news from Pennon Group Plc

**PENNON GROUP PLC** **5 June 2008**

**PRELIMINARY RESULTS FOR THE YEAR ENDED 31 MARCH 2008**

Pennon Group announces its unaudited results for the year ended 31 March 2008.

A presentation for City audiences will be held today, 5 June 2008, at 11:30 at Smeaton Vaults, The Brewery, Chiswell Street, London, EC1.

For further information today, 5 June 2008, please contact :

| | | | |
|---|---|---|---|
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## FINANCIAL HIGHLIGHTS

- Underlying operating profit [(1)] up 19.8% to £242.1m.
  - South West Water up 17.8% to £185.0m.
  - Viridor up 24.1% to £58.1m.
- Underlying profit before tax [(2)] up 16.3% to £154.9m.
- Underlying earnings per share [(3)] up 19.4% to 36.9p.
- Dividend
  - Recommended final dividend per share up 6.8% to 13.56p.
  - Full year dividend up 6.8% to 19.81p.
  - Continued dividend policy of 3% per annum real increases to 2009/10.
- Share buy back programme completed.

## RECONCILIATION OF UNDERLYING AND STATUTORY RESULTS

| | 2008 | 2007 | Growth |
|---|---|---|---|
| | £m | £m | |
| **OPERATING PROFIT** | | | |
| Statutory operating profit | 236.8 | 200.0 | 18.4% |
| Non-underlying costs : | | | |
| - Restructuring – South West Water | 4.0 | 0.3 | |
| - Intangibles amortisation – Viridor | 1.3 | 1.8 | |
| Underlying operating profit [(1)] | 242.1 | 202.1 | 19.8% |
| **PROFIT BEFORE TAX** | | | |
| Statutory profit before tax | 149.6 | 131.1 | 14.1% |
| Non-underlying costs : | | | |
| - Restructuring – South West Water | 4.0 | 0.3 | |
| - Intangibles amortisation – Viridor | 1.3 | 1.8 | |
| Underlying profit before tax [(2)] | 154.9 | 133.2 | 16.3% |
| **EARNINGS PER SHARE** | | | |
| Statutory earnings per share | 38.2p | 26.5p | 44.2% |
| Non-underlying costs : | | | |
| - Restructuring – South West Water | 0.9 | 0.1 | |
| - Intangibles amortisation – Viridor | 0.4 | 0.5 | |
| Deferred tax | (2.6) | 3.8 | |
| Underlying earnings per share [(3)] | 36.9p | 30.9p | 19.4% |

## OPERATIONAL HIGHLIGHTS

- **South West Water :**
  - On target to deliver 2005 – 2010 Regulatory Contract.
  - Profit increase reflecting strong growth in Regulatory Capital Value 2005 – 2010, due to reach £2.7bn by end of K4.
  - Eleventh consecutive year without hosepipe bans and drought orders.
  - Leakage performance maintained in 2007/08 – amongst the very best in the industry.
  - Capital investment of £170m.
  - Next Periodic Review (PR09) programme on track – Strategic Direction Statement and 25 year Draft Water Resources Plan published.

- **Viridor :**
  - Another year of strong growth in operating profits, especially from landfill, power generation and recycling.
  - Grosvenor Waste Management acquired for £79.5m (plus net debt of circa £1.5m) in December 2007.
  - Shore Recycling acquired for £23m in March 2008.
  - Planning permissions achieved for a 60,000 tonne Energy from Waste (EfW) plant in Exeter and a Mechanical Biological Treatment (MBT) and Anaerobic Digestion (AD) facility in Somerset.

"I am delighted to announce further significant profitable growth in the Group" said Ken Harvey, Chairman. "We are delivering the benefits of our strategy of focusing on our two key businesses, South West Water and Viridor. South West Water remains on target to deliver the current regulatory contract (2005-2010) and is now formulating its business plan submission for the next regulatory period. Viridor has had another outstanding year, achieving a very strong performance based on both organic growth and sound acquisitions."

## GROUP OVERVIEW

**Throughout this report, unless otherwise stated, all figures are underlying results excluding restructuring costs, intangibles amortisation and deferred tax.**

- Revenue rose by 16.9% to £875.0m.
- Operating profit rose by 19.8% to £242.1m.
- Profit before tax was up 16.3% to £154.9m.
- Earnings per share increased by 19.4% from 30.9p to 36.9p. Statutory earnings per share increased from 26.5p to 38.2p.
- Capital expenditure was £228.8m (2006/07 – £245.1m).
- Net borrowings at 31 March 2008 were £1,764m, an increase of £207m since 31 March 2007. Gearing, being net borrowings to shareholders' funds plus net borrowings, was 73% (2006/07 – 71%). Interest cover was 2.8 times (2006/07 – 2.9 times). South West Water net debt to RCV was 60% (2007 – 62%).
- The Board has recommended a final dividend of 13.56p, up 6.8%, subject to shareholder approval. Together with the interim dividend of 6.25p, this will result in a total dividend for the year of 19.81p, an increase of 6.8% on the total dividend for 2006/07. The Board's stated policy is to grow the Group dividend by 3% above inflation per annum up to 2009/10. Shareholders will again be given the opportunity to participate in a Dividend Re-Investment Plan, details of which will be circulated in August.

