Annual report and financial statements 2009

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SOUTH WEST WATER

SOUTH WEST WATER

ANNUAL REPORT
AND
FINANCIAL STATEMENTS 2009

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

ANNUAL REPORT AND FINANCIAL STATEMENTS 2009

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CHIEF EXECUTIVE'S REVIEW

Against an uncertain global economic background, South West Water has had a strong performance this year, improving customer service, delivering further operational efficiency and a sound financial performance.

South West Water has a clear 25 year vision 'Pure Water, Pure Service and Pure Environment', which was at the heart of our Strategic Direction Statement published in December 2007. Underpinning the vision is the strategy of striking the right balance between investing to improve our services, financeability and, importantly, customer affordability.

It is now over a year since the company's vision was launched. The vision and strategy have been used to focus delivery in what has been the penultimate year in this regulatory cycle 2005-2010 and as the basis for our detailed plans which have been developed for the next five-year cycle 2010-2015.

Significant preparation has been undertaken this financial year ahead of the Price Determination due in November 2009 by Ofwat for the 2010-2015 regulatory period:

- in August 2008 we submitted our draft business plan detailing targeted improvements to customer services and a modest number of water and environmental quality projects
- in April 2009, following the feedback from the public consultation on our draft plan and a comprehensive review of our proposals, we submitted our Final Business Plan to Ofwat.

Given the current economic conditions, our strategy of striking the right balance is key; our plans are mindful of the impact further investment in our assets has on the level of bills when customers are least able to afford higher charges. We have also ensured that overall funding requirements are minimised at a time when the cost of new financing is expected to be at a premium. We have targeted our plan to reflect customer priorities, whilst challenging ourselves to deliver increased efficiencies.

This strategy has also worked well during this financial year. South West Water has made excellent progress by:

- improving service to customers, tackling affordability issues and levels of customer debt
- completing required investment in our assets and infrastructure for the benefit of our customers and the environment
- delivering further operating efficiencies
- ensuring there is efficient financing in place secured into the next 2010-2015 regulatory period.

Some of our key operational results and achievements in last 12 months have demonstrated the benefits of our focused approach through our 'Pure Water, Pure Service and Pure Environment' vision.

Pure Water

Drinking water quality overall compliance for the calendar year 2008, as monitored by the Drinking Water Inspectorate (DWI), maintained a consistently high percentage of 99.96%.

This has been our 12th consecutive year without water restrictions. The company has put in place a comprehensive strategy to help ensure a continued secure supply of water for the region. During 2008 the use of two new reservoirs for Cornwall was secured. The reservoirs were previously disused china clay pits; a much more cost-effective solution compared with building new reservoirs. Both lakes are on Bodmin Moor and will become the fourth and fifth largest in South West Water's service area.

CHIEF EXECUTIVE'S REVIEW (Continued)

In 2008/09, South West Water abstracted 163,792 Megalitres (Ml) of raw water from its 82 licensed abstraction locations which have a total licensed volume of 388,366 Ml. The abstraction sources are reservoirs and rivers, accounting for 93% of supplies, with 7% drawn from groundwater aquifers.

Despite a very cold winter causing a series of burst pipes both for customers and for our own network, we achieved our target leakage performance of 84 Megalitres per day (Ml/d). We have achieved or beaten our leakage targets every year since targets were introduced by Ofwat in 1999/00. Our leakage remains amongst the lowest in the industry at 5.6 cubic metres per kilometre of pipe per day.

One of the most significant elements of the current investment programme is water mains rehabilitation. A further 363km of water mains were replaced or relined during the year as part of the company's ongoing 'Putting the Sparkle Back into Your Water' programme, agreed with the DWI for completion by 2010. Four key programme milestones have now been successfully achieved. Work to meet the fifth and final milestone is underway and is due to be completed this year with a significant project in Exeter finishing ahead of schedule in 2008.

Pure Service

Customers are benefiting from our focused approach to customer service. There has been an increase in first-time resolution of operational issues for customers. This has led to a reduction in the number of customer complaints received.

With the current adverse economic conditions, South West Water has further developed its range of measures to assist those customers with affordability issues:

- 'WaterCare', a ground-breaking new customer care programme, was launched early in 2007 targeted at helping those most in need to pay their bills. Customers are advised on how to manage better both their water use and household budget, including claiming all the benefits to which they are entitled. Some customers benefit from moving on to a special payment plan which enables them to make regular affordable payments, thereby reducing the company's outstanding debtors. In 2008/09 the number of customers receiving tangible benefits through the programme has doubled

- an innovative water tariff trial was approved by Ofwat at the beginning of 2009. The tariff, being trialled with a random sample of 1,000 customers, will incentivise customers to use less water by pricing water for essential use 27% lower than the standard tariff and for non-essential at a premium rate. This will enable customers who conserve their water to make savings on their annual bills. We will review the data obtained at the end of the three-year trial period.

Pure Environment

Our continued focus on the proactive maintenance and operation of our assets has resulted in a step change improvement in waste water-related pollution incidents. This has been our 10th consecutive year without a Category 1 incident, and the number of Category 2 and 3 incidents has almost halved.

A new sewage treatment works for Sennen Cove and Porthcurno in West Cornwall was formally opened by Andrew George MP in May 2009, completing a significant final piece in South West Water's 'Clean Sweep' waste water programme which has transformed the quality of the coastal and estuarine environment of the South West.

CHIEF EXECUTIVE'S REVIEW (Continued)

Situated close to Britain's most westerly point, the works have been built to blend in within the surrounding Area of Outstanding Natural Beauty which is popular with residents, visitors, surfers and swimmers. The new sewage treatment works has ended the discharge of untreated sewage directly into the sea.

Compliance with the mandatory EU bathing water standard was 93.1%, a marked contrast to a decade ago when compliance was only 47.5%. Although lower than the 2007 result of 97.9%, in the summer of 2008 the South West had in excess of 150% more rainfall than normal. During May to September (the bathing water season) the region also had more rain than anywhere else in England and Wales with the wet weather washing agricultural and other surface water pollutants into the sea. The Environment Agency has confirmed that none of the bathing water failures was attributed to South West Water's operations. In 2008, all but 10 of the region's 144 bathing waters achieved the EU mandatory standard and 72.2% achieved the more stringent EU Guideline standard (78.3% in 2007).

The percentage of population equivalent served by sanitary-compliant waste water treatment works in the calendar year 2008 was 99.54% (99.73% in 2007).

This performance contributes to South West Water's region having the highest percentage length of high quality rivers in England.

In November 2008, South West Water overcame strong competition to claim an International Gold Green Apple Award for Environmental best practice. The award was presented by the Green Organisation in recognition of the efforts South West Water is making to help businesses save water and money.

To support the 'Pure' vision, South West Water is maintaining momentum in delivering further operational efficiencies and creating a platform to enable more improvements to operational and customer service performance:

- due to the continuing pressure of rising energy prices, energy management is increasingly important and we have been driving a major programme of energy efficiency throughout our operations. During 2008/09 the 'Megawatt Challenge' has focused employees' attention on mitigating energy use
- continued investment has been made this year in our infrastructure to move the organisation towards a more centralised operational structure employing increased levels of automation and remote working
- as part of our ongoing drive for service improvement and operational efficiency, a significant programme of organisational restructuring across the business has been ongoing through the year costing £5m
- we continue to work with our service partners, including our extended supply chain, to deliver an improved service to customers. This year we have delivered a specific project on the clean water distribution network which has led to more innovative ways of working
- we achieved the Investor in People (IIP) Silver Status in March 2009 as part of our IIP reaccreditation, valid for a period of three years.

This has been a successful year for South West Water. Significant improvements have been made to deliver service excellence and achieve new operational efficiencies. It is a testimony to the professionalism of our employees that we have maintained the momentum for a step change in customer service whilst delivering significant change across the business.

CHIEF EXECUTIVE'S REVIEW (Continued)

Financial Review

South West Water delivered further value for shareholders through a strong set of operational, financial and regulatory results whilst improving customer service.

Operating profit (before restructuring costs of £5.0m) up by £6.7m (3.6%) to £191.8m, despite a £9.8m (4.2%) fall in measured demand.

The company's revenue increased by £10.7m to £432.0m:

- increases: tariff increases approved by Ofwat (£27.7m) and 7,035 new customer connections (£3.6m).
- decreases: customers switching to metered tariffs (£9.5m) and a 4.2% fall in measured demand (£9.8m).

66% (2008: 62%) of our domestic customers now receive a metered supply.

Operating costs, before restructuring costs and excluding depreciation, reduced by £0.8 million to £150.4m:

- Efficiency savings were £3.9m in the year; a £15.1m cumulative base cost reduction since 2005
- Additional costs from new capital schemes were £0.8m
- Inflation was £5.6m
- Other costs decreased by £3.3m including income from property disposals
- The company is on track to deliver the demanding efficiency targets set by Ofwat at the last price determination over the 2005-2010 period, with operating cost efficiencies being delivered ahead of schedule.

Restructuring costs were £5.0m in 2008/09 with a further £5.0m expected to be provided in 2009/10.

Despite the downturn in the property market, property disposals in the year contributed £1.7m to profit (2008: £0.1m loss).

Doubtful debt charge rose by £0.7m from £5.7m to £6.4m. The average percentage rate of cash collections of debt from customers is in line with previous years.

Tax charge increased by £40.7m to £51.3m, mainly due to a deferred tax charge of £19.1m relating to the abolition of industrial building allowances following the credit to deferred tax last year of £20.5m in respect of the reduction in the rate of corporation tax.

Capital expenditure was £147.8 million of which £101m was invested in water supply improvements, including water treatment and water mains rehabilitation.

Further contributions totalling £28.8m were made to the defined benefit pension schemes.

South West Water has committed funding in place to at least 2011.

Further analysis of the financial results achieved in the year is presented within the Business Review on page 8.

C Loughlin
Chief Executive

DIRECTORS, REGISTERED OFFICE AND AUDITORS

Chairman	K G Harvey
Chief Executive	C Loughlin
Operations Director	S C Bird
Finance Director	S J Davy
Customer Service Director	M S Read
Secretary	K D Woodier
Registered Office	Peninsula House Rydon Lane Exeter EX2 7HR
Auditors	PricewaterhouseCoopers LLP Chartered Accountants 31 Great George Street Bristol BS1 5QD

NOTICE OF MEETING

The twentieth Annual General Meeting of South West Water Limited will be held at Peninsula House, Rydon Lane, Exeter on 21 July 2009 at 10.00 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 2009.
Resolution 2	To re-appoint PricewaterhouseCoopers LLP as auditors of the Company to hold office until the conclusion of the next general meeting at which accounts are laid before the Company and to authorise the Directors to fix their remuneration.

By Order of the Board

K D Woodier
Secretary
Peninsula House
Rydon Lane
Exeter EX2 7HR

26 June 2009

For the purposes of the appointment of auditors (Resolution 2 in this notice), Special notice in accordance with Sections 379 and 388(3), Companies Act 1985 of the intention to move Resolution 2 as an ordinary resolution has been received by the Company.

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 for the year ended 31 March 2009.

PRINCIPAL ACTIVITIES

The principal activities of the Company are the provision of water and sewerage services. The Company holds the water and sewerage appointments for Cornwall and Devon and small areas of Somerset and Dorset.

BUSINESS REVIEW

Financial Results

South West Water's revenues rose 2.5% to £432.0m as a result of tariff increases and new connections, offset by the effects of customers switching and lower demand.

Approved tariff increases, including the 1.7% K factor, amounted to £27.7m and 7,035 new customer connections contributed £3.6m of additional turnover.

The effect of meter option switchers was to reduce turnover by £9.5m, benefiting 23,162 customers (2008 28,528 customers) by, on average, about £372 each (2008 £350 each). 66% (2008: 62%) of South West Water's domestic customers are now metered.

The impact of the 4.2% decrease in measured demand for the year was to reduce turnover by £9.8m compared to last year. Demand has been impacted by wet weather in 2008, coupled with underlying base demand reductions as seen in previous years.

Operating profit rose by 3.1% to £186.8m. Operating profit before restructuring costs of £5.0m (2008 £4.0m) rose by 3.6.% to £191.8m.

Operating costs, excluding depreciation, increased by £0.2m to £155.4m:

- Efficiency savings £3.9m in year; a £15.1m cumulative cost base reduction since 2005
- Additional costs from new capital schemes £0.8m
- Inflation £5.6m
- Restructuring costs £1.0m increase from £4.0m to £5.0m
- Other costs decreased by £3.3m including income from property disposals of £1.7m

The depreciation charge increased by £4.8m to £89.8m due to the capital programme.

The bad debt charge increased by £0.7m from £5.7m to £6.4m. An additional £1.2m (2008 £0.7m) was excluded from turnover under IFRS as being judged uncollectible). Overall the debt collection position is assessed as stable with improved collections from recent billing offsetting slower collection of older debt.

