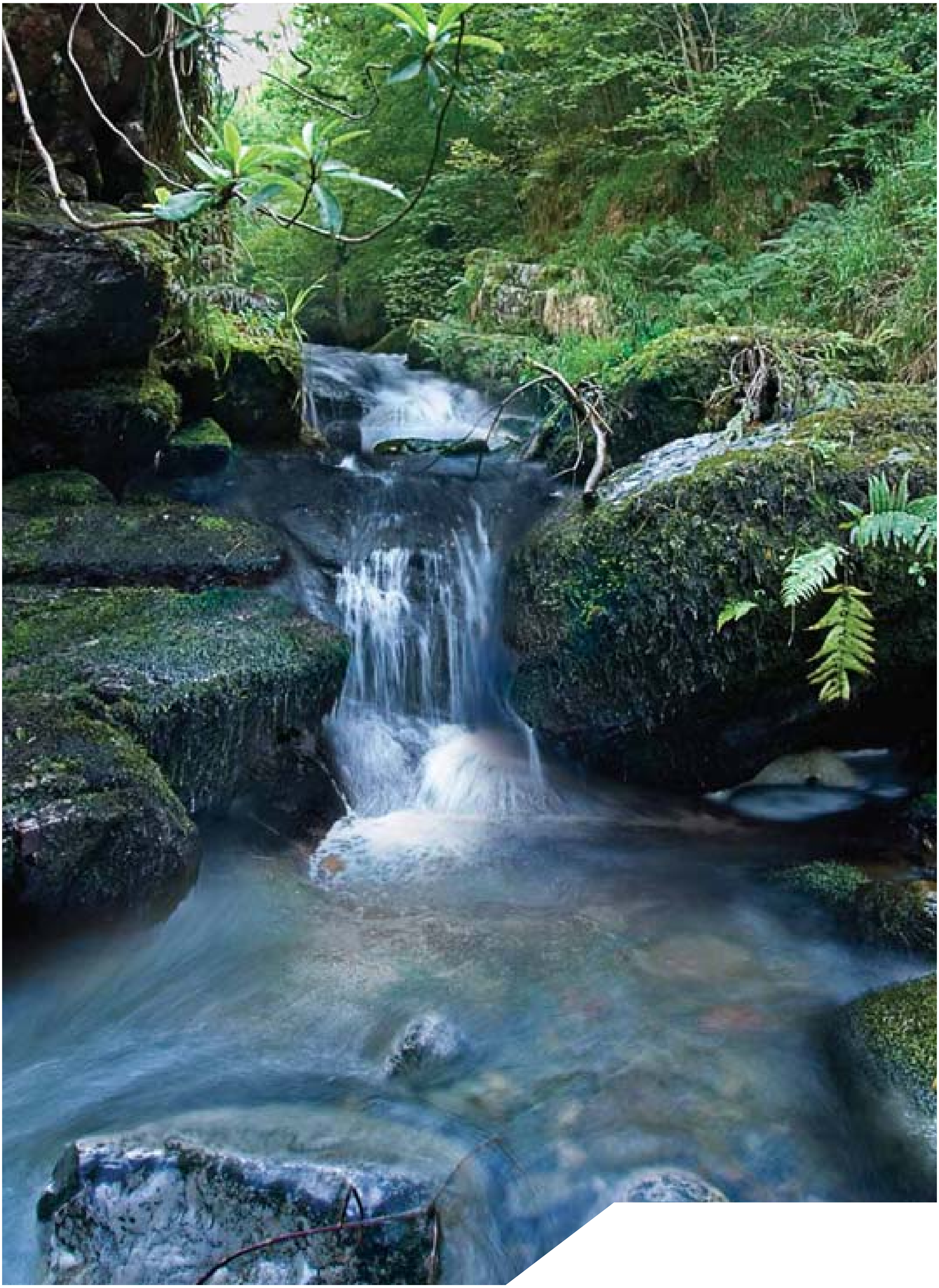


ANNUAL REPORT & ACCOUNTS 2008

Pennon Group Plc

Contents

Photographs marked with this symbol were from entries in the 2007 Pennon Environmental Photographic Competition by employees and their families.

Cover photo: Waterfall at Watersmeet, Exmoor – photography by Rob Kendall
Above: Respryn, Lanhydrock, Bodmin – photography by Dave Bridges

REVENUE UP 16.9% TO £875.0 MILLION

UNDERLYING OPERATING PROFIT UP 19.8% TO £242.1 MILLION

UNDERLYING PROFIT BEFORE TAX UP 16.3% TO £154.9 MILLION

UNDERLYING EARNINGS PER SHARE UP 19.4% TO 36.9P

DIVIDEND PER SHARE UP 6.8% TO 19.81P

A reconciliation to underlying measures of performance is given on page 28. Statutory results are:

- operating profit £236.8 million (2006/07 £200.0 million)
- profit before tax £149.6 million (2006/07 £131.1 million)
- earnings per share 38.2p (2006/07 26.5p).

PENNON GROUP OPERATES AND INVESTS IN WATER AND SEWERAGE SERVICES AND WASTE MANAGEMENT. IT HAS ASSETS OF AROUND £3.5 BILLION AND A WORKFORCE OF OVER 3,300 PEOPLE.

Pennon Group's business is operated through two main subsidiaries:

- South West Water Limited holds the water and sewerage appointments for Devon, Cornwall and parts of Dorset and Somerset
- Viridor Limited is one of the leading waste management and renewable energy businesses in the United Kingdom.

PENNON GROUP BOARD'S STRATEGY is to promote the success of the Group for the benefit of its shareholders through its focus on water and sewerage services and waste management.

In pursuit of its strategy the Group aims to be a pre-eminent provider of customer services to high standards of quality, efficiency and reliability whilst having regard to a wide range of matters including:

- the impact of its operations and activities on the community and the environment
- maintaining high standards of business conduct
- the need to foster business relationships with suppliers, customers and other key persons important to the success of the Group
- the likely long-term consequences of any decisions
- the interests of employees.

Chairman's statement

Ken Harvey
Chairman
Pennon Group Plc

Another excellent year for the Group – we are continuing to deliver the benefits of our strategy of focusing on our two key businesses of South West Water and Viridor.

FINANCIAL OVERVIEW

Group revenue increased by 16.9% to £875.0 million with operating profit up 19.8% to £242.1 million. Profit before tax was up 16.3% to £154.9 million and earnings per share were 36.9p, an increase of 19.4% (all figures being underlying results as explained on page 28).

The Board is recommending a final dividend of 13.56p which, together with the interim dividend of 6.25p, will result in a total dividend for the year of 19.81p. This represents an increase of 6.8% on the total dividend for the previous year. The Board's stated policy is to grow the Group dividend to 2009/10 by 3% above inflation per annum. Shareholders will again be given an opportunity to participate in the Company's Dividend Re-investment Plan, details of which will be circulated in August.

In the year Group capital expenditure was £228.8 million (2006/07 £245.1 million) and net borrowings at 31 March 2008 were £1,763.8 million, an increase of £206.5 million over the year. Gearing, being net borrowings to shareholders' funds plus net borrowings, was 73% (2007 71%). Interest cover was 2.8 times (2006/07 2.9 times). South West Water's net debt to Regulatory Capital Value (RCV) was 60% (2007 62%).

SOUTH WEST WATER

South West Water's revenue increased by £39.5 million to £421.0 million and operating profit rose 17.8% to £185.0 million. Operating costs, excluding depreciation, increased by £4.3 million to £151.0 million. This arose from inflation of £2.3 million (net of a reduction in power costs of £2.5 million), the additional costs from new capital schemes of £1.1 million, reduced property disposals of £2.6 million and other cost increases of £2.5 million (including infrastructure expenditure charged to operating costs), partially offset by £4.2 million of efficiency savings.

In the 'Water and Sewerage Companies' and 'All Companies' league tables for 2006/07 covering the wide range of measures used by Ofwat, referred to as the Overall Performance Assessment (OPA), South West Water achieved a best ever ranking of fifth out of 10 amongst the water and sewerage companies, compared with sixth place in 2005/06. Ofwat's 'Financial Performance and Expenditure' report, published in September 2007, reported that the company was the only water and sewerage company to achieve a 'stable' serviceability assessment in all four service areas in 2006/07.

South West Water is implementing detailed plans to target outperformance of the operating cost efficiency targets set by Ofwat for the period up to 2010. Further efficiency projects are under way to enable further improvements to operational and customer service performance. The company is continuing to deliver efficiencies through investment in infrastructure to move the organisation towards a more centralised operational structure employing increased levels of automation and remote working. The company also has an ongoing programme of organisational restructuring across the business.

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

The RCV of South West Water is expected to grow by 36% over the current regulatory period to March 2010 – the highest forecast percentage increase of any quoted UK water company. After adjusting for the effect of the 2006 capital return to shareholders, the company expects its growth in RCV to outstrip significantly the anticipated growth in net borrowings over the period.

As part of its preparation for the next Periodic Review in 2009, South West Water last December published its Strategic Direction Statement setting out its vision for the next 25 years. This Statement outlines the first steps the company proposes to take towards facing the challenges of the future, including climate change and new legislative requirements. The draft Water Resources Plan published in May 2008 affirms that, despite a forecast 12% regional population increase by 2035 and new challenges created by climate change, no new reservoirs will need to be built in the region. Instead the Plan describes several new water conservation proposals

Pennon Group focus

The further significant profitable growth achieved in the year is testament to the Board's strategy of focusing on its key business areas.

- Right: Restored landfill site, Heathfield
- Far right: Wimbleball Lake

to manage demand efficiently and to improve future water availability, including further strengthening of the company's existing infrastructure.

VIRIDOR

Viridor traded particularly strongly during the year, building further on the growth achieved over the past six years. Revenue was up £87.4 million (23.8%) to £455.1 million, of which acquisitions accounted for £35.0 million and existing business £52.4 million. The total increase included landfill tax of £26.2 million. Viridor's earnings before interest, tax, depreciation and amortisation (EBITDA) for the year increased by 22.0% to £101.0 million. This increase included a full year's contribution from last year's Wyvern Waste and Skipaway acquisitions, the positive effect of this year's acquisition of Grosvenor Waste Management and 12.2% of organic growth.

Total landfill disposal volumes grew strongly and were 11% higher compared with the previous year. Landfill gas power generation output also increased by a further 13% with power generation capacity now 84 Megawatt (MW) compared with 75MW at the previous year end. Viridor collects nearly 90% of the estimated total methane generated by its landfill sites and uses the majority of this for energy generation. This has the double environmental benefit of reducing emissions of methane to the atmosphere (methane is 21 times more harmful than CO_2 as a greenhouse gas) and generating renewable energy. Whilst consented landfill void fell from 90 million cubic metres to 84 million cubic metres at the year end, reflecting usage, planning consents for additional void of 2.4 million cubic metres were gained after the year end.

As part of its overall strategy Viridor is pursuing a number of energy from waste (EfW) opportunities. The Lakeside joint venture with Grundon Waste Management involves capital expenditure of £160 million for the construction of an EfW plant at Colnbrook near Heathrow with a capacity of 410,000 tonnes and up to 37MW. Construction is advanced and a profit contribution is expected in 2009/10. Last summer Viridor also achieved planning permissions for a 60,000 tonne and 3MW EfW plant in Exeter and it is pursuing other possible long-term EfW opportunities in Cardiff and Dunbar.

As Private Finance Initiative (PFI) and Public Private Partnership (PPP) contracts are also a key part of Viridor's strategy, it continues to bid selectively for further integrated municipal contracts. It was reported last year that the Viridor/Laing consortium had achieved preferred bidder status on the Greater Manchester PFI, the UK's largest waste contract. Financial close on this contract is expected shortly. Viridor also continues to bid selectively for other contracts elsewhere in the UK.

STRATEGY AND PROSPECTS

The Board's priority continues to be the creation of shareholder value through its strategic focus on water and sewerage services and waste management. The further significant profitable growth achieved in the year is testament to the Board's strategy of focusing on these key business areas.

The Board remains confident that South West Water will successfully deliver the current regulatory contract and significantly grow its RCV up to 2010. Viridor's successful strategy to create long-term sustainable profit growth is expected to continue through capitalising on its landfill asset base, maximising its renewable energy generation from landfill gas and energy from waste and pursuing profitable opportunities in line with the Government's landfill diversion and recycling targets.
In addition the Group has put in place a long-term funding structure to enable it to continue to finance its activities efficiently.

BOARD MATTERS

There have been no changes to the Board during the year. We have continued to strengthen our corporate governance to ensure best practice is applied throughout the Group in terms of risk management and corporate responsibility in the interests of our shareholders, employees and all other key groups important to the success of the Group.

EMPLOYEES

During the period I have been Chairman there have been many changes and developments in the Group, throughout which employees have continued to be loyal and committed and have carried out their work with a high standard of professionalism. I thank them most sincerely for their continuing support. My personal thanks also go to the Executive Directors and Non-executive Directors for their significant contributions during what has been another successful and demanding year.

KEN HARVEY, Chairman
Pennon Group Plc
26 June 2008

South West Water

Chris Loughlin
Chief Executive
South West Water Limited

It has been another successful year for South West Water. Improvements have been made to both operational and customer service whilst providing a satisfactory return for shareholders.

OVERVIEW

This year South West Water has been laying the foundations for the future. Our vision 'Pure Water, Pure Service and Pure Environment' was launched during 2007 and is being used as the basis for our plans over the next 25 years.

The vision defines the following aspirations for South West Water:

- Pure Water – investment in maintaining our assets to give our customers the highest quality drinking water
- Pure Service – improving the services that customers experience
- Pure Environment – delivering sustainable sewerage services for the region's benefit.

Underpinning the vision is the strategy of striking the right balance between investing to improve our services, financeability and, importantly, customer affordability.

We must meet ongoing regulatory requirements. The Government's new water strategy for England, 'Future Water', was published in February 2008. The themes of the South West Water vision are echoed in the Government's strategy and the key challenges of addressing future requirements for water supply and demand; water quality in our natural environment; the impacts of climate change; and tackling customer affordability, form a significant part of our strategy.

The new vision and strategy for South West Water formed the basis of our early work in preparation for the next Periodic Review due in 2009.

- in December 2007 we published our Strategic Direction Statement which sets out our aspirations and the challenges we face in pursuing our Pure Water, Pure Service and Pure Environment vision over the next 25 years
- in March 2008 we issued our draft Water Resources Plan, which sets out our strategy to ensure that all customers have a secure supply of water for the next 25 years.

Developing the 'Pure' framework has assisted South West Water in focusing on delivering a strong performance over the past 12 months.

We have made excellent progress with our focused objectives of:

- improving service to customers and tackling affordability issues
- completing required investment in our assets and infrastructure for the benefit of our customers and the environment
- improving operating efficiencies.

Delivery against our long-term aspirations set out in our vision has already started.

PURE WATER

To progress the Pure Water vision, there have been a number of key achievements during the year:

- this has been our 11th consecutive year without water restrictions. Persistent rain during the summer months, followed by below average rainfall during the winter months, have tested our supply/demand resilience. The company has put in place a comprehensive strategy to help ensure a continued secure supply of water for the region. Customer satisfaction with the reliability of the supply received from South West Water is at its highest ever level of 94%
- projects have been delivered to modernise our infrastructure, such as a major upgrade for Littlehempston Water Treatment Works, which serves 160,000 homes in Torbay and South Devon
- we achieved our target of keeping leakage at or below 84Ml/d. We have achieved or beaten our leakage target in every year since targets were introduced by Ofwat in 1999/2000
- one of the most significant elements of the current investment programme (2005-2010) is water mains rehabilitation. A further 479.9km of water mains were replaced or relined during the year as part of the company's ongoing 'Putting the Sparkle Back into Your Water' programme, agreed with the Drinking Water Inspectorate (DWI) for completion by 2010. Four key programme milestones have now been successfully achieved. Work to meet the fifth and final milestone is under way and is due to be completed before 2010
- drinking water quality overall compliance for the calendar year 2007, as monitored by the DWI, achieved its highest ever level of 99.97% compared with the 99.96% level achieved in 2005 and 2006.

PURE SERVICE

This year a number of projects have been delivered to progress the Pure Service vision:

- Accenture was awarded the customer service and billing contract, giving us the opportunity for a step change in customer service through quality improvements and more efficient ways of working
- a new contact centre system was installed to improve our call-handling services for customers using our helplines. The benefits of the new system are already being seen, with a significant improvement in capacity and a reduction in the number of repeat contacts from customers
- 'WaterCare', a ground-breaking new customer care programme, was launched early in 2007 targeted at helping those most in need to pay their bills. Customers are advised on how to manage better both their water use and household budget, including claiming all the benefits to which they are entitled. Some customers benefit from moving on to a special payment plan which enables them to make regular affordable payments, thereby reducing the company's outstanding debt. In 2007/08 'WaterCare' has delivered tangible benefits to nearly 2,000 customers and has been commended by the Government as an exemplary service offered to customers
- the company improved its position in both the 'Water and Sewerage Companies' and 'All Companies' league tables for 2006/07 in Ofwat's Overall Performance Assessment (OPA), with a best ever ranking of fifth out of ten amongst the water and sewerage companies compared with our sixth place in 2005/06
- we won first place in the sustainability category of the Water Industry Achievement Awards 2008 for our work in assisting business customers to save money and conserve water.

PURE ENVIRONMENT

The environment is a continuing focus for South West Water, building on the success of our coastal clean-up programme, 'Clean Sweep'. Our work to improve the natural environment in the South West this year included:

- investments to increase capacity at a number of sewage treatment works and to deliver environmental benefits by treating previously untreated sewage
- continuing investment in coastal waste water improvements. Compliance with the Mandatory EU bathing water standard was 97.9%. This was a slight reduction on the previous year which was believed to be due to the wettest summer on record causing excessive agricultural and surface water run-off. We also contributed to the achievement of 78.3% compliance with the EU's strictest Guideline bathing water standard, compared with only 47.5% compliance 10 years ago
- the number of sanitary-compliant waste water treatment works was the highest ever at 99.73% in the calendar year 2007, based on the 'percentage population equivalent' (see Glossary, page 42, for description)
- promotion of innovative work in some of our wider water catchments to improve natural water retention and the quality of water reaching our reservoirs and abstraction points. The projects are being undertaken with land owners and users, and a wide range of statutory and voluntary organisations.

Underpinning the vision is the need to drive additional operational efficiencies and create opportunities to enable further improvements to operational and customer service performance. We have continued to do this in the following ways:

- investment has been made this year in the infrastructure to move the organisation towards a more centralised operational structure employing increased levels of automation and remote working
- a significant programme of organisational restructuring across the business has been ongoing throughout the year costing £4 million, leading to increased operational efficiency
- to support the operational and service improvements, a number of employee development programmes are being undertaken, developing staff across the business. During the year 26 employees were awarded National Vocational Qualifications and 67 employees were working towards completing them
- a 'rightsourcing' review was completed this year ensuring we have the optimal combination of internal and external resource provision. This led to a number of improvements to existing outsourcing arrangements; in particular changes in the way we manage our water distribution network.

South West Water focus

This year South West Water has been laying the foundations for the future. Our vision 'Pure Water, Pure Service and Pure Environment' was launched during 2007 and is being used as the basis for our plans from now until 2030.

Above: Sidmouth sea front – photography by Eddie Simmins
Top: Taking water samples in Exmouth

FINANCIAL REVIEW

2007/08 has been another successful year for South West Water, delivering further value for shareholders through a strong set of operational, financial and regulatory results whilst improving customer service.

Underlying operating profit (before restructuring costs of £4.0 million) up by £27.9 million to £185.0 million, despite a £7.9 million (4.1%) fall in measured demand (2007 saw the wettest summer for decades).

The company's revenue increased by £39.5 million to £421.0 million:

- increases: tariff increases approved by Ofwat (£52.3 million) and 8,300 new customer connections (£3.6 million)
- decreases: customers switching to metered tariffs (£10.0 million) and 4.1% fall in measured demand (£7.9 million).

Over 62% of our domestic customers now receive a metered supply.

Operating costs, excluding depreciation, increased by £4.3 million to £151.0 million:

- efficiency savings of £4.2 million in the year; an £11.2 million cumulative base cost reduction since 2005
- additional costs from new capital schemes of £1.1 million
- inflation of £2.3 million (net of a reduction in power costs of £2.5 million)
- other costs increased by £4.9 million after lower property disposals of £2.6 million in the year.

The cost of bad debts rose more slowly than the tariff increase.

We are on track to deliver the demanding efficiency targets set by Ofwat at the last Determination for the 2005-2010 period.

Capital expenditure was £169.7 million with over £68 million being spent on quality schemes, principally water mains rehabilitation.

Looking forward, there is a significant programme of change under way which will deliver benefits to all stakeholders into the next Periodic Review. I am confident that through the professionalism and dedication of our people at all levels within our organisation we will move towards achieving our vision of 'Pure Water, Pure Service and Pure Environment'.

BUSINESS ENVIRONMENT

South West Water is the licensed water and sewerage service provider for Devon, Cornwall and parts of Dorset and Somerset. It serves a region of nearly 10,300 square kilometres with 1.65 million residents and in excess of 10 million annual visitors. On average each day it distributes over 440 million litres of treated water and disposes of around 250 million litres of waste water through an asset base comprising:

- 15,015 kms of water distribution mains
- 9,178 kms of sewers
- 15 impounding reservoirs
- 40 water treatment works
- 631 waste water treatment works including 54 works with ultra-violet treatment and three with membrane filtration
- 1,696 intermittent discharges, including 1,019 combined sewer overflows.

- Above: Watergate Bay, Newquay
- Right: Walking at Wimbleball Lake
- Far right: St. Michaels Mount – photography by James Saldivar

Since privatisation in 1989 the company has successfully delivered the largest capital programme per capita of any of the water and sewerage companies with an initial focus on improving coastal waste water treatment and disposal. The region currently has 143 EU designated bathing waters, almost one third of the total in England and Wales, and 132 of these have been improved over the last 18 years arising from the company's marine investment programme. The emphasis has now moved to completing a 15 year programme of improving the quality of drinking water and to providing better customer service.

South West Water expects to create value through delivering the regulatory contract agreed with Ofwat. The contract scope is reviewed every five years. As well as determining outputs, Ofwat sets prices to enable efficient companies to earn a reasonable rate of return on their assets.

In the current regulatory period (2005 – 2010) Ofwat assumed that the equity cost of capital for all companies would be 7.7% real after tax with an overall weighted average cost of capital of 5.1% real after tax. Ofwat's determination allows for further investment by South West Water to improve the quality of water and sewerage services. As a result the company's RCV is expected to increase from £1.956 billion in March 2005 to £2.662 billion in March 2010, an increase of 36%. This will enlarge the base for the calculation of the return allowed by Ofwat. Additional value may be created where South West Water outperforms Ofwat's assumptions by, for example, delivering services at lower operating and/or capital costs and/or financing the investment programme and operation at lower cost.

REGULATORY AND COMPETITIVE ENVIRONMENT

COMPETITION

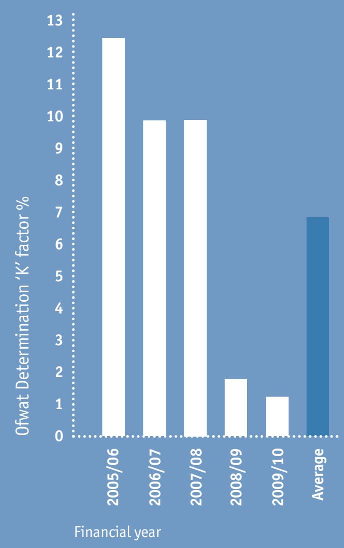
The Government is undertaking a full review of the scope for increased competition in water supplies. Ofwat is currently consulting on changes to the competition regime and South West Water is responding to this. Currently South West Water has no direct competition for the provision of water and sewerage services to the vast majority of its customers.

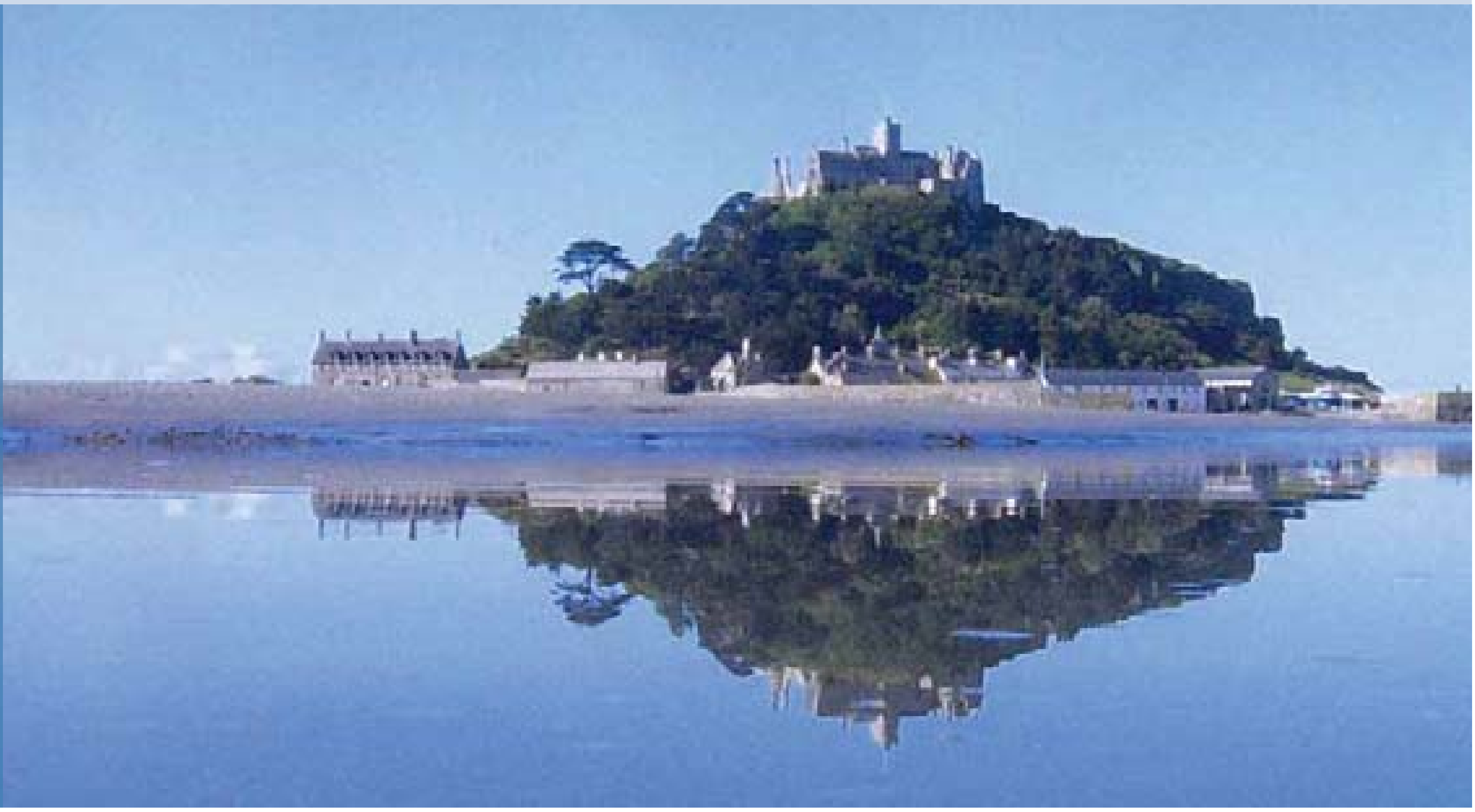
The Government has introduced a regime whereby customers using more than 50Ml per year can contract with alternative suppliers for water supply. South West Water has 44 customers in this category whose aggregate water charges account for less than 2% of its total revenue. No single customer accounts for more than 1% of revenue.