**SOUTH WEST WATER**

South West Water revenue rose by £39.5m (10.4%) to £421.0m. Approved tariff increases, including the 9.8% K factor, amounted to £52.3m. 8,300 new customer connections contributed £3.6m. Customers switching from unmeasured to metered charging caused a revenue reduction of £10.0m. 62% of South West Water's domestic customers are now metered - up from 57% at March 2007. A 4.1% decrease in measured demand, impacted in part by the wettest summer since records began, reduced turnover by £7.9m.

South West Water's operating profit rose 17.8% to £185.0m. Operating costs, excluding depreciation, increased by £4.3m to £151.0m. This arose from inflation of £2.3m (net of a reduction in power costs of £2.5m), the additional costs from new capital schemes of £1.1m, reduced property disposals of £2.6m and other cost increases of £2.5m (including infrastructure expenditure charged to operating costs), partially offset by £4.2m of efficiency savings. The cost of bad debts (part of which is charged against revenue) is rising more slowly than the tariff increase. Depreciation increased by £7.3m to £85.0m as a result of new capital schemes.

Capital expenditure was £169.7m (2006/07 - £184.0m). £100.0m was invested in water supply improvements including water mains renovation and water treatment works enhancement. The water treatment works at Littlehempston in South Devon, serving 160,000 homes in the Torbay area, was substantially upgraded. Continued high levels of investment in the £240m water mains renovation programme to replace or reline 3,200kms of water mains is a key element during the K4 period. A further 480kms of water mains were laid, replaced or refurbished during the year, in line with the Drinking Water Inspectorate's (DWI) agreed programme for completion by 2010.

South West Water improved its position in both the 'Water and Sewerage Companies' and 'All Companies' league tables for the wide range of measures used by Ofwat referred to as the Overall Performance Assessment (OPA) with a best ever ranking of fifth out of 10 among water and sewerage companies compared to our sixth place in 2005/06. Ofwat's 'Financial Performance and Expenditure' report, published September 2007, reported that South West Water was the only water and sewerage company to achieve a 'stable' serviceability assessment in all 4 service areas.

Drinking water quality compliance in 2007 was at its highest ever level – 99.97%.

South West Water has put in place a comprehensive strategy to help ensure a continued secure supply of water for the region. 2007 was the eleventh consecutive year with no water restrictions. The company is benefiting from the infrastructure installed several years ago which enables the pumping of water into a number of key reservoirs from downstream to supplement the natural inflow.

Ofwat's latest report on leakage confirms that South West Water remains one of the leading companies in managing water leakage and continues to achieve Ofwat's target of keeping leakage at or below 84 ML/day. South West Water has achieved Ofwat's leakage targets every year since their inception. In 2007/08 South West Water maintained its low level of leakage and continues to have one of the very lowest levels in the industry.

Waste water treatment works performance in 2007 was at an all time high. The region features the highest proportion of high quality rivers in England. Investment expenditure totalled £69.7m for the year and included one of the last remaining Clean Sweep projects at Sennen and Porthcurno.

The company is implementing detailed plans to target outperformance of the operating cost efficiency targets set by Ofwat for the period up to 2010. Further 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. The company has also implemented a significant programme of organisational restructuring across the business costing £4m in 2007/08. The restructuring programme is ongoing and it is expected that a further £5m will be provided in 2008/09. To support operational and service improvements, a number of employee development programmes have been completed in the year.

A new contact centre system was installed during the year to improve call-handling services for customers using helplines. The benefits of the new system are already being seen, with a significant improvement in capacity and a reduction in the number of repeat contacts from customers.

In October 2007 South West Water awarded a new customer contact/billing contract to Accenture. Accenture commenced operations in April 2008 and are targeting a step change in customer service through quality improvements and more efficient ways of working.

‘WaterCare’, a ground-breaking new customer care programme, was launched in early 2007. ‘WaterCare’ aims to help those most in need pay their bills by advising them on how to manage better both their water use and household budget, including claiming all the benefits to which they are entitled. During this last year, ‘WaterCare’ has delivered tangible benefits to circa 2,000 customers. The programme has been commended by the Government as an exemplary service offered to customers.

South West Water continues to deliver capital projects in line with Ofwat, DWI and EA expectations. The company is targeting delivery of Ofwat’s allowed K4 capital programme for 5% less than Ofwat’s assumed £762m (2002/03 price base) and is on track to achieve this.

Regulatory Capital Value (RCV) is expected to grow by 36% over the K4 period to £2.7bn by March 2010 – the highest forecast percentage increase of any quoted UK water company. After adjusting for the effect of the 2006 capital return, the company expects its growth in RCV to outstrip significantly the anticipated growth in net borrowings over the K4 period.

As part of its preparation for the next Periodic Review (PR09), last December South West Water published its Strategic Direction Statement outlining its vision for the next 25 years. The Strategic Direction Statement outlines the first steps the company proposes to take towards facing the challenges of the future, including climate change and new legislative requirements.