The target of £13m per annum of efficiency cost savings by the end of the K4 period has been achieved ahead of schedule. We are implementing detailed plans targeting outperformance of the operating cost efficiency targets set by Ofwat for the period up to 2010. Efficiency projects are under way to create a platform to enable further improvements to operational and customer service performance. South West Water is continuing to drive and deliver efficiencies through investment in infrastructure to move the organisation towards a more centralised operational structure employing increased levels of automation and remote working.

REPORT OF THE DIRECTORS (continued)

The Company has also implemented a significant programme of organisational restructuring across the business which has cost £9m to date, of which £5m was incurred in 2008/09; it is expected that a further £5m will be provided in 2009/10. To support operational and service improvements, a number of employee development programmes have been completed in the year.

Investment

Capital investment was £147.8m (2008 £169.6m). £101m was invested in water supply improvements including water mains renovation and water treatment works enhancement. Continued high levels of investment in the £240m water mains renovation programme to replace or reline water mains are a key element during the current K4 period.

Sewerage business investment was predominantly on small maintenance and improvement projects and totalled £47m for the year.

Targeted investment in capital maintenance programmes ensured that serviceability was assessed as 'stable' for all the company's areas of service.

Financing

Net interest payable increased by £5.0m to £69.9m from £64.9m. Net debt at 31 March 2009 was £1,571.1m compared to £1,455.2m at 31 March 2008, an increase of £115.9m. The main reasons for the increase in net debt were the capital programme, increased payments to the pension fund and the payment of a back-log of dividends following a share capital reduction exercise (section below on Dividends and Reserves).

The main factors leading to the increase in net interest payable were an increase of £3.5m in respect of the non-cash charge for pension liabilities and £2.8m relating to interest rate swaps. Overall movements in interest rates were beneficial to the company.

At 31 March 2009 loans and finance lease obligations were £1,806m and the company held cash and deposits of £235m.

Despite the general shortage of funds in the debt markets which has made both refinancing and the availability of new facilities more challenging, the following financing initiatives were implemented during the financial year 2008/09:

- £100m 15 year EIB funding
- £25m finance lease facility

Pennon Group and the company have robust treasury policies in place. These include policies that there are always pre-drawn or committed facilities to cover at least one year's estimated cashflow and that no more than 20% of borrowing matures in any one year. The Treasury function seeks to ensure that sufficient funding is available to meet foreseeable needs, maintain reasonable headroom for contingencies and manage interest rate risk. It operates within policies approved by the Board and does not undertake any speculative trading activity. Treasury policies and risk management are described in more detail on pages 32 to 34.

Funding facilities are in place to cover both medium and long term requirements, including loans from the European Investment Bank. In addition, short term facilities exist with a range of financial institutions. Committed funding is in place to cover the company's requirements until 2011.

Short term facilities in place at 31 March 2009 and not utilised totalled £124.0m (2008 £135.0m). In addition the company has short-term uncommitted bank facilities of £80.0m (2008 £80.0m).

REPORT OF THE DIRECTORS (continued)

Derivatives, usually interest rate swaps, are used to manage the mix of fixed and floating rate debt. The notional principal amounts of the interest rate swaps are used to determine settlement under those swaps and do not, therefore, constitute an exposure for the company.

The balance sheet value of derivatives moved from an overall asset position of £3.0m at 31 March 2008 to an overall liability position of £18.5m at 31 March 2009 due to the reduction of floating interest rates in the year. The movement is taken to reserves through the Statement of Recognised Income and Expense.

South West Water has approximately 25% of its debt index-linked to 2041-2057.

South West Water has entered into covenants with lenders. Whilst terms vary, these typically provide for limits on gearing (primarily based on Regulatory Capital Value) and interest cover.

Redemption penalties included in the facility documentation can be invoked if debt facilities are redeemed early. The redemption penalties vary in each facility.

The financial covenants included in the company's debt facilities are monitored on a regular basis. The financial covenants accepted by the company include a provision to re-test the covenants applying frozen GAAP accounting standards. This is to protect the company from changes in accounting standards that may have a detrimental impact on the financial covenant testing methodology.

South West Water's debt to Regulatory Capital Value (RCV) was 63.8% at 31March 2009 2007/08 60.4%), within Ofwat's 'optimum range' of 55% - 65%.

The Board regularly monitors the Company's expected financial requirements for the next 12 months. These will be met from existing cash balances, loan facilities and cash flows for the coming year.

The Company has considerable financial resources and operates in a relatively stable, regulated business environment. Consequently the Directors believe that the Company is well positioned to manage its business risks successfully despite the current uncertain general economic outlook.

Going concern

Having considered the company's funding position and financial projections, the Directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the financial statements.

Dividends and reserves

The company undertook a share capital reduction exercise in accordance with the Companies Act 2006 in 2008/09 which created sufficient reserves to pay a backlog of dividends that had built up. (The company's ability to pay dividends had previously been limited by the balance on distributable reserves as reported in its statutory accounts, which had been reduced by the requirement of International Financial Reporting Standards for deferred tax to be on an undiscounted basis).

Dividends totalling £103.8m (2008 £68.7m) were paid to the parent undertaking, comprising £48.8m relating to 2007/08, £51.4m relating to 2008/09 and £3.6m in respect of 2006/07. These dividends were calculated with reference to the projections in the Final Determination.

REPORT OF THE DIRECTORS (continued)

The Company has established a dividend policy, which involves the following components:

- a sustainable level of base dividend growth, determined by a number of factors including the shareholder's investment and the cost of capital.
- a further level of growth funded by efficiency out-performance.
- consistency with the assumptions made by Ofwat in setting prices for the K4 period.

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

Principal risks and uncertainties

The following are identified as the principal risks and uncertainties facing the Company:

Risk	Mitigation
Tighter price controls over the revenue of the company's regulated	South West Water has met Ofwat's efficiency expectations in the last two Periodic Review periods and is on track to meet them in the current period.
Failure to deliver the capital investment programme	The company has a track record of delivering its capital programme in accordance with regulatory requirements. The current capital programme is on track and progress is regularly monitored and reviewed.
The company may be unable to raise sufficient funds to finance its functions	Pennon Group and the company have robust treasury policies in place. These include policies that there are always pre-drawn or committed facilities to cover at least one year's estimated cashflow and that no more than 20% of borrowing matures in any one year. Treasury policies and risk management are described in more detail on pages 32 to 35.
Failure to deliver operating cost savings implicit in the regulatory review	In line with its track record, the company remains confident of delivering the assumed operating cost savings. A major restructuring programme is currently being implemented.
Environmental regulations and quality standards could increase the company's costs	These issues are addressed through the five year regulatory review mechanism.
Climate change	The company has plans ready and will adapt the way it conducts its business to respond effectively to the hotter, drier summers and wetter winters which are anticipated.

REPORT OF THE DIRECTORS (continued)

Risk	**Mitigation**
Contamination to water supplies	The Company has established procedures and controls in place, as well as contingency plans and incident management procedures. It also maintains insurance policies in relation to these risks, although there can be no assurance that all or any of the costs associated with these risks would be covered or that coverage will continue to be available in the future.
Non-recovery of customer debt	In addition to existing strategies, South West Water has implemented new initiatives to improve and secure cash collection, including the use of property charging orders. Stretching debt and collection targets – with incentives – have been agreed with the customer service contractor. The accounts of major customers are kept under close review. Provision was made in the last Periodic Review for companies to make an application for an Interim Determination in the event of bad debts being significantly above the amount allowed by the water regulator.
Energy cost volatility	South West Water mitigates rising energy costs through careful system operation, by maximising renewable energy generation and by purchasing and using all forms of energy in the most efficient way.
Pension costs may increase due to factors outside the company's control	All defined benefit schemes have been closed to new entrants and replaced by defined contribution arrangements.
Poor investment performance may affect the defined benefit scheme assets and increases the pension scheme deficit	Employee and employer contributions are also kept under review and have been increased. Further contributions of £28.8m were made in the year. Pension trustees keep investment policy under review and use professional investment advisers
Water resource adequacy	The company has a number of schemes in place to maintain water resources (such as pumped storage for certain reservoirs) and promotes conservation measures. In particular, South West Water prepares a new Water Resources Plan every five years and reviews it annually for a range of climate change and demand scenarios. The Water Resources Plan indicates that no new reservoirs are required before the planning horizon of 2035. However, investment is needed to develop the overall trunk main infrastructure, to expand treatment capacity and to enhance certain pumped storage facilities.

REPORT OF THE DIRECTORS (continued)

Risk	Mitigation
Operational failures	The company is able to monitor its significant assets by automated and remote operation and has routine controls and operating procedures in place that are constantly kept under review. Asset management techniques are employed to pre-empt the failure of assets.
Reduced revenue from falling customer demand for water	The reduced demand experienced in the current five year regulatory period will be taken into account by the regulator in setting a baseline turnover level for the next five year period. The water regulator is proposing a form of revenue cap regulation from 2010, which would allow water companies to recover a shortfall in income for a five year regulatory period in the next period.
Meter option take-up greater than forecast, resulting in reduced revenues	An interim Determination may be used to fully or partially recover revenue losses if they exceed the prescribed materiality threshold.
Financial loss arising from the insolvency of a major supplier or contractor	The company does not have material exposure to payment before receipt of goods and services. The company uses a third party credit monitoring service for changes to major suppliers' financial status and creditworthiness to supplement an annual risk review of key and strategic suppliers.
Impact of competition in the industry	South West Water is assessing the implications of the Cave Commission report published in April 2009 in order to prepare for an extension of competition for non-household customers in the water industry. Legislation will be required for any further extension of competition in the water and sewerage markets.

The Directors have established a formal framework for the identification and monitoring of both operational and financial risks arising from the Company's activities. The effectiveness of this framework is regularly reviewed by the Board.

REPORT OF THE DIRECTORS (continued)

Key Performance Indicators (KPI's) – Pure Water

Drinking Water Compliance

During 2008, South West Water maintained its high level of overall compliance with the drinking water quality regulations with 99.96% of its regulatory tests meeting the required standards, a consistently high performance standard.

Key Performance Indicators – Pure Service

Overall Performance Assessment

The Overall Performance Assessment (OPA) index is maintained by Ofwat as a comparative tool to measure companies' performance. The OPA is based on performance in areas such as customer service and complaint handling, billing, debt collection, asset serviceability, environmental compliance and quality of drinking water delivered. In 2007/08 South West Water's performance dipped to seventh place amongst the 10 water and sewerage companies (fifth in 2006/07).

Customer Satisfaction Call Handling

In April 2005, Ofwat introduced a new measure for the overall manner in which a customer call was handled. The measure is obtained by quarterly tracking surveys undertaken by an independent company engaged and managed by Ofwat. The data has been averaged for the year to assess a performance trend. For 2008/09 the satisfaction score was 4.5 (2007/08 4.5). The maximum score is 5.0.

Key Performance Indicators – Pure Environment

The Company recognises the importance of its environmental responsibilities, monitors its impact on the environment, and designs and implements policies to reduce any damage that might be caused by its activities. The Company is subject to significant regulation and must comply with the high standards set by the Environment Agency. The Pennon Group has a long established environmental policy, as set out in its annual Corporate Responsibility Report, which does not form part of this Report.

Waste Water Treatment Compliance

The percentage of population equivalent served by sanitary-compliant waste water treatment works in the calendar year 2008 was 99.54% (99.73% in 2007).

This performance contributes to South West Water's region having the highest percentage length of high quality rivers in England.

Incidents and Prosecutions

There were no Category 1 incidents for the 10th year in succession. Three Category 2 (significant pollution) events and 64 Category 3 events were recorded by the Environment Agency in 2008 which were deemed non-compliant with discharge consents. This compares with four Category 2 and 114 Category 3 incidents in 2007. The total number of pollution incidents in 2008 was 92 (2007 166).

During the year the company was convicted on four occasions for environmental offences and fined a total of £28,000 (2007/08: eight convictions and £36,100 in fines).

REPORT OF THE DIRECTORS (continued)

The Company always self-reports incidents it becomes aware of and co-operates fully with any investigation with the relevant regulatory authority. After each pollution incident, including incidents leading to prosecution, the company takes such steps as are necessary to ensure that the incident will not be repeated and also seeks to ensure that lessons learned are widely disseminated throughout the Company.

Bathing Water Performance

Compliance with the mandatory EU bathing water standard was 93.1%, a marked contrast to a decade ago when compliance was only 47.5%. Although lower than the 2007 result of 97.9%, in the summer of 2008 the South West had in excess of 150% more rainfall than normal. During May to September (the bathing water season) the region also had more rain than anywhere else in England and Wales with the wet weather washing agricultural and other surface water pollutants into the sea. The Environment Agency has confirmed that none of the bathing water failures were attributed to South West Water's operations. In 2008, all but 10 of the region's 144 bathing waters achieved the EU mandatory standard and 72.2% achieved the more stringent EU Guideline standard (78.3% in 2007).

