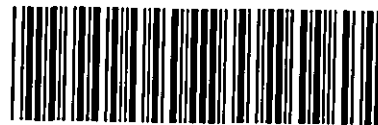


# South East Water Limited

## Group Financial Statements

31 March 2008

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## **Directors and Secretary**

### **Directors**

G W Maxwell (Chairman)

P Butler (Managing Director)

J E Stimpson (Finance Director)

P Seeley (Asset Director)

D G Shore (Operations Director)

T Meinert (Non-executive director)

V Rosati (Non-executive director)

R Hoskins (Non-executive director)

### **Independent non-executive directors**

D H Green MP

C D Harries

G H Setterfield

R Weeden

### **Company Secretary**

N Burns

### **Registered Office**

Rocfort Road  
Snodland  
Kent  
ME6 5AH

Registered No 02679874

Country of domicile and incorporation Great Britain

## Chairman's statement

I am pleased to present my report for the year which saw the merging of the South East Water (SEW) and Mid Kent Water (MKW) businesses. I reported last year on the process the Company had embarked upon to achieve the merger including the Competition Commission referral and the application to Ofwat to extend South East Water's licence to incorporate the area of operation served by Mid Kent Water. I am pleased to report that the merger of the Companies was concluded via a statutory transfer scheme on 14 December 2007. This was a significant achievement for all concerned and was delivered whilst service levels to customers were maintained, and in several cases, improved.

In the main body of my report I comment on some of the key activities during the year.

### Merger of SEW and MKW

Whilst the legal, corporate and financing merger was achieved in December, work continued in all areas of the Company to plan for and effect the merger of all operational, customer service and support functions. Key elements of our plan include the merging and rationalisation of all support functions, the centralisation of the laboratory function at the Company's Frimley site and the integration and rationalisation of the Company's IT systems.

My Board also took the significant decision to insource our Customer Service function which in the former SEW had largely been outsourced. Significant refurbishment was undertaken at the Company's Snodland head office so that a new state of the art customer contact centre could be built and a major recruitment and training programme was set in train. We also took the decision to complete the outsourcing of our streetworks direct labour in the former Mid Kent Water area, in line with the working methods already used in the former SEW. A contract was already in place between Mid Kent Water and Clancy Doerwa Ltd and this contract was used, at the end of March 2008, as a vehicle to transfer all relevant work and to TUPE (Transfer of Undertakings Protection of Employment) transfer the staff associated with it.

The changes as a result of the merger have had a major impact on staff and the Company necessarily engaged in an extensive consultation process with all our employees, Staff Councils and Trade Unions to ensure that staff were informed and could influence plans. Although we are recruiting 80 new employees to work in Customer Services we expect that the merger and resultant changes will lead to around 100 redundancies. I would like to take this opportunity to thank all staff for the great professionalism they have shown through this period of uncertainty and know that with such commitment and talent the Company is well placed to become the leading water company in the South East of England.

### Results

For the 12 month period ended 31 March 2008 the Group delivered an operating profit of £74.9 million (2007 £59.4 million) on turnover of £169.5 million (2007 £133.0 million as restated). It should be noted that due to the impact of merger accounting the 2008 results incorporate a full year of trading of the combined business whereas the 2007 comparative includes a full year of the former South East Water but only 6 months of the former Mid Kent Water.

Following the cessation of water restrictions in February 2007 water revenues did not show the anticipated return to previous normal levels as the wet summer kept volumes subdued. We once again saw high levels of customers switching to metered supplies and the Company now has a metering penetration of some 37% in its domestic customer base. We remain committed to encouraging water efficiency measures amongst our customers and to the extension of metered supplies throughout our region.

Strong cost controls remained in place but exceptional costs amounting to £3.5m were incurred as a result of the changes I have outlined above. Whilst energy costs have largely stabilised for the current period as a result of a forward contract put in place in 2006 they are still significantly higher than those reflected in prices and remain a concern for the future.

## Capital Investment

Capital investment during the year was £86 million reflecting our strong commitment to the long-term sustainability of our business. We are committed to improving Security of Supply for our customers and a significant portion of our programme was devoted to new resources and improving the water transfer links across our area. We also continue to invest in the maintenance of our above and below ground assets and to achieve our leakage targets. All of this investment allows us to maintain the high level of service we provide to our customers.

During the remaining two years of the current five year Asset Management Plan, the Group will continue with our £384 million (2008/9 prices) programme of capital investment to improve water resources, renew ageing infrastructure and deliver excellent water quality.

## Water Resources

As I reported last year the Company removed hosepipe and sprinkler restrictions in February 2007 and I am pleased to report that there has been no need to impose such restrictions since. Winter rain has been sufficient to allow average levels of recharge in most of the Company's aquifers and above ground reservoirs are currently reporting higher than typical levels. Although there remains a small number of sources that are close to (although above) historic minimum levels the Company is currently well-placed and the imposition of restrictions is not envisaged.

The Company manages its Water Resources in the context of a twenty-five year planning horizon and our Draft Water Resource Plan is currently out for consultation. The Plan includes the measures the Company wishes to take in terms of both water supply and managing water demand which will ensure that the Company will be able to continue to meet the needs of an ever increasing customer base in the years ahead.

## The Board of South East Water

Following the merger of the businesses of South East Water and Mid Kent Water on 14 December 2007 Baroness Julia Cumberlege, Baroness Delta O'Cathain and Keith Henry resigned from their independent non-executive board roles to be replaced by Damian Green, Charles Harries, Graham Setterfield and Robert Weeden who had been independent non-executive directors of Mid Kent Water. At the same time Peter Taylor (Hastings Funds Management) resigned from his non executive board role and was replaced by David Ridley and Valeria Rosati. David Ridley resigned from the board role on 7 May 2008 to return to Australia and Tom Meinert joined the Board.

In addition the Executive members of the Board were further strengthened by the appointment of Paul Seeley as Asset Director, who had been performing the duties of Managing Director of Mid Kent Water prior to the merger.

## Prospects

I am pleased to be able to confirm that prospects for the new business are excellent. We have significant challenges ahead in the coming year but I, along with my Board, firmly believe that the initiatives we have in place are set to deliver an efficient business that provides an excellent level of service to our customers and a stimulating and rewarding environment for our staff.



**Gordon Maxwell**  
Chairman  
Date 11 July 2008

## Managing Director's report

### Introduction

I am pleased to present my report in a year which has seen a key change at South East Water (SEW). As we reported in our 2007 Annual Report the acquisition of the Company by Utilities Trust of Australia and Hastings Diversified Utilities Fund led to a mandatory reference to the Competition Commission as our new shareholders already owned Mid Kent Water. The Competition Commission reported on 1 May 2007 confirming that the merger could proceed subject to a £4million one-off rebate being passed to customers and for merger savings to be reflected in the next price review. This does not require an accounting entry in these accounts. These conditions were agreed and, following an intense period of activity, the legal merger was achieved on 14 December 2007. I would like to take this opportunity to thank all staff, shareholders, advisers and Regulators who worked so hard in order for this merger to be achieved, and to thank all staff for their commitment to the Company through an extended period of uncertainty.

### Key Performance Indicators (KPIs)

The Group regularly monitors its financial and operating performance through regular KPI measurement.

#### *Financial KPIs*

SEW and MKW became entities under common control on 2 October 2006 and merger accounting has been applied from this date. As a result, the financial comparatives in this Report and Accounts include SEW stand alone results until 2 October 2006 and the combined results of SEW and MKW from that date onwards. The financial results for the year ended 31 March 2008 therefore show the combined results for the entire year.

Financial performance as measured by the ratio of group operating profit before exceptional items to revenue increased from 44.7% to 46.2% reflecting allowed revenue increases and good cost control. The cash flow measure of net cash generated from operations for the Group in 2008 was £76.2 million (2007 £58.5 million).

#### *Covenant KPIs*

Under Condition F of its licence of operation the Company is required to maintain a credit rating equivalent to investment grade. The Company's credit rating is one notch better than the minimum level required at Moody's Baa2 and S&P BBB. This investment Grade rating requirement is also reinforced by the Company's financing package which also requires that an investment grade rating is maintained.

In addition, as part of the ring-fenced group for the issuance of the bond by its wholly-owned subsidiary South East Water (Finance) Limited, the Company is required to comply with financing covenants which include:

- Regulatory Asset Ratio (RAR) with a distribution lock-up at 85%
- Interest Cover Ratio (ICR) with a default at 1.4 times cover
- Adjusted ICR with a trigger event at 1.1 times cover

The Company was fully in compliance with its covenants at 31 March 2008.

**Operational KPIs**

KPIs measuring operational performance are used extensively in the Company. Amongst these are those particularly monitored by Ofwat:

- Number of properties experiencing inadequate pressure
- Number of properties suffering unplanned and prolonged interruptions to supply
- Number of properties subject to water restrictions
- Speed of response to billing contacts
- Meter reading performance
- Ease of telephone contact
- Drinking water quality
- Leakage
- Environmental impacts (pollution incidents)

Whilst measured separately, each of the indicators is weighted by Ofwat and combined to give an Overall Performance Assessment (OPA) which is compared to the assessments for other water companies in England and Wales.

Ofwat assessed the OPA in the year ended 31 March 2007 to be 240 (2005/6 279) out of a maximum possible score of 288 for South East Water and 270 (2005/6 278) for Mid Kent Water. Ofwat's assessment for 2007/8 will be published in September 2008 and we estimate this to be a merged score of 250. SEW's 2006/7 OPA score was impacted by the bedding down issues experienced with the new billing system and the effect of the hosepipe restrictions imposed during the drought.

In addition to regulatory measures, the Group monitors other company and departmental KPIs and relies on external audit of its systems and processes.

Staff absence was 2.13% (2006/7 2.3%) for the former South East Water Limited and 2.94% (2006/7 2.40%) for the former Mid Kent Water Limited compared to the national average of 3.3%. Because of the impact of the merger and company reorganisation it would not be meaningful to report employee turnover statistics.

Through external audit, the Group's quality systems were certified to ISO9001 and our safety management systems to OHSAS 18001, the laboratory retained its UKAS accreditation and our people development processes were re-certified to Investor in People standard.

**Water Resources**

With the lifting of water restrictions at the end of February 2007, demands began to rise in most zones to more normal levels after the previous year with depressed consumption. However, the rising demand was dampened by the wet summer experienced in the Company's supply area. The Peak Week demand for the whole year was recorded over the warm early May bank holiday, and thereafter the demands remained subdued during the very wet summer. In particular, it appears that horticultural irrigation has been held back to a minimum as the Summer rainfall provided most of the crop requirement.

The 2007/08 recharge season running to the end of April 2008 has delivered around normal levels of recharge expected, although the Eastern side of the Company has been below 90% of average. However, with groundwater levels in all the monitoring boreholes at least above minimum levels and largely at average levels, the year has started very well. Surface water reservoir stocks at the end of April are all looking very healthy with most at 100% full, which is higher than typically expected.

At this stage it is not envisaged that water use restrictions will be required for the foreseeable future.

**Investment**

Capital investment in 2007/8, the third year of the current five year programme, was £86 million taking total expenditure in the quinquennium to £234 million. The £384 million (2008/9 prices) programme from 2005 to 2010 demonstrates our ongoing commitment to developing new water resources and renewing the existing infrastructure.

In excess of 40% of our programmed investment relates to essential new resource projects, as our supply area is recognised as being water resource deficient, a position highlighted by the recent two year drought. Much of the expenditure in the early part of the period has been on the preliminary design, environmental studies and planning of water resource schemes.

In our Western region work has now commenced on the construction of the 17km 1200mm diameter Bray transfer scheme. This gives the facility to transfer an additional 23 Mld of water from the Bray Water Treatment Works on the River Thames to Surrey Hills Reservoir. 7km of mains were laid at a cost of £6.3 million.

Also in the Western region we continue with our groundwater development schemes. A series of work is being undertaken to enhance existing yields. These include existing source improvement works that provide an additional 7.4Mld and the sinking of new boreholes that will yield an additional 3.7Mld.

We are continuing to plan for the future with our major investigations into new significant resources at both Clay Hill and Broad Oak. Clay Hill Reservoir could provide an additional 16.8 million litres of water each day and Broad Oak an extra 27.6 million litres.

Alternative schemes to compensate for the deferral of the Newhaven desalination scheme have been developed. These include the Ouse Valley Transfer Scheme, Kemsing Resource development and two cross border connections between East Peckham and Pembury and Kippings Cross and Pembury, which have been accommodated in the AMP4 programme. Together, these will provide an equivalent volume of water for less cost than the Newhaven desalination scheme.

Work continues with the construction of the new Bewl to Ashford transfer main. 9.2km of 500mm diameter main has been laid this year at a cost of £2.4 million.

As part of the strategy to transfer water from Kingston to Canterbury and Herne Bay the Canterbury Southern ring main scheme has been completed. This comprises 3.5km of 315mm diameter main at a cost of £0.6 million.

A new 14Mld membrane ultra filtration plant was completed on 31 December 2007 at Wichling WTW. This was in compliance with our DWI undertaking. Spending in the year was £2.9 million.

Investment in demand management continues. The Company has maintained the focus on managing demand with the installation of 14,089 customer meters at a cost of £3.3 million and our draft business plan will be proposing meter coverage of approximately 60% by 2015 and nearly 90% by 2020.

Our leakage targets of 69.35Mld and 27.40Mld for the former South East Water and former Mid Kent Water respectively have again been met this year.

A large proportion of our programme covers the replacement or refurbishment of deteriorating assets. The rehabilitation and relining programme is now complete, having completed 209km of mains over the last three years at a cost of £14 million. Pre and post rehabilitation assessment has been undertaken with DWI sign off anticipated. During the year we have spent £7.4 million on repairing and replacing burst and worn out pipes. Furthermore, during the year we have spent in the region of £11 million on refurbishing and maintaining our above ground assets in a condition that will sustain a stable level of serviceability. We have also spent a further £1 million on improving the security of supply to our customers.

The Group has also invested significantly in merger related activities. The Head Office at Snodland is undergoing a significant refurbishment, which includes the incorporation of a brand new customer call centre with appropriately integrated IT systems.

## **Water Quality and Supply**

The quality of the water supplied by South East Water remains amongst the best in the world, with 99.95% of 98,500 tests complying with EU and UK mandatory standards for the two companies

In addition to these regulatory tests we carried out a further 180,000 tests to ensure that our assets consistently performed to deliver excellent quality water to our customers. Our laboratory testing procedures once again received UKAS accreditation and were acclaimed by the assessors as 'one of the finest water laboratories in the country'

## **Our Customers**

During the past 12 months we have seen a significant improvement in the level of service we deliver to our customers as measured by the Regulators performance indicators. We do acknowledge however that more still needs to be done if we are to be recognised as the leading water company in the South East, and to that end the Company has taken the strategic decision to in-source its Customer Services activities

Through the merger we now serve some two million customers across Kent, Sussex, Hampshire, Surrey and Berkshire. To serve our customers better we are building an in-house customer contact centre in Kent housing some 140 staff dedicated to providing excellent customer service

The new Contact Centre in Kent is more than just rhetoric and a new home, it marks a fundamental shift in how we deal with our customers, and with it will come many organisational and process changes that will link Customer Services to the wider operational activities of the business, bringing significant improvements in the end-to-end customer experience, and help us deliver the level of service that our customers expect and deserve

## **Debt**

Customer debt continues to provide a challenge to the business and the Industry as a whole. The Company is delighted to have continued its support of the EOS Foundation for the third consecutive year. This independent Charitable Trust awards grants to customers who have found themselves in arrears through events that may be outside of their control. These one-off grants have helped numerous customers get back on their feet during the year with £200,000 worth of grants being awarded

Whilst the Company can offer a helping hand to some of our most vulnerable customers, we will take tough action against those who can pay their water charges, but choose not to. Where appropriate we pursue customers through the county court system in order to obtain settlement of both water and debt charges

## **Non Regulated Business**

2007/8 has been a period of change for non-appointed business activity. The commercial work areas from both SEW and MKW have been brought together to form a separate commercial services department. The focus on delivering the budgeted commercial income and profit during 07/08 has been maintained throughout the period whilst reviewing all the commercial processes of the merged business

The e-conveyancing service has shown particular growth with the introduction of Home Information Packs contributing to a considerable increase in income. Review of the former MKW procedures has shown there is possibility for income growth by adopting the former SEW's methodologies and process

Income from telecommunications mast rentals has come under pressure as providers consolidate their networks, sharing rental agreements with other providers to give improved coverage at lower cost. This area will come under increased pressure in future years. Rationalisation of the existing contract arrangements may help reduce costs as income comes under pressure

SEW laboratories continued to offer a comprehensive range of water quality sampling and analysis. The focus will be on growing this activity across the merged business.

Former MKW commercial activity through Waterlink performed well during 07/08. Contracts with Ashford, Canterbury and Tonbridge councils contributed significantly toward profitability.

Former MKW commercial insurance policy sales through Homeserve performed well during this year although reduced marketing due to the merger and brand change did impact on the overall figures. The focus in the coming period will be looking to expand the insurance portfolio and policy take up across the former SEW area.

Mid Kent Fisheries had a disappointing year initially and was re-structured during the period to re-focus the work stream on the fishing membership and reducing consultancy activity. Profitability during the second half of the year showed a marked improvement and it is hoped this can be developed further during next year.

## Our Staff

The year has proved to be an extremely challenging year for employees within the Company. Through the process of merging the two predecessor companies and the subsequent reorganisation and redundancy process, our employees have continued to respond in a positive and professional manner to the day-to-day business of the Company.

Prior to the merging of the two companies, a series of management briefings kept departments informed of the forthcoming changes and in December 2007 employees within the former MKW were transferred under TUPE regulations into SEW. Our partnerships with the trade unions and staff council have proved very important during an extensive consultation period.

During the merger and reorganisation process the Company had to undertake a redundancy process which unfortunately meant the loss of a number of long-serving employees. In addition, the decision to outsource some aspects of our operations in the new Eastern region resulted in a number of employees transferring to Clancy Docwra under TUPE regulations.

The Company has continued to encourage a learning culture within the organisation by providing a wide range of opportunities for staff in vocational and developmental training activities. Health and safety training remains a priority and the interactive e-learning health and safety training programme has proved beneficial.

Our absence rate remains under 3% for the year, which is better than the national average.

Our approach to rewards is outlined in the report of the Remuneration Committee.

## Pensions

The Company is the Sponsoring Employer of three Defined Benefit Pension Schemes. The two major schemes are both due actuarial valuations as at 31 March 2008 and the Company is committed to working with the Trustees of the Schemes to ensure that the Schemes are appropriately funded for the future. As at 31 March 2008 and 2007 the position of the Schemes under FRS17 and IAS19 are as shown in the following table.

### *Position of the principal pension schemes at 31 March*

	FRS 17 2008 £000	IAS 19 2008 £000	FRS 17 2007 £000	IAS 19 2007 £000
Deficit on the South East Water Pension scheme	(24,050)	(33,045)	(16,999)	(25,531)
Surplus on Mid Kent Water Pension scheme	1,529	1,278	3,912	3,912

## Our Environment

We recognise that the way we operate our business can have both a positive and negative impact on the environment, which is intrinsically linked with our core business function. We continue to adopt an environmentally responsible approach to all aspects of our business.

SEW own and maintain twenty "Sites of Special Scientific Interest". We aim to ensure that 90% of company owned SSSIs are in a favourable/recovering condition by 2010 and I am pleased to report that this level has now been reached.

Detailed environmental impact assessments are carried out on major engineering schemes to ensure that the least environmentally damaging options are chosen. This is carried out in tandem with survey and mitigation programmes, which are developed to counteract any environmental damage. Our ecologists pre-screen schemes to highlight environmental issues. This involves collection of historical ecological data, a site walkover identifying potential habitat and protected species issues, possible modification to the scheme, or further surveys and DEFRA consents to ensure that environmental legislation is respected. During this reporting period surveys have been undertaken to detect the presence of diverse protected species including dormice, great crested newts, badgers, birds, reptiles and bats.

Throughout the year we have ensured that our land holdings are managed in a way that develops their environmental potential. Using local volunteers, specialist contractors and our own staff volunteers we have carried out exciting conservation initiatives including detailed ecological surveys, hedge-laying, woodland management and chalk grassland management work. In addition to this work the Company has helped develop wetland habitats in Sussex and Kent through its sponsorship of Sussex Otters and Rivers Project.

## Our Communities

The Group continued to maintain close links with the communities we serve.

Public access to a number of our sites, particularly Arlington and Ardingly Reservoirs, provides facilities much valued by the public for walking, fishing, horse riding, bird watching and, at Ardingly, water sports.

Our staff were active in fund-raising activities on behalf of local charities. In our Berkshire, Hampshire and Surrey Region, staff raised £1,633 for the Phyllis Tuckwell Hospice for the terminally ill. In our Kent and Sussex Region staff raised £1,095 for the St Peter & St James Hospice, which also cares for those with terminal illnesses.

The continuing interest in water resources and water efficiency meant there was a steady demand for our staff to talk to local interest groups on the subject. Nearly 40 presentations were made to local councils, schools, clubs and societies during the year. Similarly our promotional trailer was active over the summer months at festivals and events at Bexhill, Arlington Water Festival, Sevenoaks, Tunbridge Wells, Arundel and Ringmer to help promote water conservation.

The Group sponsored many local environmental interests in the year to encourage a responsible attitude to the environment as well as water use in the garden. Along with other South East water companies and our regulators, we were joint sponsors of three water efficient show gardens at the BBC's Gardeners' World Live Show at Birmingham NEC. We also continue to be a principal sponsor of Sussex Wildlife Trust's Sussex Otters and Rivers Partnership, Water for Wildlife UK and have made grants to community environmental initiatives and donated water butts to a number of schools gardening clubs.

Nearly 6,000 primary school pupils have received South East Water drinking water bottles throughout the year, an activity aimed at raising awareness of the health value of drinking top quality tap water in school.

Our staff contributed via payroll deduction to Water Aid, a charity bringing clean water to communities in the third world and, once again, one of our managers contributed to a drinking water project in Tanzania under the auspices of Partners in Water and Sanitation. We have also encouraged our customers in the WaterAid fundraising process by including information on the charity in our annual billing process.

Our close relationship with our communities is reciprocal and we gratefully acknowledge the contribution of 167 public volunteers who have carried out conservation enhancement and monitoring work on our Sites of Special Scientific Interest.



**Paul Butler**  
**Managing Director**  
Date 11 July 2008

## Our Directors

**Gordon Maxwell, Chairman** (appointed 2 October 2006)

Gordon has a wide range of senior executive and managerial experience gained at Thames Water, where he was Managing Director, Mid Kent Water where he was Chairman and at Courtaulds plc. He also holds a number of non-executive directorships in business and charitable organisations.

**Paul Butler, Managing Director** (appointed 2 October 2006)

Paul has a wealth of water industry experience, including most recently serving as Managing Director of Mid Kent Water from 2001 to October 2006. A Chartered Accountant he previously worked for Mid Kent Water as Group Financial Controller, Ernst & Young and Marks and Spencer.

Paul is currently the Chairman of UKWIR, a water industry research organisation, Water UK, the industry trade association and a member of the South East Regional Council of the CBI.

**Paul Seeley** (appointed 18 December 2007)

Paul has more than 30 years experience in the water industry, most recently serving as Managing Director of Mid Kent Water from October 2006 to December 2007. A Chartered Environmentalist, he previously worked for Mid Kent Water as Asset Director. Prior to this he has held posts with Southern Water, Severn Trent and North West Water.

**David Shore, Operations Director** (appointed 28 February 2007)

David is a Chartered Civil Engineer with a BSc in Chemical Engineering, an MSc in Public Health Engineering, and an MBA. He has 28 years experience in the water industry, both in the UK and overseas. David joined Southern Water in 1978, worked for the Newcastle & Gateshead Water Company (later North East Water) from 1984, North West Water International from 1994, and later for Three Valleys Water. David joined South East Water as Director of Operations in 1999 and was appointed to the Board in 2007.