The Draft Water Resources Plan published in May 2008 affirms that, despite a forecast 12% regional population increase by 2035 and new challenges created by climate change, no new reservoirs will need to be built in the region. Instead, the Plan outlines several new water conservation proposals to manage demand efficiently and to improve future water availability including further strengthening of the company’s existing infrastructure.

**VIRIDOR**

Viridor traded particularly strongly in 2007/08, building further on the growth achieved over the past six years. Revenue was up £87.4m (23.8%) to £455.1m, of which acquisitions accounted for £35.0m and existing business £52.4m. The total increase included landfill tax of £26.2m.

Viridor's earnings before interest, tax, depreciation and amortisation (EBITDA) rose 22.0% from £82.8m to £101.0m. Profit before interest, tax and amortisation of intangibles (PBITA) for the year increased by 24.1% (£11.3m) to £58.1m, compared to £46.8m in 2006/07. The increase reflected a full year's contribution from last year's Wyvern and Skipaway acquisitions, the positive effect of this year's acquisitions (Grosvenor and Shore), a one-off profit of £0.6m in 2006/07 on the disposal of Viridor's interest in Devon Waste Management Limited and 12.2% organic growth. Within the existing business, landfill, power generation and recycling performed particularly strongly. Viridor has achieved PBITA compound growth of 24% per annum since 2000/01.

Profit before tax at £35.5m was up 20.7% on the previous year. Capital expenditure for the year was £59.0m (2006/07 - £60.9m).

Landfill inputs excluding cover grew very strongly and were 5.2m tonnes (or 11%) higher in 2007/08 compared with the previous year. Of this total, approximately 0.2m tonnes is not expected to recur in 2008/09. Average revenue per tonne increased by 2.5% (to £19.30 per tonne) or 3.5% after adjusting for changes in sales mix. Consented landfill void fell from 90 million cubic metres last year to 84 million cubic metres at 31 March 2008, reflecting usage during the year. Since the year end Viridor has gained planning consents at two sites totalling 2.4m cubic metres, being an additional 2m cubic metres of landfill capacity at the Beddington Integrated Waste and Recycling Centre, near Croydon, as part of a wider expansion of operations, and an additional 400,000 cubic metres of landfill disposal capacity at its Horton site in West Sussex.

Viridor's landfill gas power generation output increased by a further 13% to 477 Gigawatt hours (on top of a 15% increase last year). As flagged at the beginning of the year, underlying brown energy prices were lower in 2007/08 than in the previous year. This was largely offset by an increase in the renewable premium in the UK and Viridor's average revenues per Megawatt hour (MWh) fell by 2% to £60. Viridor's brown energy contract prices in 2008/09 are at a higher level than in 2007/08. At 31 March 2008, Viridor's landfill gas power generation capacity was 84MW compared with 75MW at the previous year end (both figures exclude a small amount of sub-contract capacity). Viridor now collects nearly 90% of the estimated total methane generated by its landfill and uses the majority of this for energy generation. This has the double environmental benefit of reducing emissions of methane to the atmosphere (methane is 21 times as harmful as $CO_2$ as a greenhouse gas) and generating renewable energy. At the same time Viridor earns significant profits from this aspect of its business. At 31 March 2008 55% of Viridor's power generating capacity was eligible for Renewable Obligation Certificates (ROCs) and 45% for Non Fossil Fuel Obligation (NFFO).

The UK is required under the EU Landfill Directive to reduce the amount of biodegradable municipal waste going to landfill sites. Municipal waste accounts for around one third of Viridor's landfill market. The alternatives to landfill sites for final waste disposal in the UK are currently limited. In order to meet the requirements of the Landfill Directive, local authorities have been set statutory targets by the Government for the recycling of household waste and must also implement strategies for the diversion of biodegradable municipal waste from landfill. Accordingly, the recycling and contracts segments are increasingly important to Viridor's business and both performed strongly in 2007/08. Total profit contribution grew by over 80% (27% excluding the effect of acquisitions) and now represents 24% of total contribution compared to 16% last year.

Profits in Viridor's industrial and commercial collection business grew 22% in 2007/08 maintaining the segment's overall share of Viridor profits (8% in both years). At the same time the business provided useful volumes to Viridor's landfill business.

In line with its strategy, Viridor made two significant acquisitions in 2007/08 to strengthen its recycling business. In December 2007 Viridor acquired Grosvenor Waste Management for £79.5m (plus net debt of circa £1.5m). Grosvenor is a leading UK materials recycling company with the UK's largest Materials Recycling Facility (MRF) at Crayford in South-East London which benefits from advanced automated recycling technologies and an associated collection fleet. It has a further MRF in Peterborough which is currently being expanded. In addition Grosvenor has an extensive recyclate sales network in both the UK and overseas. The business has an excellent geographic and business fit with Viridor's existing operations in the South East of England. Grosvenor has been renamed Viridor Resource Management, has been integrated operationally and was already earnings enhancing after integration costs in 2007/08.

