

FINANCIAL STATEMENTS
NORTHUMBRIAN WATER LIMITED
FOR THE FIFTEEN MONTHS ENDED 31 MARCH 2004

Registered no: 2366703

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FINANCIAL STATEMENTS FOR THE FIFTEEN MONTHS ENDED 31 MARCH 2004

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DIRECTORS' REPORT

For the fifteen months ended 31 March 2004

The directors present their report and the audited financial statements for the 15 months ended 31 March 2004. The company has changed the end date of its financial reporting period from 31 December to 31 March, bringing the regulatory and statutory reporting periods into line.

Results and dividends

The group's profit after taxation for the fifteen months ended 31 March 2004 amounts to £96.5m (year ended December 2002: £90.3m – as restated). The directors propose a final dividend on the ordinary shares of the company of £63.3m (2002: £43.9m) which, together with the first interim dividend of £42.2m (2002: £43.9m) and an exceptional second interim dividend of £46.0m (2002: nil), makes a total for the fifteen months of £151.5m (2002: £87.8m).

The group comprises the company Northumbrian Water Limited and its subsidiaries as detailed in note 12.

During the period, Suez S.A. decided to reduce its shareholding in the company's immediate parent company, Northumbrian Services Limited (formerly Ondeo Services UK plc). To facilitate this disposal, a new company, Atlantic Water Limited, was incorporated (registered in Guernsey) to acquire 100% of the shares of Northumbrian Services Limited.

A new company, Aquavit plc was incorporated by the successful consortium, which conditionally acquired Atlantic Water Limited for a consideration of £1,009.7m on 16 May 2003. The consideration was satisfied by a short term loan from Deutsche Bank AG London for £536.0m, cash of £344.0m (net of expenses) raised from a group of institutional investors and 25% of the issued share capital of the new company, Aquavit plc (£129.7m). The acquisition became unconditional and effective from 23 May 2003.

On 20 May 2003, Aquavit plc changed its name to Northumbrian Water Group plc ("NWG"), on 23 May 2003 its shares were listed on the Alternative Investment Market and on 23 September 2003 its shares were listed on the Official List of the London Stock Exchange.

Prior year adjustment

The company has changed its accounting treatment for court costs and solicitors fees charged to customers as part of the debt recovery process. Previously these were credited to the profit and loss account as they were invoiced. However, due to the high degree of uncertainty surrounding recovery of these items, the policy has changed so that court costs and solicitors fees are not shown in the accounts until the cash is received. The prior year adjustment (note 2) restates the opening balance sheet to remove all court costs and solicitors fees for which a charge had been raised but no cash received as at the opening balance sheet date (£6.4m) along with an adjustment for taxation in relation to the same item (£1.9m).

Principal activities and review of the business

The principal activities of the business comprise the supply of potable water in both the Northern and Southern regions, and the collection, treatment and disposal of sewage and sewage sludge throughout the North East of England.

The company improved on its excellent customer service record against five of the seven Ofwat customer service measures in 2003/04. The regulator has not yet published comparative results for 2003/04, but NWL anticipates that it will improve on the performance it achieved in 2002/03. In the three years to 2001/02 NWL had achieved seven out of a possible seven Ofwat customer service 'stars' and it is still the only water and sewerage company to have ever achieved this. During August 2002, severe storms meant NWL lost the two stars that relate to sewer flooding.

These storm events also had a dramatic effect on NWL's ranking in Ofwat's overall performance assessment in 2002/03, accounting for two thirds of the points lost and losing NWL the 'top of the league' position it occupied in 2000/01 and 2001/02. The results for 2003/04 have not yet been published, but NWL's own performance has improved.

DIRECTORS' REPORT (continued)

Principal activities and review of the business (continued)

On a pro-rata basis, turnover has increased by £16.2m. This mainly reflects increases due to the application of RPI of 2.71% to the previous regulatory years tariff income of £410.3m (£11.1m), additional income arising from a project to identify occupiers of properties which had previously been classed as empty (£0.9m), a change in the method for accruing unbilled income which depressed income in 2002/03 (£0.9m) and an increase in commercial contract income from Bran Sands (£0.6m).

Again on a pro-rata basis, ordinary operating costs have increased by £11.7m. This mainly reflects annualised increases in abstraction charges and rates (£3.1m), increased manpower costs (£4.6m), higher sludge treatment costs (£1.9m) and bad debt costs (£1.2m). It also reflects the impact of leakage costs which were charged to profit rather than capital, following the achievement of the economic level of leakage in 2002/03 (£2.5m). These cost increases were partially offset by efficiencies and some provision releases.

Exceptional operating costs of £5.5m (note 4d) in the fifteen month period relate to pensions payable to former directors of water only companies which have since merged with Northumbrian Water Limited and severance and pension costs relating to senior managers who are leaving the business.

Capital maintenance costs have increased by only £1.0m on a pro-rata basis. This is due to increased depreciation following commissioning of new assets, offset by a reduction in depreciation charges following a comprehensive review of the asset lives of operational assets. This review was undertaken to support the depreciation charges included in the final business plan submitted to Ofwat in April 2004, and resulted in shorter asset lives for civil structures and longer asset lives for electrical, mechanical and instrumentation equipment

Net interest payable increased by £15.5m on a pro-rata basis, mainly reflecting an increase of £157.2m in the underlying level of net debt in the period required to fund investment in new assets, and the higher interest rates payable on long term loans raised in late 2002 to fund future capital investment. Additional interest charges were also incurred on a new loan for £46.0m which was raised in June 2003, and on committed facilities which were required to back up the existing EIB loans following the change in control of the holding company. Offsetting these increased interest charges was the impact of the lower interest rates in 2003/04 on the variable rate loans.

The future focus of the company continues to be improving efficiency levels and driving down operating costs while maintaining high standards of customer service and developing the skills and effectiveness of its employees. Continuous improvement will be necessary to ensure the company is successful in the competitive market.

Events since the balance sheet date

On 12 May 2004, the Group's financial position was improved by the securitisation of the contract with the Environment Agency for the operation of the Kielder Water transfer scheme. The proceeds were used to repay short term debt of £159.0m repayable by the immediate holding company, Northumbrian Services Limited ("NSL"), and £46.0m repayable by the non appointed business, both arising from the acquisition of the Group business in May 2003.

Financial Statements Preparation and Going Concern

The directors consider that it is appropriate to prepare the financial statements for the financial period on the going concern basis. The directors have arrived at their decision based on consideration of the company's detailed budget for 2004/05 and the forecast for 2005/06. Their analysis included a review of the capital expenditure and investment plans, the anticipated funding requirements and facilities available, and the reasonableness of the underlying assumptions of both the budget and the forecast.

Research and development

The company places a high priority on research and technological innovation to serve the needs of customers. Northumbrian Water Technical Centre Limited (NWTC), a specialist subsidiary of NWG, co-ordinates all research and development activities relating to underground assets for the NWG group. The company maintains a programme of research and development activities, which are linked to UK business operations. The company incurred costs of research and development in the fifteen months of £6.4m (December 2002: £5.5m).

DIRECTORS' REPORT (continued)

Northumbrian Water Limited payment policy

The company's policy is to agree payment terms with suppliers when agreeing the terms of each transaction, also ensuring that suppliers are made aware of and abide by the terms of payment. The period end trade creditors expressed as a number of days of purchases made during the period is 21 days (December 2002: 28 days).

Fixed assets

Freehold land and buildings are carried in the accounts at historical cost with a net book value of £62.3m (December 2002: £62.1m). In the opinion of the directors, at 31 March 2004, there is no significant difference between the net book value and market value of property capable of disposal within the foreseeable future. Note 11 gives more details of the fixed asset movements during the period.

Financial review

The level of capital expenditure that the company is obliged to incur is such that it cannot be wholly financed by internally generated sources. As a result, the company must rely upon raising additional finance on a regular basis, to be principally used to fund the long-term assets required in its regulated businesses. The strategy of NSL is to finance such investment by raising medium to long term debt, providing a balance sheet match with long term assets, and to fix a major proportion of interest rates.

Directors

The directors who served during the period were as follows:

Professor Sir F G T Holliday CBE (68)
Non-Executive Chairman

J A Cuthbert (51)
Executive Managing Director

C M Green (49)
Executive Finance Director

G Neave (48)
Executive Director

A C Jones (38)
Executive Director - appointed 1 January 2004

R R Allan (69)
Independent Non-Executive Director

A G Balls (60)
Independent Non-Executive Director

A M Frew (46)
Independent Non-Executive Director

B Guirkinger (52)
Non-Executive Director

J F Petry (49)
Non-Executive Director - resigned 27 May 2004

A Chaigneau (52)
Non-Executive Director - resigned 23 May 2003

Directors' interests are disclosed in note 6 to the financial statements.

