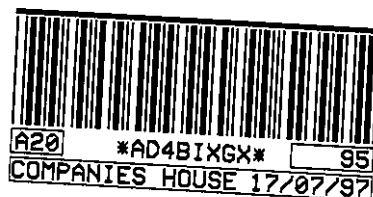


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# **SOUTH WEST WATER SERVICES LIMITED**

## **ANNUAL REPORT AND FINANCIAL STATEMENTS 1997**



REGISTERED OFFICE: Peninsula House, Rydon Lane, Exeter EX2 7HR  
REGISTERED IN ENGLAND NO 2366665

# ANNUAL REPORT AND FINANCIAL STATEMENTS 1997

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## **DIRECTORS, REGISTERED OFFICE AND AUDITORS**

Chairman	K G Harvey	(appointed 1 March 1997)
Managing Director	R J Baty	
East Division Director	P G Ashcroft	(appointed 1 April 1996)
West Division Director	P J Briens	(appointed 1 April 1996)
Finance Director	I R Douglas	
Regulatory Director	D J Dupont	(appointed 1 April 1996)
Technical and Infrastructure Investment Director	I R Hume	(appointed 1 April 1996)
Secretary	R C Milligan	
Registered Office	Peninsula House Rydon Lane Exeter EX2 7HR	
Auditors	Price Waterhouse Chartered Accountants 31 Great George Street Bristol BS1 5QD	

## NOTICE OF MEETING

The eighth Annual General Meeting of South West Water Services Limited will be held at Peninsula House, Rydon Lane, Exeter on 10 July 1997 at 9.30 am for the transaction of the following business:-

- Resolution 1                      To receive the Report of the Directors and the audited financial statements for the year ended 31 March 1997.
- Resolution 2                      To re-appoint Price Waterhouse as auditors and to authorise the Directors to fix their remuneration.

By Order of the Board



R C Milligan  
Secretary  
Peninsula House  
Rydon Lane  
Exeter EX2 7HR

12 June 1997

A member of the Company is entitled to attend and vote at the meeting or may appoint one or more proxies to attend and, on a poll, vote instead of her or him. A proxy need not be a member of the Company.

## REPORT OF THE DIRECTORS

The Directors submit their annual report and the audited financial statements of South West Water Services Limited for the year ended 31 March 1997.

### PRINCIPAL ACTIVITIES

The principal activities of the Company are the provision of water-care and waste water processing and technology. The Company holds the water and sewerage appointments for Cornwall and Devon and small areas of Somerset and Dorset.

### FINANCIAL RESULTS

#### Turnover

Company turnover for the year increased by 2.2% to £244.6m. Turnover from main water and sewerage charges was £238.2m which is after a rebate of customer charges for the year of £10.0m (1996 £6.9m).

#### Operating Costs

Operating costs increased by 6.2% to £121.1m principally resulting from the absence of the net credit of £7.5m in 1996 from the release of a provision for exceptional restructuring costs.

#### Profit

Operating profit was static at £125.4m (1996 £125.5m). The net interest payable decreased to £11.3m (1996 £20.8m), due principally to the gain of £8.7m (1996 nil) arising from defeasance finance lease transactions. Net profit before taxation amounted to £114.1m (1996 £104.7m), after reflecting the lower net interest payable.

The Company's taxation position has moved into a charge to mainstream corporation tax of £8.9m for the year.

#### Dividends

Interim dividends, totalling £56.1m, were paid to the parent undertaking. The Directors do not recommend payment of a final dividend.

The Company has established a dividend policy which involves two components:

- a sustainable level of base dividend growth, determined by a number of factors including the shareholders' investment and the cost of capital; and
- a further level of growth funded by efficiency out-performance.

Dividend payments ensure that key financial ratios are not prejudiced and that the ability of the Appointee to finance its Appointed Business is not impaired.

£49.1m of retained profit was transferred to reserves after payment of the interim dividend.

#### Cash Flow

Net cash inflow from operating activities increased to £142.1m (1996 £124.8m) as a result of a reduction in cash payments associated with the utilisation of the 1995 exceptional restructuring provision.

## **REPORT OF THE DIRECTORS (Continued)**

### **FINANCIAL NEEDS AND RESOURCES**

Capital expenditure on tangible fixed assets during the year was £153.6m, 53.6% above the 1996 level of £100.0m, reflecting the refocusing of the Company's investment programme following the Monopolies and Mergers Commission referral.

The capital works programme comprises over 132 on-going projects at 31 March 1997 with 61 major projects completed during the year. Further progress on the "Clean Sweep" bathing water schemes was achieved. Capital scheme work-in-progress at 31 March 1997 increased to £118.7m (1996 £100.5m).

Significant funding facilities exist for both the short and medium term by way of finance leasing, loans from the European Investment Bank and a Bond, issued by South West Water Plc.

At 31 March 1997 loans and finance lease obligations amounted to £412m compared with £414m at 31 March 1996. Current asset investments of £114m (1996 £173m) were held at the Balance Sheet date. Facilities in place but not yet drawn totalled £124m for finance leasing at 31 March 1997. Together with current asset investments these resources form part of the funding strategy put in place to finance the future investment expenditure needs of the Company.

The Directors confirm that the Company can meet its short term requirements from existing facilities without breaching covenants or other borrowing restrictions.

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

### **FUTURE DEVELOPMENTS**

The Company awaits details of the Government's proposed windfall profits tax which it believes should be applied equitably. The outcome of the Director General's 1999 review of price limits will be important to the financial position of the Company in the new millennium.

### **RESEARCH AND DEVELOPMENT**

The development and testing of innovative techniques and processes will continue to play a role in the further improvement of cost effective provision of services.