In March 2008 Viridor acquired Shore Recycling for £23m. Shore is a leading UK waste electrical and electronic equipment (WEEE) recycling company headquartered in Perth, Scotland. It has recycling facilities in Perth, Manchester and St Helens and an associated collection fleet. It processes a full range of WEEE and has modern purpose built recycling equipment. This business has an excellent fit with Viridor's existing operations in the north west of England and in Scotland. The business has been renamed Viridor Electrical Recycling and is expected to be earnings enhancing in the first full year, 2008/09.

As part of its overall strategy, Viridor is pursuing a number of further energy from waste opportunities. The Lakeside joint venture with Grundon Waste Management comprises a 400k tonne and up to 37MW energy from waste (EfW) plant at Colnbrook near Heathrow. As previously reported, it involves £160m capex financed by 86% non-recourse debt with the balance split equally between the two equity providers. Construction is advanced and a profit contribution is expected in 2009/10.

Last summer Viridor achieved planning permission for a 60k tonne and 3MW EfW plant in Exeter. It is also pursuing other possible long-term EfW opportunities in Cardiff and Dunbar.

Private Finance Initiative (PFI) and Public Private Partnership (PPP) contracts are also a key part of Viridor's strategy and Viridor will continue to bid selectively for further integrated municipal contracts. It was reported last year that the Viridor/Laing consortium had achieved preferred bidder status on the Greater Manchester PFI, the UK's largest waste contract. Financial close is expected soon. Viridor also continues to bid selectively for other contracts and is one of the last two bidding for the Oxfordshire PPP, one of the last four for the Cheshire PFI and is short-listed for the Medway PPP. It is also bidding for the Merseyside PFI.

**INTEREST CHARGE AND FINANCING INITIATIVES**

The total net interest charge increased from £69.2m in 2006/07 to £87.4m in 2007/08. The average interest rate on net debt has increased to 5.3% (2006/07 – 4.6%) for the Group and 4.5% (2006/07 – 4.3%) for South West Water. This is believed to be amongst the lowest in the sector.

The Group funding strategy utilises a mix of fixed, floating and index-linked rate borrowings. To reduce the risk of adverse interest rate movements, South West Water has swap arrangements in place to fix the interest rate on circa 60% of its debt up to March 2010. In addition, circa 25% of South West Water current net debt is index-linked to 2041 – 2057, at an average real rate of 1.66%.

During the year, the following financing initiatives were implemented :

- South West Water :
    - £200m 1.99% index-linked bonds due 2057 – issued at £208m giving a real rate of 1.86%;
    - £93m 13 year finance lease extension;
    - £50m finance lease drawdown for long-life assets which are treated for tax purposes as industrial buildings;
    - £50m finance lease drawdown for water mains rehabilitation.
- Pennon : £100m bonds due 2022.
- Viridor : £10m sub-LIBOR lease.

The effect of these initiatives was to extend the Group's average debt maturity from 16 to 24 years; provide committed funding to cover South West Water's requirements for at least the remainder of the K4 period up to March 2010 and increase the fair value benefit (i.e. the difference between the book value and market value of Group debt) from £117m to £170m at 31 March 2008.

**PENSIONS**

The Group's pension schemes had a deficit (net of deferred tax) under IAS 19 at 31 March 2008 of circa £19m, representing just under 1% of current market capitalisation. The longevity assumption has been strengthened to a scheme-specific 'medium cohort' basis. The triennial actuarial valuation for March 2007 has been completed and has resulted in higher future service and deficit recovery contributions. A further contribution prepayment of £19m was made during the year. The Group's existing defined benefit schemes have been closed to new entrants from 1 April 2008.

**TAXATION**

The mainstream corporation tax charge for the year was £25.0m (2006/07 - £23.9m) giving a mainstream effective tax rate of 17%.

Deferred tax for the year was a credit of £9.0m (2006/07 - £13.3m charge) resulting from a non-recurring credit of £21.0m relating to the reduction in the rate of UK corporation tax from 30% to 28% (effective from 1 April 2008). The abolition of industrial buildings allowances is expected to be enacted in 2008/09 and is then expected to increase deferred tax by an estimated £30m.

**RETURN OF CAPITAL**

The on-market share buy back programme is now complete with £49.3m spent during the year.

**STRATEGY & PROSPECTS**

The Board's strategy remains focussed on its two businesses, South West Water and Viridor.

South West Water is successfully delivering the current five year regulatory contract and is expected to grow significantly its Regulatory Capital Value up to £2.7 billion by 2010. Preparation for the next five year period (2010 – 2015) is progressing well.

Viridor's successful strategy to create long-term sustainable profit growth is expected to continue through capitalising on its landfill asset base, maximising its renewable energy generation from landfill gas and energy from waste and pursuing profitable opportunities in line with the Government's landfill diversion and recycling targets.

In addition, the Group has put in place a long-term funding structure to enable it to continue to finance its activities efficiently.

