

Bristol Water plc  
Annual Report and accounts  
2003

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## BRISTOL WATER plc

The Company is one of the largest independent water supply companies in the country, providing an average of 300 million litres of water each day through 6,500 kilometres of mains.

It is responsible for supplying over one million people and businesses in an area of almost 2,400 square kilometres centred on Bristol.

The area served covers Bristol and surrounding parts of Somerset, Gloucestershire and Wiltshire.

# Financial highlights

Year ended 31 March	2003 £m	2002 £m	% change
Turnover	70.0	68.0	3
Operating profit	19.4	17.7	9
Profit before tax	14.6	13.9	5
Profit after tax	8.5	10.3	(18)
Earnings per ordinary share	123.0p	153.2p	(20)
Dividend per ordinary share	263.2p	91.9p	186

# Chairman's statement

The company has delivered another strong performance and has achieved excellent financial results.

In last year's Annual Report we signalled that the progressive build up of the regulated business's capital programme, with its consequent additional financing, depreciation and operating costs, together with the relatively low level of increase in charges under the RPI+K price limits of 1.9%, would have a significant impact on profits. Given this background, the result achieved of a profit before tax of £14.6m compared to £13.9m in the previous year represents an excellent outcome. This is due to a combination of factors including a real terms reduction in operating costs and the effects of a lower than expected level of capital expenditure.

During the year, we commenced a £12m project for a major upgrade of Barrow, our second largest water treatment plant, with completion planned for Spring 2004.

We continued to deliver high levels of service to customers. This is reflected by our position in the latest Ofwat report on service levels for 2001/02, which ranked us third of all water companies in England and Wales.

We have developed a new financing package for the business. This was completed shortly after the year end. Prior to completion, the company had a relatively short debt maturity profile. The new structure will provide a better mix of financing and a considerably longer maturity profile, more appropriate to the long-term nature of its asset base. The new facilities offer flexibility for the future, including the ability to substantially increase the financial gearing of the company. However, it is not the Board's current intention to do so.

The key issue for the water sector is the Periodic Review process through which Ofwat will set price limits for the 5 years 2005-10. It is much too early to forecast the outcome, but we are encouraged that the approach that Ofwat are taking in the early stages of the process is intended to lead to an appropriate balance between the interests of customers and shareholders.

## Dividends

Two interim ordinary dividends were declared for the year totalling 194.44p per share. We have now proposed a 5.0% increase in the final ordinary dividend. This brings the total ordinary dividend for the year to 263.21p, a 186% increase from 2002. The interim dividend includes a special dividend of £10m and reflects the Board's view that a modest increase in gearing levels was appropriate.

## Corporate changes

We are proposing to make some changes to the share capital structure of the company and adopt modernised Articles of Association.

We currently have a small number of non-voting ordinary shares. We propose to convert these to voting shares, thus removing an historical anomaly.

The company currently has 5,770,250 authorised but unissued 6.75% Cumulative Convertible Redeemable Preference Shares. The Board proposes to cancel these.

Full details of the proposed changes, which require approval at an extraordinary class meeting of the non-voting shareholders, in respect of the proposed conversion to voting status, and as special business at the Annual General Meeting of the company will be set out in the formal notices for those meetings.

## Outlook and summary

The continued progressive build up of the capital programme, with its consequent additional financing, depreciation and operating cost implications, together with the relatively low level of increase in charges under the RPI+K price limits to customers for 2003/04 of 2.7%, including a K factor of 0%, and a negative K factor of 1.9% in 2004/05, will constrain profits over the next two years.

The company has continued to deliver high quality services to customers while making further operational efficiency gains and putting in place key initiatives that will form the basis of future success. The refinancing of the business creates a firm and flexible financing structure for the future.

My thanks go to all our employees who have contributed to the success of the company.

Alan Parsons  
Chairman  
29 May 2003

# Business review

During the year, we have continued to consolidate the considerable operating cost reductions made in recent years.

A major focus has been the continued development of the joint venture with Wessex Water to enable the two companies to issue combined bills to customers. The first joint bills for unmeasured customers were issued at the beginning of the year with the first metered bills being issued in November. With the billing system now fully operational, this will allow us to progressively realise the planned efficiency gains from the new arrangement together with the provision of a simplified and improved service to customers. High levels of service to customers have been maintained throughout this complex process.

During the year, we achieved certification to the new ISO 9001:2000 quality standard, upgrading from our previous ISO 9000:1994 assessment. The scope of our quality management system covers all aspects of the production and distribution of water, technical design and the procurement of related products and services.

We have initiated a major review of the processes and cost structure in the business. Our objective is to identify the potential scope for further efficiency gains. The exercise will take a further few months to complete. Throughout the process we are evaluating carefully the trade-offs between cost reductions and the associated risks.

We were pleased by our ranking in the latest Ofwat report on service levels by water companies in 2001/02. We were ranked third of all water companies in England and Wales and have been the most consistently highly rated company over the past few years. This recognises our commitment to the delivery of high levels of service to customers.

Our capital programme for the five years to 2005, as set out in the Final Determination amounts to £125m at May 1999 prices. In accordance with the Drinking Water Inspectorate's protocol we have not yet commenced the lead pipe replacement programme that was incorporated in Ofwat's price determination, pending the results of orthophosphate dosing trials currently in progress. These are currently demonstrating substantial compliance with the lead standard that comes into force in 2013 and it is increasingly likely that the actual spend on lead pipe replacements during the five year period will be at a relatively low level.

Capital investment, including infrastructure renewals, net of grants and contributions, for the year totalled £20.0m. Key projects included the completion of our 30 month £12m mains renovation programme, which has involved the renovation of some 250km of mains throughout our area. We also completed the installation of a barrier to remove cryptosporidium oocysts at the Chelvey water treatment works, bringing the total of treatment works with such barriers to eight.

We have recently commenced a £12m project for a major upgrade of our Barrow treatment plant, with completion planned for Spring 2004. Expenditure on the project at some £1.7m during the year was lower than originally expected reflecting a revised project plan and delays in obtaining relevant planning approvals. This is a complex project and is progressing well.

Ofwat has set out details of the planned Periodic Review process that will set price limits for the 5 years from 2005 to 2010. Ofwat's process will take almost two years to complete and the outcome will be extremely important to the business. The first major milestone is the submission of our draft business plan to Ofwat during August 2003.

The refinancing arrangements explained in the Chairman's statement effectively apply a financial ringfencing to the regulated water business and provide flexibility to increase its debt levels significantly in the future. We have no current plans to substantially increase gearing levels, but believe that in arranging long term financing it was appropriate to create this type of flexibility.

As noted in the Chairman's statement, profits for the next two years will be influenced by a range of additional costs, in particular the financing, depreciation and operating cost implications of the continuing capital programme. As outlined above, we will continue to seek further operational efficiency gains whilst ensuring that we do not compromise our high standards of service.

# Operating and financial review

## FINANCIAL HIGHLIGHTS

	2003 £m	2002 £m
Turnover	70.0	68.0
Profit before tax	14.6	13.9
Taxation		
Current tax	(2.3)	(2.3)
Deferred tax	(3.8)	(1.3)
Total	(6.1)	(3.6)
Profit after tax	8.5	10.3

### Results Overview

In November 1999, Ofwat issued the Periodic Review Final Determination. This set maximum price limits for charges to customers for the five years 2000-05. The limits, known as K factors, plus movements in the RPI index, determine the allowed increase or decrease in overall charges each year. For 2002/03, the K factor was 1%, which together with an RPI movement of 0.9% meant an average increase in charges to customers of some 1.9%.

Overall turnover increased by some £2.0m, mainly due to the RPI+K increase.

Operating costs before depreciation were £36.6m, slightly above £36.5m recorded in 2002 and represent, after taking the effect of inflation into account, a reduction in real terms.

Net depreciation increased slightly by £0.3m to £14.0m reflecting the commissioning of new assets offset by the non-recurrence of an accelerated depreciation charge of £0.4m for other assets in the previous year.

Overall profit before tax of £14.6m represents a £0.7m improvement from 2002.

The results include a total tax charge of some 42% (2002 – 26%). This includes a deferred tax charge of £3.8m (2002 - £1.3m) in addition to the underlying current tax charge of £2.3m. The deferred tax element is unusually high because of a reduction in the discount rates used to calculate our overall deferred tax liability. As required by FRS19, the discount rates applied are based on government gilts for relevant periods. The change in rates essentially reverses a corresponding gain made in the second half of 2001/02 when discount rates increased.