DIRECTORS' REPORT (continued)

Employees and employment policies

Equal Opportunities

The company operates an equal opportunity policy and promotes equality of opportunity in recruitment, employment continuity, training and career development. The policy is designed to ensure that no applicant or employee receives less favourable treatment than another. The company is a member of 'Opportunity Now', which demonstrates our commitment to equal opportunity, and has been awarded an 'Exemplars of Best Practice' certificate.

Training and Development

Training and development of employees is a priority of the company. The company has developed a management development programme from which all senior managers in the business have benefited. The programme is shortly to be extended to team leaders. The company also has an accelerated development programme for employees with management potential. Annual appraisals are conducted and training needs properly assessed.

Communication

Communication with staff is achieved through a weekly newsletter 'lowdown', the company's bi-monthly corporate magazine 'Hel'eau', a bi-monthly 'team talk' cascading briefing process, occasional information booklets and widespread use of noticeboards. The intranet is increasingly used for the provision of news and information and also for the storage of corporate documents. Employees are regularly informed about matters concerning their interests and the financial and economic factors affecting the company. During the period the company won a silver award from the northern region of the Institute of Public Relations for its internal communication activities. The company encourages open feedback and protects employees who wish to voice concerns about behaviour or decisions that they believe to be unethical. The company also invites employee feedback through the use of annual questionnaires.

Employees receive the bi-annual group-wide magazine 'Watermark', produced by NWG, which includes articles on NWG activities and news from subsidiary companies. Urgent information is communicated via a 'news flash' facility ensuring employees are kept abreast of important news.

Health and Safety

Health and safety policies are maintained and implemented through the company's safety team. Occupational health services are provided by the company's medical adviser, Previa UK. Most employees are members of a company wide corporate health care plan.

Employee Investment Schemes

The directors believe that employee investment is a valuable method of strengthening the ties between NWG and its employees by providing the opportunity for employees to participate more closely in NWG's economic performance and results.

In January 2004, NWG launched its Share Incentive Plan (SIP). All UK tax paying employees of NWG with at least three months service are eligible to participate in the SIP. The SIP enables NWG employees to purchase ordinary shares in a flexible and tax efficient way. In addition, for every three shares purchased, the employee receives a bonus of one free share. Shares must be held in the plan for five years to obtain the full tax benefits.

DIRECTORS' REPORT (continued)

Employees and employment policies (continued)

Long Term Incentive Plan

Under this plan, executive directors and senior managers may receive, at the discretion of the Remuneration Committee, a conditional award of shares in NWG with a value of up to 75% of basic salary. In relation to the LTIP awards made in the period, however, the Committee decided that the value of awards would not exceed the value of the annual cash bonus opportunity of the relevant directors or managers. Executive directors were therefore made conditional LTIP awards worth 40% of their basic salaries, based on NWG's share price on 1 October 2003, which was 102.9p per share. The proportion of the shares awarded that will vest is based on NWG's performance in terms of total shareholder return ("TSR") (i.e. share price movements and re-invested dividends) during a fixed three-year period (from 1 October 2003) against the TSR of two comparator groups of companies. Up to 70% of the shares awarded will vest based on a comparison of NWG's TSR against the TSR of other quoted water companies, comprising Kelda Group plc, AWG plc, Pennon Group plc, Severn Trent plc, United Utilities plc, Bristol Water plc and East Surrey Holdings plc. Up to the remaining 30% of the shares awarded will vest based on a comparison of NWG's TSR against the TSR of companies (other than investment trusts) included in the FTSE 250 Total Return Index.

These performance targets will be applied on a graduated scale so that the better the performance of NWG, the greater the proportion of each award that will vest and thus the greater the number of shares that each participant will be able to acquire. For example, in relation to the performance based on the other quoted water companies, 30% of the 70% allocated to this target will vest if NWG has a median performance compared to the comparator group. The proportion of the award that will vest will increase the higher the relative position of NWG compared to the comparator group. Where NWG is the top performing company in the comparator group, 100% of the 70% will vest. None of the 70% will vest where NWG's performance is below the median performance.

Similarly, in relation to the performance based on the FTSE 250 Total Return Index, 30% of the 30% allocated to this target will vest if NWG's TSR equals that of the index and 100% of the 30% will vest where NWG's performance is the index growth plus at least 6%, with a sliding scale for pro rata performance.

The performance conditions described above were chosen to align the interests of participants in the LTIP with those of NWG shareholders. An independent firm of chartered accountants will be engaged to assess the extent to which the performance conditions have been met, so that the process is rigorous and transparent.

Pensions

Information about the pension schemes operated by the group is contained in note 28 to the financial statements.

DIRECTORS' REPORT (continued)

Charitable and Political Contributions

During the period the company made charitable donations of £64,115 (December 2002: £55,100) and political donations of £7,961 (2002: £nil).

It is the company's policy that it does not, directly or through any subsidiary, make what are commonly regarded as donations to any political party. The definition of donations in the Political Parties, Elections and Referendums Act 2000 (PPERA 2000) is wide and covers activities that form part of the normal relationship between the company and political organisations (such as sponsoring receptions and fringe meetings at party conferences and taking tables at dinners) intended to heighten awareness within the political arena of key industry issues and matters affecting the company. Political expenditure and/or donations up to a total of £40,000 for the Group for the period of two years from the date of the approval were approved by the shareholders at the Extraordinary General Meeting of NWG held on 16 December 2003. During the period the company did not incur any political expenditure as defined in the PERA 2000 but did make political donations, applying the wide definitions from the PERA 2000, as follows:

Name of EU Political Organisation	Donations for the Period
Labour	£5,989.00
Liberal Democrats	£889.00
Conservative	£1,082.83
Total	£7,960.83

Auditors

The company has appointed Ernst & Young LLP as its auditors and has, by elective resolution pursuant to section 386 of the Companies Act 1985, dispensed with the obligation to appoint auditors annually.

Statement of Directors' responsibilities

The directors are required by United Kingdom company law to prepare financial statements for each financial period that give a true and fair view of the state of affairs of the company and of the group as at the end of the financial period and of the profit or loss of the group for that period.

The directors confirm that suitable accounting policies have been used and applied consistently, and reasonable, prudent judgements and estimates have been made in the preparation of the financial statements for the fifteen months ended 31 March 2004. The directors also confirm that applicable accounting standards have been followed and that the financial statements have been prepared on the going concern basis.

The directors are responsible for keeping proper accounting records which 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 group, and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

BY ORDER OF THE BOARD

M Parker
Company Secretary

4 August 2004

INDEPENDENT AUDITORS' REPORT

To the shareholders of Northumbrian Water Limited:

We have audited the financial statements of Northumbrian Water Limited for the fifteen months ended 31 March 2004 which comprise the group profit and loss account, group statement of total recognised gains and losses, group balance sheet, company balance sheet, group cash flow statement, notes to the cash flow statement and the related notes numbered 1 to 31. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As described in the Statement of Directors' Responsibilities the company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if 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 transactions with the company is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of opinion

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the circumstances of the company, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the company and of the group at 31 March 2004 and of the group's profit for the period then ended and have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young LLP
Registered Auditor
Newcastle-upon-Tyne

13 August 2004

GROUP PROFIT AND LOSS ACCOUNT
For the fifteen months ended 31 March 2004

	Note	15 months ended March 2004	12 months ended December 2002 (as restated)
		£'m	£'m
Turnover	3	565.2	439.2
Operating costs - ordinary	4(a)	(258.1)	(197.1)
Operating costs - exceptional	4(d)	(5.5)	-
Capital maintenance costs	4(b)	(102.8)	(81.4)
OPERATING PROFIT		198.8	160.7
Net interest payable	5	(101.2)	(68.6)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION	4(c)	97.6	92.1
Taxation	9(a)	(1.1)	(1.8)
PROFIT FOR THE FINANCIAL PERIOD		96.5	90.3
Dividends	10	(151.5)	(87.8)
(LOSS)/PROFIT RETAINED FOR THE PERIOD	25	(55.0)	2.5

All activities are continuing.