Ken Harvey
Chairman
5 June 2008

**DISCLAIMER IN RESPECT OF FORWARD-LOOKING STATEMENTS**

This preliminary results statement contains forward-looking statements relating to the Pennon Group's operations, performance and financial position based on current expectations of, and assumptions and forecasts made by, Pennon Group management. Various known and unknown risks, uncertainties and other factors could lead to substantial differences between the actual future results, financial situation development or performance of the Group and the estimates and historical results given herein. Undue reliance should not be placed on forward-looking statements which are made only as of the date of this document. Nothing in this preliminary results statement should be construed as a profit forecast. The Group accepts no obligation publicly to revise or update these forward-looking statements or adjust them as a result of new information or for future events or developments, except to the extent legally required.

## PENNON GROUP PLC

**Consolidated income statement for the year ended 31 March 2008**

| | Note | **2008 (Unaudited) £m** | 2007 £m |
|---|---|---|---|
| **Revenue** | 4 | **875.0** | 748.3 |
| **Operating costs** | | | |
| Manpower costs (excluding restructuring costs) | | **(100.4)** | (90.7) |
| Raw materials and consumables used | | **(54.8)** | (47.2) |
| Other operating expenses | | **(349.8)** | (294.6) |
| Depreciation | | **(127.9)** | (113.7) |
| Restructuring costs | | **(4.0)** | (0.3) |
| Amortisation of intangibles | | **(1.3)** | (1.8) |
| **Operating profit** | 4 | **236.8** | 200.0 |
| Finance income | | **42.0** | 29.0 |
| Finance costs | | **(129.4)** | (98.2) |
| Share of post-tax profit from joint ventures | | **0.2** | 0.3 |
| **Profit before tax** | 4 | **149.6** | 131.1 |
| Taxation | 5 | **(16.0)** | (37.2) |
| **Profit for the year** | | **133.6** | 93.9 |
| Profit attributable to equity shareholders | | **133.6** | 93.9 |
| **Earnings per share** (pence per share) | 6 | | |
| - Basic | | **38.2** | 26.5 |
| - Diluted | | **37.9** | 26.3 |
| **Proposed dividend per share** (pence per share) | 7 | **19.81** | 18.55 |
| **Proposed dividend for the year** (£m) | 7 | **69.1** | 65.6 |

All operating activities are continuing operations.

**PENNON GROUP PLC**

**Consolidated statement of recognised income and expense for the year ended 31 March 2008**

| | **2008 (Unaudited) £m** | 2007 £m |
|---|---|---|
| **Profit for the year** | **133.6** | 93.9 |
| Actuarial gains/(losses) on defined benefit schemes | **5.1** | (1.2) |
| *Cash flow hedges* | | |
| Net fair value (losses)/gains | **(12.7)** | 15.7 |
| Tax on items taken directly to or transferred from equity | **(1.4)** | 0.4 |
| **Net (losses)/gains not recognised directly in equity** | **(9.0)** | 14.9 |
| **Total recognised income for the year** | **124.6** | 108.8 |
| Attributable to equity shareholders | **124.6** | 108.8 |

## PENNON GROUP PLC

**Consolidated balance sheet at 31 March 2008**

| | Note | **2008 (Unaudited) £m** | 2007 (Restated note 3) £m |
|---|---|---|---|
| **Assets** | | | |
| **Non-current assets** | | | |
| Goodwill | | **234.6** | 137.5 |
| Other intangible assets | | **9.2** | 7.9 |
| Property, plant and equipment | | **2,663.0** | 2,558.9 |
| Trade and other receivables | | **10.4** | 6.9 |
| Derivative financial instruments | | **4.0** | 16.0 |
| Investments accounted for using equity method | | **1.4** | 1.4 |
| | | **2,922.6** | 2,728.6 |
| **Current assets** | | | |
| Inventories | | **6.6** | 5.1 |
| Trade and other receivables | | **164.7** | 122.5 |
| Derivative financial instruments | | **11.9** | - |
| Cash and cash deposits | | **357.4** | 127.9 |
| | | **540.6** | 255.5 |
| **Liabilities** | | | |
| **Current liabilities** | | | |
| Borrowings | | **(89.2)** | (85.8) |
| Derivative financial instruments | | **(17.0)** | - |
| Trade and other payables | | **(204.2)** | (176.6) |
| Current tax liabilities | | **(43.1)** | (36.6) |
| Provisions for liabilities and charges | | **(18.1)** | (13.2) |
| | | **(371.6)** | (312.2) |
| **Net current assets/(liabilities)** | | **169.0** | (56.7) |
| **Non-current liabilities** | | | |
| Borrowings | | **(2,032.0)** | (1,599.4) |
| Other non-current liabilities | | **(4.0)** | (4.3) |
| Derivative financial instruments | | **(0.5)** | - |
| Retirement benefit obligations | | **(26.3)** | (41.2) |
| Deferred tax liabilities | | **(307.2)** | (313.5) |
| Provisions for liabilities and charges | | **(81.3)** | (86.3) |
| | | **(2,451.3)** | (2,044.7) |
| **Net assets** | | **640.3** | 627.2 |
| **Shareholders' equity** | | | |
| Share capital | | **144.5** | 144.9 |
| Share premium account | | **11.7** | 11.7 |
| Capital redemption reserve | | **144.2** | 143.8 |
| Retained earnings and other reserves | | **339.9** | 326.8 |
| **Total shareholders' equity** | 8 | **640.3** | 627.2 |