The Company continues to commission pilot plants to test rigorously potential new processes in field conditions.

### **DIRECTORS**

The present Directors of the Company and their dates of appointment are shown on page 5. K W Court retired on 28 February 1997.

None of the Directors held any beneficial interest in the shares of the Company during the year. The interests of the Directors in shares of South West Water Plc are shown in note 10 of the Financial Statements. No Director has, or has had, a material interest, directly or indirectly, at any time during the year under review in any contract significant to either the individual Director or the Company's business.

## **REPORT OF THE DIRECTORS (Continued)**

### **EMPLOYEES**

Employee numbers decreased during the year as the Company introduced further manpower efficiencies.

Industrial relations and negotiating arrangements designed to meet business needs are in place. Employee consultation is maintained through a staff council and supporting consultative committees, both chaired by Directors of the Company with representatives drawn from all functional areas.

A Performance Appraisal and Pay Related System exists for all non-manual staff and managers.

The Company remains committed to a non-discriminatory employment policy, making every reasonable effort to provide disabled people with equal opportunities for employment, training and development.

### **DONATIONS**

During the year no charitable or political donations were made.

### **TAX STATUS**

The Company is not a close company within the meaning of the Income and Corporation Taxes Act 1988.

### **PAYMENTS TO SUPPLIERS**

It is the Company's payment policy for the year ending 31 March 1998 to follow the Confederation of British Industry (CBI) Code of Practice on Supplier Payments. The Company is committed to the payment of its suppliers to agreed terms. Information about the Code, and copies thereof, may be obtained from the CBI at Centre Point, 103 New Oxford Street, London, WC1A 1DU. Trade creditors at 31 March 1997 represented 64 days of the amount invoiced by suppliers during the year.

### **PARENT COMPANY**

The Company is a wholly owned subsidiary of South West Water Plc.

### **AUDITORS**

Price Waterhouse were appointed auditors until the conclusion of the eighth annual general meeting and have indicated their willingness to continue in office. A resolution for their re-appointment will be proposed at the annual general meeting.

### **ANNUAL GENERAL MEETING**

The eighth annual general meeting will be held at Peninsula House, Rydon Lane, Exeter on 10 July 1997 at 9.30 am.

By Order of the Board



R C Milligan  
Secretary  
Peninsula House  
Rydon Lane  
Exeter EX2 7HR

12 June 1997

## **DIRECTORS' RESPONSIBILITY STATEMENT**

The following statement, which should be read in conjunction with the auditors' statement of responsibilities set out on page 11, is made with a view to distinguishing for shareholders the respective responsibilities of the Directors and Auditors in relation to 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 as at the end of the financial year and of the profit for the financial year.

The Directors consider that in preparing the financial statements on pages 12 to 34, the Company has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider to be applicable have been followed.

The Directors have responsibility for ensuring that the Company keeps accounting records which disclose with reasonable accuracy the financial position of the Company and which enable them to ensure that the financial statements comply with the Companies Act 1985.

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and hence to prevent and detect fraud and other irregularities.



## AUDITORS' REPORT TO THE MEMBERS OF SOUTH WEST WATER SERVICES LIMITED

We have audited the financial statements on pages 12 to 34 which have been prepared under the historical cost convention and the accounting policies set out on pages 15 to 17.

### Respective Responsibilities of Directors and Auditors

As described on page 10 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.

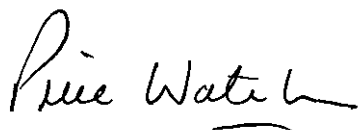
### Basis of Opinion

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 at 31 March 1997 and of its profit and cash flows for the year then ended and have been properly prepared in accordance with the Companies Act 1985.



PRICE WATERHOUSE  
Chartered Accountants  
and Registered Auditors  
Bristol

12 June 1997

**PROFIT AND LOSS ACCOUNT**  
for the year ended 31 March 1997

	Notes	1997 £m	1996 £m
Turnover	2	244.6	239.3
Other operating income		1.9	0.2
Operating costs	3	(121.1)	(114.0)
<b>Operating Profit</b>	2	<b>125.4</b>	<b>125.5</b>
Net interest payable	5	(11.3)	(20.8)
<b>Profit on Ordinary Activities</b>			
Before Taxation	2	114.1	104.7
Tax on profit on ordinary activities	6	(8.9)	0.3
<b>Profit on Ordinary Activities</b>			
After Taxation		105.2	105.0
Dividends	7	(56.1)	(46.5)
<b>Retained Profit</b>			
Transferred to Reserves	20	49.1	58.5

A statement of movements in reserves is given in note 20.

There are no recognised gains or losses other than the profit on ordinary activities after taxation for the year, in 1997 or 1996.

All operating activities are continuing operations.

The notes on pages 15 to 34 form part of these financial statements.

