


Pennon Group Plc



IFRS City Presentation

28 JUNE 2005

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David Dupont
Group Director of Finance
Pennon Group

IFRS Presentation Team

- Pennon Group Plc David Dupont Group Director of Finance
 Edward Jackson Group Financial Controller
 Tony Hooper Group Treasurer & Taxation
 Manager
- South West Water Richard Hughes Finance & Regulatory Director
- Viridor Waste David Robertson Finance Director

IFRS Implementation *Agenda*

- Overview
 - Annual Report
- Key IFRS Accounting Changes
- Q & A

Overview

- **Purpose: To set out illustrative impact of key IFRS changes**

- **IFRS adjustments to 2004/05:**

Opening balance-sheet – 31/03/04

Closing balance-sheet – 31/03/05

2004/05 financial results

- **First full results under IFRS – six months ending 30 September 2005**

All figures included in this presentation are for illustrative purposes only and represent current best estimates of the impact of IFRS. The figures are subject to further interpretation and change and should therefore not be relied on or considered definitive

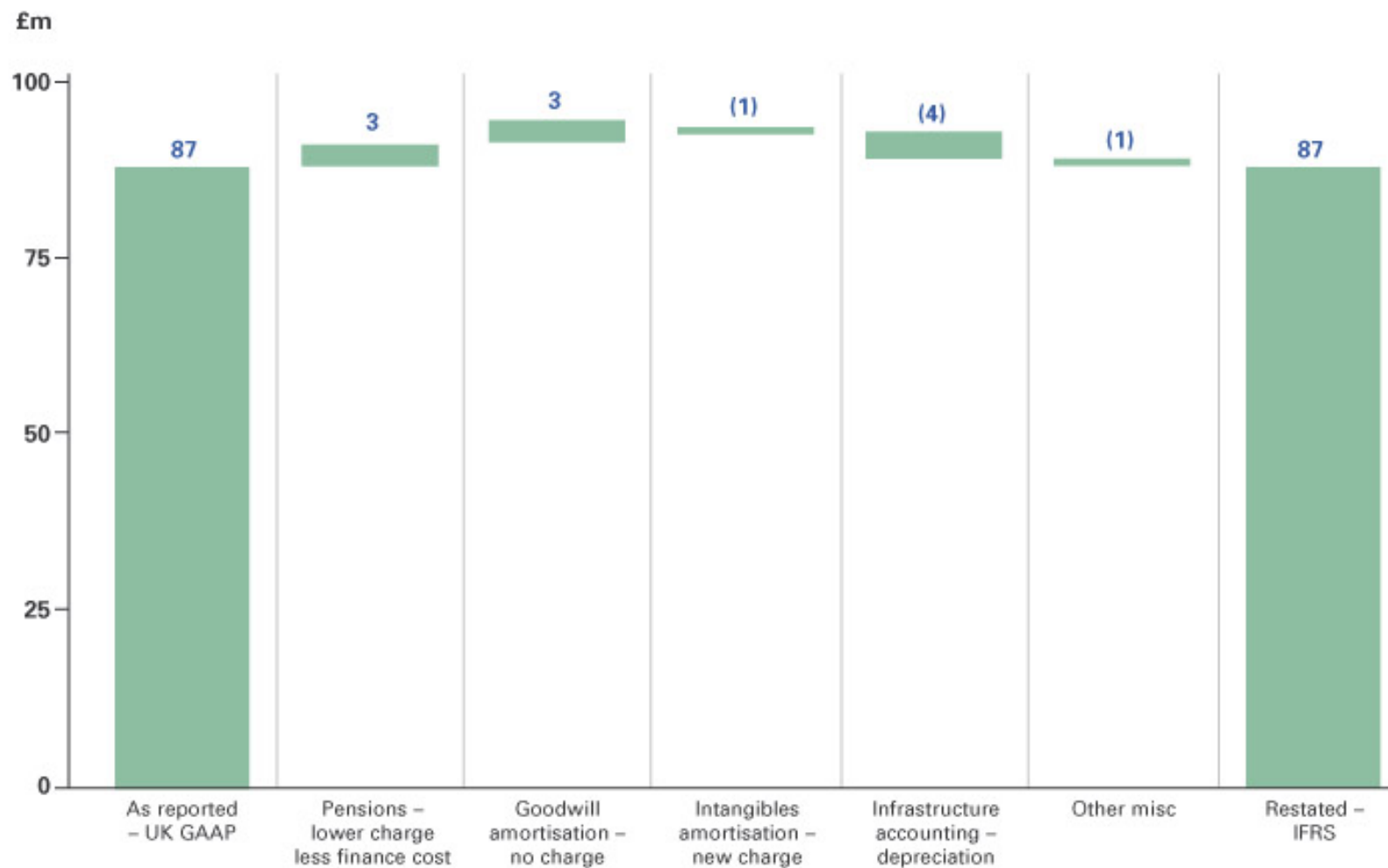
Key IFRS Changes Impacting Financial Statements