## PENNON GROUP PLC

**Consolidated cash flow statement for the year ended 31 March 2008**

| | Note | **2008 (Unaudited) £m** | 2007 £m |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Cash generated from operations | 9 | **337.1** | 305.1 |
| Interest paid | | **(96.7)** | (58.1) |
| Tax paid | | **(21.0)** | (12.0) |
| Net cash generated from operating activities | | **219.4** | 235.0 |
| **Cash flows from investing activities** | | | |
| Interest received | | **17.0** | 6.7 |
| Acquisition of subsidiary undertakings (net of cash acquired) | | **(89.0)** | (37.0) |
| Return of loan from joint venture | | **0.1** | 0.1 |
| Proceeds from investment disposal | | **-** | 0.6 |
| Purchase of property, plant and equipment | | **(219.2)** | (251.4) |
| Proceeds from sale of property, plant and equipment | | **1.1** | 5.0 |
| Net cash used in investing activities | | **(290.0)** | (276.0) |
| **Cash flows from financing activities** | | | |
| Net proceeds from issue of ordinary share capital | | **-** | 1.9 |
| Purchase of ordinary shares subsequently cancelled | | **(5.9)** | (3.5) |
| Purchase of ordinary shares held as treasury shares | | **(43.4)** | - |
| Proceeds from treasury shares re-issued | | **1.6** | - |
| Ordinary shares acquired by the Pennon Employee Share Trust | | **(0.3)** | (2.3) |
| Deposit of restricted funds | | **(106.7)** | (4.1) |
| Net proceeds from new borrowing | | **473.5** | 110.0 |
| Repayment of borrowings | | **(157.5)** | (71.1) |
| Finance lease drawdowns | | **110.4** | 130.2 |
| Finance lease principal repayments | | **(20.4)** | (21.4) |
| Dividends paid | | **(65.6)** | (61.0) |
| B Share payments | | **-** | (5.7) |
| Net cash received from financing activities | | **185.7** | 73.0 |
| **Net increase in cash and cash equivalents** | | **115.1** | 32.0 |
| Cash and cash equivalents at beginning of year | 10 | **112.3** | 80.3 |
| **Cash and cash equivalents at end of year** | 10 | **227.4** | 112.3 |

## PENNON GROUP PLC

## NOTES

1. **General information**

Pennon Group Plc is a Company incorporated in the United Kingdom under the Companies Act 1985. The address of the registered office is given at the end of these notes. Pennon Group's business is operated through two main subsidiaries : South West Water Limited holds the water and sewerage appointments for Devon, Cornwall and parts of Dorset and Somerset, Viridor Limited's business is waste treatment and disposal.

The financial information for the years ended 31 March 2008 and 31 March 2007 does not constitute full financial statements within the meaning of section 240 of the Companies Act 1985. The full financial statements for the year ended 31 March 2007 were approved by the Board of Directors on 23 June 2007 and have been delivered to the Registrar of Companies. The independent auditors' report on those financial statements was unqualified, did not contain an emphasis of matter paragraph and did not contain a statement under section 237 (2) or (3) of the Companies Act 1985.

2. **Basis of preparation**

These unaudited financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretation (IFRIC) interpretations adopted by the European Union, with those parts of the Companies Act 1985 applicable to companies reporting under IFRS and the requirements of the Financial Services Authority.

The accounting policies adopted in the unaudited financial statements are consistent with those applied and set out in the Pennon Group Plc Annual Report and Accounts for the year ended 31 March 2007.

3. **Restatements at 31 March 2007**

At 31 March 2007 the accounting for the acquisition of Skipaway Holdings Limited (renamed Viridor Waste (Medway) Holdings Limited) was provisional. Completion of the accounting for the acquisition by 31 March 2008 has resulted in an increase in goodwill of £3.2m, an increase in intangible assets of £0.1m, a decrease in property, plant and equipment of £0.5m and an increase in provisions and other liabilities of £2.9m with an additional creditor for current tax of £0.1m and a £0.2m reduction in deferred tax. Comparative figures at 31 March 2007 have been restated accordingly.

These restatements have had no impact on profit for the year or retained earnings.

4. **Segment information**

| | **2008 (Unaudited) £m** | 2007 £m |
|---|---|---|
| **Revenue** | | |
| Water and sewerage | **421.0** | 381.5 |
| Waste management | **455.1** | 367.7 |
| Other | **8.4** | 7.6 |
| Less intra-segment trading * | **(9.5)** | (8.5) |
| | **875.0** | 748.3 |
| **Segment result** | | |
| **Underlying operating profit before depreciation and amortisation (EBITDA)** | | |
| Water and sewerage | **270.0** | 234.8 |
| Waste management | **101.0** | 82.8 |
| Other | **(1.0)** | (1.8) |
| | **370.0** | 315.8 |