Profit after tax was £8.5m, a decrease of £1.8m from 2002.

In these accounts the appropriate transitional disclosures required under FRS17, the new accounting standard on pensions, are made. These show that the company's section within the Water Companies' Pension Scheme would be represented on the balance sheet as a deficit net of tax of £13.0m, this compares to an asset net of tax of £10.0m in 2002 under FRS17. The change reflects the negative and increasingly volatile movements of the equity markets.

An actuarial review of the pension section as at 1 April 2002 has recently been completed and shows a surplus on an actuarial basis of £6.3m. The section is currently invested primarily in equities. In consultation with both the trustees and the actuary we have carefully examined the investment strategy and concluded that the appropriate long-term strategy is to reduce the proportion of equities with a corresponding increase in investments in bonds and other fixed income securities. Given the current equity market position, we have delayed the implementation of this change until we see some further recovery in equity market values.

We have agreed a significant increase in cash contributions to the pension funds effective from 1 April 2003. The total cash contributions will be broadly in line with the SSAP24 charge of £1.3m reflected in these accounts for 2003. The appropriate disclosures are set out in note 18.

Net capital investment in the year after grants and contributions from developers was £20.0m, compared to £23.5m in 2002.

The Board proposes a total ordinary dividend for the year of 263.21p, a 186% increase from 2002. As a result, a final ordinary dividend of 68.77p is being recommended.

## Treasury

Net cash inflow from operating activities was £29.7m (2002-£28.9m), net cash outflows from investments and servicing of finance totalled £6.7m (2002-£5.7m) and net capital expenditure amounted to £16.1m (2002-£22.8m). Total cash outflows before management of liquid resources and financing were £1.7m (2002-£6.7m).

Net borrowings increased from £71.5m to £74.8m during the year, and at 31 March 2003 represented approximately 41% of Regulatory Capital Value.

At the year end, net gearing (net debt/equity) was 114% compared to 97% in 2002. Net debt and gearing levels are expected to increase during 2003-04 as the level of capital investment increases.

A major post balance sheet event is the finalisation of a new financing structure. Prior to the refinancing, the company had a relatively short debt maturity profile and the new structure provides a better mix and considerably longer maturity profile appropriate to the long term nature of the assets being financed. The new facilities provide for repayment of £20m of existing bank debt and to finance the ongoing capital expenditure programme. £15m of index-linked debt was drawn through the existing Artesian Finance plc monoline wrapped bond programme arranged by the Royal Bank of Scotland, previously used by three other water companies. An equivalent £30m financing was also drawn on a fixed interest basis through a new bond programme issued by Artesian Finance II plc. The facilities extend to 2032 and 2033 respectively.

The new financing is based on a ringfenced structure and some existing lenders have entered into an intercreditor arrangement to share the ringfencing security package. It is expected that all new senior debt will also become part of the intercreditor arrangement.

The intercreditor structure is governed by two key financial ratio covenants: debt to regulated asset value and a cash interest cover ratio. The structure would enable a substantial increase in gearing of the ringfenced business should it be concluded that this is appropriate, in which case it is expected that Ofwat would seek changes, in line with those recently adopted by more highly geared water companies, to the company's licence of appointment as a water undertaker.

The company uses interest rate derivatives to manage exposures to fluctuations in interest rates. Positions on hedges are deferred and matched to appropriate underlying transactions. As part of the refinancing arrangement the company has redesignated a £20m interest rate swap which swaps variable rate LIBOR to fixed rate. This was previously matched to the £20m bank loan repaid in May 2003. The redesignation matches it to a £10m variable rate bank loan and to £10m of variable rate leases.

Net interest charges in the year totalled £5.2m (2002 - £4.6m) and were covered 3.7 times (2002 - 3.9 times).

The net interest charge is expected to increase during 2003/04. This reflects the additional net debt resulting from planned capital expenditure together with an increase in the effective average interest rate following the refinancing. The average interest rate is expected to increase as the Artesian borrowing is subject to long term interest rate margins and the investment returns on temporary cash surpluses will be lower than borrowing costs. We maintain temporary cash surpluses to provide pre-funding for future capital expenditure and working capital requirements and to provide financial flexibility.

## Strategy/Objectives

The company's strategy is set out in its vision statement whereby Bristol Water seeks to be "a water company, balancing all stakeholders' interests, delivering world class performance at best value, both now and in the future."

## Monitoring the business

A number of systems are used to monitor the financial and operational performance of the business including

- monthly management accounts and budgetary control
- monthly key performance indicators
- ad hoc internal audits of business processes
- a detailed Quality Assurance system

## Outlook

The continued progressive build up of the capital programme, with its consequent additional financing, depreciation and operating cost implications, together with the relatively low level of increase in charges under the RPI+K price limits to customers for 2003/04 of 2.7%, including a K factor of 0%, and a negative K factor of 1.9% in 2004/05, will constrain profits over the next two years.

# Directors' report

for the year ended 31 March 2003

The directors have pleasure in submitting their report and the accounts for the year ended 31 March 2003.

## PRINCIPAL ACTIVITIES

The company's principal activities are the provision of water supply and related services to a population of more than one million people and businesses in an area of 2,391 square kilometres centred on Bristol. The company is a water undertaker and its duties are discharged under the terms of the Water Industry Act 1991.

## RESULTS FOR THE YEAR

The results for the year are shown in the profit and loss account and discussed in the Business Review and the Operating and Financial Review. Dividends are disclosed in Note 5. A final ordinary dividend of 68.77p per share is proposed, equating to a total ordinary dividend for the year of 263.21p.

## DIRECTORS AND THEIR INTERESTS

The directors throughout the year, and their beneficial interests in the ordinary shares of the ultimate parent company, were:

	1 April 2002	31 March 2003
A Parsons, <i>Chairman</i>	9,276	9,282
Dr A J Bates	1,942	3,675
P D Knowlson	333	345
A S Nield, <i>Finance Director</i>	500	500
R W Wyatt, <i>Managing Director</i>	5,103	5,103

There have been no changes in directors' interests from 31 March 2003 to the date of this report.

Mr A Parsons, Mr A S Nield and Mr R W Wyatt have service contracts with the ultimate parent company. Details are set out in the Remuneration Committee Report of the ultimate parent company.

Dr A J Bates has a provision in his service contract for the enhancement of his Water Companies' Pension Scheme pensionable service by a maximum of 6<sup>2</sup>/<sub>3</sub> years in the event of redundancy. Executive Directors appointed since 1995 do not have this benefit.

Mr A Parsons, who currently has a service contract with a 12-month notice period as at the date of this report, and Mr P D Knowlson, who has a service contract with a 12-month notice period, will offer themselves for re-election at the Annual General Meeting.

The following options over ordinary shares of the holding company have been granted to and not been exercised by the directors under the terms of the Executive Share Option Scheme and group Savings Related Share Option Scheme -

	Date of Grant	Options		Exercise price £	Exercisable from	to
		Unexercised at 31.3.02	Unexercised at 31.3.03			
A Parsons	20.12.95 16.07.02*	2,434 -	2,434 1,628	11.80 10.16	Dec 1998 Sept 2007	Dec 2005 March 2008
Dr A J Bates	20.12.95 16.07.02*	915 -	915 1,628	11.80 10.16	Dec 1998 Sept 2007	Dec 2005 March 2008
P D Knowlson	05.07.00*	1,513	1,513	6.40	Sept 2003	March 2004
A S Nield	13.07.01*	2,062	2,062	8.18	Sept 2006	March 2007
R W Wyatt	20.12.95 16.07.02*	2,136 -	2,136 935	11.80 10.16	Dec 1998 Sept 2005	Dec 2005 March 2006

\*Savings Related Share Option Scheme

Executive share options were issued at mid-market value and must be exercised between three and ten years after grant subject to the approval of the Remuneration Committee of the holding company and the meeting of earnings per share growth criteria. Savings Related Share Option Scheme options were issued at a 20% discount to the market price to any group employee entering an Inland Revenue approved Save As You Earn contract for a period of three or five years. The market price of the relevant shares at 31 March 2003 was £11.63 and ranged from £10.50 to £12.80 during the year.

At no time during the year has any director had a material interest in any contract of significance with any company in the group, other than his service contract, nor held any shares in any group company except in the ultimate holding company.