**Jo Stimpson, Finance Director** (appointed 2 October 2006)

Jo, a Chartered Accountant and a law graduate, was Finance Director at Mid Kent Water from August 2003 until October 2006. She has also held a number of senior management posts in finance, including those at Charteris and ICL.

**Valeria Rosati, Non-executive director** (appointed 18 December 2007)

Valeria Rosati is Investment Director at Hastings Fund Management (UK) Ltd and was appointed to the South East Water board in December 2007. She manages the funds of the two principal shareholders which own South East Water. Valeria, who holds a degree *cum laude* in Business and Economics from LUISS University in Rome, was heavily involved in both the acquisition of South East Water and the subsequent Competition Commission process in relation to its merger with Mid Kent Water.

**Tom Meinert, Non-executive director** (appointed 25 June 2008)

Tom Meinert joined Hastings in September 2006 as part of the Transactions team focussing on the origination and execution of new investment opportunities for all Hastings' funds. In early 2007, Tom was appointed as the Chief Operating Officer of the Hastings Diversified Utilities Fund (ASX: HDF) and TAPS Trust (ASX: TTXPA).

Prior to joining Hastings, Tom worked for 5 years at Macquarie Bank as an Associate Director within the Investment Banking Group where he specialised in infrastructure projects including Australian Public Private Partnerships and United Kingdom Private Finance Initiative projects.

Tom holds a Bachelor of Commerce degree from the University of Cape Town, South Africa and a Bachelor of Science (Honours) from the University of South Africa.

**Richard Hoskins, Non-executive director** (appointed 25 June 2008)

Richard joined Hastings in May 2006 and is Joint Chief Operating Officer of Utilities Trust of Australia, and is Head of Unlisted Infrastructure for Hastings. Richard's directorships include Perth Airport, Epic Energy, Interlink (Sydney M5) and Statewide Roads (Sydney M4) and Port of Portland. Prior to joining Hastings, Richard was a partner of Mallesons Stephen Jaques specialising in project and infrastructure finance. He has over 17 years experience in the finance industry. Richard holds a Bachelor of Commerce and a Bachelor of Laws (Honours) from the University of Melbourne.

**Damian Green MP – Independent Non-Executive Director** (appointed 18 December 2007)

The MP for Ashford was appointed to the South East Water board in December 2007 and is currently Shadow Minister for Immigration. Damian was the Conservative spokesman for the Environment from 1999-2001.

**Charles Harries – Independent Non-Executive Director** (appointed 18 December 2007)

A Chartered Civil Engineer, Charles was appointed to the South East Water board in December 2007. He has previously held a number of senior management positions at Southern Water including, latterly, responsibility for the regulatory price setting process.

**Graham Setterfield – Independent Non-Executive Director** (appointed 18 December 2007)

Graham was appointed to the South East Water board in December 2007 and previously served as Chairman of the former Mid Kent Water Company. Graham has also chaired the Institute of Civil Engineers Water board and the South East Water Forum. A former deputy managing director of Southern Water, Graham most recently worked at Water UK where he was Director of Water Services.

**Robert Weeden – Independent Non-Executive Director** (appointed 18 December 2007)

Robert was appointed to the South East Water board in December 2007 and has a background in economic regulation. Previous roles have included senior positions at Water UK, H M Treasury, the Inland Revenue and the Department of Health.

## Corporate Governance Statement

The Group is committed to high standards of corporate governance. In conducting its business activities the directors pay particular attention to the principles of good governance as set out in the FRC Combined Code 2006 (Combined Code). In determining the scope and content of this report it has been the Group's aim to provide a level of disclosure that meets the requirements of the Combined Code in as far as these are applicable to the circumstances of a private jointly owned group.

### Directors and the Board

It is the Board's responsibility to provide strategic leadership of the Group and to promote good corporate governance within a framework of effective controls, which enables risk to be assessed and managed.

Following the merger of Mid Kent Water Limited and South East Water Limited on 14 December 2007, the Board was restructured. It now comprises a Chairman, Managing Director, Asset Director, Finance Director, Operations Director and six non-executive directors of which four are considered by the Board to be independent with respect to Condition P of the Licence. The remaining two non-executive directors are shareholder appointments. The Board has adopted a formal schedule of the division of responsibilities between the Chairman and the Managing Director. All directors are subject to re-election by the shareholders at intervals of no more than three years.

The Board has adopted a formal schedule of matters specifically reserved for it. These include, strategy and management, structure and capital, financial reporting and controls, approval of the annual business plan, major contracts, regulation and dividend policy.

Prior to the restructuring the Board met on ten occasions for the period 1 April to 18 December 2007. The attendance of the directors was as follows:

Director	Number of meetings attended	Appointment/Resignation
G W Maxwell	nine	
P Butler	ten	
J Cumberlege	nine	Resigned 18 December 2007
K Henry	nine	Resigned 18 December 2007
P N Taylor	eight	Resigned 18 December 2007
D O' Cathain	eight	Resigned 18 December 2007
D G Shore	eight	
J E Stimpson	ten	

Following the merger the Board met on two occasions for the period 19 December 2007 to 31 March 2008. The attendance of the directors was as follows:

Director	Number of meetings attended	Appointment/Resignation
G W Maxwell	two	
P Butler	two	
J E Stimpson	two	
D G Shore	two	
D H Green	two	Appointed 18 December 2007
C D Harries	two	Appointed 18 December 2007
G H Setterfield	two	Appointed 18 December 2007
R Weeden	two	Appointed 18 December 2007
V Rosati	two	Appointed 18 December 2007
P Seeley	two	Appointed 18 December 2007
D Ridley	one	Appointed 18 December 2007/ Resigned 7 May 2008

As the Group is a privately jointly owned group, judgements of, and decisions relating to, the performance of the Board are taken by the holding company, HDF (UK) Holdings Limited. Consequently, the Board has not for the previous twelve months complied with provision A6, Performance Evaluation of the Combined Code of Corporate Governance.

It has been discussed and agreed by the Board that with the current Board working arrangements the appointment of a senior independent director would not improve the corporate governance performance of the Group.

All directors have access to the advice and services of the Company Secretary in furtherance of their duties. Directors also have access, when necessary, to independent professional advice at the Group's expense.

### **Board Committees**

Formal committees have been established as described below. There is in place formal written terms of reference, which are reviewed annually by the Board. The Board considers all minutes of committees.

### **Audit Committee**

During the year the Group did not comply with the requirement to establish an audit committee.

Currently the directors do not consider that there is a need for an Audit Committee as the entire Board reviews the work of external auditors and any issues arising from the audit. The entire Board also reviews reports from management on the Group's internal control system's effectiveness.

The need for an Audit Committee is kept under review and should circumstances change so that the establishment of an Audit Committee became necessary it would be put in place.

### **The Remuneration Committee**

Prior to the merger, the Remuneration Committee consisted of six members appointed by the Board including the Chairman and the Managing Director. As one member was a shareholder representative, the required standards of good corporate governance were maintained given the circumstances of the Group as a private jointly owned group. The Committee met once during the period 1 April to 18 December 2007 with two of the three members attending.

Post the merger, the Remuneration Committee now consists of the Chairman, the four independent non executive directors and the shareholders' representative. Other individuals including the Managing Director, the Head of Human Resources and external advisors are invited to submit reports or attend all or part of any meeting as and when appropriate. The Committee met once during this period. All members were in attendance.

The role and responsibilities of the Remuneration Committee are

- to determine and agree with the Board the policy for the remuneration of the Group's Managing Director, and other members of the executive management. The Managing Director and Chairman do not participate in the determination of their remuneration. The remuneration of non-executive directors is also a matter for the Committee,
- to approve the design of and determine targets for the performance related senior management bonus scheme,
- to ensure that contractual terms on termination, and any payments made, are fair to the individual, and the Group, that failure is not rewarded and that the duty to mitigate loss is fully recognised,
- to review and note annually remuneration trends across the Group,
- to oversee any major changes in employee benefits structures throughout the Group, and,

- to be exclusively responsible for establishing the selection criteria, selecting, appointing and setting the terms of reference for any remuneration consultants who advise the committee

The Remuneration Committee approves the Remuneration Report included in this Annual Report

**Members** Prior to the merger the members were G W Maxwell (Chairman), Paul Butler (Managing Director), Baroness Detta O’Cathain (resigned 18 December 2007) K Henry (resigned 18 December 2007), Baroness Julia Cumberlege (resigned 18 December 2007), P N Taylor (resigned 18 December 2007)

Post the merger the members were G W Maxwell (Chairman), D H Green (appointed 18 December 2007), C D Harries (appointed 18 December 2007), G H Setterfield (appointed 18 December 2007), R Weeden (appointed 18 December 2007) and D Ridley (appointed 18 December 2007/ resigned 7 May 2008)

### **Nominations Committee**

Appointments to the Board are made by the shareholder and consequently there is no separate Nomination Committee This is considered appropriate given that the Group is a wholly owned subsidiary

### **Internal Control**

The Board has responsibility for the Group’s system of internal controls and for reviewing its effectiveness During the year under review and up to the date of the approval of the Annual Report and financial statements, the Board had regularly reviewed the ongoing process for identifying, evaluating and managing the significant risks faced by the Group This review is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss Key features of the system of internal control include the following

- regular Board meetings with a formal schedule of matters reserved for the Board for decision,
- clearly defined organisation structures, appropriate delegated authorities and established policies and procedures, reviewed annually, for conducting significant aspects of the Group’s activities,
- risk management procedures for the identification, evaluation and mitigation of risks including regular review by executive management and reporting to the Board,
- a comprehensive five year business plan and annual budget and a rigorous process of monitoring actual performance against the budget and business plan,
- through the Executive Investment Committee, policies and procedures for the approval of and control of all major items of capital expenditure and for the acquisition and disposal of material assets, and,
- policies and procedures for the approval and control of any arrangements which could give rise to a material liability for the Group

## Remuneration report

**The Remuneration Committee of the Board met on 26 July 2007 and 24 April 2008.**

Rewards for Independent Non-Executive Directors are based on a structure of fees which are periodically compared with market practice

Rewards for the Managing Director and senior executives are based on a total reward package of basic salary, performance incentive scheme and benefits sufficient to attract, motivate and retain individuals of the required calibre to lead the business. Our policy aims to be around median market practice, with a performance bonus for achieving stretching corporate, directorate and personal targets, which is sufficient to motivate strong commitment to achieving the goals set, and to establish a close link between overall rewards and corporate performance. Performance targets include maintaining the Group's credit rating, improving its OPA score and industry efficiency ranking, and reducing customer debt, as well as financial performance targets and meeting capital investment targets. The Remuneration Committee establishes corporate bonus targets at the beginning of the financial year and decides the performance bonus payment to each member of the executive team. Decisions on the pay of senior executives take in to account information from independent reward surveys. The Managing Director and senior executives participate in the same pension schemes as other staff.

The Group's reward policy is to maintain a total reward package for staff throughout the business consisting of basic salary and benefits sufficient to attract, motivate and retain good quality staff. Senior Managers participate in the management performance bonus scheme. However, following the merger of the two companies, we currently have a situation where terms and conditions of employment are different between the two groups of staff. Our aim is to work towards harmonisation of terms and conditions wherever possible, fully dependent on a cost-benefit analysis.

The intention is to be positioned around median market practice and the Group participates in reward surveys to benchmark its reward practices.

Approved by the Remuneration Committee



**Gordon Maxwell**

**Chairman**

Date 11 July 2008

## Directors' report

The directors have pleasure in submitting their report and the audited financial statements for the year ended 31 March 2008

### Principal activities and future developments

The principal activities of the Group comprise the supply of water to a population of 1.98 million in an area of 5,657 square kilometres and the provision of certain ancillary services for customers, developers and other bodies within the constraints of the regulating statutes. The directors consider the performance of the business to be satisfactory and that this is expected to continue in the future.

### IFRS

The financial information presented in the audited Group financial statements on pages 27 to 67 has been prepared in accordance with International Financial Reporting Standards adopted for use in the European Union (IFRS). The financial information concerning the Company as a single entity on pages 71 to 105 has been prepared in accordance with UK GAAP.

### Business review

On 14 December 2007 Mid Kent Water Limited completed its merger with South East Water Limited. The merger was effected by way of a transfer scheme under Schedule 2 of the Water Industries Act 1991 whereby substantially all of the property, rights and liabilities of Mid Kent Water Ltd were transferred and assumed by South East Water with the approval of the Water Services Regulation Authority (Ofwat).

The date of common ownership for the merger was 2 October 2006 which, due to the impact of merger accounting, has meant that the 2008 results incorporate a full year of trading of the combined business whereas the 2007 comparative includes a full year of the former South East Water but only six months of the former Mid Kent Water.

Turnover for the merged group was £169.5 million (2007 £133.0 million). Operating profit for the merged group was £74.9 million for the year (2007 £59.4 million).

The merged group profit before taxation for the year was £39.4 million (2007 £36.2 million). The financial position at 31 March 2008 for the Group and for the Company is shown in the balance sheets on pages 28 and 72 respectively. Further analysis of the performance of the business and future developments is included in the Chairman's Statement and Managing Director's Report.

### Dividends

The directors have approved a first interim dividend of £16.0 million (2007 £16.4 million), a second interim dividend of £nil million (2007 £16.1 million), a third interim dividend of £5.5 million (2007 £2.5 million) and a final dividend of £9.5 million (2007 £9.8 million), which results in dividends paid during the year of £31.0 million (2007 £44.8 million). Further details are given in notes 11 and 41.

### Capital expenditure

Capital expenditure during the year totalled £86 million for both the Group and the Company (2007 £57.7 million). Further details are given in notes 13, 14 and 42. In the opinion of the directors, the market value of land and buildings is in excess of the value shown in the balance sheet, but cannot be quantified with sufficient precision.

## Capital Management

The primary objective of the Group's capital management is to ensure that it maintains an appropriate credit rating and healthy financial ratios in accordance with covenants stipulated in the Finance documents as agreed with the Finance Parties including the lenders to the business. The Group manages its capital structure and makes adjustments as required throughout the delivery capital programme during the Asset Management Period and as economic conditions vary. To change or adjust the capital structure the Group may adjust the dividend payment to shareholders or borrow additional capital from the money markets.

The Group monitors interest cover ratios and the ratio of net debt to Regulated Capital Value. This is monitored regularly to ensure covenant compliance both in the current reporting period and future reporting periods.

## Directors and their interests

The directors who served at the date of this report are set out on page 3. The appointment and resignation of directors during the year and up to the date of signing these accounts are detailed in the table below.

No director held any shares or loan stock in the Company or other associated companies required to be disclosed under the Companies Act 1985 during the financial year.

Director	Date of appointment	Date of resignation
P N Taylor		18 December 2007
J Cumberlege		18 December 2007
D O'Cathain		18 December 2007
K Henry		18 December 2007
D H Green	18 December 2007	
C D Harries	18 December 2007	
D Ridley	18 December 2007	7 May 2008
V Rosati	18 December 2007	
P Seeley	18 December 2007	
G H Setterfield	18 December 2007	
R Weeden	18 December 2007	
T Meinert	25 June 2008	
R Hoskins	25 June 2008	

## Directors' liabilities

The Group has granted an indemnity to one or more of its directors against liability in respect of proceedings brought by third parties, subject to the conditions set out in the Companies Act 1985. Such qualifying third party indemnity provision remains in force as at the date of approving the directors' report.

## Principal risks and uncertainties

The Board is responsible for the Group's risk management processes. These processes are constantly reviewed for effectiveness and aspire to take a comprehensive view of business risk.

### Changes to the regulatory environment

The prices South East Water charges our customers are set every five years by Ofwat. In determining prices, Ofwat make a number of assumptions on required investment levels, appropriate cost of capital and operational costs. The risk of variations in these assumptions is mitigated by the Group as far as possible but to a significant extent, the risk of such variations is carried by the Group until the next price review.

The next price review is due to be concluded in 2009, with prices effective from April 2010.

**Water industry competition**

The Water Act 2003 established a framework for market competition in the water industry but as yet, this has not resulted in any significant competitive activity. Ofwat is looking into ways to increase the level of competition in the industry which carries the risk of South East Water losing customers to other water companies.

**Water Framework Directive**

The Water Framework Directive (WFD) is the most substantial piece of European water legislation to date. It requires all inland and coastal waters to reach 'good status' by 2015. It will do this by establishing a river basin district structure within which demanding environmental objectives will be set, including ecological targets for surface waters. The WFD therefore sets a framework which aims to provide substantial benefits for the long term sustainable management of water.

This Directive has the potential to drive major additional capital investment and increases in customers' charges.

**Climatic changes**

The Group's resources are a mixture of water captured in reservoirs or abstracted from rivers or underground aquifers. These resources are closely linked to the weather and any changes in climate have the potential to impact on the Group's primary business activity of providing high quality water.

**Social influences**

The Group is subject to social influences and may be required to change its business practices in light of regulatory changes brought about by stakeholder and consumer pressure.

**Supplier markets**

The Group is also subject to external market forces, where input prices can sometimes rise beyond the regulatory allowance.

**Treasury management and financial risk**

The Group's financial instruments comprise fixed and variable rate borrowings, an interest rate swap, cash, short term deposits, loans to parent and fellow subsidiary undertakings and various items, such as trade debtors and creditors, which arise directly from its operations. The main purpose of these financial instruments is to raise finance for the Group's operations.

The Group's treasury operations are managed within parameters defined by the Board and its parent undertaking. It is the Group's policy to minimise liquidity risk within an acceptable range of interest rates. The Group does not use foreign currency financial instruments.

The main risks arising from the Group's financial instruments are interest rate and liquidity risk.

**Interest rate and cash flow risk**

The Group finances its activities through a mixture of cash generated from operations, debenture loans, finance leases, long term bonds and short term bank borrowing facilities. Debentures are long term fixed rate loans, bonds are long term fixed rate loans of which some have been linked to RPI inflation through the use of an interest rate swap, in order to reflect movements in the expected future income of the Group. Borrowings were £73.8 million under the Group's bank facilities as at 31 March 2008. Finance leases are both fixed and variable rate instruments. Further details are given in notes 20 and 23. The Group's policy is to manage short term interest rate risk by using short term fixed rate drawdowns. It is the view of the Group that long term fluctuations in interest rates will be within the parameters that are considered acceptable by the Group.

**Liquidity risk**

The Group aims to maintain a balance between continuity of funding and flexibility. Continuity of funding has been guaranteed throughout the period by the existence of long term group funding facilities. Short term flexibility is achieved by varying the amounts drawn down under these facilities. Further details are given in note 20 and 23. Cash is put on deposit with variable maturity dates so as to mitigate liquidity risk.

**Credit risk**

The Group's financial assets are loans and other amounts due from parent and group undertakings and cash and trade receivables, which represent the Group's maximum exposure to credit risk in relation to financial assets. The Group's credit risk is primarily attributable to its trade receivables, which are stated in the balance sheet at original invoice amount less an allowance for doubtful debts. An estimate for the provision for doubtful debts is calculated by the Group's management based on applying expected recovery rates to an aged debt profile and an assessment of current socio-economic conditions. The Group has no significant concentration of credit risk, with exposure spread over a large number of domestic and commercial customers.

**Price risk**

The prices for the water revenue are set by Ofwat as part of the five year Price Determination. The K factor and RPI increases allow for the Group's operations and for infrastructure investment.

**Employment policies**

The Group offers equal opportunities to all staff and applicants for employment. Its managers and officers are trained to ensure there is no unlawful discrimination on grounds of race, gender, age, religion, union membership, disability or sexual orientation. Employment policies are intended to confirm the Group as an employer of choice through provision of a safe work environment, satisfying work, personal development and fair rewards. Further details are given in the Managing Director's report.

**Supplier payment policy**

The Group has established its own policy and procedures regarding the payment of suppliers and does not follow a prescribed supplier payment code. The Group's current policy concerning the payment of creditors for goods is as follows:

- to pay in accordance with its contractual and legal obligations
- whenever it is reasonable to do so, to settle the terms of payment when agreeing the terms of each transaction and to ensure that suppliers are made aware of the terms of payment by their inclusion in the relevant terms in contracts

At the balance sheet date, the amount due to trade creditors by the Group and Company represented 35 days (2007: 33 days) of purchases during the year.

**Environmental and corporate social responsibility**

The Group's approach to sustainable development of its business includes a strong commitment to the environment and corporate social responsibility. Further details are given in the Managing Director's report.

**Donations**

Charitable donations during the year to 31 March 2008 amounted to £165,000, including £160,000 to the EOS Foundation, an independent charitable trust which assists customers who have genuine difficulties in paying their water bills (2007: £126,000, including £120,000 to the EOS Foundation). No political donations were made by the Group in either period.

**Auditors**

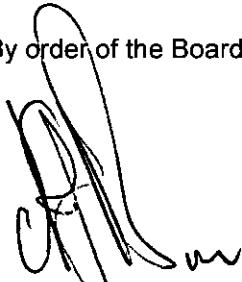
On 24 April 2008 PriceWaterhouseCoopers LLP resigned as auditors of the Group and were replaced by Ernst & Young LLP. A resolution to reappoint Ernst & Young LLP as auditors will be put to the members at the Annual General Meeting.

**Directors' statement as to disclosure of information to auditors**

The directors who were members of the Board at the time of approving the directors' report are listed on page 3. Having made enquiries of fellow directors and of the Group's auditors, each of these directors confirms that

- to the best of each director's knowledge and belief, there is no information (that is, information needed by the Group's auditors in connection with preparing their report) of which the Group's auditors are unaware, and,
- each director has taken all the steps a director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Group's auditors are aware of that information

By order of the Board



**Noel Burns**  
**Company Secretary**  
Date 11 July 2008

## Statement of directors' responsibilities

The directors are responsible for preparing the Annual Report and the Group financial statements in accordance with applicable United Kingdom law and those International Financial Reporting Standards as adopted by the European Union

The directors are required to prepare group financial statements for each financial year which present fairly the financial position of the Group and the financial performance and cash flows of the Group for that period. In preparing those group financial statements the directors are required to

- select suitable accounting policies in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and then apply them consistently,
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information,
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's financial position and financial performance, and,
- state that the Group has complied with IFRSs, subject to any material departures disclosed and explained in the financial statements

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and enable them to ensure that the Group financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities



**P Butler**  
**Managing Director**  
Date 11 July 2008

## **Independent auditors' report to the members of South East Water Limited**

We have audited the group financial statements of South East Water Limited for the year ended 31 March 2008 which comprise the Group Income Statement, the Group Balance Sheet, the Group Cash Flow Statement, the Group Statement of Recognised Income and Expense and the related notes 1 to 31. These group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of South East Water Limited for the year ended 31 March 2008.

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 work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's 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**

The directors' responsibilities for preparing the Annual Report and the group financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the group financial statements give a true and fair view and whether the group financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the directors' report is consistent with the financial statements. The information given in the directors' report includes that specific information presented in the managing directors' report that is cross referred from the Business Review section of the directors' report.

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding director's remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited group financial statements. The other information comprises only the directors' report, the Remuneration Report, the Chairman's Statement, the Managing Directors' report and the Corporate Governance Statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the group financial statements. Our responsibilities do not extend to any other information.

### **Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the group financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the group financial statements, and of whether the accounting policies are appropriate to the group's circumstances, consistently applied and adequately disclosed.

## Independent auditors' report to the members of South East Water Limited

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 group 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 group financial statements.