GROUP STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
For the fifteen months ended 31 March 2004

	March 2004	December 2002 (as restated)
	£'m	£'m
Total recognised gains in the period	96.5	90.3
Prior year adjustment (note 2)	(4.5)	-
Total gains and losses recognised since last annual report and financial statements	92.0	90.3

GROUP BALANCE SHEET
At 31 March 2004

	Note	March 2004 £'m	December 2002 (as restated) £'m
FIXED ASSETS			
Tangible assets	11	2,619.5	2,483.7
CURRENT ASSETS			
Stocks	13	3.1	2.8
Debtors	14	102.4	98.1
Investments	15	-	120.1
Cash at bank and in hand		0.3	3.5
		105.8	224.5
CREDITORS			
Amounts falling due within one year	16	(284.5)	(224.6)
NET CURRENT LIABILITIES			
		(178.7)	(0.1)
TOTAL ASSETS LESS CURRENT LIABILITIES			
		2,440.8	2,483.6
CREDITORS: Amounts falling due after more than one year			
	17	(1,336.6)	(1,327.4)
PROVISIONS FOR LIABILITIES AND CHARGES			
	22	(164.2)	(172.3)
ACCRUALS AND DEFERRED INCOME			
	23	(139.3)	(128.2)
		(1,640.1)	(1,627.9)
NET ASSETS			
		800.7	855.7
CAPITAL AND RESERVES			
Called up share capital	24	122.7	122.7
Profit and loss account	25	678.0	733.0
EQUITY SHAREHOLDERS' FUNDS			
	26	800.7	855.7

Approved on behalf of the board

J A Cuthbert

C M Green

4 August 2004

COMPANY BALANCE SHEET
At 31 March 2004

	Note	March 2004	December 2002 (as restated)
		£'m	£'m
FIXED ASSETS			
Tangible assets	11	2,619.6	2,483.7
Investments	12	-	89.4
		<u>2,619.6</u>	<u>2,573.1</u>
CURRENT ASSETS			
Stocks	13	3.1	2.8
Debtors	14	102.4	98.1
Investments	15	-	120.1
Cash at bank and in hand		0.3	3.5
		<u>105.8</u>	<u>224.5</u>
CREDITORS			
Amounts falling due within one year	16	(284.5)	(224.6)
		<u>(178.7)</u>	<u>(0.1)</u>
NET CURRENT LIABILITIES			
		<u>(178.7)</u>	<u>(0.1)</u>
TOTAL ASSETS LESS CURRENT LIABILITIES			
		<u>2,440.8</u>	<u>2,573.0</u>
CREDITORS: Amounts falling due after more than one year			
	17	(1,336.6)	(1,416.8)
PROVISIONS FOR LIABILITIES AND CHARGES			
	22	(164.2)	(172.3)
ACCRUALS AND DEFERRED INCOME			
	23	(139.3)	(128.2)
		<u>(1,640.1)</u>	<u>(1,717.3)</u>
NET ASSETS			
		<u>800.7</u>	<u>855.7</u>
CAPITAL AND RESERVES			
Called up share capital	24	122.7	122.7
Profit and loss account	25	678.0	733.0
EQUITY SHAREHOLDERS' FUNDS			
	26	<u>800.7</u>	<u>855.7</u>

Approved on behalf of the board

J A Cuthbert

C M Green

4 August 2004

GROUP CASH FLOW STATEMENT
For the fifteen months ended 31 March 2004

	Note	15 months ended March 2004	12 months ended December 2002
		£'m	£'m
NET CASH INFLOW FROM OPERATING ACTIVITIES	a	264.5	232.9
Return on investments and servicing of finance			
Interest received		2.3	6.1
Interest paid		(98.1)	(70.8)
Interest element of finance lease rentals		(2.0)	(1.6)
Net cash outflow from returns on investments and servicing of finance		(97.8)	(66.3)
Taxation			
United Kingdom corporation tax paid		(6.1)	(6.8)
Net cash outflow from taxation		(6.1)	(6.8)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(247.9)	(203.2)
Sale of tangible fixed assets		1.9	0.7
Grants, contributions and connection charges		18.9	11.6
Net cash outflow from capital expenditure and financial investment		(227.1)	(190.9)
Equity dividends paid		(132.1)	(86.0)
CASH OUTFLOW BEFORE MANAGEMENT OF LIQUID RESOURCES AND FINANCING		(198.6)	(117.1)
Management of liquid resources			
Purchase of short term deposits		-	(843.4)
Sale of short term deposits		120.0	963.7
Net cash inflow from management of liquid resources	b	120.0	120.3
Financing			
New loans		98.0	327.7
New leases		0.1	-
Debenture repayments		-	(8.0)
Loan repayments		(19.6)	(318.1)
Capital element of finance lease rental payments		(3.1)	(3.2)
Net cash inflow / (outflow) from financing	b	75.4	(1.6)
(DECREASE) / INCREASE IN CASH IN THE PERIOD	b	(3.2)	1.6

NOTES TO THE CASH FLOW STATEMENT
For the fifteen months ended 31 March 2004

a RECONCILIATION OF OPERATING PROFIT TO NET CASH INFLOW FROM OPERATING ACTIVITIES

	Note	15 months ended March 2004	12 months ended December 2002 (as restated)
		£'m	£'m
Operating profit		198.8	160.7
Depreciation of tangible fixed assets	4(b)	103.5	82.0
Amortisation of capital grants		(4.2)	(3.0)
Profit on sale of fixed assets	4(b)	(0.7)	(0.6)
Increase in stock		(0.3)	(0.1)
Decrease/(increase) in debtors		1.6	(12.9)
(Decrease)/increase in creditors		(26.2)	8.5
Decrease in restructuring provision		(8.0)	(1.7)
Net cash inflow from operating activities		264.5	232.9

The operating cash flows are all from continuing operations.

b ANALYSIS AND RECONCILIATION OF NET DEBT

	1 January 2003	Cash flow	Other non- cash changes	31 March 2004
	£'m	£'m	£'m	£'m
Cash at bank and in hand	3.5	(3.2)	-	0.3
Debt due after 1 year	(1,270.5)	(46.0)	38.3	(1,278.2)
Debt due within 1 year	(19.6)	(32.4)	(38.1)	(90.1)
Finance leases	(59.1)	3.0	(4.8)	(60.9)
	(1,349.2)	(75.4)	(4.6)	(1,429.2)
Current asset investments	120.0	(120.0)	-	-
Net debt	(1,225.7)	(198.6)	(4.6)	(1,428.9)

	15 months ended March 2004	12 months ended December 2002
	£'m	£'m
Reconciliation of cash flow movement to net debt:		
(Decrease)/increase in cash in the period	(3.2)	1.6
Cash (inflow)/outflow from (increase)/decrease in debt and lease financing	(75.4)	1.6
Cash inflow from decrease in liquid resources	(120.0)	(120.3)
Change in net debt resulting from cash flows	(198.6)	(117.1)
Finance costs incurred during the period	0.2	0.1
Finance lease interest capitalised	(1.0)	(1.0)
Finance lease non cash movement	(3.8)	(4.4)
Movement in net debt in period	(203.2)	(122.4)
Net debt at 1 January 2003	(1,225.7)	(1,103.3)
Net debt at 31 March 2004	(1,428.9)	(1,225.7)

NOTES TO THE FINANCIAL STATEMENTS
For the fifteen months ended 31 March 2004

1. STATEMENT OF ACCOUNTING POLICIES

These financial statements have been prepared in accordance with applicable Accounting Standards in the United Kingdom. A summary of the principal accounting policies is set out below. These have been applied consistently throughout the current and preceding periods.

(a) Basis of accounting

The financial statements have been prepared under the historic cost convention on a going concern basis.

(b) Basis of consolidation

The consolidated financial statements include the company and its subsidiary undertakings. The results of subsidiaries and operations acquired during the period are included from the date of their acquisition. Intra-group sales and profits are eliminated fully on consolidation.

(c) Turnover

Turnover, which excludes Value Added Tax, represents the income receivable in the ordinary course of business for services provided within the United Kingdom.

(d) Tangible fixed assets and depreciation

Tangible fixed assets comprise:

(i) Infrastructure assets

Infrastructure assets comprise a network of systems which include water mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls.

Expenditure on infrastructure assets relating to increases in capacity or enhancements of the network and on maintaining the operational capability of the network in accordance with defined standards of service, is treated as additions which are included at cost. Costs include external and internal costs to bring the asset into use.

The depreciation charge for infrastructure assets is based on the company's independently certified asset management plan which has estimated the level of expenditure required over the next five years to maintain the operating capability of the network. This is adjusted if the forecast expenditure is expected to differ significantly from the amounts included in the original plan.

(ii) Non-infrastructure assets

Other assets (including properties, overground plant and equipment) are included at cost less accumulated depreciation and, where required, provision for impairment. Additions are included at cost.

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

Freehold buildings	30 – 60 years
Operational structures, plant and machinery	4 – 92 years
Fixtures, fittings, tools and equipment	4 – 10 years

Where the remaining useful economic life of the asset is estimated to be greater than 50 years, an impairment review is performed at the end of each reporting period to ensure that the carrying amount can be supported.

1. STATEMENT OF ACCOUNTING POLICIES (continued)

(d) Tangible fixed assets and depreciation (continued)

(iii) Assets in the course of construction

Assets in the course of construction are not depreciated until commissioned, which is when the asset is available for use.

(e) Grants and contributions

Revenue grants are credited to the profit and loss account when received.