#### **ULTIMATE PARENT COMPANY**

At 31 March 2003, all the company's ordinary shares were owned by Bristol Water Holdings plc. As part of the refinancing arrangements described in the Operating and Financial Review, the ownership of the shares has been subsequently transferred to a new company, Bristol Water Core Holdings Limited. The new company is a wholly-owned subsidiary of Bristol Water Holdings plc. All of the company's irredeemable preference shares are owned outside the Bristol Water Holdings plc group.

#### **FIXED ASSETS**

In the opinion of the directors there is no material difference between the book value and market value of land expected to be disposed of within the next twelve months.

#### **EMPLOYEE MATTERS**

The company is committed to policies of employee involvement, communication, training and sound relationships with trade unions. The company participates in a Savings Related Share Option Scheme for all eligible employees.

The company is an equal opportunity employer providing employment and appropriate facilities for disabled people. High standards for Health and Safety policies have been set together with targets for quality and customer service.

#### **PAYMENT PRACTICES**

It is company policy to comply with the terms of payment agreed with a supplier. Where payment terms are not negotiated, the company endeavours to adhere to the supplier's standard terms. The company pays creditors in accordance with payment terms on receipt of valid invoices. At the end of the year, trade creditors represented the equivalent of 8 days purchases (2002 - 15 days), the low figure this year being a consequence of the timing of payments to suppliers.

#### **CHARITABLE DONATIONS**

The company made no donations to charitable causes during the year (2002 - £Nil) as such payments are made by the ultimate parent company.

#### **RESEARCH AND DEVELOPMENT**

The company undertakes research and development projects in relation to its business. Expenditure during the year amounted to £59,000 (2002 - £72,000).

#### **POST BALANCE SHEET EVENTS**

During April 2003, all the ordinary issued shares of the company were transferred to Bristol Water Core Holdings Limited, a wholly-owned subsidiary of the ultimate parent company, Bristol Water Holdings plc.

During May 2003, the company entered into a new financing structure. Details are set out in the Operating and Financial Review and in Note 13 to the Accounts.

#### **AUDITORS**

Following the conversion of our auditors PricewaterhouseCoopers to a Limited Liability Partnership (LLP) on 1 January 2003, PricewaterhouseCoopers resigned on 27 January 2003 and the directors appointed its successors PricewaterhouseCoopers LLP as its auditors. A resolution to reappoint PricewaterhouseCoopers LLP as auditors of the company will be proposed at the Annual General Meeting.

#### **APPOINTMENT AND REGULATORY ACCOUNTS**

In accordance with its Instrument of Appointment made under the Water Act 1989, the directors are of the opinion that the company is in compliance with paragraph 3.1 of Condition K of that Instrument, which relates to the control over the assets of the Appointed Business. Copies of the Regulatory Accounts required under the Instrument of Appointment will be available from the Company Secretary.

#### **CORPORATE GOVERNANCE AND OTHER DISCLOSURES REQUIRED BY A LISTED COMPANY**

As the company has listed debt and fixed income preference shares only, a statement on Corporate Governance and certain other requirements of the listing Rules and Statistics are not required. However, one does appear in the accounts of Bristol Water Holdings plc, the ultimate parent company, and the policies and procedures outlined there are applicable to the company.

# Directors' report<sub>continued</sub>

for the year ended 31 March 2003

## **DIRECTORS' RESPONSIBILITIES FOR THE PREPARATION OF FINANCIAL STATEMENTS**

The following statement, which should be read in conjunction with the statement of responsibilities set out in the independent auditors' report, is made with a view to distinguishing for shareholders the respective responsibilities of the directors and of the auditors in relation to the financial statements.

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

In preparing the financial statements the directors are required to select and apply consistently suitable accounting policies framed by reference to reasonable and prudent judgements and estimates. Applicable accounting standards also have to be followed and a statement made to that effect in the financial statements, subject to any material departures being disclosed and explained in the notes to the financial statements. The directors are required to prepare the financial statements on a going concern basis unless it is inappropriate to presume the company will continue in business. Directors are responsible for ensuring proper accounting records are kept 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 taking reasonable steps to safeguard the assets of the company and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

By order of the Board  
**S C Robson**  
Secretary  
29 May 2003

# Accounting policies

The significant accounting policies adopted in the preparation of the accounts, which have been applied consistently, are set out below.

**a. Accounting convention**

The accounts of the company are prepared under the historical cost convention and in accordance with applicable accounting standards in the United Kingdom and with the provisions of the Companies Act 1985, except for the treatment of certain capital contributions as explained in Note d.

**b. Turnover**

Turnover comprises charges to and accrued income from customers for water and other services, exclusive of VAT.

Income from metered supplies is based upon volumes of water invoiced plus estimated volumes of uninvoiced water delivered to customers during the year.

**c. Tangible fixed assets and depreciation**

Tangible fixed assets comprise infrastructure assets and other assets.

**i. Infrastructure assets**

Infrastructure assets comprise the integrated network of impounding and pumped raw water storage reservoirs and water mains and associated underground pipework. Expenditure on such assets relating to increases in capacity, enhancements or planned maintenance of the network is treated as an addition to fixed assets and is included at cost. The cost of infrastructure assets is their purchase cost together with incidental expenses of acquisition and directly attributable labour costs which are incremental to the company.

**ii. Other assets**

Other assets include land and buildings, operational structures, fixed and mobile plant, equipment and motor vehicles. All are included at cost. The cost of other assets is their purchase cost together with incidental expenses of acquisition and any directly attributable labour costs which are incremental to the company.

**iii. Depreciation**

Depreciation is charged, where appropriate, on a straight-line basis on the original cost of assets over their expected economic lives. Freehold land is not depreciated.

Depreciation of infrastructure assets takes account of planned expenditure levels to maintain the operating capability of the company's infrastructure assets in perpetuity. Regard is primarily taken of the five year plans submitted to the Office of Water Services for use in setting price limits under the RPI+K formula.

Other assets are depreciated after commissioning over the following estimated economic lives -

Operational properties and structures	40 to 100 years
Treatment, pumping and general plant	20 to 24 years
Computing and communications and telemetry equipment	3 to 15 years
Vehicles and mobile plant	5 to 7 years

**d. Grants and contributions**

Contributions received in respect of tangible assets other than infrastructure assets are treated as deferred income and amortised in the profit and loss account over the expected useful lives of the related assets. Contributions received in respect of enhancing the infrastructure network are not shown as deferred income but are deducted from the cost of the related fixed assets. This treatment is permitted by SSAP 4 but is a departure from the Companies Act 1985 which requires such contributions to be shown as deferred income. It is the directors' opinion that this treatment is necessary to show a true and fair view as the related assets do not have determinable finite lives and therefore no basis exists for the amortisation of the contributions. The effect on tangible fixed assets is shown in Note 7(d) to the accounts.

Grants and contributions in respect of expenditure charged to the profit and loss account are netted against such expenditure as received.

# Accounting policies continued

**e. Leased assets**

Assets financed by leasing agreements that transfer substantially all the risks and rewards of ownership of an asset to the lessee are capitalised and depreciated over the shorter of their estimated useful lives and the lease term. The capital portion of the lease commitment is included in current or non-current creditors as appropriate. The capital element of the lease rental is deducted from the obligation to the lessor as paid. The interest element of lease rentals and the depreciation of the relevant assets are charged to the profit and loss account.

Operating lease rental payments are charged to the profit and loss account as incurred over the term of the lease.

**f. Pension costs**

The cost of providing pension benefits is charged to the profit and loss account to spread the cost over the expected average service lives of employees. Differences between the amounts funded and amounts charged to the profit and loss account are recorded as prepayments or provisions, as appropriate, in the balance sheet.

The appropriate transitional disclosures under FRS17, "Retirement Benefits", the accounting standard on pensions, are included in note 18 to the accounts.

**g. Research and development**

Research and development expenditure is charged to the profit and loss account as incurred.

**h. Taxation**

The charge for taxation is computed based on the profit for the period adjusted according to tax legislation.

Advance Corporation Tax in respect of dividends in previous years was written off to the profit and loss account unless it could be recovered against mainstream corporation tax in the current year or with reasonable assurance in the future. Credit is taken for Advance Corporation Tax previously written off when it is recovered against mainstream corporation tax liabilities.