Key Performance Indicators – Financial and Business

Growth in Regulatory Capital Value

Regulatory Capital Value (RCV) is the financial base used by Ofwat to allow a rate of return and set prices at each Periodic Review. The RCV at 31 March 2009 amounted to £2.461 billion. This compares with £2.408 billion at 31 March 2008, an increase of 2.2%. This is a lower growth than the previous year because of the movement in year-end RPI being minus 0.4% in 2008/09 compared with positive 3.8% in 2007/08. From 31 March 2005 to 31 March 2010 the company is expecting a 25.7% growth in RCV, the highest percentage increase of any quoted UK water company. Lower values for RPI, the movement on which is one of the elements of the annual uplift in RCV, have led to lower expected growth than that reported last year. The RCV is £78m lower than the estimate made at this time last year because of the year end RPI falling to minus 0.4%

Net debt increased by £115.9m to £1,571.1m, with the gearing ratio in relation to year-end RCV of £2,461m moving to 63.8% from 60.4%.

The RCV for 2009/10 is based upon Ofwat's projections. It was set out in 'Future Water and Sewerage Charges 2005 -10' published in December 2004 and has been adjusted by South West Water's estimates of outturn prices. The growth in RCV adds directly to shareholder value as the allowed return is attributed to South West Water's asset base by the water regulator.

Operating Profit

South West Water achieved an operating profit (before restructuring costs of £5.0m) of £191.8m in 2008/09, up £6.7m from 2007/08.

REPORT OF THE DIRECTORS (continued)

Key Performance Indicators – Health and Safety Performance

The health, safety and welfare of South West Water's employees remain paramount in all its activities. The company has developed a health and safety strategy which focuses on providing strong leadership, engaging with employees, building competence and measuring performance. These principles are promoted by a health and safety steering group comprising a cross section of directors, managers and employee representatives.

Occupational health and safety are key elements of South West Water's risk management and internal control processes. We continue to pursue initiatives to improve further the health and safety of the company's employees through the provision of training and promotion of health and safety.

The total number of accidents has remained stable during the last three years with an average of 113 per annum. An more rigorous system of accident and incident reporting was introduced in 2008. It shows an increase in incidents which it is believed reflects better reporting compared with previous years and a new arrangement whereby all potential reportable dangerous occurrences are provided to the Health and Safety Executive's Reporting Line for advice whenever there is an doubt over classifying an incident as reportable under RIDDOR. Data for 2007 and earlier years has been provided on the previous method of recording, consistent with South West Water's previous June Returns.

Customer, Community and Employees

Customers

South West Water has consulted with customers about its priorities for 2010-2015 and has used their feedback for the development of its customer service improvement plans.

The company leads the industry in the provision of priority services to vulnerable customers and has helped thousands of customers in 2008/09 with reading their meter or by providing extra help in an emergency.

'WaterCare', the company's industry-leading scheme to support customers who have difficulty in paying their bills, completed a second successful year. Since the start of the programme a total of 4,548 customers have been helped with benefit entitlement checks, tariff advice and water-saving measures. The 'WaterCare' programme has been commended by the Government.

Customers are kept informed about our services through 'WaterLevel', our company newspaper, leaflets, the media and our website www.southwestwater.co.uk. Detailed research and consultation has been undertaken with customers and stakeholders in relation to the Periodic Review process.

The company meets regularly with the Consumer Council for Water (CCWater), which champions the interests of water customers. It regularly consults with CCWater and other stakeholders such as pensioners' forums and citizens' advice bureaux, prior to major changes or initiatives.

South West Water's 'Customer Plus' programme is aimed at transforming its customer service and making it amongst the best in the industry. Working with Accenture (South West Water's customer service and billing partner) the company is investing £4 million in improving customer services. The company's monthly customer satisfaction survey shows rising satisfaction with South West Water's customer service.

REPORT OF THE DIRECTORS (continued)

Accenture has made significant steps in transforming billing and contact management in its first year with new systems and processes which include scanning and electronic processing of all incoming customer mail; workflow management; bill production with a specialist subcontractor; and implementing improved reporting, quality management and audit.

Against this background of significant change, service levels have been maintained making for a successful first year and delivering a sound basis for improvements in the future.

The company continues to promote the efficient use of water with advice and practical support for householders and non-domestic customers. As part of the 'WaterCare' programme and to investigate customers' high water consumption queries, 3,088 audits were completed in 2008/09.

South West Water continues to support business customers through water efficiency reviews, waste minimisation projects, providing advice for water management plans and by highlighting opportunities for reduction, re-use or alternative sources of supply.

Business customers continue to have access to a secure online system which tracks and displays consumption on their sites. South West Water's 'Business Accounts Online' also offers a water efficiency calculator with a free water audit. Since the launch of the calculator tool in November 2007, 182 businesses with over 6,200 accounts have registered to use the water efficiency element of the service.

No single customer accounts for more than 1% of revenue.

Community and Sponsorship

South West Water concentrates its sponsorship on community projects and organisations within its service area which are linked to water, benefit the environment or promote youth participation.

Highlights in 2008/09 included the company's sponsorship of the Falmouth Tall Ships Regatta which included South West Water running a competition for young customers enabling five 16 to 18-year-olds win a trip of a lifetime on board one of the tall ships racing to Porto.

For the second year the company also co-sponsored South West Tourism's annual awards and funded the sustainable tourism prize to demonstrate how its 'Clean Sweep' project has helped underpin the renaissance of the region's number one industry since 1989. This proved particularly successful when the winner of the award went on to win first place at national level.

Youth participation projects included sponsoring national junior championships in Cornwall run by the Surf Life Saving Association of Great Britain and the Plymouth-based Drake Trust. The company is proud to continue to support the water industry charity, WaterAid, through sponsorship and many other fund-raising activities. In total, 45 organisations and individuals across the region were sponsored during the year.

Employees

South West Water has developed a clear and coherent strategy concentrating on recruitment, and the development and performance of its employees. The strategy is aimed at supporting the company's 'Pure vision' values enabling the delivery of a high quality service to customers and achievement of operational outputs and cost efficiencies through its employees.

Continuity of the business is vital to its future success and the focus on management and graduate development programmes continues to provide employees with opportunities to develop their managerial and organisational skills. A range of other learning programmes support the development of customer, technical and operational skills.

REPORT OF THE DIRECTORS (continued)

We achieved the 'Investor in People' (IIP) Silver Status, which represents the achievement of a high standard in IIP evidence requirements, in March 2009 as part of our IIP reaccreditation, valid for a period of three years. Particular areas of strength include the company's approach to leadership and succession planning; the production of a new corporate values which employees understand and to which they can relate.

Employee involvement and participation in all aspects of business and organisational change is encouraged and supported through the staff council, and craft and industrial consultative forums.

The Company as a 'good employer' has been introducing a number of 'Family Friendly' policies, which exceed statutory requirements. All employees are entitled to participate in a Pennon Group Sharesave Scheme and a Pennon Group Share Incentive Plan, both of which are all-employee plans where performance conditions do not apply.

The Company remains committed to a non-discriminatory employment policy, making every reasonable effort to ensure that no current or future employee is disadvantaged because of age, gender, religion, colour, ethnic origin, marital status, sexual orientation or disability. In particular, the Company welcomes applications for employment from disabled persons and makes special arrangements and adjustments as necessary to ensure that disabled applicants are treated fairly when attending for interview or for pre-employment aptitude tests. Wherever possible, the opportunity is taken to retrain people who become disabled during their employment in order to maintain their employment within the Company.

Key Relationships

Regulators and others

Relationships with regulators, Government and its agencies, customer representative organisations and its customers are central to South West Water's operations. The Company maintains a continuing dialogue with Ofwat, the Environment Agency and the Drinking Water Inspectorate. It contributes to national policy on developing issues through its membership of Water UK, the industry trade body. The company works with the Consumer Council for Water to ensure that customers' issues and concerns are addressed and a full understanding of the company's activities is maintained.

Procurement and Suppliers

South West Water's procurement strategy is focused on partnering and strategic alliances with 60 key suppliers who account for the large majority of expenditure. Regular meetings are held to manage performance, encourage sustainable business activity and to identify and deliver continuous improvement opportunities for reducing costs further whilst improving performance and service levels.

The company is also in the process of setting up a new 'Alliance' structure for delivery of its 2010 - 2015 capital programme. This will enable the company to work closely with suppliers, particularly small and medium-sized businesses across the South West, ensuring value-for-money for customers and supporting the regional economy.

No supplier (revenue) accounts for more than 4% of the turnover and South West Water sources all its purchases from competitive markets.

REPORT OF THE DIRECTORS (continued)

Payments to suppliers

It is the Company's payment policy for the year ending 31 March 2010 to follow the Code of The Better Payment Practice Group on supplier payments. The Company will agree payment terms with individual suppliers in advance and abide by such terms. Information about the Code may be obtained from The Better Payment Practice Group's website at www.payontime.co.uk. Trade creditors at 31 March 2009 represented 29 days of the amount invoiced by suppliers during the year.

FUTURE DEVELOPMENTS

The key factor affecting the Company's performance for 2009/10 is the Periodic Review completed in December 2004 when Ofwat set water company charges for the years 2005-2010 giving 'K' price increases of 12.5%, 9.8%, 9.8%, 1.7%, 1.4% for 2005-2010 (an average of 6.9% p.a. over the five years). It also determined the investment outputs to be delivered by the Company over this period. The Company is confident that it can deliver the efficiency improvements assumed over this period and deliver the required investment programme.

For the period 2010 to 2015 (K5), the contents of the Final Determination due to be published in November 2009 will be the key factor affecting the company's future performance.

Following submission of the company's Draft Business Plan in August 2008, the company's Final Business Plan was completed and provided to Ofwat on 3 April 2009. Summary information on the final plan is available on the company's website.

Key dates for the current Periodic Review are:

Date	Activity
April 2008	Ofwat published information requirements
April 2008 - May 2008	Companies' draft water resources plans published for consultation
August 2008	Submit and publish draft business plans
August 2008 - January 2009	Public consultation on draft business plans
December 2008	Ofwat publish draft baseline, outputs package and 'menu'
January 2009	Ofwat issue final business plan reporting requirements
April 2009	Submit and publish final business plans
July 2009	Ofwat publish draft Determinations for comments
July - August 2009	Companies publish final water resources plans
November 2009	Ofwat publish final Determinations
January 2010	Decisions made by companies on Determinations
April 2010	New price limits take effect for period 2010 to 2015

DONATIONS

During the year, charitable donations amounting to £7,000 were made (2008 £2,000). No political donations were made.

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.

REPORT OF THE DIRECTORS (continued)

DIRECTORS

The current Directors of the Company are shown on page 6.

None of the Directors held any beneficial interest in the shares of the Company during the year.

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 the Company's business.

PARENT COMPANY

The Company is a wholly owned subsidiary of Pennon Group Plc.

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT AND THE FINANCIAL STATEMENTS

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. The financial statements are required by law to give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state that the financial statements comply with IFRSs as adopted by the European Union;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business, in which case there should be supporting assumptions or qualifications as necessary.

The directors confirm that they have complied with the above requirements in preparing the financial statements.

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

The directors are responsible for the maintenance and integrity of the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

REPORT OF THE DIRECTORS (continued)

STATEMENT AS TO DISCLOSURE OF INFORMATION TO AUDITORS

a) so far as each director is aware, there is no relevant audit information of which the company's auditors are unaware; and

b) they have taken all the steps that he ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

AUDITORS

A resolution to re-appoint PricewaterhouseCoopers LLP as auditors to the Company will be proposed at the annual general meeting. PricewaterhouseCoopers LLP have indicated their willingness to continue as auditors.

ANNUAL GENERAL MEETING

The twentieth annual general meeting will be held at Peninsula House, Rydon Lane, Exeter on 21 July 2009 at 10.00 am.