### Opinion

In our opinion

- the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's affairs as at 31 March 2008 and of its profit for the year then ended,
- the group financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the directors' report is consistent with the group financial statements

*Ernst & Young LLP*

**Ernst & Young LLP**  
**Registered auditor**  
**London**  
Date 11 July 2008

## Group Income statement

for the year ended 31 March 2008

	Note	2008 £000	2007 Restated £000
<b>Revenue</b>	4	169,460	133,033
Net operating costs – non-exceptional		(97,428)	(78,833)
Net operating costs – exceptional		(3,471)	-
<b>Group net operating costs</b>	5	(100,899)	(78,833)
Other income	6	6,290	5,221
<b>Group operating profit</b>		74,851	59,421
Finance costs	8	(52,831)	(38,511)
Finance income	9	17,390	15,278
<b>Profit before taxation</b>		39,410	36,188
Taxation	10	(686)	(8,558)
<b>Profit for the year</b>		38,724	27,630
<b>Basic and diluted earnings per share</b>	12	48 98p	54 27p

## Group statement of recognised income and expense

for the year ended 31 March 2008

	Note	2008 £000	2007 Restated £000
<b>Profit for the year</b>		38,724	27,630
Income and expense recognised directly in equity			
Actuarial (loss)/gain on defined benefit pension plans	25	(12,211)	3,766
Movement on deferred tax on actuarial gains/(loss) on defined benefit pension plans	10	3,419	(1,130)
		(8,792)	2,636
<b>Total recognised income and expense for the year</b>		29,932	30,266

# Group balance sheet

as at 31 March 2008

	Note	2008 £000	2007 Restated £000
<b>Non-current assets</b>			
Intangible assets	13	4,431	5,160
Property, plant and equipment	14	881,986	820,824
Defined benefit pension asset	25	1,278	3,912
Non-current receivables	16	190,013	190,013
		<u>1,077,708</u>	<u>1,019,909</u>
<b>Current assets</b>			
Inventories	17	643	690
Trade and other receivables	18	34,668	31,912
Cash and cash equivalents	19	16,757	30,103
		<u>52,068</u>	<u>62,705</u>
<b>Total assets</b>		<u>1,129,776</u>	<u>1,082,614</u>
<b>Current liabilities</b>			
Financial liabilities - Loans and borrowings	20	(1,734)	(1,584)
Trade and other payables	22	(62,958)	(58,996)
Deferred income	26	(2,577)	(1,182)
Provisions	21	(1,800)	(1,538)
		<u>(69,069)</u>	<u>(63,300)</u>
<b>Non-current liabilities</b>			
Financial liabilities			
- Loans and borrowings	20	(648,001)	(624,066)
- Derivative financial instruments	20/24	(46,869)	(31,968)
Deferred tax liabilities	10/21	(122,654)	(135,073)
Defined benefit pension liability	25	(33,045)	(25,531)
Trade and other payables	20	(1,818)	(460)
Deferred income	26	(44,545)	(41,730)
Provisions	21	(638)	(1,288)
		<u>(897,570)</u>	<u>(860,116)</u>
<b>Total liabilities</b>		<u>(966,639)</u>	<u>(923,416)</u>
<b>Net assets</b>		<u>163,137</u>	<u>159,198</u>
<b>Equity</b>			
Ordinary shares	27	10,092	5,092
Capital redemption reserve	28	4,000	4,000
Merger reserve	28	9,845	9,845
Retained earnings	28	139,200	140,261
<b>Total equity</b>	28	<u>163,137</u>	<u>159,198</u>

## Group balance sheet

as at 31 March 2008

The accompanying notes are an integral part of this balance sheet

The consolidated financial statements on pages 27 to 67 were approved by the Board of Directors on 11 July 2008 and were signed on its behalf by



**P Butler**  
**Managing Director**



**J E Stimpson**  
**Finance Director**  
Date 11 July 2008

## Group cash flow statement

for the year ended 31 March 2008

	Note	2008 £000	2007 Restated £000
<b>Operating activities</b>			
Net cash generated from operations	29	99,120	75,495
Interest received		13,133	19,613
Interest paid		(29,636)	(27,717)
Tax paid		(6,402)	(8,843)
<b>Net cash flow from operating activities</b>		<b>76,215</b>	<b>58,548</b>
<b>Investing activities</b>			
Proceeds from sale of property, plant and equipment		620	1,104
Purchase of property, plant and equipment		(84,495)	(54,737)
Purchase of intangible assets		(1,457)	(3,035)
Fixed asset contributions received		7,021	2,833
<b>Net cash flow from investing activities</b>		<b>(78,311)</b>	<b>(53,835)</b>
<b>Financing activities</b>			
Transfer in of cash and cash equivalents due to merger	3	(19)	-
Finance lease principal payments		(1,584)	(1,448)
Other long term creditors		(386)	-
Net proceeds from borrowings		18,000	43,800
Dividends paid to shareholder	11	(32,261)	(46,115)
Shares issued	28	5,000	-
<b>Net cash flow from financing activities</b>		<b>(11,250)</b>	<b>(3,763)</b>
<b>(Decrease)/Increase in cash and cash equivalents</b>		<b>(13,346)</b>	<b>950</b>
Cash and cash equivalents at the beginning of the year		30,103	29,153
<b>Cash and cash equivalents at the year end</b>	19	<b>16,757</b>	<b>30,103</b>

## Notes to the Group financial statements

### 1. Authorisation of financial statements and statement of compliance with IFRSs

The financial statements of South East Water Limited and its subsidiaries (the "Group") for the year ended 31 March 2008 were authorised for issue by the board of directors on 11 July 2008 and the balance sheet was signed on the board's behalf by Paul Butler and Jo Stimpson. South East Water Limited is a limited liability company incorporated and domiciled in Great Britain.

The principal accounting policies adopted by the Group are set out in note 2.

### 2. Accounting policies

#### ***Basis of preparation***

The Group financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union as they apply to the financial statements of the Group for the year ended 31 March 2008 and applied in accordance with the Companies Act 1985.

The Group financial statements are prepared under the historical cost convention except for pension assets and liabilities and certain financial instruments that have been measured at fair value and property, plant and equipment which was recognised at the date of transition to IFRS at deemed cost by reference to fair value, and are prepared in accordance with applicable accounting standards. The date of transition for South East Water Limited was 1 April 2004 and for Mid Kent Water Limited was 1 April 2006.

The principles of merger accounting have been applied to account for the group reorganisation between South East Water Limited and Mid Kent Water Limited. Refer to note 3 for further details.

The Group financial statements are presented in sterling and all values are rounded to the nearest thousand pounds (£000) except when otherwise indicated.

#### ***Changes in accounting policies***

As a result of the merger of South East Water Limited (SEW Limited) and Mid Kent Water Limited (MKW Limited) (note 3), the following adjustments have been made to achieve uniformity of accounting policies in the combining entities which have given rise to changes in the accounting policies adopted by SEW Limited:

- Cost of rechargeable work related to new connections, previously expensed by SEW Limited, is now capitalised,
- Cost of leakage detection, previously capitalised by SEW Limited, is now recognised in the income statement within operating expenditure.

The comparative period has been restated to incorporate the above changes in the accounting policies of SEW Limited.

The Group has adopted IFRS 7 *Financial Instrument Disclosures* during the year. Adoption of this standard did not have any effect on the financial performance or position of the Group in the current or prior periods but did give rise to additional disclosures.

The amendment to IAS 1 *Presentation of Financial Statements Capital Disclosure* was adopted during the year and the new disclosures are shown in the investment section of the Managing Director's report.

# Notes to the Group financial statements

as at 31 March 2008

## 2 Accounting policies (continued)

### ***Basis of consolidation***

The Group financial statements incorporate the financial information of SEW Limited (the Company) and its subsidiary South East Water (Finance) Limited

Transactions and balances between the company and its subsidiary have been eliminated fully on consolidation

Subsidiaries are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group

### ***Judgements and key sources of estimation uncertainty***

The preparation of financial statements requires the application of estimates and judgement by management, which affects assets and liabilities at the balance sheet date and income and expenditure for the year. Actual results may differ from those estimates

Estimates made by the management of South East Water in the preparation of financial information affect the remaining useful lives of infrastructure assets, un-invoiced liabilities at the year end, the provision for doubtful trade receivables, deferred revenue, deferred tax assets, pensions and other post-retirement benefits and derivative financial instruments

### ***Revenue***

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group, there has been a transfer of risk and control and the revenue can be reliably measured. All revenue arises within the United Kingdom and is recorded net of VAT. The following specific recognition criteria must also be met before revenue is recognised

### ***Metered and unmetered water income***

Revenue is recognised when water has been delivered to the customer. Revenue includes an estimation of the volume of mains water supplied but unbilled at the year end. This is estimated using a defined methodology based upon a measure of unbilled water consumed, which is calculated from historical customer data

Cash received in advance from customers is not treated as current year revenue, being recognised as payments received in advance within creditors

### ***Other income***

Other income includes rechargeable works, infrastructure charges and charges for engineering, scientific, laboratory, billing and cash collection services

Rechargeable works represent payments received from developers for installing meters and connections to new property developments. Revenue is recognised when the work is complete. Infrastructure charges represent 'joining the network fees'. Such fees are recognised in the income statement when they are received

### ***Finance income***

Finance income is recognised using the effective interest method

### ***Taxation***

Current tax, being UK Corporation tax, is provided at amounts expected to be paid (or recovered) using tax rates and laws that have been enacted or substantially enacted by the balance sheet date

Tax relating to items recognised directly in equity is recognised in equity and not in the income statement

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts in the financial statements

# Notes to the Group financial statements

as at 31 March 2008

## 2. Accounting policies (continued)

### *Taxation (continued)*

Deferred tax liabilities are recognised for all taxable temporary differences except where the deferred tax liability arises from goodwill amortisation or the initial recognition of an asset or liability in a transaction that is not a business combination and at the time of the transaction affects neither the accounting profits nor taxable profit or loss

Deferred tax assets are recognised for all deductible temporary differences, carry forward of unused tax assets and unused tax losses to the extent that it is probable that taxable profits will be available against which the deductible temporary differences, and the carry forward of unused tax assets and unused tax losses can be utilised

Deferred tax assets are recognised for the deductible temporary differences arising from the initial recognition of an asset or liability in a transaction that is not a business combination and at the time of the transaction affects neither the accounting profit nor taxable profit or loss

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at the balance sheet date. In accordance with IAS 12 *Income Taxes* deferred taxes are not discounted

### *Intangible assets*

#### *Software*

Software intangible assets externally acquired are recognised at cost. They have finite useful lives and are amortised over 3 to 5 years on a straight line basis

Residual values and useful lives of all assets are re-assessed annually and, where necessary, changes are accounted for prospectively

Employee and other costs directly attributable to intangible asset projects are capitalised in the financial statements as part of the cost of the intangible asset to which they relate. Training costs, administration and other general overhead costs including interest are not capitalised

### *Derecognition*

An intangible asset is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset, calculated as the difference between the net disposal proceeds and the carrying amount of the item, is included in the income statement in the year in which the item is derecognised

### *Property, plant and equipment*

#### *Infrastructure Assets*

Infrastructure assets comprise a network of systems relating to water distribution, such as water mains and surface reservoirs. Infrastructure assets in the course of construction are depreciated from the time they are brought into use. Infrastructure assets are stated at deemed cost less accumulated depreciation and any impairment in value. Depreciation is calculated on a straight-line basis over the estimated useful life of the assets as follows

	Years
Surface reservoirs	250
Mains	20-100

## Notes to the Group financial statements

as at 31 March 2008

### 2. Accounting policies (continued)

#### *Property, plant and equipment (continued)*

##### *Non - Infrastructure Assets*

Freehold land is not depreciated. Assets in the course of construction are depreciated from the time they are brought into use. All other non-infrastructure assets are stated at cost less accumulated depreciation and any impairment in value. Depreciation is calculated on a straight-line basis over the estimated useful life of the asset as follows:

	Years
Freehold buildings	80
Operational structures	50-80
Fixed plant and machinery	10-35
Meters, vehicles, mobile plant, computers, furniture and office equipment	3-10

##### *Derecognition*

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the year the item is derecognised.

##### *Residual values and useful lives*

Residual values and useful lives of all assets are re-assessed annually and, where necessary, changes are accounted for prospectively.

##### *Capitalisation of employee and other directly attributable costs*

Employee and other costs directly attributable to capital projects are capitalised in the financial statements as part of the cost of the property, plant and equipment to which they relate. Training costs, administration and other general overhead costs including interest are not capitalised.

##### *Leased Assets*

Property, plant and equipment held under finance leases are capitalised at the lower of the fair value of the leased asset and the present value of the minimum lease payments. These assets are depreciated over the shorter of the estimated useful life of the asset and the lease term.

##### *Impairment*

###### *Property, plant and equipment, investments and intangible assets*

At each reporting date an assessment is carried out to determine whether there is any indication that property, plant and equipment, investment and software intangible assets may be impaired. If there is an indication of impairment, the recoverable amount of the asset or respective cash-generating unit is compared to the carrying amount. Where the recoverable amount is less than the carrying amount, the asset value is reduced to the recoverable amount with an impairment loss recognised as an operating cost in the income statement in the year in which the respective assessment takes place.

###### *Financial assets*

At each reporting date an assessment is carried out to determine whether there is any indication that financial assets may be impaired. Where there is objective evidence that an impairment loss has arisen, the carrying amount is reduced in accordance with IAS 39 *Financial Instruments: Recognition and measurement*, with the loss being recognised in the income statement in the year in which the respective assessment takes place.

##### *Borrowing costs*

Borrowing costs are recognised as an expense when incurred.

# Notes to the Group financial statements

as at 31 March 2008

## 2. Accounting policies (continued)

### **Leases**

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease with a corresponding liability being recognised, at the lower of the fair value of the leased asset and the present value of the minimum lease payments

Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability

Finance charges are charged directly to the income statement

Leases where the lessor retains a significant portion of the risks and benefits of ownership of the asset are classified as operating leases and rentals payable are recognised as an expense in the income statement on a straight-line basis over the lease term

### **Grants and Contributions**

Grants and contributions are received in respect of both infrastructure and non-infrastructure assets. These are recognised as deferred income and are released to the income statement over the life of the assets to which they relate

### **Inventory**

Inventory is valued at the lower of average cost or net realisable value. No value is placed upon stocks of treated water in accordance with accepted practice in the water industry. Consumable chemical purchases are recognised as an expense in the income statement at the point of purchase

Work in progress for chargeable services is valued at the lower of cost and net realisable value

### **Cash and cash equivalents**

Cash and cash equivalents in the balance sheet comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less

Included within cash and cash equivalents are amounts that are held in designated bank accounts as short term deposits in order to meet the interest and associated swap payments falling due in respect of listed debt and other long term borrowings

### **Pension and other post-employment benefits**

The Group accounts for pensions and other post employment benefits under IAS 19 *Employee Benefits*. The Group operates both defined benefit and defined contribution pension schemes. Defined benefits are provided using both funded and unfunded pension plans

#### *Defined contribution plans*

Contributions to defined contribution plans are recognised as an expense in the income statement when the contributions fall due

#### *Defined benefit plans*

The pension scheme liability in the balance sheet represents the net of the present value of the defined benefit obligation and the fair value of scheme assets at the balance sheet date. The present value of the defined benefit obligation is analysed between the funded and unfunded pension plans

The present value of the defined benefit obligation and the cost of providing benefits under defined benefit plans is determined on a triennial basis, and updated to each year end by an independent qualified actuary using the Projected Unit Credit actuarial valuation method, discounted at an interest rate equivalent at measurement date to the rate of return on a high quality corporate bond of equivalent term and currency to the scheme liabilities

The pension cost in the income statement includes current and past service cost and the effect of any settlements and curtailments

## Notes to the Group financial statements

as at 31 March 2008

### 2. Accounting policies (continued)

#### *Pension and other post-employment benefits (continued)*

A net finance charge or credit is recognised within finance costs in the income statement and comprises the net of the expected return on pension scheme assets and the interest on pension scheme liabilities

All actuarial gains and losses and the related deferred taxation are recognised outside the income statement in the statement of recognised income and expense

#### *Financial instruments*

The Group's financial instruments comprise fixed and variable rate borrowings, index linked loans, fixed rate debentures, an interest rate swap, finance leases, cash, short-term deposits, trade receivables and trade and other payables

#### *Recognition*

Financial instruments are recognised on the balance sheet when the Group becomes party to the contractual provisions of the instrument. The Group determines the classification of its financial liabilities at initial recognition.

#### *Derecognition*

Financial liabilities are removed from the balance sheet when the related obligation is discharged, cancelled or expires.

Financial assets are removed from the balance sheet when the rights to the cash flows from the asset expire, or when the risks and rewards of ownership of the asset are transferred or when control of the asset is transferred.

#### *Embedded derivatives*

Financial instruments that are not carried at fair value through the income statement are reviewed to determine if they contain embedded derivatives. Embedded derivatives are accounted for separately as derivative financial instruments when the economic characteristics and risks are not closely related to the respective host financial instrument.

#### *Derivative financial instruments*

The Group uses an interest rate swap to hedge its risks associated with certain interest rate fluctuations. This use does not qualify for hedge accounting. Derivative financial instruments are recognised initially and subsequently in the balance sheet at fair value with any movements during the year charged or credited to the income statement. The fair value is determined by reference to market values for similar instruments.

#### *Interest bearing loans and borrowings*

All loans and borrowings are initially recognised at cost, being the fair value of the consideration received net of issue costs associated with the borrowing.

Interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement.

#### *Short-term trade and other receivables*

Short-term trade receivables are recognised and carried at original invoice amount less an allowance for any doubtful debts. An estimate for the provision for doubtful debts is calculated by the Group's management based on applying expected recovery rates to an aged debt profile and an assessment of current socio-economic conditions.

#### *Trade payables*

Trade payables are carried at payment or settlement amounts.

# Notes to the Group financial statements

as at 31 March 2008

## 2. Accounting policies (continued)

### **Provisions**

A provision is recognised when the Group has a legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Provisions are measured at management's best estimate of the expenditure required to settle the present obligation at the balance sheet date. Where the effect is material, expected future cash flows are discounted using a current pre-tax rate that reflects the risks specific to the liability.

### **Non-current assets held for sale**

Assets are classified as held for sale when the carrying amount of an asset will be recovered principally through a sale transaction rather than continuing use. These assets are held at the lower of carrying amount and fair value less costs to sell and are no longer depreciated.

### **Research and development**

Research costs are charged to the income statement in the year in which they are incurred.

Development costs are capitalised in accordance with the accounting policy given below. Initial capitalisation of costs is based on management's judgement that technological and economical feasibility is confirmed, usually when a project has reached a defined milestone according to an established project management model. In determining the amounts to be capitalised management makes assumptions regarding the expected future cash generation of the assets, discount rates to be applied and the expected period of benefits. At 31 March 2008, the best estimate of the carrying amount of capitalised development costs was £nil (2007: £nil).

### **Dividends**

Dividends are recorded in the accounts in the year in which they are approved by the Company's shareholders.

### **Exceptional items**

Exceptional items are material items of income and expense disclosed separately to enable a full understanding of the Group's financial performance.

### **New standards and interpretations not applied**

The IASB and IFRIC have issued the following standards and interpretations with an effective date after the date of these financial statements:

International Accounting Standards (IAS/IFRSs)	Effective date
IFRS 2 Amendment to IFRS 2 – Vesting Conditions and Cancellations	1 January 2009
IFRS 3 Business Combinations (revised January 2008)	1 July 2009
IFRS 8 Operating Segments	1 January 2009
IAS 1 Presentation of Financial Statements (revised September 2007)	1 January 2009
IAS 23 Borrowing Costs (revised March 2007)	1 January 2009
IAS 27 Consolidated and Separate Financial Statements (revised January 2008)	1 July 2009
International Financial Reporting Interpretations Committee (IFRIC)	
IFRIC 12 Service Concession Arrangements	1 January 2008
IFRIC 13 Customer Loyalty Programmes	1 July 2008
IFRIC 14 The Limit of a Defined Benefit Asset, Minimum Funding Requirements and their Interaction	1 January 2008

The following information provides guidance on the impact of new Standards and Interpretations that will be applicable to the Group.

# Notes to the Group financial statements

as at 31 March 2008

## 2. Accounting policies (continued)

### *New standards and interpretations not applied (continued)*

#### **IFRS 3 Business Combinations**

The Group does not anticipate early adoption of the revised IFRS 3 and so will apply it prospectively to all business combinations on or after 1 April 2010. Whilst it is not possible to estimate the outcome of adoption, the key features of the revised IFRS 3 include a requirement for acquisition-related costs to be expensed and not included in the purchase price, and for contingent consideration to be recognised at fair value on the acquisition date (with subsequent changes recognised in the income statement and not as a change to goodwill). The standard also changes the treatment of non-controlling interest (formerly minority interests) with an option to recognise these at full fair value as at the acquisition date and a requirement for previously held non-controlling interests to be fair valued as at the date control is obtained, with gains and losses recognised in the income statement.

#### **IFRS 8 Operating Segments**

IFRS 8 was issued in November 2006 and becomes effective for annual periods beginning on or after 1 January 2009. This Standard requires disclosure of information about the Group's operating segments. This standard changes disclosure requirements, but otherwise does not impact on the financial position or performance of the Group. This is not expected to change the business segments about which information is given, the secondary segment information will be replaced by group-wide analysis of revenues and non-current assets by major geographic area. The Group does not expect to have customers that individually account for more than 10% of total revenues.

#### **IAS 1 Presentation of Financial Statements**

A revised IAS1 *Presentation of the Financial Statements* was issued in September 2007. Whilst the revised IAS 1 will have no impact on the measurement of the Group's results or net assets it is likely to result in certain changes in the presentation of the Group's financial statements from 2009 onwards.

#### **IAS 23 Borrowing Costs**

A revised IAS 23 *Borrowing costs* was issued in March 2007, and becomes effective for financial years beginning on or after 1 January 2009. IAS 23 has been revised to require capitalisation of borrowing costs when such costs relate to a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. In accordance with the transitional provisions in the Standard, the Group will adopt this as a prospective change. Accordingly, borrowing costs will be capitalised on qualifying assets with a commencement date on or after 1 April 2009. No changes will be made for borrowing costs incurred prior to this date that have been expensed.

#### **IAS 27 Consolidated and Separate Financial Statements**

IAS 27 revised is effective for annual periods beginning on or after 1 July 2009, with earlier application only permitted when the revised IFRS 3 is applied. The revised standard applies retrospectively with some exceptions. IAS 27 revised no longer restricts the allocation to minority interest of losses incurred by a subsidiary to the amount of the non-controlling equity investment in the subsidiary. A partial disposal of an equity interest in a subsidiary that does not result in a loss of control will be accounted for as an equity transaction and will have no impact on goodwill nor will it give rise to any gain or loss. Where there is loss of control of a subsidiary, any retained interest will have to be re-measured to fair value, which will impact the gain or loss recognised on disposal. The Group is currently assessing the impact on its financial statements from adopting IAS 27 revised.

#### **IFRIC14 The Limit on a Defined Benefit Asset, Minimum Funding Requirements, and their Interaction**

IFRIC14 provides clarification regarding how to determine whether a surplus may be recognized on the balance sheet in relation to a retirement benefit plan. The directors do not anticipate that the adoption of this interpretation will have a material effect on the reported income or net assets of the Group. The Group plan to adopt this interpretation with effect from 1 April 2008.

The Directors do not anticipate that the adoption of the remaining standards and interpretations will have a material impact on the Group's financial statements in the period of initial application.

# Notes to the Group financial statements

as at 31 March 2008

## 2. Accounting policies (continued)

### *New standards and interpretations not applied (continued)*

#### **IFRIC14 *The Limit on a Defined Benefit Asset, Minimum Funding Requirements, and their Interaction* (continued)**

The effective dates stated here are those given in the original IASB/IFRIC standards and interpretations

As the Group prepare their financial statements in accordance with IFRS as adopted by the European Union, the application of new standards and interpretations will be subject to their having been endorsed for use in the EU via the EU Endorsement mechanism. In the majority of cases this will result in an effective date consistent with that given in the original standard or interpretation but the need for endorsement restricts the Group's discretion to early adoption of the standards.