Deferred tax has been recognised as a liability or asset if transactions have occurred at the balance sheet date that give rise to an obligation to pay more taxation in future, or a right to pay less taxation in future. An asset is not recognised to the extent that the transfer of economic benefits in future years is not probable. Deferred tax assets and liabilities recognised have been discounted at rates equivalent to the post-tax yields to maturity that could be obtained at the balance sheet date on government bonds with maturity dates similar to those of the deferred tax assets and liabilities.

**i. Stocks**

Stocks are valued at the lower of cost and net realisable value. Following established practice in the water industry no value is included in the accounts in respect of water held in store.

**j. Financial instruments**

The company uses interest rate derivatives to manage exposures to fluctuations in interest rates. Positions on hedges are deferred and matched to the underlying transaction.

# Profit and Loss account

for the year ended 31 March 2003

	Note	2003 £000	2002 £000
Turnover	1	69,974	68,013
Operating costs	2	(50,613)	(50,272)
<b>Operating profit</b>		<b>19,361</b>	<b>17,741</b>
Profit on disposal of tangible fixed assets		386	760
Net interest payable and similar charges	3	(5,184)	(4,598)
<b>Profit on ordinary activities before taxation</b>		<b>14,563</b>	<b>13,903</b>
Taxation on profit on ordinary activities	4	(6,093)	(3,622)
<b>Profit on ordinary activities after taxation</b>		<b>8,470</b>	<b>10,281</b>
Dividends -	5		
On irredeemable preference shares		(1,094)	(1,094)
On ordinary shares		(15,788)	(5,512)
<b>Total dividends</b>		<b>(16,882)</b>	<b>(6,606)</b>
<b>(Loss)/profit retained for the financial year</b>		<b>(8,412)</b>	<b>3,675</b>
Earnings per share	6	123.0p	153.2p

All of the turnover and operating costs relate to continuing operations.

There is no difference between the profit on ordinary activities before taxation and the retained (loss)/profit for the year stated above and their historical cost equivalents.

*The accompanying notes to the accounts form an integral part of this statement.*

## Statement of total recognised gains and losses

for the year ended 31 March 2003

	2003 £000	2002 £000
Profit attributable to Bristol Water plc shareholders	8,470	10,281
Prior year adjustments net of attributable taxation	-	(11,202)
<b>Total gain/(loss) recognised since last annual report</b>	<b>8,470</b>	<b>(921)</b>

The prior year adjustments related to:

(a) the recognition of income from metered supplies on the basis of volumes of water delivered, rather than volumes invoiced - £1,768,000;

(b) the application of FRS19 Accounting for deferred tax - (£12,970,000).

*The accompanying notes to the accounts form an integral part of this statement.*

# Balance sheet

at 31 March 2003

	Note	2003 £000	2002 £000
Tangible fixed assets	7	184,685	179,426
<b>Current assets</b>			
Stocks	8	634	437
Debtors	9	16,765	12,311
Cash at bank and on deposit	10	9,661	14,676
		<u>27,060</u>	<u>27,424</u>
<b>Creditors: Amounts falling due within one year</b>			
Short term borrowings	10	6,760	3,355
Other creditors	11	34,056	23,092
		<u>40,816</u>	<u>26,447</u>
<b>Net current (liabilities)/assets</b>		<u>(13,756)</u>	<u>977</u>
<b>Total assets less current liabilities</b>		<b>170,929</b>	<b>180,403</b>
<b>Creditors: Amounts falling due after more than one year</b>	10	<b>(77,724)</b>	<b>(82,825)</b>
Deferred income	12	(8,429)	(8,396)
Provisions for liabilities and charges	14	(19,242)	(15,236)
<b>Net assets</b>		<u><b>65,534</b></u>	<u><b>73,946</b></u>
<b>Capital and reserves</b>			
Called up share capital	15	18,498	18,498
Share premium account	16	4,415	4,415
Other reserves	16	5,770	5,770
Profit and loss account	16	36,851	45,263
<b>Total shareholders' funds</b>	16	<u><b>65,534</b></u>	<u><b>73,946</b></u>
<i>Analysed as:</i>			
<i>Equity shareholders' funds</i>		<u>53,034</u>	<u>61,446</u>
<i>Non-equity shareholders' funds</i>		<u>12,500</u>	<u>12,500</u>

The accounts were approved by the Board on 29 May 2003 and signed on its behalf by -

**A Parsons** Chairman  
**A Nield** Finance Director

*The accompanying notes to the accounts form an integral part of this statement.*

# Cash flow statement

for the year ended 31 March 2003

	Note	2003 £000	2002 £000
Net cash inflow from operating activities	19(a)	29,743	28,869
<b>Returns on investments and servicing of finance</b>			
Interest received		517	815
Interest paid		(4,761)	(4,150)
Interest paid on finance leases		(1,354)	(1,280)
Dividends paid on non-equity shares		(1,094)	(1,094)
		<u>(6,692)</u>	<u>(5,709)</u>
<b>Taxation</b>			
Corporation tax paid		(3,010)	(1,995)
<b>Capital expenditure</b>			
Purchase of tangible fixed assets		(20,395)	(26,237)
less contributions received		3,409	2,588
Proceeds on disposal of tangible fixed assets		887	888
		<u>(16,099)</u>	<u>(22,761)</u>
Dividends paid on equity shares		(5,592)	(5,151)
Cash outflow before management of liquid resources and financing		(1,650)	(6,747)
<b>Management of liquid resources</b>			
being decrease/(increase) in short term deposits		7,500	(5,200)
<b>Financing</b>			
Cash inflow from refinancing assets under new finance leases		-	8,159
New bank loans and overdrafts		-	5,222
Capital element of lease repayments		(1,580)	(1,427)
Loan and bank overdraft repayments		(1,785)	-
		<u>(3,365)</u>	<u>11,954</u>
Increase in cash	19(c)	2,485	7
Cash, beginning of year		676	669
Cash, end of year		<u>3,161</u>	<u>676</u>

The accompanying notes to the accounts form an integral part of this statement.

# Notes to the accounts

## 1. TURNOVER

Turnover is wholly derived from water supply and related activities in the United Kingdom. The maximum level of prices the company may levy for the majority of water charges is controlled by the Director General of the Office of Water Services.

## 2. OPERATING COSTS

The directors believe that the nature of the company's business is such that the analysis of operating costs required by the Companies Act 1985 is not appropriate. As required by the Act the directors have therefore adapted the prescribed format so that disclosure of operating costs is appropriate to the company's business.

### (a) Operating costs comprise -

	2003 £000	2002 £000
Wages and salaries	10,053	11,187
Social security costs	721	802
Pension costs	1,258	810
Total payroll cost	<u>12,032</u>	<u>12,799</u>
less charged to fixed assets	(3,003)	(2,721)
Net payroll cost	<u>9,029</u>	<u>10,078</u>
<b>Other operating costs</b>		
Operating lease rentals on plant and machinery	115	49
Research and development expenditure	59	72
Auditors' remuneration -		
Statutory audit	47	49
Other audit services including audit of regulatory returns	28	28
Other non-audit services mainly tax advice and compliance work	12	20
Raw materials, consumables, bad debts and other charges less recoveries	<u>27,355</u>	<u>26,246</u>
Total other operating costs	<u>27,616</u>	<u>26,464</u>
<b>Depreciation of tangible fixed assets -</b>		
On owned assets	11,693	11,250
On leased assets	2,567	2,763
Amortisation of related deferred income	(292)	(283)
Net depreciation	<u>13,968</u>	<u>13,730</u>
<b>Total operating costs</b>	<u>50,613</u>	<u>50,272</u>

### (b) Employee details -

The average number of employees (full time equivalents) during the year was 422 (2002 – 430). The figure for 2002 excluded approximately 50 full time equivalent former employees of Bristol Water plc, transferred during 2002 to Bristol Wessex Billing Services Limited, whose costs were recorded within the payroll costs noted above during transitional financial arrangements and are now included in other operating costs for 2003.

### (c) Directors' emoluments -

	2003 £000	2002 £000
Aggregate emoluments of all directors, being remuneration, bonus and benefits in kind	<u>685</u>	<u>719</u>

The emoluments above include charges towards the remuneration of three directors – Mr A Parsons, Mr A Nield and Mr R Wyatt - who are employed and paid by the ultimate parent company, and for whom a charge is made to this company.

Bonus represents amounts accrued, and approved, but not paid as at 31 March 2003.

In addition, during the year a director exercised options to purchase shares in the ultimate parent company with a net gain on exercise of £4,000, of which £Nil relates to the highest paid director.

