interim report 2003

Pennon Group Plc

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financial highlights

- Operating profit up 5.8% to £70.6 million
- Profit before tax up (after goodwill) 2.4% to £42.7 million
- Earnings per share (before deferred tax) up 5.8% from 29.5p to 31.2p
- Interim dividend per share up 4.8% to 13.2p

business highlights

South West Water Limited

- Operating profit up 4.4%
- On track to outperform the current regulatory contract
- Draft Business Plan submitted to Ofwat for period 2005-2010
- Continuing to improve efficiency whilst delivering record levels of drinking water and bathing water compliance
- Highest proportion of high quality rivers in England

Viridor Waste Limited

- Operating profit before goodwill up 26%
- Strong growth in profits from landfill and power generation
- 2002/03 acquisitions in total earnings enhancing (before goodwill) and performing in line with expectations
- Churngold Holdings acquired for £19.8 million in June 2003
- 2.8 million cubic metres planning gain at Pilsworth landfill and preferred bidder for West Sussex PFI

strategic highlights and prospects

- Pennon Group clearly focused on water, sewerage and waste management
- The Group continues to be well placed for the future:

  – South West Water: strong growth in Regulatory Asset Value to 2005; remains confident of outperforming the regulatory contract to 2005

  – Viridor Waste: successful focused strategy – capitalising on landfill asset base; exploiting landfill gas power generation opportunities; continuing to pursue profitable opportunities in line with the Government's developing waste strategy

These results demonstrate further profitable growth in the Group, affirming our strategy of concentrating on our two key businesses, South West Water and Viridor Waste.

South West Water continues with its service improvements to customers, has delivered further efficiencies and will outperform the regulatory contract to 2005. As a result of its successful focused strategy, Viridor Waste has delivered continued strong growth in the trading year to date.

The strong performance across the Group underpins our confidence in pursuing our progressive dividend policy.

Ken Harvey, Chairman

Chairman's interim statement

Group overview

- Group turnover rose 12.3% to £234.8 million.
- Group operating profit rose by 5.8% to £70.6 million.
- Group profit before tax was up 2.4% to £42.7 million.
- Earnings per share before deferred tax increased by 5.8% to 31.2p. Earnings per share after deferred tax increased by 27.4% to 30.7p.
- Capital expenditure for the Group was £85.6 million (2002 £90.9 million).
- One waste management business, Churngold Holdings Limited, was acquired during the half year for a total cash consideration of £19.8 million.
- Net debt for the Group was £1,036.9 million, an increase of £48.3 million since 31 March 2003. Gearing, being net borrowings to shareholders' funds, was 114%. Interest cover was 2.5 times for the 30 September 2003 half year (2002 2.7 times). At 31 March 2003 the equivalent figure was 2.4 times.
- The interim dividend of 13.2p per share represents an increase of 4.8% over the equivalent figure for September 2002. It will be paid on 8 April 2004 to shareholders on the register on 9 January 2004. The Board reaffirms its intention to pursue a progressive dividend policy and is offering shareholders a scrip dividend alternative.

South West Water Limited

South West Water turnover rose by £9.4 million to £146.0 million in the half year. Approved tariff increases, including the 4.4% K factor, amounted to £10.1 million. Customers switching from unmeasured to metered charging caused a reduction of £3.1 million in turnover. Other factors, including 4,000 new customer connections, together with a small increase in measured demand, contributed £2.4 million.

South West Water's operating profit rose 4.4% to £61.1 million. Operating costs, including depreciation, increased by £6.8 million to £84.9 million. Additional costs from new capital schemes of £3.8 million, inflation of £1.3 million and £3.6 million of other cost increases, mainly pensions and direct cost of sales, were offset by £1.9 million of efficiency savings in the half year. South West Water remains ahead of Ofwat's efficiency targets and is on track to deliver further efficiency savings to outperform the regulatory contract to 2005.

The company's Draft Business Plan, which forms part of the 2004 Periodic Review process, was submitted to Ofwat in August. The Draft Plan comprises three options, these being Reference Plans A and B and the company's Preferred Strategy, and now goes forward for a period of consultation. Its purpose is to inform a debate which will lead to decisions by Government early in 2004 as to the quality obligations on which final proposals will be prepared for April 2004. Following a Draft Determination in July 2004, Ofwat will make a Final Determination in November 2004 of the prices which customers will pay from 1 April 2005.