## 3. Merger of South East Water Limited (SEW Limited) and Mid Kent Water Limited (MKW Limited)

### **Terms of the merger**

MKW Limited has transferred its trade and assets to SEW Limited under a statutory transfer scheme within the Water Industry Act (1991). The transfer scheme operated on the effective date of 14 December 2007, transferring all the assets and liabilities of MKW Limited to SEW Limited other than the £43.7 million intercompany loan receivable from Mid Kent Financing Limited, its holding company, and the £2.1 million intercompany debt for group tax relief owed to Swan Group. This was approved by Ofwat. Nil consideration was paid by SEW Limited to MKW Limited for the transfer of the assets as is permissible under UK corporate law in these particular circumstances.

SEW Limited became part of the HDF UK Group on 2 October 2006. HDF UK Group is owned by Utilities Trust of Australia and Hastings Fund Management as responsible entity for the Hastings Diversified Utilities Fund, who were also the ultimate owners of MKW Limited and hence both companies became entities under common control at this point. The transfer of assets between MKW Limited and SEW Limited is within the HDF UK Group, and hence merger accounting has been applied on the grounds of a group reconstruction.

### **Accounting for the merger**

The scope of IFRS 3 *Business Combinations* does not include business combinations involving entities under common control. In this case it is necessary to refer to the hierarchy of authoritative guidance contained in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* that must be considered in the absence of a Standard or Interpretation that specifically applies to this situation.

Under the principles of merger accounting, the carrying values of the assets and liabilities of the parties to the combination are not required to be adjusted to fair value on consolidation, although appropriate adjustments should be made to achieve uniformity of accounting policies in the combining entities. The net assets of MKW Limited of £9.8 million have been transferred into SEW Limited at net book value. The difference between the net book value transferred and the consideration paid by SEW Limited of nil has given rise to the merger reserve of £9.8 million (note 28).

SEW Limited and MKW Limited became entities under common control on 2 October 2006 and merger accounting has been applied from that date. As a result, the income statement comparative includes SEW Limited stand alone results until 2 October 2006 and the combined results of SEW Limited and MKW Limited from that date onwards.

## Notes to the Group financial statements

as at 31 March 2008

### 3. Merger of South East Water Limited (SEW Limited) and Mid Kent Water Limited (MKW Limited) (Continued)

#### *Net assets of MKW Limited transferred as at the date of common control*

<i>Balance sheet as at 2 October 2006</i>	£000
<b>Non-current assets</b>	
Intangible assets	628
Property, plant and equipment	223,120
Defined benefit pension asset	409
	<u>224,157</u>
<b>Current assets</b>	
Inventories	720
Trade and other receivables	10,335
Cash and cash equivalents	13,405
	<u>24,460</u>
<b>Total assets</b>	<u>248,617</u>
<b>Current liabilities</b>	
Trade and other payables	(23,242)
Current tax payables	(552)
	<u>(23,794)</u>
<b>Non-current liabilities</b>	
Financial liabilities	
- Loans and borrowings	(182,154)
Deferred tax liabilities	(27,114)
Other provisions for liabilities	(2,974)
Deferred income	(2,736)
	<u>(214,978)</u>
<b>Total liabilities</b>	<u>(238,772)</u>
<b>Net assets</b>	<u>9,845</u>

### 4. Revenue

	2008	2007
	£000	Restated £000
Metered water income	87,220	73,158
Unmetered water income	74,776	55,630
Other sales	7,464	4,245
	<u>169,460</u>	<u>133,033</u>

All revenue is to customers within the United Kingdom

## Notes to the Group financial statements

as at 31 March 2008

### 5. Group net operating costs

	Note	2008 £000	2007 £000
Employee benefits expense	7	19,123	12,630
Asset expense/(income)			
Depreciation – owned assets		21,275	15,143
Depreciation – leased assets		517	518
Amortisation of intangible assets		1,709	1,289
Impairment of intangible assets		473	-
Mains disposals		1,327	1,449
Profit on disposal of non-current assets		(541)	(918)
		<u>24,760</u>	<u>17,481</u>
Other operating expenses			
Operating lease rentals			
- vehicles and office equipment		570	590
- land and buildings		517	499
Fees payable to the Group's auditors		267	247
Other expenses		55,569	50,475
Other operating expenses charged to capital projects		(3,378)	(3,089)
Merger costs		3,471	-
		<u>57,016</u>	<u>48,722</u>
		<u>100,899</u>	<u>78,833</u>

Merger costs consist of redundancy and associated restructuring costs and legal and consulting costs in relation to the transfer of MKW Limited assets and liabilities to SEW Limited

	2008 £000	2007 £000
Fees were payable to the Group's auditors in respect of the following services		
For the audit of the Group and Company financial statements	185	131
Fees payable to the Group's auditor and its associates for other services		
Other services pursuant to legislation	40	83
Other services relating to taxation	-	8
All other services	42	25
	<u>267</u>	<u>247</u>

The fees for the prior year include an amount of £152,000 paid for audit (£79,000) and other services (£73,000) to PriceWaterhouseCoopers LLP, as the previous auditors of the Group

## Notes to the Group financial statements

as at 31 March 2008

### 6. Other income

	2008 £000	2007 £000
Rental income	1,314	803
Sundry income	4,976	4,418
	<u>6,290</u>	<u>5,221</u>

### 7. Directors and employees

The average monthly number of people, including salaried directors, employed by the Group during the year was

	2008 Number	2007 Number
Operations	427	430
Management and administration	205	199
	<u>632</u>	<u>629</u>

The aggregate payroll costs of these people were as follows

	Note	2008 £000	2007 £000
Wages and salaries		21,965	14,544
Social security costs		2,289	1,427
Pension schemes' costs	25	2,364	1,691
Other pension costs		287	108
		<u>26,905</u>	<u>17,770</u>
Less direct salary costs charged to capital projects and infrastructure renewals schemes		<u>(7,782)</u>	<u>(5,140)</u>
		<u>19,123</u>	<u>12,630</u>

Emoluments and compensation for loss of office of the directors are as follows

	2008 £000	2007 £000
Aggregate emoluments including bonuses	1,003	763
Compensation for loss of office	-	150
Company contributions to defined contribution scheme	-	5
Unfunded pension costs	259	235
	<u>1,262</u>	<u>1,153</u>

Retirement benefits are accruing to three directors (2007 three) under the defined benefit pension schemes and one director (2007 one) under a defined contribution scheme. Unfunded pension costs relate to former directors who no longer serve the Group (note 25)

## Notes to the Group financial statements

as at 31 March 2008

### 7. Directors and employees (continued)

Emoluments and compensation for loss of office of the highest paid director are as follows

	2008 £000	2007 £000
Aggregate emoluments including bonuses	202	206
Compensation for loss of office	-	150
Company contributions to defined contribution scheme	-	5
	<u>202</u>	<u>361</u>

### 8. Finance costs

	2008 £000	2007 £000
Debenture interest	1,089	1,085
Effective interest on listed debt	15,935	15,821
Fair value movements on interest rate swap	14,901	9,720
Bank interest and other finance charges	4,628	1,425
Financing guarantee fees	997	920
Interest payable on finance leases	716	861
Interest payable on index linked loan	6,858	3,339
Indexation of interest payable on index linked loan	7,246	4,858
Amortisation of loan issue costs	461	482
	<u>52,831</u>	<u>38,511</u>

### 9. Finance income

	2008 £000	2007 £000
Interest receivable on bank balances and short term deposits	1,572	1,468
Interest receivable from group undertakings	15,108	13,185
Interest from current asset investments	16,680	14,653
Pension fund finance	710	625
	<u>17,390</u>	<u>15,278</u>

## Notes to the Group financial statements

as at 31 March 2008

### 10. Taxation

Major components of the tax expense for the years ended 31 March 2008 and 2007 are

	2008 £000	2007 £000
<i>Group income statement</i>		
Current tax		
Current UK tax charge	9,686	6,393
Amounts overprovided in previous years	-	(514)
	9,686	5,879
Deferred tax		
Relating to origination and reversal of temporary differences	(9,000)	2,679
<b>Tax expense reported in the income statement</b>	<b>686</b>	<b>8,558</b>
<i>Deferred tax charge to equity</i>		
Deferred tax (credit)/charge on actuarial loss/gain	(3,419)	1,130
<b>Tax reported in equity</b>	<b>(3,419)</b>	<b>1,130</b>

#### **Factors affecting the tax charge for the year**

The tax for the year is lower (2007 lower) than the standard rate of corporation tax in the UK. The differences are explained below

	2008 £000	2007 £000
Profit before tax	39,410	36,188
Profit multiplied by the rate of corporation tax in the UK of 30% (2007 30%)	11,823	10,856
Effects of		
Adjustments to current tax charge in respect of previous periods	-	(514)
Adjustments to deferred tax charge in respect of previous periods	(1,868)	(1,664)
Expenses not deductible for tax purposes	(201)	6
Impact of rate change	(9,126)	-
Other	58	(126)
<b>Total tax expense reported in the consolidated income statement</b>	<b>686</b>	<b>8,558</b>

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 28% (2007 30%)

#### **Deferred tax**

The movement on the net deferred tax liability is as shown below

	2008 £000	2007 £000
As at 1 April	135,073	104,150
Transfer due to merger	-	27,114
(Credit)/charge to the income statement	(9,000)	2,679
(Credit)/charge to equity	(3,419)	1,130
<b>As at 31 March</b>	<b>122,654</b>	<b>135,073</b>

## Notes to the Group financial statements

as at 31 March 2008

### 10. Taxation (continued)

#### *Deferred tax (continued)*

Deferred tax assets have been recognised in respect of all tax losses and other temporary differences giving rise to deferred tax assets because it is probable that these assets will be recovered by giving relief against future taxable profits

The movements in deferred tax assets and liabilities during the year are shown below

Deferred tax assets and liabilities are only offset where there is a legally enforceable right of offset and there is an intention to settle the balances net

	Accelerated tax depreciation £000	Other £000	Total £000
<i>Deferred tax liabilities</i>			
As at 1 April 2006	118,121	149	118,270
Transfer in due to merger	26,991	-	26,991
Charged to the income statement	3,717	-	3,717
At 1 April 2007	148,829	149	148,978
(Credit) to the income statement	(8,582)	-	(8,582)
At 31 March 2008	140,247	149	140,396

	Fair value Swap £000	Deferred income £000	Pension provision £000	Other £000	Total £000
<i>Deferred tax assets</i>					
At 1 April 2006	4,512	1,024	8,525	59	14,120
Transfer in due to merger	-	-	(123)	-	(123)
Charged/(credited) to the income statement	930	343	(786)	551	1,038
Charged/(credited) to equity	-	-	(1,130)	-	(1,130)
At 1 April 2007	5,442	1,367	6,486	610	13,905
(Charged)/credited to the income statement	1,386	(202)	(1,010)	244	418
Credited to equity	-	-	3,419	-	3,419
At 31 March 2008	6,828	1,165	8,895	854	17,742

All of the deferred tax assets were available for offset against deferred tax liabilities and hence the net deferred tax liability at 31 March 2008 was £122.7 million (2007: £135.1 million)

The UK corporation tax rate reduced from 30% to 28% from 1 April 2008. This rate change will affect the amount of future cash tax payments to be made by the Group and has also reduced the size of the Group's balance sheet deferred tax liability at 31 March 2008.

## Notes to the Group financial statements

as at 31 March 2008

### 10 Taxation (continued)

The Finance Bill 2008 proposed that from 1 April 2008 the rate of capital allowances applicable to plant and machinery expenditure will be reduced from 25% to 20% per annum on a reducing balance basis and the rate of allowances applicable to long life assets increases from 6% to 10% also on a reducing balance basis. If enacted, these changes to the capital allowances rates will impact the rate at which tax relief is received on capital expenditure.

The Finance Bill 2008 also proposed the phased abolition of industrial buildings allowances by 31 March 2011. It is estimated that the abolition of these tax allowances will cost the Group circa £6m of future tax relief. This number is subject to adjustment if the Group makes substantial acquisitions or disposals of buildings that qualify for industrial buildings allowances before 31 March 2011. At the balance sheet date, this proposed change in legislation was still subject to parliamentary agreement and its accounting effect, which will be an increase in the Group's net deferred tax liability, will not be reflected in the Group's financial statements until the legislation has been substantively enacted.

### 11. Dividends

Note	2008 £000	2007 £000
Equity dividends paid during the year		
First interim dividend of 158.07p per ordinary share (2007 322.5p per ordinary share)	15,952	16,420
Second interim dividend of nil per ordinary share (2007 317.1p per ordinary share)	-	16,143
Third interim dividend of 54.41p per ordinary share (2007 49.8p per ordinary share)	5,491	2,536
Final declared dividend of 94.63p per ordinary share (2007 191.5p per ordinary share)	9,550	9,748
	<u>30,993</u>	<u>44,847</u>

There were no dividends proposed for approval as at 31 March 2008 and 2007. At 31 March 2007, £1,268,000 dividends were unpaid. These dividends were paid in June 2007.

### 12. Earnings per ordinary share

Basic earnings per share amounts are calculated by dividing profit for the year attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year.

The following reflects the income and shares data used in the basic and diluted earnings per share computations:

	2008 £000	2007 £000
Profit for the year	<u>38,724</u>	<u>27,630</u>
	Number	Number
Basic and diluted weighted average number of shares	7,905,756	5,091,548
Basic and diluted earnings per share	<u>48.98p</u>	<u>54.27p</u>

There have been no other transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of completion of these financial statements.

## Notes to the Group financial statements

as at 31 March 2008

### 13. Intangible assets

	Computer software £000
Cost	
At 1 April 2007	10,045
Additions	1,457
Disposals	(27)
	<hr/>
At 31 March 2008	11,475
Amortisation	
At 1 April 2007	(4,885)
Charge for the year	(1,709)
Impairment loss	(473)
Eliminated on disposals	23
	<hr/>
At 31 March 2008	(7,044)
	<hr/>
Net book amount at 31 March 2008	4,431
	<hr/>
Cost	
At 1 April 2006	6,814
Additions	3,035
Transfers in due to merger	628
Disposals	(432)
	<hr/>
At 31 March 2007	10,045
Amortisation	
At 1 April 2006	(4,025)
Charge for the year	(1,289)
Eliminated on disposals	429
	<hr/>
At 31 March 2007	(4,885)
	<hr/>
Net book amount at 31 March 2007	5,160

The impairment loss during 2008 of £473,000 arose on reducing the carrying value of works and asset management computer software to an estimate of its realistic value to the Group

## Notes to the Group financial statements

as at 31 March 2008

### 14. Property, plant and equipment

	Land, wells, reservoirs and buildings £000	Mains £000	Plant, equipment and vehicles £000	Total £000
<b>Cost</b>				
At 1 April 2007	179,835	535,721	201,990	917,546
Additions	3,617	48,413	32,326	84,356
Disposals	(61)	(2,539)	(525)	(3,125)
Reclassification	(1,363)	2,985	(1,622)	-
<b>At 31 March 2008</b>	<b>182,028</b>	<b>584,580</b>	<b>232,169</b>	<b>998,777</b>
<b>Accumulated depreciation</b>				
At 1 April 2007	(19,007)	(17,262)	(60,453)	(96,722)
Charge for the year	(2,122)	(7,675)	(11,995)	(21,792)
Eliminated on disposals	20	1,212	491	1,723
<b>At 31 March 2008</b>	<b>(21,109)</b>	<b>(23,725)</b>	<b>(71,957)</b>	<b>(116,791)</b>
<b>Net book amount at 31 March 2008</b>	<b>160,919</b>	<b>560,855</b>	<b>160,212</b>	<b>881,986</b>
<b>Net book amount includes</b>				
- leased assets	5,159	928	10,065	16,152
- assets under construction	12,706	23,833	17,558	54,097
<b>Cost</b>				
At 1 April 2006	105,323	387,566	144,467	637,356
Transfers in due to merger	58,469	116,477	48,174	223,120
Additions	13,368	33,541	12,521	59,430
Disposals	(150)	(1,660)	(550)	(2,360)
Reclassifications	2,825	(203)	(2,622)	-
<b>At 31 March 2007</b>	<b>179,835</b>	<b>535,721</b>	<b>201,990</b>	<b>917,546</b>
<b>Depreciation</b>				
At 1 April 2006	(17,453)	(11,762)	(52,574)	(81,789)
Charge for the year	(1,569)	(5,711)	(8,381)	(15,661)
Eliminated on disposals	15	211	502	728
<b>At 31 March 2007</b>	<b>(19,007)</b>	<b>(17,262)</b>	<b>(60,453)</b>	<b>(96,722)</b>
<b>Net book amount at 31 March 2007</b>	<b>160,828</b>	<b>518,459</b>	<b>141,537</b>	<b>820,824</b>
<b>Net book amount includes</b>				
- leased assets	5,228	928	10,504	16,660
- assets under construction	16,499	10,180	12,776	39,455

The Group's index linked loans are secured on certain of the assets of the Group

## Notes to the Group financial statements

as at 31 March 2008

### 15. Investments

Details of the Company's subsidiary, the results of which are included in the Group financial statements at 31 March 2008 and 31 March 2007 are as follows

Name of subsidiary	Place of incorporation	Ownership interest %	Voting rights held %	Principal activity
South East Water (Finance) Limited	Cayman Islands	100	100	Finance Company

### 16. Non-current receivables

	2008 £000	2007 £000
Amounts due from parent and fellow subsidiary undertakings due in more than one year	190,013	190,013

The amount due from parent and fellow subsidiary undertakings falls due for repayment on 27 July 2034 and bears interest at the rate of LIBOR plus 2%

### 17. Inventories

	2008 £000	2007 £000
Consumables	408	433
Work in progress	235	257
	<u>643</u>	<u>690</u>

### 18. Trade and other receivables

	2008 £000	2007 £000
Trade receivables	12,219	13,791
Amounts due from parent and fellow subsidiary undertakings due within one year	610	140
Prepayments and accrued income	18,156	15,246
Other receivables	3,683	2,735
	<u>34,668</u>	<u>31,912</u>

All trade receivables at 31 March 2008 and 31 March 2007 are denominated in sterling

Trade receivables are stated after provision for doubtful debts of £15 million (2007 £13 million) They are non-interest bearing, generally on 30 days' terms and are shown net of a provision for impairment

Bad debts written off during the year totalled £961,000 (2007 £568,000)

At 31 March 2008 and 2007, the amounts due from parent and fellow subsidiary undertakings relates to interest and group tax relief

## Notes to the Group financial statements

as at 31 March 2008

### 18. Trade and other receivables (continued)

As at 31 March, the analysis of trade receivables that were past due but not impaired is as follows

	Total £000	Current £000	<30 days £000	30-60 days £000	60-90 days £000	90-120 days £000	>120 days £000
2008	12,219	(6,189)	4,350	2,445	1,732	449	9,432
2007	13,791	(4,508)	4,296	2,197	2,506	(311)	9,611

### 19. Cash and cash equivalents

For the purpose of the consolidated cash flow statement, cash and cash equivalents comprise the following at 31 March

	2008 £000	2007 £000
Cash at bank and in hand	16,757	19,441
Short-term deposits	-	10,662
	<u>16,757</u>	<u>30,103</u>

At 31 March 2008, £11.8 million (2007 £17.6 million) of restricted cash is held in designated bank accounts in order to meet interest and associated swap payments falling due in respect of the listed debt and interest payments on index linked loans (note 20)

### 20. Financial liabilities

	2008 £000	2007 £000
<i>Non-current liabilities summary analysis</i>		
Loans and borrowings	648,001	624,066
Derivative financial instruments – Interest rate swap	46,869	31,968
Trade and other payables	1,398	-
Other	420	460
	<u>696,688</u>	<u>656,494</u>

## Notes to the Group financial statements

as at 31 March 2008

### 20 Financial liabilities (continued)

		2008 £000	2007 £000
<i>Non-current liabilities detailed analysis</i>			
Irredeemable debenture stock	(i)	1,063	1,063
Redeemable debenture stock			
- between two and five years		3,500	3,500
- after five years		6,000	6,000
	(ii)	9,500	9,500
Obligations under finance leases	(iii)	8,509	10,243
Listed bonds due after five years	(iv)	366,000	366,000
Less unamortised issue costs	(v)	(4,810)	(5,137)
Interest rate swap	(vi)	46,869	31,968
Index linked loans	(vii)	193,939	186,597
Other term loans and creditors	(viii)	75,198	55,800
Financing guarantee fees	(ix)	420	460
		686,125	645,931
<i>Current liabilities</i>			
Obligations under finance leases	(iii)	1,734	1,584
<i>(i) Irredeemable debenture stock</i>			
3 % perpetual stock		26	26
3 ½ % perpetual stock		394	394
4 % perpetual stock		180	180
5 % perpetual stock		420	420
5 ½ % perpetual stock		3	3
6 ½ % perpetual stock		40	40
		1,063	1,063
<i>(ii) Redeemable debenture stock</i>			
12 % debenture stock 2010		3,500	3,500
11 % debenture stock 2012/2016		3,000	3,000
10 % debenture stock 2013/2017		3,000	3,000
		9,500	9,500

All debenture stocks, apart from the irredeemable stock, are redeemable at par in the year stated. Where more than one redemption year is quoted it is at the Group's option to redeem the stock at any time between the dates stated. Interest on irredeemable and redeemable debenture stock is payable six monthly. Redeemable debenture stock is secured on the future revenues of the Group.

## Notes to the Group financial statements

as at 31 March 2008

### 20. Financial liabilities (continued)

#### (iii) Finance leases

The Group has finance lease contracts for various items of plant and machinery with an effective interest rate for 2008 and 2007 of 7.5%. Future minimum lease payments under finance leases, together with the present value of the net minimum lease payments are as follows

	Minimum payments 2008 £000	Present value of payments 2008 £000	Minimum payments 2007 £000	Present value of payments 2007 £000
Within one year	2,447	1,734	2,447	1,584
In second to fifth years	7,767	6,124	8,966	6,791
Over five years	2,665	2,385	3,996	3,452
	12,879	10,243	15,409	11,827
Less future finance charges	(2,636)		(3,582)	
Present value of minimum lease payments	10,243		11,827	
		Present value of payments 2008 £000		Present value of payments 2007 £000
Non-current		8,509		10,243
Current		1,734		1,584
		10,243		11,827

Each finance lease is secured against the asset to which it relates, as far as allowed by the Water Industries Act 1991 and South East Water Limited's licence

#### (iv) Listed bonds due after five years

The Group holds £366 million of bonds listed on the London Stock Exchange, with effective terms, having taken account of a related interest rate swap, as follows

- £200 million at a variable rate linked to RPI inflation, falling due for repayment on 30 September 2019 (or earlier at the option of the Group)
- £166 million at a fixed effective rate of 5.7071%, falling due for repayment on 29 March 2029 (or earlier at the option of the Group)

At 31 March 2008 and 31 March 2007 the listed bonds are stated at amortised cost using the effective interest rate method

The listed bonds are secured on the assets of the Group, as far as allowed by the Water Industry Act 1991 and the South East Water Limited's licence and against the assets of the immediate parent company South East Water (Holdings) Limited

#### (v) Unamortised issue costs

Issue costs incurred by the Group in securing the long-term borrowings were deducted from the amount of consideration received. Issue costs have been amortised under the effective interest rate method on a pro rata basis over the 15 and 25 years to which the associated loans relate (see (iv))

## Notes to the Group financial statements

as at 31 March 2008

### 20 Financial liabilities (continued)

#### *(vi) Interest rate swap*

As at 31 March 2008 the interest rate swap is stated at its fair value of £46.9 million (2007 £32.0 million). The movement of fair value on the interest rate swap of £14.9 million (2007 £9.7 million) during the year has been recognised in the income statement in finance costs (see note 8).