By Order of the Board

K D Woodier
Secretary
Peninsula House
Rydon Lane
Exeter
EX2 7HR

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SOUTH WEST WATER LIMITED

We have audited the financial statements of South West Water Limited for the year ended 31 March 2009 which comprise the Income Statement, the Balance Sheet, the Cash Flow Statement, the Statement of Recognised Income and Expense and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors

The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

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

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Chief Executive's Review, the Directors' Report and all of the other information listed on the contents page. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) 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 judgments 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.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SOUTH WEST WATER LIMITED (continued)

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the company's affairs as at 31 March 2009 and of its profit and cash flows for the year then ended;

- the financial statements have been properly prepared in accordance with the Companies Act 1985; and

- the information given in the Directors' Report is consistent with the financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Bristol

26 June 2009

Income statement for the year ended 31 March 2009

	Notes	2009 £m	2008 £m
Revenue	5	**432.0**	421.3
Operating costs	6		
Manpower costs (excluding restructuring costs)		**(32.9)**	(34.8)
Raw materials and consumables used		**(13.2)**	(14.0)
Other operating expenses		**(104.3)**	(102.4)
Depreciation		**(89.8)**	(85.0)
Restructuring costs		**(5.0)**	(4.0)
Operating profit		**186.8**	181.1
Interest payable and similar charges	7	**(99.6)**	(94.2)
Interest receivable	7	**29.7**	29.3
Profit before tax		**116.9**	116.2
Tax on ordinary activities	8	**(51.3)**	(10.6)
Profit for the year		**65.6**	105.6

All operating activities are continuing activities

Statement of recognised income and expense for the year ended 31 March 2009

	Notes	2009 £m	2008 £m
Profit for the year		**65.6**	105.6
Actuarial (losses)/gains on defined benefit schemes	24	**(50.6)**	3.9
Cash flow hedges: net fair value losses		**(19.0)**	(11.6)
Tax on items taken directly to / (transferred from) equity	25	**13.9**	(0.9)
Net losses not recognised directly in income statement	29	**(55.7)**	(8.6)
Total recognised income for the year		**9.9**	97.0

The notes on pages 27 - 63 form part of these financial statements

Balance sheet at 31 March 2009

	Notes	2009	2008
Assets		**£m**	£m
Non-current assets			Restated
Property, plant and equipment	12	**2,377.9**	2,323.8
Investment in subsidiary undertakings	15	**3.3**	3.3
Investment in joint venture	15	**0.1**	0.1
Trade and other receivables	14	**1.1**	0.8
Derivative financial instruments	18	**0.2**	3.5
		2,382.6	2,331.5
Current assets			
Inventories	16	**4.1**	4.1
Trade and other receivables	17	**66.5**	77.5
Cash and cash deposits	19	**251.7**	242.3
		322.3	323.9
Liabilities			
Current liabilities			
Borrowings	22	**(55.3)**	(53.4)
Derivative financial instruments	18	**(2.1)**	-
Trade and other payables	20	**(69.4)**	(94.7)
Current tax liabilities	21	**(23.2)**	(26.8)
Provisions for liabilities and charges	26	**(0.3)**	(1.5)
		(150.3)	(176.4)
Net current assets		**172.0**	147.5
Non-current liabilities			
Borrowings	22	**(1,767.5)**	(1,660.9)
Other non-current liabilities	23	**(1.6)**	(1.8)
Derivative financial instruments	18	**(16.6)**	(0.5)
Retirement benefit obligations	24	**(51.4)**	(21.7)
Deferred tax liabilities	25	**(316.9)**	(300.0)
		(2,154.0)	(1,984.9)
Net assets		**400.6**	494.1
Shareholders' equity			
Share capital	27	**150.9**	450.9
Retained earnings and other reserves	29	**249.7**	43.2
Total shareholders' equity		**400.6**	494.1

The notes on pages 27 to 63 form part of these financial statements

The financial statements on pages 24 to 63 were approved by the Board of Directors on 26 June 2009 and were signed on its behalf by:

C. Loughlin
Chief Executive

Cash flow statement for the year ended 31 March 2009

	Notes	2009 £m	2008 £m
Cash flows from operating activities			
Cash generated from operations	30	**231.3**	255.4
Interest paid		**(67.7)**	(73.5)
Tax paid		**(21.8)**	(7.2)
Net cash generated from operating activities		**141.8**	174.7
Cash flows from investing activities			
Interest received		**11.6**	11.4
Receipt of grants and contributions		**1.1**	3.0
Purchase of property, plant and equipment		**(156.9)**	(163.7)
Proceeds from sale of property, plant and equipment		**2.2**	0.2
Net cash used in investing activities		**(142.0)**	(149.1)
Cash flows from financing activities			
Deposit of restricted funds		**(5.9)**	(5.8)
Net proceeds from new borrowing		**100.0**	206.7
Repayment of borrowings		**(14.2)**	(136.3)
Finance lease sale and lease back		**25.4**	100.9
Finance lease principal repayments		**(10.6)**	(12.6)
Dividends paid		**(103.8)**	(68.7)
Loans to parent company repaid		**16.8**	-
Net cash received from financing activities		**7.7**	84.2
Net increase in cash and cash deposits		**7.5**	109.8
Cash and cash deposits at beginning of the year	19	**210.6**	100.8
Cash and cash deposits at end of the year	19	**218.1**	210.6

The notes on pages 27 to 63 form part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1. **General information**

South West Water Limited is a company incorporated in the United Kingdom under the Companies Act 1985. The address of the registered office is given on page 6. The nature of the Company's operations and its principal activities are set out in the Directors' report on page 8.

These financial statements were approved by the Board of Directors on 26 June 2009.

2. **Principal accounting policies**

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented unless otherwise stated.

(a) Basis of preparation

These financial statements have been prepared under the historical cost convention in accordance with International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretation Committee (IFRIC) interpretations, as adopted by the European Union, with those parts of the Companies Act 1985 applicable to companies reporting under IFRS. A summary of the principal accounting policies is set out below, together with an explanation where changes have been made to previous policies on the adoption of new accounting standards in the year.

At the date of approval of these financial statements the following standards and interpretations, which have not been applied in these financial statements, were in issue but not yet effective:

IFRS 8	'Operating segments'
IAS 23	'Borrowing costs' (revised)
IAS 1	'Presentation of financial statements' (revised.
IFRS 2	'Share based payment' (amendment)
IAS27	'Consolidated and separate financial statements' (revised)
IFRS 3	'Business combinations' (revised)
IAS 32	'Financial instruments: presentation' (amendment) and consequential amendments to IAS 1
IFRS 1	'First-time adoption of IFRS' and amendments to IAS 27 'Consolidated and separate financial statements'
-	'Improvements to IFRS'
IAS 39	'Financial instruments: recognition and measurement' (amendment)
IAS 39	'Financial instruments: recognition and measurement' (amendment) and consequential amendments to IFRS 7
IFRIC 12	'Service concession arrangements'
IFRIC 13	'Customer loyalty programmes'
IFRIC 14	'IAS 19 The limit on a defined benefit asset, minimum funding requirements and their interaction'
IFRIC 15	'Agreement for the construction of real estate'
IFRIC 16	'Hedges of a net position in a foreign operation'
IFRIC 17	'Distribution of non-cash assets to owners'
IFRIC 18	' Transfers of assets from Customers'

The presentational impact of these standards and interpretations is being assessed and the Directors expect that the adoption of these standards and interpretations in future periods will have no material impact on the financial statements of the Company.

NOTES TO THE FINANCIAL STATEMENTS

2. **Principal accounting policies (continued)**

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best assessment of the amounts, events or actions, actual results ultimately may differ from those estimates. Details of critical accounting judgements and estimates are set out in note 4.

(b) Basis of consolidation

The Company is exempt under the provisions of section 228 of the Companies Act 1985 from the requirement to produce group financial statements (as amended by section 5 of the Companies Act 1989) as it is a wholly-owned subsidiary of Pennon Group Plc which is registered within the European Economic Area and which itself produces consolidated financial statements. Accordingly consolidated financial statements have not been prepared and the financial information presented is for the Company as an individual undertaking. Group financial statements are included in the Annual Report of Pennon Group Plc which is available from Peninsula House, Rydon Lane, Exeter, EX2 7HR.

(c) Revenue recognition

Revenue comprises charges to customers for water, sewerage and other services excluding value added tax and is derived only from the United Kingdom.

Revenue is not recognised until the service has been provided to the customer.

Revenue relates to charges due in the year, excluding any amounts paid in advance. Revenue for measured charges includes amounts billed plus an estimation of the amounts unbilled at the year end. The accrual for unbilled charges is estimated using a defined methodology reflecting historical consumption, estimated demand trends and current tariffs. Revenue for unmeasured charges is recognised on a time apportioned basis.

Interest income is recognised on a time-proportion basis using the effective interest method.

(d) Property, plant and equipment

i) *Infrastructure assets (being water mains and sewers, impounding and pumped raw water storage reservoirs, dams, pipelines and sea outfalls)*

Infrastructure assets are included at fair value on transition to IFRS and subsequent additions at cost, less accumulated depreciation. Expenditure to increase capacity or enhance infrastructure assets is capitalised where it can be reliably measured and it is probable that incremental future economic benefits will flow to the entity. The cost of day to day servicing of infrastructure components is recognised in the income statement as it arises.

Infrastructure assets are depreciated over their useful economic lives, which are principally as follows :

Dams and impounding reservoirs	200 years
Water mains	40 – 100 years
Sewers	40 – 100 years

NOTES TO THE FINANCIAL STATEMENTS

2. **Principal accounting policies (continued)**

(d) Property, plant and equipment (continued)

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

ii) *Other assets (including properties, over-ground plant and equipment)*

Other assets are included at cost less accumulated depreciation.

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

Freehold buildings	30 – 60 years
Leasehold buildings	Over the period of the lease
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.

The cost of assets includes directly attributable labour and overhead costs which are incremental to the Company.

Asset lives and residual values are reviewed annually.

(e) Grants and contributions

Grants and contributions receivable in respect of property, plant and equipment are deducted from the cost of those assets.

Grants and contributions receivable in respect of expenditure charged against profits in the year have been included in the income statement.

(f) Leased assets

Assets held under finance leases are included in the balance sheet as property, plant and equipment 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 borrowings. The interest element of the rental costs 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.

(g) Inventories

Inventories and work in progress is stated at the lower of cost and net realisable value.

(h) Cash and cash deposits
Cash and cash deposits comprise cash in hand, short-term deposits held at banks and other short-term highly liquid deposits subject to insignificant risk of changes in value. Bank overdrafts are shown within current borrowings.

NOTES TO THE FINANCIAL STATEMENTS

2. **Principal accounting policies (continued)**

(i) Derivatives and other financial instruments

The Company classifies its financial instruments in the following categories:
i) *Loans and receivables*

All loans and borrowings are initially recognised at cost, being the net fair value of the consideration received. Following initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost.

Gains and losses are recognised in the income statement when the instruments are derecognised or impaired. Premiums, discounts and other costs and fees are recognised in the income statement through the amortisation process.

Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

ii) *Derivative financial instruments*

The Company uses derivative financial instruments, principally interest rate swaps, to hedge its risks associated with interest rate fluctuations. Such derivative instruments are initially recorded at cost and subsequently re-measured at fair value for the reported balance sheet.

The gain or loss on re-measurement is taken to the income statement except for cash flow hedges that meet the conditions for hedge accounting, when the portion of the gain or loss on the hedging instrument which is determined to be an effective hedge is recognised directly in equity, and the ineffective portion in the income statement. The gains or losses deferred in equity in this way are subsequently recognised in the income statement in the same period in which the hedged underlying transaction or firm commitment is recognised in the income statement.

In order to qualify for hedge accounting, the Company is required to document in advance the relationship between the item being hedged and the hedging instrument. The Company is also required to document and demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an on-going basis. This effectiveness testing is re-performed at the end of each reporting period to ensure that the hedge remains highly effective.

The full value of a hedging derivative is classified as a non-current asset or liability when the remaining hedged item is more than 12 months, and as a current asset or liability when the remaining maturity of the hedged item is less than 12 months.

Derivative instruments that do not qualify for hedge accounting are classified as a current asset or liability with any change in fair value recognised immediately in the income statement.

iii) *Trade receivables*

Trade receivables do not carry any interest and are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts and the impact of discounting. The allowance for estimated irrecoverable amounts is calculated by applying expected recovery rates to debts outstanding at the end of the accounting period. The expected recovery rate takes into account age of the debt, payment history and credit characteristics.

NOTES TO THE FINANCIAL STATEMENTS

2. **Principal accounting policies (continued)**

iv) *Trade payables*

Trade payables are not interest bearing and are stated at their nominal value.

(j) Taxation including deferred tax

Tax payable for the year is provided at current rates. Deferred taxation is provided in full, using the liability method, on temporary differences between the tax basis of assets and liabilities and their carrying amounts in the financial statements. A deferred tax asset is only recognised to the extent it is probable that sufficient taxable profits will be available in the future to utilise it.

(k) Dividend distributions

Dividend distributions are recognised as a liability in the Company's financial statements in the period in which the dividends are approved by the Company's shareholders. Interim dividends are recognised when paid; final dividends when authorised in general meeting by shareholders.

(l) Employee benefits

i) *Pension obligations*

The company operates defined benefit and defined contribution pension schemes through its parent company.

Defined benefit pension scheme assets are measured using bid price. Defined benefit pension scheme liabilities are measured by an independent actuary using Directors' best estimates. The projected unit credit method is employed and liabilities discounted at the current rate of return on high quality corporate bonds of equivalent term to the liability. The increase in the present value of the liabilities of the Group's defined benefit pension schemes expected to arise from employee service in the period is charged to operating profit. The expected return on scheme assets and the increase during the period in the present value of scheme liabilities are included in other finance income or cost. Changes in past service costs arising from changes in benefits are recognised immediately in income.