Capital expenditure reduced as expected in line with the regulatory requirements by £11 million to £69.8 million. £25.8 million was invested in water supply improvements including water mains renovation, water treatment works enhancement and leakage control. Ofwat's latest report on leakage notes that South West Water is one of the leading companies in managing water leakage and continues to deliver results in line with Ofwat's leakage target. The report also confirms that South West Water is in the top band for security of supply. Over 200km of water mains were laid, replaced or refurbished during the half year. Drinking water quality and river water quality are at an all time high and the region features the highest proportion of high quality rivers in England.

Waste water services investment expenditure was £28.8 million of which £11.9 million was invested in the company's 'Clean Sweep' bathing water programme which is now virtually complete. New works were commissioned at Croyde Bay and the waste water treatment works at Lynmouth was upgraded. Only one of the region's 141 bathing waters along the South West coastline failed to comply with the European Union's mandatory standards and Devon has achieved 100% compliance for the first time ever. In addition 115 of the region's bathing waters met the more stringent EU guideline standards, one of the best performances of any region in the UK.

The strong growth in South West Water's Regulatory Asset Value (RAV) is expected to outstrip the increase in the company's net debt to 2005.

South West Water's Draft Business Plan projects debt to RAV reaching around 60% by March 2010. On this basis, the Group does not expect to need additional equity funding for South West Water for the K4 period.

Viridor Waste Limited

Viridor Waste has continued to trade strongly in the six months ended 30 September 2003, building further on the growth achieved over the past three years. Turnover was £90.7 million, an increase of £16.3 million over the half year to 30 September 2002.

Viridor Waste operating profit before goodwill for the half year rose by 26% to £11.1 million (£10.0 million after goodwill) compared with £8.8 million in 2002/03 (£8.3 million after goodwill). Excluding the effect of acquisitions made since 30 September 2002 operating profit grew by 9%. Operating profit contributions from landfill and power generation increased by 10% and 78% respectively, the latter including the premium pricing benefits of renewables obligation certificates (ROCs). Operating margin, excluding landfill tax, was 16.8% (2002 16.6%). Earnings before interest, tax, depreciation and amortisation (EBITDA) grew from £19.0 million to £21.5 million. Capital expenditure for the half year was £15.7 million (2002 £10.7 million).

Total landfill disposal volumes increased by 9.2% to 1,865k tonnes. Underlying gate fees rose by 8%, well ahead of cost increases. In October, Viridor Waste achieved planning permission for a further 2.8 million cubic metres of landfill void at Pilsworth, serving North Manchester and the surrounding area, which will extend landfilling operations at this site until 2020. Consented landfill, including Pilsworth, increased from 80 million cubic metres at 31 March 2003 to 81 million cubic metres currently as a result of this planning gain less usage during the half year. Viridor Waste is currently filling its landfills at a rate of circa 4 million cubic metres per annum.

Viridor Waste's total power generation capacity increased by 8% to 40 MW during the half year, in addition to the 30% increase in 2002/03. All of this increased capacity benefits from premium prices under ROCs and underpins the strong profit growth achieved.

Viridor Waste has been chosen as preferred bidder for its first PFI waste management contract with West Sussex County Council. The final 25 year contract is expected to see Viridor Waste taking over and running the county's 11 civic amenity sites and recycling centres as well as new facilities, including a new materials recovery facility, as they come on stream.

The three acquisitions made during 2002/03 were in total earnings enhancing before goodwill in the half year, as projected. In June 2003, Churngold Holdings Limited was acquired. Churngold has waste recycling and transfer stations along with associated collection activities in the Bristol area, Glasgow and Edinburgh. It has an excellent geographic and business fit with Viridor Waste's existing activities in the South West of England and in Scotland. Churngold is currently being integrated and is trading in line with expectations.

Reflecting the growth in business and to further improve operational effectiveness, Viridor Waste has implemented a new regional management structure.

Pensions

The Group pension schemes showed an indicative net deficit at 30 September 2003 at a similar level to the reported FRS17 net deficit of £59.4 million at 31 March 2003, with a recovery in investment values being offset by further adverse movements in the interest rates used in discounting liabilities. This deficit represents circa 7% of total market capitalisation. The next triennial actuarial valuation is due in April 2004. From 1 April 2003 employer contributions were increased to 11.5% from 4.8%. The Group's defined contribution pension scheme for Viridor Waste employees was introduced in July 2003.