#### *(vii) Index linked loans*

Index linked loans comprise two loans of £135 million and £34 million (2007 £135 million and £34 million). The £135 million index linked loan is stated after indexation uplift of £24.1 million (2007 £18.3 million) and the deduction of issue costs to be amortised over the life of the loan of £2.0 million (2007 £2.1 million). Cumulative issue costs of £435,000 (2007 £354,000) have been amortised to date. The £34 million index linked loan is stated after indexation uplift of £3.2 million (2007 £1.8 million) and the deduction of issue costs to be amortised over the life of the loan of £352,000 (2007 £365,000). Cumulative issue costs of £37,000 (2007 £24,000) have been amortised to date.

The £135 million index linked loan is a 30 year facility repayable on 30 September 2032. The £34 million index linked loan is a 28 year facility repayable 30 September 2033. The loans are secured upon the assets of the Group. The £135 million loan increases each year in line with the Retail Price Index ("RPI") and additionally bears interest at 3.692% per annum. The £34 million loan also increases in line with RPI and bears interest at 2.801% per annum. The Group has the option to repay the indexed linked loans in total on giving the lenders notice of 30 days in respect of the £135 million loan and 10 days for the £34 million loan.

The loan agreements for the index linked loans also contain a number of covenants that the Group is required to meet to safeguard the interests of the lenders. The current position of the covenants and the required targets are detailed in the Directors report on page 6.

#### *(viii) Other term loans and creditors*

Other term loans and creditors comprise a bank loan of £73.8 million (2007 £55.8 million) and deposits payable to developers. The bank loan is secured on the assets of the Group, as far as allowed by the Water Industry Act 1991 and the South East Water Limited's licence and against the assets of the immediate parent company South East Water (Holdings) Limited, at a variable interest rate of LIBOR plus 0.45% with a maturity of 2 to 5 years.

#### *(ix) Financing guarantee fees*

Financing guarantee fees of £420,000 (2007 £460,000) comprise cash received in advance to settle fees waived in connection with the £200 million listed debt raised (see (iv)). The balance is being amortised over the life of the listed debt.

## Notes to the Group financial statements

as at 31 March 2008

### 21. Provisions

	Other provisions £000	Deferred tax £000	Total £000
As at 1 April 2007	2,826	135,073	137,899
Utilised during the year	(388)	(12,419)	(12,807)
As at 31 March 2008	2,438	122,654	125,092
Current	1,800	-	1,800
Non-current	638	122,654	123,292
	2,438	122,654	125,092

Other provisions include the provision for the refund of contributions for mains development which reflects the outstanding level of exposure to future claims against the contributions received in this regard. The need for the provision will reduce over time, however, the probability of a claim being received will be assessed each year.

### 22 Trade and other payables

	2008 £000	2007 £000
<i>Current</i>		
Trade payables	13,756	10,316
Amounts due to parent and fellow subsidiary undertakings	9,925	6,817
Payments received in advance	10,383	13,235
Other taxes and social security	655	605
Other payables	2,343	848
Accruals	25,896	25,907
Approved Dividend	-	1,268
	62,958	58,996

As at 31 March 2008 and 2007, amounts due to parent and fellow subsidiary undertakings represent unsecured non interest bearing balances relating to the surrender of group tax relief.

### 23. Financial instruments

#### **Financial risk management objectives and policies**

The Group's financial instruments comprise fixed and variable rate borrowings, index linked loans, fixed rate debentures, an interest rate swap, finance leases, cash, short-term deposits and trade receivables and trade and other payables. The main purpose of the Group's financial instruments other than the interest rate swap is to raise finance for the Group's operations.

Derivative activity is undertaken as determined by the Board of Directors. The Board considers the overall risk profile of the Group and enters into derivatives to mitigate or hedge any risks identified, as appropriate. The Group does not use derivative financial instruments for speculative purposes.

The Group's treasury operations are managed within parameters defined by the Board and its parent undertaking. It is the Group's policy to minimise liquidity risk within an acceptable range of interest rates. The Group does not use foreign currency financial instruments. The main risks arising from the Group's financial instruments are interest rate and liquidity risk. There are no regulatory capital requirements placed on the Group.

## Notes to the Group financial statements

as at 31 March 2008

### 23. Financial instruments (continued)

#### *Interest rate and cash flow risk*

The Group finances its activities through a mixture of cash generated from operations, debenture loans, finance leases, long-term bonds and long-term index linked loans. Debentures are long-term fixed rate loans, bonds are long-term fixed rate loans of which £200 million have been linked to RPI inflation through the use of an interest rate swap, in order to reflect movements in the expected future income of the Group. Finance leases are both fixed and variable rate instruments. The Group's policy is to manage short-term interest rate risk by using short-term fixed rate draw downs. During the year to 31 March 2008 there were £18.0 million of net drawings by the Group (2007 £43.8 million) under its bank facilities (note 20 viii). It is the view of the Group that long-term fluctuations in interest rates will be within the parameters that are considered acceptable by the Group.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, on the Group's profit before tax (through the impact on floating rate borrowings)

The sensitivity analysis excludes all non-derivative fixed rate financial instruments carried at amortised cost but includes those recognised at fair value as well as all non-derivative floating rate financial instruments

	Increase/ decrease in basis points	Effect on profit before tax £000	Effect on Shareholders equity £000
<b>2008</b>			
Sterling	+50	(12,651)	(12,651)
Sterling	-50	12,651	12,651
<b>2007</b>			
Sterling	+50	(11,793)	(11,793)
Sterling	-50	11,793	11,793

#### *Inflation risk*

The Group manages its RPI inflation risk on its financial liabilities through the use of an interest rate swap and index linked loans (note 20). The Group considers that the inflation rate risk is effectively managed as the Water Services Regulation Authority ("OFWAT") allows revenues to be increased in line with the retail price index.

#### *Liquidity risk*

The Group aims to maintain a balance between continuity of funding and flexibility. Continuity of funding has been guaranteed throughout the period by the existence of long-term funding facilities. Short-term flexibility is achieved by varying the drawdown amounts under these facilities. Further details are given below and in note 20.

Cash is put on deposit with variable maturity dates so as to mitigate liquidity risk.

## Notes to the Group financial statements

as at 31 March 2008

### 23. Financial instruments (continued)

#### *Credit risk*

The Group's financial assets are loans and other amounts due from other group undertakings, cash and trade receivables, which represent the Group's maximum exposure to credit risk in relation to financial assets. The Group's credit risk is primarily attributable to its trade receivables, which are stated in the balance sheet at original invoice amount less an allowance for any doubtful debts. An estimate for the provision for doubtful debts is calculated by the Group's management based on applying expected recovery rates to an aged debt profile and an assessment of current socio-economic conditions. The Group has no significant concentration of credit risk, with exposure spread over a large number of domestic and commercial customers.

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

In the opinion of the directors, the fair values of the financial assets and liabilities of the Group (apart from the specific items shown in the fair value table below) are not materially different from the book values.

All fair values are based on arms length transactions in normal market conditions. The fair value of the Group's long term borrowings has been estimated based on quoted market prices for the same or similar debt where possible. Where prices did not exist, the fair value has been estimated based on the calculations of the present value of future cash flows using the appropriate discount rates in effect at the balance sheet dates.

The following tables provide a comparison by category of the carrying amount and the fair values of the Group's financial assets and financial liabilities at 31 March 2008. Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties.

	Book Value 2008 £000	Fair Value 2008 £000	Book Value 2007 £000	Fair Value 2007 £000
<i>Group financial assets</i>				
Trade receivables	12,219	12,219	13,791	13,791
Cash	16,757	16,757	19,441	19,441
Short term deposits	-	-	10,662	10,662
Amounts due from parent and group undertakings	190,013	190,013	190,319	190,319
	<u>218,989</u>	<u>218,989</u>	<u>234,213</u>	<u>234,213</u>
<i>Group financial liabilities</i>				
Trade and other payables	27,137	27,137	26,272	26,272
Finance leases	10,243	11,473	11,827	12,522
Redeemable debentures	9,500	13,235	9,500	11,300
Irredeemable debentures	1,063	735	1,063	735
Listed bonds	366,000	381,049	366,000	379,415
Interest rate swap	46,869	46,869	31,968	31,968
Index linked loans	196,305	196,305	189,058	189,058
Other long-term financial liabilities	73,800	73,800	55,800	55,800
Amounts due to parent and group undertakings	9,925	9,925	6,817	6,817
	<u>740,842</u>	<u>760,528</u>	<u>698,305</u>	<u>713,887</u>

## Notes to the Group financial statements

as at 31 March 2008

### 23. Financial instruments (continued)

The fair value of long-term fixed rate debentures, fixed rate finance leases and the interest rate swap have been calculated using discounted cash flow methods using appropriate discount rates in effect at the balance sheet dates. The fair value of listed bonds has been calculated using year end quoted market prices. The net book value is considered to equate to the fair value for trade receivables and trade and other payables due to the short maturity of the amounts receivable and payable.

For all other financial instruments the net book value is considered to equate to the fair value as future cash flows are discounted at the effective interest rate of the respective financial instrument.

#### *Maturity of financial instruments*

The table below summarises the maturity profile of the Group's financial assets and liabilities based on contractual undiscounted payments.

Year ended 31 March 2008

	Within 1 year £000	1 – 2 years £000	2 – 5 years £000	More than 5 years £000	Total £000
<i>Fixed rate</i>					
Fixed rate financial liabilities					
Finance leases	1,332	1,332	3,997	2,664	9,325
Irredeemable debentures	-	-	-	2,429	2,429
Redeemable debentures	-	-	4,760	11,970	16,730
Listed bond	-	-	-	374,423	374,423
<b>Total fixed rate financial liabilities</b>	<b>1,332</b>	<b>1,332</b>	<b>8,757</b>	<b>391,486</b>	<b>402,907</b>
<i>Floating rate</i>					
Floating rate financial assets					
Short-term financial assets	28,976	-	-	-	28,976
Long-term financial assets	-	-	-	594,798	594,798
<b>Total floating rate financial assets</b>	<b>28,976</b>	<b>-</b>	<b>-</b>	<b>594,798</b>	<b>623,774</b>
Floating rate financial liabilities					
Finance leases	1,115	1,143	1,295	-	3,553
Short-term financial liabilities	37,062	-	-	-	37,062
Listed bond	-	-	-	200,000	200,000
Interest rate swap	-	-	-	96,197	96,197
Index linked loans	-	-	-	766,913	766,913
Other long-term financial liabilities	-	-	96,641	-	96,641
<b>Total floating rate financial liabilities</b>	<b>38,177</b>	<b>1,143</b>	<b>97,936</b>	<b>1,063,110</b>	<b>1,200,366</b>

The £200 million fixed rate instrument is classified as a floating rate financial liability due to the associated interest rate swap arrangement.

## Notes to the Group financial statements

as at 31 March 2008

### 23. Financial instruments (continued)

#### *Maturity of financial instruments (continued)*

Year ended 31 March 2007

	Within 1 year £000	1 – 2 years £000	2 – 5 years £000	More than 5 years £000	Total £000
<i>Fixed rate</i>					
Fixed rate financial liabilities					
Finance leases	1,332	1,332	3,997	3,997	10,658
Irredeemable debentures	-	-	-	2,475	2,475
Redeemable debentures	-	-	5,180	12,600	17,780
Listed bond	-	-	-	383,897	383,897
<b>Total fixed rate financial liabilities</b>	<b>1,332</b>	<b>1,332</b>	<b>9,177</b>	<b>402,969</b>	<b>414,810</b>
<i>Floating rate</i>					
Floating rate financial assets					
Short-term financial assets	43,894	-	-	-	43,894
Long-term financial assets	-	-	-	609,790	609,790
<b>Total floating rate financial assets</b>	<b>43,894</b>	<b>-</b>	<b>-</b>	<b>609,790</b>	<b>653,684</b>
Floating rate financial liabilities					
Finance leases	1,081	1,115	2,438	-	4,634
Short-term financial liabilities	33,089	-	-	-	33,089
Listed bond	-	-	-	200,000	200,000
Interest rate swap	-	-	-	91,539	91,539
Index linked loans	-	-	-	773,848	773,848
Other long-term financial liabilities	-	-	101,209	-	102,209
<b>Total floating rate financial liabilities</b>	<b>34,170</b>	<b>1,115</b>	<b>103,647</b>	<b>1,065,387</b>	<b>1,205,319</b>

The £200 million fixed rate instrument is classified as a floating rate financial liability due to the associated interest rate swap arrangement

#### ***Borrowing facilities***

The Group has access to borrowing facilities of £100 million (2007 £113.9 million), of which £73.8 million (2007 £55.8 million) was drawn down at 31 March 2008 and is due for repayment within 2 to 5 years (see note 20). Once drawn upon the remaining borrowing facility would have repayments due as follows

Within 2 to 5 years	£26.2 million	(2007 £11 million)
After more than 5 years	£nil	(2007 £47.1 million)

### 24 Derivative financial instruments

	2008 £000	2007 £000
Interest rate swap	46,869	31,968

In accordance with IAS 39 *Financial Instruments Recognition and measurement*, the Group has reviewed all contracts for embedded derivatives and, as at 31 March 2008, the book and fair value were nil

## Notes to the Group financial statements

as at 31 March 2008

### 25. Retirement benefit schemes

The South East Water Pension Scheme provides benefits to current and former group employees on either a final salary defined benefit basis or a defined contribution basis depending on the category of membership. The scheme was originally contracted-out under the Guaranteed Minimum Pension Test. After taking independent actuarial advice, at 6 April 1997 the companies decided to contract-out via the Protected Rights Test. The final salary defined benefit section of the scheme was closed to new members with effect from July 2002.

The last full actuarial valuation of scheme was taken place as at 31 March 2005, which has been updated to 31 March 2008 by a qualified independent actuary.

The Group contribution rate was 30% of pensionable remuneration during the year.

As a result of the merger of SEW Limited and MKW Limited, the Group has acquired the Mid Kent Group Pension Scheme, which is a defined benefit scheme in the UK.

A full actuarial valuation was carried out for the Mid Kent Group Pension Scheme as at 31 March 2005 and updated to 31 March 2008 by a qualified independent actuary. The service cost has been calculated using the Projected Unit method.

The Group contributed 22% of pensionable remuneration plus £352,000 in respect of the deficit as at 31 March 2005 to the scheme in the year to 31 March 2008.

The Group also provides unfunded defined pension benefits to some former directors where directors' pensions are paid directly from group funds.

Pension costs recognised in the income statement for the defined contribution scheme were as follows:

	2008 £000	2007 £000
Defined contribution scheme	72	41

The assumptions used in the following tables were:

	SEW pensions 2008 %	SEW pensions 2007 %	MKW pensions 2008 %	MKW pensions 2007 %
<b>Main assumptions</b>				
Rate of increase in salaries	4.50	4.20	4.50	4.00
Rate of increase in pensions in payment	3.50	3.20	3.50	3.00
Discount rate	6.30	5.40	6.30	5.50
Inflation assumption	3.50	3.20	3.50	3.00
<b>Expected weighted average return on plan assets</b>				
Expected rates of return on scheme assets	6.77	6.91	5.69	5.39
Equities	7.60	7.60	7.30	6.80
Corporate bonds	6.30	5.40	6.60	5.20
Government bonds	4.50	4.50	4.30	4.30
Property	5.70	7.60	-	-
Cash	5.00	5.25	5.00	4.25

## Notes to the Group financial statements

as at 31 March 2008

### 25. Retirement benefit schemes (continued)

#### Post-retirement mortality (in years)

	SEW Pensions 2008	SEW Pensions 2007	MKW Pensions 2008	MKW Pensions 2007
Current pensioners at 60 – male	27.3	25.5	-	-
Current pensioners at 60 – female	29.6	28.5	-	-
Future pensioners at 67 – male	19.9	17.9	-	-
Future pensioners at 67 – female	22.1	20.9	-	-
Current pensioners at 65 – male	-	-	22.0	18.9
Current pensioners at 65 – female	-	-	24.8	21.7
Future pensioners at 65 – male	-	-	23.4	20.5
Future pensioners at 65 – female	-	-	26.2	23.2

The actuarial valuation of the present value of the defined benefit obligation uses the year of birth mortality tables for post retirement mortality. The expected return on plan assets is set having taken actuarial advice and is based on the long term expectation for each asset class at the beginning of the financial year.

The fair value of the assets and liabilities of the schemes at 31 March are

	SEW Pensions £000	MKW Pensions £000	Total £000
<b>2008</b>			
Equities	58,790	37,702	96,492
Corporate bonds	18,422	11,199	29,621
Government bonds	11,333	26,627	37,960
Property	13,382	-	13,382
Cash	144	62	206
Fair value of scheme assets	102,071	75,590	177,661
Present value of defined benefit obligations	(135,116)	(74,312)	(209,428)
<b>Defined benefit pension plan (deficit)/surplus</b>	<b>(33,045)</b>	<b>1,278</b>	<b>(31,767)</b>
<b>2007</b>			
Equities	66,295	39,133	105,428
Corporate bonds	19,701	11,183	30,884
Government bonds	10,948	26,977	37,925
Property	15,981	-	15,981
Cash	291	123	414
Fair value of scheme assets	113,216	77,416	190,632
Present value of defined benefit obligations	(138,747)	(73,504)	(212,251)
<b>Defined benefit pension plan (deficit)/surplus</b>	<b>(25,531)</b>	<b>3,912</b>	<b>(21,619)</b>

## Notes to the Group financial statements

as at 31 March 2008

### 25. Retirement benefit schemes (continued)

Analysis of the amounts recognised in the income statement

	SEW Pensions £000	MKW Pensions £000	Total £000
<i>2008</i>			
Current service costs	(956)	(782)	(1,738)
Past service costs	(323)	(244)	(567)
Curtailment credits/(costs)	332	(391)	(59)
<b>Total pensions charge to net operating cost</b>	<b>(947)</b>	<b>(1,417)</b>	<b>(2,364)</b>
<b>Total net finance credit</b>	<b>356</b>	<b>354</b>	<b>710</b>
<b>Total charged to income statement</b>	<b>(591)</b>	<b>(1,063)</b>	<b>(1,654)</b>
<i>2007</i>			
Current service cost	(1,215)	(476)	(1,691)
Total net finance credit	411	214	625
<b>Total charged to income statement</b>	<b>(804)</b>	<b>(262)</b>	<b>(1,066)</b>

Analysis of the amounts recognised as net finance credit in the income statement

	SEW Pensions £000	MKW Pensions £000	Total £000
<i>2008</i>			
Expected return on pension scheme assets	7,760	4,351	12,111
Interest on pension scheme liabilities	(7,404)	(3,997)	(11,401)
<b>Net finance credit</b>	<b>356</b>	<b>354</b>	<b>710</b>
<i>2007</i>			
Expected return on pension scheme assets	7,028	2,028	9,056
Interest on pension scheme liabilities	(6,617)	(1,814)	(8,431)
<b>Net finance credit</b>	<b>411</b>	<b>214</b>	<b>625</b>

## Notes to the Group financial statements

as at 31 March 2008

### 25 Retirement benefit schemes (continued)

Analysis of amounts taken to the statement of recognised income and expenses

	SEW Pensions £000	MKW Pensions £000	Total £000
<b>2008</b>			
Actuarial gain at 1 April	603	1,804	2,407
Actuarial loss recognised for year	(9,242)	(2,969)	(12,211)
Cumulative actuarial loss	(8,639)	(1,165)	(9,804)
<b>2007</b>			
Actuarial loss at 1 April	(119)	-	(119)
Transferred due to merger	-	(1,240)	(1,240)
Actuarial gain recognised for year	722	3,044	3,766
Cumulative actuarial gain	603	1,804	2,407

Present value of defined benefit obligations at 31 March relating to

	SEW Pensions 2008 £000	MKW Pensions 2008 £000	SEW Pensions 2007 £000	MKW Pensions 2007 £000
Funded plans	(135,116)	(74,312)	(138,747)	(73,504)
Unfunded plans	(3,840)	-	(4,279)	-

Movements in the present value of defined benefit obligations are analysed as follows

	SEW Pensions £000	MKW Pensions £000	Total £000
At 1 April 2006	(136,605)	-	(136,605)
Transferred due to merger	-	(76,539)	(76,539)
Current service cost	(1,215)	(476)	(1,691)
Aged related rebates	(196)	-	(196)
Interest cost	(6,617)	(1,814)	(8,431)
Contributions	(522)	(178)	(700)
Benefits paid	5,067	1,853	6,920
Actuarial gain	1,340	3,650	4,990
At 31 March 2007	(138,748)	(73,504)	(212,252)
Current service cost	(956)	(782)	(1,738)
Aged related rebates	(181)	-	(181)
Interest cost	(7,404)	(3,997)	(11,401)
Contributions	(544)	(380)	(924)
Benefits paid	4,935	3,806	8,741
Actuarial gain	7,773	1,180	8,953
Past service cost	(323)	(244)	(567)
Curtailment costs	332	(391)	(59)
At 31 March 2008	(135,116)	(74,312)	(209,428)

## Notes to the Group financial statements

as at 31 March 2008

### 25. Retirement benefit schemes (continued)

Movements in the present value of fair value of schemes' assets are analysed as follows

	SEW Pensions £000	MKW Pensions £000	Total £000
At 1 April 2006	108,188	-	108,188
Transferred due to merger	-	76,947	76,947
Expected return on scheme assets	7,028	2,028	9,056
Actuarial loss	(622)	(606)	(1,228)
Contributions by employer	2,971	721	3,692
Contributions by employee	522	178	700
Benefits paid	(5,067)	(1,852)	(6,919)
Aged related rebates	196	-	196
At 31 March 2007	113,216	77,416	190,632
Expected return on scheme assets	7,760	4,351	12,111
Actuarial loss	(17,015)	(4,149)	(21,164)
Contributions by employer	2,324	1,398	3,722
Contributions by employee	540	380	920
Benefits paid	(4,935)	(3,806)	(8,741)
Aged related rebates	181	-	181
At 31 March 2008	102,071	75,590	177,661

The actual return on plans' assets was £9.3 million (2007 £6.4 million) in the South East Water Pension Scheme and £0.2 million (2007 £3.7 million) in the Mid Kent Group Pension Scheme

History of experience gains and losses

	2008 £000	2007 £000	2006 £000	2005 £000	2004 £000
<i>SEW Pensions</i>					
Present value of defined benefit obligation	(135,116)	(138,747)	(136,605)	(127,985)	(113,951)
Fair value of scheme assets	102,075	113,216	108,189	89,413	84,164
<b>Deficit on scheme</b>	<b>(33,041)</b>	<b>(25,531)</b>	<b>(28,416)</b>	<b>(38,572)</b>	<b>(29,787)</b>
Experience adjustments on plan liabilities					
Amount (£000)	7,773	1,340	(4,214)	(11,439)	7,531
Percentage of plan liabilities	5.8%	1.0%	(3.1)%	(8.9)%	6.6%
Experience adjustments on plan assets					
Amount (£000)	(17,015)	(622)	14,012	1,525	2,806
Percentage of plan assets	(16.7)%	(0.5)%	13.0%	1.7%	3.3%

## Notes to the Group financial statements

as at 31 March 2008

### 25. Retirement benefit schemes (continued)

	2008 £000	2007 £000	2006 £000	2005 £000	2004 £000
<i>MKW Pensions</i>					
Present value of defined benefit obligation	(74,312)	(73,504)	(74,287)	(66,992)	(66,303)
Fair value of scheme assets	75,590	77,416	75,537	63,787	60,366
<b>Surplus/(deficit) on scheme</b>	<b>1,278</b>	<b>3,912</b>	<b>1,250</b>	<b>(3,205)</b>	<b>(5,937)</b>
Experience adjustments on plan liabilities					
Amount (£000)	3,886	(860)	(119)	2,686	-
Percentage of plan liabilities	5%	(1)%	0%	4%	0%
Experience adjustments on plan assets					
Amount (£000)	(4,149)	(359)	9,229	2,317	8,565
Percentage of plan assets	(5)%	0%	12%	4%	14%