In total, at 31 March 2003 five directors were accruing retirement benefits under a defined benefit scheme (2002 - five).

The remuneration of each director is established by the Remuneration Committee of the ultimate parent company on the basis of duties and responsibilities held using market data for comparable positions in other companies. Bonuses relate to the achievement of corporate objectives and are subject for the year to 31 March 2003 to a maximum of 30% of base salary. Details of options previously granted to directors are shown in the Directors' Report.

The aggregate emoluments of the highest paid director in the year, paid under his service contract with the ultimate parent company, were £193,000 (2002 - £193,000). At the end of the year, the highest paid director in the year had an accrued pension entitlement available on his normal retirement date of £32,000 and an accrued lump sum entitlement of three times that amount.

### 3. NET INTEREST PAYABLE AND SIMILAR CHARGES

The net interest payable and similar charges for the year comprise -	2003 £000	2002 £000
On bank borrowings	3,131	3,010
On other borrowings	1,166	1,096
Finance leases	1,375	1,335
Less interest income	(488)	(843)
Net interest expense	<u>5,184</u>	<u>4,598</u>

### 4. TAXATION ON PROFIT ON ORDINARY ACTIVITIES

	2003 £000	2002 £000
<b>(a) Analysis of charge for the year all arising in the United Kingdom:</b>		
<b>Current tax</b>		
Corporation tax at 30% (2002 - 30%)	2,535	4,202
Advance Corporation Tax written off/(back)	1,379	(473)
Adjustment to prior periods	(1,643)	(1,389)
	<u>2,271</u>	<u>2,340</u>
<b>Deferred tax</b>		
Current year movement	1,413	(176)
Adjustment to prior periods	1,204	2,851
Effect of discounting	1,205	(1,393)
	<u>3,822</u>	<u>1,282</u>
<b>Tax on profit on ordinary activities</b>	<u><u>6,093</u></u>	<u><u>3,622</u></u>

The adjustment to prior periods mainly relates to the effects of an agreement with the Inland Revenue to accelerate certain capital allowances. This has reduced the mainstream Corporation Tax charge, but reduced the recovery of Advance Corporation Tax.

#### Factors that may affect future tax charges

Based on current capital investment plans, the company expects to continue to be able to claim capital allowances in excess of depreciation in future years.

Advance Corporation Tax (ACT) has only been recognised as an asset, to the extent that it is foreseen to be recoverable in the next 12 months. There is a further £5.4m not recognised, including ACT previously assumed to be recoverable in prior years, now not recovered following increased capital allowances claimed for the relevant years.

Changes in the discount rate year on year may cause large fluctuations in the effective tax rate.

# Notes to the accounts

## (b) Factors affecting the tax charge:

The current tax for the period is lower (2002 - lower) than the standard rate of corporation tax in the United Kingdom (30%).

The differences are explained below:

	2003 £000	2002 £000
Profit on ordinary activities before tax	14,563	13,903
Profit on ordinary activities multiplied by standard rate of corporation tax in the United Kingdom at 30% (2002 - 30%)	4,369	4,171
Effects of:		
ACT set off for the current year	(266)	(473)
Expenses not deductible for tax	(87)	83
Capital allowances in excess of depreciation	(1,994)	(78)
Other net charges	247	26
	<u>2,269</u>	<u>3,729</u>
Adjustment to tax in respect of prior periods	(1,643)	(1,389)
Adjustment in respect of ACT for prior years	1,645	-
	<u>2,271</u>	<u>2,340</u>

## 5. DIVIDENDS

	2003 £000	2002 £000
<b>On non-equity shares -</b>		
Irredeemable 8.75% preference shares -		
Paid	547	547
Payable 1 April	547	547
	<u>1,094</u>	<u>1,094</u>
<b>On ordinary shares (equity shares) -</b>		
Interim dividend paid of 27.72p (2002 - 26.4p)	1,663	1,583
Second interim dividend 166.72p (2002 - Nil) paid post 31 March 2003	10,000	-
Proposed final dividend of 68.77p (2002 - 65.5p)	4,125	3,929
	<u>15,788</u>	<u>5,512</u>
Total dividends paid and proposed	<u>16,882</u>	<u>6,606</u>

## 6. EARNINGS PER SHARE

	2003 000	2002 000
Earnings per share have been calculated as follows -		
On average number of ordinary shares in issue during the year -		
Earnings attributable to ordinary shares	£7,376	£9,187
Weighted average number of ordinary shares	5,998	5,998

As the Company has no obligation to issue further shares, disclosure of earnings per share on a fully diluted basis is not required.

## 7. TANGIBLE FIXED ASSETS

(a) The movements for the year comprise -

	Freehold land and operational structures £000	Plant and equipment £000	Infra- structure assets £000	Total £000
<b>Cost</b>				
At 1 April 2002	132,877	24,658	147,328	304,863
Additions	7,551	3,508	12,370	23,429
Disposals	(722)	(1,602)	(1,695)	(4,019)
Grants and contributions	(168)	-	(3,241)	(3,409)
<b>At 31 March 2003</b>	<b>139,538</b>	<b>26,564</b>	<b>154,762</b>	<b>320,864</b>
<b>Depreciation</b>				
At 1 April 2002	44,614	14,608	66,215	125,437
Charge for year	4,633	2,680	6,947	14,260
Disposals	(259)	(1,564)	(1,695)	(3,518)
<b>At 31 March 2003</b>	<b>48,988</b>	<b>15,724</b>	<b>71,467</b>	<b>136,179</b>
<b>Net book value</b>				
<b>At 31 March 2003</b>	<b>90,550</b>	<b>10,840</b>	<b>83,295</b>	<b>184,685</b>
At 31 March 2002	88,263	10,050	81,113	179,426

(b) Included above at 31 March 2003 is freehold land, not subjected to depreciation in the year, of £1,316,000 (2002 - £1,317,000).

(c) Included above at 31 March 2003 are fixed assets held under finance leases with a cost of £49,414,000 (2002 - £50,788,000) and cumulative depreciation of £21,771,000 (2002 - £19,800,000). Comparative figures have been reanalysed following a review with the relevant leasing company of the allocation of expenditure on partly completed assets. The previously published values were cost £48,001,000 and cumulative depreciation of £16,874,000. There is no Profit and Loss account impact of the reanalysis.

This is analysed by asset type as follows -

	Freehold land and operational structures £000	Plant and equipment £000	Infra- structure assets £000	Total £000
<b>At 31 March 2003</b>				
Cost	38,568	9,694	1,152	49,414
Depreciation	(13,421)	(8,350)	-	(21,771)
<b>Net book value</b>	<b>25,147</b>	<b>1,344</b>	<b>1,152</b>	<b>27,643</b>
<b>At 31 March 2002</b>				
Cost	38,569	11,067	1,152	50,788
Depreciation	(11,439)	(8,361)	-	(19,800)
<b>Net book value</b>	<b>27,130</b>	<b>2,706</b>	<b>1,152</b>	<b>30,988</b>

(d) The net book value of infrastructure assets is stated after the deduction of contributions of £33,887,000 (2002 - £30,646,000) as explained in Accounting Policy d.

(e) The charge for depreciation includes £Nil (2002 - £422,000) accelerated depreciation in respect of certain assets that are to be replaced significantly earlier than previously planned.

## 8. STOCKS

Stocks comprise consumable stores. The replacement cost of stocks is not considered to be materially different from their carrying value in the balance sheet.