Capital grants and contributions relating to other assets are treated as deferred income and amortised to the profit and loss account over the expected useful economic lives of the qualifying assets. Specifically in the case of infrastructure assets, the expected useful economic lives have been determined by reference to the physical replacement cycle of these assets.

(f) Hire purchase and leasing

Where assets are financed by hire purchase or leasing arrangements which transfer substantially all the risks and rewards of ownership to the company, the assets are treated as if they had been purchased and the corresponding capital cost is treated as a liability. Rentals or leasing payments are treated as consisting of a capital element and finance costs, the capital element reducing the outstanding liability and the finance costs being charged to the profit and loss account over the period of the hire purchase contract or lease in proportion to the reducing outstanding liability.

Rental costs arising under operating leases are charged to the profit and loss account in the period in which they are incurred.

(g) Stocks

Raw materials and consumables are stated at cost less any provision necessary to recognise damage and obsolescence. Cost of work in progress includes labour, materials, transport and an element of overheads.

(h) Pension costs

The company is a member of the Northumbrian Water Pension Scheme (formerly the Northumbrian Lyonnaise Pension Scheme) which is a multi employer scheme and the assets cannot be apportioned to individual companies. Accordingly, these financial statements account for pension costs as a defined contribution scheme and charges are made as incurred.

The company also operates a defined contribution scheme. The costs are charged to the profit and loss account in the period they are incurred.

1. STATEMENT OF ACCOUNTING POLICIES (continued)

(i) Taxation

The charge for current UK corporation tax is based on the profit for the period as adjusted for taxation purposes using the rates of tax enacted by the balance sheet date.

Provision is made for deferred tax in respect of all timing differences that have originated but not reversed at the balance sheet date that will result in an obligation to pay more, or a right to pay less tax in future periods. Deferred tax is measured at the tax rates that are expected to apply in the periods in which timing differences are expected to reverse.

Deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

As permitted by FRS19 the company has decided to adopt a policy of discounting deferred tax assets and liabilities to reflect the time value of money over the period between the balance sheet date and the dates on which it is estimated that the underlying timing differences will reverse. The discount rates used reflect the post-tax yields to maturity that can be obtained at the balance sheet date on government bonds with similar maturity dates to those of the deferred tax assets or liabilities.

(j) Foreign currency

All transactions denominated in foreign currencies are translated into sterling at the actual rates of exchange ruling at the date of transaction. Foreign currency balances are translated into sterling at the rates of exchange ruling at the balance sheet date. Exchange gains or losses are recognised in the profit and loss account in the period incurred.

(k) Research and development

Research and development expenditure is charged to the profit and loss account in the period in which it is incurred.

(l) Investments

Fixed asset investments are stated at their purchase cost, less provision for diminution in value.

(m) Derivative Financial Instruments

The company utilises interest rate swaps, forward rate agreements and forward exchange contracts as derivative financial instruments.

A derivative instrument is considered to be used for hedging purposes when it alters the risk profile of an underlying exposure of the company in line with the company's risk management policies.

Interest rate swap agreements are used to manage interest rate exposures. Amounts payable or receivable in respect of these derivatives are recognised over the period of the contracts as adjustments to net interest payable in the profit and loss account.

Forward exchange contracts are valued at the period end rates of exchange. Resultant gains and losses are offset against foreign exchange gains or losses on the related borrowings or, where the instrument is used to hedge a committed future transaction, are deferred until the transaction occurs.

(n) Bad debt provisioning

The bad debt provision is calculated by applying a range of percentages to debt of different ages. These percentages also vary between different categories of debt. Higher percentages are applied to those categories of debt which are considered to be of greater risk and also to debt of greater age. The value of the bad debt provision is sensitive to the specific percentages applied.

2. PRIOR YEAR ADJUSTMENT

The company has changed its accounting policy for court costs and solicitors fees charged to customers as part of the debt recovery process. As a result the comparatives have been restated as follows:

(a) Group profit and loss account

	Operating costs - ordinary £'m	Taxation £'m	Profit for the financial period £'m
Year ended 31 December 2002 as previously reported	(196.2)	(2.1)	90.9
Prior year adjustment	(0.9)	0.3	(0.6)
Year ended 31 December 2002 as restated	<u>(197.1)</u>	<u>(1.8)</u>	<u>90.3</u>

The brought forward reserves for 2002 have been restated by £3.9m.

(b) Group balance sheet

	Debtors Trade debtors £'m	Provisions for liabilities and charges Deferred tax £'m	Profit and loss reserve £'m
Year ended 31 December 2002 as previously reported	52.1	(161.9)	737.5
Prior year adjustment	(6.4)	1.9	(4.5)
Year ended 31 December 2002 as restated	<u>45.7</u>	<u>(160.0)</u>	<u>733.0</u>

3. TURNOVER AND OPERATING PROFIT

The directors consider that the company has one class of business and this is conducted wholly within the United Kingdom.

4. OPERATING COSTS, CAPITAL MAINTENANCE COSTS AND PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

(a) Operating costs comprise:

	15 months ended March 2004	12 months ended December 2002 (as restated)
	£'m	£'m
Materials and consumables	16.8	13.2
Other external charges	70.4	48.2
Manpower costs (note 8a)	85.0	63.3
Other operating charges	107.6	89.3
Own work capitalised	(21.7)	(16.9)
	258.1	197.1

(b) Capital maintenance costs comprise:

	15 months ended March 2004	12 months ended December 2002
	£'m	£'m
Depreciation:		
Non-infrastructure assets	62.3	48.7
Non-infrastructure assets held under finance leases	4.7	4.4
Infrastructure assets	36.5	28.9
Profit on disposal of fixed assets	(0.7)	(0.6)
	102.8	81.4

The movement in the capital maintenance costs in 2003/04 is explained in the Directors Report.

(c) Profit on ordinary activities before taxation:

	15 months ended March 2004	12 months ended December 2002
	£'m	£'m
Profit on ordinary activities before taxation is stated after crediting:		
Amortisation of capital grants (note 23)	4.2	3.0
And after charging:		
Operating leases: Plant and machinery	0.1	0.2
Other assets	1.1	0.8
Costs of research and development	6.4	5.5
Directors' emoluments (note 6)	1.2	0.7

Auditors' remuneration for the statutory audit amounted to £63,300 (2002: £66,000). Auditors' remuneration for the regulatory audit amounted to £22,000 (2003: £31,543). Fees of £25,000 and £12,000 were also incurred in the auditing of RAG 5 information and the June Return respectively.

Non audit services were incurred in respect of reviewing the Draft Business Plan for Ofwat (£17,308) and reviewing the Idok Clause 14.3 claim (£5,000) and tax and accounting advice in respect of the Kielder securitisation (£30,500).

(d) Exceptional operating costs

Exceptional operating costs comprise £3.0m in respect of pensions payable to former directors of water only companies which have since merged with Northumbrian Water Limited, and £2.5m in respect of severance and pension costs relating to senior managers who are leaving the business.

5. NET INTEREST PAYABLE

	15 months ended March 2004	12 months ended December 2002
	£'m	£'m
Net interest payable comprises:		
Interest payable:		
Bank loans and overdrafts	99.6	69.2
Debenture stock interest	1.5	2.6
Financing charges payable under finance leases	3.0	2.8
	<hr/>	<hr/>
Total interest payable	104.1	74.6
Interest receivable	(2.9)	(6.0)
	<hr/>	<hr/>
Net interest payable	<u>101.2</u>	<u>68.6</u>

6. DIRECTORS' EMOLUMENTS AND INTERESTS

(a) Directors' remuneration

The remuneration of the directors of the company was as follows:

	15 months ended March 2004	12 months ended December 2002
	£'000	£'000
Emoluments (including benefits in kind)	<u>1,201.9</u>	<u>728.5</u>

Four of the directors at 31 March 2004 were members of a defined benefit pension scheme where the company makes contributions towards the cost (December 2002: 3).

The directors who held office at 31 March 2004 had no interest in the shares of the company.

The directors who held office as at 31 March 2004 had the following interests in the debentures of the Company's immediate parent company, Northumbrian Services Limited:

Name of Director	Class of Debentures	Amount of debentures held as at 1 January 2003	Amount of debentures held as at 31 March 2004
John Arthur Cuthbert	8.625% bonds 28/6/06	-	40,000
Christopher Michael Green	8.625% bonds 28/6/06	-	25,000

(1) These are beneficially owned by Mrs Geraldine Green.