| | UK GAAP | IFRS |
|--|----------------|-------------|
| Taxation – deferred tax | FRS 19 | IAS 12 |
| Pensions | SSAP 24 | IAS 19 |
| Acquisitions/goodwill | FRS 6/7/10 | IFRS 3 |
| Fixed assets – infrastructure accounting | FRS 15 | IAS 16 |
| Dividends | Cos. Act | IAS 10 |

Items not Impacted by IFRS

- Cash balances and cash flows
- Financial strength and flexibility
 - Debt covenant compliance
 - Frozen GAAP
 - Deferred tax carve out
 - Dividends
 - Paid from current year profit

Indicative Profit Before Tax – 2004/05

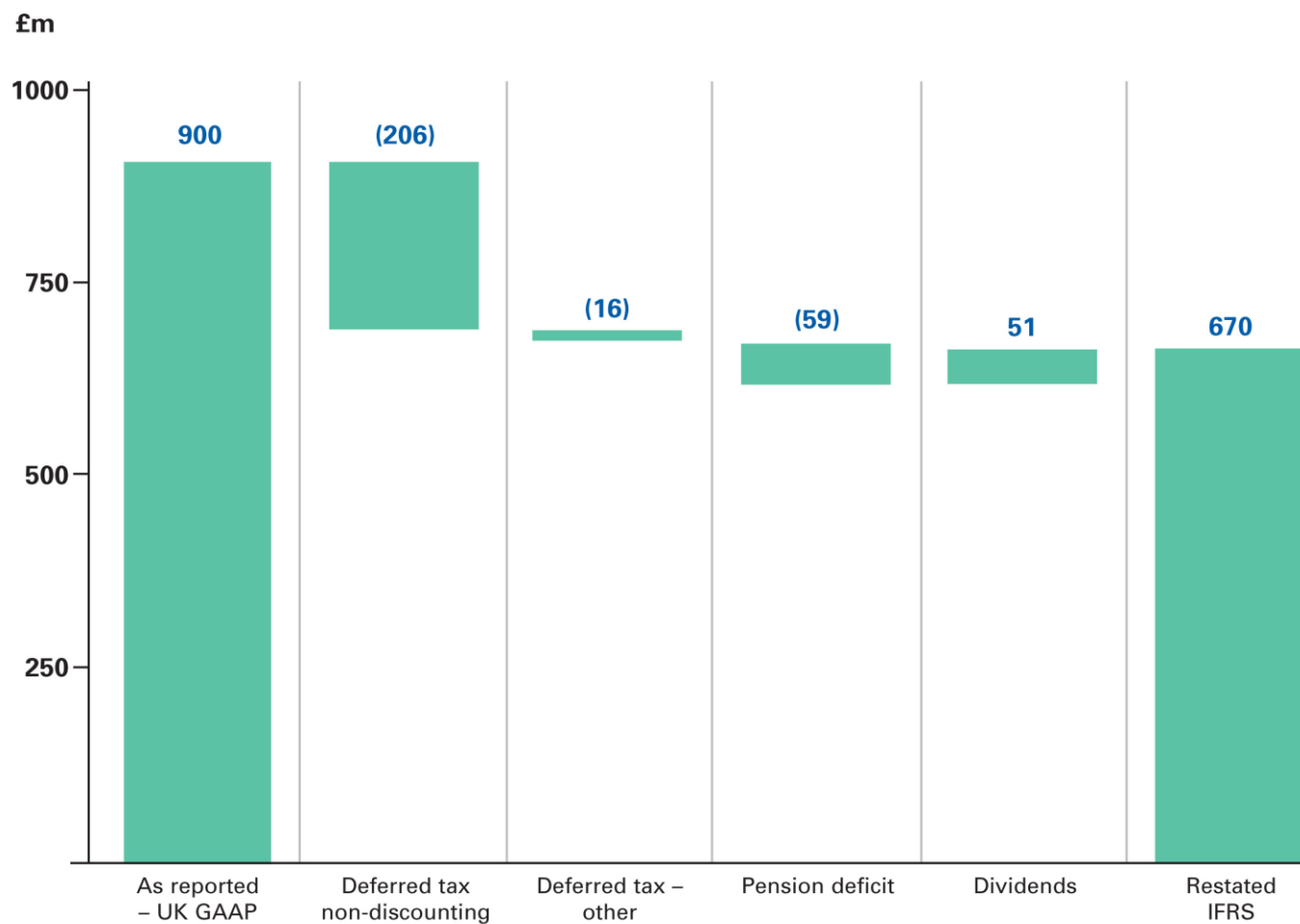


Key Financial Impacts of IFRS (Indicative) - I

| | UK GAAP | IFRS |
|---|----------------|-------------|
| 2004/05 P&L | £m | £m |
| Earnings before interest, taxation, depreciation and amortisation | 244 | 243 |
| Group operating profit | 148 | 149 |
| Profit before taxation | 87 | 87 |
| Adjusted earnings per share (before deferred tax) | 63p | 63p |
| Basic earnings per share | 55p | 49p |

- ***Little overall impact on 2004/05 P&L***

Indicative Shareholders' Equity – 31 March 2004



Key Financial Impacts of IFRS (Indicative) - II

| | UK GAAP £M | IFRS £M |
|-----------------------|-----------------------|--------------------|
| Shareholders' equity: | | |
| 31 March 2004 | 900 | c. 670 |