### 26. Deferred income

	Total £000
As at 1 April 2006	38,141
Transfers in due to merger	2,736
Received in the year	3,686
Released during the year	(1,651)
As at 1 April 2007	42,912
Received in the year	5,620
Released during the year	(1,410)
As at 31 March 2008	47,122
As at 31 March 2008	
Non-current	44,545
Current	2,577
	47,122
As at 31 March 2007	
Non-current	41,730
Current	1,182
	42,912

Amounts received towards above ground assets are released to the income statement over the period to which they are deemed to relate

Contributions received towards below ground assets are released to the income statement over the period that corresponds to the life of the asset to which the contribution relates

## Notes to the Group financial statements

as at 31 March 2008

### 27 Share capital

	2008 £000	2007 £000
<i>Authorised, issued, called up, allotted and fully paid</i>		
10,091,548 ordinary shares of £1 each (2007 5,091,548)	10,092	5,092

There is one class of ordinary share, which carries no right of fixed income and no restrictions on dividends or capital repayment

Five million shares were issued and fully paid at par on 16 August 2007

### 28 Changes in shareholders' equity

	Share capital £000	Capital redemption reserve £000	Merger Reserve £000	Retained earnings £000	Total £000
At 1 April 2006	5,092	4,000	-	154,842	165,067
Dividends paid	-	-	-	(44,847)	(44,847)
Total recognised income and expense for the year	-	-	-	30,266	30,266
Creation of merger reserve			9,845	-	9,845
At 31 March 2007	5,092	4,000	9,845	140,261	159,198
Dividends paid	-	-	-	(30,993)	(30,993)
Total recognised income and expense for the year	-	-	-	29,932	29,932
Shares issued	5,000	-	-	-	5,000
At 31 March 2008	10,092	4,000	9,845	139,200	163,137

#### **Merger reserve**

The trade and certain assets and liabilities of MKW Limited amounting to £9.8 million have been transferred into SEW Limited at net book value. The difference between the net book value transferred and the consideration paid by SEW Limited of nil has given rise to the merger reserve of £9.8 million (see note 3)

## Notes to the Group financial statements

as at 31 March 2008

### 29. Cash flow from operating activities

	2008 £000	2007 £000
Profit for the year	38,724	27,630
Adjustments for		
Income tax expense	686	8,558
Finance income	(17,390)	(15,278)
Finance costs	52,831	38,511
Depreciation	21,792	15,661
Amortisation of intangibles	1,709	1,289
Impairment, write off and disposal of intangibles & property plant and equipment	473	-
Loss on disposal of fixed assets	786	531
Release of deferred income	(1,410)	(1,650)
Difference between pension contributions paid and amounts recognized in the income statement	(1,353)	(1,919)
Changes in working capital		
Increase in trade and other receivables	(845)	(2,608)
Decrease in inventory	47	94
Increase in trade and other payables	3,070	4,676
Net cash generated from operations	99,120	75,495

### 30. Commitments and contingent liabilities

#### a) Capital commitments

	2008 £000	2007 £000
The Group had the following contracted capital commitments for the acquisition of property, plant and equipment	22,371	21,144

#### b) Operating leases commitments

Minimum lease payments under non-cancellable operating leases are as follows

	Land and buildings 2008 £000	Land and buildings 2007 £000	Vehicles and office equipment 2008 £000	Vehicles and office equipment 2007 £000
Amounts for the following periods				
- within one year	498	498	71	535
- between two and five years	1,942	1,963	975	853
- after more than five years	1,071	1,656	-	-
	3,511	4,117	1,046	1,388

## Notes to the Group financial statements

as at 31 March 2008

### 31 Related party transactions

On 2 October 2006 Utilities of Australia Pty Limited as Trustee for the Utilities Trust of Australia and Hastings Funds Management Limited as Responsible Entity for the Hastings Diversified Utilities Fund became the Group's joint ultimate holding companies. Both of these holding companies are resident in Australia and it is the directors' belief that they control the Group jointly.

The group of companies into which results of the Group are consolidated is that headed by HDF (UK) Holdings Limited, a company registered in England and Wales. The consolidated financial statements of HDF (UK) Holdings Limited may be obtained from the Company Secretary, Rocfort Road, Snodland, Kent, ME6 5AH.

HDF (UK) Holdings Limited charged fees for the year to 31 March 2008 of £1.9 million (2007 £350,000) for corporate and financial services. As at 31 March 2008 the balance due to HDF (UK) Holdings Limited of £1.9 million (2007 £149,000) is included in trade and other payables in note 22.

A loan to the immediate parent company South East Water (Holdings) Limited of £190 million (2006 £190 million) is disclosed in note 16 under non-current receivables. Loan interest receivable during the year was £15.1 million (2007 £13.2 million). There was no interest outstanding as at 31 March 2008 (2007 £nil) included under trade and other receivables in note 18.

Until 2 October 2006 Macquarie Bank Limited was a related party by virtue of its non-controlling stake in the Group and charged fees up to this date of £1.0 million for corporate and financial. No amounts were outstanding at the year end.

Key management compensation is disclosed in note 7 remuneration of directors.

Contributions to retirement benefit schemes are disclosed in note 25.

## Statement of directors' responsibilities in relation to the parent company financial statements

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing those financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and estimates that are reasonable and prudent,
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements, and,
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping proper accounting records that 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 Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.



**P Butler**  
**Managing Director**  
Date 11 July 2008

## **Independent auditors' report to the members of South East Water Limited**

We have audited the parent company financial statements of South East Water Limited for the year ended 31 March 2008 which comprise the Profit and Loss Account, the Balance Sheet, the Statement of Total Recognised Gains and Losses and the related notes 32 to 60. These parent company financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the group financial statements of South East Water Limited for the year ended 31 March 2008.

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 work 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**

The directors' responsibilities for preparing the Annual Report and the parent company financial statements in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the parent company financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the parent company financial statements give a true and fair view and whether the parent company financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the directors' report is consistent with the parent company financial statements. The information given in the directors' report includes that specific information presented in the Managing Directors' report that is cross referred from the Business Review section of the directors' report.

In addition we report to you if, in our opinion, 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 other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited parent company financial statements. The other information comprises only the directors' report, the Remuneration Report, the Chairman's Statement and the Managing Directors' report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company financial statements. Our responsibilities do not extend to any other information.

### **Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent company financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the parent company financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

## Independent auditors' report to the members of South East Water Limited

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 parent company financial statements and the part of the Directors' Remuneration Report to be audited 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 parent company financial statements and the part of the Directors' Remuneration Report to be audited.

### Opinion

In our opinion

- the parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 March 2008 and of its profit for the year then ended,
- the parent company financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the directors' report is consistent with the parent company financial statements

*Ernst & Young LLP*

**Ernst & Young LLP**  
**Registered auditor**

**London**  
**Date 11 July 2008**

## Company Income statement

as at 31 March 2008

	Note	2008 £000	2007 Restated £000
Turnover	34	168,668	132,598
Operating costs	36	(104,771)	(87,304)
Other operating income	35	6,343	5,268
Operating profit		70,240	50,562
Merger costs	36	(3,471)	-
Profit on ordinary activities before interest		66,769	50,562
Interest receivable and similar income	38	16,154	14,051
Interest payable and similar charges	39	(52,997)	(38,509)
Other finance income	58	1,170	840
Profit on ordinary activities before taxation		31,096	26,944
Tax on profit on ordinary activities	40	(2,297)	(3,862)
<b>Profit on ordinary activities after taxation</b>		<b>28,799</b>	<b>23,082</b>

Operating profit relates to continuing operations

The accompanying notes are an integral part of this profit and loss account

## Company statement of total recognised gains and losses

as at 31 March 2008

	Note	2008 £000	2007 Restated £000
Profit for the year		28,799	23,082
Actuanal (loss)/gain on pension scheme for the year	58	(11,496)	8,129
Movement on deferred tax relating to pension deficit		3,219	(2,439)
<b>Total recognised gains for the year</b>		<b>20,522</b>	<b>28,772</b>

# Company balance sheet


as at 31 March 2008

	Note	2008 £000	2008 £000	2007 Restated £000	2007 Restated £000
<b>Fixed assets</b>					
Tangible assets	42		713,746		664,010
Investments	42		-		-
<b>Current assets</b>					
Stocks	43	643		690	
Debtors amounts falling due after more than one year	44	35,685		34,050	
Debtors amounts falling due within one year	44	195,613		193,613	
Total debtors		231,298		227,663	
Cash at bank and in hand		6,582		19,938	
		238,523		248,291	
Creditors amounts falling due within one year	45	(62,405)		(56,944)	
<b>Net current assets</b>			176,118		191,347
<b>Total assets less current liabilities</b>			889,864		855,357
Creditors amounts falling due after more than one year	46		(696,688)		(656,494)
Provisions for liabilities	49		(24,942)		(33,353)
Deferred income	50		(7,251)		(6,112)
Net assets excluding pension liability			160,983		159,398
Defined benefit pension asset	58		1,101		2,738
Defined benefit pension liability	58		(17,316)		(11,897)
<b>Net assets including pension liability</b>			144,768		150,239
<b>Capital and reserves</b>					
Called up share capital	51		10,092		5,092
Capital redemption reserve	52		4,000		4,000
Merger reserve	33		12,320		12,320
Profit and loss account	53		118,356		128,827
<b>Equity shareholders' funds</b>	54		144,768		150,239

The accompanying notes are an integral part of this balance sheet

The financial statements on pages 71 to 105 were approved by the Board of directors on 11 July 2008 and were signed on its behalf by

  
**P Butler**  
 Managing Director  
 Date 11 July 2008

  
**J E Stimpson**  
 Finance Director  
 Date 11 July 2008

## Company cash flow statement

as at 31 March 2008

	Note	2008 £000	2007 Restated £000
Net cash inflow from operating activities	55	99,126	75,495
Returns on investments and servicing of finance			
Interest paid		(29,893)	(18,923)
Interest received		16,169	13,874
Issue costs of listed debt		(79)	(1)
Interest element of finance lease payments		(716)	(899)
Net cash outflow from returns on investments and servicing of finance		(14,519)	(5,949)
UK corporation tax paid		(6,402)	(8,640)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(85,952)	(57,772)
Fixed asset contributions received		7,021	2,833
Net proceeds from disposal of tangible assets		620	1,104
Net cash outflow from capital expenditure and financial investment		(78,311)	(53,835)
Equity dividends paid to shareholders		(32,261)	(46,115)
Transfer in of cash and cash equivalents due to merger	33	(19)	-
Net cash outflow before management of liquid resources and financing		(32,772)	(39,044)
Management of liquid resources Money market deposits		10,662	(1,662)
Financing			
Capital element of finance leases		(1,584)	(1,448)
Issue of ordinary capital shares		5,000	-
Other long term creditors		(386)	-
Proceeds from loan drawdown		27,300	43,800
Repayment of loans		(9,300)	-
New group loans		(2,000)	-
Net cash inflow from financing		19,030	42,352
Net cash inflow from management of liquid resources and financing		30,078	40,690
(Decrease)/increase in net cash		(2,694)	1,646

## Company cash flow statement

as at 31 March 2008

Reconciliation of increase in net cash to movement in net debt

	Note	2008 £000	2007 £000
Net cash at the start of the year		9,276	7,630
(Decrease)/Increase in net cash (above)		(2,694)	1,646
Liquid resources		-	10,662
Total cash		6,582	19,938
Opening borrowings		(464,005)	(406,667)
Net increase in borrowings		(14,337)	(42,324)
Other non-cash changes		(22,649)	(15,014)
Net debt at the end of the year	56	(494,409)	(444,067)

# Notes to the Company financial statements

as at 31 March 2008

## 32. Accounting policies

The principal accounting policies are summarised below. The policies were applied consistently throughout the year with the exception of the adoption of FRS 29 *Financial Instruments Disclosure*, which did not have any impact on the financial performance of the Company in the current or prior periods but gave rise to additional disclosures.

### ***Basis of preparation***

The Company financial statements have been prepared in accordance with applicable UK accounting standards and under the historical cost convention and the Companies Act 1985, other than in respect of grants and contributions as described below.

### ***Changes in accounting policy***

As a result of the merger of South East Water Limited (SEW Limited) and Mid Kent Water Limited (MKW Limited) (note 33), the following changes have been made in the accounting policies adopted by SEW Limited:

- Cost of rechargeable work related to new connections, previously expensed by SEW Limited, is now capitalised, and,
- Cost of leakage detection, previously capitalised by SEW Limited, is now recognised in the income statement within operating expenditure.

The comparative period has been restated to incorporate the above changes in the accounting policies of SEW Limited.

### ***Turnover***

Turnover, arising solely in the United Kingdom, represents income from the supply of water and other chargeable services to customers. Turnover is recorded net of VAT and is stated before any deduction for bad and doubtful debts.

### ***Metered and unmetered water income***

Water income is recognised when water has been delivered to the customer. Water income includes an estimation of the volume of mains water supplied but unbilled at the year end. This is estimated using a defined methodology based upon a measure of unbilled water consumed, which is calculated from historical customer data.

Cash received in advance from customers is not treated as current year revenue, being recognised as payments received in advance within creditors.

### ***Capitalisation of employee and overhead costs***

Employee and overhead costs directly attributable to capital projects are capitalised in the financial statements as part of the cost of the assets to which they relate.

### ***Taxation***

Current tax, being UK Corporation tax, is provided at amounts expected to be paid (or recovered) using tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is provided in respect of the material tax effect of all timing differences between the treatment of certain items for taxation and accounting purposes, at the rates of tax expected to apply when the timing differences reverse. 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 similar maturity dates. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

## Notes to the Company financial statements

as at 31 March 2008

### 32. Accounting policies (continued)

#### **Infrastructure renewals accounting**

Infrastructure assets comprise a network of systems relating to water distribution, such as water mains and surface reservoirs. Expenditure on infrastructure assets relating to enhancements and renewals of the network is treated as additions, which are included at cost. Expenditure on maintaining the operating capability of the network in accordance with defined standards of service is charged as an operating cost.

The depreciation charge for infrastructure assets is the estimated level of average annual expenditure required to renew the network based upon the Company's independently certified asset management plans. No other depreciation is charged on infrastructure assets because the network of systems is required to be maintained in perpetuity and therefore has no finite economic life.

#### **Grants and contributions in respect of non-infrastructure assets**

Grants and contributions received in respect of non-infrastructure assets are recognised as deferred income and released to the profit and loss account over the life of the assets to which they relate.

#### **Grants and contributions in respect of infrastructure assets**

In certain circumstances third parties make non-returnable contributions towards the cost of specific infrastructure assets. Capital contributions towards infrastructure assets are deducted from the cost of these assets. This is not in accordance with Schedule 4 of the Companies Act 1985 under which infrastructure assets should be stated at their purchase price or production cost, and capital contributions treated as deferred income and released to the profit and loss account over the useful life of the corresponding assets.

The directors are of the opinion that, as infrastructure assets have no finite economic lives for the reason set out above and the capital contributions would therefore remain in the balance sheet in perpetuity, the treatment otherwise required by the Companies Act 1985 would not present a true and fair view of the Company's effective investment in infrastructure assets. Contributions received and the effect of this policy in the financial year are shown in note 42.

#### **Depreciation**

Freehold land is not depreciated. Assets in the course of construction are depreciated from the time they are brought into use. Infrastructure assets are depreciated using infrastructure renewals accounting as set out above. Other fixed assets are depreciated on a straight line basis over their estimated useful lives as follows:

	Years
Freehold buildings	80
Operational structures	50-80
Fixed plant and machinery	10-35
Meters, vehicles, mobile plant, computers, furniture and equipment	3-10

#### **Borrowing costs**

Borrowing costs are recognised as an expense when incurred.

#### **Leases**

Assets acquired under finance leases are included in tangible fixed assets and are depreciated on a straight line basis over the shorter of the estimated useful life and the term of the lease. The related obligations, representing the capital element of future rentals, are included in creditors. The interest element of rentals is charged to the profit and loss account at a constant rate over the remaining life of the lease.

Operating lease payments are recognised as an expense in the profit and loss account on a straight-line basis over the lease term.

# Notes to the Company financial statements

as at 31 March 2008

## 32. Accounting policies (continued)

### **Stocks and work in progress**

Stock is valued at the lower of average cost or net realisable value. No value is placed upon stocks of treated water in accordance with accepted practice in the water industry. Consumable chemical purchases are recognised as an expense in the profit and loss account at the point of purchase.

Work in progress for chargeable services is valued at the lower of cost and net realisable value.

### **Pension benefits**

The Company accounts for pension benefits under FRS 17 *Retirement Benefits*. The Company operates both defined benefit and defined contribution pension schemes. Defined benefits are provided using both funded and unfunded pension plans.

### **Defined contribution plans**

Contributions to defined contribution plans are recognised as an operating expense when the contributions fall due.

### **Defined benefit plans**

The defined benefit pension scheme liability in the balance sheet represents the net of the present value of the defined benefit liability and the fair value of the scheme assets at the balance sheet date, and is disclosed after deferred taxation. It is shown on the face of the balance sheet above total net assets.

The present value of the defined benefit liability and the cost of providing benefits under defined benefit plans is determined on a triennial basis, and updated to each year end by an independent qualified actuary using the Projected Unit Credit actuarial valuation method, discounted at an interest rate equivalent at measurement date to the rate of return on a high quality corporate bond of equivalent term and currency to the scheme liabilities.

The pension cost charged to operating profit includes current and past service cost and the effect of any settlements and curtailments.

Other finance cost or income comprises the net of the expected return on pension scheme assets and the interest on pension scheme liabilities.

Actuarial gains and losses and the related deferred taxation are recognised outside the profit and loss account in the statement of total recognised gains and losses.

### **Financial instruments**

The Company's financial instruments comprise fixed and variable rate borrowings, fixed rate debentures, a derivative financial instrument comprising an interest rate swap, finance leases, loans due to and owed by parent and fellow subsidiary undertakings, cash, short-term deposits, trade debtors and trade and other creditors.

### **Recognition**

Financial instruments are recognised in the balance sheet when the Company becomes party to the contractual provisions of the instrument.

### **Derecognition**

Financial liabilities are removed from the balance sheet when the related obligation is discharged, cancelled or expires.

Financial assets are removed from the balance sheet when the rights to the cash flows from the asset expire, or when the risks and rewards of ownership of the asset are transferred or when control of the asset is transferred.

## Notes to the Company financial statements

as at 31 March 2008

### 32. Accounting policies (continued)

#### *Financial instruments (continued)*

##### ***Embedded derivatives***

Financial instruments that are not carried at fair value through profit and loss are reviewed to determine if they contain embedded derivatives. Embedded derivatives are accounted for separately as derivative financial instruments when the economic characteristics and risks are not closely related to the respective host financial instrument.

##### ***Derivative financial instruments***

The Company uses derivative financial instruments such as an interest rate swap to hedge its risks associated with interest rate fluctuations. This use does not qualify for hedge accounting. Derivative financial instruments are recognised initially and subsequently in the balance sheet at fair value with any movements during the year charged or credited to the profit and loss account. The fair value is determined by reference to market values for similar instruments.

##### ***Interest bearing loans and borrowings***

All loans and borrowings are initially recognised at cost, being the fair value of the consideration received net of issue costs associated with the borrowing.

Interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement.

Interest costs are expensed in the profit and loss account as incurred.

##### ***Short-term trade and other receivables***

Short-term trade receivables are recognised and carried at original invoice amount less an allowance for any doubtful debts. An estimate for the provision for doubtful debts is calculated by the Company's management based on applying expected recovery rates to an aged debt profile and an assessment of current socio-economic conditions.

##### ***Trade payables***

Trade payables are carried at payment or settlement amounts.

##### ***Provisions***

A provision is recognised when the Group has a legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect is material, expected future cash flows are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability.

##### ***Research and development***

Research and development expenses are charged to the income statement in the year in which they are incurred.

## Notes to the Company financial statements

as at 31 March 2008

### 32. Accounting policies (continued)

#### *Impairment*

At each reporting date an assessment is carried out to determine whether there is any indication that financial assets may be impaired. Where there is objective evidence that an impairment loss has arisen, the carrying amount is reduced in accordance with FRS 26 *Financial Instruments Measurement*, with the loss being recognised in the profit and loss account in the year in which the respective assessment takes place.

#### *Debt issue costs*

Debt instruments are stated at the amount of net proceeds received. Issue costs incurred for the purpose of providing future funds are accounted for as a deduction from the amount of consideration received and amortised over the period of the loan to which the issue costs relate.

#### *Related party disclosures*

As a wholly owned subsidiary of HDF (UK) Holdings Limited, the Company has taken advantage of the exemption under FRS 8 *Related Party Disclosures* not to provide information on related party transactions with other companies within the HDF (UK) Holdings Limited group. Note 60 gives details of how to obtain a copy of the published financial statements of HDF (UK) Holdings Limited.

#### *Investments*

Investments are recorded at historical cost. Where the directors are of the opinion that there has been a permanent diminution in the value of investments, the carrying amount of such investments is written down to the recoverable amount.

#### *Dividends*

Dividends are recognised as a distribution when paid. Dividends either proposed, or declared but unpaid at the balance sheet date, are disclosed in the notes to the financial statements.

### 33. Merger of South East Water Limited (SEW Limited) and Mid Kent Water Limited (MKW Limited)

#### *Terms of the merger*

MKW Limited has transferred its trade and assets to SEW Limited under a statutory transfer scheme within the Water Industry Act (1991). The transfer scheme operated on the effective date of 14 December 2007, transferring all the assets and liabilities of MKW Limited to SEW Limited other than the £43.7 million intercompany loan receivable from Mid Kent Financing Limited, its holding company, and the £2.1 million intercompany debt for group tax relief owed to Swan Group. This scheme was approved by Ofwat. Nil consideration was paid by SEW Limited to MKW Limited for the transfer of the assets as is permissible under UK corporate law in these particular circumstances.

SEW Limited became part of the HDF UK Group on 2 October 2006. HDF UK Group is owned by Utilities Trust of Australia and Hastings Fund Management as responsible entity for the Hastings Diversified Utilities Fund, who were also the ultimate owners of MKW Limited and hence both companies became entities under common control at this point. The transfer of assets between MKW Limited and SEW Limited is within the HDF UK Group, and hence merger accounting has been applied on the grounds of a group reconstruction.

#### *Accounting for the merger*

FRS 6 *Acquisitions and mergers* allows for a group reconstruction to be accounted for by using merger accounting. Under the principles of merger accounting, the carrying values of the assets and liabilities of the parties to the combination are not required to be adjusted to fair value on consolidation, although appropriate adjustments should be made to achieve uniformity of accounting policies in the combining entities. The net assets of MKW Limited of £12.3 million have been transferred into SEW Limited at net book value. The difference between the net book value transferred and the consideration paid by SEW Limited of nil has given rise to the merger reserve of £12.3 million.

## Notes to the Company financial statements

as at 31 March 2008

### 33. Merger of South East Water Limited (SEW Limited) and Mid Kent Water Limited (MKW Limited) (continued)

#### *Accounting for the merger (continued)*

SEW Limited and MKW Limited became entities under common control on 2 October 2006 and merger accounting has been applied from that date. As a result, the income statement comparative includes SEW Limited stand alone results until 2 October 2006 and the combined results of SEW Limited and MKW Limited from that date onwards.