Taxation

The mainstream corporation tax charge for the half year was £4.2 million (2002 £2.0 million).

The deferred tax charge for the half year to 30 September 2003 was £0.7 million (2002 £7.3 million).

Financing

The total interest charge increased from £24.5 million to £27.8 million. The 2002/03 result included a £2 million interest benefit from the sale proceeds of Viridor Instrumentation Limited. The average interest rate on net debt was reduced from 6.4% to 5.5%.

The Group funding strategy utilises a mix of fixed and floating rate borrowings. To take advantage of current low interest rates and reduce the risk of adverse movements, South West Water continues its strategy of entering into swap arrangements to fix the interest rate on the majority of its debt for the period up to March 2005.

Strategy and prospects

The Board's priority continues to be on creating shareholder value and satisfying customer needs. This will be achieved by South West Water continuing to grow its Regulatory Asset Value and outperforming the regulatory contract up to 2005 and Viridor Waste continuing its strategy of creating long-term sustainable profit growth, particularly in landfill and power generation.

Ken Harvey, Chairman
27 November 2003

Group profit and loss account

for the half year ended 30 September 2003

	Notes	**Half year ended 30 September 2003 (unaudited) £m**	Half year ended 30 September 2002 (unaudited) £m	Year ended 31 March 2003 £m
Turnover				
Continuing operations		**227.2**	209.0	417.2
Acquisitions		**7.6**	–	–
Total turnover		**234.8**	209.0	417.2
Group operating profit				
Continuing operations		**70.5**	66.7	127.0
Acquisitions		**0.1**	–	–
Total Group operating profit		**70.6**	66.7	127.0
Share of operating loss in joint venture/associate		**(0.1)**	(0.5)	(0.7)
Total operating profit		**70.5**	66.2	126.3
Net interest payable		**(27.8)**	(24.5)	(52.1)
Profit on ordinary activities before taxation		**42.7**	41.7	74.2
Tax on profit on ordinary activities	(3)	**(4.9)**	(9.3)	(17.1)
Profit on ordinary activities after taxation		**37.8**	32.4	57.1
Dividends	(4)			
Special interim dividend		**–**	(95.9)	(95.9)
Interim and final dividends		**(16.4)**	(15.6)	(48.4)
		(16.4)	(111.5)	(144.3)
Retained surplus/(deficit) transferred to/(from) reserves		**21.4**	(79.1)	(87.2)
Earnings per share	(5)			
Before deferred tax				
Adjusted basic		**31.2p**	29.5p	55.0p
Adjusted diluted		**31.1p**	29.4p	54.8p
After deferred tax				
Basic		**30.7p**	24.1p	44.3p
Diluted		**30.5p**	24.0p	44.2p
Dividend per share	(4)	**13.2p**	82.6p	109.1p

There were no recognised gains or losses other than the profit for the six months to 30 September 2003 and for the year to 31 March 2003.

The special interim dividend in the half year ended 30 September 2002 related to the return to shareholders of the sale proceeds from the disposal of Viridor Instrumentation Limited.

Summarised Group balance sheet

at 30 September 2003

	30 September 2003 (unaudited) £m	30 September 2002 (unaudited) £m	31 March 2003 £m
Fixed assets			
Intangible assets	**45.7**	19.7	37.6
Tangible assets	**2,105.6**	1,968.9	2,046.4
Investments	**2.1**	3.2	1.9
	2,153.4	1,991.8	2,085.9
Current assets			
Stocks	**3.8**	3.0	4.0
Debtors	**104.8**	87.0	87.6
Investments and cash	**225.1**	340.0	191.0
	333.7	430.0	282.6
Creditors: amounts falling due within one year	**(258.9)**	(362.0)	(265.1)
Net current assets	**74.8**	68.0	17.5
Total assets less current liabilities	**2,228.2**	2,059.8	2,103.4
Creditors: amounts falling due after more than one year	**(1,187.7)**	(1,040.3)	(1,083.3)
Provisions for liabilities and charges	**(90.3)**	(81.6)	(90.6)
Deferred income	**(39.1)**	(39.9)	(39.4)
Net assets	**911.1**	898.0	890.1
Capital and reserves			
Called-up share capital	**137.6**	137.2	137.2
Share premium account	**154.2**	152.6	152.8
Profit and loss account	**619.3**	608.2	600.1
Shareholders' funds	**911.1**	898.0	890.1