**BALANCE SHEET**  
**at 31 March 1997**

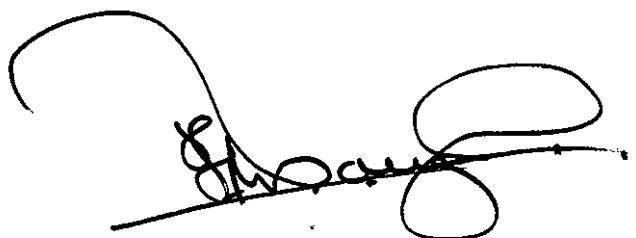
	Notes	1997 £m	1996 £m
<b>Fixed Assets</b>			
Tangible assets	11	<u>1,333.3</u>	<u>1,212.0</u>
<b>Current Assets</b>			
Stocks	12	3.2	2.5
Debtors	13	51.8	46.4
Investments	14	114.0	172.8
Cash at bank and in hand		<u>0.2</u>	<u>0.3</u>
		169.2	222.0
<b>Current Liabilities</b>			
Creditors: amounts falling due within one year	15	<u>(117.4)</u>	<u>(96.8)</u>
<b>Net Current Assets</b>		<u>51.8</u>	<u>125.2</u>
<b>Total Assets Less Current Liabilities</b>		1,385.1	1,337.2
Creditors: amounts falling due after more than one year	16	(390.4)	(390.4)
Provisions for liabilities and charges	17	(12.4)	(11.4)
Accruals and deferred income	18	<u>(22.4)</u>	<u>(23.2)</u>
<b>Net Assets</b>	2	<u>959.9</u>	<u>912.2</u>
<b>Capital and Reserves</b>			
Called-up share capital	19	365.9	365.9
Profit and loss account	20	<u>594.0</u>	<u>546.3</u>
<b>Shareholders' Funds</b>	21	<u>959.9</u>	<u>912.2</u>

The notes on pages 15 to 34 form part of these financial statements.

Approved by the Board on 12 June 1997 and signed on its behalf by:-



R J Baty  
Managing Director



I R Douglas  
Finance Director

**CASH FLOW STATEMENT**  
**for the year ended 31 March 1997**

	Notes	1997 £m	1996 £m
Cash Flow from Operating Activities	27a	142.1	124.8
Returns on Investments and Servicing of Finance	27b	(12.6)	(15.1)
Taxation		0.6	(0.3)
Capital Expenditure	27b	(138.5)	(95.7)
Acquisitions	27b	(0.4)	-
Equity Dividends Paid		(56.1)	(46.5)
Cash Outflow Before Use of Liquid Resources and Financing		(64.9)	(32.8)
Management of Liquid Resources	27b	61.7	187.5
Financing	27b	8.0	(148.3)
Increase in Cash in Year		4.8	6.4

The introduction of FRS 1 (revised 1996), 'Cash Flow Statements', has required revised presentation of certain comparative figures.

## NOTES TO THE FINANCIAL STATEMENTS

### 1 Accounting Policies

The following paragraphs describe the main policies:-

#### (a) Accounting Convention

The financial statements have been prepared under the historical cost convention and in compliance with all applicable accounting standards and, except for the treatment of grants and contributions on infrastructure assets, with the Companies Act 1985. An explanation of this departure from the requirements of the Companies Act 1985 is given in note 1(e) below.

The results of the business undertaking acquired during the year has been included for the period of ownership.

#### (b) Turnover

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

#### (c) Tangible Fixed Assets and Depreciation

Tangible fixed assets comprise:-

- (i) infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls).

Infrastructure assets comprise a network of systems. Expenditure on infrastructure assets relating to increases in capacity or enhancements of the network is treated as capital expenditure on tangible fixed assets and included at cost after deducting grants and contributions. No depreciation is charged on infrastructure assets because the network of systems is required to be maintained in perpetuity and therefore has no finite economic life.

Expenditure on maintaining the operating capability of the network is charged as an operating cost.

Expenditure on the maintenance of infrastructure assets may vary significantly from the long term normal annual level, either because maintenance is deferred or because the pattern of expenditure is uneven. In such instances, the charge against profits is equalised by way of accruals or deferrals as appropriate to reflect the long term normal level of charges, in accordance with defined standards of service.

- (ii) other assets (including properties, overground plant and equipment).

Other assets are stated at cost less accumulated depreciation.

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

Buildings	30-60 years
Operational structures	40-80 years
Fixed plant	20-40 years
Vehicles, mobile plant and computers	3-10 years

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

## NOTES TO THE FINANCIAL STATEMENTS

### 1 Accounting Policies (Continued)

#### (d) Leased Assets

Assets held under finance leases are included in the balance sheet as tangible fixed assets at their equivalent capital value and are depreciated over their estimated economic lives or the finance lease period, whichever is the shorter. The corresponding liability is recorded as a creditor. The interest element of the rental cost is charged against profits, using the actuarial method, over the period of the lease.

Rental costs arising under operating leases are charged against profits in the year they are incurred.

#### (e) Grants and Contributions

Grants and contributions receivable in respect of capital expenditure on non-infrastructure assets are included in the balance sheet as deferred income and are released to profits over the depreciable lives of the assets to which they relate.

Grants and contributions receivable relating to infrastructure assets are deducted from the cost of tangible fixed assets. This is not in accordance with the Companies Act 1985 which requires tangible fixed assets to be shown at cost and hence grants and contributions as deferred income. This departure from the requirements of the Companies Act 1985 is, in the opinion of the Directors, necessary for the financial statements to show a true and fair view as no provision is made for depreciation and any grants and contributions relating to such assets would not be taken to the profit and loss account. The effect of this treatment on the value of tangible fixed assets is disclosed in Note 11.

Grants and contributions receivable in respect of expenditure charged against profits in the year have been included in the profit and loss account.

#### (f) Investments

Listed investments held as current assets are stated at the lower of cost and net realisable value. Short dated unlisted securities held as current assets are stated at cost plus accrued income.

#### (g) Stocks

Stocks are stated at the lower of cost and net realisable value. Cost includes labour, materials and an element of overheads.

#### (h) Pension Costs

The expected cost of pensions in respect of the Company's employees (who are members of the South West Water Plc Group's defined benefit pension schemes) is charged against profits so as to spread evenly the cost of pensions over the service lives of employees in the schemes. A pension surplus is released to profits, using the straight line method, over the average remaining service lives of employees in the schemes.