Actuarial gains and losses arising from experience adjustments, changes in actuarial assumptions and amendments to pension plans are charged or credited to equity and recorded in the statement of recognised income and expense.

Costs of the defined contribution pension scheme are charged to the income statement in the period in which they arise.

ii) *Share-based payment*

The Company operates a number of equity settled, share-based payment plans for employees. The fair value of the employee services required in exchange for the grant is recognised as an expense over the vesting period of the grant.

Fair values are calculated using an appropriate pricing model. Non-market based vesting conditions are adjusted for assumptions as to the number of awards which are expected to vest.

NOTES TO THE FINANCIAL STATEMENTS

2. **Principal accounting policies (continued)**

(m) Fair values

The fair value of the interest rate swaps is based on the market price of comparable instruments at the balance sheet date if they are publicly traded.

The fair values of short-term deposits, loans and overdrafts with a maturity of less than one year are assumed to approximate to their book values. In the case of bank loans and other loans due in more than one year the fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate available to the Company for similar financial instruments.

3. **Financial risk management**

(a) Financial risk factors

The Company's activities expose it to a variety of financial risks; market risk (interest rate risk), liquidity risk and credit risk. The Company receives treasury services from the treasury function of Pennon Group Plc, the parent company, which seeks to ensure that sufficient funding is available to meet foreseeable needs, maintains reasonable headroom for contingencies and manages interest rate risk.

Treasury operations are managed in accordance with policies established by the Board. Major transactions are individually approved by the Board. Treasury activities are reported to the Board and are subject to review by internal audit.

Financial instruments are used to raise finance and to manage risk. The Company does not engage in speculative activity.

The principal financial risks faced by the Company relate to interest rate and counterparty risk.

i) Market risk

The Company has both interest bearing assets and interest bearing liabilities. The Company has a policy of maintaining at least 50% of interest bearing liabilities at fixed rates. At the year end 62% of net borrowings were at fixed rates and 22% index-linked. The Company uses a combination of fixed rate and index-linked borrowings and fixed rate interest swaps as cash flow hedges of future variable interest payments to achieve this policy. The notional principal amounts of the interest rate swaps are used to determine settlement under those swaps and are not, therefore, an exposure for the Company. These instruments are analysed in more detail in note 18.

The interest rate for index-linked debt is based upon an RPI measure which is also used in determining the amount of income from customers.

At 31 March 2009, if interest rates on net borrowings at that date had been 0.5% higher/lower with all other variables held constant, post-tax profit for the year would have been £1.5m (2008 £0.9m).

NOTES TO THE FINANCIAL STATEMENTS

3. **Financial risk management (continued)**

ii) Liquidity risk

The Company actively maintains a mixture of long-term and short-term committed facilities that are designed to ensure the Company has significant available funds for operations and planned expansions and facilities equivalent to at least one year's forecast requirements are maintained at all times. Details of undrawn committed facilities and short-term uncommitted facilities are provided in note 22.

Refinancing risk is managed under the policy that no more than 20% of Company net borrowing is permitted to mature in any financial year.

Contractual undiscounted cash flows were:

31 March 2009	**Due within 1 year** £m	**Due between 1 and 2 years** £m	**Due between 2 and 5 years** £m	**Over 5 years** £m	**Total** £m
Non-derivative financial liabilities					
Borrowings excluding finance lease liabilities	14.1	114.1	63.3	897.7	1,089.2
Interest payments on borrowing	12.7	10.6	32.3	367.4	423.0
Finance lease liabilities	55.9	56.2	248.8	1,947.2	2,308.1
Derivative financial liabilities					
Derivative contracts – net (payments)	(16.4)	(4.6)	(3.0)	(0.3)	(24.3)

31 March 2008	**Due within 1 year** £m	**Due between 1 and 2 years** £m	**Due between 2 and 5 years** £m	**Over 5 years** £m	**Total** £m
Non-derivative financial liabilities					
Borrowings excluding finance lease liabilities	14.1	14.1	156.3	818.8	1,003.3
Interest payments on borrowing	19.1	21.7	32.4	369.8	443.0
Finance lease liabilities	69.8	143.0	159.8	1,977.9	2,350.5
Derivative financial liabilities					
Derivative contracts – net receipts	3.5	-	-	-	3.5

NOTES TO THE FINANCIAL STATEMENTS

3. **Financial risk management (continued)**

iii) Credit risk

Credit risk arises from cash and cash deposits, derivative financial instruments and deposits with bank and financial institutions, as well as exposure to customers, including outstanding receivables. Further information on the credit risk relating to trade receivables is given in note 17.

Counterparty risk arises from the investment of surplus funds and from the use of derivative instruments. The Board has agreed a policy for managing such risk, which is controlled through credit limits, counterparty approvals, and rigorous monitoring procedures. The Company has no other significant concentration of credit risk. Surplus funds of the Company are usually placed in short-term fixed interest deposits or the overnight money markets. All deposits are with counterparties that have a credit rating threshold approved by the Pennon Group Board.

(b) Capital risk management

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

Consistent with the industry peer group, the Company monitors capital on the basis of the gearing ratio. This ratio is calculated as net borrowings divided by total capital. Net debt is calculated as total borrowings (including current and non-current borrowings as shown in the consolidated balance sheet) less cash and cash deposits. Total capital is calculated as equity as shown in the balance sheet plus net borrowings.

The gearing ratios at 31 March 2009 and 2008 were as follows:

	2009	2008
	£m	£m
Net borrowings (note 31)	**1,571.1**	1,455.2
Total equity	**400.6**	494.1
Total capital	**1,971.7**	1,949.3
Gearing ratio	**79.7%**	74.7%

The Company is also monitored by the ratio of its debt to Regulated Capital Value in line with guidance from the water industry regulator Ofwat.

	2009	2008
	£m	£m
Regulatory Capital Value	**2,461.0**	2,408.0
Net borrowings	**1,571.1**	1,455.2
Debt / Regulatory Capital Value	**63.8%**	60.4%

NOTES TO THE FINANCIAL STATEMENTS

3. **Financial risk management (continued)**

(c) Determination of fair values

The fair value of financial instruments traded in active markets (such as trading and available-for-sale securities) is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Company is the current bid price.

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. The Company uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. Quoted market prices or dealer quotes for similar instruments are used for long-term debt. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments. The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows.

The carrying value less impairment provision of trade receivables and payables are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Company for similar financial instruments.

4. **Critical accounting judgements and estimates**

The Company's principal accounting policies are set out in note 2 to these financial statements. Management is required to exercise significant judgement and make use of estimates and assumptions in the application of these policies.

Areas which management believes require the most critical accounting judgements are:

Revenue recognition

Revenue is not recognised by the Company until the service has been provided to the customer.

The Company raises bills and recognises revenue in accordance with its entitlement to receive revenue in line with the limits established by the Periodic Review price setting process. For water and waste water customers with water meters, income recognised is dependent upon the volume supplied including an estimate of the sales value of units supplied between the date of the last meter reading and the year end. Estimated usage is based on historic data, judgement and assumptions; actual results could differ from these estimates which would result in operating revenue being adjusted in the period that the revision to the estimates is determined. Revenue for unmeasured charges is recognised on a time apportioned basis.

Provision for doubtful debts

At each balance sheet date, the Company evaluates the collectability of trade receivables and records provisions for impairment of receivables based on experience including, for example, comparisons of the relative age of accounts and consideration of actual write-off history. The actual level of debt collected may differ from the estimated levels of recovery, which could impact operating results positively or negatively. As at 31 March 2009 current trade receivables were £62.8m, before provision for impairments.

NOTES TO THE FINANCIAL STATEMENTS

4. **Critical accounting judgements and estimates (Continued)**

Carrying value of long-life assets

The Company's accounting policy for property, plant and equipment is detailed in note 2 of the financial statements. The carrying value of property, plant and equipment as at 31 March 2009 was £2,377.9m (2008: £2,323.8m). In the year ended 31 March 2009 additions to property, plant and equipment totalled £147.8m and the depreciation charge was £91.3m. Estimated useful economic lives of tangible fixed assets are based on management's judgement and experience. When management identifies that actual useful lives differ materially from the estimates used to calculate depreciation, that charge is adjusted prospectively. Due to the significance of capital investment to the Company, variations between actual and estimated useful lives could impact operating results both positively and negatively. Historically, only minor changes to estimated useful lives have been required.

Retirement benefit obligations

The Company's employees are eligible to participate in funded defined benefit schemes, operated by the parent company. Actuarial valuations of the schemes are carried out as determined by the trustees at intervals of not more than three years.

The pension cost under IAS 19 is assessed in accordance with the advice of an independent qualified actuary based on the latest actuarial valuation and assumptions determined by the actuary. The assumptions are based on information supplied to the actuary by the Company, supplemented by discussions between the actuary and management. The assumptions are disclosed in note 24 of the financial statements.

Exceptional items

The Directors consider that items of income or expense which are material and non-recurring by virtue of their nature and amount should be disclosed separately if the financial statements are to fairly present the financial position and financial performance of the Company. The Directors label these items collectively as "exceptional items".

5. **Segmental reporting**

The Directors believe that the whole of the Company's activities constitute a single class of business.

The Company's turnover is wholly generated from within the United Kingdom.

NOTES TO THE FINANCIAL STATEMENTS

6. Operating costs

	2009 £m	2008 £m
Manpower costs (note 10)	**32.9**	34.8
Raw materials and consumables	**13.2**	14.0

Other operating expenses include

	2009 £m	2008 £m
(Profit) / loss on disposal of property, plant and equipment	**(1.7)**	0.1
Operating lease rentals payable:		
- Plant and machinery	**0.7**	0.6
- Property	**1.3**	1.5
Research and development expenditure	**0.2**	0.2
Trade receivables impairment	**6.4**	5.7
Depreciation of property, plant and equipment:		
- Owned assets	**63.4**	59.4
- Under finance leases	**26.4**	25.6
	89.8	85.0

Fees payable to the Company's auditors in the year were as follows:

	2009 £000	2008 £000
Audit of the Company's accounts	**100**	92
Audit-related regulatory reporting	**124**	28
Other services	**24**	-
	248	120

Expenses reimbursed to the auditors in relation to the audit of the Company were £14,000 (2008: £13,000).

7. Net finance costs

	2009 £m	2008 £m
Finance Costs		
Intercompany interest	**(12.7)**	(11.1)
Bank borrowings and overdrafts	**(10.5)**	(14.6)
Interest element of finance lease rentals	**(53.8)**	(51.9)
Other finance costs	**(3.8)**	(1.3)
Interest cost on retirement benefit obligations	**(18.8)**	(15.3)
	(99.6)	(94.2)
Finance Income		
Interest receivable	**10.2**	11.1
Intercompany interest	**1.7**	0.8
Expected return on pension scheme assets	**17.8**	17.4
	29.7	29.3
Net finance costs	**(69.9)**	(64.9)

NOTES TO THE FINANCIAL STATEMENTS

8. Taxation

	2009 £m	2008 £m
Analysis of charge in year		
Current tax	**20.5**	18.5
Deferred tax (note 25)	**11.7**	12.6
Deferred tax: effect of change in rate of corporation tax	**-**	(20.5)
Deferred tax: effect of abolition of industrial building allowances	**19.1**	-
	51.3	10.6

UK Corporation tax is calculated at 28% (2008: 30%) of the estimated assessable profit for the year. The deferred tax charge has been increased by a non-recurring charge of £19.1m reflecting the effect of the abolition of industrial building allowances. The tax for the year differs from the theoretical amount that would arise using the standard rate of corporation tax in the UK (28%). The differences are explained below:

	2009 £m	2008 £m
Profit before tax	**116.9**	116.2
Profit before tax multiplied by standard rate of corporation tax in the UK of 28% (2008 : 30%)	**32.7**	34.9
Effects of :		
Expenses not deductible for tax purposes	**0.7**	0.6
Sale of assets and finance leasing		-
Other	**(0.3)**	(0.9)
Adjustments to tax charge in respect of prior year	**(0.9)**	(2.9)
Effect on deferred tax of change in corporation tax rate	**-**	(21.1)
Effect of deferred tax on abolition of industrial buildings allowances	**19.1**	-
Tax charge for year	**51.3**	10.6

The average applicable tax rate for the year was 44% (2008 9%), due to the one off effect of the abolition of industrial buildings allowances as set out above.

In addition to the amount credited to the income statement, a deferred tax credit relating to actuarial losses on defined benefit schemes of £14.2m (2008 charge on actuarial gains £1.1m) has been charged directly to equity. A deferred tax charge relating to share-based payments of £0.3m (2008 tax credit £0.2m) has been charged to equity.

NOTES TO THE FINANCIAL STATEMENTS

9. **Dividends**

	2009 **£m**	2008 £m
Amounts recognised as distributions to equity holders in the year :		
2006/07 Outperformance dividend paid 24 July 2008	**3.6**	23.0
Base dividend in respect of 2007/08 and 2008/09 paid 30 January 2009	**100.2**	45.7
	103.8	68.7

10. **Employment costs**

The average number of persons (including Directors) employed by the Company was 1,227 (2008 1,276).