#### *Net assets of MKW Limited transferred as at the date of common control*

<b>Balance sheet as at 2 October 2006</b>	£000
<b>Fixed assets</b>	
Tangible assets	204,353
<b>Current assets</b>	
Stocks	720
Debtors amounts falling due within one year	10,335
Cash at bank and in hand	13,405
	<u>24,460</u>
Creditors amounts falling due within one year	<u>(20,150)</u>
<b>Net current assets</b>	<u>4,310</u>
<b>Total assets less current liabilities</b>	<u>208,663</u>
Creditors amounts falling due after more than one year	(182,154)
Provision for liabilities	<u>(14,475)</u>
<b>Net assets excluding pension asset</b>	12,034
Defined benefit pension asset	<u>286</u>
<b>Net assets including pension asset</b>	<u>12,320</u>

### 34. Turnover

	2008 £000	2007 £000
Metered water income	87,220	73,158
Unmetered water income	74,776	55,630
Other sales	6,672	3,810
	<u>168,668</u>	<u>132,598</u>

All turnover is to customers within the United Kingdom

## Notes to the Company financial statements

as at 31 March 2008

### 35. Other operating income

	2008 £000	2007 £000
Rental income	1,314	803
Sundry income	5,029	4,465
	6,343	5,268

Sundry income includes charges for engineering, scientific, laboratory, billing and cash collection services

### 36. Operating costs

	Note	2008 £000	2007 £000
Non-salary operating costs charged to capital projects		(3,378)	(3,089)
Wages and salaries	37	19,640	13,363
Depreciation, other amounts written off fixed assets and non-exceptional profit on sale of fixed assets			
Depreciation			
- owned assets		31,469	25,636
- leased assets		508	507
- Impairment of tangible fixed assets		473	-
Non-exceptional profit on sale of fixed assets		(541)	(918)
Other operating charges			
Operating lease rentals			
- vehicles and office equipment		570	590
- land and buildings		517	499
Fee for audit of company financial statements		259	144
Other operating costs		55,254	50,572
		104,771	87,304
Merger costs		3,471	-
		108,242	87,304

#### **Merger costs**

Merger costs consist of redundancy and associated restructuring costs and legal and consulting costs in relation to the transfer of MKW Limited assets and liabilities to SEW Limited

The audit fees for the prior year include an amount of £79,000 paid to PriceWaterhouseCoopers LLP, as the previous auditors of the Company

## Notes to the Company financial statements

as at 31 March 2008

### 37. Directors and employees

The average monthly number of persons, including salaried directors, employed by the Company during the year was

	2008	2007
Operations	427	430
Management and administration	205	199
	<u>632</u>	<u>629</u>

The aggregate payroll costs of these persons were as follows

	Note	2008 £000	2007 £000
Wages and salaries		21,965	14,742
Social security costs		2,289	1,427
Pension costs	58	2,882	2,226
Other pension costs		286	108
		<u>27,422</u>	<u>18,503</u>
Less direct salary costs charged to capital projects and infrastructure renewals schemes		<u>(7,782)</u>	<u>(5,140)</u>
		<u>19,640</u>	<u>13,363</u>

Remuneration of directors

	2008 £000	2007 £000
Aggregate emoluments including bonuses	1,003	763
Compensation for loss of office	-	150
Company contributions to defined contribution scheme	-	5
Unfunded pension costs	259	235
	<u>1,262</u>	<u>1,153</u>

Retirement benefits are accruing to three directors (2007 three) under the defined benefit pension schemes and one director (2007 one) under a defined contribution scheme. Unfunded pension costs relate to former directors who no longer serve the Company (note 25)

Emoluments and compensation for loss of office of the highest paid director are as follows

	2008 £000	2007 £000
Aggregate emoluments including bonuses	202	206
Compensation for loss of office	-	150
Company contributions to defined contribution scheme	-	5
	<u>202</u>	<u>361</u>

## Notes to the Company financial statements

as at 31 March 2008

### 38. Interest receivable and similar income

	2008 £000	2007 £000
Interest receivable from group undertakings	15,484	13,415
On bank balances and short term deposits	670	636
	<u>16,154</u>	<u>14,051</u>

### 39. Interest payable and similar charges

	2008 £000	2007 £000
Debenture interest	1,089	1,085
On loans to group undertakings		
- interest	16,103	15,821
- fair value movements on interest rate swap	14,900	9,720
Bank interest and other finance charges	4,628	1,423
Interest payable on index linked loan	6,858	3,339
Indexation of interest payable on index linked loan	7,246	4,858
Financing guarantee fees	996	920
Interest payable on finance leases	716	861
Amortisation of issue costs	461	482
	<u>52,997</u>	<u>38,509</u>

### 40. Taxation

#### a) Analysis of tax charge for the period

	Note	2008 £000	2007 £000
Current tax			
UK Corporation tax on profits at 30%		9,482	6,183
Over provision in prior years		-	(514)
<b>Total current tax</b>		<u>9,482</u>	<u>5,669</u>
Deferred tax			
Origination and reversal of timing differences		(13,076)	(620)
Increase in discount		5,052	(1,891)
Deferred tax excluding pension scheme	49	(8,024)	(2,511)
Pension scheme	58	839	704
<b>Total deferred tax</b>		<u>(7,185)</u>	<u>(1,807)</u>
<b>Tax on profit on ordinary activities</b>		<u>2,297</u>	<u>3,862</u>

## Notes to the Company financial statements

as at 31 March 2008

### 40. Taxation (continued)

#### b) Factors affecting tax for the period

	2008 £000	2007 £000
Profit on ordinary activities before taxation	31,096	26,944
Profit on ordinary activities before taxation multiplied by the standard rate of tax of 30%	9,329	8,083
Effects of		
Expenses not deductible for tax purposes	(680)	6
Capital allowances exceeding depreciation	(265)	(1,757)
Other timing differences	71	(224)
Adjustment to tax charge in respect of previous periods	-	(514)
Timing difference on RPI indexation	1,827	930
FRS 17 pension adjustment tax effect	(858)	(697)
Other	58	(158)
<b>Current tax charge for the year</b>	<b>9,482</b>	<b>5,669</b>

#### c) Factors that may affect future tax charges

Capital investment is expected to remain at similar levels and the Company expects to be able to claim capital allowances in excess of depreciation in future years, allowing for any group relief arrangements within the HDF (UK) Holdings Limited group of companies

Changes in the medium and long-term interest rates used to discount deferred tax assets and liabilities will affect the amount of deferred tax charged in the profit and loss account

The UK corporation tax rate reduced from 30% to 28% from 1 April 2008. This rate change will affect the amount of future cash tax payments to be made by the Company and has also reduced the size of the Company's balance sheet deferred tax liability at 31 March 2008.

The Finance Bill 2008 proposed that from 1 April 2008 the rate of capital allowances applicable to plant and machinery expenditure will be reduced from 25% to 20% per annum on a reducing balance basis and the rate of allowances applicable to long life assets increases from 6% to 10% also on a reducing balance basis. If enacted, these changes to the capital allowances rates will impact the rate at which tax relief is received on capital expenditure.

The Finance Bill 2008 also proposed the phased abolition of industrial buildings allowances by 31 March 2011. It is estimated that the abolition of these tax allowances will cost the Company circa £6m of future tax relief. This number is subject to adjustment if the Company makes substantial acquisitions or disposals of buildings that qualify for industrial buildings allowances before 31 March 2011.

## Notes to the Company financial statements

as at 31 March 2008

### 41. Dividends

	Note	2008 £000	2007 £000
Equity dividends paid during the year			
First interim dividend of 158 07p per ordinary share (2007 322 5p per ordinary share)		15,952	16,420
Second interim dividend of nil per ordinary share (2007 317 1p per ordinary share)		-	16,143
Third interim dividend of 54 41p per ordinary share (2007 49 8p per ordinary share)		5,491	2,536
Final declared dividend of 94 63p per ordinary share (2007 191 5p per ordinary share)		9,550	9,748
		<u>30,993</u>	<u>44,847</u>

There were no dividends proposed for approval as at 31 March 2008 and 2007. At 31 March 2007, £1,268,000 dividends were unpaid. These dividends were paid in June 2007.

### 42. Fixed assets

#### *Tangible fixed assets*

	Land, wells, reservoirs and buildings £000	Mains £000	Plant, equipment and vehicles £000	Total £000
Cost				
At 1 April 2007	187,400	543,448	258,920	989,768
Reclassification	(1,363)	2,985	(1,622)	-
Additions	3,617	48,413	33,783	85,813
Disposals	(61)	-	(552)	(613)
Grants and contributions	(189)	(3,359)	-	(3,548)
At 31 March 2008	<u>189,404</u>	<u>591,487</u>	<u>290,529</u>	<u>1,071,420</u>
Depreciation				
At 1 April 2007	(28,586)	(184,394)	(112,778)	(325,758)
Charge for the year	(2,089)	(16,225)	(13,663)	(31,977)
Impairment loss	-	-	(473)	(473)
Eliminated on disposals	20	-	514	534
At 31 March 2008	<u>(30,655)</u>	<u>(200,619)</u>	<u>(126,400)</u>	<u>(357,674)</u>
Net book amount at 31 March 2008	<u>158,749</u>	<u>390,868</u>	<u>164,129</u>	<u>713,746</u>
Including - leased assets	5,159	706	10,065	15,930
- assets under construction	12,706	23,833	17,558	54,097
Net book amount at 31 March 2007	<u>158,814</u>	<u>359,054</u>	<u>146,142</u>	<u>664,010</u>
Including - leased assets	5,228	706	10,504	16,438
- assets under construction	16,499	10,180	12,776	39,455

## Notes to the Company financial statements

as at 31 March 2008

### 42 Fixed assets (continued)

The net book amount of land and buildings comprises

	2008 £000	2007 £000
Freehold	46,499	44,878
Long leaseholds	242	247
Short leaseholds	5	5
	46,746	45,130

The net book amount of infrastructure assets at 31 March 2008 is stated after the deduction of grants and contributions amounting to £84 million (2007 £81 million) in order to give a true and fair view

During the year, the sale of property with a net book amount of £4,000 (2007 £71,000) for proceeds of £241,000 (2007 £532,000) resulted in a profit recognised in the profit and loss account of £237,000 (2007 £461,000)

The impairment loss during 2008 of £473,000 arose on reducing the carrying value of works and asset management computer software to an estimate of its realistic value to the Company

### Investments

The carrying value of this investment in the Company is £100 (see note 15)

### 43. Stocks

	2008 £000	2007 £000
Consumables	408	433
Work in progress	235	257
	643	690

### 44. Debtors

	2008 £000	2007 £000
Trade debtors	12,219	13,791
Amounts due from parent and group undertakings	2,223	2,515
Corporation tax	138	137
Other debtors	3,516	2,569
Prepayments and accrued income	17,589	15,038
	35,685	34,050
Amounts due from parent and group undertakings due after more than one year	195,613	193,613
<b>Total debtors</b>	231,298	227,663

Trade receivables are stated after provision for doubtful debts of £15 million (2007 £13 million) They are non-interest bearing, generally on 30 days' terms and are shown net of a provision for impairment

Bad debts written off during the year totalled £961,000 (2007 £568,000)

## Notes to the Company financial statements

as at 31 March 2008

### 44. Debtors (continued)

At 31 March 2008 and 2007, the amounts due from parent and fellow subsidiary undertakings relate to interest and group tax relief

As at 31 March, the analysis of trade receivables that were past due but not impaired is as follows

	Total £000	Current £000	<30 days £000	30-60 days £000	60-90 days £000	90-120 days £000	>120 days £000
2008	12,219	(6,189)	4,350	2,445	1,732	449	9,432
2007	13,791	(4,508)	4,296	2,197	2,506	(311)	9,611

At 31 March 2008, the amounts due from parent and group undertakings due after more than one year comprise

- £190,013,000 (2007 £190,013,000) due from the parent company, falling due for repayment on 27 July 2034 and bearing interest at the rate of LIBOR plus 2%
- £5,600,000 (2007 £3,600,000) due from the subsidiary company, falling due for repayment on 27 July 2034 and bearing interest at the rate of LIBOR plus 2%

Amounts due within one year relate to interest and group tax relief

### 45. Creditors: amounts falling due within one year

	2008 £000	2007 £000
Obligations under finance leases (note 47 iii)	1,734	1,584
Trade creditors	13,756	10,316
Amounts due to parent and group undertakings	11,108	6,638
Payments received in advance	10,383	13,235
Other taxes and social security	655	605
Other creditors	2,343	848
Accruals	22,426	22,450
Approved Dividends	-	1,268
	<hr/> 62,405	<hr/> 56,944

At 31 March 2008 and 2007, amounts owed to parent and group undertakings represent unsecured non interest bearing balances including the surrender of group tax relief to the Company

## Notes to the Company financial statements

as at 31 March 2008

### 46. Creditors' amounts falling due after more than one year

		2008 £000	2007 £000
Irredeemable debenture stock	(i)	1,063	1,063
Redeemable debenture stock			
- between two and five years		3,500	3,500
- after five years		6,000	6,000
	(ii)	9,500	9,500
Obligations under finance leases	(iii)	8,509	10,243
Amounts due to group undertakings			
- fixed rate loans	(iv)	366,000	366,000
- RPI indexation	(v)	46,869	31,968
Less unamortised issue costs	(vi)	(4,810)	(5,137)
Index linked loans	(vii)	193,939	186,597
Other term loans and creditors	(viii)	75,198	55,800
Financing guarantee fees waived	(ix)	420	460
		677,616	635,688
<b>(i) Irredeemable debenture stock</b>			
3 % perpetual stock		26	26
3 ½ % perpetual stock		394	394
4 % perpetual stock		180	180
5 % perpetual stock		420	420
5 ½ % perpetual stock		3	3
6 ½ % perpetual stock		40	40
		1,063	1,063
<b>(ii) Redeemable debenture stock</b>			
12 % debenture stock 2010		3,500	3,500
11 % debenture stock 2012/2016		3,000	3,000
10 % debenture stock 2013/2017		3,000	3,000
		9,500	9,500

All debenture stocks, apart from the irredeemable stock, are redeemable at par in the year stated. Where more than one redemption year is quoted it is at the Company's option to redeem the stock at any time between the dates stated. Interest on irredeemable and redeemable debenture stock is payable six monthly. Redeemable debenture stock is secured on the future revenues of the Company.

## Notes to the Company financial statements

as at 31 March 2008

### (iii) Finance leases

The Company has finance lease contracts for various items of plant and machinery with an effective interest rate for 2008 and 2007 of 7.5%. The maturity of obligations under finance leases and hire purchase contracts is as follows

	2008 £000	2007 £000
Within one year	2,447	2,447
In second to fifth years	7,767	8,966
Over five years	2,665	3,996
	<hr/>	<hr/>
	12,879	15,409
Less future finance charges	(2,636)	(3,582)
	<hr/>	<hr/>
	10,243	11,827

Each finance lease is secured against the asset to which it relates, as far as allowed by the Water Industries Act 1991 and the Company's licence

### (iv) Amounts due to group undertakings – Fixed rate loans

The Company's subsidiary undertaking, South East Water (Finance) Limited has £366 million of debt listed on the London Stock Exchange which it on-lent to the Company. Under the loan agreement between the Company and South East Water (Finance) Limited, the latter on-lent an amount equal to each bond or other debt raised, at an interest rate 0.01% higher than the associated listed debt. The listed bonds are secured as far as allowed by the Water Industry Act 1991 and the Company's licence, against the assets of the South East Water (Holdings) Limited group, including the assets of the Company.

The terms of the £366 million loan due to South East Water (Finance) Limited are as follows

- £200 million at a variable rate linked to RPI inflation, falling due for repayment on 30 September 2019 (or earlier at the option of the Company)
- £166 million at a fixed effective rate of 5.7171%, falling due for repayment on 29 March 2029 (or earlier at the option of the Company)

### (v) Amounts due to group undertakings – RPI indexation

The RPI indexation on the £200 million variable rate loan due to South East Water (Finance) Limited falling due for repayment on 30 September 2019 (or earlier at the option of the Company) is stated at fair value of £46.9 million (2007: £32.0 million) in accordance with FRS 26. The movement of £14.9 million (2007: £9.7 million) has been charged to the profit and loss account as interest payable and similar charges (note 39).

### (vi) Unamortised issue costs

Issue costs incurred by the Company on behalf of its subsidiary undertaking in securing the long term borrowings, amounted to £6.0 million. These costs have been deducted from the amount of the consideration received and are being amortised at a constant rate on a pro rata basis over the 15 and 25 years to which the associated loans relate.

### (vii) Index linked loans

Index linked loans comprise two loans of £135 million and £34 million (2007: £135 million and £34 million). The £135 million index linked loan is stated after indexation uplift of £24.1 million (2007: £18.3 million) and the deduction of issue costs to be amortised over the life of the loan of £2.0 million (2007: £2.1 million). Cumulative issue costs of £435,000 (2007: £354,000) have been amortised to date. The £34 million index linked loan is stated after indexation uplift of £3.2 million (2007: £1.8 million) and the deduction of issue costs to be amortised over the life of the loan of £352,000 (2007: £365,000). Cumulative issue costs of £37,000 (2007: £24,000) have been amortised to date.

## Notes to the Company financial statements

as at 31 March 2008

### 46 Creditors: amounts falling due after more than one year (continued)

#### *(vii) Index linked loans (continued)*

The £135 million index linked loan is a 30 year facility repayable on 30 September 2032. The £34 million index linked loan is a 28 year facility repayable 30 September 2033. The loans are secured upon the assets of the Company. The £135 million loan increases each year in line with the Retail Price Index ("RPI") and additionally bears interest at 3.692% per annum. The £34 million also increases in line with RPI and bears interest at 2.801% per annum. The Company has the option to repay the indexed linked loans in total on giving the lenders notice of 30 days in respect of the £135 million loan and 10 day for the £34 million loan.

The loan agreements for the index linked loans also contain a number of covenants that the Company is required to meet to safeguard the interests of the lenders. The current position of the covenants and the required targets are detailed in the Directors report on page 6.

#### *(viii) Other term loans and creditors*

Other term loans and creditors comprise a bank loan of £73.8 million (2007 £55.8 million) and deposits received from developers. The bank loans are secured on the assets of the Company as far as allowed by the Water Industry Act 1991 and the South East Water Limited's licence and against the assets of the immediate parent company South East Water (Holdings) Limited, at a variable interest rate of LIBOR plus 0.45% with a maturity of 2 to 5 years.

#### *(ix) Financing guarantee fees*

Financing guarantee fees waived of £420,000 (2007 £460,000) comprise cash received in advance to settle fees waived in connection with the £200 million listed debt raised (see (iv)). The balance is being amortised over the life of the listed debt.

### 47. Financial instruments

#### *Financial risk management objectives and policies*

The Company's financial instruments comprise fixed and variable rate borrowings, index linked loans, fixed rate debentures, finance leases, cash, short-term deposits and trade receivables and trade and other payables. The main purpose of the Company's financial instruments is to raise finance for the Company's operations.

Derivative activity is undertaken as determined by the Board of Directors. The Board considers the overall risk profile of the Company and enters into derivatives to mitigate or hedge any risks identified, as appropriate. The Company does not use derivative financial instruments for speculative purposes.

The Company's treasury operations are managed within parameters defined by the Board and its parent undertaking. It is the Company's policy to minimise liquidity risk within an acceptable range of interest rates. The Company does not use foreign currency financial instruments. The main risks arising from the Company's financial instruments are interest rate and liquidity risk. There are no regulatory capital requirements placed on the Company.

#### *Interest rate and cash flow risk*

The Company finances its activities through a mixture of cash generated from operations, debenture loans, finance leases, long-term bonds and long-term index linked loans. Debentures are long-term fixed rate loans, bonds are long-term fixed rate loans of which £200 million have been linked to RPI inflation through the use of an interest rate swap. Index linked loans of £169 million are linked directly to RPI inflation. The linking of borrowing to RPI inflation reflects movements in the expected future income of the Company. Finance leases are both fixed and variable rate instruments. The Company's policy is to manage short-term interest rate risk by using a fixed rate loan facility. During the year to 31 March 2008 there were net drawings of £18.0 million by the Company (2007 £43.8 million) under these bank facilities (see note 46 (viii)). It is the view of the Company that long-term fluctuations in interest rates will be within the parameters that are considered acceptable by the Company.

## Notes to the Company financial statements

as at 31 March 2008

### 47. Financial instruments (continued)

#### *Interest rate and cash flow risk (continued)*

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, on the Company's profit before tax (through the impact on floating rate borrowings)

The sensitivity analysis excludes all non-derivative fixed rate financial instruments carried at amortised cost but includes those recognised at fair value as well as all non-derivative floating rate financial instruments

	Increase/ decrease in basis points	Effect on profit before tax £000	Effect on shareholders equity £000
<b>2008</b>			
Sterling	+50	(12,651)	(12,651)
Sterling	-50	12,651	12,651
<b>2007</b>			
Sterling	+50	(11,793)	(11,793)
Sterling	-50	11,793	11,793

#### *Inflation risk*

The Company manages its RPI inflation risk on its financial liabilities through the use of an interest rate swap and index linked loans (note 46) The Company considers that the inflation rate risk is effectively managed as the Water Services Regulation Authority ("OFWAT") allows revenues to be increased in line with the retail price index

#### *Liquidity risk*

The Company aims to maintain a balance between continuity of funding and flexibility Continuity of funding has been guaranteed throughout the period by the existence of long-term funding facilities Short-term flexibility is achieved by varying the drawdown amounts under these facilities Further details are given below and in note 46

Cash is put on deposit with variable maturity dates so as to mitigate liquidity risk

#### *Credit risk*

The Company's financial assets are loans and other amounts due from parent and other group undertakings, cash and trade receivables, which represent the Company's maximum exposure to credit risk in relation to financial assets The Company's credit risk is primarily attributable to its trade receivables, which are stated in the balance sheet at original invoice amount less an allowance for any doubtful debts An estimate for the provision for doubtful debts is calculated by the Company's management based on applying expected recovery rates to an aged debt profile and an assessment of current socio-economic conditions The Company has no significant concentration of credit risk, with exposure spread over a large number of domestic and commercial customers

## Notes to the Company financial statements

as at 31 March 2008

### 47. Financial instruments (continued)

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

In the opinion of the directors, the fair values of the financial assets and liabilities of the Company (apart from the specific items shown in the fair value table below) are not materially different from the book values

All fair values are based on arms length transactions in normal market conditions. The fair value of the Company's long term borrowings has been estimated based on quoted market prices for the same or similar debt where possible. Where prices did not exist, the fair value has been estimated based on the calculations of the present value of future cash flows using the appropriate discount rates in effect at the balance sheet dates.

The following tables provide a comparison by category of the carrying amount and the fair values of the Company's financial assets and financial liabilities at 31 March 2008. Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties.

	Book Value 2008 £000	Fair Value 2008 £000	Book Value 2007 £000	Fair Value 2007 £000
<i>Company's financial assets</i>				
Trade receivables	12,219	12,219	13,791	13,791
Cash	6,582	6,582	9,276	9,276
Short term deposits	-	-	10,662	10,662
Amounts due from parent and group undertakings	197,836	197,836	196,128	196,128
	<u>216,637</u>	<u>216,637</u>	<u>229,857</u>	<u>229,857</u>
	Book Value 2008 £000	Fair Value 2008 £000	Book Value 2007 £000	Fair Value 2007 £000
<i>Company's financial liabilities</i>				
Trade and other payables	13,756	13,756	10,316	10,316
Finance leases	10,243	11,051	11,827	12,522
Redeemable debentures	9,500	13,235	9,500	11,300
Irredeemable debentures	1,063	735	1,063	735
Listed bonds	366,000	381,049	366,000	379,415
Interest rate swap	46,869	46,869	31,968	31,968
Index linked loans	196,305	196,305	189,058	189,058
Other long-term financial liabilities	75,198	75,198	55,800	55,800
Amounts due to parent and group undertakings	11,108	11,108	6,638	6,638
	<u>730,042</u>	<u>749,306</u>	<u>682,170</u>	<u>697,752</u>

The fair value of long-term fixed rate debentures and fixed rate finance leases have been calculated using discounted cash flow methods using appropriate discount rates in effect at the balance sheet dates. The fair value of listed bonds has been calculated using year end quoted market prices.