The directors who held office as at 31 March 2004 had the following interests in the shares of the Company's ultimate parent company, Northumbrian Water Group plc:

Name of Director	Class of Shares	Number of shares held as at 1 January 2003	Number of shares held as at 31 March 2004
John Arthur Cuthbert	Ordinary 10p	-	80,000
Christopher Michael Green	Ordinary 10p	-	50,000
Sir Frederick George Thomas Holliday	Ordinary 10p	-	8,700
Andrew Ceri Jones	Ordinary 10p	-	4,433

6. DIRECTORS' EMOLUMENTS AND INTERESTS (continued)

The directors who held office as at 31 March 2004 held the following conditional interests in Ordinary 10p shares of the Company's ultimate parent company, Northumbrian Water Group plc ("NWG"), awarded in accordance with the terms of its Long Term Incentive Plan:

Name of Director	Number of awards held as at 1 January 2003	Number of shares awarded during the period	Number of awards vested during the period*	Number of awards held as at 31 March 2004
John Arthur Cuthbert	-	85,603	-	85,603
Christopher Michael Green	-	56,618	-	56,618
Andrew Ceri Jones	-	22,463	-	22,463
Graham Neave	-	40,000	-	40,000

* Some or all of the shares will vest only if specified performance targets are achieved during the three year period 1 October 2003 to 30 September 2006. The performance conditions are complex but, in essence, shares can vest depending on NWG's total shareholder return ("TSR") in this three year period compared with the TSR of a group of other water companies (in respect of 70% of the shares awarded) and with the FTSE 250 Total Return Index (in respect of 30% of the shares awarded). No awards lapsed or vested during the period.

As at 31 March 2004, no directors hold any other interests required to be disclosed, in accordance with Schedule 7 of the Companies Act 1985.

(b) Highest paid director

The amounts for remuneration in note 6a include the following in respect of the highest paid director:

	15 months ended March 2004	12 months ended December 2002
	£'000	£'000
Emoluments (including benefits in kind)	386.8	239.3

The accrued pension entitlement under the company's defined benefit scheme of the highest paid director at 31 March 2004 was £91,789 (31 December 2002: £64,558).

7. TRANSACTIONS WITH DIRECTORS AND OFFICERS

No transactions or arrangements with Directors and Officers which are disclosable under the provisions of the Companies Act 1985 have occurred during the period.

8. EMPLOYEE INFORMATION

(a) The total employment costs of all employees (including directors) were as follows:

	15 months ended March 2004	12 months ended December 2002
	£'m	£'m
Costs charged to the profit and loss account:		
Wages and salaries	54.8	41.5
Social security costs	4.7	3.2
Other pension costs	5.0	3.2
	64.5	47.9
Costs charged to capital schemes:		
Wages and salaries	17.4	13.3
Social security costs	1.5	1.1
Other pension costs	1.6	1.0
	20.5	15.4
Total employee costs	85.0	63.3

(b) The average monthly number of employees on the payroll during the financial period was as follows:

	15 months ended March 2004	12 months ended December 2002
	Number	Number
Average during the period	2,320	2,259
Total at the period end date	2,420	2,320

9. TAXATION

(a) Analysis of tax charge for the financial period:

	15 months ended March 2004	12 months ended December 2002 (as restated)
	£'m	£'m
Current tax:		
UK corporation tax on profits for the period at 30%	2.1	1.5
Adjustments in respect of prior periods	(4.5)	(9.1)
Payable in respect of group relief for the current period at 30%	3.6	6.2
Adjustments in respect of prior periods	-	(4.9)
Total current tax charge / (credit) (note 9b)	<u>1.2</u>	<u>(6.3)</u>
Deferred tax:		
Origination and reversal of timing differences in the period	25.5	22.3
Adjustments in respect of prior periods	(2.0)	9.5
	<u>23.5</u>	<u>31.8</u>
Increase in discount	(23.6)	(23.7)
Total deferred tax (note 22)	<u>(0.1)</u>	<u>8.1</u>
Tax on profit on ordinary activities	<u><u>1.1</u></u>	<u><u>1.8</u></u>

The company has provisionally claimed tax losses from fellow subsidiaries in the current period of £11.9m (2002: £20.7m) for which payment will be made at the rate of 30%.

(b) Factors affecting the tax charge / (credit) for the financial period:

The tax assessed for the period is lower than the standard rate of corporation tax in the UK (30%) (2002: 30%). The differences are explained below:

	15 months ended March 2004	12 months ended December 2002 (as restated)
	£'m	£'m
Profit on ordinary activities before tax	<u>97.6</u>	<u>92.1</u>
Profit on ordinary activities multiplied by standard rate of UK corporation tax (30%) (2002 30%)	29.3	27.6
Effects of:		
Expenses not deductible for tax purposes	0.6	1.3
Depreciation in respect of non-qualifying items	1.3	1.1
Capital allowances in excess of depreciation	(27.1)	(25.2)
Other timing differences	1.6	2.9
Adjustment to tax charge in respect of previous years	(4.5)	(14.0)
Current tax charge / (credit) (note 9a)	<u><u>1.2</u></u>	<u><u>(6.3)</u></u>

9. TAXATION (continued)

(c) Factors that may affect future tax charges:

The company expects to continue to incur high levels of capital expenditure and accordingly it expects to be able to claim capital allowances in excess of depreciation at a similar level to the current period.

Deferred tax is provided on a discounted basis using post-tax yields on UK government gilts. The charge for deferred tax will therefore be influenced by future fluctuations in gilt rates.

10. DIVIDENDS

	15 months ended March 2004	12 months ended December 2002
	£'m	£'m
Equity:		
Interim paid of 34.41p (2002: 35.81p) per share on an aggregated basis	42.2	43.9
Exceptional paid of 37.51p (2003; £nil) per share on an aggregated basis	46.0	-
Final proposed for 12 months ended 31 December 2003 of 34.41p (2002: £35.81p) per share on an aggregated basis	42.2	43.9
Final proposed for 3 months ended 31 March 2004 of 17.21p per share on an aggregated basis	21.1	-
	<u>151.5</u>	<u>87.8</u>

The directors have a policy which, unless circumstances dictate otherwise, aims to grow dividends on a slow but regular basis and which takes into account the principle of incentive based price cap regulation, including operating and investment performance.

The company has maintained its policy of a steady 2% real growth per annum for the appointed business dividend. Dividends from the non-appointed business are determined by the directors and are based on performance.

The directors are of the opinion that it is appropriate to maintain the current dividend policy notwithstanding the significant reduction in profit before tax, as this has been influenced by factors outside the company's control, as described in the directors' report.

In accordance with the principle of incentive based price cap regulation, rewards to shareholders will reflect company performance against Ofwat targets, in particular operating and investment targets.

Accordingly, the level of dividend has been declared by reference to:-

- the company's ability to finance its functions;
- the company's cumulative financial performance; and
- the directors' judgement as to a fair reward for shareholders in the context of market conditions.

11. TANGIBLE FIXED ASSETS – GROUP AND COMPANY

	Freehold land and buildings	Infra- structure assets	Operational structures, plant and machinery	Fixtures, fittings, tools and equipment	Assets in the course of construction	Total
	£'m	£'m	£'m	£'m	£'m	£'m
Cost:						
At 1 January 2003	81.8	1,305.7	1,393.2	92.6	143.4	3,016.7
Additions	-	-	-	-	244.1	244.1
Schemes commissioned	5.9	143.3	127.5	49.2	(325.9)	-
Reclassifications	-	(30.6)	-	-	27.1	(3.5)
Disposals	-	(23.5)	(0.1)	-	-	(23.6)
At 31 March 2004	<u>87.7</u>	<u>1,394.9</u>	<u>1,520.6</u>	<u>141.8</u>	<u>88.7</u>	<u>3,233.7</u>
Depreciation:						
At 1 January 2003	19.7	149.2	300.2	63.9	-	533.0
Provision for period	4.4	36.5	45.7	16.9	-	103.5
Reclassifications	1.3	-	(1.5)	0.3	-	0.1
Disposals	-	(22.4)	-	-	-	(22.4)
At 31 March 2004	<u>25.4</u>	<u>163.3</u>	<u>344.4</u>	<u>81.1</u>	<u>-</u>	<u>614.2</u>
Net book value:						
At 31 March 2004	<u><u>62.3</u></u>	<u><u>1,231.6</u></u>	<u><u>1,176.2</u></u>	<u><u>60.7</u></u>	<u><u>88.7</u></u>	<u><u>2,619.5</u></u>
At 31 December 2002	<u><u>62.1</u></u>	<u><u>1,156.5</u></u>	<u><u>1,093.0</u></u>	<u><u>28.7</u></u>	<u><u>143.4</u></u>	<u><u>2,483.7</u></u>
Leased assets included above:						
Net book value						
At 31 March 2004	<u><u>-</u></u>	<u><u>2.2</u></u>	<u><u>25.7</u></u>	<u><u>0.7</u></u>	<u><u>-</u></u>	<u><u>28.6</u></u>
At 31 December 2002	<u><u>-</u></u>	<u><u>2.2</u></u>	<u><u>25.4</u></u>	<u><u>4.5</u></u>	<u><u>-</u></u>	<u><u>32.1</u></u>

12. FIXED ASSET INVESTMENT - COMPANY

	March 2004	December 2002
	£'m	£'m
At 1 January and 31 March / December	-	89.4

At 31 December 2002, the company had a wholly owned subsidiary undertaking, Newcastle and Gateshead Water plc, whose principal activity was the holding of a loan note due from the company. This investment equated to a 100% holding in Newcastle and Gateshead Water plc of £40.7m, and a long term loan investment of £6.5m. Included in the net assets of Newcastle and Gateshead Water plc was a loan note receivable from Northumbrian Water Limited of £47.2m. During the period, Newcastle and Gateshead Water plc was in liquidation and repaid the £6.5m loan to Northumbrian Water Limited along with dividends and capital of £40.7m. Northumbrian Water Limited repaid the £47.2m loan note in full at par (note 21).