Employment costs comprise :	**2009** **£m**	2008 £m
Wages and salaries	**33.0**	34.6
Social security costs	**2.5**	2.4
Pension costs	**7.9**	10.0
Share-based payments	**1.2**	0.8
Total employment costs	**44.6**	47.8
Charged as follows :		
Manpower costs	**32.9**	34.8
Capital schemes	**9.5**	10.2
Restructuring provision	**2.2**	2.8
Total employment costs	**44.6**	47.8

Details of Directors emoluments are set out in note 11. There are no personnel other than Directors, who as key management exercise authority and responsibility for planning, directing and controlling the activities of the Company.

SOUTH WEST WATER

NOTES TO THE FINANCIAL STATEMENTS

11. **Directors' emoluments**	**2009** **£000**	2008 £000
Total emoluments of the Directors of the Company :		
Salary	**602**	555
Performance related	**159**	169
Share-based payments	**289**	213
Other emoluments	**133**	147
Total emoluments	**1,183**	1,084

The cost of share-based payments represents the amount charged to the income statement, as described in note 28.

The performance related payment represents the cash element. In addition Directors receive a conditional award of shares for a matching amount which is subject to a future service criterion.

Other emoluments include car benefit and health care, and, in respect of the highest paid Director, a cash payment of 30% of his annual basic salary in lieu of any pension provision by the Company.

The emoluments of the highest paid Director were £421,000 (2008 £397,000).

At 31 March 2009 retirement benefits were accruing to 3 Directors (2008 3 Directors) under defined benefit pension schemes operated by the parent company.

The highest paid Director did not participate in a company pension scheme.

The Chairman, K G Harvey, is a director of Pennon Group Plc and his remuneration is disclosed in the financial statements of that company.

NOTES TO THE FINANCIAL STATEMENTS

12. Property, plant & equipment

	Land and buildings	Infrastructure assets	Operational properties	Fixed and mobile plant, vehicles and computers	Construction in progress	Total
	£m	£m	£m	£m	£m	£m
Cost :						
At 1 April 2007	15.6	1,185.2	579.0	912.0	92.3	2,784.1
Additions	1.1	50.0	1.5	35.5	81.5	169.6
Grants & contributions	0.0	(2.7)	0.0	0.0	0.0	(2.7)
Disposals	(0.1)	(0.7)	0.0	(2.7)	0.0	(3.5)
Transfers/reclassifications	1.0	17.3	13.1	34.9	(66.3)	0.0
At 31 March 2008	17.6	1,249.1	593.6	979.7	107.5	2,947.5
Additions	0.5	53.7	1.7	29.0	62.9	147.8
Grants & contributions	0.0	(1.9)	0.0	0.0	0.0	(1.9)
Disposals	(0.3)	(0.7)	0.0	(1.7)	0.0	(2.7)
Transfers/reclassifications	1.1	34.0	10.5	35.0	(80.6)	0.0
At 31 March 2009	**18.9**	**1,334.2**	**605.8**	**1,042.0**	**89.8**	**3,090.7**
Depreciation :						
At 1 April 2007	3.7	27.7	134.6	374.6	0.0	540.6
Charge for year	0.3	16.9	10.6	58.5	0.0	86.3
Disposals	0.0	(0.7)	0.0	(2.5)	0.0	(3.2)
At 31 March 2008	4.0	43.9	145.2	430.6	0.0	623.7
Charge for year	0.3	18.7	11.1	61.2	0.0	91.3
Disposals	(0.1)	(0.7)	0.0	(1.4)	0.0	(2.2)
At 31 March 2009	**4.2**	**61.9**	**156.3**	**490.4**	**0.0**	**712.8**
Net book value :						
At 31 March 2008	13.6	1,205.2	448.4	549.1	107.5	2,323.8
At 31 March 2009	**14.7**	**1,272.3**	**449.5**	**551.6**	**89.8**	**2,377.9**

Out of the total depreciation charge for the Company of £91.3m (2008 £86.3m), the sum of £1.5m (2008 £1.3m) has been charged to capital projects, and £89.8m (2008: £85.0m) against profits.

NOTES TO THE FINANCIAL STATEMENTS

12. Property, plant & equipment (continued)

Assets held under finance leases included above :

	Land & buildings £m	Infrastructure assets £m	Operational Properties £m	Fixed & mobile plant, vehicles & computers £m	Construction in progress £m	Total £m
Cost :						
At 31 March 2008	-	324.0	432.3	303.9	48.0	1,108.2
At 31 March 2009	**-**	**350.1**	**444.9**	**312.5**	**25.0**	**1,132.5**
Depreciation :						
At 31 March 2008	-	10.5	66.5	137.2	-	214.2
At 31 March 2009	**-**	**15.4**	**73.8**	**150.5**	**-**	**239.7**
Net book amount:						
At 31 March 2008	-	313.5	365.8	166.7	48.0	894.0
At 31 March 2009	**-**	**334.7**	**371.1**	**162.0**	**25.0**	**892.8**

13. Financial instruments by category

The accounting policies for financial instruments have been applied to the line items as below:

		Fair value	**Amortised cost**		
	Note	**Derivatives used for hedging £m**	**Loans and receivables £m**	**Trade receivables and trade payables £m**	**Total £m**
31 March 2009					
Financial assets					
Trade and other receivables	14 & 17	-	14.5	24.0	38.5
Derivative financial instruments	18	0.2	-	-	0.2
Cash and cash deposits	19	-	251.7	-	251.7
Total		0.2	266.2	24.0	290.4
Financial liabilities					
Borrowings	22	-	(1,822.8)	-	(1,822.8)
Derivative financial instruments	18	(18.7)	-	-	(18.7)
Trade and other payables	20	-	(19.2)	(50.2)	(69.4)
Total		(18.7)	(1,842.0)	(50.2)	(1,910.9)

NOTES TO THE FINANCIAL STATEMENTS

13. **Financial instruments by category (continued)**

		Fair value	Amortised cost		
	Note	**Derivatives used for hedging £m**	**Loans and receivables £m**	**Trade receivables and trade payables £m**	**Total £m**
31 March 2008					
Financial assets					
Trade and other receivables	14 & 17	-	29.4	21.1	50.5
Derivative financial instruments	18	3.5	-	-	3.5
Cash and cash deposits	19	-	242.3	-	242.3
Total		3.5	271.7	21.1	296.3
Financial liabilities					
Borrowings	22	-	(1,714.3)	-	(1,714.3)
Derivative financial instruments	18	(0.5)	-	-	(0.5)
Trade and other payables	20	-	(33.3)	(61.4)	(94.7)
Total		(0.5)	(1,747.6)	(61.4)	(1,809.5)

14. **Trade and other receivables non-current**

	2009 £m	2008 £m
Amounts owed by subsidiary company	**1.1**	0.8

15. **Investments**

	2009 £m	2008 £m
Subsidiary undertakings	**3.3**	3.3
Joint venture	**0.1**	0.1

The Company has four wholly-owned subsidiaries, Peninsula Properties (Exeter) Limited, Peninsula Leasing Limited, South West Water Finance Plc and Haldon Collections Limited. All companies are incorporated, registered and operate in England.

The Company holds 99,999 (100%) A ordinary shares in Echo South West Limited, a joint venture engaged in customer contact management, established between the Company and Echo Managed Services Limited, a subsidiary of South Staffordshire Group Plc. The proportion of the nominal value of ordinary shares held by the Company is 50%. The joint venture in Echo South West Limited ceased operations on 31 March 2008.

Consolidated financial statements have not been prepared, as explained in note 2 (b).

SOUTH WEST WATER

NOTES TO THE FINANCIAL STATEMENTS

16.	**Inventories**	**2009 £m**	2008 £m
	Raw materials and consumables	**4.1**	4.1

17.	**Trade and other receivables – current**	**2009 £m**	2008 £m
	Trade receivables	**62.8**	53.5
	Less : provision for impairment of receivables	**(38.8)**	(32.4)
	Net trade receivables	**24.0**	21.1
	Amounts owed by subsidiary companies	**0.3**	0.7
	Amounts owed by fellow subsidiary companies	**2.1**	6.5
	Amounts owed by joint venture	**-**	2.1
	Amount owed by parent undertaking	**1.0**	16.5
	Other receivables	**10.0**	2.8
	Other prepayments and accrued income	**29.1**	27.8
		66.5	77.5

The Directors consider that the carrying amount of trade and other receivables approximates to their fair values.

There is no concentration of credit risk in trade receivables. The Company has a large number of customers who are dispersed and there is no significant loss on trade receivables that has not been provided for.

The company has created IAS 39 portfolio provisions, but it cannot identify which receivables specifically are the ones impaired. It is company policy is to consider a receivable in a portfolio to which an impairment has been allocated on a collective basis as not being impaired for the purposes of IFRS 7 disclosures until the loss can be specifically identified with the receivable.

The ageing of gross trade receivables was:

	2009 £m	2008 £m
Past due 0 – 30 days	**8.4**	7.6
Past due 31 – 120 days	**7.7**	8.3
Past due more than 120 days	**56.5**	47.4

The aged gross trade receivables above are taken directly from the Company's aged debt datamart before the deduction of credit balances and other adjustments. The figures are therefore higher the trade receivables balance stated in note 17.

The Company has a duty under legislation to continue to provide domestic customers with services regardless of payment. It specifically reviews separate categories of debt to identify an appropriate provision for impairment.

SOUTH WEST WATER

NOTES TO THE FINANCIAL STATEMENTS

17. Trade and other receivables – current (continued)

The movement in the allowance for impairment in respect of trade receivables was:

	2009 £m	2008 £m Restated
At 1 April	**32.4**	26.3
Provision for receivables impairment	**6.4**	5.7
Amounts written-off during the period	**(4.9)**	(3.6)
Cumulative amounts previously excluded from debt	**4.9**	4.0
At 31 March	**38.8**	32.4

18. Derivative financial instruments

	2009 £m	2008 £m
Interest rate swaps – cash flow hedges :		
Non-current assets	**0.2**	3.5
Non-current liabilities	**(16.6)**	(0.5)
Derivatives deemed held for trading		
Current liabilities	**(2.1)**	-

Interest rate swaps and fixed rate borrowings are used to manage the mix of fixed and floating rates to ensure at least 50% of net borrowings is at fixed rate. At 31 March 2009 62% of net borrowings was at fixed rate (2008: 64%)

At 31 March 2009 interest rate swaps to hedge financial liabilities with a notional principal value of £540m existed, with a weighted average maturity of 2.5 years (2008 £584.0m, with 3.0 years) to swap from floating to fixed rate. The weighted average interest rate of the swaps was 4.8% (2008 4.9%).

The amounts above are the fair value of swaps based on the market value of equivalent instruments at the balance sheet date.

In 2009 derivatives held for trading relate to interest rate swaps which no longer qualify for hedge accounting.

NOTES TO THE FINANCIAL STATEMENTS

19. **Cash and cash deposits**

	2009 £m	2008 £m
Cash at bank and in hand	**1.1**	0.8
Overnight deposits	**63.8**	141.1
Other short-term deposits	**170.2**	90.3
Other deposits	**16.6**	10.1
	251.7	242.3

The effective interest rate on short-term deposits was 2.1% (2008 5.6%) and these deposits have an average maturity of 23 days (2008: 9 days).

Other deposits include £16.6m (2008 £10.1m) of restricted funds to settle long-term liabilities (note 22).

Cash and cash deposits comprise the following for the purposes of the cash flow statement:

	2009 £m	2008 £m
Cash and cash deposits as above	**251.7**	242.3
Overdrafts (note 22)	**(17.0)**	(21.6)
	234.7	220.7
Less: deposits with a maturity of three months or more	**(16.6)**	(10.1)
	218.1	210.6

20. **Trade and other payables – current**

	2009 £m	2008 £m
Trade payables	**50.2**	61.4
Amounts owed to subsidiary companies	**1.6**	3.4
Amounts owed to fellow subsidiaries	**0.1**	0.1
Amounts owed to joint venture	**-**	0.2
Other tax and social security	**1.0**	7.0
Other payables	**0.8**	2.3
Accruals	**15.5**	20.1
Deferred income	**0.2**	0.2
	69.4	94.7

The Directors consider that the carrying amount of trade and other payables approximates to their fair value.

21. **Current tax liabilities**

	2009 £m	2008 £m
Corporation tax	**23.2**	26.8

NOTES TO THE FINANCIAL STATEMENTS

22. Borrowings	2009 £m	2008 £m Restated
Current		
Bank overdrafts	**17.0**	21.6
European Investment Bank	**14.1**	14.1
	31.1	35.7
Obligations under finance leases	**24.2**	17.7
	55.3	53.4
Non-current		
European Investment Bank	**287.7**	201.8
Loan from subsidiary company	**318.0**	311.7
	605.7	513.5
Obligations under finance leases	**1,161.8**	1,147.4
	1,767.5	1,660.9
Total borrowings	**1,822.8**	1,714.3

Accrued finance charges arising on obligations under finance leases have been re-analysed between current and non-current amounts and comparatives have been restated accordingly.