PRICE CAP REGULATION

Ofwat regulates water and waste water charges by determining the maximum increase in charges which a company can impose in any year. The water regulator conducts a Periodic Review and sets price limits every five years. Prices are set by reference to inflation as measured by the Retail Price Index (RPI) plus an adjustment factor known as 'K' which is specific for each company. The 'K' factors for the period 2005 to 2010 for South West Water were set by Ofwat in its Determination in December 2004 and are:

'K' factors for the period 2005 – 2010

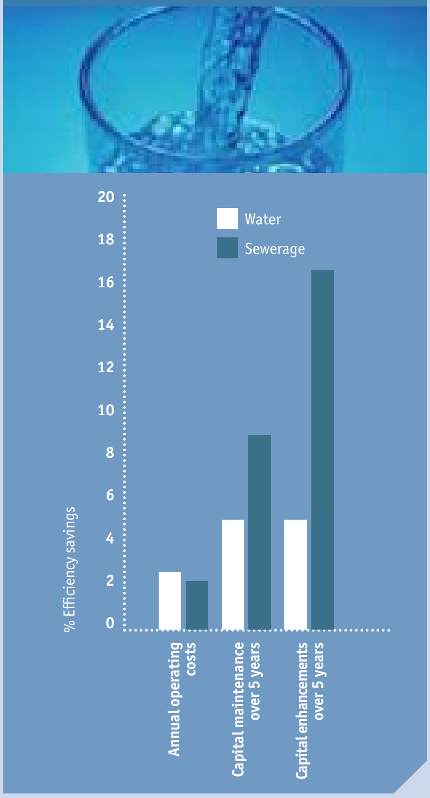




PRICE CAP REGULATION *continued*

In setting price limits for South West Water for 2005 to 2010, Ofwat assumed the following efficiency improvements:

Efficiency improvements



The 2004 Determination provided for total capital expenditure of £762 million (2002/03 prices) over the five year period. Good progress has been made against the required customer service and infrastructure outputs by 31 March 2008, including:

Activity	2005 – 2010 Objective	Status at 31 March 2008
Adequacy of water resources	Security of Supply Index to be maintained at 1.0	Security of Supply Index was 0.97 No water restrictions for 11th year
Leakage control	Maintain at not more than 84Ml/d	84Ml/d achieved
Asset condition above ground	Stable	Stable
Asset condition below ground	Stable	Stable
Meet Drinking Water Inspectorate milestones for water mains rehabilitation	Complete five milestone packages of improvements	Four milestones met, fifth progressing to plan
Improvements to waste water treatment works	Complete 95 schemes by 31 March 2010	Completed 77
Improvements to intermittent sewage overflows	Complete 113 schemes by 31 March 2010	Completed 104

PERIODIC REVIEW 2009

Significant work has been undertaken through the year to prepare for the next Periodic Review (2010 – 2015) of the water industry's prices. South West Water published its 25 year view of future aims in December 2007 in its Strategic Direction Statement. This is based on the themes of 'Pure Water, Pure Service and Pure Environment'. The development of the draft Business Plan for submission by August 2008 is a key activity. It is supported by extensive studies, analysis and preparation of the many sub-components of the Periodic Review.

Key dates for the next Periodic Review are:

Date	Activity
April 2008	Ofwat published information requirements
April – May 2008	Companies' draft water resources plans published for consultation
August 2008	Submit and publish draft business plans
August 2008 – January 2009	Public consultation on draft business plans
December 2008	Ofwat publishes draft baseline, outputs package and 'menu'
January 2009	Ofwat issues final business plan reporting requirements
April 2009	Submit and publish final business plans
July 2009	Ofwat publishes draft Determinations for comment
July – August 2009	Companies publish final water resources plans
November 2009	Ofwat publishes final Determinations
January 2010	Decisions made by companies on Determinations
April 2010	New price limits take effect for period 2010 to 2015

LEGISLATIVE DRIVERS

The water industry in the UK is subject to substantial UK and EU regulation. This places significant statutory obligations on South West Water with regard to, amongst other things, the quantity of water abstracted and the quality and quantity of waste water discharged. Examples of relevant EU Directives include the Drinking Water Directive, the Habitats Directive, the Urban Waste Water Treatment Directive and the recently updated Bathing Water Directive.

The Water Framework Directive was incorporated into UK law in 2003. It provides a framework for the protection of and improvement in the quality of water resources, together with the promotion of sustainable water consumption. To comply with the Water Framework Directive, member states will have to achieve the challenging target of 'good status' for groundwater, rivers, estuarine waters and coastal waters, in three six-year cycles, the first running from 2009 to 2015. From preliminary findings published by the Environment Agency in March 2008, the expected programmes of measures resulting from the Water Framework Regulations are unlikely to be significant for South West Water's assets at least until 2015, following the successful delivery of a wide range of environmental improvements by the company since 1989.

CLIMATE CHANGE

South West Water is working closely with many organisations to assess the implications of climate change for water supply and waste water services. Adaptation and mitigation plans are being developed which will involve innovative approaches and new methods of influencing catchment behaviour, upstream of its water supply systems, in sewered areas and downstream of its waste water systems to protect the wider environment.

The company's draft Water Resources Plan for the next 25 years has been developed with the latest information on rainfall and temperature alterations, with allowance for demand changes associated with climate change. Predictive models are in place to handle uncertainty. Infrastructure developments have been identified, the timing of which can be adjusted if the expected rate of climate change alters. Increasing efficient and careful use of water will play a major part in adapting to the expected effects.

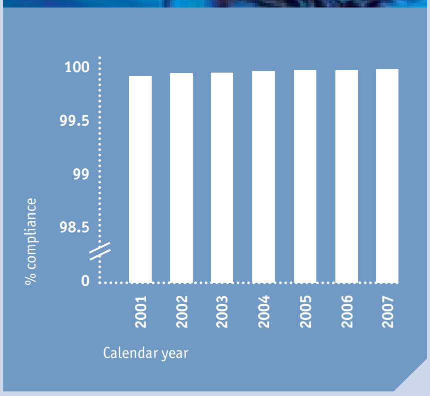
◣ Above: Enjoying cleaner beaches
◣ Left: South West Water Service Centre
◣ Far left: Budleigh Salterton – photography by Dave Corcoran

KEY PERFORMANCE INDICATORS – PURE WATER

DRINKING WATER COMPLIANCE

During 2007 South West Water maintained its high level of overall compliance with the drinking water quality regulations with 99.97% of its regulatory tests meeting the required standards, an improvement on the 2006 and 2005 performances of 99.96%.

Drinking water quality overall compliance



ABSTRACTION, SUPPLY AND LEAKAGE CONTROL

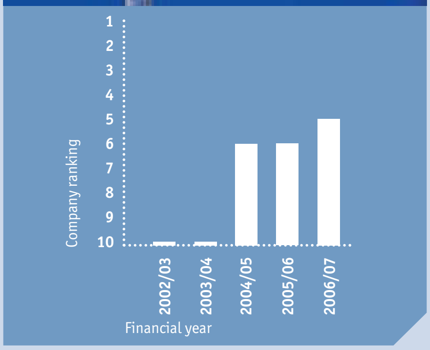
In 2007/08 South West Water abstracted 170,313 Ml of raw water from its 81 licensed abstraction locations which have a total licensed volume of 385,466 Ml. The abstraction sources are reservoirs and rivers, accounting for 90% of supplies, with 10% drawn from groundwater aquifers.

KEY PERFORMANCE INDICATORS – PURE SERVICE

OVERALL PERFORMANCE ASSESSMENT

The Overall Performance Assessment (OPA) index is maintained by Ofwat as a comparative tool to measure companies' performance. The OPA is based on performance in areas such as customer service and complaint handling, billing, debt collection, asset serviceability, environmental compliance and quality of drinking water delivered. In 2006/07 South West Water improved its position to fifth amongst the 10 water and sewerage companies, compared with sixth in 2005/06.

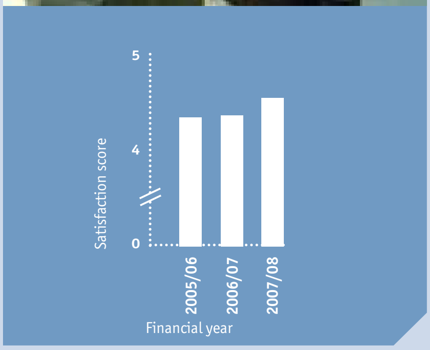
Overall performance assessment



CUSTOMER SATISFACTION

In April 2005 Ofwat introduced a new measure for the overall manner in which a customer call was handled. The measure is obtained by quarterly tracking surveys undertaken by an independent company engaged and managed by Ofwat. Results are provided to the company. The data has been averaged for the year to assess a performance trend. For 2007/08 the satisfaction score was 4.53, compared with 4.36 for 2006/07. The maximum score is 5.0 and at December 2007 Ofwat ranked the company in sixth position of the 10 water and sewerage companies.

Customer satisfaction

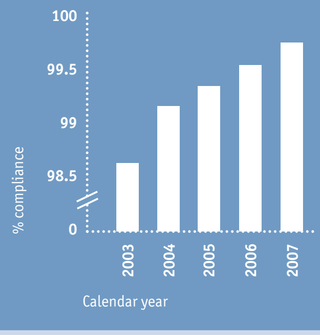


KEY PERFORMANCE INDICATORS – PURE ENVIRONMENT

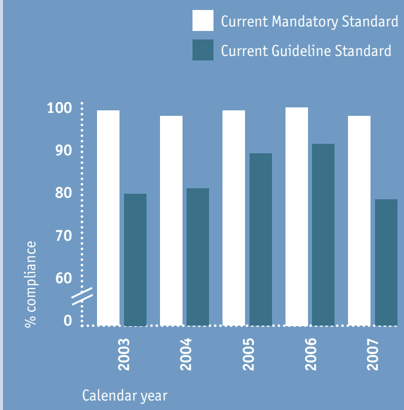
WASTE WATER TREATMENT COMPLIANCE

The percentage population equivalent of sanitary-compliant waste water treatment works improved to 99.73% in 2007 compared with 99.58% in 2006. This performance contributes to South West Water's region having the highest percentage length of high quality rivers in England.

Percentage population equivalent sanitary compliance



Bathing water performance



INCIDENTS AND PROSECUTIONS

Five 'category two' (significant pollution) incidents were recorded by the Environment Agency in 2007/08, all of which were deemed non-compliant with discharge consents. This compares with five incidents in 2006/07, four of which were deemed non-compliant. During the year the company was convicted on eight occasions for environmental offences and fined a total of £36,100 compared with seven convictions and £30,000 in fines in 2006/07.

There was also a Drinking Water Inpectorate prosecution in the year in respect of water supplies to a small part of Exeter. The company was fined £5,000 on each of four charges.

The company always self reports incidents it becomes aware of and seeks to co-operate with any investigation with the relevant regulatory authority. After each pollution incident, including incidents leading to prosecution, the company takes such steps as are necessary to ensure that the incident will not be repeated and also seeks to ensure that lessons learned are widely disseminated throughout the company.

BATHING WATER PERFORMANCE

Our investment in waste water performance over the last 18 years is an important contributor to the region having a significant proportion of the finest bathing waters, beaches and rivers in the UK. In 2007 all but three of the region's 143 bathing waters (usually 144 but one private beach was closed in 2007) achieved the EU Mandatory standard (100% in 2006) and 78.3% achieved the more stringent EU Guideline standard (91.7% in 2006). The bathing water results in 2007 were affected by an exceptionally wet summer which led to increased run-off from land.

- Above: Coastline at Newquay
- Left: Plymbridge – photography by Philip Nelson
- Far left: Bystock Pond – photography by Karen Land

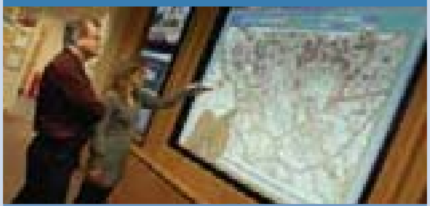
KEY PERFORMANCE INDICATORS – FINANCIAL AND BUSINESS

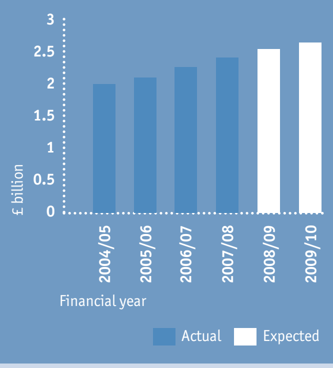
GROWTH IN REGULATORY CAPITAL VALUE

RCV is the financial base used by Ofwat to allow a rate of return and set prices at each periodic review. The RCV at 31 March 2008 amounted to £2.408 billion. This compares with £2.265 billion at 31 March 2007, an increase of 6.3%. From 31 March 2005 to 31 March 2010 we are expecting a 36% growth in RCV, the highest percentage increase of any quoted UK water company.

Future RCVs up to 2009/10 are based on Ofwat's projections. These were set out in 'Future Water and Sewerage Charges 2005–10' published in December 2004 and have been adjusted by South West Water's estimates of outturn prices. The growth in RCV adds directly to shareholder value as the allowed return is attributed to South West Water's asset base by the water regulator.

Regulatory Capital Value

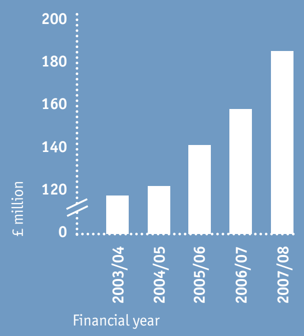




OPERATING PROFIT

South West Water achieved an underlying operating profit of £185.0 million in 2007/08, up £27.9 million on 2006/07. For the five year period 2003/04 to 2007/08, underlying operating profit is shown in the following graph.

Operating profit



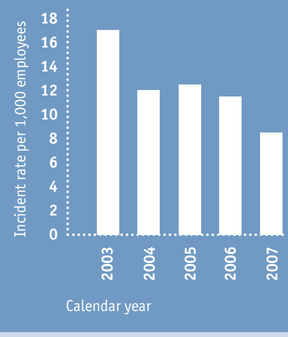
HEALTH AND SAFETY PERFORMANCE

Occupational health and safety are key elements of South West Water's risk management and internal control processes. South West Water's reportable accident rate remains an important KPI and the number of reportable accidents continues to fall as we improve the skills of our personnel and make their working environment safer.

We continue to pursue initiatives to improve further the health and safety of our employees through the provision of training and promotion of health and safety. These are designed to ensure that employees have the knowledge and expertise to undertake their jobs in a well motivated, contented and productive manner.

The company had its lowest number of reportable accidents in 2007 at 8.55 accidents per 1,000 employees compared with 11.55 accidents per 1,000 employees in 2006 and 12.56 per 1,000 employees in 2005.

RIDDOR accident and incident rates



CUSTOMERS, COMMUNITY AND EMPLOYEES

CUSTOMERS

Customers are informed through a company newspaper 'Waterlevel', leaflets, the media and our website, *www.southwestwater.co.uk* Detailed research and consultation has been undertaken with customers and stakeholders in relation to the Periodic Review process.

During the summer our customer caravan visits the Devon and Cornwall county shows as well as other fairs and events throughout the region. Staff help with customer enquiries and provide information about water conservation and how we invest to improve our assets and services.

We meet regularly with the Consumer Council for Water (CCWater), which champions water customers. We regularly consult CCWater and other stakeholders such as pensioners' forums and citizens' advice bureaux, prior to major changes or initiatives.

Our 'Customer Plus' programme is aimed at transforming our customer service and making it amongst the best in the industry. Working with Accenture we will be investing £4 million in improving customer service.

We publish our 'Customer Promise', setting out clearly how we will respond when things go wrong and what we will do to put them right.

Staff across the company deliver a 'company talk' to community groups and water conservation staff provide a school talks service for young people.

Our monthly customer satisfaction survey shows rising satisfaction with South West Water's customer service.

COMMUNITY AND SPONSORSHIP

South West Water concentrates its sponsorship on community projects and organisations within its service area which are linked to water, benefit the environment or promote youth participation.

Highlights in 2007/08 included the company's first involvement in green arts as lead sponsor of TRAIL – an exhibition of environmental sculptures on the South West Coastal Path – and a joint project with South West Lakes Trust to plant a new natural woodland at Wimbleball Lake.

The company also took the opportunity to co-sponsor South West Tourism's annual awards and fund a new sustainable tourism prize to demonstrate how the 'Clean Sweep' project has helped underpin the renaissance of the region's number one industry since 1989.

Youth participation projects included sponsoring a national junior championship in Cornwall run by the Surf Life Saving Association of Great Britain and Exmouth's first kite festival. In total 64 organisations and individuals across the region were sponsored.

EMPLOYEES

The company is focused on developing well trained and motivated employees in order to achieve the 'Pure Water, Pure Service and Pure Environment' vision and to successfully meet the growing expectations in customer service, operational outputs and cost efficiency.

A new employee development framework co-ordinates training and development for all employees and better outlines and explains what the company offers and what employees are required to do in support of their own personal development. A new graduate development programme was created and launched in early 2008 involving around 60 current graduate employees within the company. All training activities are undertaken under the 'Investor in People' (IIP) standard, which is closely aligned with business requirements.

South West Water continues to drive change management programmes and take advantage of new technology. Two examples are the creation of a new service centre at the company's headquarters in Exeter and further deployment of mobile computing to improve the efficient operation of its workforce in the field.

In pursuing efficiency projects, the company is engaging employees in the design and development of business improvements.

- Above: Land yachting on the beach
- Left: Wimbleball Lake
- Far left: Enjoying high quality rivers

EMPLOYEES *continued*

Further initiatives include reviewing and improving work activities, employee practices and delivering more flexible terms and conditions in key operational areas affecting service provision to customers. Negotiations in craft and industrial areas regarding terms and conditions of employment are progressing well and these are linked to improved training and development and broader progression schemes.

South West Water continues to play a major role in 'Clear Water 2010', a 10-year occupational health programme for the water industry. The company continues to pursue initiatives to further improve the health and safety of its employees through the provision of training and promotion of health and safety to ensure that employees continue to have the knowledge and expertise to undertake their jobs safely.

KEY RELATIONSHIPS

REGULATORS AND OTHERS

Relationships with regulators, Government and its agencies, customer representative organisations and its customers are central to South West Water's operations. The company maintains a continuing dialogue with Ofwat, the Environment Agency and the Drinking Water Inspectorate. It contributes to national policy on developing issues through its membership of Water UK, the industry trade body. The company works with the Consumer Council for Water to ensure that customers' issues and concerns are addressed and a full understanding of the company's activities is maintained.

PROCUREMENT AND SUPPLIERS

South West Water's procurement strategy is focused on partnering and strategic alliances with around 60 key suppliers who account for the majority of expenditure. Regular meetings are held to manage performance, encourage sustainable business activity and to identify and deliver continuous improvement opportunities for reducing costs further while improving performance and service levels.

RISKS AND UNCERTAINTIES

Risk	Mitigation
Tighter price controls over the revenue of the company's regulated business could adversely affect profitability	South West Water has met Ofwat's efficiency expectations in the last two Periodic Review periods and is on track to meet them in the current period.
Failure to deliver the capital investment programme could adversely affect future profitability	The company has a track record of delivering its capital programme in accordance with regulatory requirements. The current capital programme is on track and progress is regularly monitored and reviewed.
The company may be unable to raise sufficient funds to finance its functions	Pennon Group and the company have robust treasury policies in place. These include policies that there are always pre-drawn or committed facilities to cover at least one year's estimated cashflow and that no more than 20% of borrowing matures in any one year.
Failure to deliver operating cost savings implicit in the regulatory review could adversely affect profitability	In line with its track record, the company remains confident of delivering the assumed operating cost savings. A major restructuring programme is currently being implemented.
Environmental regulations and quality standards could increase the company's costs and adversely affect profitability	These issues are addressed through the five year regulatory review mechanism.
Climate change	The company has plans ready and will adapt the way it conducts its business to respond effectively to the hotter, drier summers and wetter winters which are anticipated.
Contamination of water supplies could adversely affect profitability	The company has established procedures and controls in place, as well as contingency plans and incident management procedures. It also maintains insurance policies in relation to these risks, although there can be no assurance that all or any of the costs associated with these risks would be covered or that coverage will continue to be available in the future.
Non-recovery of customer debt could adversely affect profitability	In addition to existing strategies, South West Water is implementing new initiatives to improve and secure cash collection, including the use of property charging orders. Provision was made in the last Periodic Review for companies to make an application for an Interim Determination in the event of bad debts being significantly above the amount allowed by the water regulator.
Energy cost pressures	South West Water mitigates rising energy costs through careful system operation, by maximising renewable energy generation and by purchasing all forms of energy in the most efficient way.
Pension costs may increase due to factors outside the company's control	Employer costs were reduced from 1 April 2006 through the closure of the existing defined benefit scheme to new entrants (replaced by a new scheme with reduced benefits) and an increase in employee contributions. From 1 April 2008 the new defined benefit scheme was also closed to new entrants and replaced by defined contribution arrangements. Employee and employer contributions have also been further increased.
Water resource adequacy	The company has a number of schemes in place to maintain water resources (such as pumped storage for certain reservoirs) and promotes conservation measures. In particular, South West Water prepares a new Water Resources Plan every five years and reviews it annually for a range of climate change and demand scenarios. The Water Resources Plan indicates that no new reservoirs are required before the planning horizon of 2035. However, investment is needed to develop the overall trunk main infrastructure, to expand treatment capacity and to enhance certain pumped storage facilities.
Operational failures	The company is able to monitor its significant assets by automated and remote operation and has routine controls and operating procedures in place that are constantly kept under review. Asset management techniques are employed to pre-empt the failure of assets.
Reduced revenue from falling customer demand for water	The water regulator is proposing a form of revenue cap regulation from 2010, which would allow water companies to recover a shortfall in income for a five year regulatory period in the next period.
Meter option take-up being greater than forecast, resulting in reduced revenues	An Interim Determination may be used to fully or partially recover revenue losses if they exceed the prescribed materiality threshold.

- Left: Cyclist splash – photography by Jim Cockburn
- Above: Fly fishing at Kennick Reservoir
- Top: Sunset surfers – photography by Oliver Denne

Viridor

Colin Drummond
Chief Executive
Viridor Limited

Another year of strong profit growth and strategic development.

OVERVIEW

Continuing developments in the UK's waste management and renewable energy policies, driven by climate change and environmental awareness, create major opportunities for Viridor. In 2007/08 Viridor delivered another year of strong profit growth. At the same time it progressed various major strategic initiatives which are expected to enhance further its business in future years. This reflects its focused strategy of:

- capitalising on its strong position in landfill waste disposal
- maximising its landfill gas renewable energy generation
- exploiting opportunities arising from the Government's landfill diversion and recycling targets including:
  - Private Finance Initiative (PFI) and Public Private Partnership (PPP) contracts
  - recycling operations
  - energy from waste plants (EfW).

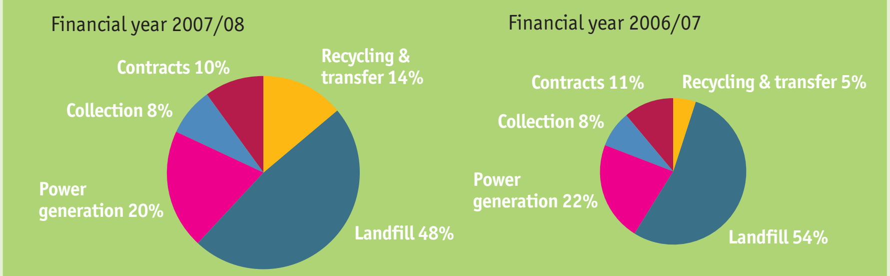
More detail on the climate change and environmental drivers behind the Government's policies and Viridor's strategy is given in the sections on main trends and business and strategy, both on page 20.

In 2007/08 revenue at £455.1 million increased by 23.8% over the previous year. Profit before interest, tax and amortisation of intangibles (PBITA) at £58.1 million increased by 24.1% over the previous year. This was driven by particularly strong growth in the landfill, power generation and recycling parts of the business. In the seven years since 2000/01 PBITA has grown by a compound average rate of 24% per annum, of which 11% has been organic and the remainder from acquisitions. This year around 12% of the growth has been organic with the remainder being from acquisitions. Underlying profit before tax (PBT) at £35.5 million was 20.7% up on the previous year. Return on equity at 16.5% was 2.3% up on the previous year's figure of 14.2%. This consistent strong financial performance reflects the success of Viridor's focused strategy.

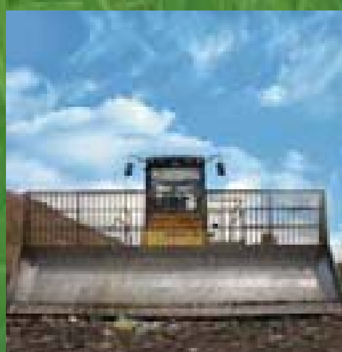
VIRIDOR PROFIT CONTRIBUTION BY SEGMENT

The pie charts below provide a breakdown of Viridor's profit contribution by segment (before amortisation of intangibles and central overhead costs including pensions). In 2007/08 landfill and power generation (the first two elements of the strategy outlined above) accounted for 68% of the profit contribution, compared with the previous year's 76%. Recycling and contracts (the third element of the strategy) increased to 24% from 16%.

Viridor profit contribution by segment



All segments grew in absolute terms both before and after acquisitions.



LANDFILL AND LANDFILL GAS UTILISATION

Landfill inputs excluding cover grew very strongly and were 5.2 million tonnes or 11% higher in 2007/08 compared with the previous year. Of this total volume approximately 0.2 million tonnes were of items not expected to continue into 2008/09. Average revenue per tonne increased by 2.5% to £19.30 per tonne, or 3.5% after adjusting for changes in sales mix. Consented landfill void fell from 90 million cubic metres last year end to 84 million cubic metres at 31 March 2008, reflecting usage. Since the year end Viridor has gained planning consents at two sites providing an additional 2.4 million cubic metres of void.