#### (i) Research and Development Expenditure

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

# NOTES TO THE FINANCIAL STATEMENTS

## 1 Accounting Policies (Continued)

### (j) Taxation

Corporation tax payable is provided on taxable profits at current rates. Tax deferred or accelerated as a result of timing differences between the treatment of certain items for taxation and for accounting purposes is provided for to the extent that it is probable that a material liability or asset will crystallise in the foreseeable future.

### (k) Goodwill

Goodwill arising from the purchase of a business undertaking, representing the excess of the purchase consideration over the fair value of the net assets acquired, is written off to reserves.

## 2 Segmental Analysis

By class of business:-

	Water		Sewerage		Company	
	1997	1996	1997	1996	1997	1996
	£m	£m	£m	£m	£m	£m
<b>Turnover</b>						
Total turnover	108.0	107.3	137.2	132.5	245.2	239.8
Inter-segmental turnover	(0.4)	(0.3)	(0.2)	(0.2)	(0.6)	(0.5)
Turnover to third parties	107.6	107.0	137.0	132.3	244.6	239.3
<b>Profit</b>						
Segmental operating profit	41.3	42.2	84.1	83.3	125.4	125.5
Net interest payable	(4.3)	(7.7)	(7.0)	(13.1)	(11.3)	(20.8)
Profit on ordinary activities before taxation	37.0	34.5	77.1	70.2	114.1	104.7
<b>Net Assets</b>						
Segmental net assets	433.2	383.3	526.7	528.9	959.9	912.2

“Water” includes the provision of water resources, treatment and distribution services and “Sewerage” includes the transfer of sewage, its treatment and disposal.

An analysis by geographical origin and destination is not appropriate as the Company’s activity was substantially located in the United Kingdom.

## NOTES TO THE FINANCIAL STATEMENTS

### 3 Operating Costs

	1997 £m	1996 £m
Manpower costs (note 8)	23.8	17.9
Raw materials and consumables	8.1	7.7
Rentals under operating leases:-		
Hire of plant and machinery	0.9	0.7
Other operating leases	1.1	1.5
Research and development expenditure	0.3	0.2
Auditors' remuneration	0.1	0.1
Other external charges	44.8	45.1
Depreciation:-		
On owned assets	18.3	12.6
On assets held under finance leases	8.1	11.5
On assets held under defeased finance leases	0.4	-
Deferred income (note 18)	(1.2)	(0.8)
Infrastructure renewals charge (note 17)	6.8	6.9
Other operating charges	9.6	10.6
	<u>121.1</u>	<u>114.0</u>

Fees payable to the Company's auditors, Price Waterhouse, for non-audit work for the year ended 31 March 1997 amounted to £0.1m (1996 £0.1m).

Operating costs for 1996 include the exceptional item set out in note 4.

### 4 Exceptional Item

Operating profit is after crediting the following exceptional item:-

	1997 £m	1996 £m
Operating costs:-		
Restructuring provision release		
Manpower costs	-	7.5
	<u>-</u>	<u>7.5</u>

In 1996 £6.9m was charged against profits, as an exceptional item, to cover the cost of a £10 water and sewerage customer rebate. In 1997 a second rebate of £15 costing £10.0m has been provided. Given the second occurrence it is no longer considered appropriate to treat the 1996 cost as exceptional and the comparatives have been amended accordingly.



## NOTES TO THE FINANCIAL STATEMENTS

### 5 Net Interest Payable

	1997 £m	1996 £m
Interest payable:-		
To parent undertaking	(17.0)	(17.1)
Bank loans and overdrafts	(10.3)	(12.4)
Interest element of finance lease rentals	(7.3)	(9.8)
Other finance costs	(0.2)	(0.2)
	<u>(34.8)</u>	<u>(39.5)</u>
Interest receivable:-		
Listed redeemable securities	2.2	4.4
Other investments (as defined in note 14)	<u>12.6</u>	<u>14.3</u>
	14.8	18.7
Gain on defeasance of finance leases	<u>8.7</u>	<u>-</u>
Net interest payable	<u>(11.3)</u>	<u>(20.8)</u>

The interest element of finance lease rentals is shown after netting £7.2m (1996 £6.4m) interest receivable on cash deposited against collateralised finance lease obligations (note 22).

The gain on defeasance of finance leases results from the in-substance early settlement (defeasance) of obligations under finance leases. The Company has:

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

These deposited funds, which totalled £52.7m at 31 March 1997 (1996 nil), together with interest earned thereon, may be used to settle the rental obligations under those finance leases. If the finance leases terminate due to the insolvency of the financial institutions which have issued the letters of credit no liability will fall on the Company.

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

## NOTES TO THE FINANCIAL STATEMENTS

### 5 Net Interest Payable (Continued)

A gain of £8.7m (1996 nil) has been recognised, equivalent to the difference between the finance lease drawdowns and the funds deposited with financial institutions to cover rentals arising therefrom, after making provision for possible rental variations and costs as follows:

	1997 £m	1996 £m
Gain on defeasance of finance leases	12.7	-
less provision for finance lease rental variations (note 17)	(2.9)	-
less costs	(1.1)	-
	<u>8.7</u>	<u>-</u>

### 6 Tax on Profit on Ordinary Activities

	1997 £m	1996 £m
UK corporation tax at 33% for the current year	9.6	-
Amount receivable from South West Water group companies in respect of surrender of tax losses for :-		
the current year	-	(0.3)
prior years	(0.7)	-
	<u>8.9</u>	<u>(0.3)</u>

The corporation tax charge for the year has been reduced by the availability of capital allowances for which no deferred tax has been provided (note 17).

Taxable losses of the Company may be surrendered to other South West Water group companies. Payment for such tax losses surrendered will have regard to the current corporation tax rate and the probable date that the Company would otherwise have utilised those losses.