# Notes to the accounts

## 9. DEBTORS

Debtors comprise -	2003 £000	2002 £000
Trade debtors	6,693	8,210
Due from group companies	2,502	139
Other debtors	1,127	1,058
Prepayments and accrued income	6,443	2,904
	<u>16,765</u>	<u>12,311</u>

## 10. NET BORROWINGS

(a) At 31 March 2003 net borrowings comprise -

	Term loans less cash £000	Finance leases £000	Debentures £000	Total 2003 £000	Total 2002 £000
Repayment due:					
Between one and two years	-	1,682	3,455	5,137	1,544
Between two and five years	18,000	6,704	-	24,704	22,854
After five years:					
Other than by instalment	15,000	-	1,776	16,776	16,776
By instalment	12,000	17,537	-	29,537	40,081
Irredeemable debentures	-	-	1,570	1,570	1,570
Total borrowings due after one year	45,000	25,923	6,801	77,724	82,825
Current portion of debt	3,400	1,532	1,828	6,760	3,355
Less cash balances and short term deposits	(9,661)	-	-	(9,661)	(14,676)
Net borrowings	<u>38,739</u>	<u>27,455</u>	<u>8,629</u>	<u>74,823</u>	<u>71,504</u>

(b) Details of borrowings not wholly repayable within five years -

	2003 £000	2002 £000
Debentures (listed on the London Stock Exchange) -		
11.20% Redeemable 2005 to 2009 at the company's option	1,776	1,776
4.00% Consolidated irredeemable	1,405	1,405
4.00% Perpetual irredeemable	55	55
4.25% Perpetual irredeemable	37	37
3.50% Perpetual irredeemable	73	73
	<u>3,346</u>	<u>3,346</u>
Bank loans -		
Unsecured, repayable in instalments between 2006 and 2010, fixed interest at 7.75% pa to 2003 then LIBOR related	20,000	20,000
Unsecured, repayable 2008, fixed interest at 6.1% pa	5,000	5,000
Unsecured, repayable 2008, fixed interest at 6.5% pa	10,000	10,000
Finance leases	17,537	20,081
	<u>55,883</u>	<u>58,427</u>

The unsecured £20m bank loan, of which £12m was repayable after 5 years as at 31 March 2003, was repaid in May 2003 as part of the refinancing arrangements.

## 11. OTHER CREDITORS DUE WITHIN ONE YEAR

Other creditors due within one year comprise -	2003 £000	2002 £000
Receipts in advance	4,546	2,655
Trade creditors	3,546	3,877
Due to group companies	1,269	985
Due to associated undertakings	1,417	409
Dividends payable	14,672	4,476
Tax, social security and payroll deductions	559	496
Corporation tax payable	1,041	1,532
Accruals and deposits received	7,006	8,662
	<u>34,056</u>	<u>23,092</u>

## 12. DEFERRED INCOME

Deferred income represents grants and contributions received in respect of non-infrastructure assets less amounts amortised to the profit and loss account.

	2003 £000	2002 £000
Beginning of year	8,396	8,467
Contributions received	325	212
Less amortised	(292)	(283)
End of year	<u>8,429</u>	<u>8,396</u>

## 13. FINANCIAL INSTRUMENTS

The company's financial instruments, other than derivatives, comprise preference shares, borrowings, cash and various items, such as trade debtors and trade creditors, that arise directly from its operations. The sole purpose of these financial instruments is to finance the company's operations. The company also enters into interest rate swaps to manage the interest rate risk arising from its operations and sources of finance. It is the company's policy not to trade in financial instruments.

### Interest rate risk management

The company borrows at fixed, index-linked and floating rates of interest; it then uses interest rate swaps to generate the desired interest rate profile and manage its exposure to interest rate fluctuations. The company's policy is to maintain the majority of its net debt on a fixed or index-linked interest basis, using swaps where appropriate to manage this position. At the year end, 61% of the company's financial instruments, including irredeemable preference shares, were at fixed rates after taking into account interest rate swaps.

### Liquidity risk management

It is company policy to ensure continuity of funding. At the year end at least 62% (2002 - 72%) of its financial instruments, including irredeemable preference shares, mature after five years. This percentage will increase following the refinancing completed in May 2003. Short-term flexibility is achieved using committed bank facilities and short term deposits.

### Interest rate risk profile of financial liabilities

The interest rate risk profile of the company's financial liabilities at 31 March 2003, after taking account of the interest rate swaps used to manage the interest profile, was –

	Floating rate financial liabilities £000	Fixed rate financial liabilities £000	Total £000
Financial liabilities	37,358	45,556	82,914
Irredeemable debentures	-	1,570	1,570
Irredeemable preference shares	-	12,500	12,500
<b>At 31 March 2003*</b>	<b><u>37,358</u></b>	<b><u>59,626</u></b>	<b><u>96,984</u></b>
Financial liabilities	38,793	45,817	84,610
Irredeemable debentures	-	1,570	1,570
Irredeemable preference shares	-	12,500	12,500
<b>At 31 March 2002*</b>	<b><u>38,793</u></b>	<b><u>59,887</u></b>	<b><u>98,680</u></b>

\*Short-term debtors, creditors, cash and deposits have been excluded from the above disclosures. All the company's creditors falling due within one year (other than lease borrowings) are excluded from the above table either due to the exclusion of short-term balances or because they do not meet the definition of a financial liability within FRS 13, such as tax balances.

At 31 March 2003, the company was party to one interest rate swap. This swap commenced in September 2002 and originally hedged for a five year period £20 million of borrowings that became floating rate at that time. In preparation for the refinancing completed in May 2003, during the year the Board redesignated the swap against a £10m variable rate bank loan and £10m of variable rate leases. At 31 March 2003, the variable rate bank loan had a maturity date approximately seven months less than the swap. As part of the refinancing the bank loan was replaced in May 2003 by a similar loan with a 5 year maturity with a 0.075% increase in margin. The swap exchanges libor rates on a 3 monthly basis for a fixed rate of 7.72%. The Board's current intention is to maintain a future interest rate management profile consisting of financial liabilities at either fixed or index-linked rates amounting to 70% or more of such liabilities.

# Notes to the accounts

	Weighted average interest rate %	Weighted average period for which rate is fixed Years
Financial liabilities*	7.6	3.8
Irredeemable debentures	4.0	-
Irredeemable preference shares	8.8	-
<b>As at 31 March 2003</b>	<b>7.7</b>	
Financial liabilities	8.0	4.6
Irredeemable debentures	4.0	-
Irredeemable preference shares	8.8	-
<b>As at 31 March 2002</b>	<b>8.0</b>	

\*including £10m variable rate bank loan, hedged by the swap, for its remaining term as at 31 March 2003.

Floating rate liabilities bear interest at rates based on relevant LIBOR equivalents, which are fixed in advance for periods of up to one year.

#### Interest rate risk of financial assets

The financial assets comprise only cash at bank and short-term deposits. Cash and short-term deposits are placed with banks and building societies on a rolling basis of up to one year earning interest based on LIBID equivalents.

#### Borrowing facilities

At 31 March 2003, the company had a £5m (2002 - £5m) undrawn, committed 364 day borrowing facility available in respect of which all conditions precedent have been met.

During May 2003, the company agreed a 5-year term £10m committed borrowing facility in respect of which all conditions precedent have been met. The facility is floating rate and incurs non-utilisation fees at market rates. At the same time, the company cancelled the £5m 364 day facility referred to above.

#### Fair values of financial assets and financial liabilities

Although the company does not intend to trade in any financial instruments, the following table provides a comparison, by category, of the carrying amounts and the fair value of the group's financial assets and financial liabilities. Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties, other than a forced or liquidation sale and excludes accrued interest. Where available, market values have been used to determine fair values. Where market values are not available, fair values have been calculated by discounting expected cash flows at prevailing interest rates. The table below summarises the methods and assumptions used for each category of financial instrument.

	31 March 2003		31 March 2002	
	Book value £000	Fair value £000	Book value £000	Fair value £000
<b>Primary financial instruments held or issued to finance the company's operations:</b>				
Cash at bank and short term deposits	9,661	9,661	14,676	14,676
Short-term borrowings	(6,760)	(6,760)	(3,355)	(3,355)
Long-term borrowings	(77,724)	(79,354)	(82,825)	(84,130)
Irredeemable Preference shares	(12,500)	(16,625)	(12,500)	(17,188)
<b>Derivative financial instruments held to manage the interest rate profile:</b>				
Interest rate swaps	-	(2,145)	-	(2,579)
	<b>(87,323)</b>	<b>(95,223)</b>	<b>(84,004)</b>	<b>(92,576)</b>

#### Summary of methods and assumptions used -

Short-term borrowings The fair value of short-term borrowings approximates to the carrying amount because of the short maturity of these instruments.

Long-term borrowings The fair value of the company's debentures has been calculated by discounting the expected cash flows at prevailing market rates including an estimated margin over gilts. Fixed rate bank loans and leases have been discounted on a similar basis but to LIBOR futures. In the case of floating rate facilities the fair values approximate to the carrying values as payments are reset to market rates at intervals of one year or less.

Preference shares            The company's preference shares are listed on the London Stock Exchange and their fair value is based on their quoted market price.

Interest rate swaps            Fair value is based on the market price of comparable instruments at the balance sheet date.