At 31 December 2002 the company had a wholly owned subsidiary undertaking in Suffolk Water plc, whose principal activity was the holding of a loan note due from the company. This investment was valued at £42.2m which equated to the net assets of that company. During the period, Suffolk Water plc was in liquidation and repaid capital and dividends totalling £42.2m to Northumbrian Water Limited. Northumbrian Water Limited repaid the £42.2m loan note in full at par (note 21).

The company has a wholly owned subsidiary undertaking, Northumbrian Water Finance plc, whose principal activity is to hold certain finance instruments on behalf of Northumbrian Water Limited.

The company has a wholly owned subsidiary undertaking, Reiver Holdings Limited, incorporated on 20 August 2003, which in turn has a new wholly owned subsidiary Reiver Finance Limited, whose principal activity is a sole special purpose financing vehicle.

13. STOCKS – GROUP AND COMPANY

	March 2004	December 2002
	£'m	£'m
Raw materials and consumables	3.1	2.8

There is no material difference between the balance sheet value of stocks and their replacement cost.

14. DEBTORS – GROUP AND COMPANY

	March 2004	December 2002 (as restated)
	£'m	£'m
Trade debtors	46.8	45.7
Amounts owed by other group companies	6.5	2.4
Corporation tax repayable	11.1	5.7
Other debtors	6.2	7.1
Prepayments and accrued income	31.8	37.2
	102.4	98.1

Trade debtors are shown net of bills raised in advance.

15. INVESTMENTS – GROUP AND COMPANY

	March 2004	December 2002
	£'m	£'m
Short term deposits	-	120.0
Assets held for resale	-	0.1
	-	120.1

16. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	March 2004		December 2002	
	Group	Company	Group	Company
	£'m	£'m	£'m	£'m
Obligations under finance leases (note 20)	3.6	3.6	3.2	3.2
Loans (note 18)	33.1	33.1	18.4	18.4
Debenture stock (note 19)	5.0	5.0	-	-
Trade creditors	12.8	12.8	2.8	2.8
Amounts owed to other group companies	71.8	93.4	36.6	40.7
Taxation and social security	1.5	1.5	1.4	1.4
Other creditors	13.7	13.7	15.1	15.1
Receipts in advance	15.9	15.9	39.3	39.3
Dividend payable	63.3	63.3	43.9	43.9
Accruals and deferred income	63.8	42.2	63.9	59.8
	<u>284.5</u>	<u>284.5</u>	<u>224.6</u>	<u>224.6</u>

Accruals and deferred income includes accruals related to capital projects of £16.9m (2002: £23.4m). Amounts owed to other group companies include amounts related to capital projects of £2.7m (2002: £3.8m). Included in amounts owed to other group companies is £9.7m (2002: £9.2m) payable in respect of tax losses surrendered from fellow group companies. Also included in amounts owed to other group companies is £52.0m (2002: £1.2m) relating to loans repayable within one year (note 21).

17. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	March 2004		December 2002	
	Group	Company	Group	Company
	£'m	£'m	£'m	£'m
Obligations under hire purchase contracts and finance leases (note 20)	57.3	57.3	55.9	55.9
Loans (note 18)	917.4	370.0	904.5	357.1
Debenture stocks (note 19)	9.2	9.2	14.3	14.3
Amounts owed to other group companies (note 21)	351.6	899.0	351.7	988.5
Other creditors	1.1	1.1	1.0	1.0
	<u>1,336.6</u>	<u>1,336.6</u>	<u>1,327.4</u>	<u>1,416.8</u>

At 31 March 2004 the group and company had entered into the following interest swap arrangements: £15.0m (2002: £15.0m) over a ten year period commencing on 10 May 1994 under which the group and company is required to pay interest at a rate linked to LIBOR and will receive interest at 9.00%.

18. LOANS

	March 2004		December 2002	
	Group	Company	Group	Company
	£'m	£'m	£'m	£'m
Loans are repayable as follows:				
Within one year (note 16)	33.1	33.1	18.4	18.4
Between one and two years	64.8	64.8	48.1	48.1
Between two and five years	143.7	143.7	53.0	53.0
After five years	708.9	161.5	803.4	256.0
	<u>950.5</u>	<u>403.1</u>	<u>922.9</u>	<u>375.5</u>

Loans wholly repayable by instalments repayable within 5 years amount to £23.0m (2002: £23.4m). Loans repayable by instalments not wholly repayable within 5 years amount to £229.1m (2002: £247.1m) and bear interest rates in the range of 4.15% to 8.55% of which £67.7m (2002: £66.1m) falls due in less than 5 years and £161.4m (2002: £181.0m) falls due after more than 5 years.

Loans repayable otherwise than by instalments which fall due in less than 5 years amount to £151.0m (2002: £30.0) and bear interest at rates in the range of 4.09% and 7.95%.

Loans repayable otherwise than by instalments which fall due after more than 5 years amount to £547.4m (2002: £622.4m) and bear interest at rates in the range of 5.60% and 6.0%.

Treasury operations

The company's board of directors is responsible for the financing strategy of the company which is determined within treasury policies set by the company's ultimate parent company, Northumbrian Water Group plc. The aim of this strategy is to assess the ongoing capital requirement of the company and to raise funding on a timely basis, taking advantage of any favourable market opportunities.

The Treasury department carries out treasury operations on behalf of the company. Surplus funds are invested based upon forecast requirements, in accordance with the treasury policy. On occasion, derivatives are used as part of this process, but the treasury policies prohibit their use for speculation.

Risks arising from company's financial instruments

The main risks arising from the company's financial instruments are liquidity risk and interest rate risk. As noted above, the company's financing strategy is developed in accordance with the treasury policies of Northumbrian Water Group plc, whose board reviews and agrees policies for managing each of these risks. These are summarised below. All Northumbrian Water Limited treasury activities are conducted in accordance with these policies.

Liquidity risk

As regards day to day liquidity, the company is responsible for cash management but is reliant upon the committed borrowing facilities available to Northumbrian Water Group plc. Northumbrian Water Group plc's policy is to have available standby committed bank borrowing facilities with a value of no less than £50m and with a bank agreement availability period of no less than 3 months.

Interest rate risk

The company finances its operations through a mixture of retained profits and borrowings. It borrows at both fixed and floating rates of interest and, as noted above, on occasion uses derivatives to generate the desired interest profile and to manage its exposure to interest rate fluctuations. Northumbrian Water Group plc's policy is to keep a minimum 60 per cent of its borrowings at fixed rates of interest.

Foreign currency risk

Northumbrian Water Group plc's policy is that any foreign currency exposure in excess of £100,000 sterling equivalent of a transactional nature, or £3m sterling equivalent of a translation nature, should be covered immediately on recognition.