### 7 Dividends

	1997 £m	1996 £m
Interim dividend of 15.2p (1996 12.7p) per Ordinary share paid on 6 December 1996	55.6	46.5
Further interim dividend of 0.14p per Ordinary share paid on 21 January 1997	0.5	-
	<u>56.1</u>	<u>46.5</u>

## NOTES TO THE FINANCIAL STATEMENTS

### 8 Employees and Employment Costs

The average number of persons (including Directors) employed by the Company was:-

	1997	1996
Water services	968	1,029
Sewerage services	797	786
	<u>1,765</u>	<u>1,815</u>

	1997 £m	1996 £m
Employment costs comprise:-		
Wages and salaries		
excluding exceptional item	31.8	32.7
exceptional item	-	(0.2)
Social security costs	2.5	2.6
Pension costs (note 24)		
excluding exceptional item	(2.4)	(1.5)
exceptional item	-	(7.3)
	<u>31.9</u>	<u>26.3</u>

Charged as follows:-

Manpower costs (note 3)		
excluding exceptional item	23.8	25.4
exceptional item	-	(7.5)
	<u>23.8</u>	<u>17.9</u>
Capital schemes, infrastructure renewals, and other expenditure	8.1	7.3
Restructuring provision	-	1.1
	<u>31.9</u>	<u>26.3</u>

## NOTES TO THE FINANCIAL STATEMENTS

### 9 Directors' Emoluments

	1997 £000	1996 £000
Total emoluments of the Directors of the Company:-		
Remuneration - salary	353	238
- performance bonus	36	31
	<hr/> 389	<hr/> 269
Other emoluments	32	32
Payment in respect of tax liability from supplementary pension arrangements	-	21
	<hr/> 421	<hr/> 322

The emoluments of the highest paid Director included above, are:-

	1997 £000	1996 £000
Remuneration - salary	68	81
- performance bonus	11	7
	<hr/> 79	<hr/> 88
Other emoluments	6	12
Payment in respect of tax liability from supplementary pension arrangements	-	21
	<hr/> 85	<hr/> 121

As a consequence of changes to the Companies Act 1985, the format of disclosure has been changed and certain comparatives have accordingly been modified.

The emoluments of South West Water Services Limited Directors are determined by the Remuneration Committee of South West Water Plc consisting of non-executive Directors. The Remuneration Committee takes external professional advice in determining the level of emoluments. Other emoluments include car benefit and health care.

Payments under the incentive performance bonus plan are related to the achievement of Company profit and individual performance targets as determined by the Remuneration Committee of South West Water Plc. Performance bonuses for 1996 have been disclosed in the 1997 numbers above. The bonuses payable for 1997 performances have not yet been determined and will be disclosed in the 1998 financial statements.

At 31 March 1997 retirement benefits were accruing to 6 Directors under defined benefit pension schemes, operated by the parent company (1996 2 Directors under defined benefit and 1 Director under defined benefit and defined contribution pension schemes).

The highest paid Director participated in defined benefit pension schemes, with an accrued pension of £41,000 at 31 March 1997 (1996 £32,000).

## NOTES TO THE FINANCIAL STATEMENTS

### 9 Directors' Emoluments (Continued)

The South West Water Group has also established pension arrangements to provide benefits above the Inland Revenue earnings cap and improved pensions benefits for certain Directors. These supplementary pension arrangements, which are not approved for tax relief, are funded by Company contributions. The Directors included in these arrangements receive payment to cover the tax liability which arises in respect of these contributions.

### 10 Directors' Interests

The beneficial interest of Directors holding office at 31 March 1997 in shares of South West Water Plc at 31 March 1997 and 31 March 1996, or date of appointment, were as follows:-

	Share Interests		Scheme	Options			
	1997	1996		1997	Granted in Year	Exercised in Year	1996
P G Ashcroft	3,647	39	Executive Sharesave	5,000 4,482	- -	10,000 -	15,000 4,482
P J Briens	97	4,110	Executive	13,800	-	-	13,800
I R Douglas	4,349	39	Executive Sharesave	5,000 2,930	- -	27,500 -	32,500 2,930
D J Dupont	7,987	78	Executive Sharesave	4,000 5,647	- -	22,100 -	26,100 5,647
I R Hume	97	38	Executive	14,000	-	-	14,000

No Director has had any interest in shares of the Company during the year. The interests in shares of South West Water Plc of Messrs K G Harvey and R J Baty, together with details of the share options exercised by K W Court, are disclosed in the financial statements of that Company.

On 7 April 1997, as a result of opting for the scrip dividend alternative, the following Directors acquired additional share interests in South West Water Plc:-

	<u>Shares</u>
P G Ashcroft	2
P J Briens	2
I R Douglas	1

There have been no changes in the Directors' interests in shares of the Company, or of South West Water Plc, since that date.

## NOTES TO THE FINANCIAL STATEMENTS

### 11 Tangible Fixed Assets

	Freehold land and buildings	Infra- structure assets	Opera- tional properties	Fixed & mobile plant, vehicles and computers	Construc- tion in progress	Total
	£m	£m	£m	£m	£m	£m
<b>Cost:-</b>						
At 1 April 1996	10.1	533.8	389.4	342.3	100.5	1,376.1
Additions	2.2	21.2	19.7	42.2	68.3	153.6
Grants and contributions	-	(2.8)	-	-	-	(2.8)
Transfers	-	22.0	22.5	5.6	(50.1)	-
Disposals	(0.1)	-	-	(2.4)	-	(2.5)
At 31 March 1997	<u>12.2</u>	<u>574.2</u>	<u>431.6</u>	<u>387.7</u>	<u>118.7</u>	<u>1,524.4</u>
<b>Depreciation:-</b>						
At 1 April 1996	2.4		65.8	95.9		164.1
Charge for year	0.1		8.0	20.5		28.6
Disposals	-		-	(1.6)		(1.6)
At 31 March 1997	<u>2.5</u>		<u>73.8</u>	<u>114.8</u>		<u>191.1</u>
<b>Net Book Value:-</b>						
At 31 March 1997	<u>9.7</u>	<u>574.2</u>	<u>357.8</u>	<u>272.9</u>	<u>118.7</u>	<u>1,333.3</u>
At 31 March 1996	<u>7.7</u>	<u>533.8</u>	<u>323.6</u>	<u>246.4</u>	<u>100.5</u>	<u>1,212.0</u>