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

RECYCLING CONTRACTS AND ENERGY FROM WASTE (EfW)

The UK is required under the EU Landfill Directive to reduce the amount of bio-degradable municipal waste going to landfill sites as described in the section on regulatory and competitive environment on page 22. Municipal waste accounts for around one third of Viridor's landfill market.

The alternatives to landfill sites for final waste disposal in the UK are currently limited. In order to meet the requirements of the Landfill Directive, local authorities have been set statutory targets by the Government for the diversion of biodegradable municipal waste from landfill. Accordingly, the recycling and contracts segments are increasingly important to Viridor's business and both performed strongly in 2007/08. Total profit contribution grew by over 80% (27% excluding the effect of acquisitions) and now represents 24% of total contribution compared with 16% last year.

Viridor's industrial and commercial collection business provides support for the landfill business and is profitable in its own right. In 2007/08 profits grew 22% maintaining the segment's overall share of Viridor profits (8% in both years).

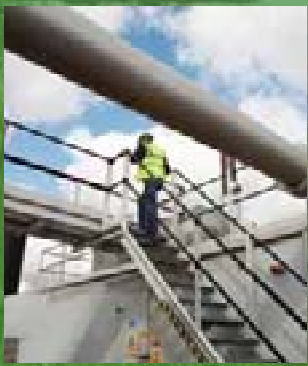
In line with its strategy, in 2007/08 Viridor made two significant acquisitions to strengthen its recycling business. In December 2007 Grosvenor Waste Management was acquired for £79.5 million (plus net debt assumed of £1.7 million). Grosvenor is a leading UK materials recycling company with the UK's largest Materials Recycling Facility (MRF) at Crayford in South East London which benefits from advanced automated recycling technologies and an associated collection fleet. It has a further MRF in Peterborough which is currently being expanded. In addition Grosvenor has an extensive recyclate sales network in both the UK and overseas. The business has an excellent geographic and business fit with Viridor's existing operations in the South East of England. Grosvenor, renamed Viridor Resource Management, has been operationally integrated and was already earnings enhancing after integration costs in 2007/08.

In March 2008 Shore Recycling was acquired for £23.3 million (including debt assumed of £12.5 million). Shore is a leading UK waste electrical and electronic equipment (WEEE) recycling company headquartered in Perth, Scotland. It processes a full range of WEEE and has modern purpose built recycling equipment. It has recycling facilities in Perth, Manchester and St Helens and an associated collection fleet providing an excellent fit with Viridor's existing operations in the North West of England and in Scotland. The company has been renamed Viridor Electrical Recycling and is expected to be earnings enhancing in the first full year, 2008/09.

Viridor focus

Continuing developments in the UK's waste management and renewable energy policies, driven by climate change and environmental awareness, create major opportunities for Viridor. In 2007/08 Viridor delivered another year of strong profit growth.

- Left: Materials reception at Crayford MRF
- Above left: Materials recycling process line control
- Below left: Landfill compactor
- Far left: Priorswood MRF



- Above: Landfill gas monitoring
- Right: Crayford MRF
- Top left: Glass recycling inputs
- Top right: Landfill gas power plant

RECYCLING CONTRACTS AND ENERGY FROM WASTE (EfW) *continued*

Viridor is pursuing a number of further EfW opportunities. The Lakeside joint venture with Grundon Waste Management comprises a 410,000 tonnes and up to 37MW capacity EfW plant at Colnbrook near Heathrow. As previously reported it involves capital expenditure of £160 million financed by 86% non-recourse debt with the balance split equally between the two equity providers. Construction is well advanced and a profit contribution is expected in 2009/10. Last summer Viridor achieved planning permission for a 60,000 tonnes and 3MW EfW plant in Exeter. It is also pursuing other possible long-term EfW opportunities in Cardiff and Dunbar.

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

KEY PERFORMANCE INDICATORS

Profit before interest, tax and amortisation of intangibles and profit before taxation

PBITA and PBT are key overall measures of Viridor's performance and are set out in the table below for the seven year period 2001 to 2008. The table also sets out the Compound Annual Growth Rate (CAGR) for these measures, being the rate of growth between 2001 and 2008 expressed as a single annual average figure over the period.

Return on equity

Return on equity is also a key measure of Viridor's performance and is calculated as PBT expressed as a percentage of Pennon Group's equity investment in Viridor (£207.0 million at 31 March 2008).

Year ended 31 March	2001* £m	2002* £m	2003* £m	2004* £m	2005 £m	2006 £m	2007 £m	2008 £m	CAGR 2001 – 08
Operating profit before intangibles amortisation	13.1	15.2	19.1	22.7	30.0	35.9	46.8	58.1	24%
Profit before taxation	11.7	13.8	15.7	17.2	21.5	23.5	29.4	35.5	17%
Return on equity investment	6.1%	7.2%	8.2%	8.8%	11.0%	11.3%	14.2%	16.5%	–

*UK GAAP

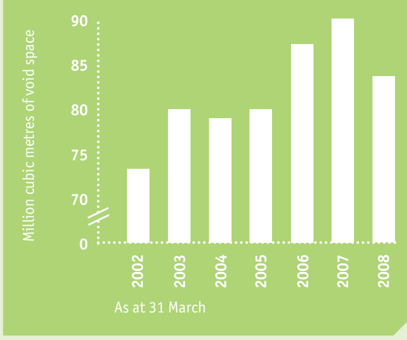
CONSENTED LANDFILL VOID

As at 31 March 2008 Viridor had a consented void capacity of 84 million cubic metres.

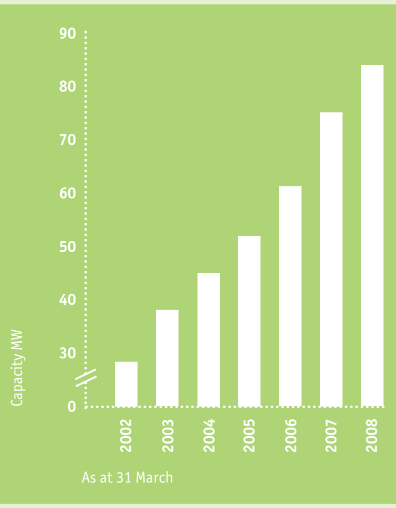
LANDFILL GAS ELECTRICITY GENERATION CAPACITY

Electricity generated is sold to electricity suppliers, usually under NFFO contracts or under shorter term contracts with ROCs. As at 31 March 2008, Viridor had 84MW of generating capacity, an increase of 9MW over the year. These figures exclude 3MW of sub-contract capacity in Suffolk.

Consented landfill void



Power generation capacity



MAIN TRENDS AND FACTORS LIKELY TO AFFECT THE FUTURE DEVELOPMENT, PERFORMANCE AND POSITION OF THE COMPANY'S BUSINESS

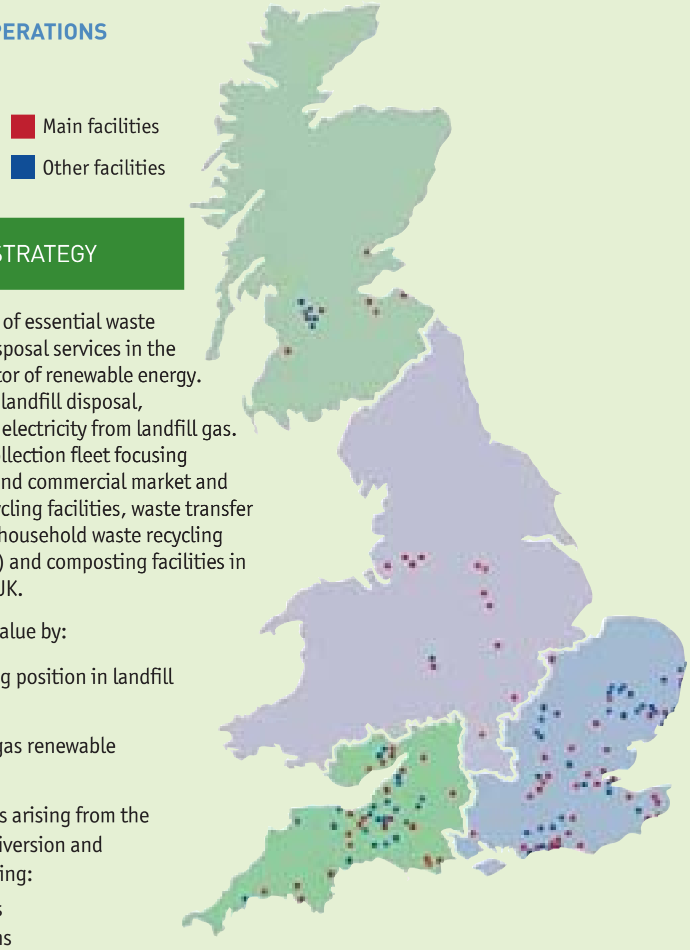
The waste management and renewable energy business is heavily impacted by environmental and climate change considerations and associated Government policies. Viridor's strategy reflects this and our belief is that being green is good for business, as is demonstrated by the company's financial performance.

Government policies are designed in the first instance to minimise the amount of waste generated, then to maximise reuse and recycling, followed by treatment and energy recovery in EfW facilities and other technologies. This is underpinned by final safe disposal in landfills. The Government is implementing the EU Landfill Directive and reducing the amount of waste to go to landfill. This Directive was originally initiated because of the methane generated by landfills, although in fact the bulk of this is now captured for renewable energy generation.

At the same time it is increasingly recognised that waste is a major renewable energy source, accounting for approximately 30% of current UK renewable energy or roughly 1.5% of total UK electricity production; principally this is currently from landfill gas utilisation, which has grown by 600% over the past 10 years. The Institution of Civil Engineers has recently estimated that waste could theoretically account for up to 17% of total UK electricity production. Even if this is an over-estimate it is still clear that waste can make a major contribution to the UK's future energy needs.

The Government's target of diverting municipal waste away from landfill up to 2020 is leading to a decline in the landfill market. However, with only around six or seven years' consented capacity in the UK as a whole (according to Environment Agency estimates) and with new consents difficult to achieve, Viridor's 84 million cubic metres is regarded as a very valuable resource. Whilst open-market 'brown energy' prices in 2007/08 were below 2006/07 peaks, they have since recovered strongly, and the premium for renewable energy is also strong. As the UK increasingly relies on imports of energy and seeks to grow its output of renewables, Viridor's power generation business is expected to become an increasingly valuable asset. The need for councils to achieve their landfill diversion targets creates attractive opportunities for PFI/PPP contracts such as Viridor's with West Sussex and Somerset, for facilities such as the Lakeside EfW plant, and for recycling operations such as Viridor Resource Management and Viridor Electrical Recycling.

VIRIDOR'S MAIN UK OPERATIONS AS AT 31 MARCH 2008



BUSINESS AND STRATEGY

Viridor is a leading provider of essential waste treatment, recycling and disposal services in the UK and a significant generator of renewable energy. It has core competencies in landfill disposal, recycling and generation of electricity from landfill gas. The company has a waste collection fleet focusing primarily on the industrial and commercial market and also operates materials recycling facilities, waste transfer stations, treatment plants, household waste recycling (civic amenity) sites (HWRS) and composting facilities in a number of regions in the UK.

Viridor's strategy is to add value by:

- capitalising on its strong position in landfill waste disposal
- maximising its landfill gas renewable energy generation
- exploiting opportunities arising from the Government's landfill diversion and recycling targets including:
  - PFI & PPP contracts
  - recycling operations
  - EfW plants.

Viridor's landfill market consists of municipal, commercial and industrial wastes along with certain other special types of waste. Landfill is currently the major final disposal route for these wastes.

Viridor is one of the largest landfill site operators in the UK with a total consented landfill capacity of approximately 84 million cubic metres at 31 March 2008. The company is at present filling this at a rate of approximately six million cubic metres per annum which results in an average remaining life of 14 years at current rates of fill – significantly longer than the industry as a whole.

Gas produced from decomposing waste on landfill sites is increasingly used to generate electricity. It is a form of renewable energy and now represents 24% of the UK's total renewable energy generation with EfW a further 6%. The Government's strategy is to increase the percentage of electricity generated from renewable sources from the current figure of approaching 5% to a target of 10% in 2010 and 15% in 2015, with an aspiration of 20% in 2020. Historically, renewable energy projects were supported by the Government through the NFFO scheme. Fixed price Retail Price Index (RPI) contracts with terms of up to 15 years were awarded to the most competitive renewable projects in five tranches of bidding. In April 2002 the NFFO regime was replaced by the Renewables Obligation Certificates (ROCs) regime. The overall price for electricity supplied under ROCs is currently substantially higher than that achieved under the most recent NFFO scheme. This has facilitated the increasing of Viridor's total landfill gas power generation capacity to a current 84 MW at 31 March 2008, compared with 28MW in March 2002. Of this 45% is under NFFO and 55% under ROCs.

To take advantage of opportunities presented by the Government's developing waste strategy, Viridor is pursuing composting, EfW and a range of recycling or related treatment opportunities (including materials recycling facilities, mechanical-biological treatment, anaerobic digestion, composting and civic amenity or household waste recycling sites). These may be combined in integrated waste management contracts.

In pursuing its strategy, Viridor seeks to grow its waste management business, both organically and through acquisition. It has continued to be an active participant in the consolidation of the UK waste market to date and, since October 2001, has made 13 acquisitions in the waste sector for an aggregate consideration of over £290 million. They have been integrated into the Viridor group with the exception of Shore Recycling acquired in March 2008 where integration is ongoing.

- Left: Plymouth waste transfer station
- Above: Landfill compaction
- Middle: Baled recyclate
- Top: Composting operations

REGULATORY AND COMPETITIVE ENVIRONMENT

The UK is required under the EU Landfill Directive to reduce the amount of biodegradable municipal waste going to landfill sites as follows:

- to 75% of 1995 level by 2010
- to 50% of 1995 level by 2013
- to 35% of 1995 level by 2020.

Following the implementation in October 2007 of the Pre-Treatment Regulations, all waste going to landfill must have undergone some form of pre-treatment (including recycling).

At the same time the UK Government has set targets for recycling and composting of municipal waste to increase from the current level of a little over 30% to 40% by 2010, 45% by 2015 and 50% in 2020. The Government is promoting recycling by various measures including encouraging councils to provide separate collection of recyclables which enhances the recycling rate obtainable at MRFs. There are specific targets for recycling of all packaging with financial incentives in the form of Packaging Recovery Notes (PRNs) and Packaging Export Recovery Notes (PERNs). Specific regulations affect waste electrical and electronic equipment which has its own system of WEEE Evidence Notes which are tradable.

In order to meet the requirements of the Landfill Directive, individual local authorities have been set statutory targets for the diversion of biodegradable municipal waste from landfill.

Each waste disposal authority has been allocated an allowance of the amount of biodegradable waste it may dispose of to landfill for the years 2005 to 2020. These allowances are designed to ensure that the UK as a whole achieves the requirements of the EU Landfill Directive. Subject to some constraints, local authorities can carry forward or trade allowances under the Landfill Allowance Trading Scheme (LATS). Any authority exceeding its allocation without such an allowance faces a penalty of £150 per tonne in addition to the cost of disposing of the waste. This is expected to result in the introduction of alternative treatment and disposal processes at higher cost than current routes.

The Government introduced landfill tax as a further incentive to divert waste away from landfill sites. Landfill tax applies to all waste disposed of at a licensed landfill site, unless the waste is specifically exempt, such as soil from historically contaminated sites up to 2012. Landfill tax is chargeable by weight. For inert waste, landfill tax was chargeable at £2 per tonne increasing to £2.50 from 1 April 2008. A standard rate of £32 per tonne applies to all other taxable waste (up from £24 in 2007/08) which is due to rise by a further £8 per tonne per annum to reach a level of £48 per tonne in 2010/11.

Planning for landfill sites and waste and recycling infrastructure

All waste management facilities including the development and expansion of landfill sites, are subject to planning permission from the relevant local authority. Major facilities such as EfW plants above 50MW must also receive consent from the Secretary of State for Business, Enterprise and Regulatory Reform. In addition significant facilities including landfill sites and waste treatment facilities require an Environmental Permit (previously a Pollution Prevention and Control (PPC) permit) from the relevant regulator.

Viridor believes that good environmental and operational management is important in winning future planning consents. It has achieved ISO 14001 (Environmental Management Systems) accreditation at all of its key sites and is now implementing its Business Management System incorporating externally accredited environmental, quality and health and safety management standards.

Planning applications are subject to rigorous assessment by local authorities who will consider them against the backdrop of policies contained within waste local plans that have been adopted for their areas. Applications have to address a wide range of issues and the relevant regulator is a statutory consultee in this process.

- Above: Waste treatment laboratory testing
- Right: Waste collection
- Far right: Restored landfill at Beddington

Integrated municipal waste management contracts and the role of Private Finance Initiatives or Public Private Partnerships

To assist in meeting their landfill diversion targets, many local authorities are seeking to let integrated waste management contracts covering a range of activities often including household waste recycling sites (HWRS), composting, recycling and recovery, EfW, waste transfer and bulk transport and final disposal.

In a number of instances these will be financed under PFI arrangements where local authorities apply to the Government for funding of capital projects which fall within the eligibility criteria. Successful applicants receive cash funds (known as PFI credits) which do not have to be repaid and can be used by the local authority to fund a proportion of the capital and operating expenditures needed for the project.

Councils may also choose to let long-term contracts using PPP arrangements. Under this they forego the complexities of securing PFI credits. Viridor considers that the nature of the contract is very similar whether it is a PFI or a PPP. The Institution of Civil Engineers estimates that as much as £30 billion of investment will be required in the UK to meet municipal waste landfill diversion targets by 2020.

Viridor has been operating a PFI contract with West Sussex County Council since April 2005. In May 2006 Viridor signed a 25-year PPP contract with Somerset County Council, at the same time acquiring Somerset's Local Authority Waste Disposal Company (LAWDC), Wyvern Waste Services which has been renamed Viridor Waste (Somerset). The Viridor/Laing consortium is expected to reach financial close shortly for the Greater Manchester Waste Disposal Authority PFI contract.

Viridor recognises that there is a range of risks associated with entering into such contracts, which are often for a 25-year term. However, subject to a careful assessment of the risks on a contract-by-contract basis, the company will continue seeking to secure such contracts.

Waste Regulation Environment

EU directives and related UK legislation, as well as planning and licensing, have been referred to previously.

The Environment Agency (EA) and the Scottish Environment Protection Agency (SEPA) monitor performance against permit conditions and general environmental law. Breaches are subject to prosecution. The EA and SEPA can also require the operator to undertake upgrades to ensure future compliance and, where a pollution incident or licence breach has occurred, for remedial action to be undertaken.

Waste facilities are also subject to the same regulations as other industries, including health and safety, control of substances hazardous to health and the Working Time Directive. In addition the transport of waste is subject to specific controls.

Renewables Obligation (RO)

Under the RO the Government has a target to generate 10% of UK electricity usage from renewables by 2010, and 15% by 2015 (compared with under 5% generation from renewables at present). The EU has an aspirational target to generate 20% of total energy from renewables by 2020 (which equates to over 30% of electricity from renewables in the UK).

Production of renewable energy is incentivised under the system of ROCs whereby renewable energy generators get a premium in addition to the underlying 'brown energy' price for their production. This premium relates to the balance between actual UK output and target UK output. At present the UK is behind target and many believe it will remain so for some considerable time. Eligibility for ROCs is governed by complex rules. Landfill gas, anaerobic digestion and certain other waste technologies are eligible.

A recent change was the introduction of the banding of ROCs. This will mean that all landfill gas projects accredited by 1 April 2009 will continue to receive one ROC per Megawatt hour. Those accredited after that date will receive 25% of one ROC. Viridor is currently ensuring that the vast majority of its capacity is accredited by 1 April 2009. In addition certain technologies such as Anaerobic Digestion (AD) have been incentivised with double ROCs. Viridor is pursuing a number of AD planning applications.

CORPORATE RESPONSIBILITY/RELATIONSHIPS

EMPLOYEES

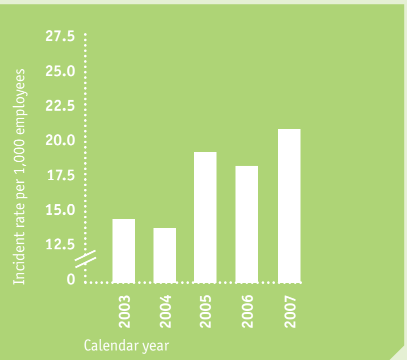
The company employs a comprehensive range of technical and professional managerial personnel and supervisory, administrative, clerical, semi-skilled and unskilled staff. Many are vocationally trained and have extensive operational experience. Membership of relevant trade and professional bodies is widespread and is encouraged.

Viridor's equal opportunities policies and procedures seek to ensure that bias and discrimination in the treatment of job applicants and employees on grounds of disability are eliminated. Training and appropriate support are provided to implement this throughout the company. If an employee becomes disabled whilst in the company's employment, every effort is made to make reasonable adjustments.

Viridor is pursuing a number of occupational health and safety initiatives. It currently has six sites accredited to the OHSAS18001 international health and safety standard and is extending this across further sites as part of its integrated business management system. All other sites are covered by the company's environmental management system (EMS) (most accredited to ISO14001), which is also the vehicle for delivering health and safety standards and procedures.

Viridor's reportable accident rate per 1,000 employees is an important KPI and is set out below for the five year period 2003 to 2007. The company was disappointed to note that the rate rose to 21.42 in 2007 compared with 18.18 in 2006. This increase in reportable accidents was due primarily to an increase in manual handling type injuries and is attributable to the change in business mix as more labour intensive recycling businesses are acquired or developed. All other accident types have fallen slightly. Despite continuing to compare favourably with industry averages, Viridor's focus on health and safety improvement and performance remains strong and it has re-doubled its efforts to reduce manual handling type accidents. The company has recruited additional health and safety professionals during the year and continues to raise the level of training and support available to its staff.

RIDDOR accident and incident rates



ENVIRONMENT

The most significant positive environmental impacts of Viridor's operations arise from the safe and efficient disposal of society's waste materials; increased resource and energy efficiency from its recycling and recovery operations; the capture of methane (a greenhouse gas 21 times as potent as CO_2); the generation of renewable energy; and the restoration of despoiled landscapes such as disused mineral workings through the controlled deposit of waste materials. Significant negative impacts include transportation and associated emissions, methane production (where not harnessed for energy generation or flared), leachate production and potential local impacts such as dust, noise, litter and odour.

Viridor developed its own EMS in the early 1990s recognising the growing importance of measuring and monitoring the environmental impact of its operations. This has allowed targets to be set and met to maximise positive environmental impacts and reduce negative impacts, resulting in continuous improvement in environmental performance.

Viridor was the first UK waste company to achieve ISO 14001 accreditation across all major operational sites and has 53 accredited centres covering 145 operational facilities as at 31 March 2008. The company is now implementing its Business Management System (BMS) which incorporates externally accredited environmental, quality and health and safety management systems. Three BMS accreditations were achieved in the year in addition to one PAS99 accreditation for the Crayford MRF. It has also played a leading role in developing and reporting against the environmental performance indicators for the waste industry as promoted by the Green Alliance.

The amount of waste recycled by the company increased over the year to 1.4 million tonnes (1.2 million tonnes in 2006/07).

SOCIAL AND COMMUNITY ISSUES

Landfill (and many other facilities) require waste management licences or environmental and PPC permits, issued and monitored by the EA and SEPA. Viridor maintains a positive working relationship with the regulators, proactively liaising on, and managing issues at, both a site-specific and strategic level.

A 'good neighbour' policy is implemented at all facilities managed by Viridor with local liaison groups at most major sites consisting of locally elected representatives of the community meeting regularly to be consulted and informed about the company's plans and operating procedures. Liaison groups also include representatives of the regulator, the relevant planning authority and other key local stakeholders.

Viridor also fully participates in the Landfill Communities Fund, a scheme whereby a proportion of Landfill Tax can be claimed as credits and distributed to qualifying community and environmental projects. During the year Viridor provided £9.2 million to Viridor Credits Environmental Company, an independent distributive environmental body. Funding is allocated at grassroots level by steering groups established to serve areas close to operational landfill sites.

KEY CONTRACTUAL AND OTHER ARRANGEMENTS

Local authorities are the largest single customer group accounting in total for 30% of the company's revenue. No individual authority accounts for more than 4%. Viridor's ROC contracts account for 6% of revenue primarily with one customer. No supplier accounts for more than 1% of Viridor's revenue. The company sources from competitive markets.

RISKS AND UNCERTAINTIES

Increases in landfill costs may not be recovered through price increases

The raising of environmental standards is leading to a gradual increase in landfill costs in general. Particular areas of cost increases include site engineering (which results in increased depreciation), restoration and aftercare costs (see below), leachate management, landfill gas management and general site management. Companies such as Viridor with landfills engineered to modern standards and which have good environmental control systems, should incur lower than average increases in costs. However, there remains a risk that rising standards may generate higher treatment and disposal costs than currently assumed. Landfill sites are filled and restored on a cell-by-cell basis. After site closure final restoration and aftercare are undertaken in accordance with the planning permission for the site. The costs related to aftercare are expected to continue for around 30 years post closure. These costs are best estimates based on Viridor's own extensive experience and they are updated at each stage of the capital expenditure programme. Nevertheless, as with any estimate of future costs, there is a risk that circumstances may change which may affect the level of the costs.

The costs are charged on a landfill usage basis, i.e. per tonne input. This is calculated by dividing the total expected cost by the number of tonnes expected to be input into the site up to its closure. This number is derived from the remaining void space, as estimated by external consultants, and estimated compaction rates (tonnes per cubic metre). These are best estimates, based on current information, which are reviewed every year. However, to the extent that tonnages are over or underestimated, there is a risk that the amount provided may be too high or low.

Municipal waste contracts typically last for a number of years. They usually have provision for price increases under set formulae covering inflation as measured by the RPI and in some cases specific legislative or technical changes. Prices for other types of waste depend more on local markets and competitive conditions. Viridor's experience over a number of years is that prices as a long-term trend have risen fast enough at least to cover cost increases in the areas where it operates, although in individual years price increases may have been less than cost increases. There remains a risk that landfill prices may not rise sufficiently in all locations and in all years to recover recent and projected cost increases.

The UK Government's Waste Strategy, stemming from the Landfill Directive, will lead to a reduction in volumes of waste being disposed of to landfill.

Viridor focuses on the landfill disposal of municipal, industrial and commercial, construction and demolition waste. Around 30%, approaching 20 million tonnes of the UK total for these waste streams is municipal, of which approximately two thirds is biodegradable municipal waste. These figures are based on estimates from DEFRA, the EA, SEPA and HM Revenue & Customs.