18. LOANS (continued)

Interest rate risk profile of financial assets and financial liabilities

The interest rates and currency profile of the net borrowings of the group at 31 March 2004 were:

	Total net Borrowings	Variable rate net borrowings	Fixed Rate Net Borrowings			Financial liabilities on which no interest is paid	
			Fixed rate borrowings	Weighted average interest rate	Weighted average period until maturity		Weighted average period for which rate is fixed
	£'m	£'m	£'m	%	Years	Years	£'m
Sterling borrowings:							
External loans	(403.1)	(200.2)	(202.9)	6.43	9.9	9.9	-
Eurobonds	(547.4)	-	(547.4)	5.85	20.6	20.6	-
Debentures	(14.2)	-	(14.2)	9.84	3.2	3.2	-
Internal loans	(403.6)	(52.0)	(351.6)	6.75	18.9	18.9	-
Finance leases	(60.9)	(53.0)	(7.9)	7.55	5.0	5.0	-
Total borrowings	(1,429.2)	(305.2)	(1,124.0)	6.44	16.9	16.9	-
Cash	0.3	0.3	-				-
Net borrowings	(1,428.9)	(304.9)	(1,124.0)				-

The interest rates and currency profile of the net borrowings of the group at 31 December 2002 were:

	Total net borrowings	Variable rate net borrowings	Fixed Rate Net Borrowings			Financial liabilities on which no interest is paid	
			Fixed rate borrowings	Weighted average interest rate	Weighted average period until maturity		Weighted average period for which rate is fixed
	£'m	£'m	£'m	%	Years	Years	£'m
Sterling borrowings:							
External loans	(922.9)	(135.5)	(787.4)	6.06	18.4	18.4	-
Debentures	(14.3)	-	(14.3)	9.84	4.5	4.5	-
Internal loans	(352.9)	(1.2)	(351.7)	6.75	20.1	20.1	-
Finance leases	(59.1)	(52.1)	(7.0)	7.15	5.8	5.8	-
Total borrowings	(1,349.2)	(188.8)	(1,160.4)	6.32	12.2	12.2	-
Cash	3.5	3.5	-				-
Short term investments	120.0	120.0	-				-
Net borrowings	(1,225.7)	(65.3)	(1,160.4)				-

The variable rate net borrowings comprise sterling denominated bank borrowings, overdrafts and deposits that bear interest at rates based upon up to twelve months LIBOR. In addition there are provisions due after more than one year of £4.3 million, on which no interest is payable.

As permitted by FRS 13, short term debtors and creditors have been excluded from the disclosures, other than the currency disclosures.

Included in the debentures above are £2.0m of irredeemable debentures that have been excluded from the calculation of the weighted average maturity and fixed periods.

18. LOANS (continued)

Currency exposures

At 31 March 2004, the group and the company had no currency exposures (2002: £nil).

Borrowing facilities

Northumbrian Water Limited has an undrawn committed borrowing facility. The facility available at 31 March 2004, in respect of which all conditions precedent have been met are as follows:

Expiring in more than one year but not more than three years	£'m
	<u>90.0</u>

Fair values of financial assets and financial liabilities

Set out below is a comparison by category of book values and fair values of the financial assets and liabilities of the group as at 31 March 2004:

	<u>Book value</u>	<u>Fair value</u>
	£'m	£'m
Primary financial instruments held or issued to finance the group's operations:		
Short-term financial liabilities and current portion of long-term borrowings	(41.5)	(44.4)
Short-term loan from parent company	(52.0)	(52.0)
Long term borrowings	(1,335.7)	(1,391.0)
Financial assets	0.3	0.3
Derivative financial instruments held to manage the interest rate and currency profile:		
Interest rate swaps	<u>-</u>	<u>2.1</u>
As at 31 March 2004	<u>(1,428.9)</u>	<u>(1,485.0)</u>

Set out below is a comparison by category of book values and fair values of the financial assets and liabilities of the group as at 31 December 2002:

	<u>Book value</u>	<u>Fair value</u>
	£'m	£'m
Primary financial instruments held or issued to finance the group's operations:		
Short term financial liabilities and current portion of long-term borrowings	(22.8)	(26.4)
Long term borrowings	(1,326.4)	(1,410.5)
Financial Assets	123.5	123.5
Derivative financial instruments held to manage the interest rate and currency profile:		
Interest rate swaps	<u>-</u>	<u>1.0</u>
As at 31 December 2002	<u>(1,225.7)</u>	<u>(1,312.4)</u>

The fair values of the interest rate swaps and sterling denominated long term fixed rate debt with a book value of £913.2m (2002: £913.3m) have been determined by reference to prices available from the markets on which the instruments involved are traded. All the other fair values shown above have been calculated by discounting cash flows at prevailing interest rates.

18. LOANS (continued)

Gains and losses on hedges

The company's board uses the Northumbrian Water Limited treasury function to enter into any necessary forward foreign currency contracts on the company's behalf to eliminate the currency exposures that arise on sales denominated in foreign currencies immediately those sales are transacted. The company also uses interest rate swaps to manage its interest rate profile. Changes in the fair value of instruments used as hedges are not recognised in the financial statements until the hedged position matures. An analysis of these unrecognised gains and losses is as follows:

Group

	Gains	Losses	Total net gains/losses
	£'m	£'m	£'m
Unrecognised gains and losses on hedges at 1 January 2003	1.4	0.4	1.0
Gains and losses arising in previous years that were recognised in 2003/2004	(0.6)	(0.4)	(0.2)
Gains and losses arising before 1 January 2003 that were not recognised in 2003/2004	0.8	-	0.8
Gains and losses arising in 2003/2004 that were not recognised in 2003/2004	0.5	-	0.5
Unrecognised gains and losses on hedges at 31 March 2004	<u>1.3</u>	<u>-</u>	<u>1.3</u>
Of which:			
Gains and losses expected to be recognised in 2004/2005	1.3	-	1.3
Gains and losses expected to be recognised in 2005/2006 or later	<u>-</u>	<u>-</u>	<u>-</u>
	<u>1.3</u>	<u>-</u>	<u>1.3</u>

Market price risk

The company's exposure to market price risk principally comprises interest rate exposure. The company's policy is to accept a degree of interest rate risk. On the basis of the company's analysis, it is estimated that a 1% rise in interest rates would not have a material affect on its pre-tax profits.

19. DEBENTURE STOCKS

	<u>March 2004</u>	<u>December 2002</u>
	£'m	£'m
Debenture stocks are repayable as follows:		
In less than one year:		
£1, 12.0% Redeemable 2004	5.0	-
Between one and two years		
£1, 12.0% Redeemable 2004	-	5.0
£1, 12.0% Redeemable 2005	2.0	-
£1, 11.2% Redeemable 2005/09	3.5	-
Between two and five years:		
£1, 12.0% Redeemable 2005	-	2.0
£1, 11.2% Redeemable 2005/09	-	3.5
In five years or more:		
£1, 3.75% Redeemable 2012	0.3	0.3
£1, 4.25% Redeemable 2012	0.7	0.7
£1, 5.25% Redeemable 2012	0.7	0.7
£1, 3.5% Irredeemable	0.2	0.2
£1, 4.0% Irredeemable	0.8	0.8
£1, 5.0% Irredeemable	1.0	1.1
	<hr/>	<hr/>
Total due in more than one year	9.2	14.3
	<hr/>	<hr/>
At 31 March / December	14.2	14.3
	<hr/> <hr/>	<hr/> <hr/>

The debenture stocks are secured by a floating charge on the company's business undertaking and on its assets.

20. OBLIGATIONS UNDER FINANCE LEASES – GROUP AND COMPANY

Obligations under hire purchase contracts and finance leases are as follows:

	<u>March 2004</u>	<u>December 2002</u>
	£'m	£'m
Amounts due:		
Within one year	3.6	3.2
Between one and two years	4.0	3.2
Between two and five years	10.4	8.9
After five years	66.1	68.9
	<hr/>	<hr/>
	84.1	84.2
Less:		
Finance charge allocated to future periods	(23.2)	(25.1)
	<hr/>	<hr/>
	60.9	59.1
	<hr/> <hr/>	<hr/> <hr/>
Disclosed as due:		
Within one year (note 16)	3.6	3.2
After more than one year (note 17)	57.3	55.9
	<hr/>	<hr/>
	60.9	59.1
	<hr/> <hr/>	<hr/> <hr/>

21. AMOUNTS DUE TO OTHER GROUP COMPANIES

Amounts due to other group companies include loans repayable as follows:

	March 2004		December 2002	
	Group	Company	Group	Company
	£'m	£'m	£'m	£'m
Within one year	52.0	52.0	1.2	1.2
Between one and two years	-	-	-	-
Between two and five years	-	-	-	-
After five years	351.6	899.0	351.7	988.5
	<u>403.6</u>	<u>951.0</u>	<u>352.9</u>	<u>989.7</u>

At 31 December 2002 £47.2m was owed to a subsidiary undertaking of the group, Newcastle and Gateshead Water plc, in the form of an unsecured loan note repayable, at par. At that time there was no intention to repay and the loan was therefore classified as being due in five years or more. In March 2004, the company exercised its option to repay the loan note at any time, also at par.

At 31 December 2002 £42.2m was owed to a subsidiary undertaking of the group, Suffolk Water plc, in the form of an unsecured loan note repayable, at par. At that time there was no intention to repay and the loan was therefore classified as being due in five years or more. In March 2004, the company exercised its option to repay the loan note at any time, also at par.

£351.6m is owed to the immediate parent company, Northumbrian Services Limited. Northumbrian Services Limited issued £200.0m Guaranteed Eurobonds in February 1998 and issued a further £150.0m Guaranteed Eurobonds in September 2001, maturing 6 February 2023, with an annual coupon of 6.875%. The issues were guaranteed by the company who received the issue proceeds by way of inter-company loans of £194.2m and £156.2m respectively. Finance costs allocated during the period amounted to £0.3m (2002: £nil). Amortisation of loan issue receipts during the period amounted to £0.3m (2002: £nil).