Out of the total depreciation charge for the Company of £28.6m (1996 £25.6m), the sum of £1.8m (1996 £1.5m) has been charged to capital projects, and £26.8m (1996 £24.1m) against profits.

The cost of freehold land and buildings and operational properties includes non-depreciable land of £1.3m (1996 £1.1m) and £7.2m (1996 £7.6m) respectively.

The net book value of infrastructure assets is stated after deducting £33.7m (1996 £30.9m) grants and contributions.

## NOTES TO THE FINANCIAL STATEMENTS

### 11 Tangible Fixed Assets (Continued)

Assets held under finance leases included above:-

	Infra- structure assets	Opera- tional properties	Fixed & mobile plant, vehicles and computers	Construc- tion in progress	Total
	£m	£m	£m	£m	£m
Cost:- At 31 March 1997	-	189.5	105.6	4.3	299.4
Depreciation:- Charge for year	-	2.4	5.7	-	8.1
Depreciation:- At 31 March 1997	-	9.6	31.0	-	40.6

Assets held under defeased finance leases also included above:-

Cost:- At 31 March 1997	31.8	8.6	10.3	14.7	65.4
Depreciation:- Charge for year and at 31 March 1997	-	0.1	0.3	-	0.4

### 12 Stocks

	1997 £m	1996 £m
Raw materials and consumables	3.2	2.5

### 13 Debtors

	1997 £m	1996 £m
Trade debtors	25.5	23.6
Amounts owed by parent undertaking	0.4	-
Amounts owed by fellow subsidiary undertakings	0.3	0.5
Other debtors	3.3	2.3
Prepayments and accrued income	15.5	15.8
Prepayments for pension costs	6.8	4.2
	51.8	46.4
Included above are amounts due after more than one year:-		
Prepayments for pension costs	6.8	4.2

# NOTES TO THE FINANCIAL STATEMENTS

## 14 Current Asset Investments

	1997 £m	1996 £m
Listed investments	29.5	55.4
Other investments:-		
Overnight deposits	3.5	0.6
Other	81.0	116.8
	<u>114.0</u>	<u>172.8</u>
Market value of listed investments	<u>29.5</u>	<u>55.4</u>

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

The analysis of other investments has been expanded to provide disclosure of overnight deposits following the introduction of FRS1 (revised 1996), 'Cash Flow Statements'.

£150.0m (1996 £150.0m) deposited against collateralised finance lease obligations (note 22) is not included above.

## 15 Creditors:- Amounts Falling Due Within One Year

	1997 £m	1996 £m
Loans:- (note 22)		
European Investment Bank loans	9.0	7.8
Bank loans and overdrafts	0.3	2.3
	<u>9.3</u>	<u>10.1</u>
Obligations under finance leases (note 22)	13.3	13.4
Trade creditors	15.3	9.9
Capital creditors	38.3	30.1
Amounts owed to parent undertaking	8.4	3.5
Amounts owed to fellow subsidiary undertakings	5.3	5.6
Amounts owed to associated undertakings	-	0.5
Other creditors	5.0	0.4
Taxation and social security	4.6	1.0
Accruals and deferred income	17.9	22.3
	<u>117.4</u>	<u>96.8</u>

As a result of the growing significance of capital creditors these are now separately identified, with a similar reanalysis of comparative figures.



## NOTES TO THE FINANCIAL STATEMENTS

### 16 Creditors:- Amounts Falling Due After More Than One Year

	1997 £m	1996 £m
Loans:- (note 22)		
European Investment Bank loans	106.7	115.6
Amounts owed to parent undertaking	150.0	150.0
	<hr/>	<hr/>
	256.7	265.6
Obligations under finance leases (note 22)	133.2	124.6
Other creditors	0.5	0.2
	<hr/>	<hr/>
	390.4	390.4
	<hr/>	<hr/>

### 17 Provisions for Liabilities and Charges

	Infra- structure Renewals £m	Restruc- turing £m	Finance Lease Variations (note 5) £m	Other £m	Total £m
At 1 April 1996	2.1	9.3	-	-	11.4
Charged against profits	6.8	-	2.9	0.3	10.0
Arising on acquisition	-	-	-	1.0	1.0
Utilised during year	(6.5)	(3.5)	-	-	(10.0)
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
At 31 March 1997	2.4	5.8	2.9	1.3	12.4
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

### Deferred Taxation

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

	1997 £m	1996 £m
Tax effect of timing differences due to:-		
Accelerated capital allowances	71.5	61.5
Other timing differences	(4.1)	(5.4)
	<hr/>	<hr/>
	67.4	56.1
	<hr/>	<hr/>

As infrastructure assets are not depreciated, deferred taxation will only crystallise in the event of their disposal at amounts in excess of their tax written down value. The tax effect (at 33%) due to accelerated capital allowances on infrastructure assets, which has been excluded from the amounts set out above, amounts to £144.8m (1996 £128.1m). In the opinion of the Directors, the likelihood of a liability crystallising in the foreseeable future is remote.