Existing Government initiatives are having an impact and the amount of municipal waste being disposed of to landfill is now declining. Assuming the EU Landfill Directive targets are met, the total amount of municipal solid waste which will be landfilled from 2020 will be under 10 million tonnes per annum (depending on the precise interpretation of the Directive). If there is no change in other waste streams, this would still leave a substantial landfill market in 2020. This should be seen in the context of EA estimates of a current consented landfill capacity UK-wide of around six to seven years.

Generally, Viridor has seen its underlying landfill volumes holding steady with a small increase in 2007/08, probably reflecting a greater share of the landfill market. However, the combined effect of the various Government measures is likely to continue to reduce the total amount of waste being landfilled in the UK in the future.

Liquid waste services

Not all landfills may meet the standards of the Integrated Pollution Prevention and Control Directive and the Landfill Directive, or requirements may be imposed which would impact adversely on the economics of landfill

Landfills (and other industrial processes) in the UK are subject to a permitting regime pursuant to the Pollution Prevention and Control (England and Wales) Regulations 2000 (PPC Regulations), superseded in England and Wales by the Environmental Permitting (England and Wales) Regulations 2007. Existing landfills which opened before July 2001 operated under waste management licences but subsequently required a PPC permit granted under the PPC Regulations. PPC permits often imposed higher standards and costs in general. PPC permits in England and Wales automatically became Environmental Permits from April 2008. Any landfills which fail to obtain a permit will be subject to a closure plan with the EA or SEPA.

The net result of this is that it is expected that, after a transitional period, the average technical and operational standards of landfill in the UK will improve and that the number of landfills may decrease. All but one of Viridor's operational landfills have achieved PPC permits, though in some cases the company is appealing against certain of the conditions proposed, which might have cost or other implications for the landfills. The operational landfill which has not yet received a permit is currently due to close in 2009.

The EA is also considering the implications of a December 2007 Court of Appeal judgment regarding landfill 'piggybacking' and the Groundwater Directive, and how this affects Environmental Permits. This may affect sections of a small number of Viridor sites.

Under both waste management licences and permits, landfills require expenditure on restoration when the site is closed and subsequently on aftercare (maintenance, supervision, monitoring and management of gas and leachate levels) long after the landfilling activities have ceased. The EA or SEPA will only grant a full or partial licence or permit surrender once it is satisfied that the landfill no longer poses any environmental risk. There may still be a risk of liability arising from any residual contamination following the surrender of the permit. Landfill licences or permits cannot be surrendered during the aftercare period.

Pricing and other risks relating to renewable energy

Renewable energy prices under the current ROCs scheme are primarily a function of the underlying 'brown energy' price and the premium achieved from the sale of ROCs.

Underlying 'brown energy' prices rose significantly in 2006/07 reflecting the general energy supply/demand position in the UK and worldwide. 'Brown energy' prices fell back significantly in 2007/08 but have increased for 2008/09. In line with its current policy, Viridor has sold energy approximately one year ahead.

'Brown energy' prices will continue to be determined by the world and UK energy markets and may go down as well as up. Any changes in underlying energy prices will directly affect Viridor's revenues when its sales contracts come up for renewal.

Oil is an important component of overall 'brown energy' prices. Whilst Viridor's power generation business may be positively affected by increases in oil prices, other parts of the business, in particular collection, may be adversely affected.

Without a pricing mechanism such as ROCs, further investment in renewable energy generation would not generally be economic. The Government has made a strong commitment to renewables which are key to meeting the long-term carbon reduction strategy set out in the energy white paper and the UK's targets for CO_2 reductions under the Kyoto Protocol. Renewables are also important in minimising the UK's increasing reliance on imported energy. Nevertheless, there remains a risk that the Government may change the pricing mechanism. ROC banding is referred to on page 23.

The value of ROCs is increased by the sharing of the buy-out price monies among holders of ROCs. The value of a ROC depends on the supply of renewable electricity relative to the UK's annually increasing targets. If large amounts of renewable energy generating capacity gained planning permission and commenced operations there is a risk that the value of a ROC would decline. The value of ROCs is also dependent on the financial strength of those suppliers who opt to pay the buy-out price. There is a risk that the insolvency of a licensed electricity supplier could lead to a drop in the value of the ROCs which Viridor sells to licensed suppliers.

A landfill gas project must be able to collect and burn sufficient gas to produce electricity. Ultimately, the volume of gas generated will depend on the amount and composition of the waste landfilled. For example, as the amount of biodegradable municipal waste diverted away from landfill is increased in the future in accordance with the EU Landfill Directive obligations, the total biodegradable component of the waste going to landfill will reduce, affecting the volumes of landfill gas produced. It is therefore possible that the gas obtained will not be available either in the amounts or of the calorific value required to make a project cost effective.

Lakeside EfW construction and technical risks

The Lakeside joint venture involves building a 410,000 tonnes EfW capacity plant at a cost of around £160 million and operating it for 25 years. 86% of the project is funded by non-recourse bank debt which limits the financial risk to Pennon Group. The remainder is funded by the joint venture, in which Viridor has 50% of the equity.

The plant is a modern conventional EfW facility. As a result of a competitive procurement procedure it is being supplied by the Japanese consortium Itochu/Takuma in accordance with a fixed price contract which was drawn up with the assistance of specialist external consultants. Nevertheless, as with any major infrastructure project, unforeseen circumstances may arise which may affect or delay the construction process. There is a significant number of similar plants operating successfully worldwide.

Efficiencies and output of the plant will be affected by the precise calorific value of the waste throughput. The plant is well proven and it is a robust conventional technology designed to take the currently projected waste mix. Nevertheless, if the mix of the waste changes significantly over the next 25 years, there may be some adverse impact on efficiencies and output.

The current planning regime may restrict the availability of future waste treatment facilities

Achievement of the Government's targets for waste management is critically dependent on the planning system delivering sufficient waste treatment facilities. Obtaining planning permission for any type of waste treatment facility is difficult and will represent a major challenge for the waste management industry.

Continued skills shortages in many disciplines across the waste industry place focus on recruitment and retention of staff

Good quality staff with the required technical skills and certification are essential in the waste industry. Viridor focuses on the best possible employment policies to recruit and retain quality staff in all disciplines. Viridor seeks to be regarded as an employer of choice in the sector and has embraced many modern employment practices to allow a flexible approach to employment terms and conditions. There is more to be achieved but good progress has been made.

Risks associated with long-term integrated contracts (including PFIs and PPPs)

Any long-term integrated contract has a range of risks associated with it. Indeed, risk transfer is a key part of Government PFI procurement guidelines. The risks include waste volumes and mix; planning; technology; input costs; and recyclate prices. A careful assessment of the risks and the apportionment of them between client; main contractor; technology and equipment suppliers; and subcontractors is a key part of the process of bidding and finalising a contract.

Viridor seeks to protect itself against the risks in such contracts in the first instance by carrying out extensive due diligence, typically using a combination of external advisers and in-house experts, so that risks are correctly identified.

Viridor will then seek to protect itself against the risks identified through contractual documentation with its client, subcontractors and sub-suppliers. The degree it does so depends of course on the other parties' attitude to risk transfer and on the specific commercial situation.

To the degree that Viridor is not able to (or chooses not to) cover off all the risks identified in the contractual documentation, then it includes in its price an assessment of a reasonable return for accepting such risks. Viridor takes a robust approach on this issue. If it cannot cover off the risks satisfactorily or cannot get a reasonable commercial return for taking such risks, its policy is to accept the loss of such a contract rather than win it on unsatisfactory terms.

Whilst Viridor's policy on such risks is careful and robust, there remains a risk that Viridor's commercial assessment will not be satisfactory and the results from such contracts will be adverse.

Recyclate Price Risks

Recycling is becoming an increasingly important part of Viridor's business. Recyclate prices are driven by global supply/demand trends among manufacturing reprocessors who wish to use the recyclate, coupled with national and European legislation setting targets for landfill diversion, recovery and use based on 'polluter pays' principles. Reprocessing capacity in the UK is finite with limited growth forecast, whilst increasing amounts of recyclate are being sought by, and exported to, the rapidly expanding major manufacturing locations in China and elsewhere.

Non-European export prices and freight costs for recyclate are set in US dollars. They can be expected to vary with the world and regional economic cycles and with the environmental impact and increasing cost of sourcing and processing competing virgin raw materials. They may also be expected to adjust over time for movements in the value of the US dollar.

Viridor may mitigate any recyclate price risk by sharing downsides/upsides with both its clients and customers. Nevertheless recyclates are essentially global commodities and therefore there remains a risk that profits in recycling may be adversely or positively affected by movements in recyclate prices.

Landfill void space and power generation calculations

The landfill void space figures quoted in this review in relation to Viridor are in respect of consented void only (void with planning permission for landfilling).

The void space figures are based upon Viridor's most recent assessment of void available to the company for waste and daily cover materials. The void figures have been assessed using pre-settlement levels (based upon the extent of the planning consent), proposed base levels (based upon the terms of the site licence/ permit) and existing waste surfaces (determined by survey). These calculations necessarily involve an element of management judgement and are based on certain other assumptions (such as the waste mix profile of a site). However, Viridor is of the opinion that its calculation methodologies are in line with convention typical in the landfill industry. The void actually available at any one time may be different from the figures quoted.

The gas/electricity generating capacity of Viridor is defined by the Megawatt capacity of the engines installed on landfill sites through which the gas passes to generate electricity. Modelling future power generation requires consideration of a number of factors including the waste mass and composition already in place and volumes of gas currently being extracted. In addition the model requires an assessment of how the current position is expected to change throughout each site's remaining life as an operational landfill and beyond into the aftercare period. Any such assessment requires certain assumptions to be made including in relation to the amount of waste in the site, its biodegradable content, the age of the waste and the likelihood of obtaining a grid connection at an economic cost.

Left: Automated materials recycling
Above: Waste transfer station

Pennon Group

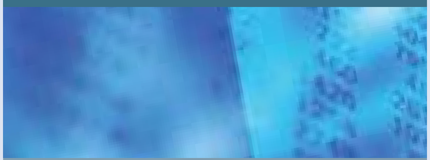
David Dupont
Group Director of Finance
Pennon Group Plc

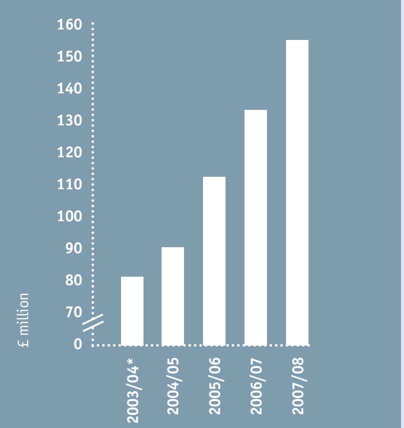
The Group's financial results showed continued growth in both revenue and profit from both main businesses.

KEY PERFORMANCE INDICATORS

The Directors assess the financial performance of the Group through:

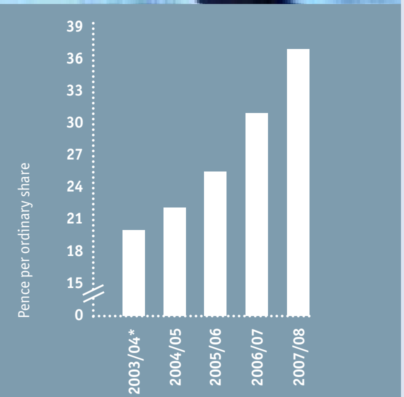
Profit before tax (PBT)
PBT has grown by 17.5% CAGR over the last five years:





Financial year *UK GAAP basis

Earnings per share (EPS)
EPS has grown by 16.7% CAGR over the last five years:



Financial year *UK GAAP basis

FINANCIAL PERFORMANCE

All figures relate to underlying business performance (as defined below) unless otherwise stated.

	2007/08 £m	2006/07 £m	Growth
OPERATING PROFIT			
Statutory operating profit	**236.8**	200.0	18.4%
Non-underlying costs:			
– Restructuring – South West Water	**4.0**	0.3	
– Intangibles amortisation – Viridor	**1.3**	1.8	
Underlying operating profit	**242.1**	202.1	19.8%
PROFIT BEFORE TAX			
Statutory profit before tax	**149.6**	131.1	14.1%
Non-underlying costs:			
– Restructuring – South West Water	**4.0**	0.3	
– Intangibles amortisation – Viridor	**1.3**	1.8	
Underlying profit before tax	**154.9**	133.2	16.3%
EARNINGS PER SHARE			
Statutory earnings per share	**38.2p**	26.5p	44.2%
Non-underlying costs:			
– Restructuring – South West Water	**0.9**	0.1	
– Intangibles amortisation – Viridor	**0.4**	0.5	
Deferred tax	**(2.6)**	3.8	
Underlying earnings per share	**36.9p**	30.9p	19.4%

Underlying results exclude restructuring costs, intangibles amortisation and deferred tax. The Directors believe that the underlying measures provide more representative information on business trends and performance. The term underlying is not a defined term under IFRS and may not be comparable with similarly titled measures used by other companies.

Operating costs

Group operating costs totalled £633 million and included the following major categories of expenditure:

	£m
Depreciation	128
Landfill tax	124
Manpower	100
Transport	42
Property	25
Power	19
Raw materials and consumables	14
Abstraction and discharge consents	8
Lease rentals – plant and machinery	6
Statutory operating licences and royalties	6

Finance costs

Net finance costs were £87.4 million (2006/07 £69.2 million) and were 2.8 times covered by Group operating profits (2006/07 2.9 times).

Gross finance costs were £129.4 million. Gross finance income of £42.0 million included £21.0 million from the investment of temporarily surplus funds.

Net interest payable represents a rate of 5.3% when measured against average net debt (2006/07 4.6%) and demonstrates the Group's effective management of interest rates. Over the last five years interest rates on average net debt for the Group have been:

Interest rate on average net debt

South West Water's average interest rate on net debt was 4.5% (2006/07 4.3%).

Interest rate management is analysed further on page 32.

Profit before tax

Profit before tax was £154.9 million, £21.7 million up on 2006/07, an increase of 16.3%.

Taxation

The corporation tax charge for the year was £25.0 million, including £0.7 million tax relief on restructuring costs (2006/07 £23.9 million). The deferred tax charge for the year was a credit of £9.0 million (2006/07 a charge of £13.3 million). A non-recurring credit of £21.0 million in 2007/08 reflected the reduction of UK corporation tax from 30% to 28% effective from 1 April 2008. The abolition of industrial buildings allowances is contained in the Finance Bill 2008 and, if fully enacted, is likely to increase the deferred tax liability by an estimated £30 million in 2008/09.

Earnings per share

Earnings per share increased by 19.4% to 36.9p. Statutory earnings per share increased from 26.5p to 38.2p.

The weighted average number of shares in issue during the year was 349.7 million (2006/07 353.9 million). The value of net assets per share at book value at 31 March 2008 was 184p.

Pennon Group focus

The Board's strategy is to promote the success of the Group for the benefit of its shareholders through its focus on water and sewerage services and waste management, underpinned by efficient finance.

Above: Viridor fleet vehicles
Top: Roadford Lake

Dividends and retained earnings

The statutory net profit of £133.6 million has been transferred to reserves.

The Directors recommend the payment of a final dividend of 13.56p per share for the year ended 31 March 2008. Together with the interim dividend of 6.25p per share paid on 9 April 2008, this gives a total dividend for the year of 19.81p per share, an increase of 6.8% compared with 2006/07. Proposed dividends of £69.1 million (2006/07 £65.6 million) are covered 1.9 times (2006/07 1.7 times) by profit after tax. Dividends are charged against retained earnings in the year in which they are paid.

Dividend policy

The Group is committed to a progressive dividend policy of 3% per annum increase above inflation in dividend per share until 2009/10.

SUBSIDIARY COMPANY FINANCIAL PERFORMANCE

Details of the financial performance of South West Water and Viridor are set out in this business review on pages 6 and 16.

CASHFLOWS

	2007/08 £m	2006/07 £m
Cash inflow from operations	**356**	314
Pension prepayment	**(19)**	(9)
Net cash inflow from operations	**337**	305
Net interest paid	**(80)**	(52)
Dividends and tax paid	**(86)**	(73)
Capital expenditure	**(218)**	(246)
Acquisitions/disposals	**(89)**	(36)
Net cash outflow	**(136)**	(102)
Shares issued	**–**	2
Own shares acquired (net of proceeds on re-issue)	**(48)**	(6)
B Share payments	**–**	(6)
Debt acquired with acquisitions	**(16)**	(1)
Debt indexation/interest accruals	**(6)**	(17)
Increase in net borrowings	**(206)**	(130)

The larger increase in net borrowings compared with the prior year was principally attributable to acquisitions, the share buy back and the prepayment of pension contributions.

During the year new borrowings and financial lease drawdowns, less debt repayments, amounted to £426 million and as a result net cash and cash deposits increased by £222 million to £339 million as at 31 March 2008.

Debt profile

At 31 March 2008, loans and finance lease obligations were £2,121 million and the Group held cash and deposits of £357 million.

During 2007/08 the following finance initiatives were implemented:

In South West Water:
- £200 million 1.99% index-linked bonds due 2057 – issued at £208 million giving a real rate of 1.86%
- £93 million 13 year finance lease extension
- £50 million finance lease drawdown for long-life assets which were previously treated for tax purposes as industrial buildings
- £50 million finance lease drawdown for water mains rehabilitation

In the Company:
- £100 million bonds due 2022

In Viridor:
- £10 million sub-LIBOR finance lease.

Pennon Group debt has a maturity of 0-49 years with average maturity increasing during the year from 16 to 24 years as a result of these initiatives.

The major components of debt finance as at 31 March 2008 were:

Within finance leasing £135 million (March 2007 £135 million) is index-linked debt.

Share capital

The on-market share buy back programme is now complete with £49.3 million spent during the year (2006/07 £3.5 million). Of the shares acquired, 960,000 were cancelled and 7,285,008 held as treasury shares. Subsequently 873,602 treasury shares were re-issued under the Company's Sharesave Scheme in 2007/08.

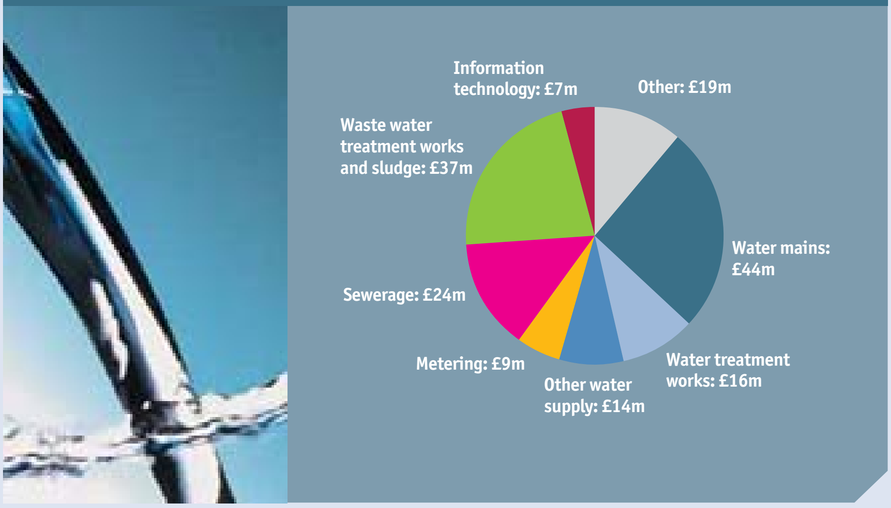
Authority was obtained from shareholders at the Annual General Meeting in July 2007 to purchase up to 10% of the Company's ordinary share capital. Similar authority will be sought at the July 2008 Annual General Meeting.

Left: Bedruthan Steps – photography by John Laurence
Above: Bridge over the River Exe
Top: Waste water treatment works maintenance

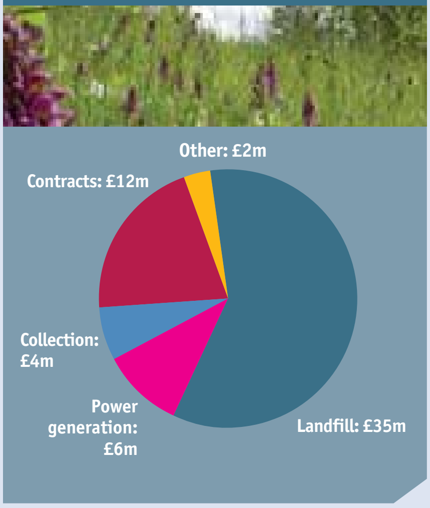
GROUP INVESTMENT

Capital expenditure by the Group on property, plant and equipment was £228.8 million (2006/07 £245.1 million). The major categories of expenditure comprised:

South West Water



Viridor



In addition, capital expenditure in the Lakeside joint venture was £65 million (cumulative £135 million).

ASSET VALUE OPINION

In the opinion of the Directors, the current market value of land and buildings is not significantly different from the holding cost shown in the financial statements.

CAPITAL STRUCTURE

Overall position

With year end net debt of £1,764 million, the Group year end ratio of debt (equity plus debt) was 73% (2006/07 71%).

The borrowing powers of the Directors are limited to two-and-a-half times adjusted capital and reserves, as defined in the Company's Articles of Association. At 31 March 2008, the limit was £2.3 billion.

The Directors confirm that the Group can meet its current requirements from the existing borrowing facilities without breaching covenants or other borrowing restrictions.

South West Water

South West Water's debt to Regulatory Capital Value (RCV) was 60% at 31 March 2008 (2006/07 62%), within Ofwat's 'optimum range' of 55%-65%. The scale of the remaining K4 investment programme means that this ratio is expected to remain relatively stable up to 2010.

Viridor

Viridor is funded by a combination of Pennon Group equity and debt (raised by Pennon Group) and direct borrowing by Viridor. At the year end, Viridor's net debt stood at £383 million (March 2007 £257 million), equivalent to 3.8 times EBITDA (2006/07 3.1 times).

TREASURY OBJECTIVES AND POLICIES

The Group's treasury function seeks to ensure that sufficient funding is available to meet foreseeable needs, maintain reasonable headroom for contingencies and manage interest rate risk. It operates within policies approved by the Board and does not undertake any speculative trading activity.

Interest rate management

Net finance costs of £87.4 million equated to an average interest rate of 5.3% for the Group. South West Water's average interest rate equated to 4.5%.

The Group's exposure to interest rate movements is managed by the use of interest rate derivatives. The Board's policy is that in any one year at least 50% of net debt is fixed. Interest rate swaps are used to manage the mix of fixed and floating rates. The Group has taken advantage of relatively low interest rates to fix approximately 60% of existing net debt up to 31 March 2010. In addition South West Water has index-linked approximately 25% of its current net debt up to 2041 – 2057.

South West Water's total index-linked debt of £347 million has an average real interest rate of 1.66%. The interest rate for index-linked debt is based upon an RPI measure which is also used in determining the amount of income from customers in South West Water.

At 31 March 2008 the Group had interest rate swaps to convert floating rate liabilities to fixed rate and hedge financial liabilities with a notional value of £634 million and a weighted average maturity of 2.1 years (2007 £636 million, with 3.1 years). The weighted average interest rate of the swaps for their nominal amount was 4.8% (2007 4.8%). The notional principal amounts of the interest rate swaps are used to determine settlement under those swaps and are not, therefore, an exposure for the Group. These instruments are analysed in more detail in note 22 to the financial statements.

The fair value of borrowings, based on the market value of equivalent instruments at the balance sheet date, is detailed in note 26 to the financial statements and amounted to a £170 million benefit compared with book value as at 31 March 2008 (2007 £117 million).

Refinancing risk management

Refinancing risk is managed under the Group Policy so that no more than 20% of Group net debt is permitted to mature in any financial year.

The Group had undrawn committed bank facilities of £185 million as at 31 March 2008.

Counterparty risk management

Surplus funds of the Group are usually placed in short-term fixed interest deposits or the overnight money markets.

Counterparty risk arises from the investment of surplus funds and from the use of derivative instruments. The Board has agreed a policy for managing such risk, which is controlled through credit limits, counterparty approvals, and rigorous monitoring procedures. All deposits are with counterparties which have a credit rating approved by the Board.

LIQUIDITY

It is Group policy to ensure that the Group has committed loan facilities equivalent to at least one year's forecast requirements at all times. This is achieved through the use of credit facilities which are utilised as required and refinanced using drawdowns for longer-term facilities. Payment commitments are expected to be met on the loan refinancing as required during the coming period.

INTERNAL TRANSFERS

For regulatory purposes, South West Water funding is treated as effectively ring-fenced. Funds raised by or for South West Water are used in the appointed business (provision of water and sewerage services) and are not available as long-term funding for the rest of the Group.

KEY CONTRACTUAL AND OTHER ARRANGEMENTS

The majority of the Group's debt is raised by:

- finance leasing
- European Investment Bank loans
- bank bilateral facilities
- private placements
- index-linked bonds.

COVENANTS

Pennon Group and South West Water have entered into covenants with lenders. Whilst terms vary, these typically provide for limits on gearing (primarily based on South West Water's Regulatory Capital Value and Viridor's EBITDA) and interest cover.

Redemption penalties included in the facility documentation can be invoked if debt facilities are redeemed early. The redemption penalties vary in each facility.

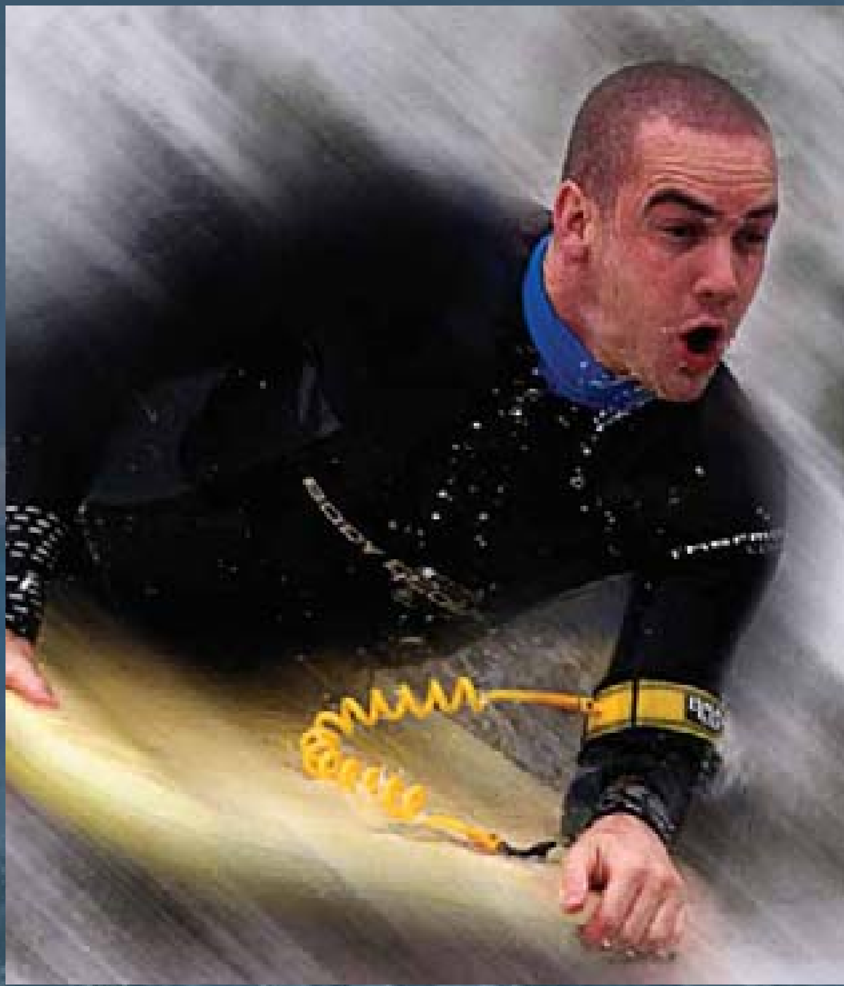
The financial covenants included in the Group's debt facilities are monitored on a regular basis. The financial covenants offered by the Group include a provision to re-test the covenants applying to frozen GAAP accounting standards. This is to protect the Group from changes in accounting standards that may have a detrimental impact on the financial covenant testing methodology.