The Directors consider that the carrying amounts of current borrowings approximate to their fair value.

The fair value of the non-current borrowings were :

	2009		2008	
	Book value £m	**Fair value £m**	Book value £m	Fair Value £m
European Investment Bank	**287.7**	**245.6**	201.8	197.4
Loan from subsidiary company	**318.0**	**249.6**	311.7	280.7
	605.7	**495.2**	513.5	478.1
Obligations under finance leases	**1,161.8**	**1,044.8**	1,147.4	984.2
	1,767.5	**1,540.0**	1,660.9	1,462.3

Where market values are not available, fair values of borrowings have been calculated by discounting expected future cash flows at prevailing interest rates.

NOTES TO THE FINANCIAL STATEMENTS

22. Borrowings (continued)

The exposure to interest rate changes (before the impact of swaps – note 18) and the repricing dates at the balance sheet date is :

	2009	2008
	£m	£m
6 months or less	**748.4**	797.4
6 – 12 months	**758.2**	488.4
1 – 5 years	**224.8**	216.8
Over 5 years	**91.2**	211.7
	1,822.8	1,714.3

The maturity of non-current borrowings was :

	2009	2008
	£m	£m
		Restated
Between 1 and 2 years	**147.7**	35.6
Between 2 and 5 years	**180.7**	257.5
Over 5 years	**1,439.1**	1,367.8
	1,767.5	1,660.9

The effective interest rates (before the impact of swaps – note 18) at the balance sheet date were :

	2009	2008
	%	%
Bank overdrafts	**2.0**	6.3
European Investment Bank	**2.1**	6.0
Bank loans	**n/a**	n/a
Finance leases	**3.3**	4.6
Loan from subsidiary company	**1.3**	5.0

Finance lease liabilities – minimum lease payments :

	2009	2008
	£m	£m
		Restated
Within one year	**54.9**	70.5
In the second to fifth years inclusive	**296.3**	303.3
After five years	**1,966.2**	1,977.9
	2,317.4	2,351.7
Less: future finance charges	**(1,131.3)**	(1,186.6)
	1,186.1	1,165.1

Included above are accrued finance charges arising on obligations under finance leases totalling £136.0m (2008 £129.8m), of which £13.8m (2008 restated: £8.1m) is repayable within one year.

Included above is £14.6 m (2008 £21.7m) due to Peninsula Leasing Limited, a subsidiary company, under finance lease agreements of which £7.2m (2008 £7.6m) is repayable within one year.

NOTES TO THE FINANCIAL STATEMENTS

22. **Borrowings (continued)**

Within obligations under finance leases, South West Water Limited has utilised finance lease facilities of £180.0m for certain water and sewerage business tangible fixed assets that are secured by bank letters of credit issued by United Kingdom financial institutions. These letters of credit, covering the full period of the finance leases, are renewable between the financial institutions and South West Water Limited at five-yearly intervals, the next being March 2011.

During 2006/07 the period for repayment of these leases was extended with an agreement to deposit with the lessor group amounts equal to the difference between the original and revised payments due. The accumulated deposits of £16.6m at 31 March 2009 (2008: £10.1m) are being held to settle the lease liability over the period from the end of the original lease term. The deposits are subject to a registered charge given as security to the lessor for the balance outstanding.

The Company has undrawn committed borrowing facilities :

	2009	2008
	£m	£m
Floating rate :		
Expiring within one year	**-**	55.0
Expiring after one year	**124.0**	80.0
	124.0	135.0

In addition, the Company has short-term uncommitted bank facilities of £80.0m (2008 £80.0m).

23. **Other non-current liabilities**

	2009	2008
	£m	£m
Other creditors	**1.6**	1.8

24. **Retirement benefit obligations**

The Company's employees are eligible to participate in funded defined benefit schemes, operated by the parent company. The assets of the group's pension schemes are held in separate trustee administered funds. The trustees of the funds are required to act in the best interest of the funds' beneficiaries. The appointment of the schemes' trustees is determined by the schemes' trust documentation. The Group has a policy that one-half of all trustees other than the Chairman are nominated by active members of the fund and current pensioners.

The principal actuarial assumptions at the balance sheet date were :

	2009	2008
	%	%
Expected return on scheme assets	**7.0**	7.0
Rate of increase in pensionable pay	**3.75**	4.4
Rate of increase for present and future pensions	**2.75**	3.4
Rate used to discount schemes' liabilities	**6.5**	6.9
Inflation	**2.75**	3.4

NOTES TO THE FINANCIAL STATEMENTS

24. **Retirement benefit obligations (continued)**

More detailed information for the Pennon Group pension funds on assumptions regarding future mortality experience and the sensitivities regarding the principal assumptions used to measure the schemes' liabilities are given in the financial statements of Pennon Group Plc.

The amounts recognised in the income statement were :

	2009 £m	2008 £m
Current service cost	**(6.8)**	(8.7)
Past service cost	**(1.6)**	(1.2)
Total included within operating costs	**(8.4)**	(9.9)
Expected return on pension schemes' assets	**17.8**	17.4
Interest cost on retirement benefit obligations	**(18.8)**	(15.3)
Total included within net finance costs	**(1.0)**	2.1
Total charge	**(9.4)**	(7.8)

The actual return on schemes' assets was a decrease of £27.6m (2008 decrease of £34.1m).

The amounts recognised in the statement of recognised income and expense were :

	2009 £m	2008 £m
Actuarial (losses)/gains recognised in the year (net of tax)	**(50.6)**	3.9

The amounts recognised in the balance sheet were :

	2009 £m	2008 £m
Fair value of scheme's assets	**209.9**	255.4
Present value of defined benefit obligations	**(261.3)**	(277.1)
Net liability recognised in the balance sheet	**(51.4)**	(21.7)

The assets in the schemes and the expected long-term rates of return at the year end were:

	Expected Return %	**2009 Value £m**	**Fund %**	Expected Return %	2008 Value £m	Fund %
Equities	**8.8**	**126.8**	**60**	8.5	152.1	60
Property / currency	**7.9**	**7.7**	**4**	7.8	11.6	4
Bonds	**5.2**	**72.5**	**35**	4.6	91.6	36
Other	**8.75**	**2.9**	**1**	8.5	0.1	-
		209.9	**100**		255.4	100

Asset values have been reanalysed to show other assets which principally represent cash contributions received from the company towards the year-end which are invested during the subsequent financial year. Comparatives have been restated accordingly.

NOTES TO THE FINANCIAL STATEMENTS

24. **Retirement benefit obligations (continued)**

The expected return on plan assets is determined by considering the long-term returns and the balance between risk and reward on the various categories of investment assets held. Expected returns on equity and property investments reflect long-term rates of return experienced in the respective markets. Expected yields on fixed interest investments are based on gross redemption yields as at the balance sheet date.

In conjunction with its investment advisers, the trustees have structured the schemes' assets with the objectives of balancing investment returns and levels of risk. The asset allocation has three main elements:

- holding of bonds which is expected to be less volatile than most other asset classes and reflects the schemes' liabilities
- a proportion of equities, with fund managers having freedom in making investment decisions to maximise returns
- investment of a relatively small proportion of the schemes' assets (circa 10%) in alternative asset classes which give the potential for gaining higher returns (property and currency).

Equities held by the scheme are spread between the UK and international markets circa 50% each.

Movements in the balance sheet liability were :

	2009	2008
	£m	£m
At 1 April	**(21.7)**	(34.5)
Income statement	**(9.4)**	(7.8)
Statement of recognised income and expenditure	**(50.6)**	3.9
Regular contributions	**1.5**	1.3
Prepayment of contributions	**28.8**	15.4
At 31 March	**(51.4)**	(21.7)

Movements in the fair value of scheme's assets were :

	2009	2008
	£m	£m
At 1 April	**255.4**	285.5
Expected return on scheme's assets	**17.8**	17.4
Actuarial losses	**(81.5)**	(53.6)
Members' contributions	**0.4**	0.3
Benefits paid	**(12.5)**	(10.9)
Company regular contributions	**1.5**	1.3
Prepayment of Company regular contributions	**28.8**	15.4
At 31 March	**209.9**	255.4

NOTES TO THE FINANCIAL STATEMENTS

24. **Retirement benefit obligations (continued)**

Movements in the present value of defined benefit obligations were :

	2009	2008
	£m	£m
At 1 April	**(277.1)**	(320.0)
Service costs	**(8.4)**	(9.9)
Interest cost	**(18.8)**	(15.3)
Members' contributions	**(0.4)**	(0.3)
Benefits paid	**12.5**	10.9
Actuarial gains	**30.9**	57.5
At 31 March	**(261.3)**	(277.1)

The Company adopted IAS 19 from 1 April 2005 and the following historical data has been presented from that date.

	2009	2008	2007	2006	2005
	£m	£m	£m	£m	£m
Fair value of scheme's assets	**209.9**	255.4	285.5	266.7	187.9
Present value of defined benefit obligations	**(261.3)**	(277.1)	(320.0)	(301.7)	(255.0)
Net liability recognised	**(51.4)**	(21.7)	(34.5)	(35.0)	(67.1)
Experience (losses) / gains on scheme's assets					
Amount (£m)	**(80.7)**	(53.6)	3.2	33.7	8.9
Percentage of scheme's assets	**(38.4)%**	(21.0)%	1.1%	12.6%	4.7%
Experience losses/(gains) on defined benefit obligations					
Amount (£m)	**18.3**	(5.8)	(4.4)	(32.2)	(7.9)
Percentage of defined benefit obligations	**7.0%**	(2.1)%	(1.4)%	(10.7)%	(3.1)%

The Company's current service cost during the year was 16.4% of pensionable earnings (2008 21.7%). The Company's existing defined benefit schemes have been closed to new entrants from 1 April 2008.

In 2008 the Pennon Group completed the triennial actuarial valuation of its defined benefit schemes as at 1 April 2007 which resulted in higher future service and deficit recovery contributions. The Group further updated this valuation to 30 September 2008 and the company has made further prepayments of contributions in the year totalling £28.8m (2008 £15.4m).

The Pennon Group monitors funding levels on an annual basis and no further Company regular contributions are expected to be paid to the scheme during the year ended 31 March 2010.

NOTES TO THE FINANCIAL STATEMENTS

25. **Deferred tax liabilities**

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 28% (2008: 30%).

The movements on the deferred tax account were :

	2009	2008
	£m	£m
At 1 April	**300.0**	307.0
Effect of change in corporation tax rate	**-**	(20.5)
Effect of abolition of industrial buildings allowance	**19.1**	-
Charged to the income statement	**11.7**	12.6
(Credited)/Charged to equity	**(13.9)**	0.9
At 31 March	**316.9**	300.0

Deferred tax assets have been recognised in respect of all temporary differences giving rise to deferred tax assets because it is probable that these assets will be recovered.

All deferred tax assets and liabilities are within the same jurisdiction and may be offset as permitted by IAS12. The movement in deferred tax assets and liabilities is shown below.

Deferred tax liabilities

	Accelerated tax depreciation		
	Owned assets	Leased assets	**Total**
	£m	£m	**£m**
At 1 April 2007	317.4	10.0	**327.4**
Effect of change in corporation tax rate	(21.2)	(0.7)	**(21.9)**
(Credited) / charged to the income statement	(0.7)	6.2	**5.5**
At 31 March 2008	295.5	15.5	**311.0**
Effect of abolition of industrial buildings allowance	19.1	-	**19.1**
Charged to the income statement	1.2	0.8	**2.0**
At 31 March 2009	315.8	16.3	**332.1**

NOTES TO THE FINANCIAL STATEMENTS

25. Deferred tax liabilities (continued)

Deferred tax assets

	Provisions £m	Retirement benefit obligations £m	Other £m	**Total £m**
At 1 April 2007	(3.8)	(10.3)	(6.3)	**(20.4)**
Effect of change in corporation tax rate	0.3	0.7	0.4	**1.4**
Charged to the income statement	1.9	2.5	2.7	**7.1**
Charged / (credited) to equity	-	1.1	(0.2)	**0.9**
At 31 March 2008	(1.6)	(6.0)	(3.4)	**(11.0)**
Charged to the income statement	1.2	5.9	2.6	**9.7**
Charged / (credited) to equity	-	(14.2)	0.3	**(13.9)**
At 31 March 2009	(0.4)	(14.3)	(0.5)	**(15.2)**

Net deferred tax liability:

At 31 March 2008	300.0
At 31 March 2009	**316.9**

The deferred tax (charged) / credited to equity during the year was :

	2009 £m	2008 £m
Actuarial gains/(losses) on defined benefit schemes	**14.2**	(1.1)
Share-based payments (note 29)	**(0.3)**	0.2
	13.9	(0.9)

26. Provisions for liabilities and charges

Restructuring	**2009 £m**	2008 £m
At 1 April	**1.5**	-
Charged to the income statement	**5.0**	4.0
Utilised during year	**(6.2)**	(2.5)
At 31 March	**0.3**	1.5

The provisions are all current.