## NOTES TO THE FINANCIAL STATEMENTS

### 18 Accruals and Deferred Income

	1997 £m	1996 £m
<b>Deferred Income</b>		
At 1 April	24.2	24.5
Additions	0.4	0.5
Released to profit and loss account	(1.2)	(0.8)
At 31 March	23.4	24.2
Amount to be released within one year	(1.0)	(1.0)
Amount to be released after more than one year	22.4	23.2

### 19 Called-up Share Capital

	1997 £m	1996 £m
Authorised, allotted, called-up and fully paid:- 365,950,000 Ordinary shares of £1 each	365.9	365.9

### 20 Reserves

	Profit and loss account £m
At 1 April 1996	546.3
Retained profit for year	49.1
Goodwill on purchase of business undertaking (note 26)	(1.4)
At 31 March 1997	594.0

The cumulative value of goodwill at 31 March 1997 resulting from acquisitions, which has been written off against reserves, is £1.4m (1996 nil).

## NOTES TO THE FINANCIAL STATEMENTS

### 21 Statement of Movements in Shareholders' Funds

	1997 £m	1996 £m
Profit on ordinary activities after taxation	105.2	105.0
Dividends	(56.1)	(46.5)
Goodwill written off	(1.4)	-
Shareholders' Funds (equity interest) :-		
Addition for year	47.7	58.5
At 1 April	912.2	853.7
At 31 March	959.9	912.2

### 22 Loans and Other Borrowings

	1997 £m	1996 £m
<b>Loans</b>		
Repayable:-		
After five years	212.0	224.1
Between two and five years	34.4	32.6
Between one and two years	10.3	8.9
Falling due after more than one year (note 16)	256.7	265.6
Falling due within one year (note 15)	9.3	10.1
	266.0	275.7

Loans are denominated in sterling and are repayable over the period 1997-2012. The rates of interest payable on loans, any part of which is due after five years, vary from 4% to 11%.

	1997 £m	1996 £m
<b>Obligations under finance leases</b>		
Repayable:-		
After five years	118.4	113.4
Between two and five years	5.4	6.9
Between one and two years	9.4	4.3
Falling due after more than one year (note 16)	133.2	124.6
Falling due within one year (note 15)	13.3	13.4
	146.5	138.0

Included above are finance charges arising on obligations under finance leases totalling £14.9m (1996 £9.4m), of which £8.7m (1996 £9.4m) is repayable within one year.

## NOTES TO THE FINANCIAL STATEMENTS

### 22 Loans and Other Borrowings (Continued)

Obligations under finance leases of £150.0m (1996 £150.0m) are not included above because cash of an equal amount has been deposited with the lessor's bank group. The Company can insist that these funds are utilised to meet the finance lease rentals as they fall due. Such cash deposits are likewise not shown on the balance sheet.

The Company has no present plans to withdraw the deposits, but, in the event that some, or all, of the deposits were withdrawn, an equivalent amount of finance lease obligations would require to be reinstated as a liability in the balance sheet.

#### Loans and obligations under finance leases

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

	1997 £m	1996 £m
Loans	265.6	265.6
Obligations under finance leases	133.6	122.4
	<hr/> 399.2	<hr/> 388.0

### 23 Financial Instruments and Risk Management

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

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

The Board approves treasury policies and procedures relating to the use of financial instruments. Trading for speculative purposes is not permitted. Major transactions are individually approved by the Board.

The principal interest rate swap agreements outstanding at 31 March 1997 covered a notional amount of £62.8m and aligned the basis of interest receivable from current asset investments with that payable on certain finance lease obligations. During the year the Company entered into a series of interest rate swaps, subsequently closed, based on a notional principal of £150.0m and with maturities ranging to 2001/03.

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

# NOTES TO THE FINANCIAL STATEMENTS

## 24 Pensions

The Company's employees are eligible to participate in funded defined benefit schemes, operated by the parent Company. Contributions are based upon pension costs across the South West Water Plc group as a whole.

The net pensions credit for the Company for the year ended 31 March 1997 was £2.4m (1996 £1.5m) before the exceptional item, as a result of significant surpluses revealed in the last actuarial valuation. Full details of the valuations and the actuarial assumptions are given in the financial statements of South West Water Plc.

Pension prepayments included as debtors of the Company amount to £6.8m (1996 £4.2m), representing the accumulated difference between the Company pension credits and employer contributions paid.

## 25 Commitments and Contingent Liabilities

	1997 £m	1996 £m
<b>Capital commitments</b>		
Contracted but not provided	66.3	19.7
<b>Commitments under operating leases</b>		
Rentals during the year following the balance sheet date		
Land and buildings leases expiring:-		
after five years	1.4	1.6
<b>Contingent Liabilities</b>		
Contractors' claims on capital schemes	16.7	18.8
Guarantee of borrowings by the parent undertaking	150.0	150.0
	166.7	168.8

## 26 Acquisitions

On 16 October 1996 the Company acquired the business of an unincorporated hydro electric generation unit from National Power Plc for a cash consideration of £0.4m. Goodwill on acquisition amounting to £1.4m has been written off to reserves. The post acquisition results and cash flows of the business were not material. The fair value of the net liabilities acquired is shown in note 27 (e).