Group cash flow statement

for the half year ended 30 September 2003

	Notes	**Half year ended 30 September 2003 (unaudited) £m**	Half year ended 30 September 2002 (unaudited) £m	Year ended 31 March 2003 £m
Net cash inflow from operating activities	(7)	**103.8**	108.4	198.9
Returns on investments and servicing of finance		**(9.6)**	(7.0)	(42.9)
Taxation		**–**	0.5	–
Capital expenditure and financial investment		**(95.5)**	(95.4)	(198.2)
Acquisitions		**(20.0)**	(19.7)	(37.2)
Equity dividends paid		**(15.6)**	(16.6)	(147.3)
Net cash outflow before use of liquid resources and financing		**(36.9)**	(29.8)	(226.7)
Management of liquid resources		**5.1**	69.4	67.6
Financing		**72.8**	103.8	140.7
Increase/(decrease) in cash in period		**41.0**	143.4	(18.4)

Segmental analysis by class of business

for the half year ended 30 September 2003

	Half year ended 30 September 2003 (unaudited) £m	Half year ended 30 September 2002 (unaudited) £m	Year ended 31 March 2003 £m
Turnover			
Continuing operations			
Water and sewerage	**146.0**	136.6	270.2
Waste management	**90.7**	74.4	152.3
Other	**3.8**	2.6	5.2
Less intra-group trading	**(5.7)**	(4.6)	(10.5)
Group totals	**234.8**	209.0	417.2
Group operating profit			
Continuing operations before goodwill amortisation			
Water and sewerage	**61.1**	58.5	111.5
Waste management	**11.1**	8.8	19.1
Other	**(0.5)**	(0.1)	(2.1)
Total continuing operations	**71.7**	67.2	128.5
Goodwill amortisation			
Waste management	**(1.1)**	(0.5)	(1.5)
Group totals	**70.6**	66.7	127.0
Profit on ordinary activities before taxation			
Continuing operations			
Water and sewerage	**37.2**	36.8	67.1
Waste management	**7.5**	7.0	14.2
Other*	**(2.0)**	(2.1)	(7.1)
Group totals	**42.7**	41.7	74.2

*includes interest arising on parent company financing of acquisitions.

Continuing operations include acquisitions.

Notes

1. The results for the half year ended 30 September 2003 are unaudited as were those for the half year ended 30 September 2002. The same accounting policies have been applied as those set out in the Pennon Group Plc Annual Report and Accounts for the year ended 31 March 2003.

2. The financial information for the year ended 31 March 2003 does not constitute full financial statements within the meaning of section 240 of the Companies Act 1985. The full financial statements for that year have been delivered to the Registrar of Companies. The independent auditors' report on those financial statements was unqualified and did not contain a statement under section 237 (2) or (3) of the Companies Act 1985.

3. Tax on profit on ordinary activities comprises:

	September 2003 £m	September 2002 £m	March 2003 £m
United Kingdom corporation tax	**4.2**	2.0	3.4
Deferred taxation	**0.7**	7.3	13.7
	4.9	9.3	17.1

The tax charge for September 2003 and September 2002 has been derived by applying the anticipated effective annual tax rate to the first half year profit before tax.

4. Dividends

	September 2003 £m	September 2002 £m	March 2003 £m
Special interim dividend of 70.0p per share	**–**	95.9	95.9
Interim dividend of 13.2p (September 2002 12.6p) per share	**16.4**	15.6	15.6
Final dividend of 26.5p per share	**–**	–	32.8
	16.4	111.5	144.3

The special interim dividend in the half year ended 30 September 2002 related to the return to shareholders of the sale proceeds from the disposal of Viridor Instrumentation Limited.

5. Earnings per Ordinary share

Basic and diluted earnings per share

The calculation of earnings per share is based on the profit on ordinary activities after taxation divided by the weighted average number of Ordinary shares in issue during the half year of 123.3 million (2002 134.4 million). The average number of shares in issue was reduced by a share capital consolidation on 2 September 2002 whereby every 111 Ordinary shares of £1 each were replaced by 100 new Ordinary shares of £1.11 each.