NOTES TO THE FINANCIAL STATEMENTS

27. **Called-up share capital**

	2009 £m	2008 £m
Authorised		
500,000,000 Ordinary shares of £1 each	**500.0**	500.0
Allotted, called-up and fully paid		
150,950,000 (2008: 450,950,000) Ordinary shares of £1 each	**150.9**	450.9

The company undertook a share capital reduction exercise in accordance with the Companies Act 2006 in 2008/09 which created sufficient reserves to pay a backlog of dividends that had built up.

28. **Employee share schemes**

The Company operates a number of equity settled share plans for the benefit of employees. Details of each plan are set out below.

i) Sharesave Scheme

An all-employee savings related plan is operated that enables employees to invest up to a maximum of £250 per month for three or five years. These savings can then be used to buy shares at a price set at a 20% discount to the market value at the start of the savings period at the third, fifth or seventh year anniversary of the option being granted. Options expire six months following the exercise date and, except for certain specific circumstances such as redundancy, lapse if the employee leaves the Pennon Group before the option exercise period commences.

Outstanding options to subscribe for Pennon Group Plc shares of 40.7p each under the Sharesave scheme are :

Date granted and subscription price fully paid		Period when options normally exercisable	Thousands of shares in respect of which options outstanding at 31 March	
			2009	2008
6 July 1999	275p	2002 – 2006	**-**	-
5 July 2000	154p	2003 – 2007	**-**	-
4 July 2001	163p	2004 – 2008	**-**	29
9 July 2002	189p	2005 – 2009	**27**	27
8 July 2003	177p	2006 – 2010	**41**	256
6 July 2004	200p	2007 – 2011	**187**	195
5 July 2005	270p	2008 – 2012	**188**	403
4 July 2006	358p	2009 – 2013	**381**	394
3 July 2007	522p	2010 – 2014	**294**	306
8 July 2008	517p	2012 – 2016	**247**	-
			1,365	1,610

At 31 March 2009 there were 723 participants in the Sharesave Scheme (2008 752).

NOTES TO THE FINANCIAL STATEMENTS

28. Employee share schemes (continued)

i) Sharesave Scheme (continued)

The number and weighted average exercise price of Sharesave options are :

	2009		2008	
	Number of Ordinary shares (thousands)	**Weighted average exercise price per share p**	Number of Ordinary shares (thousands)	Weighted average exercise price per share p
At 1 April	**1,610**	**313**	2,052	240
Granted	**262**	**517**	332	522
Exercised	**(438)**	**221**	(606)	186
Expired	**(69)**	**353**	(168)	292
At 31 March	**1,365**	**379**	1,610	313

The weighted average price at the date of exercise of Sharesave options during the year was 594p (2008: 606p). The options outstanding at 31 March 2009 had a weighted average exercise price of 379p (2008: 313p) and a weighted average remaining contractual life of 1.8 years (2008: 1.9 years).

The aggregate fair value of options granted during the year was £0.4m (2008: £0.5m), determined using the Black-Scholes valuation model. The significant inputs into the valuation model were :

	2009	2008
Weighted average share price	**646p**	652p
Weighted average exercise price	**517p**	522p
Expected volatility	**21.3%**	18.7%
Expected life	**3.8 years**	3.9 years
Risk-free rate	**4.9%**	5.3%
Expected dividend yield	**3.3%**	3.6%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous two years.

NOTES TO THE FINANCIAL STATEMENTS

28. **Employee share schemes (continued)**

ii) Restricted Share Plan

Under this plan, Directors and senior management receive a conditional award of ordinary shares in Pennon Group Plc. The eventual number of shares, if any, which vest is dependent upon the achievement of the performance condition of the plan (which is related to the performance of the entire Pennon Group) over the restricted period, being not less than three years.

The number and weighted average price of shares in the Restricted Share Plan are :

	2009		2008	
	Number of ordinary shares (thousands)	**Weighted average price per Share p**	Number of ordinary shares (thousands)	Weighted average price per share p
At 1 April	**325**	**411**	563	360
Vested	**(96)**	**392**	(176)	270
Lapsed	**(105)**	**410**	(62)	350
At 31 March	**124**	**494**	325	411

The plan was succeeded in 2007 by the Performance and Co-investment Plan and only the 2006 award remains at 31 March 2009. None of the 2006 award will vest in September 2009 as the performance criterion has not been met.

The awards outstanding at 31 March 2009 had an average price of 494p (2008 411p) and a weighted average remaining contractual life of 0.5 years (2008 1.1 years).

The fair value of awards was determined using a Monte-Carlo simulation model.

iii) Performance and Co-investment Plan

Executive Directors and senior management receive a conditional award of ordinary shares in the Company and are also required to hold a substantial personal holding in Pennon Group Plc shares. The eventual number of shares, if any, which vest is dependent upon the achievement of conditions of the plan over the restricted period, being not less than three years.

The number and exercise price of shares in the Performance and Co-investment Plan are :

	2009		2008	
	Number of ordinary shares (thousands)	**Exercise price per Share p**	Number of ordinary shares (thousands)	Exercise price per share p
At 1 April	**112**	**557**	-	-
Granted	**121**	**638**	112	557
At 31 March	**233**	**598**	112	557

NOTES TO THE FINANCIAL STATEMENTS

28. **Employee share schemes (continued)**

iii) Performance and Co-investment Plan (continued)

The awards outstanding at 31 March 2009 had a weighted average exercise price of 598p (2008: 557p) and a remaining contractual life of 1.9 years (2008: 2.5 years). The aggregate fair value of awards granted during the year was £0.5m (2008: £0.6 million), determined using a Monte-Carlo simulation model. The significant inputs into the valuation model at the date of the share awards were:

	2009	2008
Share price	**638p**	557p
Expected volatility	**21.3%**	18.7%
Risk-free rate	**4.9%**	5.3%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous two years.

iv) Annual Incentive Bonus Plan – Deferred Shares

Awards under the plan to Directors and senior management involve the release of ordinary shares in Pennon Group Plc to participants. There is no performance condition since vesting is usually conditional upon continuous service with the Pennon Group for a period of three years from the award.

The number and weighted average price of shares in the Incentive Bonus Plan are:

	2009		2008	
	Number of Ordinary shares (thousands)	**Weighted average price per Share p**	Number of Ordinary Shares (thousands)	Weighted average price per share p
At 1 April	**122**	**457**	165	349
Granted	**58**	**620**	51	600
Vested	**(62)**	**411**	(94)	345
At 31 March	**118**	**578**	122	457

The awards outstanding at 31 March 2009 had a weighted average price of 578p (2008: 457p) and a weighted average remaining contractual life of 1.4 years (2008: 1.4 years). The Company's share price at the date of the awards ranged from 484p to 620p.

The aggregate fair value of awards granted during the year was £0.4m (2008: £0.3m), determined from market value. No option pricing issues arise as dividends declared on the shares are receivable by the participants in the scheme.

NOTES TO THE FINANCIAL STATEMENTS

29. Retained earnings and other reserves

	Hedging reserve	Retained earnings	Total
	£m	£m	£m
At 1 April 2007	14.2	1.0	15.2
Profit for the year	-	105.6	105.6
Other recognised income and expense for the year	(11.6)	3.0	(8.6)
Dividends paid	-	(68.7)	(68.7)
Adjustment in respect of share-based payments	-	0.5	0.5
Adjustment in respect of share options vesting	-	(0.8)	(0.8)
At 31 March 2008	2.6	40.6	43.2
Profit for year	-	65.6	65.6
Other recognised income and expense for the year	(19.0)	(36.7)	(55.7)
Dividends paid	-	(103.8)	(103.8)
Adjustment in respect of share-based payments	-	1.0	1.0
Adjustment in respect of share options vesting	-	(0.6)	(0.6)
Adjustment for reduction in share capital	-	300.0	300.0
At 31 March 2009	**(16.4)**	**266.1**	**249.7**

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NOTES TO THE FINANCIAL STATEMENTS

30. Cash flow from operating activities

Reconciliation of profit for the year to cash generated from operations:

Cash generated from operations

	2009 £m	2008 £m
Continuing operations		
Profit for the year	**65.6**	105.6
Adjustments for :		
Employee share schemes	**1.1**	0.8
Deferred income released to profits	**(0.2)**	(0.2)
(Profit) / loss on disposal of property, plant and equipment	**(1.7)**	0.1
Depreciation charge	**89.8**	85.0
Interest payable and similar charges	**99.6**	94.2
Interest receivable	**(29.7)**	(29.3)
Taxation	**51.3**	10.6
Changes in working capital		
Increase in inventories	**-**	(0.1)
Increase in trade and other receivables	**(9.1)**	(6.4)
(Decrease) / increase in trade and other payables	**(12.0)**	0.5
Decrease in retirement benefit obligations	**(22.1)**	(6.9)
(Decrease) / increase in provisions for liabilities and charges	**(1.3)**	1.5
Cash generated from operations	**231.3**	255.4

31. Net borrowings

	2009 £m	2008 £m Restated
Cash and cash deposits	**251.7**	242.3
Loan to parent company	**-**	16.8
Borrowings - current		
Bank overdrafts	**(17.0)**	(21.6)
Other current borrowings	**(14.1)**	(14.1)
Finance lease obligations	**(24.2)**	(17.7)
Total current borrowings	**(55.3)**	(53.4)
Borrowings – non current		
Other non-current borrowings	**(605.7)**	(513.5)
Finance lease obligations	**(1,161.8)**	(1,147.4)
Total non-current borrowings	**(1,767.5)**	(1,660.9)
Total net borrowings	**(1,571.1)**	(1,455.2)

NOTES TO THE FINANCIAL STATEMENTS

32. Operating lease commitments – minimum lease payments

	2009 £m	2008 £m
Aggregate commitments under non-cancellable operating leases expiring:		
Within one year	**1.4**	1.3
Later than one year and less than five years	**5.3**	5.0
After five years	**20.4**	19.5
	27.1	25.8

The Company leases various offices, depots and workshops under non-cancellable operating lease agreements. The leases have various terms, escalation clauses and renewal rights. Property leases are negotiated for an average term of 26 years and rentals are reviewed on average at five yearly intervals.

The Company also leases plant and machinery under non-cancellable operating lease agreements.

33. Contingent liabilities

	2009 £m	2008 £m
Contractors' claims on capital schemes	**1.3**	2.3
Guarantee of borrowings of subsidiary undertaking	**300.0**	300.0
	301.3	302.3

34. Capital commitments

	2009 £m	2008 £m
Contracted but not provided	**76.2**	74.1

35. Related party transactions

During the year, the Company entered into the following transactions with related parties:

Parent company	**2009 £m**	2008 £m
Purchase of goods and services		
Group expenses	**4.0**	3.9
Sale of goods and services		
Administrative services	**0.5**	0.5
Loan interest received	**1.6**	0.8
Dividends paid	**103.8**	68.7

NOTES TO THE FINANCIAL STATEMENTS

35. Related party transactions (continued)

<u>**Subsidiaries of the Company**</u>	**2009 £m**	2008 £m
Purchase of goods and services		
Property consultancy	**0.1**	0.1
Payment for provision of finance		
Loan interest	**12.7**	11.1
Finance lease charges: vehicles	**0.1**	0.1
Finance lease charges: plant & machinery	**-**	1.9
Sale of goods and services (administrative services)	**0.3**	0.2
Loan interest received	**0.1**	0.1
<u>**Fellow subsidiaries of the Pennon Group**</u>		
Purchase of goods and services		
Sludge tankering and waste disposal	**0.6**	0.6
Insurance premia	**0.9**	1.6
Sale of goods and services		
Tankered waste and trade effluent charges	**0.7**	0.5
<u>**Joint venture**</u>		
Purchase of goods and services		
Customer service and billing facilities	**-**	10.3
Sale of goods and services		
Administrative services	**-**	2.7

Year end balances	**2009 £m**	2008 £m
Borrowings (note 22)		
Loan from subsidiary	**318.0**	311.7
Finance lease balances with subsidiary	**14.6**	21.7
Receivables (notes 14 and 17)		
Parent company	**0.1**	16.5
Subsidiaries	**0.2**	1.5
Fellow subsidiaries	**2.7**	6.5
Joint venture	**-**	2.1
Payables (note 20)		
Parent company	**-**	-
Subsidiaries	**1.6**	3.4
Fellow subsidiaries	**0.1**	0.1
Joint venture	**-**	0.2

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NOTES TO THE FINANCIAL STATEMENTS

36. **Parent Company**

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