TAXATION OBJECTIVES AND POLICIES

Pennon Group's tax strategy is to enhance shareholder value by legally minimising taxes whilst having regard to the longer-term relationships with the taxing authorities. The Group will consider bona fide business arrangements which qualify for tax exemption or tax relief.

The Group has a taxation policy which has been reviewed and approved by the Board with the guidance of the Group Director of Finance.

A material tax risk for the Group is the possibility that the capital expenditure qualifying for capital allowances is mis-allocated or categorised incorrectly, resulting in under-claims or over-claims of tax reliefs. This risk is managed by employing professional tax consultants with experience of analysing the types of specialist assets involved.



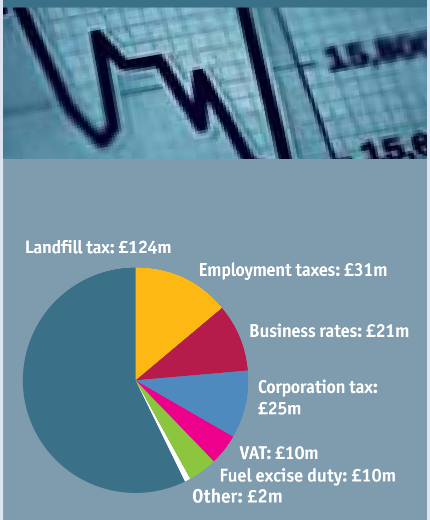
Above: Old groyne – photography by Rob Kendall
Top: Surfer at Newquay – photography by John Perriam

TAXATION OBJECTIVES AND POLICIES
continued

The current corporation tax charge of £25 million was less than the charge which would have arisen from the accounting profit of £150 million taxed at the statutory corporation tax rate of 30%. A reconciliation is provided in note 8 to the financial statements.

The Group's total tax contribution extends beyond the corporation tax charge. A variety of taxes are incurred by the Group.

Total tax contribution 2007/08



The most significant taxes involved and their profit impact were:

- landfill tax of £124 million was accounted for by the Group on behalf of the taxation authorities. Landfill tax is an operating cost which is recovered from customers in turnover. The impact on profit before tax is nil
- Value Added Tax (VAT) of £10 million (net) was collected by the Group and paid to the taxation authorities. VAT has no material impact on profit before tax
- business rates of £21 million were paid during the year to local authorities. These are a direct cost to the Group and reduce profit before tax
- employment taxes of £31 million contained employees' 'Pay As You Earn' (PAYE) and total National Insurance Contributions (NICs). Employer NICs of £8 million were expensed around 91% to operating costs and around 9% to fixed assets
- Fuel Excise Duty of £10 million related to transport costs. This reduced profit before tax.

The Group's total tax contribution in 2007/08 was £64 million, with a further £159 million collected on behalf of the tax authorities.

PENSIONS

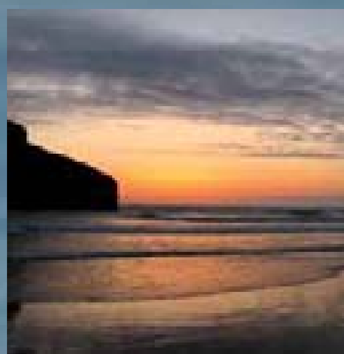
The Group has defined benefit pension schemes for existing staff of Pennon and South West Water, and for certain employees of Viridor.

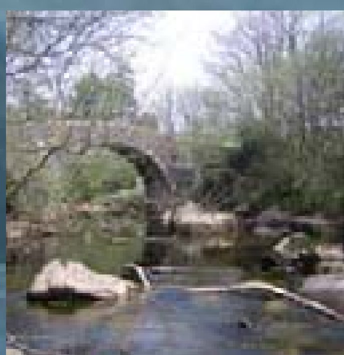
Employer costs have been contained through the introduction of defined contribution arrangements for Viridor employees from 2003 and for new South West Water employees from April 2008.

Employee contributions for defined benefit membership increased in 2006 and will increase further from April 2008 to reflect the results of the 2007 actuarial valuation.

The Group pension schemes had net liabilities (before deferred tax) at 31 March 2008 of £26 million (2007 £41 million). An increase in the market interest rate used to discount liabilities has been offset by adverse investment performance from market volatility. The triennial actuarial valuation for March 2007 has been completed and has resulted in higher future service costs and deficit recovery contributions. The longevity assumption has been strengthened to a scheme-specific 'medium cohort' basis which allows for improved life expectancy for existing and future pensioners. A further £19 million prepayment of employer contributions was made during the year.

The net liabilities (after deferred tax) of £19 million represent just under 1% of the Group's total market capitalisation as at 31 March 2008.





INSURANCE

The Group manages property and third party risks by the purchase of insurance policies. Main insurance policies cover property, business interruption, public liability, environmental pollution and employers' liability. There are three tiers of insurance for most policies. The first tier is self-insurance in the form of a moderate deductible. The second tier is covered by the Group's subsidiary, Peninsula Insurance Limited, which insures the layer of risk between the deductible and the cover provided by external insurers. The third tier of risk is placed with the external insurance market. The Group's insurance brokers assist in sourcing appropriate insurance cover from insurance companies which have good credit ratings.

RISKS AND UNCERTAINTIES

It may not be possible to continue to sustain the same level of earnings and growth of the Group as in the past

There is a risk to shareholder value if the Group is not able to continue to grow its key businesses and produce sustainable earnings growth. This is dependent upon the correct strategies being pursued by strong and able management within the Group as well as on external factors.

The Group has maintained earnings and has successfully grown both South West Water and Viridor and intends to continue to create shareholder value through its strategic focus on water and waste water services and waste management.

Pension risks

The future costs of defined benefit schemes are subject to a number of factors including:

- the returns achieved on pension fund investments
- movements in interest rates and inflation
- pensioner longevity.

Treasury risks

These are discussed in the treasury objectives and policies section on page 32.

Tax risks

These are discussed in the taxation objectives and policies section on page 33.

- Above: Wimbleball spillway
- Left: Venford Reservoir – photography by James Saldivar
- Middle bottom: Hexworthy bridge – photography by Steve Chapple
- Middle top: Newquay sunset
- Far left: Grey seals – photography by Lee O'Dwyer

OUR CORPORATE RESPONSIBILITY

WE OPERATE ENVIRONMENTALLY SENSITIVE AND SUSTAINABLE BUSINESSES

Pennon Group is committed to exemplary engagement with society and to the conservation and enhancement of the natural environment. Its social and environmental policy ensures that these activities are pursued, paying particular attention to:

- operating through best practice to ensure the sustainability of its activities by maximising the efficiency of its resource uses; effective project and programme delivery; and minimising waste
- regularly assessing the Group's built heritage and ensuring its long-term preservation
- ensuring compliance with all health and safety and environmental legislation, regulations and codes of practice so that its conduct in these areas is of the highest possible standard
- undertaking its activities in a way that minimises potential adverse effects on society, the environment and those living or working in proximity to the Group's sites
- procuring goods and services through approved suppliers and contractors whose products and services meet the Group's requirements and whose quality and environmental practices correspond with our own
- undertaking longer-term strategic assessments of its activities and opportunities and adopting whole-life assessment methods for approaches that are designed to benefit society; customers of the Group; suppliers and partners; all other stakeholders; and the environment
- the challenges of climate change. This will involve action to optimise energy and resource efficiency; maximise opportunities for renewable energy generation; and reduce the emissions of greenhouse gases
- reporting openly and transparently on Group performance; setting targets for continuous improvement and monitoring progress; and addressing risk and adopting policies related to wider sustainability considerations in relation to its key activities of water supply, waste water treatment and waste management
- making non-operational land accessible to the public where practicable to satisfy, as a minimum, the Group's obligations under the Countryside and Rights of Way Act. Wherever possible additional opportunities for conservation, access and recreation are provided, subject to health and safety and environmental considerations.

WE ALSO CARRY OUT OUR ACTIVITIES IN AN ETHICAL MANNER

Overlaying our social and environmental policy is our ethical policy. The preservation of a reputation for integrity and fair dealing is of paramount importance to the Group. Such a reputation is essential to the long-term well-being of the Group itself, its shareholders, employees, customers, suppliers and the community in which it operates. To maintain this reputation, Group companies are required to:

- conduct all transactions with fairness and honesty and in a professional manner
- build and maintain relationships with all parties based on trust and treat everyone with respect and dignity
- not make any promises and commitments which they do not have the intention to fulfil, or which they do not believe they have the resources to meet
- carry out all financial transactions and financial reporting, with due observance of all relevant laws, regulations and financial standards
- avoid any activities that could involve or lead to involvement in any unlawful practice or any harm to the Group's reputation or image.

The Group has a 'whistleblowing' policy which supports its approach to ethical employment practices by encouraging employees to raise, in accordance with a formalised procedure, concerns which relate to potential unlawful conduct, financial malpractice, dangers to the public or damage to the environment. This policy is reviewed regularly.

Through its Corporate Responsibility Committee, the Pennon Group Board monitors performance against its ethical policy and its societal, environmental and health and safety targets. Further details of the work of this Committee are set out on page 55.

CORPORATE RESPONSIBILITY HIGHLIGHTS

Pennon Group has achieved recognition in a range of independent surveys: the Business in the Environment Index, FTSE4Good Index and the Carbon Disclosure Project (CDP).

Both South West Water and Viridor have made significant advances in enhancing their environmental and community performance, as set out in our Corporate Responsibility report available online from 4 July 2008 at *www.pennon-group.co.uk*

Investor Survey Results

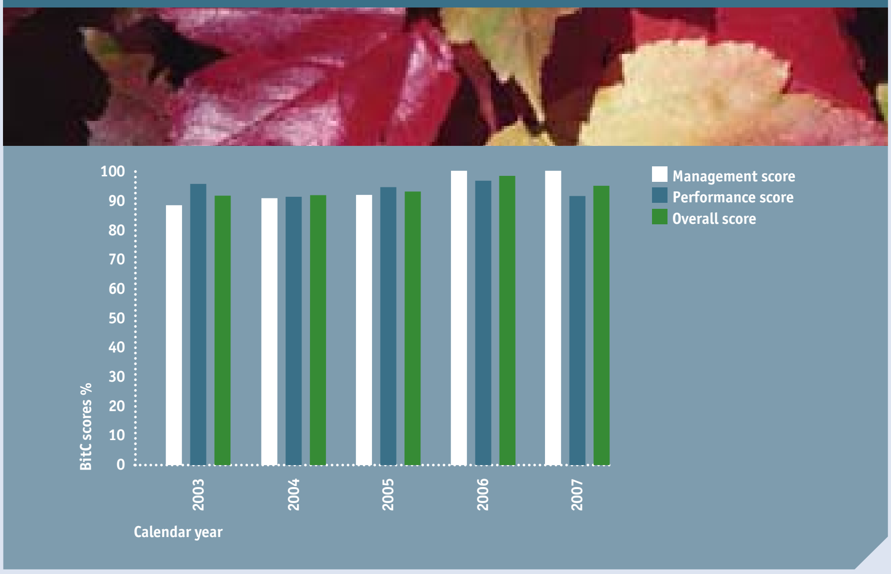
In the Business in the Community (BitC) Environmental Index 2007, Pennon Group scored 95.34% and has maintained its listing in the Platinum rank. BitC commented "You should be very proud of this exemplary result, which reflects highly on your business both against your competitors and absolutely."

The Group continues to be a constituent member of the FTSE4Good Index which measures Corporate Social Responsibility.

In the Co-op Investment research findings on Ethical Investing, Pennon Group was ranked 12th in a table of the 20 best firms in the FTSE 350.

In June 2007 Pennon Group received a special commendation for best use of electronic communications in the South West Financial and Corporate Communications Award. These awards recognise the region's quoted companies who have demonstrated best practice communications with their stakeholders, including shareholders, the financial press, analysts and employees.

BitC Environment Index score



◣ Left: Par beach boardwalk – photography by Oliver Denne
◣ Above: Land's End – photography by Michael Saldivar
◣ Top: Mousehole harbour – photography by Michael Saldivar

Carbon Disclosure Project (CDP)

Pennon Group's ability to log its carbon footprint and assess how climate change will affect its business has put the Company in the lead amongst other corporations. The CDP team awarded a 'best reporting company' status to 45 out of 245 FTSE companies who responded to the survey. Of these 45 companies Pennon Group was the only water and waste utility listed out of the five water utilities that reported.

Companies responded to a questionnaire with information on direct and indirect emissions, disposal issues, and details on how they saw the risks and opportunities and their carbon reduction targets and strategies. CDP collates data from major corporations around the world and their website is the largest repository of corporate greenhouse gas emissions data in the world.

Climate Change and Sustainability

Objective: To take appropriate action to minimise emissions of greenhouse gases and to adapt to the potential impacts of climate change.

ELECTRICITY CONSUMPTION AND GENERATION

On-site electricity consumed			**GWh**
South West Water[1]			259
Viridor			11
Total consumed			**270**
Electricity generation	No of sites	Capacity MW	GWh
South West Water			
– Hydro	7	6	12
– Biogas from combined heat and power	7	1	5
Viridor			
– Landfill – biogas[2]	29	84	499
Total generated			**516**
Generated/consumed ratio			**191%**

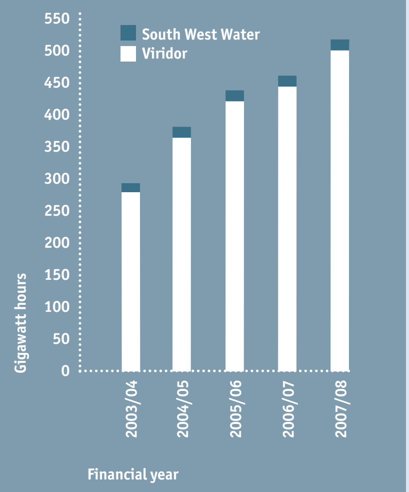
(1) includes Pennon Group Plc and partners' related activity
(2) Includes subcontracted sites in Suffolk

Climate Change Strategy

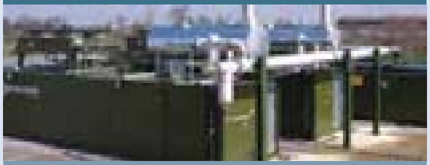
The Group seeks to optimise energy efficiency and maximise appropriate opportunities for renewable energy generation. The Group will take appropriate action to reduce the emissions of greenhouse gases for which it is responsible, wherever this is possible. In planning for the future the Group works to ensure its readiness to meet the challenge of maintaining high quality levels of service in the face of a changing climate.

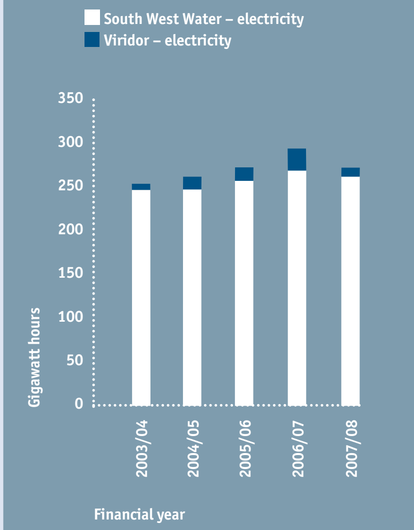
Waste is currently the UK's main source of renewable energy (30% of renewables) and represents 1.5% of the electricity from all sources. According to the Institution of Civil Engineers this could theoretically account for over 15%; even if this is an over estimate it is still clear that waste can make a major contribution to UK energy supplies.

◣ 'Green energy' generated



◣ On-site electricity use in Pennon Group





Carbon Reduction Commitment

Pennon Group is preparing for the Government's 'Carbon Reduction Commitment'. This is a mandatory emissions trading scheme based on reductions in energy use for commercial and public sector organisations using annually over 6,000 MWh of half hourly metered electricity. The baseline year for energy use will be calendar year 2008, and the earliest the scheme will begin is 2010, with the capped phase beginning in 2013. Companies in the scheme will be placed in a league table: those which perform well will be rewarded and those at the bottom will face penalties.

◣ Above: Training at South West Water
◣ Left: Valley Cruz Boconnoc, Lostwithiel – photography by Gary Chenery
◣ Far left: Godrevy Hayle, Cornwall – photography by Michael Saldivar

International Labour Organisation core conventions

In common with other responsible employers the Group supports the principles of the International Labour Organisation's eight core conventions for the protection and safety of workforces. Details of the Group's employment practices are set out on pages 13, 24 and 45.

Renewable energy generation

Renewable energy is generated by both subsidiaries. Viridor's renewable power generation capacity from landfill gas continues to increase and is now 84MW. Viridor captures nearly 90% of the methane arising from its landfills and uses 70% of this for energy generation. South West Water generates renewable energy from hydro-power and combined heat and power at waste water treatment works.

Net electricity export

Since 1999/2000, the Pennon Group has exported more electrical energy each year than it has consumed. In 2007/08 Viridor and South West Water generated 516GWh renewable energy through their operations. This is 191% of the Group's electricity consumption of 270GWh.

Group transport

South West Water and Viridor review their transport fleets regularly to meet their operational requirements. Environmental criteria such as clean engine technology, fuel efficiency, reliability and end of life recyclability are considered during the selection process.

Pennon Environmental Awards

In 2007 the winning prize was awarded to a project which achieved environmental benefits and cost savings whilst proactively managing ultra-violet (UV) disinfection at Plymouth Central waste water treatment works. This type of disinfection achieves the highest standard of effluent consent and is monitored by the Environment Agency. Compliance with UV consent has been maintained, with the site operating in a UV dose paced arrangement, switching banks of lamps on and off as required. This has prolonged the operating life of the lamps and saved about £13,000 in lamp costs in a year. In addition, there were 520 fewer lamps (a hazardous waste) disposed of from this site. Savings of almost £16,000 in energy costs were made over a six month period, together with estimated savings of 95 tonnes of carbon dioxide. These savings are on-going and will give continued environmental benefits year on year.

Rebecca Bragg and Roger Wills receive the trophy from Ken Harvey, Pennon Group chairman

Green Apple Awards

South West Water is included in the Green Organisation's list of 'Green Heroes', and in 2007, won a Green Apple Award for the 'Sludge Judge', which optimises moisture content prior to tankering to save fuel and increase transport efficiencies. This project won the 2006 Pennon Environmental Award.

Steve Chapple receiving the 2007 Green Apple award from Professor David Bellamy OBE

COMMUNITY ENGAGEMENT

Pennon Charitable Donations

The Pennon Charitable Donations Committee provided a total of £64,297 funding to various causes including Hayle Surf Life Saving Club, Torbay and South Devon Hospice and Dunsford Pre-School Playgroup.

◣ Pennon Charitable Donations Committee gave money to Vranch House in 2007/08. Photography by John Sculpher

Pennon Environmental Fund

The Pennon Environmental Fund awarded £53,700 to projects in 2007/08 including church and village hall improvements and various habitat creation schemes to benefit wildlife.

◣ Lamerton Sports and Community Hall

Viridor Credits Environmental Company (a Distributive Environmental Body)

During the year Viridor donated £9.2 million via the Landfill Communities Fund (LCF) to Viridor Credits, an independent charity established to distribute LCF funding in areas surrounding landfills. Decisions on funding use criteria of sustainability, value for money and proven need and are made at grass roots level by established local steering groups for each area. Projects supported during the year included creating, improving and restoring important habitats; new and improved village and amenity halls; and vital support for local museums and similar community assets. For further details see Viridor Credits' website at *www.viridor-credits.co.uk*

Stakeholder engagement

Viridor's Chief Executive is chairman of the UK's Knowledge Transfer Network, which comprises representatives of the public sector, businesses and the academic community. The network is designed to assist the development and uptake of innovative environmental technologies. Priority areas of focus include recovery of energy from waste and energy efficient water and waste water treatments.

Viridor's Chief Executive is also chairman of the Government's Environmental Sector Advisory Group which promotes export and inward investment in the environmental goods and services sector.

Progress against 2007/08 Corporate Responsibility Target	Status	Comment
Maintain corporate standing of Pennon Group Plc on sustainability credentials	Met	Good results in BiE* and investor surveys

*BiE is the Business in the Community's Environment Index

Corporate Responsibility Target 2008/09: maintain corporate standing of Pennon Group Plc on sustainability credentials.

Pennon's corporate responsibility performance has been audited by Acona (an independent risk and compliance management company) for 2007/08. The Verification Statements for Pennon, South West Water and Viridor are provided on their respective websites with their corporate responsibility reports.

◣ Left: Engaging in community initiatives
◣ Above: Canterbury Cathedral – donation made for restoration
◣ Far left: Peak Hill – photography by John Perriam

INTERPRETATION

FORWARD LOOKING STATEMENTS

This business review contains forward looking statements regarding the financial position; results of operations; cash flows; dividends; financing plans; business strategies; operating efficiencies; capital and other expenditures; competitive positions; growth opportunities; plans and objectives of management; and other matters. These forward looking statements, including, without limitation, those relating to the future business prospects, revenues, working capital, liquidity, capital needs, interest costs and income in relation to the Pennon Group and its subsidiaries, wherever they occur in this business review, are necessarily based on assumptions reflecting the views of Pennon Group and its subsidiary companies, as appropriate. They involve a number of risks and uncertainties that could cause actual results to differ materially from those suggested by the forward looking statements. Such forward looking statements should, therefore, be considered in light of relevant factors, including those set out in the sections entitled 'Risks and uncertainties' on pages 14, 24 to 27 and 35.

GLOSSARY

The following are descriptions of some of the terms used in this Business Review:

CAGR	Compound Annual Growth Rate, being the rate of growth over a period, expressed as a single annual average figure
DEFRA	Department for Environment, Food and Rural Affairs
Determination	The price limits and expenditure plans determined by Ofwat for South West Water for a five year period
DWI	Drinking Water Inspectorate
EA	Environment Agency
EfW	Energy from Waste
EMS	Environmental Management System
Financial year	Financial year of the Group ending 31 March
GWh	Gigawatt hours
HWRS	Household waste recycling sites
IFRS	International Financial Reporting Standards
Interim Determination	Interim Determination of K
ISO 14001	International environmental management accreditation standard
June Return	The annual return to Ofwat made by South West Water on its performance during the previous financial year
KPIs	Key Performance Indicators
LATS	Landfill Allowance Trading Scheme
LAWDC	Local Authority Waste Disposal Company
Ml	Megalitres
MW	Megawatts
NFFO	Non Fossil Fuel Obligation
Ofwat or water regulator	Water Services Regulatory Authority
'percentage population equivalent'	Waste water treatment works loadings from domestic, industrial and diffuse sources, averaged and stated as a population equivalent load, expressed as a percentage
Periodic Review	The process of determining the water industry's price limits and expenditure plans for five-year regulatory periods
PFI	Private Finance Initiative
PPC	Pollution, Prevention and Control
PPP	Public Private Partnership
RCV	Regulatory Capital Value
RIDDOR	Reporting of Injuries, Diseases and Dangerous Occurrences Regulations (1995)
ROCs	Renewables Obligation Certificates
RPI	The UK Government's Retail Price Index
SEPA	Scottish Environment Protection Agency
UK GAAP	United Kingdom Generally Accepted Accounting Principles
Viridor	Viridor Limited (subsidiary of Pennon Group Plc) or a Viridor Limited operating subsidiary, depending on the nature of the activity described
WEEE	Waste electrical and electronic equipment
	Pennon Environmental Photographic Competition 2007 entry

Electronic data management for leakage control

OTHER STATUTORY INFORMATION

PRINCIPAL ACTIVITIES AND BUSINESS REVIEW

The principal activities of the Company and its subsidiaries ('the Group') are the provision of water and sewerage services and waste management. Information regarding the Group, including important events and its progress during the year, events since the year end and likely future developments is contained in the business review set out on pages 2 to 42 of this Directors' report.

In addition the business review contains a fair and balanced review of the business of the Group, including its position and prospects, Key Performance Indicators and a description of the principal risks and uncertainties facing the Group in accordance with the requirements of the Combined Code and Section 234ZZB of the Companies Act 1985 as well as further information on employee, environmental, social and community matters, reflecting the requirements of Section 417 of the Companies Act 2006 (which came into force on 1 October 2007 in respect of financial years commencing on or after 1 October 2007). In addition in accordance with the ABI Corporate Social Responsibility Guidelines, statements are included on any significant environmental, social and governance (ESG) risks and the actions taken in mitigating these risks within the business review on pages 14, 24 to 27 and 35. Further information on ESG aspects of the Group's business are included in the corporate responsibility section of the business review on pages 36 to 41. The principal subsidiaries of the Company are listed in note 38 to the financial statements on page 109.

TAKEOVER CODE DISCLOSURES

The following disclosures are made pursuant to Part 7 of Schedule 7 of the Companies Act 1985 (as inserted by Section 992, Companies Act 2006 in accordance with the EU Takeover Directive 2004/25/EC). As at 31 March 2008:

(a) details of the Company's issued share capital, which consists of ordinary shares of nominal value 40.7 pence each, are set out in Note 31 to the financial statements on pages 99 to 103. All of the Company's issued shares are fully paid up, rank equally in all respects and are listed on the Official List and traded on the London Stock Exchange. The rights and obligations attaching to the Company's shares, in addition to those conferred on their holders by law, are set out in the Company's Articles of Association ("Articles"), copies of which can be obtained from Companies House in the UK or by writing to the Company Secretary at the registered office. The holders of the Company's shares are entitled to receive the Company's reports and accounts and in relation to general meetings of the Company they have the right to attend and speak, exercise voting rights and appoint proxies.