## NOTES (Continued)

4. **Segment information (Continued)**

| | **2008 (Unaudited) £m** | 2007 £m |
|---|---|---|
| **Underlying operating profit** | | |
| Water and sewerage | **185.0** | 157.1 |
| Waste management | **58.1** | 46.8 |
| Other | **(1.0)** | (1.8) |
| | **242.1** | 202.1 |
| **Operating profit** | | |
| Water and sewerage | **181.0** | 156.8 |
| Waste management | **56.8** | 45.0 |
| Other | **(1.0)** | (1.8) |
| | **236.8** | 200.0 |
| **Underlying profit before tax** | | |
| Water and sewerage | **120.5** | 99.2 |
| Waste management | **35.5** | 29.4 |
| Other | **(1.1)** | 4.6 |
| | **154.9** | 133.2 |
| **Profit before tax** | | |
| Water and sewerage | **116.5** | 98.9 |
| Waste management | **34.2** | 27.6 |
| Other | **(1.1)** | 4.6 |
| | **149.6** | 131.1 |

* Intra-segment trading between and to other segments by the water and sewerage and waste management segments is under normal commercial terms and conditions that would also be available to unrelated third parties. Intra-segment revenue of the Other segment is at cost.

A reconciliation between underlying and reported measures is included in note 6.

5. **Taxation**

| | **2008 (Unaudited) £m** | 2007 £m |
|---|---|---|
| Analysis of charge in year | | |
| UK corporation tax | **25.0** | 23.9 |
| Deferred tax | **12.0** | 13.3 |
| Deferred tax arising on change of rate | **(21.0)** | - |
| | **16.0** | 37.2 |

UK corporation tax is calculated at 30% (2007 30%) of the estimated assessable profit in the year. The deferred tax charge has been reduced by a non-recurring credit of £21.0m reflecting the reduction in the rate of UK corporation tax from 30% to 28% effective 1 April 2008.

It has also been announced that industrial building allowances will be phased out over three years commencing 1 April 2008 but at 31 March 2008 the change was not substantively enacted. The provision to abolish industrial buildings allowances is contained in the Finance Bill 2008 and, if fully enacted, is likely to increase the deferred tax liability by an estimated £30m.

## NOTES (Continued)

6. **Basic and diluted earnings per share**

Basic earnings per share are calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period, excluding those held in the employee share trust, which are treated as cancelled. For diluted earnings per share, the weighted average number of ordinary shares is adjusted to include all dilutive potential ordinary shares.

The weighted average number of shares and earnings used in the calculations were :

| **Number of shares** (millions) | **2008 (Unaudited)** | 2007 |
|---|---|---|
| **For basic earnings per share** | **349.7** | 353.9 |
| Effect of dilutive potential ordinary shares from share options | **2.7** | 3.2 |
| **For diluted earnings per share** | **352.4** | 357.1 |

*Underlying basic and diluted earnings per share*

Underlying earnings per share is presented to provide more representative information on underlying trends. The term underlying is not a defined term under IFRS and may not be comparable with similarly titled profit measures reported by other companies. Underlying earnings have been calculated as follows :

| | **2008 (Unaudited)** | | | 2007 | | |
|---|---|---|---|---|---|---|
| | **Profit after tax £m** | **Basic p** | **Diluted p** | Profit after tax £m | Basic p | Diluted p |
| Earnings per share | **133.6** | **38.2** | **37.9** | 93.9 | 26.5 | 26.3 |
| Restructuring costs (net of tax) | **3.3** | **0.9** | **0.9** | 0.2 | 0.1 | 0.1 |
| Amortisation of intangibles | **1.3** | **0.4** | **0.4** | 1.8 | 0.5 | 0.5 |
| Deferred tax | **(9.0)** | **(2.6)** | **(2.5)** | 13.3 | 3.8 | 3.7 |
| Underlying earnings per share | **129.2** | **36.9** | **36.7** | 109.2 | 30.9 | 30.6 |

All operating activities are continuing operations.

## PENNON GROUP PLC

## NOTES (Continued)

7. **Dividends**

| | **2008 (Unaudited) £m** | 2007 £m |
|---|---|---|
| Amounts recognised as distributions to equity holders in the year : | | |
| Interim dividend paid for the year ended 31 March 2007 : 5.85p (2006 5.5p) per share | **20.8** | 19.4 |
| Final dividend paid for the year ended 31 March 2007 : 12.7p (2006 11.7p) per share | **44.8** | 41.6 |
| | **65.6** | 61.0 |
| **Proposed dividends** | | |
| Proposed interim dividend for the year ended 31 March 2008 : 6.25p (2007 5.85p) per share | **21.8** | 20.8 |
| Proposed final dividend for the year ended 31 March 2008 : 13.56p (2007 12.7p) per share | **47.3** | 44.8 |
| | **69.1** | 65.6 |

The proposed interim and final dividends have not been included as liabilities in these financial statements. The proposed interim dividend for 2008 was paid on 9 April 2008 and the proposed final dividend is subject to approval by shareholders at the Annual General Meeting on 26 July 2008.

If approved at the Annual General Meeting the final dividend of 13.56p per share will be paid on 1 October 2008 to shareholders on the register at 8 August 2008.