| 31 March 2005 | 938 | c. 710 |

- ***Significant changes to shareholders' equity***

Tony Hooper
Group Treasurer & Taxation Manager
Pennon Group

Deferred Tax - I

UK GAAP policy – FRS 19

- Discounted provision to match unwinding of long-term timing differences

IFRS policy – IAS 12

- Discounting not permitted

Financial impact

- 2004/05 pbt – nil
- 2004/05 eps before deferred tax – nil
eps basic – reduced by 6p per share
- 2004/05 Deferred Tax charge – increase c. **£7m**
- Shareholders' funds reduced by c. **£206m** - 31 March 2004
c. **£214m** - 31 March 2005

Deferred Tax - II

- Quick reminder of deferred tax in financial statements - summary

| | 1999/00 £m | 2000/01 £m | 2001/02 £m | 2002/03 £m | 2003/04 £m | 2004/05 £m |
|--|---------------|---------------|---------------|---------------|---------------|---------------|
| Deferred tax charge P&L | - | 17.6 | 3.3 | 13.7 | 3.3 | 10.8 |
| Deferred tax provision BS - discounted | - | 43.1 | 46.2 | 60.0 | 63.3 | 72.4 |
| Deferred tax provision BS - undiscounted | - | 214.5 | 235.7 | 253.0 | 269.2 | 285.9 |

Deferred Tax - III

- Deferred tax arises mainly from accounting profit being different from taxable profit.

Example: assume £6m spent on a 60 year life asset with a 25% writing down allowance available