(b) there are no restrictions on the transfer of issued shares of the Company or on the exercise of voting rights attached to them, except where the Company has exercised its right to suspend their voting rights or to prohibit their transfer following the omission of their holder or any person interested in them to provide the Company with information requested by it in accordance with Part 22 of the Companies Act 2006 or where their holder is precluded from exercising voting rights by the Financial Services Authority's Listing Rules or the City Code on Takeovers and Mergers.

(c) details of significant direct or indirect holdings of securities of the Company are set out in the shareholder analysis on page 114 (shareholder information)

(d) the Company's rules about the appointment and replacement of Directors are contained in the Articles and accord with usual English company law provisions. The powers of Directors are determined by UK legislation and the Memorandum of the Company and the Articles in force from time to time. Changes to the Articles must be approved by the shareholders by passing a special resolution.

(e) the Directors have the power to make purchases of the Company's own shares in issue as set out in the section on page 45 'Purchase Of Own Ordinary Shares' and such rights have been exercised as set out in that section. The Directors also have the authority to allot shares up to an aggregate nominal value of £30,210,712 which was approved by shareholders at the 2007 Annual General Meeting (AGM). In addition, shareholders approved a resolution giving the Directors a limited authority to allot shares for cash other than pro rata to existing shareholders. These resolutions remain valid until the conclusion of this year's AGM. Resolutions will be proposed at this year's AGM to renew these authorities. The Directors have no present intention to issue ordinary shares, other than pursuant to employee share schemes.

(f) there are a number of agreements which take effect, alter or terminate upon a change of control of the Company following a takeover bid, such as bank loan agreements, Eurobond documentation, private placement debt and employees' share plans. None of these is considered to be significant in terms of their potential impact on the business of the Group as a whole except for agreements relating to £210 million of term loans and £85 million of drawn revolving credit facilities maturing on various dates up to and including 15 August 2010 which could become repayable upon a change of control of the Company. A change of control will be deemed to have occurred if any person or persons acting in concert (as defined in the City Code on Takeovers and Mergers) at any time is/are or become(s) interested in more than 50% of the issued ordinary share capital of the Company or shares in the capital of the Company carrying more than 50% of the voting rights normally exercisable at a general meeting of the Company.

FINANCIAL RESULTS AND DIVIDEND

Statutory Group profit on ordinary activities after taxation was £133.6 million. The Directors recommend a final dividend of 13.56p per ordinary share to be paid to shareholders on the register on 8 August 2008, making a total for the year of 19.81p, the cost of which will be £69.1 million, leaving a retained surplus of £64.5 million. The business review on pages 28 to 35 analyses the financial results in more detail and sets out other financial information, including the Directors' opinion on asset values on page 32.

DIRECTORS

David Dupont and Kate Mortimer are due to retire at the AGM on 31 July 2008 and offer themselves up for re-election. In addition, as Ken Harvey has been a Director for over nine years, in accordance with the Combined Code he offers himself up for re-election annually. The Board continues to believe that Kate Mortimer, as a Non-executive Director standing for re-election is independent, and that she makes an effective and valuable contribution to the Board, demonstrating continued commitment to the role. Neither Ken Harvey nor Kate Mortimer has a service contract, although Ken Harvey's contract for services is terminable upon 12 months' notice. David Dupont has a service contract which is due to expire in six years' time, being upon his normal retirement date. Resolutions for the above Directors' re-election will be proposed at the AGM. No Director has, or has had, a material interest, directly or indirectly, at any time during the year under review in any contract significant to the Company's business. A list of all the Directors during the year is set out in the emoluments table on page 50. Further details relating to the Directors and their service contracts or contracts for services are set out on pages 46 to 50 and details of the Directors' interests in shares of the Company are given on pages 51 to 53.

STATEMENT AS TO DISCLOSURE OF INFORMATION TO AUDITORS

(a) So far as each of the Directors in office at the date of the signing of the report are aware, there is no relevant audit information of which the Company's auditors are unaware; and
(b) each of the Directors has taken all the steps each Director ought to have taken individually as a director in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

FINANCIAL INSTRUMENTS

Details of the financial risk management objectives and policies of the Group and the exposure of the Group to price, credit, liquidity and cash flow risks are set out in the business review on pages 32 to 35.

EMPLOYMENT POLICIES AND EMPLOYEE INVOLVEMENT

The Group has a culture of continuous improvement through investment in people at all levels within the Group. The Group is committed to pursuing equality and diversity in all its employment activities including recruitment, training, career development and promotion and ensuring there is no bias or discrimination in the treatment of people.
In particular, applications for employment are welcomed from disabled persons and special arrangements and adjustments as necessary are made to ensure that disabled applicants are treated fairly when attending for interview or for pre-employment aptitude tests.
Wherever possible, the opportunity is taken to retrain people who become disabled during their employment in order to maintain their employment within the Group. Employees are consulted regularly about changes which may affect them either through their trade union appointed representatives or by means of the elected Staff Council which operates in South West Water for staff employees. These forums, together with regular meetings with particular groups of employees, are used to ensure that employees are kept up to date with the operating and financial performance of their employer. The Group also uses a monthly information cascade process to provide employees with important and up to date information about key events.

Further information about employment matters relating to South West Water is set out on pages 13 and 14, and to Viridor on page 24 of the business review.

The Group encourages share ownership amongst its employees by operating both an HM Revenue & Customs approved Sharesave Scheme and a Share Incentive Plan. At 31 March 2008 around 35% of the Group's employees participated in these plans.

RESEARCH AND DEVELOPMENT

Research and development activities within the Group involving water and waste treatment processes amounted to £0.2 million during the year (2006/07 £0.1 million).

PENNON GROUP DONATIONS

During the year, donations amounting to £64,300 were made. Details relating to charitable and other donations will be set out in the Corporate Responsibility Report which will be available for viewing on the Company's website at *www.pennon-group.co.uk* from 4 July 2008. No political donations were made.

TAX STATUS

The Company is not a close company within the meaning of the Income and Corporation Taxes Act 1988.

PAYMENTS TO SUPPLIERS

It is the Group's payment policy for the year ending 31 March 2009 to follow the Code of The Better Payment Practice Group on supplier payments. Information about the Code can be obtained from *www.payontime.co.uk*
The Company will agree payment terms with individual suppliers in advance and abide by such terms. The ratio, expressed in days, between the amount invoiced to the Company by its suppliers during 2007/08 and the amount owed to its trade creditors at 31 March 2008, was 33 days.

PURCHASE OF OWN ORDINARY SHARES

The Company has authority from shareholders to purchase up to 10% of its own ordinary shares (as renewed at the AGM in 2007) which was valid as at 31 March 2008 and remains currently valid. In connection with the return of cash to shareholders as set out in the Circular to shareholders dated 23 January 2006, the Company during 2007/08 purchased from the market 8,245,008 ordinary shares (40.7p) of which 960,000 were cancelled and 7,285,008 were held in Treasury for the purposes of employee share schemes at a cost of £49.3 million amounting to approximately 2.3% of its issued ordinary shares. Of the 7,285,008 shares held in Treasury 873,602 were subsequently re-issued under the Company's Sharesave Scheme for proceeds of £1.6 million.

A total of 57,967 ordinary shares were also purchased during the year by the Pennon Employee Share Trust, Pennon Share Plans Guernsey Limited, for the deferred element of the Group's Annual Incentive Bonus Plan. The total purchase price was £0.3 million and the shares amounted to approximately 0.02% of the Company's issued ordinary shares.

AUDITORS

PricewaterhouseCoopers LLP were appointed auditors until the conclusion of the nineteenth Annual General Meeting. A resolution for their re-appointment upon the recommendation of the Audit Committee of the Board will be proposed at the AGM.

APPOINTED BUSINESS

South West Water Limited is required to publish additional financial information relating to the 'appointed business' as water and sewerage undertaker in accordance with the Instrument of Appointment from the Secretary of State for the Environment.
A copy of this information will be available from 11 July 2008 upon application to the Company Secretary at Peninsula House, Rydon Lane, Exeter EX2 7HR.

ANNUAL GENERAL MEETING

The nineteenth Annual General Meeting of the Company will be held at the Sandy Park Conference Centre, Sandy Park Way, Exeter, Devon EX2 7NN on 31 July 2008 at 11.00am.
In addition to routine business, resolutions will be proposed at the Annual General Meeting to:

- renew the existing authorities to issue a limited number of shares and to purchase up to 10% of the issued share capital of the Company
- seek authority to make political donations under the Political Parties, Elections and Referendums Act 2000
- re-elect Messrs K G Harvey and D J Dupont and Ms K M H Mortimer as Directors of the Company
- approve new Articles of Association to provide for new legislative provisions arising from the implementation of further provisions of the Companies Act 2006 including dealing with conflicts of interest of Directors.

Details of the resolutions are set out in the separate Notice of Annual General Meeting circulated to shareholders with this Annual Report.

By Order of the Board
KEN WOODIER, Group General Counsel & Company Secretary
26 June 2008

Kenneth George Harvey BSc, CEng, 67
Chairman

Was appointed on 1 March 1997. Ken was formerly chairman and chief executive of Norweb Plc. He was chairman of National Grid Holdings in 1995 and was previously deputy chairman of London Electricity and earlier its engineering director. He has also been chairman of a number of limited and private equity funded companies. Currently he is the senior independent non-executive director of National Grid Plc.

Colin Irwin John Hamilton Drummond MA, MBA, LTCL, CCMI, 57
Chief Executive, Viridor Limited

Was appointed on 1 April 1992. Prior to joining the Company Colin was a divisional chief executive of Coats Viyella, having previously been corporate development director of Renold plc, a strategy consultant with the Boston Consulting Group and an official of the Bank of England. He is chairman of the Government's Environmental Sector Advisory Group and chairman of the Environmental Knowledge Transfer Network; senior visiting research fellow in Earth Sciences at Oxford University; and for the past year has been Master of the Worshipful Company of Water Conservators.

David Jeremy Dupont MA, MBA, 54
Group Director of Finance

Was appointed on 2 March 2002. David was formerly regulatory and finance director of South West Water Limited, having joined Pennon Group Plc (then South West Water Plc) in 1992 as strategic planning manager. Previously he held business planning and development roles with Gateway Corporation. He is a member of the CBI Environmental Affairs Committee and the CBI South West Regional Council.

Christopher Loughlin BSc Hons, MICE, CEng, MBA, 55
Chief Executive, South West Water Limited

Was appointed on 1 August 2006. Chris was most recently chief operating officer with Lloyd's Register and previously was an executive director of British Nuclear Fuels Plc and executive chairman of Magnox Electric Plc. Chris started his career as a chartered engineer and subsequently held a number of senior positions with British Nuclear Fuels. He was appointed chairman of Water UK with effect from 1 April 2008.

Gerard Dominic Connell MA, 50
Senior Independent Non-executive Director

Was appointed on 1 October 2003. Gerard is currently group finance director of Wincanton Plc. Previously he was a director of Hill Samuel and a managing director of Bankers Trust and has held other corporate finance and business development positions in the City and in industry.

Katharine Mary Hope Mortimer MA, BPhil, 62
Non-executive Director

Was appointed on 1 May 2000. Kate is currently a freelance financial consultant and a member of the Crown Agents Foundation Council. She was formerly a director of N M Rothschild & Sons Limited, director of policy at the Securities and Investments Board, chief executive of Walker Books and was a member of the Competition Commission between 1995 and 2001.

Dinah Alison Nichols CB, BA Hons, 64
Non-executive Director

Was appointed on 12 June 2003. Dinah was formerly Director General Environment at the Department for Environment, Food and Rural Affairs and previously held various senior appointments within Government, including being head of the water directorate during the period of water privatisation. She is also a Crown Estate Commissioner, a non-executive director of Shires Smaller Companies Plc, chair of the National Forest Company, chair of Groundwork North London and a director of several Trusts.

COMMITTEES OF THE BOARD

Audit
Gerard Connell (Chairman)
Kate Mortimer
Dinah Nichols

Corporate Responsibility
Dinah Nichols (Chairman)
Gerard Connell
Colin Drummond
Chris Loughlin
Kate Mortimer

Nomination
Ken Harvey (Chairman)
Gerard Connell
Kate Mortimer
Dinah Nichols

Remuneration
Kate Mortimer (Chairman)
Gerard Connell
Ken Harvey (from 1 June 2007)
Dinah Nichols

Group General Counsel & Company Secretary
Ken Woodier, Solicitor

Registered office
Peninsula House,
Rydon Lane,
Exeter
EX2 7HR
Registered in England No 2366640

THE REMUNERATION COMMITTEE

The Remuneration Committee comprises four Non-executive Directors: Kate Mortimer, who chairs the Committee, Gerard Connell and Dinah Nichols (who are all regarded by the Company as independent) together with the Chairman of the Company, Ken Harvey, who was appointed on 1 June 2007 following the latest edition (June 2006) of the Combined Code, which acknowledged that a company chairman may also be a member of a remuneration committee if he was considered independent upon appointment as chairman.

The Committee's terms of reference include advising the Board on the framework of executive remuneration for the Group and responsibility for determining the remuneration and terms of engagement of the Chairman, the Executive Directors and senior management of the Group. No Director or any other attendee participates in any discussion on, or determination of, his or her own remuneration.

During the year the Committee met on seven occasions and received advice, or services, that materially assisted the Committee in the consideration of remuneration matters from Ken Harvey, Chairman of the Company. In addition the Committee received advice from the following advisors, who were appointed directly by the Committee:

– Ken Woodier, Group General Counsel & Company Secretary, on remuneration and share scheme matters. He also provides legal advice and company secretarial services to the Company;

– independent remuneration advisors, Deloitte & Touche LLP, on long-term incentive arrangements;

– pensions and remuneration consultants, Hewitt Associates Limited, on calculating Total Shareholder Return for the Company's Restricted Share Plan. Hewitt also provide actuarial and investment pensions advice to the Group's Pension Trustees.

GROUP REMUNERATION POLICY

The policy of the Group, which, subject to a strategic review of remuneration later in the year, will be applied by the Remuneration Committee in 2008/09 and is also currently intended to be applied in each subsequent year, continues to be to provide for Executive Directors a remuneration package which is adequate to attract, retain and motivate good quality executives and which is commensurate with the remuneration packages provided by companies of similar size and complexity. The policy in respect of Non-executive Directors is set out on page 49 in the Non-executive Directors' remuneration section.

EXECUTIVE DIRECTORS

The remuneration package of the Executive Directors is summarised below. It comprises salary, annual bonus, long-term incentives, pensions (or benefit in lieu), car benefit and health cover. In 2008/09 (subject to fluctuations in the Company's share price) it is expected that around two-thirds of Directors' potential direct remuneration (i.e. excluding pensions, car benefit and health cover) will be performance related (two-thirds in 2007/08). It is intended that this balance between performance related and that which is not related to performance will continue.

None of the Executive Directors currently serve as a non-executive directors elsewhere and therefore do not receive any fees for such services.

With effect from 2007/08 the Committee introduced a shareholding guideline that Executive Directors and senior management shall hold a substantial personal shareholding in the Company. Executive Directors are encouraged to build up their shareholding over a five year period to a value of at least equivalent to their basic salary.

(i) Basic salary and benefits – These are set out on page 50 for each Executive Director and are not related to performance. The Committee determines revised salaries, usually on an annual basis, for Executive Directors based upon surveys generally available conducted by independent remuneration consultants and the performance of the individual Executive Directors which the Committee assesses with the advice of Ken Harvey, Chairman of the Company. Other benefits, not mentioned below, include contributory pension provision (with four times salary life assurance cover) or a cash alternative, a fully-expensed car (or a cash equivalent alternative) and health cover.

(ii) Performance related bonus – Annual performance related bonuses are awarded in accordance with an Incentive Bonus Plan for Executive Directors and based on the achievement of overall corporate and individual objectives established by the Committee. The maximum bonus achievable under the Plan for Executive Directors for 2007/08 was 100% of basic salary. To achieve a bonus towards or at the upper end of the maximum bonus in respect of earnings per share, it is necessary for the Company to achieve a specified level of superior outperformance. Half of any bonus awarded is in the form of shares in the Company which must usually be held for a period of three years before release. During this period, the Directors, in respect of these shares, are entitled to receive any dividends declared by the Company. No additional performance conditions applicable to the release of these shares, apart from maintaining continuous service with the Company, are considered appropriate by the Committee in view of the stretching performance conditions applicable to achieve the initial award of the shares. The Committee, in setting the performance objectives for Directors, is able to consider corporate performance on environmental, social and governance (ESG) issues. Objectives set embrace appropriate ESG parameters which are important to the success of the Group and which seek to ensure that the Group meets a number of its ESG targets as set out in the Group's Corporate Responsibility Report (referred to on pages 36 to 41 of the business review). The Committee in setting such objectives and in determining its remuneration policy overall, does ensure that the relevant incentives to Directors and senior management raises no ESG risks by inadvertently motivating irresponsible behaviour. In addition, the Committee will take into account ESG issues in determining the vesting of any awards under the Company's Performance and Co-investment Plan, as referred to on page 49.

(ii) Performance related bonus *(continued)*
The following corporate and individual objectives of the Executive Directors applicable to the performance related bonus award for 2008/09 were determined by the Committee as appropriate, having regard to the activities of the Group that each individual Director could most influence and also to the overall performance of the Group, all of which seek to align the interests of the Directors with those of shareholders (the references to a percentage bonus relate to a percentage of the annual basic salary of each Executive Director in 2008/09):

Colin Drummond
– A bonus of up to 40% for outperformance of Group earnings per share against budget; up to 40% calculated by reference to out-performance of the profit before tax and net debt budgets of Viridor; and up to 20% for personal objectives relating to key business targets for Viridor.

David Dupont
– A bonus of up to 40% for outperformance of Group earnings per share against budget; up to 40% for outperformance against budget relating to net debt and net interest of the Group and profit before tax of South West Water and Viridor; and up to 20% for personal objectives relating to Group financing and Group initiatives.

Chris Loughlin
– A bonus of up to 40% for outperformance of Group earnings per share against budget; up to 20% for personal objectives relating to implementing South West Water's new strategies and projects; and up to 40% calculated by reference to the average bonus earned by the other executive directors of South West Water (which relate to outperformance against the operating costs, profit before tax, capital expenditure and net debt budgets of the company; the position the company achieves in the 'Overall Performance Assessment' of water and sewerage companies established by the Water Services Regulatory Authority (WSRA); the achievement of a range of service standards set for the company by the WSRA; and personal objectives relating to key initiatives and projects of the company).

The achievements of the Executive Directors against their individual performance objectives are assessed by the Committee following the financial year end when the audited results of the Company and performance against parameters set are known. This enables the Committee to apply largely objective criteria in determining the level of bonus (if any) that should be awarded, with the advice of the Chairman of the Company, Ken Harvey.

(iii) Long-Term Incentive Plan –
A Performance and Co-investment Plan (PCP), as approved by shareholders at last year's Annual General Meeting, was operated by the Company during the year for Executive Directors and senior management.

The purpose of the PCP is to award shares to participants subject to the achievement of stretching performance conditions measured over three years. The first awards under the PCP, in the form of a conditional right over ordinary shares in the Company, were made by the Committee in August 2007 and, for Executive Directors, the award was over shares worth 100% of basic salary. In accordance with its discretion pursuant to the rules of the PCP, the Committee made the vesting of the awards also subject to the fulfilment of a co-investment condition whereby Executive Directors were required to invest and hold shares in the Company equal to 20% of the value of their award over the Restricted Period (being a period of three years from the date of the award). The percentage requirement for senior management was suitably scaled back. The number of shares subject to each award in the event of vesting will be increased by such number of shares as could have been acquired by reinvesting the dividends which would otherwise have been received on those shares prior to vesting or exercise.

The awards made in August 2007 will vest based on the Company's total shareholder return ('TSR') performance over a three year performance period against two different comparator groups as set out below. TSR measures the value created for shareholders through increases in share price and the payment of dividends and was applied by the Committee because, based upon advice received from remuneration consultants, Deloitte & Touche LLP, it believes that this is an appropriate measure to align the interests of the Executive Directors with those of shareholders:

- 50% of an award will vest according to the Company's TSR performance measured against an index made up of the following six listed water and waste comparator companies:

Biffa
Kelda Group
Northumbrian Water Group
Severn Trent
Shanks
United Utilities

These were the Company's key listed sector comparators but, as Biffa and Kelda Group have now de-listed, the Committee will have discretion to include these companies in the calculation of the index up to the date of de-listing (or other earlier date at its discretion) and exclude them from that date onwards or adopt an alternative approach.

WATER/WASTE GROUP	Vesting % of total award
Above the index +15%	50%
Equal to the index	15%
Straight-line vesting in between the above points	
Below the index	0%

- 50% of the award will vest according to the Company's ranked TSR performance against the constituents of the FTSE 250 index (excluding investment trusts). This is the FTSE index to which the Company belongs.

FTSE 250 GROUP	Vesting % of total award
At or above 75th percentile	50%
Above 50th percentile	15%
Straight-line vesting in between the above points	
At or below 50th percentile	0%

(iii) Long-Term Incentive Plan
continued

In addition to this TSR condition, before any award is capable of vesting, the Committee will also need to be satisfied that the underlying operational and economic performance of the Company is at a satisfactory level. This will include consideration of sustainability and environmental factors and safety performance, as well as financial performance.

Whilst the Committee intends currently to apply similar performance conditions to those set out above to any future PCP awards, they will be reviewed on an annual basis to ensure that they remain appropriate and suitably stretching for future awards.

(iv) Other Share Schemes – Executive Directors are entitled to participate in the Company's Sharesave Scheme. It is an all-employee plan to which performance conditions do not apply. In addition, Executive Directors are entitled to participate in the Company's Share Incentive Plan (SIP), which is also an all-employee plan to which performance conditions do not apply.

(v) Service Agreements – In accordance with Company policy, all Executive Directors have service agreements subject to one year's notice and which are due to expire when Directors reach their normal retirement age (age 60) unless extended by agreement between the Director and the Company. No provision is made for termination payments under the service agreements. In the event of termination by the Company of any Executive Director's service agreement, the Board would determine what payments (if any) should be made to the Director depending on the circumstances of the termination. The dates of the agreements are:

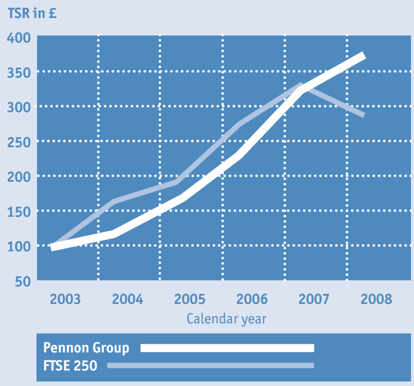
Colin Drummond	5 March 1992
David Dupont	2 January 2003
Chris Loughlin	16 May 2006

(vi) Provision for Pension – With the exception of Chris Loughlin, Executive Directors participate in the Pennon Group Pension Scheme and the Pennon Group Executive Pension Scheme. These are funded defined benefit schemes which, dependent on length of service at normal retirement date (age 60), could amount to two thirds of final pensionable pay (after deduction for the Executive Directors mentioned below of benefits accrued in the now closed Supplementary Pension Scheme). For service to 5 April 2006 an Earnings Cap applied in these Schemes to Colin Drummond and David Dupont. Both were provided with additional pension benefits under an unapproved funded Supplementary Pension Scheme of the Company in order to bring their pension benefits up to a level which would have been provided under the other schemes if the Earnings Cap had not applied. With effect from 6 April 2006 the Earnings Cap no longer applied to pension schemes as part of the simplification of taxation of pensions legislation. The Committee accordingly decided to provide all of the Directors' future service pension benefit above the Earnings Cap level from the Pennon Group Executive Pension Scheme. The Supplementary Pension Scheme was therefore closed and the accrued benefits were paid out to its members in April 2006.

The pensionable pay for Executive Directors consists of the highest basic salary in any consecutive twelve month period of service within five years of retirement. Bonuses are not included in pensionable pay. In lieu of the provision of pension benefits, Chris Loughlin receives an annual payment equivalent to 30% of his annual basic salary.

In determining remuneration arrangements for Executive Directors, the Remuneration Committee gives full consideration to their impact on the pension schemes funds and costs of providing individual pension arrangements or payments in lieu of pension provision.

TOTAL SHAREHOLDER RETURN (TSR) GRAPH



This graph shows the value, over the five year period ending in March 2008, of £100 invested in Pennon Group on 31 March 2003 compared with the value of £100 invested in the FTSE 250 Index. The other points plotted are the values at intervening financial year ends. This Index is considered appropriate as it is a broad equity market index of which the Company is a constituent.

The graph has been produced in accordance with Schedule 7A of the Companies Act 1985.

NON-EXECUTIVE DIRECTORS AND THE CHAIRMAN

Non-executive Directors' remuneration (excluding that of the Chairman, Ken Harvey) consisting of fees only as set out below, is determined by the Board of Directors, including the Chairman, but in the absence of the other Non-executive Directors. It is currently reviewed each year to take account of market changes in non-executive directors' fees. The level of fees was last reviewed in September 2007. In reviewing the fees, the Board takes into account market information on non-executive directors' fees, most recently from the Monks Partnership. Non-executive Directors receive a base fee of £31,500 per annum, the Audit, Remuneration and Corporate Responsibility Committee chairs are paid fees of £8,900, £6,300 and £6,300 per annum respectively and Committee members of these Committees receive £3,700 each. The policy to be applied in 2008/09 (which is also currently intended to be applied in each subsequent year) continues to be to set fees around the median level compared to the market, which the Board believes is appropriate to attract and retain suitably experienced non-executive directors.

The Chairman's remuneration is set by the Remuneration Committee and was reviewed in March 2008. The policy of the Committee to be applied in 2008/09 (which is also currently intended to be applied in each subsequent year) is the same as that of the Executive Directors in reviewing the fees of the Non-executive Directors. In addition to a fee (determined with market information from Deloitte & Touche and New Bridge Street Remuneration Consultants) the Chairman receives a fully-expensed car benefit and health cover. No other benefits or remuneration are received by the Chairman.

NON-EXECUTIVE DIRECTORS AND THE CHAIRMAN *continued*

The Non-executive Directors (excluding the Chairman) have contracts for services setting out their terms and conditions of appointment which are subject to the Articles of Association of the Company and which may be extended by agreement between the Company and the Non-executive Directors. No provision is made for any termination payment under these contracts.

The Chairman, Ken Harvey, has a contract for services dated 1 April 2005 which is subject to 12 months' notice to provide the Company with reasonable security with regard to his ongoing service. No provision is made for any termination payments under this contract.