## Notes to the Company financial statements

as at 31 March 2008

### 47. Financial instruments (continued)

For all other financial instruments, the net book value is considered to equate to the fair value

The net book value is considered to equate to the fair value for trade receivables and trade and other payables due to the short maturity of the amounts receivable and payable

For all other financial instruments the net book value is considered to equate to the fair value as future cash flows are discounted at the effective interest rate of the respective financial instrument

#### **Maturity of financial instruments**

The maturity profile of the carrying amount of the Company's financial instruments is as follows

Year ended 31 March 2008

	Within 1 year £000	1 – 2 years £000	2 – 5 years £000	More than 5 years £000	Total £000
<i>Fixed rate</i>					
Fixed rate financial liabilities					
Finance leases	793	854	2,976	2,385	7,008
Irredeemable debentures	-	-	-	1,063	1,063
Redeemable debentures	-	-	3,500	6,000	9,500
Listed bond	-	-	-	166,000	166,000
<b>Total fixed rate financial liabilities</b>	<b>793</b>	<b>854</b>	<b>6,476</b>	<b>175,448</b>	<b>183,571</b>
<i>Floating rate</i>					
Floating rate financial assets					
Short-term financial assets	18,801	-	-	-	18,801
Long-term financial assets	-	-	-	197,836	197,836
<b>Total floating rate financial assets</b>	<b>18,801</b>	<b>-</b>	<b>-</b>	<b>197,836</b>	<b>216,637</b>
Floating rate financial liabilities					
Finance leases	941	1,035	1,259	-	3,235
Short-term financial liabilities	38,245	-	-	-	38,245
Listed bond	-	-	-	246,869	246,869
Index linked loans	-	-	-	196,305	196,305
Other long-term financial liabilities	-	-	75,198	-	75,198
<b>Total floating rate financial liabilities</b>	<b>39,186</b>	<b>1,035</b>	<b>76,457</b>	<b>443,174</b>	<b>559,852</b>

The £200 million fixed rate instrument is classified as a floating rate financial liability due to the associated interest rate swap arrangement

## Notes to the Company financial statements

as at 31 March 2008

### 48. Financial instruments (continued)

#### Maturity of financial instruments (continued)

Year ended 31 March 2007

	Within 1 year £000	1 – 2 years £000	2 – 5 years £000	More than 5 years £000	Total £000
<i>Fixed rate</i>					
Fixed rate financial liabilities					
Finance leases	736	793	2,764	3,452	7,745
Irredeemable debentures	-	-	-	1,063	1,063
Redeemable debentures	-	-	3,500	6,000	9,500
Listed bond	-	-	-	166,000	166,000
<b>Total fixed rate financial liabilities</b>	<b>736</b>	<b>793</b>	<b>6,264</b>	<b>176,515</b>	<b>184,308</b>
<i>Floating rate</i>					
Floating rate financial assets					
Short-term financial assets	33,729	-	-	-	33,729
Long-term financial assets	-	-	-	196,128	196,128
<b>Total floating rate financial assets</b>	<b>33,729</b>	<b>-</b>	<b>-</b>	<b>196,128</b>	<b>229,857</b>
Floating rate financial liabilities					
Finance leases	848	937	2,297	-	4,082
Short-term financial liabilities	32,910	-	-	-	32,910
Listed bond	-	-	-	231,968	231,968
Index linked loans	-	-	-	189,058	189,058
Other long-term financial liabilities	-	-	55,800	-	55,800
<b>Total floating rate financial liabilities</b>	<b>33,758</b>	<b>937</b>	<b>58,097</b>	<b>421,026</b>	<b>513,818</b>

#### Borrowing facilities

The Company has access to borrowing facilities of £100 million (2007 £113.9 million), of which £73.8 million (2007 £55.8 million) was drawn down at 31 March 2008 and is due for repayment within 2 to 5 years (see note 20). Once drawn upon the remaining borrowing facility would have repayments due as follows:

Within 2 to 5 years	£26.2 million	(2007 £11.0 million)
After more than 5 years	£nil	(2007 £47.1 million)

## Notes to the Company financial statements

as at 31 March 2008

### 49. Provisions for liabilities

	Other provisions £000	Deferred tax £000	Total £000
At 1 April 2007	2,826	30,527	33,353
Credit to the profit and loss account	(387)	(8,024)	(8,410)
At 31 March 2008	2,439	22,503	24,942

Included in the deferred tax credit of £8,024,000 is an amount of £2,035,000 relating to the rate change from 30% to 28%

	2008 £000	2007 £000
<i>Deferred tax provision</i>		
Accelerated capital allowances Discount	99,244 (69,337)	111,030 (74,368)
Discounted accelerated capital allowances	29,907	36,662
Deferred income Discount	(1,634) 226	(1,974) 301
Discounted deferred income	(1,408)	(1,673)
RPI indexation Discount	(6,169) 1,027	(4,783) 931
Discounted RPI indexation	(5,142)	(3,852)
Other	(854)	(610)
Total undiscounted provision excluding deferred tax on pension liability	90,587	103,663
Total discount	(68,084)	(73,136)
	22,503	30,527

### 50. Deferred income

Non-infrastructure asset grants and contributions

	2008 £000	2007 £000
At 1 April	6,112	7,327
Received in the year	2,072	-
Released during the year	(933)	(1,215)
At 31 March	7,251	6,112

## Notes to the Company financial statements

as at 31 March 2008

### 51. Share capital

	2008 £000	2007 £000
<i>Authorised, called up, allotted and fully paid</i>		
10,091,548 ordinary shares of £1 each (2007 5,091,548)	10,092	5,092

There is one class of ordinary share, which carries no right of fixed income and no restrictions on dividends or capital repayment

Five million shares were issued and fully paid at par on 16 August 2007

### 52. Capital redemption reserve

	2008 £000	2007 £000
At 31 March	4,000	4,000

### 53. Profit and loss account

	£000
At 1 April 2007	128,827
Profit for the year	28,799
Dividends	(30,993)
Actuarial loss on pension scheme for the year	(11,496)
Movement on deferred tax relating to pension deficit	3,219
Profit/(loss) for the year	(10,471)
<b>At 31 March 2008</b>	<b>118,356</b>

### 54. Reconciliation of movements in equity shareholders' funds

	2008 £000	2007 £000
Opening shareholders' funds	150,239	153,994
Profit for the year	28,799	23,082
Dividends	(30,993)	(44,847)
Actuarial gain on pension scheme for the year	(11,496)	8,129
Movement on deferred tax relating to pension deficit	3,219	(2,439)
Merger reserve	-	12,320
Shares issued	5,000	-
Net movement on shareholders' funds	(5,471)	(3,755)
<b>Closing shareholders' funds</b>	<b>144,768</b>	<b>150,239</b>

## Notes to the Company financial statements

as at 31 March 2008

### 55. Reconciliation of operating profit to net cash inflow from operating activities

	2008 £000	2007 £000
Operating profit post merger costs	66,769	50,562
Depreciation	32,450	26,143
Profit on disposal of fixed assets	(541)	(918)
Amortisation of infrastructure charges	(933)	(1,215)
Decrease in stocks	47	94
Increase in trade and other debtors	(1,649)	(2,608)
Increase in creditors	3,872	4,868
Pension costs less contributions	(889)	(1,431)
<b>Net cash inflow from operating activities</b>	<b>99,126</b>	<b>75,495</b>

### 56. Analysis of movement in net debt

	At 1 April 2007 £000	Cash flow £000	Other non-cash changes £000	At 31 March 2008 £000
Cash at bank and in hand	19,938	(13,356)	-	6,582
Irredeemable debenture stock	(1,063)	-	-	(1,063)
Redeemable debenture stock	(9,500)	-	-	(9,500)
Obligations under finance leases	(11,827)	1,584	-	(10,243)
Amounts due to group undertakings				
- fixed rate loans	(535,000)	-	-	(535,000)
- RPI indexation	(52,026)	-	(22,148)	(74,174)
Less unamortised issue costs	7,598	79	(501)	7,176
Group loans	193,613	2,000	-	195,613
Other term loans	(55,800)	(18,000)	-	(73,800)
<b>Net borrowings</b>	<b>(464,005)</b>	<b>(14,337)</b>	<b>(22,649)</b>	<b>(500,991)</b>
<b>Net debt</b>	<b>(444,067)</b>	<b>(27,693)</b>	<b>(22,649)</b>	<b>(494,409)</b>

### 57. Commitments and contingent liabilities

#### a) Capital commitments

	2008 £000	2007 £000
Contracts placed for future capital expenditure not provided in the financial statements	22,371	21,144

## Notes to the Company financial statements

as at 31 March 2008

### 57. Commitments and contingent liabilities (continued)

#### b) Operating lease commitments

The Company's commitments in respect of non-cancellable operating leases for land and buildings and other operating leases are as follows

	Land and buildings 2008 £000	Land and buildings 2007 £000	Vehicles and office equipment 2008 £000	Vehicles and office equipment 2007 £000
Amounts due next year on operating leases expiring				
- within one year	-	-	9	106
- between two and five years	21	21	372	429
- after more than five years	477	477	-	-
	<u>498</u>	<u>498</u>	<u>381</u>	<u>535</u>

### 58. Pensions

The South East Water pension scheme provides benefits to company and other former company employees on either a defined benefit basis or a defined contribution basis depending on the category of membership. The scheme was originally contracted-out under the Guaranteed Minimum Pension Test. After taking independent actuarial advice, at 6 April 1997 the Company decided to contract-out via the Protected Rights Test. The final salary defined benefit section of the scheme was closed to new entrants with effect from July 2002.

The last full actuarial valuation of the scheme took place as at 31 March 2005, which has been updated to 31 March 2008 by a qualified independent actuary.

The Company contribution rate was 30% of pensionable remuneration during the year.

As a result of the merger of SEW Limited and MKW Limited, the Company has acquired the Mid Kent Group Pension Scheme, which is a defined benefit scheme in the UK.

A full actuarial valuation was carried out for the Mid Kent Group Pension Scheme as at 31 March 2005 and updated to 31 March 2008 by a qualified independent actuary. The service cost has been calculated using the Projected Unit method.

The Company contributed 22% of pensionable remuneration plus £352,000 in respect of the deficit as at 31 March 2005 to the scheme in the year to 31 March 2008.

The Company also provides unfunded defined pension benefits to some former directors where directors' pensions are paid directly from company funds.

Pension costs recognised in the profit and loss account for the defined contribution scheme were as follows

	2008 £000	2007 £000
Defined contribution scheme	<u>72</u>	<u>41</u>

## Notes to the Company financial statements

as at 31 March 2008

### 58 Pensions (continued)

The major assumptions used for the actuarial valuations were

	SEW Pensions 2008 %	SEW Pensions 2007 %	SEW Pensions 2006 %	MKW Pensions 2008 %	MKW Pensions 2007 %	MKW Pensions 2006 %
<i>Main assumptions</i>						
Rate of increase in salaries	4.50	4.20	4.00	4.50	4.00	3.75
Rate of increase in pensions in payment	3.50	3.20	3.00	3.50	3.00	2.75
Rate of increase in deferred pensions	3.50	3.20	3.00	3.50	3.00	2.75
Discount rate	6.30	5.40	4.90	6.30	5.50	5.00
Inflation assumption	3.50	3.20	3.00	3.50	3.00	2.75

### Post-retirement mortality (in years)

	SEW Pensions 2008	SEW Pensions 2007	MKW Pensions 2008	MKW Pensions 2007
Current pensioners at 60 – male	27.3	25.5	-	-
Current pensioners at 60 – female	29.6	28.5	-	-
Future pensioners at 67 – male	19.9	17.9	-	-
Future pensioners at 67 – female	22.1	20.9	-	-
Current pensioners at 65 – male	-	-	22.0	18.9
Current pensioners at 65 – female	-	-	24.8	21.7
Future pensioners at 65 – male	-	-	23.4	20.5
Future pensioners at 65 – female	-	-	26.2	23.2

The fair value of the assets in the schemes, the present value of the liabilities in the schemes and the expected rate of return at the balance sheet date were

	SEW Pensions		MKW Pensions		Total £000
	Expected long term rates of return %	Market Value £000	Expected long term rates of return %	Market Value £000	
2008					
Equities	7.60	58,897	7.30	37,860	96,757
Bonds	6.30	18,423	6.60	11,256	29,679
Index linked gilts	4.50	11,333	4.30	26,663	37,996
Property	5.70	14,541	-	-	14,541
Cash	5.00	144	5.00	62	206
Total fair value of assets		103,338		75,841	179,179
Present value of schemes' liabilities		(127,388)		(74,312)	(201,700)
Surplus/(deficit) in the schemes		(24,050)		1,529	(22,521)
Related deferred tax asset/(liability)		6,734		(428)	6,306
Net pension asset/ liability		(17,316)		1,101	(16,215)

## Notes to the Company financial statements

as at 31 March 2008

### 58. Pensions (continued)

	SEW Pensions		MKW Pensions		Total £000
	Expected long term rates of return %	Market Value £000	Expected long term rates of return %	Market Value £000	
<i>2007</i>					
Equities	7.60	66,418	6.80	39,133	105,551
Bonds	5.40	19,701	5.20	11,183	30,884
Index linked gilts	4.50	10,956	4.30	26,977	37,933
Property	7.60	16,442	-	-	16,442
Cash	5.25	291	4.25	123	414
Total fair value of assets		113,808		77,416	191,224
Present value of schemes' liabilities		(130,807)		(73,504)	(204,311)
Surplus/(deficit) in the schemes		(16,999)		3,912	(13,087)
Related deferred tax asset		5,102		(1,174)	3,928
Net pension asset/ liability		(11,897)		2,738	(9,159)
<i>2006</i>					
Equities	7.30	66,600	6.50	39,301	105,901
Bonds	4.90	19,600	4.70	11,017	30,617
Index linked gilts	4.20	11,100	4.00	25,096	36,196
Property	7.30	10,900	-	-	10,900
Cash	4.50	400	4.50	123	523
Total fair value of assets		108,600		75,537	184,137
Present value of schemes' liabilities		(132,600)		(74,287)	(206,887)
Surplus/(deficit) in the schemes		(24,000)		1,250	(22,750)
Related deferred tax asset		7,200		(375)	6,825
Net pension asset/ liability		(16,800)		875	(15,925)

## Notes to the Company financial statements

as at 31 March 2008

### 58. Pensions (continued)

Analysis of amounts charged to operating profit

	SEW Pensions £000	MKW Pensions £000	Total £000
<i>2008</i>			
Current service cost	(1,474)	(782)	(2,256)
Past service cost	(323)	(244)	(567)
Curtailment credit/(cost)	332	(391)	(59)
Total operating charge	<u>(1,465)</u>	<u>(1,417)</u>	<u>(2,882)</u>

*2007*

Current service cost	<u>(1,750)</u>	<u>(476)</u>	<u>(2,226)</u>
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Analysis of amounts credited to other finance income

	SEW Pensions £000	MKW Pensions £000	Total £000
<i>2008</i>			
Expected return on pension schemes' assets	7,806	4,351	12,157
Interest on pension schemes' liabilities	(6,990)	(3,997)	(10,987)
Net credit to other finance income	<u>816</u>	<u>354</u>	<u>1,170</u>

*2007*

Expected return on pension schemes' assets	7,057	2,028	9,085
Interest on pension schemes' liabilities	(6,431)	(1,814)	(8,245)
Net credit to other finance income	<u>626</u>	<u>214</u>	<u>840</u>

Analysis of amounts recognised in the statement of total recognised gains and losses (STRGL)

	SEW Pensions £000	MKW Pensions £000	Total £000
<i>2008</i>			
Actual return less expected return on pension schemes' assets	(16,442)	(3,898)	(20,340)
Experience gains and losses arising on the schemes' liabilities	7,664	3,886	11,550
Changes in financial assumptions underlying the schemes' liabilities	-	(2,706)	(2,706)
Actuarial loss recognised in the statement of total recognised gains and losses	<u>(8,778)</u>	<u>(2,718)</u>	<u>(11,496)</u>

## Notes to the Company financial statements

as at 31 March 2008

58. Pensions (continued)

	SEW Pensions £000	MKW Pensions £000	Total £000
<i>2007</i>			
Actual return less expected return on pension schemes' assets	(490)	(159)	(649)
Experience gains and losses arising on the schemes' liabilities	5,575	(410)	5,165
Changes in financial assumptions underlying the schemes' liabilities	-	3,613	3,613
Actuarial gain recognised in the statement of total recognised gains and losses	5,085	3,044	8,129
<b>Movements in surplus/deficit during the period</b>			
	SEW Pensions £000	MKW Pensions £000	Total £000
<i>2008</i>			
Surplus/(deficit) in schemes at the beginning of the year	(16,999)	3,912	(13,087)
Movements in the year			
Current service costs	(1,475)	(782)	(2,257)
Past service costs	(323)	(244)	(567)
Curtailment costs	332	(391)	(59)
Contributions	2,324	1,398	3,722
Net return	816	354	1,170
Other income	53	-	53
Actuarial loss	(8,778)	(2,718)	(11,496)
(Deficit)/surplus in schemes before deferred taxation	(24,050)	1,529	(22,521)
Deferred taxation	6,734	(428)	6,306
(Deficit)/surplus in schemes at the end of the year	(17,316)	1,101	(16,215)
<i>2007</i>			
Deficit in schemes at the beginning of the year	(23,974)	-	(23,974)
Transferred due to merger	-	409	409
Movements in the year			
Current service cost	(1,750)	(476)	(2,226)
Contributions	2,971	721	3,692
Net return	626	214	840
Other income	47	-	47
Actuarial gain	5,081	3,044	8,125
(Deficit)/surplus in schemes before deferred taxation	(16,999)	3,912	(13,087)
Deferred taxation	5,102	(1,174)	3,928
(Deficit)/surplus in schemes at the end of the year	(11,897)	2,738	(9,159)

## Notes to the Company financial statements

as at 31 March 2008

### 58. Pensions (continued)

History of experience gains and losses

	2008	2007	2006	2005	2004
<i>SEW Pensions</i>					
Difference between the expected and actual return on schemes' assets					
Amount £000	(16,442)	(490)	13,923	1,543	2,806
Percentage of schemes' assets	(15.9)%	(0.4)%	12.8%	1.7%	3.0%
Experience gains and losses on schemes' liabilities					
Amount £000	409	(30)	5,645	170	21
Percentage of the present value of the Schemes' liabilities	(0.3)%	0.0%	4.3%	0.1%	0.0%
Total amount recognised in statement of total recognised gains and losses					
Amount £000	7,664	5,571	(3,913)	(11,094)	(4,725)
Percentage of the present value of the Schemes' liabilities	6.0%	4.3%	(3.0)%	(8.9)%	(4.0)%

### *MKW Pensions*

Difference between the expected and actual return on schemes' assets

Amount £000	(3,898)	(359)	9,229	2,317	8,565
Percentage of schemes' assets	(5)%	0%	12%	4%	14%
Experience gains and losses on schemes' liabilities					
Amount £000	3,886	(860)	(119)	2,686	-
Percentage of the present value of the Schemes' liabilities	5%	(1)%	0%	4%	0%
Total amount recognised in statement of total recognised gains and losses					
Amount £000	(2,718)	1,804	3,544	3,826	5,631
Percentage of the present value of the Schemes' liabilities	(4)%	2%	5%	6%	8%

Deferred tax asset on pension liability

	Note	SEW Pensions £000	MKW Pensions £000	Total £000
At 1 April 2007		5,100	(1,174)	3,926
Charge to statement of total recognised gains and losses		2,458	761	3,219
Charge to profit and loss	45	(484)	(93)	(577)
Effect of rate change		(340)	78	(262)
At 31 March 2008		6,734	(428)	6,306

## Notes to the Company financial statements

as at 31 March 2008

### 58. Pensions (continued)

Also, as a result of the merger of SEW Limited and MKW Limited, the Company acquired Mid Kent Water Pension & Life Assurance Scheme, a further defined benefit scheme in the UK, which has been closed since 1997. For the year ended 31 March 2008 no contributions were made to the scheme by the Company or any members. As the surplus on the scheme is not available to the Company for the foreseeable future, the assets and liabilities of the scheme have not been included into the financial statements of the Company. The effect on the Company's financial statements if this scheme's assets and liabilities were to be included is detailed below.

The most recent actuarial valuation of the scheme was carried out as at 31 January 2007 and has been updated to 31 March 2008 to take account of the requirements of FRS 17. The service cost has been calculated using the Projected Unit method. The principal assumptions used by the actuary together with the assumptions used at 31 March 2007 and 31 March 2006 were as those used for the Mid Kent Group Pension Scheme.

The assets in the scheme and the expected rates of return were

	2008		2007		2006	
	Long term rate of return	Value at 31 March £000	Long term rate of return	Value at 31 March £000	Long term rate of return	Value at 31 March £000
Equities	7.30%	7	6.50%	8	6.50%	3
Fixed interest bonds	6.60%	389	4.30%	373	4.30%	369
Index linked bonds	4.30%	428	4.00%	381	4.00%	376
Total market value of assets		824		762		748
Present value of liabilities		(66)		(65)		(65)
Surplus in the scheme		758		697		683

	2008 £000	2007 £000
<i>Movement in surplus during the year</i>		
Surplus in the scheme at 1 April	697	683
Movement for the year		
Charge to operating profit	(5)	(5)
Credit to other financial income	28	28
Actuarial gain/(loss)	38	(9)
<b>Surplus in scheme at 31 March</b>	<b>758</b>	<b>697</b>
<i>Analysis of amount charged to operating profit</i>		
Current service cost	5	5
<i>Analysis of amounts credited to other financial income</i>		
Expected return on scheme assets	32	31
Interest on scheme liabilities	(4)	(3)
<b>Net credit</b>	<b>28</b>	<b>28</b>

## Notes to the Company financial statements

as at 31 March 2008

### 58 Pensions (continued)

	2008 £000	2007 £000		
<i>Analysis of amount recognised in Statement of Total Recognised Gains and Losses</i>				
Actual return less expected return on scheme assets	35	(12)		
Experience gain arising on scheme liabilities	2	2		
Gain arising from changes in assumptions underlying the present value of the scheme liabilities	1	1		
Actuarial gain recognised	38	(9)		
<b>History of experience gains and losses</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
<i>Difference between expected and actual return on scheme assets</i>				
Amount (£'000s)	35	(12)	37	25
Percentage of scheme assets	4%	2%	5%	4%
<i>Experience gains and losses on scheme liabilities</i>				
Amount (£'000s)	2	2	1	1
Percentage of scheme liabilities	3%	3%	2%	2%
<i>Total amount recognised in statement of total recognised gains and losses</i>				
Amount (£'000s)	38	(9)	38	26
Percentage of scheme liabilities	58%	13%	58%	43%

### 59. Related party transactions

As a wholly owned subsidiary of HDF (UK) Holdings Limited since 2 October 2006, the Company has taken advantage of the exemption under FRS 8 *Related Party Disclosures* not to provide information on related party transactions with other companies within the HDF (UK) Holdings Limited group

Until 2 October 2006 Macquarie Bank Limited was a related party by virtue of its non-controlling stake in the Hastings Water (UK) Limited group. During the period from 1 April 2006 to 2 October 2006 Macquarie Bank Limited charged fees to the Company of £1.0 million for corporate and financial services. No amounts were outstanding at the year end.

### 60. Parent company and ultimate controlling parties

On 2 October 2006 Utilities of Australia Pty Limited as Trustee for the Utilities Trust of Australia and Hastings Funds Management Limited as Responsible Entity for the Hastings Diversified Utilities Fund became the Company's joint ultimate holding companies. Both of these holding companies are resident in Australia and it is the directors' belief that they now control the Company jointly.

The immediate parent company is South East Water (Holdings) Limited.

The largest group of companies into which results of the Company are consolidated is that headed by HDF (UK) Holdings Limited, a company registered in England and Wales. The consolidated financial statements of South East Water Limited and HDF (UK) Holdings Limited may be obtained from the Company Secretary, Rocfort Road, Snodland, Kent, ME6 5AH.