£300.8m is owed to Northumbrian Water Finance plc, a subsidiary undertaking of the group. Northumbrian Water Finance plc issued £300.0m Guaranteed Eurobonds in December 2001, maturing October 2017, with an annual coupon of 6.0%. The issue was guaranteed by Northumbrian Water Limited who received the issue proceeds by way of an inter-company loan. Amortisation of loan receipts during the period amounted to £0.1m (2002: £0.1m).

£246.6m is owed to Northumbrian Water Finance plc, a subsidiary undertaking of the group. Northumbrian Water Finance plc issued £250.0m Guaranteed Eurobonds during December 2002, maturing April 2033, with an annual coupon of 5.625%. The issue was guaranteed by Northumbrian Water Limited who received the issue proceeds by way of an inter-company loan. Finance costs allocated during the period amounted to £0.1m (2002: £nil).

22. PROVISIONS FOR LIABILITIES AND CHARGES – GROUP AND COMPANY

	March 2004
	£'m
Reorganisation / restructuring provision:	
At 1 January 2003	12.3
Utilised during the period	<u>(12.3)</u>
At 31 March 2004	<u>-</u>
Pension provision for former directors:	
At 1 January 2003	-
Transferred from profit and loss account	3.5
Utilised during the period	<u>(0.3)</u>
At 31 March 2004	<u>3.2</u>
Severance provision:	
At 1 January 2003	-
Transferred from profit and loss account	2.6
Utilised during the period	<u>(1.5)</u>
At 31 March 2004	<u>1.1</u>
Deferred tax :	
At 1 January 2003 as previously reported	161.9
Prior year adjustment (note 2b)	<u>(1.9)</u>
At 1 January 2003 as restated	160.0
Movement in the period (note 9a)	<u>(0.1)</u>
At 31 March 2004	<u>159.9</u>
Closing balance	<u><u>164.2</u></u>

The reorganisation and restructuring provision represented the outstanding pension contributions for staff who left the business on early retirement terms as part of voluntary severance schemes in 1999 and earlier. Following the recommendation of the actuaries of the pension schemes in which the individuals concerned belong, the amount was paid in full in January 2003 with the approval of the trustees of the pension schemes.

The severance provision of £1.1m relates to severance and pension costs relating to senior managers who are leaving the business.

The pension provision for former directors relates to pensions payable to those former directors of water-only companies which have since merged with Northumbrian Water Limited. The charge of £3.2m represents the full future amounts payable, based on an actuarial assessment, for which NWL is directly liable.

**22. PROVISIONS FOR LIABILITIES AND CHARGES – GROUP AND COMPANY
(continued)**

The provision for deferred tax comprises:

	March 2004	December 2002 (as restated)
	£'m	£'m
Accelerated capital allowances	482.2	457.4
Other timing differences	(54.4)	(53.1)
Undiscounted provision for deferred tax	427.8	404.3
Discount	(267.9)	(244.3)
Discounted provision for deferred tax	159.9	160.0

23. ACCRUALS AND DEFERRED INCOME – GROUP AND COMPANY

	March 2004	December 2002
	£'m	£'m
Capital grants and contributions:		
At 1 January	128.2	119.6
Additions	15.3	11.6
Amortised during the period	(4.2)	(3.0)
At 31 March / December	139.3	128.2

24. CALLED UP SHARE CAPITAL – GROUP AND COMPANY

	March 2004	December 2002
	£'m	£'m
Authorised:		
122,650,000 Ordinary Shares of £1 each (2001: 122,650,000)	122.7	122.7
	March 2004	December 2002
	£'m	£'m
Allotted, called-up and fully paid:		
122,650,000 Ordinary Shares of £1 each (2001: 122,650,000)	122.7	122.7

25. PROFIT AND LOSS ACCOUNT – GROUP AND COMPANY

	March 2004
	£'m
At 1 January 2003 as previously reported	737.5
Prior year adjustment (note 2b)	(4.5)
At 1 January 2003 as restated	733.0
Loss retained for the period	(55.0)
At 31 March 2004	678.0

As permitted by Section 230 of the Companies Act 1985, the company's profit and loss account has not been included in these financial statements. The profit for the financial period of £96.5m (2002: £90.3m – as restated) relates to the operations of the company.

26. RECONCILIATION OF MOVEMENTS IN EQUITY SHAREHOLDERS' FUNDS – GROUP AND COMPANY

	March 2004
	£'m
Opening equity shareholders' funds as previously reported	860.2
Prior year adjustment (note 2)	(4.5)
Opening equity shareholders' funds as restated	855.7
Profit for the financial period	96.5
Dividends	(151.5)
Closing equity shareholders' funds	800.7

27. COMMITMENTS – GROUP AND COMPANY

(a) Capital expenditure

	March 2004	December 2002
	£'m	£'m
Expenditure contracted for	53.3	67.0

(b) Lease commitments:

The company and group have entered into non-cancellable operating leases in respect of land and buildings, plant, machinery and motor vehicles. The total amount payable under these leases in the next year is as follows:-

	March 2004	December 2002
	£'m	£'m
Land and buildings:		
Leases which expire:		
Within one year	0.1	0.1
In five years or more	0.6	0.6
	0.7	0.7

28. PENSIONS

Northumbrian Services Limited operates a funded defined benefit pension scheme, providing benefits based on final pensionable remuneration to 2,406 employees. The Scheme, named the Northumbrian Water Pension Scheme, comprises four unitised sub-funds – WPS, Northumbrian Water (North), Northumbrian Water (South) and MIS.

The assets of the Scheme are held separately from those of Northumbrian Services Limited in independently administered funds.

The most recent actuarial valuation of the Scheme was at 31 December 2001. At that date the market value of the assets amounted to £441.0m in aggregate (excluding MIS which was valued at approximately £20.0m). The 2001 valuation disclosed that the combined value of the assets represented 109% of the value of the accrued liabilities.

The following table sets out the contributions agreed based on the 31 December 2001 valuations for WPS, North and South sub-funds. The contributions for the MIS sub-fund were agreed on the 31 March 2001 valuation.

Section	WPS	North	South	MIS
Members' contributions	6%	5%	5%	5%/6%
Employer's contributions	15.5%	10.5%	Nil	6%/7.2%

The MIS employer contributions increased to 21% and 20.7% of Pensionable Earnings for 5% and 6% members respectively from July 2003, following advice from the actuary. In addition the company have agreed to pay £275,000 p.a. for 10 years starting on 1 January 2005.

The company contribution rate was assessed, at the December valuation, using the Projected Unit Method and the following actuarial assumptions: -

Investment Return	
- Pre Retirement	6.1%
- Post Retirement	5.7%
Pay Increases	3.5%
Pension Increases	2.5%
Price Inflation	2.5%

During the fifteen months the group made contributions amounting to £6.6m (2002: £4.2m).

The next valuation will be carried out as at 31 December 2004. An independent qualified actuary performs the actuarial valuation.

Under the transitional provisions of FRS 17 "Retirement benefits" additional disclosures regarding the group defined benefit pension scheme are required. In accordance with FRS 17, the company will account for its contributions to the Scheme as if it were a defined contribution scheme because it is not possible to identify the company's share of the net assets and liabilities in the Scheme on a consistent and reasonable basis.

The latest actuarial valuation of the Scheme, prepared for the purposes of making the transitional disclosures in accordance with FRS 17 in the consolidated financial statements of the parent company, shows a deficit of £90.6m. Further details of this valuation can be found in the consolidated financial statements of the parent company .

In addition, Northumbrian Services Limited operates the Northumbrian Water Group Personal Pension Plan which provides defined contribution benefits to 705 employees.

29. RELATED PARTY DISCLOSURES

The company is a wholly owned subsidiary of Northumbrian Water Group plc which produces publicly available financial statements which include the company. Consequently the company is exempt under the terms of Financial Reporting Standard No 8 “Related Party Disclosures” from disclosing transactions with other members of the group headed by Northumbrian Water Group plc.

30. ULTIMATE PARENT COMPANY

The ultimate parent company and controlling party of the company is Northumbrian Water Group plc, incorporated in England and Wales. The group which consolidates the results of the company is Northumbrian Water Group plc and copies of the consolidated accounts are available to the public from Communications, Northumbrian Water Group plc, Northumbria House, Abbey Road, Pity Me, Durham DH1 5FJ.

31. POST BALANCE SHEET EVENT

On 12th May 2004, the Group’s financial position was improved by the securitisation of the contract with the Environment Agency for the operation of the Kielder Water transfer scheme. The proceeds were used to repay short term Group debt of £205.0m, arising from the acquisition of the Group business in May 2003 (see Director’s Report).