#### Interest rate hedges

The company hedges interest rate risk using interest rate swaps. The table below shows the extent to which the group has unrecognised off-balance sheet positions in respect of financial instruments used as hedges at the beginning and end of the year. It also shows how they are expected to be included in the profit and loss account by year. Relative to interest rates at the year end, the hedges will increase future interest costs as follows -

	£000
Unrecognised positions on hedges at 31 March 2002	2,579
Arising in previous years included in 2003 income	<u>(645)</u>
<b>Positions not included in 2003 income</b>	
Arising before 1 April 2002	1,934
Arising in 2003	<u>211</u>
	<u>2,145</u>
<b>Positions on hedges at 31 March 2003</b>	
of which:	
Expected to be included in 2004 income	804
Expected to be included in 2005 income or later	<u>1,341</u>

#### 14. PROVISIONS FOR LIABILITIES AND CHARGES

The total provisions for liabilities and charges are as follows:

	2003	2002
	£000	£000
<b>Deferred taxation</b>		
<b>Analysis of deferred taxation liability:</b>		
Accelerated capital allowances and capital element of finance leases	35,163	32,840
Deferred income	(2,529)	(2,519)
Short term timing differences	(393)	(698)
Unrelieved Advance Corporation Tax	-	(184)
	<u>32,241</u>	<u>29,439</u>
Effect of discounting	(12,999)	(14,203)
<b>Net provision</b>	<u>19,242</u>	<u>15,236</u>
<b>Deferred tax movement</b>		
	2003	2002
	£000	£000
Provision brought forward at 1 April	15,236	12,970
Charged to Profit and Loss Account	3,822	1,282
Advance Corporation Tax utilised	184	984
<b>Provision carried forward at 31 March</b>	<u>19,242</u>	<u>15,236</u>

#### 15. CALLED UP SHARE CAPITAL

The authorised and issued share capital of the company is -

	Authorised		Issued and fully paid	
	2003	2002	2003	2002
	£000	£000	£000	£000
Ordinary shares	5,857	5,857	5,857	5,857
Non-voting ordinary shares	141	141	141	141
6.75% redeemable preference shares	5,770	5,770	-	-
8.75% irredeemable cumulative preference shares	14,000	14,000	12,500	12,500
	<u>25,768</u>	<u>25,768</u>	<u>18,498</u>	<u>18,498</u>

All shares have a nominal value of £1 each. The ordinary and non-voting ordinary shares rank pari passu in all respects except voting rights.

# Notes to the accounts

## 16. MOVEMENT IN SHAREHOLDERS' FUNDS

	Share capital	Share premium account	Capital redemption reserve	Profit and loss	Total 2003	Total 2002
	£000	£000	£000	£000	£000	£000
Beginning of year	18,498	4,415	5,770	45,263	73,946	70,271
Profit for year	-	-	-	8,470	8,470	10,281
Dividends	-	-	-	(16,882)	(16,882)	(6,606)
End of year	18,498	4,415	5,770	36,851	65,534	73,946

## 17. COMMITMENTS AND CONTINGENCIES

(a) Capital commitments at 31 March 2003 contracted for but not provided were £10,890,000 (2002 - £7,493,000).

(b) The company has the following non-cancellable operating lease commitments payable during the next financial year -

	2003 £000	2002 £000
Operating leases expiring -		
Within one year, in respect of buildings	-	-
Within one year, in respect of other plant and machinery	-	-
Within two to five years, in respect of buildings	-	-
Within two to five years, in respect of other plant and machinery	74	38
After five years, in respect of buildings	9	8
	<u>83</u>	<u>46</u>

(c) Contingencies - The company is a member of a VAT group and is jointly liable for the VAT liabilities of its holding company. Other than as shown in these accounts the directors are not aware of any other contingent liabilities that require disclosure.

## 18. PENSIONS

### (a) Pension arrangements

Pension arrangements for the majority of the company's employees are provided through the company's membership of the Water Companies' Pension Scheme (WCPS) which provides defined benefits based on final pensionable pay. Bristol Water plc's membership of WCPS is through a separate section. The assets of the section are held separately from those of the company and are invested by discretionary fund managers appointed by the trustees of the Scheme. The section has been closed to new entrants and all new eligible employees are offered stakeholder pensions.

The financial position of the section is determined by an independent actuary based on triennial valuations using the projected unit method. The assumptions that have the most significant effect on the results of the valuation are those relating to the rate of return on section investments and the rate of increase in salaries, wages, pensions and dividends. The most recent triennial actuarial valuation at 1 April 2002 assumed that investment returns would be 7.2% per annum pre-retirement and 5.2% post-retirement, salaries and wages would increase on average by 4.8%, and pensions by 2.8%.

The actuarial valuation at 1 April 2002 showed the market value of section assets relating to the company as £97.0m and that the actuarial value of these assets represented 107% of accrued benefits allowing for future earnings increases.

The section is currently invested primarily in equities. The investment strategy has been carefully examined and it has been concluded that the appropriate long term strategy is to reduce the proportion of equities with a corresponding increase in investments in bonds and other fixed income securities. The implementation of this change has been delayed until there is further recovery in equity market values. This policy has been agreed with the Trustees.

A significant increase in cash contributions, to approximately £1.3m per annum, to the WCPS sections effective from 1 April 2003 has been agreed with the Trustees.

**(b) Accounting under SSAP24**

Pension costs charged to the profit and loss account are computed in accordance with SSAP24 to spread the cost of pensions over the employees' expected working lives with the company.

For the purpose of the SSAP24 charge, the same assumptions have been made as for the triennial actuarial review with the exception of a more prudent assumption for future salaries and wages increases of 5.3% per annum.

The SSAP24 charge is broadly in line with anticipated contribution rates effective from 1 April 2003.

The total pension charge for the year was £1,258,000 (2002 - £810,000) including £661,000 (2002 - £200,000) accrued in accordance with SSAP24 bringing the total accrued at 31 March 2003 to £861,000 (2002 - £200,000). Past service surpluses are amortised over the expected remaining service lives of members. There were no outstanding or prepaid contributions at the balance sheet date.

**(c) Accounting under FRS17 "Retirement Benefits"**

Full implementation of FRS17 "Retirement Benefits" in the primary financial statements will not be mandatory for the company until the year ending 31 March 2007. The following transitional disclosures are required:

**Basis of valuation**

The actuarial valuation of the Bristol Water plc section of the Water Companies' Pension Scheme was updated to 31 March 2003, by an independent qualified actuary, using the following major assumptions in accordance with the transitional arrangements of FRS17.

**Contributions**

Contributions paid in the year ended 31 March 2003 were £597,000 (2002 - £610,000). In accordance with the terms of the scheme, during the year Bristol Water plc was required to contribute at the rates of 9.8% for the main sub section and Nil% for the alternative sub section. Following the 1 April 2002 actuarial valuation with effect from 1 April 2003, the contribution rates have increased to 18.1% and 8.1% respectively.

	2003	2002
<b>Valuation basis</b>		
RPI Inflation	2.5%	2.8%
Pension increases in payment (RPI)	2.5%	2.8%
Pension increases in payment (LPI)	2.4%	2.8%
Salary increases	4.5%	4.8%
Discount rate	5.6%	6.1%

**Analysis of company WCPS pension section assets and liabilities**

	Expected long-term rate of return		Market values of section assets	
	2003	2002	2003 £000	2002 £000
Equities	7.5%	8.3%	53,900	77,092
Bonds	4.5%	5.2%	5,400	11,198
Corporate bonds	5.6%	6.1%	7,000	4,445
Property	6.0%	6.7%	1,600	2,900
Cash	3.8%	5.2%	5,700	1,597
			<hr/>	<hr/>
			73,600	97,232
Present value of the company WCPS pension section's liabilities			<hr/>	<hr/>
(Deficit)/surplus in the section			(92,100)	(82,882)
Deferred taxation			(18,500)	14,350
			<hr/>	<hr/>
Net pension (liability)/asset			5,500	(4,305)
			<hr/>	<hr/>
			(13,000)	10,045

# Notes to the accounts

If the above amounts had been recognised in the financial statements, the company's net assets and reserves at 31 March 2003 would have been:

	2003 £000	2002 £000
Net assets:		
Net assets excluding pension (liability)/asset	65,534	73,946
Adjustment in respect of SSAP24 accrual	861	200
Deferred tax related to SSAP24 accrual	(258)	(60)
Pension (liability)/asset	(13,000)	10,045
Net assets including pension (liability)/asset	<u>53,137</u>	<u>84,131</u>
Reserves:		
Profit and Loss Account excluding pension (liability)/asset	36,851	45,263
Adjustment in respect of SSAP24 accrual	861	200
Deferred tax related to SSAP24 accrual	(258)	(60)
Pension (liability)/asset	(13,000)	10,045
Profit and Loss Account including pension (liability)/asset	<u>24,454</u>	<u>55,448</u>

Analysis of charges to Profit and Loss Account had FRS17 been fully implemented:

	2003 £000
<b>Analysis of the amount charged to operating profit</b>	
Employer's part of current service cost	1,700
Total operating charge	<u>1,700</u>

Analysis of the amount credited/(charged) to other finance income

Expected return on pension section assets	7,400
Interest on pension section liabilities	(5,100)
Net return – credit	<u>2,300</u>

Analysis of amount recognised in the Statement of Recognised Gains and Losses (STRGL)

Actual return less expected return on pension section assets	(28,450)
Experience gains arising on the section liabilities	2,100
Changes in assumptions underlying the present value of scheme liabilities	(7,800)
Actuarial (loss) recognised in STRGL	<u>(34,150)</u>

Movement in section surplus during the year

Surplus in scheme at beginning of the year	14,350
Movement in year:	
Current service cost (total)	(2,100)
Aggregate contributions	1,100
Other finance income	2,300
Actuarial (loss) recognised in STRGL	(34,150)
(Deficit) in section at end of the year	<u>(18,500)</u>

History of experience gain and losses

Difference between expected and actual return on section assets:

Amount – (loss)	(28,450)
Percentage of section assets	39%

Experience gains and losses on section liabilities

Amount – gain	2,100
Percentage of the present value of the section liabilities	2%

Total amount recognised in STRGL

Amount – (loss)	(34,150)
Percentage of the present value of the section liabilities	37%

## 19. ADDITIONAL INFORMATION TO THE CASH FLOW STATEMENT

(a) Reconciliation of operating profit to net cash inflow from operating activities -

	2003 £000	2002 £000
Operating profit	19,361	17,741
Depreciation, net	13,968	13,730
Cash flow from operations	33,329	31,471
Working capital movements -		
Stocks	(197)	106
Debtors	(4,051)	(1,667)
Creditors	662	(728)
Provisions	-	(313)
Net cash inflow from operating activities	29,743	28,869

(b) Reconciliation of net cash flow to movement in net borrowings -

	2003 £000	2002 £000
Increase in net cash in year	2,485	7
Cash used to repay borrowings	3,365	1,427
Cash from new borrowings	-	(13,381)
Cash from (decrease)/increase in liquid resources	(7,500)	5,200
Increase in net borrowings	(1,650)	(6,747)
New debt not affecting cash flow	(1,669)	(1,731)
Net borrowings at beginning of year	(71,504)	(63,026)
Net borrowings at end of year	(74,823)	(71,504)

(c) Analysis of changes in net borrowings during the year -

	Opening net borrowings £000	Cash flows in year £000	Debt maturities £000	New debt not affecting cashflow* £000	Closing net borrowings £000
Cash at bank	676	2,485	-	-	3,161
Short term deposits	14,000	(7,500)	-	-	6,500
	14,676	(5,015)	-	-	9,661
Borrowings due within one year	(3,355)	3,365	(5,101)	(1,669)	(6,760)
Borrowings due after one year	(82,825)	-	5,101	-	(77,724)
Net borrowings	(71,504)	(1,650)	-	(1,669)	(74,823)

Cash at bank includes overnight deposits

\*Represents deferred payment terms for capital expenditure relating to the joint billing arrangements established with Wessex Water.

## 20. POST BALANCE SHEET EVENTS

During April 2003, all the ordinary issued shares of the company were transferred to Bristol Water Core Holdings Limited, a wholly-owned subsidiary of the ultimate parent company, Bristol Water Holdings plc.

During May 2003, the company entered into a new financing structure. Details are set out in the Operating and Financial Review and in Note 13 to the Accounts.

## 21. ULTIMATE PARENT COMPANY AND RELATED PARTY TRANSACTIONS

As at 31 March 2003, the immediate and ultimate parent and controlling company was Bristol Water Holdings plc. Copies of its consolidated accounts are available from PO Box 218, Bridgwater Road, Bristol BS99 7AU. As described in note 20, the ownership of the ordinary shares was transferred during April 2003 to a new company, Bristol Water Core Holdings Limited. The company has taken advantage of the exemptions within Financial Reporting Standard 8 (Related Party Disclosures) and not disclosed transactions with other Bristol Water Holdings plc group undertakings and associated undertakings.

# Independent auditors' report to the shareholders of Bristol Water plc

We have audited the financial statements which comprise the accounting policies, the profit and loss account, the balance sheet, the cash flow statement, the statement of total recognised gains and losses and the related notes.

## Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the Statement of Directors' Responsibilities.

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

We report to you our opinion as to whether the financial statements give a true and fair view and 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 is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. This other information comprises the Directors' Report, the Chairman's Statement, the Business Review and the Operating and Financial Review.

## Basis of audit opinion

We conducted our audit in accordance with 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 judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

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

## Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs at 31 March 2003 and of its profit and cash flows for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP  
Chartered Accountants and Registered Auditors  
Bristol  
29 May 2003

**Note:** The maintenance and integrity of the Bristol Water website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

# Financial history

## PROFIT AND LOSS ACCOUNTS

Years ended 31 March	2003 £000	2002 £000	2001 £000	2000 £000	1999 £000
Turnover	69,974	68,013	64,887	69,672	67,032
Operating profit	19,361	17,741	17,629	18,962	19,539
Profit on disposals	386	760	268	207	135
Net interest	(5,184)	(4,598)	(4,543)	(4,970)	(4,650)
Profit before taxation	14,563	13,903	13,354	14,199	15,024
Taxation	(6,093)	(3,622)	(3,399)	(4,598)	(3,657)
Profit after taxation	8,470	10,281	9,955	9,601	11,367
Dividends paid and proposed	(16,882)	(6,606)	(6,102)	(5,449)	(5,144)
(Loss)/profit retained	(8,412)	3,675	3,853	4,152	6,223

## BALANCE SHEETS

At 31 March	2003 £000	2002 £000	2001 £000	2000 £000	1999 £000
Fixed assets	184,685	179,426	170,029	165,309	160,765
Net current (liabilities)/assets	(13,756)	977	(6,912)	(9,559)	(10,922)
Total assets less current liabilities	170,929	180,403	163,117	155,750	149,843
Debt due after one year	(77,724)	(82,825)	(71,096)	(67,619)	(68,821)
Other liabilities	(8,429)	(8,396)	(8,780)	(9,372)	(8,254)
Provision for deferred taxation	(19,242)	(15,236)	(12,970)	(12,340)	(10,500)
Net operating assets	65,534	73,946	70,271	66,419	62,268

## CASH FLOW

Years ended 31 March	2003 £000	2002 £000	2001 £000	2000 £000	1999 £000
Cash flow from operations	29,743	28,869	32,304	29,624	30,355
Interest and non-equity dividends paid	(6,692)	(5,709)	(5,321)	(5,893)	(6,144)
Tax and ACT paid	(3,010)	(1,995)	(2,764)	(2,015)	(1,604)
Capital expenditure	(16,099)	(22,761)	(15,130)	(17,420)	(29,992)
Dividends paid on equity shares	(5,592)	(5,151)	(4,629)	(3,888)	(3,686)
Cash flow before management of liquid resources and financing	(1,650)	(6,747)	4,460	408	(11,071)
Management of liquid resources	7,500	(5,200)	(8,800)	-	-
Net (decrease)/increase in financing	(3,365)	11,954	3,457	(1,306)	8,313
Increase/(decrease) in cash	2,485	7	(883)	(898)	(2,758)

## RATIOS AND STATISTICS

	2003	2002	2001	2000	1999
Operating profit margin	28%	26%	27%	27%	29%
Interest cover (times)	3.7	3.9	3.9	3.8	4.2
Earnings per ordinary share	123.0p	153.2p	147.7p	141.8p	171.3p
Net gearing ratio	114%	97%	90%	102%	109%

Notes: All comparative data have been restated where necessary to conform with accounting practices adopted for the first time in the 2002 financial statements.

All data include exceptional items where relevant.