| | Yr 1 £k | → | Yr 5 £k | Yr 6 £k | Yr 7 £k | Yr 8 £k | Yr 9 £k | Yr 10 £k | Yr 11 £k | Yr 12 £k | Yr 13 £k | Yr 14 £k | Yr 15 £k |
|---------------------------|------------|---|------------|------------|------------|------------|------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Financial Accounts | | | | | | | | | | | | | |
| Profit & Loss Deprec. | 100 | | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| Balance Sheet NBV | 5900 | | 5500 | 5400 | 5300 | 5200 | 5100 | 5000 | 4900 | 4800 | 4700 | 4600 | 4500 |
| Tax Accounts | | | | | | | | | | | | | |
| Profit & Loss C.A.'s | 1500 | | 475 | 356 | 267 | 200 | 150 | 113 | 84 | 63 | 48 | 36 | 27 |
| Balance Sheet TWDV | 4500 | | 1424 | 1068 | 801 | 601 | 451 | 338 | 253 | 190 | 143 | 107 | 80 |
| Excess of NBV over TWDV | 1400 | | 4076 | 4332 | 4499 | 4599 | 4649 | 4662 | 4647 | 4610 | 4557 | 4493 | 4420 |
| DT Liability at 30% | 420 | | 1223 | 1300 | 1350 | 1380 | 1395 | 1399 | 1394 | 1383 | 1367 | 1348 | 1326 |

CA - Capital Allowance

TWDV - Tax Written Down Value

Deferred Tax - IV

- Deferred taxation increases due to
 - withdrawal of discounting £206m
 - technical changes. Temporary differences (IAS 12) vs timing difference (FRS 19) £16m
 - offset by pensions deficit being included on the balance sheet and therefore also the associated deferred tax asset £23m
- Less volatility in deferred tax in future due to no impact of movements in discount rates
- Future capital expenditure means cash tax is expected to continue to be deferred

Other Issues – IAS 39

- Marginal impact on Pennon Group Plc
- Pennon makes extensive use of swaps to fix a substantial proportion of its debt
- IAS 39 states that all derivatives (including vanilla interest rate swaps) must be marked to market
- All cashflow hedges employed to swap floating debt into fixed debt are effective ie well within the 80%-125% tolerance corridor
- Ineffectiveness very small and therefore volatility will be through equity rather than P&L
- New software package to more efficiently re-compute valuations to reflect changes in interest rates etc

Richard Hughes
Finance & Regulatory Director
South West Water

Infrastructure Accounting - Summary

UK GAAP policy (FRS 15)

- Infra asset values not depreciated – FRS15 permits renewals accounting – “smoothed charge”
- Renewals accounting based on OFWAT 15 year Asset Management Plan

IFRS policy (IAS 16)

- Assets capitalised and depreciated under normal accounting principles
- Asset lives established to reflect useful life
- Net book value at transition date (1 April 2004) - fair value
- But: OFWAT continues to base price limits on Infra Renewals Accounting

Financial impact

- 2004/05 operating profit – c. £4m additional charge
- 2005/06 step change in allowed OFWAT IRC (Infra Renewals Charge)
- Shareholders’ funds – fair value in line with historic cost under UK GAAP

Infrastructure Assets

- *Valuation at 1 April 2004*

- Various methods identified in IFRS including depreciated cost
- Depreciated cost data is not available for infrastructure assets under an IFRS acceptable methodology
- Fair value is allowed as deemed cost under IFRS 1
- Fair value derived using discounted cash flow of whole business less identified assets and liabilities (including book value of non-infrastructure assets)
- Overall, minimal difference in valuation from 1 April 2004 book value of £976m

Depreciation

UK GAAP

- Based on infrastructure renewals charge which is linked to five yearly asset plans set at each Periodic Review
- Relatively flat charge over five year periods and then step change
- Overall concept – physical maintenance of the network at a specified service level

IFRS

- Based on remaining asset life at the valuation date
- Zero residual value
- New and significantly refurbished assets depreciated over estimated useful lives leads to a steadily rising depreciation charge (typically 30 to 100 years)

Infrastructure Assets – Profit and Loss Charge

| | 2004/05 £m |
|--|---------------|
| Infrastructure renewals charge (UK GAAP) | 15 |
| Estimated charge under IFRS: | |
| - depreciation | 12 |
| - expensed renewals | 7 |
| Total IFRS | 19 |

- OFWAT's IRC assumption for 2005/06 £21m

Source: 20% of infrastructure renewals charge of £96m shown in Appendix 6 of 'Future Water and Sewerage Charges 2005/10 – Final Determinations' published by OFWAT, November 2004