5. Earnings per Ordinary share *continued*

Basic and diluted earnings per share *continued*

All share options with an exercise price lower than the average market price of the Company's shares during the half year have been included in the calculation of diluted earnings per share. The weighted average number of shares in issue during the half year, taking account of the dilutive effect of share options, was 123.9 million (2002 134.8 million).

Adjusted basic and diluted earnings per share

Adjusted earnings per share have been calculated to exclude the impact of deferred tax on the results, as this item can have a distorting effect on earnings from year to year and therefore warrants separate consideration. Adjusted earnings have been calculated as follows:

	30 September 2003 £m	30 September 2002 £m	31 March 2003 £m
Profit on ordinary activities after taxation	**37.8**	32.4	57.1
Deferred tax	**0.7**	7.3	13.7
Adjusted earnings	**38.5**	39.7	70.8

6. The interim dividend of 13.2p per share will be paid on 8 April 2004 to shareholders on the register on 9 January 2004.

7. Reconciliation of Group operating profit to net cash inflow from operating activities:

	Half year ended 30 September 2003 (unaudited) £m	Half year ended 30 September 2002 (unaudited) £m	Year ended 31 March 2003 £m
Group operating profit	**70.6**	66.7	127.0
Depreciation charge	**42.1**	40.0	79.8
Amortisation of intangible fixed assets	**1.1**	0.5	1.5
Provision for impairment of fixed asset investments	**0.4**	0.2	1.4
Deferred income released to profits	**(0.6)**	(0.6)	(1.2)
Decrease in provisions for liabilities and charges	**(1.4)**	(0.7)	(2.0)
Decrease/(increase) in stocks	**0.2**	0.2	(0.8)
(Increase)/decrease in debtors (amounts falling due within and over one year)	**(11.0)**	(4.1)	1.1
Increase/(decrease) in creditors (amounts falling due within and over one year)	**2.3**	6.4	(7.1)
Loss/(profit) on disposal of tangible fixed assets	**0.1**	(0.2)	(0.8)
Net cash inflow from operating activities	**103.8**	108.4	198.9

8. Acquisitions

The terms of the agreement with the other shareholders of Enviro-Logic Limited (now renamed Peninsula Water Limited) provided an option for Pennon Group Plc to acquire full ownership of the company after five years. The option was taken up on 6 May 2003. No consideration was payable. Net overdraft balances acquired were £0.1 million.

On 5 June 2003 the entire issued share capital of Churngold Holdings Limited (now renamed Viridor Waste (Bristol Holdings) Limited) was purchased by Viridor Waste Management Limited for a cash consideration of £19.8 million. Net overdraft balances acquired were £0.1 million. The acquisition was accounted for using the acquisition method and provisional goodwill arising on the acquisition, amounting to £9.2 million, has been capitalised and will be amortised over 20 years.

On 31 July 2003 £3.7 million of loan notes were issued in settlement of contingent consideration now due in respect of Terry Adams Limited in 1997. Provisional goodwill arising on this acquisition, amounting to £2.2 million, has been written off to Group reserves.

9. Analysis of net debt:

	At 1 April 2003 £m	Cash flow £m	Acquisitions (excluding cash items) £m	Non-cash movements £m	At 30 September 2003 £m
Cash at bank and in hand	8.6	1.4	–	–	10.0
Current asset investments:					
Overnight deposits	4.3	37.1	–	–	41.4
Bank overdrafts	(14.1)	2.5	–	–	(11.6)
	(1.2)	41.0	–	–	39.8
Debt due within one year (other than bank overdrafts)	(58.0)	9.4	(0.1)	19.1	(29.6)
Debt due after more than one year	(385.6)	(65.0)	(0.4)	(22.8)	(473.8)
Finance lease obligations	(721.9)	(15.4)	(2.9)	(6.8)	(747.0)
	(1,165.5)	(71.0)	(3.4)	(10.5)	(1,250.4)
Current asset investments:					
Other than overnight deposits	178.1	(5.1)	–	0.7	173.7
	(988.6)	(35.1)	(3.4)	(9.8)	(1,036.9)

Non-cash movements include transfers between categories of debt for changing maturities, increased accrued finance charges within finance lease obligations, loan notes issued (note 8) and increased accrued interest on cash deposits to secure rental obligations.

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