up and fully paid		
365,535 ordinary shares of £1 each	**365,535**	365,535

17 Share premium account and reserves

	Share premium account £	Profit and loss account £
At 1 April 1997	248,334	1,578,732
Loss for the year	-	(80,382)
At 31 March 1998	**248,334**	**1,498,350**

18 Reconciliation of movements in shareholders' funds

	1998 £	1997 £
Opening shareholders' funds	**2,192,601**	1,560,347
(Loss)/profit for the year	**(80,382)**	632,254
Closing shareholders' funds	**2,112,219**	2,192,601

19 Post balance sheet events

On 1 April 1998, the company transferred its trade, assets and liabilities to Thames Waste Management Limited and then ceased to trade. Details of the disposal are as follows:

	£
Net assets disposed of	2,112,219
Profit on disposal	1,887,781
Proceeds on transfer	**4,000,000**

20 Financial commitments

At 31 March 1998 the company had annual commitments under non-cancellable operating leases as follows:

	Land and buildings	
	1998 £	1997 £
Expiring between two and five years inclusive	**145,179**	112,500
Expiring in over five years	**45,000**	25,000
	190,179	137,500

21 Capital commitments

	1998	1997
	£	£
Capital expenditure that has been authorised by the directors but has not yet been contracted for	**85,638**	168,744

22 Related party disclosures

The company is a wholly owned subsidiary of Thames Water Plc. The company has taken advantage of the exemptions under Financial Reporting Standard Number 8, from disclosing transactions with other group companies and investees of the group qualifying as related parties.

23 Ultimate parent company

The directors regard Thames Water Plc and Subterra Holdings Limited as the ultimate and immediate parent company respectively. Both companies are registered in Great Britain. According to the register kept by the company, Subterra Holdings Limited has a 100% interest in the equity share capital of Subterra Limited at 31 March 1998. Copies of the ultimate parent's consolidated financial statements may be obtained from The Secretary, Thames Water Plc, 14 Cavendish Place, London, W1M 0N4.

The directors regard Thames Water Plc, a publicly quoted company with a diverse range of shareholders, as the ultimate controlling party by virtue of its 100% interest in the equity capital of Subterra Limited.