The contracts for services of the Chairman and the Non-executive Directors reflect corporate governance best practice and, together with the Executive Directors' service contracts, are available for inspection at the Company's registered office during normal business hours.

The dates of the Non-executive Directors' contracts are:

Director	Date of contract	Expiry of contract
Gerard Connell	30 September 2003	30 September 2009
Kate Mortimer	19 March 2005	30 April 2009
Dinah Nichols	10 June 2003	11 June 2009

The information set out below and on the remaining pages of this remuneration report (pages 51 to 53) has been audited by the Group's independent auditors, PricewaterhouseCoopers LLP.

EMOLUMENTS OF DIRECTORS

The emoluments of individual Directors are shown in the table below:

Director	Salary/fees £000	Performance related bonus payable* £000	Other emoluments† £000	Payment in lieu of pension†† £000	**Total 2008 £000**	Total 2007 £000
Chairman:						
Ken Harvey	200	–	23	–	**223**	196
Executive Directors:						
Colin Drummond	300	142	22	–	**464**	461
David Dupont	300	131	19	–	**450**	439
Chris Loughlin	275	117	22	83	**497**	327**
Non-executive Directors:						
Gerard Connell	47	–	–	–	**47**	43
Kate Mortimer	44	–	–	–	**44**	41
Dinah Nichols	44	–	–	–	**44**	39
Total	1,210	390	86	83	**1,769**	1,546

† Other emoluments are car benefit and health cover.

* In addition to the performance related cash bonus, Executive Directors are due to receive a conditional award of shares as referred to in a note to (c) 'Incentive Bonus Plan – Deferred Shares (long-term incentive element)' on page 53.

†† In lieu of any pension provision by the Company, Chris Loughlin receives a cash payment equivalent to 30% of his annual basic salary.

** Chris Loughlin was appointed a Director part way through the year on 1 August 2006.

No expense allowances chargeable to tax or termination or compensation payments were made during the year.

DIRECTORS' PENSIONS

Defined benefit pensions accrued and payable on retirement for Directors holding office during 2007/08 are shown in the table below:

Director	Increase in accrued pension during 2007/08 (net of inflation) £000 *a*	Increase in accrued pension during 2007/08 £000 *b*	Accrued pension at 31 March 2008 £000 *c*	Transfer value at 31 March 2008 £000 *d*	Transfer value at 31 March 2007 £000 *e*	Increase in transfer value (net of Directors' contributions) £000 *f*	Transfer value of Column a (net of Directors' contributions) £000 *g*
Colin Drummond	17	21	111	2,319	1,967	331	334
David Dupont	15	18	99	2,009	1,511	477	286

Column *a* above is the increase in accrued pension during 2007/08 (net of inflation). It recognises:

i the accrual rate for the additional period's service based upon the pensionable pay at the end of the period; and

ii the effect of pay changes in real terms (net of inflation) upon the accrued pension at the start of the year.

Column *b* is the actual increase in accrued pension during 2007/08.
Column *c* is the accrued pension at 31 March 2008 payable at normal retirement age.
Column *d* is the transfer value of the accrued pension set out in column *c* as at 31 March 2008.
Column *e* is the transfer value of the accrued pension at the end of the previous financial year on 31 March 2007.
Column *f* is the increase in the transfer value during the year (column *d* minus column *e*) after deducting Directors' contributions.
Column *g* is the transfer value of column *a*, less Directors' contributions.
Columns *d*, *e*, *f* and *g* have been calculated in accordance with Actuarial Guidance Note GN11.

Under the Company's pension salary deduction arrangements, the Company pays all pension scheme members' contributions to the Group pension schemes and salaries are reduced by the same amount. The figures quoted above have not been adjusted to reflect this arrangement.

Until 31 March 2006 the Company operated a Supplementary Pension Scheme which mainly funded pension provision above the Earnings Cap and provided benefits in tax-paid lump sum form at retirement. Appropriate figures have been included in the accrued pension totals shown above. Since 1 April 2006 pension service benefit above the Earnings Cap level has been provided in the Pennon Group Executive Pension Scheme as described in (vi) 'Provision for Pension' on page 49.

Directors have the option to pay additional voluntary contributions; neither the contributions nor the resulting benefits are included in the table shown above.

DIRECTORS' SHARE INTERESTS

(a) Shareholdings

The number of ordinary shares of the Company in which Directors held beneficial interests at 31 March 2008 and 31 March 2007 were:

Director	**2008 Ordinary shares (40.7p each)**	2007 Ordinary shares (40.7p each)	Director	**2008 Ordinary shares (40.7p each)**	2007 Ordinary shares (40.7p each)
Gerard Connell	**–**	–	Chris Loughlin	**18,987**	9,734
Colin Drummond	**188,277**	125,043	Kate Mortimer	**1,974**	1,951
David Dupont	**166,063**	99,655	Dinah Nichols	**–**	–
Ken Harvey	**7,209**	7,209			

Additional ordinary shares (40.7p each) have been acquired by the Directors since 31 March 2008 as follows as a result of participation in the Company's Dividend Re-investment Plan, Individual Savings Accounts or the Company's Share Incentive Plan:

Colin Drummond	119	David Dupont	61	Chris Loughlin	227	Kate Mortimer	8

There have been no other changes in the beneficial interests or the non-beneficial interests of the Directors in the ordinary shares of the Company between 1 April 2008 and 30 May 2008.

DIRECTORS' SHARE INTERESTS *continued*

(b) Restricted Share Plan and Performance and Co-investment Plan (Long-Term Incentive Plans)

In addition to the above beneficial interests, the following Directors have or had a contingent interest in the number of 40.7p ordinary shares shown below, representing the maximum number of shares to which they would become entitled under the Group's Long-Term Incentive Plans should the relevant criteria be met in full:

Director and date of award	Conditional awards held at 1 April 2007	Conditional awards made in year	Market price upon award in year	Vesting in year	Value of shares upon vesting (before tax) £000	**Conditional awards held at 31 March 2008**	Date of end of period for qualifying condition to be fulfilled
Colin Drummond							
16/9/04 †	101,070††	–	269.83p	85,909	516	**–**	–
27/9/05 †	40,140	–	356.67p	–	–	**40,140**	26/9/08
18/9/06	41,363	–	498.62p	–	–	**41,363**	17/9/09
29/8/07*	–	53,859	557.00p	–	–	**53,859**	28/8/10
David Dupont							
16/9/04 †	96,015††	–	269.83p	81,612	490	**–**	–
27/9/05 †	40,140	–	356.67p	–	–	**40,140**	26/9/08
18/9/06	41,363	–	498.62p	–	–	**41,363**	17/9/09
29/8/07*	–	53,859	557.00p	–	–	**53,859**	28/8/10
Chris Loughlin							
18/9/06	36,099	–	498.62p	–	–	**36,099**	17/9/09
29/8/07*	–	49,371	557.00p	–	–	**49,371**	28/8/10

† The amount of the awards (and the market price upon award) for the awards made on 16/9/04 and 27/9/05 have been adjusted in the ratio three for one consequent upon the Company's share capital split on 31 July 2006.

With the exception of the Awards marked * the Awards relate to the Company's Restricted Share Plan (RSP). The Awards marked * relate to the Company's new Performance and Co-investment Plan (PCP) which succeeded the RSP in 2007. Details of the PCP and the performance conditions applicable to these Awards are set out in section (iii) 'Long-Term Incentive Plan' on page 48 of this report.

††Because of the existence of unpublished price sensitive information, no RSP awards were made during 2003 to the Executive Directors. Accordingly, with shareholders' approval, the usual award was made in 2004 together with a further award of shares equivalent to 75% of basic salary. 85% of this award vested on 15 September 2007 at a market price of 600.99p per ordinary share as the performance criterion had been partially met. The balance of the share awards of 15% lapsed on 15 September 2007. Bob Baty, a former director of the Company who retired on 31 July 2006, also received on 15 September 2007 54,887 ordinary shares of a total value of £330,000 at that date (market price of 600.99p each) which vested in him from a total award of 64,573 ordinary shares (adjusted as set out below) made on 16 September 2004 at a market price of 269.83p each pursuant to the provisions of the RSP. The balance of the shares awarded to Bob Baty lapsed on 15 September 2007. As reported in last year's annual report the number of shares awarded to him had been adjusted pro rata to his period of employment with the Company during the restricted period of the award.

It is anticipated that some (but not all) of the 2005 award will vest in September 2008 as the performance criterion has been partially met.

The performance criterion applicable to the 2004, 2005 and 2006 RSP Awards was: *the total shareholder return (TSR) achieved by the Company in the performance period must be greater than that of the company at or nearest to (but not above) the 50th percentile position of the comparator group*. If the TSR performance condition is met then 50% of an award will vest with 100% vesting if the Company achieves the position equal or closest to, but not above, the 75th percentile position of the comparator group. The achievement of a position between the 50th and the 75th percentile positions will result in vesting in steps reflecting the number of companies within that third quartile of the comparator group. The comparator group consists currently of 10 of the water only, water and sewerage, electricity and gas companies in the FTSE Utilities Index and quoted on the London Stock Exchange. The TSR of each company in the comparator group is measured by Hewitt Associates Limited assuming that all dividends are reinvested and is calculated by taking the average market value of each company's shares for the whole of March before the beginning of the relevant three year performance period and comparing this to the average market value of the same shares for the whole of March at the end of the three year period.

During the year the Directors received dividends on the above shares in accordance with the conditions of the RSP as follows:
Colin Drummond £33,867; David Dupont £23,584; Chris Loughlin £6,696.

DIRECTORS' SHARE INTERESTS *continued*

(c) Incentive Bonus Plan – Deferred Shares (long-term incentive element)

The following Directors also have or had a contingent interest in the number of 40.7p ordinary shares shown below, representing the total number of shares to which they have (or would) become entitled under the deferred bonus element of the Incentive Bonus Plan (the Plan) at the end of the relevant qualifying period:

Director and date of award	Conditional awards held at 1 April 2007	Conditional awards made in year	Market price upon award in year	Vesting in year	Value of shares upon vesting (before tax) £000	**Conditional awards held at 31 March 2008**	Date of end of period for qualifying condition to be fulfilled
Colin Drummond							
28/6/04 †	20,670	–	259.50p	20,670	127*	**–**	–
10/8/05 †	18,843	–	328.00p	–	–	**18,843**	9/8/08
26/7/06 †	16,527	–	486.00p	–	–	**16,527**	25/7/09
26/7/07	–	17,798	599.50p	–	–	**17,798**	25/7/10
David Dupont							
28/6/04 †	15,909	–	259.50p	15,909	98*	**–**	–
10/8/05 †	18,606	–	328.00p	–	–	**18,606**	9/8/08
26/7/06 †	16,095	–	486.00p	–	–	**16,095**	25/7/09
26/7/07	–	17,018	599.50p	–	–	**17,018**	25/7/10
Chris Loughlin							
26/7/07	–	8,767	599.50p	–	–	**8,767**	25/7/10

* The June 2004 award shares vested on 27 June 2007 at a price of 616.00p each.

† The amount of the awards made on 28/6/04, 10/8/05 and 26/7/06 have been adjusted in the ratio three for one consequent upon the Company's share capital split on 31 July 2006.

A further conditional award of shares will be made in 2008/09 to the value of the amount of the performance related cash bonus shown in the Emoluments of Directors table on page 50. (Paragraph (ii) 'Performance Related Bonus' on pages 47 and 48 set out the provisions relating to the conditional award of shares pursuant to the Plan).

During the year the Directors received dividends on the above shares in accordance with the conditions of the long-term incentive element of the Plan as follows: Colin Drummond £10,031; David Dupont £9,529; Chris Loughlin £1,113.

It is anticipated that all of the shares will vest under the 10/8/05 award in 2008/09 as the criterion is expected to be met.

(d) Sharesave Scheme

Details of options to subscribe for shares of the Company under the all-employee Sharesave Scheme were:

Director and date of grant	Options held at 1 April 2007	Granted in year	Exercised in year	Exercise price	Market price on exercising	**Options held at 31 March 2008**	Exercise period/ maturity date
Colin Drummond							
4/7/06 †	2,613	–	–	357.66p	–	**2,613**	1/9/09 – 28/2/10
David Dupont							
9/7/02 †	8,772	–	8,772	188.67p	601.50p	**–**	–
3/7/07	–	3,136	–	522.00p	–	**3,136**	1/9/12 – 28/2/13
Chris Loughlin							
3/7/07	–	3,136	–	522.00p	–	**3,136**	1/9/12 – 28/2/13

† The options held and the exercise price have been adjusted in the ratio three for one consequent upon the Company's share capital split on 31 July 2006.

(f) Share price

The market price of the Company's 40.7p ordinary shares at 31 March 2008 was 647.50p (2007 584.50p) and the range during the year was 547.50p to 699.00p (2006/07 408.33p to 584.50p*).

*Adjusted in the ratio three for one consequent upon the Company's share capital split on 31 July 2006.

By Order of the Board

KEN WOODIER, Group General Counsel & Company Secretary

26 June 2008

COMPLIANCE

The Board is committed to the highest standards of corporate governance with the aim of continuing to enhance its effectiveness. The Annual Report is the principal means of reporting to shareholders on the Board's governance policies. This section sets out how the main and supporting principles of good corporate governance contained in Section 1 of the Combined Code (June 2006 version) have been applied by the Company in practice.

The Company considers that it has complied with the provisions of the Code throughout the year.

THE BOARD AND ITS COMMITTEES

The Board of Directors at the end of the year comprised the Chairman, three Executive Directors and three Non-executive Directors. All of the Non-executive Directors are considered to be independent as none of the relationships or circumstances set out in paragraph A.3.1 of the Combined Code apply to these Non-executive Directors. They are also considered to have the appropriate skills, experience in their respective disciplines and personality to bring independent and objective judgement to the Board's deliberations. Gerard Connell is the Senior independent Non-executive Director. The biographies on page 46 demonstrate a broad range of business and financial experience. There is a clear division of responsibilities between the roles of Chairman and the Chief Executives of South West Water and Viridor as recorded in the descriptions of the roles approved by the Board. All Directors are subject to re-election when they have held office for three years.

During the year the Board met in accordance with its schedule of meetings on eleven occasions. At each meeting, all Directors were present with the exception of Gerard Connell on two occasions, David Dupont and Kate Mortimer each on one occasion. In accordance with Group policies the Board has a schedule of matters reserved for its decision and delegates more detailed consideration of certain matters to Board Committees; to the subsidiary boards of South West Water and Viridor; to the Executive Directors; and to the Group General Counsel & Company Secretary, as appropriate. Recognising this policy, the matters reserved to the Board include the approval of financial statements; acquisitions and disposals; major items of capital expenditure; authority levels for other expenditure; risk management; and approval of the Strategic Plan and annual operating budgets.

The Board operates by receiving written reports circulated in advance of its meetings from the Executive Directors and the Group General Counsel & Company Secretary on matters within their respective business areas in the Group. Under the guidance of the Chairman, all matters before the Board are discussed openly and presentations and advice are received on occasions from other senior executives within the Group or from external advisers.

Directors have access to the advice and services of the Group General Counsel & Company Secretary and the Board has established a procedure whereby Directors, in order to fulfil their duties, may seek independent professional advice at the Company's expense. The training needs of Directors are reviewed on a regular basis.

The Board has an internal procedure to evaluate the performance of the whole Board, each Committee, the Chairman, each individual Director and the Group General Counsel & Company Secretary. This evaluation procedure was administered for the year by the Group General Counsel & Company Secretary seeking all participants' views on a range of prescribed questions designed to ensure objective evaluation of performance. The participants' responses were then summarised and evaluated by the Group General Counsel & Company Secretary for the Board to consider and determine whether any changes were necessary for the Board to be more effective. Overall performance was considered to be satisfactory but a number of minor issues were identified where changes could be made to improve performance including, for example, a review of the terms of reference of certain committees to ensure that delegations from the Board were appropriate and that the Board had sufficient time to attend to strategic matters. The Chairman's performance was evaluated separately by the Non-executive Directors, led by the Senior Independent Non-executive Director. The Chairman's other significant commitments outside the Group have not changed during the year and the Board is satisfied that such commitments do not prejudice the Chairman's performance in relation to his Group role.

All Directors are equally accountable for the proper stewardship of the Group's affairs with the Non-executive Directors having a particular responsibility for ensuring that strategies proposed for the development of the business are critically reviewed. The Non-executive Directors also critically examine the operational and financial performance of the Group and fulfil a key role in corporate accountability through their membership of the Committees of the Board. In addition the Chairman during the year holds meetings with the Non-executive Directors without the Executive Directors present, to discuss performance and strategic issues.

Group policies allocate the tasks of giving detailed consideration to specified matters, to monitoring executive actions and to assessing reward, to the Board Committees as set out below:

AUDIT COMMITTEE

The Audit Committee was chaired by Gerard Connell, who has current and relevant financial experience, and the other members of the Committee were Kate Mortimer and Dinah Nichols. During the year the Committee met on five occasions and all members were present at each meeting, with the exception of Kate Mortimer on one occasion. In discharging its Terms of Reference the Committee receives reports and meets regularly in particular to:

- monitor the integrity of the financial statements of the Group, including a review of significant reporting judgements, prior to approval by the Board;
- keep under review the effectiveness of the Group's internal controls, including all material financial, operational and compliance controls and risk management systems;
- monitor and review the effectiveness of the Group's internal audit function and approve the annual internal audit plan;
- review the findings of the internal audit function and review and monitor management's responsiveness to such findings;
- oversee the relationship with the external auditors including their remuneration, appointment, re-appointment and removal and in addition monitor their independence and objectivity including the supply of non-audit services; and
- receive internal control reports from the external auditors and meet with them in the absence of management at least once a year to discuss their remit and any issues arising from the audit.

In addition the Committee periodically reviews the arrangements for, and the effectiveness of the Group's 'whistleblowing' policies (details of which are set out on page 36 of the business review).

The Committee pays particular attention to the independence and objectivity of the auditors and has established a policy for the engagement of the auditors for non-audit work by the Group. This involves the Group Director of Finance setting out in a report to the Committee reasons for appointing the auditors for any material work and obtaining the approval of the Committee to such appointment which the Committee will only grant if it is satisfied that the auditors' independence and objectivity are safeguarded. This is achieved by reviewing the appointment with the auditors as considered appropriate and receiving from the auditors at the year end a letter setting out how the auditors believe their independence and objectivity have been maintained. In addition the Company's current auditors ensure that the senior partner responsible for the external audit of the Group remains responsible for such audit for no more than five years and that there is an independent partner who is involved in planning and in the reviewing of the final accounts of the Company and also any critical matters which may be identified in the audit. Details of audit and non-audit fees are contained in note 6 to the financial statements on page 76.

The Executive Directors, subsidiary finance directors, the auditors, the Group Financial Controller and the Company's internal auditor attend meetings of the Committee by invitation. In addition both the external and internal auditors have the right of direct access to the Committee without the presence of any Executive Director or other senior management.

REMUNERATION COMMITTEE

The Remuneration Committee was chaired by Kate Mortimer. Ken Harvey (from 1 June 2007), Gerard Connell and Dinah Nichols were the other members of the Committee. The Committee met on seven occasions during the year at which all members were present with the exception of Kate Mortimer and Gerard Connell each on one occasion. The Committee is responsible for determining the Group's remuneration policy, remuneration and terms of engagement of the Chairman and the remuneration and terms of employment of the Executive Directors and senior management of the Group. Members of the Remuneration Committee do not participate in decisions concerning their own remuneration. The Directors' report on remuneration, which also provides more information on the activities of the Remuneration Committee, appears on pages 47 to 53.

NOMINATION COMMITTEE

The Nomination Committee was chaired by Ken Harvey and also comprised Kate Mortimer, Dinah Nichols and Gerard Connell. It meets as and when required to select and recommend to the Board suitable candidates for appointment as Executive and Non-executive Directors, determine the nomination process and review succession plans. During the year it met on two occasions, at which all members were present, to consider the annual performance evaluation results for the Committee and to review succession planning for the Group.

CORPORATE RESPONSIBILITY COMMITTEE

The Corporate Responsibility Committee was chaired by Dinah Nichols and also comprised Gerard Connell, Kate Mortimer and the Chief Executives of South West Water and Viridor. It met on six occasions during the year at which all members were present, except for Gerard Connell on one occasion. The Committee's duties, in the context of the requirement for companies to conduct their business in a responsible manner (including in relation to environmental, social and governance (ESG) matters), are to review the strategies, policies, management, initiatives, targets and performance of the Pennon Group of companies in the areas of occupational health and safety and security, environment, workplace policies, corporate policies, non-financial regulatory compliance and the role of the Group in society.

In reporting on corporate responsibility, the Company has sought to comply with the Association of British Insurers' Guidelines on Responsible Investment Disclosure. The business review on pages 36 to 41 contains details of ESG matters and additional information is contained in the Group's annual Corporate Responsibility Report. The 2008 Report will be on the Company's website at *www.pennon-group.co.uk* from 4 July 2008.

COMMITTEES' TERMS OF REFERENCE

The Terms of Reference of the Audit, Remuneration, Nomination and Corporate Responsibility Committees are available upon request to the Company Secretary and are also set out on the Company's website at *www.pennon-group.co.uk*

INTERNAL CONTROL

WIDER ASPECTS OF INTERNAL CONTROL

The Board is responsible for the Group's system of internal control and for reviewing its effectiveness. The system 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. There is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group that has been in place throughout the year 2007/08 and up to the date of the approval of this Annual Report and Accounts. The Board confirms that it continues to apply procedures in accordance with the Combined Code and the 'Guidance on Internal Control' (The Turnbull Guidance) which suggests means of applying the internal control part of the Code. As part of these procedures the Board has a formalised risk management policy which provides for the identification of key risks in relation to the achievement of the business objectives of the Group. This policy is applied by all business units within the Group in accordance with an annual timetable.

RISK IDENTIFICATION

A full risk and control assessment is undertaken annually by the management of each business to identify financial and non-financial risks and is continuously updated. Each business compiles (as part of its regular management reports) an enhanced and focused assessment of key risks against corporate objectives. The Board at each meeting receives from Executive Directors details of any new high-level risks identified and how they are to be managed, together with details of any changes to existing risks and their management. The subsidiary Boards

RISK IDENTIFICATION *continued*

of South West Water and Viridor also receive at each meeting similar reports in respect of their own areas of responsibility. All senior managers are required to certify on an annual basis that they have established effective controls to manage risks and to operate in compliance with legislation and Group procedures. All of these processes serve to ensure that a culture of effective control and risk management is embedded within the organisation and that the Group is in a position to react appropriately to new risks as they arise. Details of key risks affecting the Group are set out in the business review on pages 14, 24 to 27 and 35.

INTERNAL CONTROL FRAMEWORK

As well as the risk management policy of the Group there is an established internal control framework which comprises:

(a) a clearly defined structure which delegates an appropriate level of authority, responsibility and accountability, including responsibility for internal financial control, to management of operating units;

(b) a comprehensive budgeting and reporting function with an annual budget approved by the Board of Directors, which also monitors monthly achieved results and updated forecasts for the year against budget;

(c) documented financial control procedures. Managers of operating units are required to confirm annually that they have adequate financial controls in operation and to report all material areas of financial risk. Compliance with procedures is reviewed and tested by the Company's internal audit function; and

(d) an investment appraisal process for evaluating proposals for all major capital expenditure and acquisitions, with defined levels of approval and a system for monitoring the progress of capital projects.

INTERNAL CONTROL REVIEW

An evaluation of the effectiveness of overall internal control compliance by the Group is undertaken in respect of each calendar year (and subsequently regulated to the date of the report) to assist the Audit Committee in considering the Group internal audit plan for the forthcoming financial year and also the business review for the Annual Report. The Group General Counsel & Company Secretary initially carries out the evaluation with Directors and senior management for consideration by the Audit Committee and subsequently for final evaluation by the Board.

In addition the Audit Committee regularly reviews the operation and effectiveness of the internal control framework and also annually reviews the scope of work, authority and resources of the Company's internal audit function and reports to the Board on such reviews. For 2007/08 and up to the date of the approval of the Annual Report and Accounts, both the Audit Committee and the Board were satisfied with the effectiveness of the risk management policy and the internal control framework and their operation within the Group.

GOING CONCERN

The Directors consider, after making appropriate enquiries, that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the financial statements.

DIRECTORS' RESPONSIBILITIES STATEMENT

The Directors are responsible for preparing the Annual Report, the Directors' remuneration 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 prepared the Group and Company financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. The financial statements are required by law to give a true and fair view of the state of affairs of the Group and the Company and of their profits and cash flows for the year.

In preparing these financial statements the Directors are required to:

– select suitable accounting policies and then apply them consistently

– make judgements and estimates which are reasonable and prudent

– state that the financial statements comply with IFRS as adopted by the European Union.

The Directors confirm that they have complied with the above requirements in preparing the financial statements. The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and the Company and to enable them to ensure that the financial statements and the Directors' remuneration report comply with the Companies Act 1985 and, as regards the Group financial statements, article 4 of the International Accounting Standards (IAS) Regulation. They are also responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

RELATIONS WITH SHAREHOLDERS

The Company maintains a regular dialogue with its institutional shareholders and has a comprehensive investor relations programme. During the year, meetings with institutional shareholders were held and attended by the Group Director of Finance and the Company's Investor Relations Manager. On certain occasions the Chairman, the Chief Executive of South West Water and the Chief Executive of Viridor also attended. The Board encourages the participation of shareholders at the Annual General Meeting and complies with the provisions of the Combined Code in respect of relations with shareholders. In particular, Non-executive Directors are invited to attend meetings with institutional shareholders and analysts' and brokers' briefings. The Group Director of Finance reports to the Board regularly on major shareholders' views about the Company. Further, surveys of shareholder opinion conducted, usually on an annual basis, are evaluated and reported on to the Board.

By Order of the Board
KEN WOODIER, Group General Counsel & Company Secretary
26 June 2008

INDEPENDENT AUDITORS’ REPORT TO THE MEMBERS OF PENNON GROUP PLC

We have audited the group and parent company financial statements (the financial statements) of Pennon Group Plc for the year ended 31 March 2008 which comprise the Consolidated income statement, the Group statement of recognised income and expense, the Company statement of recognised income and expense, the Group balance sheet, the Company balance sheet, the Group cash flow statement, the Company cash flow statement and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors’ remuneration report that is described as having been audited.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Directors’ responsibilities for preparing the Annual Report, the Directors’ remuneration report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the European Union are set out in the Statement of Directors’ Responsibilities.

Our responsibility is to audit the financial statements and the part of the Directors’ remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company’s members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors’ remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the group financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' report is consistent with the financial statements.