## PENNON GROUP PLC

## NOTES (Continued)

8. **Statement of changes in shareholders' equity**

| | Share capital £m | Share premium account £m | Capital redemption reserve £m | Retained earnings and other reserves £m | **(Unaudited)** Total £m |
|---|---|---|---|---|---|
| Profit for the year | - | - | - | 133.6 | 133.6 |
| Other recognised income and expense for the year | - | - | - | (9.0) | (9.0) |
| Dividends paid | - | - | - | (65.6) | (65.6) |
| Adjustment in respect of share-based payments | - | - | - | 1.9 | 1.9 |
| Deferred tax in respect of share-based payments | - | - | - | 0.2 | 0.2 |
| Own shares purchased and subsequently cancelled | (0.4) | - | 0.4 | (5.9) | (5.9) |
| Own shares purchased and held as treasury shares | - | - | - | (43.4) | (43.4) |
| Proceeds from treasury shares re-issued | - | - | - | 1.6 | 1.6 |
| Own shares acquired by the Pennon Employee Share Trust | - | - | - | (0.3) | (0.3) |
| | (0.4) | - | 0.4 | 13.1 | 13.1 |
| At 1 April 2007 | 144.9 | 11.7 | 143.8 | 326.8 | 627.2 |
| **At 31 March 2008** | **144.5** | **11.7** | **144.2** | **339.9** | **640.3** |

## NOTES (Continued)

9. **Cash flow from operating activities**

The reconciliation of operating profit to net cash inflow from operating activities is :

| **Cash generated from operations** | **2008 (Unaudited) £m** | 2007 £m |
|---|---|---|
| Profit for the year | **133.6** | 93.9 |
| Adjustments for: | | |
| Employee share schemes | **1.9** | 2.1 |
| Profit on disposal of property, plant and equipment | **-** | (2.6) |
| Profit on disposal of investment | **-** | (0.6) |
| Depreciation charge | **127.9** | 113.7 |
| Amortisation of intangible assets | **1.3** | 1.8 |
| Share of post-tax profit from joint ventures | **(0.2)** | (0.3) |
| Finance income | **(42.0)** | (29.0) |
| Finance costs | **129.4** | 98.2 |
| Taxation | **16.0** | 37.2 |
| Changes in working capital *(excluding the effect of acquisition of subsidiaries)* | | |
| Increase in inventories | **(0.6)** | (0.1) |
| Increase in trade and other receivables | **(29.9)** | (20.7) |
| Increase in trade and other payables | **12.5** | 16.9 |
| (Decrease)/increase in retirement benefit obligations | **(7.3)** | 2.0 |
| Decrease in provisions for liabilities and charges | **(5.5)** | (7.4) |
| Cash generated from operations | **337.1** | 305.1 |

10. **Net borrowings**

| **Net borrowings** | **2008 (Unaudited) £m** | 2007 £m |
|---|---|---|
| Cash and cash deposits | **357.4** | 127.9 |
| *Borrowings – current* | | |
| Bank overdrafts | **(18.6)** | (10.9) |
| Other current borrowings | **(15.5)** | (26.0) |
| Finance lease obligations | **(55.1)** | (48.9) |
| **Total current borrowings** | **(89.2)** | (85.8) |
| *Borrowings – non-current* | | |
| Bank and other loans | **(706.4)** | (350.1) |
| Other non-current borrowings | **(201.8)** | (215.9) |
| Finance lease obligations | **(1,123.8)** | (1,033.4) |
| **Total non-current borrowings** | **(2,032.0)** | (1,599.4) |
| **Total net borrowings** | **(1,763.8)** | (1,557.3) |

## NOTES (Continued)

10. **Net borrowings (Continued)**

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

| | 2008 (Unaudited) £m | 2007 £m |
|---|---|---|
| Cash and cash deposits as above | **357.4** | 127.9 |
| Bank overdrafts as above | **(18.6)** | (10.9) |
| | **338.8** | 117.0 |
| Less : deposits with a maturity of three months or more | **111.4** | 4.7 |
| | **227.4** | 112.3 |

11. **Acquisitions**

On 5 December 2007 the entire issued share capital of Grosvenor Waste Management Limited, (now renamed Viridor Resource Management Limited), was purchased by Viridor Waste Management Limited for a cash consideration of £80.0m including costs of £0.5m. Cash balances on acquisition amounted to £0.6m. Debt acquired with the acquisition was £2.3m. The acquisition has been accounted for using the acquisition method. Provisional goodwill of £75.2m and intangible fixed assets of £2.6m have been capitalised. The intangible fixed assets are being amortised evenly over the Directors' estimate of useful economic life.

On 25 March 2008, the entire issued share capital of Ledge 806 Limited, (now renamed Viridor Electrical Recycling (Holdings) Limited), the holding company of Shore Recycling Limited, was purchased by Viridor Waste Management Limited for a cash consideration of £10.5m including costs of £0.3m. Cash balances on acquisition amounted to £0.9m. Debt acquired with the acquisition was £13.7m. The acquisition has been accounted for using the acquisition method. Provisional goodwill of £21.9m has been capitalised.

12. The Annual Report for 2007/08 will be posted to shareholders on 1 July 2008 and will be available for viewing on the Company's website at www.pennon-group.co.uk on 2 July 2008.

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