David Robertson
Finance Director
Viridor Waste

Acquisition Accounting

UK GAAP

- Consideration
- Fair value of acquired assets and liabilities
- Goodwill
- Amortised over 20 years

IFRS

- Consideration
- Fair value of acquired assets and liabilities
- Goodwill
- Assets include wider array of intangible assets
- Amortised over expected useful life
- Goodwill not amortised – subject to annual impairment test

Thames Waste Management

| | UK GAAP | IFRS | Difference |
|----------------------|------------|--------|---|
| | £m | £m | £m |
| Consideration | 30.8 | 30.8 | - |
| Fair value | (12.8) | (19.6) | 6.8 |
| Goodwill | 18.0 | 11.2 | (6.8) |
| Amortisation pa | | | |
| - goodwill | 0.9 | - | Higher amortisation under IFRS because of shorter life of intangibles |
| - intangibles | - | 1.4 | |
| Change in fair value | £m | | |
| DCF of royalties | 2.1 | | |
| DCF of contracts | 5.1 | | |
| Other | (0.4) | | |
| | <u>6.8</u> | | |

Overall Change

| | £m |
|---------------------------------|-------------|
| Historic goodwill at 31/03/04 | 45.0 |
| Thames Waste Management (TWM) | 11.2 |
| Goodwill at 31/03/05 | <u>56.2</u> |
| Amortisation 2004/05 | £m |
| Goodwill (UK GAAP) | 3.5 |
| TWM intangibles (IFRS) | 1.4 |
| Improvement in operating profit | <u>2.1</u> |

Annual Impairment Testing

- Goodwill identified for each cash generating unit (CGU)
- Discounted cash flow (DCF) prepared for each CGU
- Net assets in CGU plus goodwill compared to DCF
- If DCF higher – no impairment
- If DCF lower – impairment charge taken in profit and loss account
- No goodwill impairment at 31 March 2005

Edward Jackson
Group Financial Controller
Pennon Group

Pensions - I

UK GAAP policy (SSAP 24)

- Accounting based on **triennial actuarial valuation**
- P&L charge reflects service cost and spreading of valuation surplus/deficit
- FRS17 valuation disclosed separately in notes to accounts

IFRS policy (IAS 19)

- Accounting based on **annual valuation** – similar basis to FRS 17
- Opted for full surplus/deficit to be recognised on Balance Sheet (not “corridor approach”)
- P&L total charge covers service cost and net financing charge

| | |
|------------------------------|------------------|
| Interest on liabilities | - (£15.3m) |
| Estimated Return on assets | - <u>£14.0m</u> |
| 2004/05 Net Financing Charge | - <u>(£1.3m)</u> |

- Net financing charge potential volatility

Pensions - II

Financial impact (2004/05)

- Operating profit – **c£3m** higher, largely as deficit not charged to P&L
- Profit before tax – **c£2m** higher, after net finance cost
- Shareholders' funds – **c£77m** scheme deficit offset by **£23m** related deferred tax asset at 31 March 2004

Dividends

UK GAAP policy (Companies Act)

- Dividends recognised in period to which they relate

IFRS policy (IAS 10)

- Proposed dividends not recognised as liability until approved
- Interim dividend not recognised until paid
- Scrip dividend not impacted

Financial impact

- Shareholders' funds c**£51m** higher at 31 March 2004 as 2003/04 total dividend not recognised

Other Issues

- Reserves/dividend considerations
- IFRS 2 – share based payments

David Dupont
Group Director of Finance
Pennon Group

Conclusion

- Financial impacts from identified adjustments:
 - cash flow profile unchanged
 - little change to 2004/05 profit before tax and eps before deferred tax
 - shareholders' funds reduced
 - no impact on debt covenants
 - potential risk of earnings volatility
- Ready for transition to IFRS
- Communication will continue throughout 2005/06

Next Steps

| | |
|-----------------|--|
| Autumn 2005 | Fuller information on restatement of 2004/05 financial statements under IFRS |
| 8 December 2005 | Interim results to 30 September 2005 on an IFRS basis, with comparatives - unaudited |
| May 2006 | Full year results to 31 March 2006 under IFRS, with comparatives – Preliminary Results |
| June 2006 | Audited financial statements |