## NOTES TO THE FINANCIAL STATEMENTS

### 27 Notes to the Cash Flow Statement

#### (a) Reconciliation of Operating Profit to Net Cash Inflow from Operating Activities

	1997 £m	1996 £m
Operating profit	125.4	125.5
Depreciation charge	26.8	24.1
Deferred income released to profits	(1.2)	(0.8)
Decrease in provisions for liabilities and charges	(2.9)	(21.1)
Increase in stocks	(0.7)	(1.2)
Increase in debtors (amounts falling due within and over one year)	(9.2)	(4.6)
Increase in creditors (amounts falling due within and over one year)	4.1	2.9
Profit on disposal of tangible fixed assets	(0.2)	-
<b>Net cash inflow from operating activities</b>	<b>142.1</b>	<b>124.8</b>

Cash outflows from operating activities accounted for as exceptional items, included above, were £3.2m (1996 £11.7m). These relate to the utilisation of the restructuring provision established in 1995.

#### (b) Analysis of Cash Flows for Headings Netted in the Cash Flow Statement

	1997 £m	1996 £m
<b>(i) Returns on Investments and Servicing of Finance</b>		
Interest received	19.6	20.2
Interest paid	(27.6)	(30.9)
Interest element of finance lease obligation	(4.0)	(4.4)
Costs associated with defeased lease facility (note 5)	(0.6)	-
<b>Net cash outflow for returns on investments and servicing of finance</b>	<b>(12.6)</b>	<b>(15.1)</b>
	<b>1997 £m</b>	<b>1996 £m</b>
<b>(ii) Capital Expenditure</b>		
Purchase of tangible fixed assets	(143.9)	(100.1)
Grants and contributions:-		
Infrastructure assets	3.7	3.2
Non-infrastructure assets	0.6	0.7
Receipts from disposal of tangible fixed assets	1.1	0.5
<b>Net cash outflow for capital expenditure</b>	<b>(138.5)</b>	<b>(95.7)</b>
	<b>1997 £m</b>	<b>1996 £m</b>
<b>(iii) Acquisitions</b>		
Purchase of business undertaking	(0.4)	-

## NOTES TO THE FINANCIAL STATEMENTS

### 27 Notes to the Cash Flow Statement (Continued)

	1997 £m	1996 £m
(iv) Management of Liquid Resources		
Purchase of current asset investments	(251.5)	(349.4)
Sale of current asset investments	313.2	536.9
Net cash inflow from management of liquid resources	61.7	187.5

Liquid resources comprise readily disposable current asset investments.

	1997 £m	1996 £m
(v) Financing		
Debt due within one year (other than bank overdrafts): reduction	(7.8)	(4.6)
Cash deposited against finance lease obligations (note 22)	-	(150.0)
Cash placed on deposit with financial institutions (note 5)	(52.7)	-
Defeased finance lease drawdowns (note 5)	65.4	-
Other finance lease drawdowns	7.4	10.6
Capital element of finance lease rental payments	(4.3)	(4.3)
Net cash inflow/(outflow) from financing	8.0	(148.3)

### (c) Analysis of Net Debt

	At 1 April 1996 £m	Cash flow £m	Non-cash movements £m	At 31 March 1997 £m
Cash at bank and in hand	0.3	(0.1)	-	0.2
Current asset investments:-				
overnight deposits	0.6	2.9	-	3.5
Bank overdrafts	(2.3)	2.0	-	(0.3)
	(1.4)	4.8	-	3.4
Debt due within one year (other than bank overdrafts)	(7.8)	7.8	(9.0)	(9.0)
Debt due after more than one year	(115.6)	-	8.9	(106.7)
Finance lease obligations	(138.0)	(15.8)	7.3	(146.5)
Amounts owed to parent undertaking	(150.0)	-	-	(150.0)
	(411.4)	(8.0)	7.2	(412.2)
Current asset investments:-				
other than overnight deposits	172.2	(61.7)	-	110.5
	(240.6)	(64.9)	7.2	(298.3)

Non-cash movements include transfers between categories of debt for changing maturities and the in-substance settlement of finance lease obligations, £12.7m (note 5).

## NOTES TO THE FINANCIAL STATEMENTS

### 27 Notes to The Cash Flow Statement (Continued)

#### (d) Reconciliation of Net Cash Flow to Movement in Net Debt

	1997 £m	1996 £m
<b>Increase in cash in the period</b>	<b>4.8</b>	<b>6.4</b>
Cash (inflow)/outflow from (increase)/decrease in debt and finance leasing	(8.0)	148.3
Cash inflow from decrease in liquid resources	(61.7)	(187.5)
	<hr/>	<hr/>
<b>Change in net debt arising from cash flows</b>	<b>(64.9)</b>	<b>(32.8)</b>
Non-cash movements:-		
In-substance settlement of finance lease obligations	12.7	-
Other	(5.5)	(1.2)
	<hr/>	<hr/>
<b>Increase in net debt in the year</b>	<b>(57.7)</b>	<b>(34.0)</b>
	<hr/>	<hr/>
<b>Net debt at 1 April</b>	<b>(240.6)</b>	<b>(206.6)</b>
	<hr/>	<hr/>
<b>Net debt at 31 March</b>	<b>(298.3)</b>	<b>(240.6)</b>
	<hr/>	<hr/>

#### (e) Purchase of a Business Undertaking:-

	1997 £m	1996 £m
<b>Net liabilities acquired:-</b>		
Provisions for liabilities and charges	(1.0)	-
Goodwill	1.4	-
	<hr/>	<hr/>
<b>Total, satisfied by cash consideration</b>	<b>0.4</b>	<b>-</b>
	<hr/>	<hr/>

### 28 Related Party Transactions

Under FRS8, transactions with other members of the South West Water Plc group are not required to be set out herein since the Company is a wholly owned subsidiary within that group.

### 29 Parent Company

The parent Company, and ultimate controlling party, is South West Water Plc which is registered in England. Group financial statements are included in the Annual Report of South West Water Plc which is available from Peninsula House, Rydon Lane, Exeter, EX2 7HR.