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 review whether the Corporate Governance Statement reflects the company’s compliance with the nine provisions of the Combined Code (2006) specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board’s statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group’s corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Chairman’s Statement, the Chief Executives’ overviews, the business review, the Directors’ report, the unaudited part of the Directors’ remuneration report and the Board of Directors’ statement on corporate governance and internal control. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the 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 financial statements and the part of the Directors’ remuneration report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group’s and Company’s circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements 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 financial statements and the part of the Directors’ remuneration report to be audited.

OPINION

In our opinion:

– the Group financial statements give a true and fair view, in accordance with IFRS as adopted by the European Union, of the state of the Group’s affairs as at 31 March 2008 and of its profit and cash flows for the year then ended;

– the Company financial statements give a true and fair view, in accordance with IFRS as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the Company’s affairs as at 31 March 2008 and cash flows for the year then ended;

– the financial statements and the part of the Directors’ remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the group financial statements, Article 4 of the IAS Regulation; and

– the information given in the Directors’ report is consistent with the financial statements.

PRICEWATERHOUSECOOPERS LLP
Chartered Accountants and
Registered Auditors
Bristol
26 June 2008

Consolidated income statement for the year ended 31 March 2008

	Notes	2008 £m	2007 £m
Revenue	5	**875.0**	748.3
Operating costs	6		
Manpower costs (excluding restructuring costs)		**(100.4)**	(90.7)
Raw materials and consumables used		**(54.8)**	(47.2)
Other operating expenses		**(349.8)**	(294.6)
Depreciation		**(127.9)**	(113.7)
Restructuring costs		**(4.0)**	(0.3)
Amortisation of intangibles		**(1.3)**	(1.8)
Operating profit	5	**236.8**	200.0
Finance income	7	**42.0**	29.0
Finance costs	7	**(129.4)**	(98.2)
Share of post-tax profit from joint ventures		**0.2**	0.3
Profit before tax	5	**149.6**	131.1
Taxation	8	**(16.0)**	(37.2)
Profit for the year		**133.6**	93.9
Profit attributable to equity shareholders		**133.6**	93.9
Earnings per share (pence per share)	10		
– Basic		**38.2**	26.5
– Diluted		**37.9**	26.3
Proposed dividend per share (pence per share)	11	**19.81**	18.55
Proposed dividend for the year	11	**69.1**	65.6

All operating activities are continuing operations.

The notes on pages 62 to 112 form part of these financial statements.

Statements of recognised income and expense for the year ended 31 March 2008

	Notes	Group 2008 £m	Group 2007 £m	Company 2008 £m	Company 2007 £m
Profit for the year		**133.6**	93.9	**74.2**	93.8
Actuarial gains/(losses) on defined benefit schemes	28	**5.1**	(1.2)	**(1.3)**	(0.4)
Cash flow hedges					
Net fair value (losses)/gains		**(12.7)**	15.7	**(1.2)**	1.1
Tax on items taken directly to or transferred from equity	8, 29	**(1.4)**	0.4	**0.4**	0.1
Net (losses)/gains recognised directly in equity	34	**(9.0)**	14.9	**(2.1)**	0.8
Total recognised income for the year		**124.6**	108.8	**72.1**	94.6
Attributable to equity shareholders		**124.6**	108.8	**72.1**	94.6

The notes on pages 62 to 112 form part of these financial statements.

Balance sheets at 31 March 2008

	Notes	Group 2008 £m	Group 2007 (Restated note 37) £m	Company 2008 £m	Company 2007 £m
Assets					
Non-current assets					
Goodwill	14	**234.6**	137.5	**–**	–
Other intangible assets	15	**9.2**	7.9	**–**	–
Property, plant and equipment	16	**2,663.0**	2,558.9	**0.2**	0.2
Trade and other receivables	18	**10.4**	6.9	**259.6**	171.2
Derivative financial instruments	22	**4.0**	16.0	**0.5**	1.7
Deferred tax asset	29	**–**	–	**1.6**	1.8
Investment in subsidiary undertakings	19	**–**	–	**1,044.8**	943.8
Investments accounted for using equity method	19	**1.4**	1.4	**–**	–
		2,922.6	2,728.6	**1,306.7**	1,118.7
Current assets					
Inventories	20	**6.6**	5.1	**–**	–
Trade and other receivables	21	**164.7**	122.5	**70.4**	56.0
Derivative financial instruments	22	**11.9**	–	**–**	–
Current tax recoverable	25	**–**	–	**7.1**	1.2
Cash and cash deposits	23	**357.4**	127.9	**49.7**	24.1
		540.6	255.5	**127.2**	81.3
Liabilities					
Current liabilities					
Borrowings	26	**(89.2)**	(85.8)	**(297.3)**	(303.3)
Derivative financial instruments	22	**(17.0)**	–	**(17.0)**	–
Trade and other payables	24	**(204.2)**	(176.6)	**(18.9)**	(19.0)
Current tax liabilities	25	**(43.1)**	(36.6)	**–**	–
Provisions for liabilities and charges	30	**(18.1)**	(13.2)	**–**	–
		(371.6)	(312.2)	**(333.2)**	(322.3)
Net current assets/(liabilities)		**169.0**	(56.7)	**(206.0)**	(241.0)
Non-current liabilities					
Borrowings	26	**(2,032.0)**	(1,599.4)	**(394.7)**	(130.0)
Other non-current liabilities	27	**(4.0)**	(4.3)	**(8.7)**	(8.7)
Derivative financial instruments	22	**(0.5)**	–	**–**	–
Retirement benefit obligations	28	**(26.3)**	(41.2)	**(2.9)**	(3.4)
Deferred tax liabilities	29	**(307.2)**	(313.5)	**–**	–
Provisions for liabilities and charges	30	**(81.3)**	(86.3)	**–**	–
		(2,451.3)	(2,044.7)	**(406.3)**	(142.1)
Net assets		**640.3**	627.2	**694.4**	735.6
Shareholders' equity					
Share capital	31	**144.5**	144.9	**144.5**	144.9
Share premium account	32	**11.7**	11.7	**11.7**	11.7
Capital redemption reserve	33	**144.2**	143.8	**144.2**	143.8
Retained earnings and other reserves	34	**339.9**	326.8	**394.0**	435.2
Total shareholders' equity		**640.3**	627.2	**694.4**	735.6

The notes on pages 62 to 112 form part of these financial statements.

The financial statements on pages 58 to 112 were approved by the Board of Directors and authorised for issue on 26 June 2008 and were signed on its behalf by:

K G HARVEY
Chairman

Cash flow statements for the year ended 31 March 2008

	Notes	Group 2008 £m	Group 2007 £m	Company 2008 £m	Company 2007 £m
Cash flows from operating activities					
Cash generated/(outflow) from operations	35	**337.1**	305.1	**(108.9)**	(54.5)
Interest paid		**(96.7)**	(58.1)	**(15.8)**	(8.6)
Tax paid		**(21.0)**	(12.0)	**(1.3)**	(2.3)
Net cash generated/(outflow) from operating activities		**219.4**	235.0	**(126.0)**	(65.4)
Cash flows from investing activities					
Interest received		**17.0**	6.7	**21.5**	14.3
Dividends received		**–**	–	**85.7**	90.1
Acquisition of subsidiary undertakings (net of cash acquired)	37	**(89.0)**	(37.0)	**–**	–
Investment in subsidiary undertakings		**–**	–	**(101.0)**	–
Return of loan from joint venture		**0.1**	0.1	**–**	–
Proceeds from investment disposal		**–**	0.6	**–**	–
Purchase of property, plant and equipment		**(219.2)**	(251.4)	**(0.1)**	(0.2)
Proceeds from sale of property, plant and equipment		**1.1**	5.0	**0.1**	–
Net cash (used in)/from investing activities		**(290.0)**	(276.0)	**6.2**	104.2
Cash flows from financing activities					
Net proceeds from issue of ordinary share capital		**–**	1.9	**–**	1.9
Purchase of ordinary shares subsequently cancelled		**(5.9)**	(3.5)	**(5.9)**	(3.5)
Purchase of ordinary shares held as treasury shares		**(43.4)**	–	**(43.4)**	–
Proceeds from treasury shares re-issued		**1.6**	–	**1.6**	–
Ordinary shares acquired by the Pennon Employee Share Trust	34	**(0.3)**	(2.3)	**–**	–
Deposit of restricted funds		**(106.7)**	(4.1)	**(0.6)**	–
Net proceeds from new borrowing		**473.5**	110.0	**516.0**	243.2
Repayment of borrowings		**(157.5)**	(71.1)	**(257.3)**	(250.4)
Finance lease drawdowns		**110.4**	130.2	**–**	–
Finance lease principal repayments		**(20.4)**	(21.4)	**–**	–
Dividends paid	11	**(65.6)**	(61.0)	**(65.6)**	(61.0)
B Share payments	31	**–**	(5.7)	**–**	(5.7)
Net cash received/(outflow) from financing activities		**185.7**	73.0	**144.8**	(75.5)
Net increase/(decrease) in cash and cash equivalents		**115.1**	32.0	**25.0**	(36.7)
Cash and cash equivalents at beginning of the year	23	**112.3**	80.3	**24.1**	60.8
Cash and cash equivalents at end of the year	23	**227.4**	112.3	**49.1**	24.1

The notes on pages 62 to 112 form part of these financial statements.

1. GENERAL INFORMATION

Pennon Group Plc is a company incorporated in the United Kingdom under the Companies Act 1985. The address of the registered office is given on page 46. Pennon Group's business is operated through two main subsidiaries: South West Water Limited holds the water and sewerage appointments for Devon, Cornwall and parts of Dorset and Somerset; Viridor Limited's business is waste treatment and disposal.

2. PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented.

(a) Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee (IFRIC) interpretations as adopted by the European Union, with those parts of the Companies Act 1985 applicable to companies reporting under IFRS and the requirements of the Financial Services Authority. A summary of the principal accounting policies is set out below, together with an explanation where changes have been made to previous policies on the adoption of new accounting standards in the year.

At the date of approval of these financial statements the following standards and interpretations, which have not been applied in these financial statements, were in issue but not yet effective:

IFRS 8 "Operating segments".

IAS 1 "Presentation of financial statements" (revised).

IAS 23 "Borrowing costs" (revised).

IAS 27 "Consolidated and separate financial statements" (revised).

IFRIC 12 "Service concession arrangements".

IFRIC 13 "Customer loyalty programmes".

IFRIC 14 "IAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction."

The presentational impact of these standards and interpretations is being assessed and the Directors expect that the adoption of these standards and interpretations in future periods will have no material impact on the financial statements of the Group.

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions which affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best assessment of the amounts, actual events or actions and results may ultimately differ from those estimates.

(b) Basis of consolidation

The Group financial statements include the results of Pennon Group Plc and its subsidiary and joint venture undertakings.

The results of subsidiaries and joint venture undertakings are included from the date of acquisition or incorporation, and excluded from the date of disposal. The results of subsidiaries are consolidated where the Group has the power to control a subsidiary. The results of joint venture undertakings are accounted for on an equity basis where the company exercised joint control under a contractual arrangement.

On acquisition, the assets and liabilities and contingent liabilities of a subsidiary or joint venture acquired are measured at their fair values and any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. Where the cost of acquisition is below the fair values of the identifiable net assets acquired a credit is recognised in profit and loss in the year of acquisition.

2. PRINCIPAL ACCOUNTING POLICIES *continued*

(c) Revenue recognition

Revenue represents the fair value of consideration receivable, excluding value added tax, trade discounts and inter company sales, in the ordinary course of business for goods and services provided.

Revenue is recognised once the services or goods have been provided to the customer.

Income from main water and waste water charges includes billed amounts for estimated usage and also an estimation of the amount of unbilled charges at the period-end based upon a defined methodology reflecting historical consumption and current tariffs. Income from electricity generated from waste management landfill gas production includes an estimation of the amount to be received under renewables obligation certificates.

Interest income is recognised on a time-apportioned basis using the effective interest method.

(d) Landfill tax

Landfill tax is included within both revenue and operating costs. It is determined by the Government and is a cost to the Group but is recovered from customers.

(e) Segmental reporting

Each of the Group's business segments provides services which are subject to risks and returns which are different from those of the other business segments. The Group's internal organisation and management structure and its system of internal financial reporting is based primarily on business segments. The business segments comprise the regulated water and sewerage services undertaken by South West Water Limited and the waste management business of Viridor Limited. Segmental revenue and results include transactions between businesses. Inter-segmental transactions are eliminated on consolidation.

(f) Goodwill

Goodwill arising on consolidation from the acquisition of subsidiary and joint venture undertakings represents the excess of the purchase consideration over the fair value of net assets acquired.

Goodwill is recognised as an asset and reviewed for impairment at least annually. Any impairment is recognised immediately in the income statement and is not subsequently reversed. Further details are contained in accounting policy (k).

When a subsidiary or joint venture undertaking is sold, the profit or loss on disposal is determined after including the attributable amount, of unamortised goodwill.

Goodwill arising on acquisitions before 1 April 2004 (the Group's date of transition to IFRS) has been retained at the previous UK GAAP amounts, subject to being tested for impairment at that date and annually thereafter. Goodwill written off to reserves under UK GAAP prior to 1998 was not reinstated on transition to IFRS and will not be included in determining any subsequent profit or loss on disposal.

(g) Other intangible assets

Other intangible assets acquired in a business combination are capitalised at fair value at the date of acquisition. Following initial recognition, finite life intangible assets are amortised on a straight-line basis over their estimated useful economic lives, with the expense taken to the income statement through operating expenses.

2. PRINCIPAL ACCOUNTING POLICIES *continued*

(h) Property, plant and equipment

i) Infrastructure assets (being water mains and sewers, impounding and pumped raw water storage reservoirs, dams, pipelines and sea outfalls)

Infrastructure assets were included at fair value on transition to IFRS and subsequent additions are recorded at cost less accumulated depreciation. Expenditure to increase capacity or enhance infrastructure assets is capitalised where it can be reliably measured and it is probable that incremental future economic benefits will flow to the entity. The cost of day-to-day servicing of infrastructure components is recognised in the income statement as it arises.

Infrastructure assets are depreciated over their useful economic lives, which are principally:

Dams and impounding reservoirs	200 years
Water mains	40 – 100 years
Sewers	40 – 100 years

Assets in the course of construction are not depreciated until commissioned.

ii) Landfill sites

Landfill sites are included within land and buildings at cost less accumulated depreciation. Cost includes acquisition and development expenses. The cost of a landfill is depreciated to its residual value (which is linked to gas production at the site post-closure) over its estimated operational life taking account of the usage of void space.

Where the obligation to restore a landfill site is an integral part of its future economic benefits, a non-current asset within property, plant and equipment is recognised. The asset recognised is depreciated based on the usage of void space.

iii) Other assets (including properties, over-ground plant and equipment)

Other assets are included at cost less accumulated depreciation.

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

Freehold buildings	30 – 60 years
Leasehold buildings	Over the period of the lease
Operational structures	40 – 80 years
Fixed plant	20 – 40 years
Vehicles, mobile plant and computers	3 – 10 years

Assets in the course of construction are not depreciated until commissioned.

The cost of assets includes directly attributable labour and overhead costs which are incremental to the Group. Borrowing costs which are directly attributable to the construction of a qualifying asset (an asset which necessarily takes a substantial period of time to be prepared for its intended use) are capitalised as part of the asset.

Asset lives and residual values are reviewed annually.

2. PRINCIPAL ACCOUNTING POLICIES *continued*

(i) Grants and contributions

Grants and contributions receivable in respect of property, plant and equipment are deducted from the cost of those assets.

Grants and contributions receivable in respect of expenditure charged against profits in the year have been included in the income statement.

(j) Leased assets

Assets held under finance leases are included in the balance sheet as property, plant and equipment at their equivalent capital value and are depreciated over their estimated economic lives or the finance lease period, whichever is the shorter. The corresponding liability is recorded as borrowings. The interest element of the rental costs is charged against profits using the actuarial method over the period of the lease.

Rental costs arising under operating leases are charged against profits in the year they are incurred.

(k) Impairment of non-financial assets

Assets which have an indefinite useful life are not subject to amortisation and are tested annually for impairment, or whenever events or changes in circumstance indicate that the carrying amount may not be recoverable.

Assets which are subject to amortisation or depreciation are tested for impairment whenever events or changes in circumstance indicate that the carrying amount may not be recoverable.

An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Value in use represents the present value of projected future cash flows expected to be derived from a cash-generating unit, discounted using a pre-tax discount rate which reflects an assessment of the cost of capital of the cash-generating unit.

Impairments are charged to the income statement in the year in which they arise.

(l) Investment in subsidiary undertakings

Investments in subsidiary undertakings are initially recorded at cost, being the fair value of the consideration paid, including associated acquisition costs. Subsequently, investments are reviewed for impairment on an individual basis, annually or if events or changes in circumstance indicate that the carrying value may not be fully recoverable.

(m) Joint ventures

Joint ventures are entities over which the Group has joint control. Investments in joint ventures are accounted for using the equity method of accounting. Any excess of the cost of acquisition over the Group's share of the fair values of the identifiable net assets of the joint venture at the date of acquisition is recognised as goodwill and is included in the carrying value of the investment in the joint venture.

The carrying value of the Group's investment is adjusted for the Group's share of post-acquisition profits or losses recognised in the income statement. Losses of a joint venture in excess of the Group's interest are not recognised unless the Group has a legal or constructive obligation to fund those losses.

(n) Cash and cash deposits

Cash and cash deposits comprise cash in hand and short-term deposits held at banks. Bank overdrafts are shown within current borrowings.

2. PRINCIPAL ACCOUNTING POLICIES *continued*

(o) Derivatives and other financial instruments

The Group classifies its financial instruments in the following categories:

i) Loans and receivables

All loans and borrowings are initially recognised at fair value, net of transaction costs incurred. Following initial recognition, interest-bearing loans and borrowings are subsequently stated at amortised cost using the effective interest method.

Gains and losses are recognised in the income statement when the instruments are derecognised or impaired. Premia, discounts and other costs and fees are recognised in the income statement through the amortisation process.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

ii) Derivative financial instruments and hedging activities

The Group uses derivative financial instruments, principally interest rate swaps, to hedge its risks associated with interest rate fluctuations. Derivative instruments are initially recognised at fair value on the date the derivative contract is entered into and subsequently remeasured at fair value for the reported balance sheet.

The gain or loss on remeasurement is taken to the income statement except for cash flow hedges that meet the conditions for hedge accounting, when the portion of the gain or loss on the hedging instrument which is determined to be an effective hedge is recognised directly in equity, and the ineffective portion in the income statement. The gains or losses deferred in equity in this way are subsequently recognised in the income statement in the same period in which the hedged underlying transaction or firm commitment is recognised in the income statement.

In order to qualify for hedge accounting, the Group is required to document in advance the relationship between the item being hedged and the hedging instrument. The Group is also required to document and demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an on-going basis. This effectiveness testing is reperformed at the end of each reporting period to ensure that the hedge remains highly effective.

The full fair value of a hedging derivative is classified as non-current asset or liability when the remaining hedged item is more than 12 months, and as a current asset or liability when the remaining maturity of the hedged item is less than 12 months.

Derivative instruments which do not qualify for hedge accounting are classified as a current asset or liability with any change in fair value recognised immediately in the income statement.

iii) Trade receivables

Trade receivables do not carry any interest and are recognised initially at fair value and subsequently at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables.

iv) Trade payables

Trade payables are not interest bearing and are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or liability or, where appropriate, a shorter period.

2. PRINCIPAL ACCOUNTING POLICIES *continued*

(p) Taxation including deferred tax

Tax payable for the year is provided at current rates which are substantively enacted. Deferred taxation is provided in full using the liability method on temporary differences between the tax basis of assets and liabilities and their carrying amounts in the financial statements. A deferred tax asset is only recognised to the extent it is probable that sufficient taxable profits will be available in the future for it to be utilised.

(q) Provisions for liabilities and charges

Provisions are made where there is a present legal or constructive obligation as a result of a past event and it is probable that there will be an outflow of economic benefits to settle this obligation and a reliable estimate of this amount can be made. The Group's policy on provisions for specific areas is:

i) *Landfill restoration costs*

Provisions for the cost of restoring landfill sites are made when the obligation arises. Where the obligation recognised as a provision gives access to future economic benefits, a non-current asset in property, plant and equipment is recognised. Provisions are otherwise charged against profits.

ii) *Environmental control and aftercare costs*

Environmental control and aftercare costs are incurred over the operational life of each landfill site and may be incurred for a considerable period thereafter. Provision for all such costs is made over the operational life of the site and charged to the income statement on the basis of the usage of void space.

Provisions for restructuring costs are recognised when a detailed formal plan for the restructuring has been communicated to affected parties.

Where the effect of the time value of money is material the current amount of a provision is the present value of the expenditures expected to be required to settle obligations. The unwinding of the discount to present value is included as a financial item within finance costs.

(r) Share capital and treasury shares

Ordinary shares are classified as equity.

Where any Group company purchases the Company's equity share capital (treasury shares) the consideration paid, including any directly attributable costs, is deducted from equity until the shares are cancelled or reissued. Where such shares are subsequently reissued any consideration received, net of any directly attributable transaction costs, is included in equity.

The Group balance sheet incorporates the shares held by the Pennon Employee Share Trust and which have not vested by the balance sheet date. These are shown as a deduction from shareholders' equity until such time as they vest.

(s) Dividend distributions

Dividend distributions are recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders. Interim dividends are recognised when paid; final dividends when approved by shareholders at the Annual General Meeting.

2. PRINCIPAL ACCOUNTING POLICIES *continued*

(t) Employee benefits

i) Pension obligations

The Group operates defined benefit and defined contribution pension schemes.

Defined benefit schemes
Defined benefit pension scheme assets are measured using bid price. Defined benefit pension scheme liabilities are measured by an independent actuary using Directors' best estimates. The projected unit credit method is employed and liabilities are discounted at the current rate of return on high quality corporate bonds of equivalent term to the liability. The increase in the present value of the liabilities of the Group's defined benefit pension schemes expected to arise from employee service in the period is charged against operating profit. The expected return on scheme assets and the increase during the period in the present value of scheme liabilities are included in other finance income or cost. Changes in past service costs arising from changes in benefits are recognised immediately in income.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity and recorded in the statement of recognised income and expense.

Defined contribution scheme
Costs of the defined contribution pension scheme are charged to the income statement in the period in which they arise.

ii) Share-based payment

The Group operates a number of equity-settled, share-based payment plans for employees. The fair value of the employee services required in exchange for the grant is recognised as an expense over the vesting period of the grant.

Fair values are calculated using an appropriate pricing model. Non market-based vesting conditions are adjusted for in assumptions as to the number of shares which are expected to vest.

(u) Pre-contract costs

Pre-contract costs are expensed as incurred, except where it is virtually certain that the contract will be awarded, in which case they are recognised as an asset which is amortised to the income statement over the life of the contract.

(v) Fair values

The fair value of the interest rate swaps is based on the market price of comparable instruments at the balance sheet date if they are publicly traded.

The fair values of short-term deposits, loans and overdrafts with a maturity of less than one year are assumed to approximate to their book values. In the case of bank loans and other loans due in more than one year the fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments.

3. FINANCIAL RISK MANAGEMENT

(a) Financial risk factors

The Group's activities expose it to a variety of financial risks; market risk (interest rate risk), liquidity risk and credit risk. The Group's treasury function seeks to ensure that sufficient funding is available to meet foreseeable needs, maintains reasonable headroom for contingencies and manages inflation and interest rate risk.

The principal financial risks faced by the Group relate to interest rate and counterparty risk.

These risks and treasury operations are managed by the Group Director of Finance in accordance with policies established by the Board. Major transactions are individually approved by the Board. Treasury activities are reported to the Board and are subject to review by internal audit.

Financial instruments are used to raise finance, manage risk and optimise the use of surplus funds. The Group does not engage in speculative activity.

i) Market risk

The Group has a policy of maintaining at least 50% of interest bearing liabilities at fixed rates. The Group uses a combination of fixed rate and index-linked borrowings and fixed rate interest swaps as cash flow hedges of future variable interest payments to achieve this policy. At the year end 58% of net borrowings were at fixed rates and 20% index-linked. The notional principal amounts of the interest rate swaps are used to determine settlement under those swaps and are not, therefore, an exposure for the Group. These instruments are analysed in note 26.

The interest rate for index-linked debt is based upon an RPI measure which is also used in determining the amount of income from customers in South West Water.

The Group has no significant interest-bearing assets upon which the net return fluctuates from market risk. Deposit interest receivable is expected to fluctuate in line with interest payable on floating rate borrowings. Consequently the Group's income and operating cash flows are substantially independent of changes in market interest rates.

At 31 March 2008 if interest rates on net borrowings at that date had been 0.5% higher/lower with all other variables held constant, post-tax profit for the year would have been £1.0 million (2007 £1.0 million) lower/higher.

ii) Liquidity risk

The Group actively maintains a mixture of long-term and short-term committed facilities that are designed to ensure the Group has significant available funds for operations and planned expansions and facilities equivalent to at least one year's forecast requirements are maintained at all times. Details of undrawn committed facilities and short-term uncommitted facilities are provided in note 26.

Refinancing risk is managed under a Group policy which requires no more than 20% of Group net borrowings is permitted to mature in any financial year.

The Group and South West Water Limited have entered into covenants with lenders. Whilst terms vary, these typically provide for limits on gearing (primarily based on South West Water Limited's Regulatory Capital Value and Viridor Limited's EBITDA) and interest cover. More details are provided in the Directors' report on page 33.

3. FINANCIAL RISK MANAGEMENT *continued*

(a) Financial risk factors *continued*

ii) Liquidity risk (continued)

Contractual undiscounted cash flows were:

	Due within 1 year £m	Due between 1 and 2 years £m	Due between 2 and 5 years £m	Over 5 years £m	Total £m
31 March 2008					
Non-derivative financial liabilities					
Borrowings excluding finance lease liabilities	34.1	219.1	246.3	431.1	930.6
Interest payments on borrowings	42.3	40.0	43.6	827.2	953.1
Finance lease liabilities	74.9	146.0	164.4	1,977.9	2,363.2
Derivative financial liabilities					
Derivative contracts – net receipts	4.0	2.5	0.5	–	7.0

	Due within 1 year £m	Due between 1 and 2 years £m	Due between 2 and 5 years £m	Over 5 years £m	Total £m
31 March 2007					
Non-derivative financial liabilities					
Borrowings excluding finance lease liabilities	37.2	54.1	366.3	145.5	603.1
Interest payments on borrowings	34.0	28.7	47.0	27.1	136.8
Finance lease liabilities	53.6	116.3	127.1	1,693.4	1,990.4
Derivative financial liabilities					
Derivative contracts – net receipts	6.7	10.6	6.8	–	24.1

iii) Credit risk

Credit risk arises from cash and cash deposits, derivative financial instruments and deposits with banks and financial institutions, as well as exposure to trade customers, including outstanding receivables. Further information on the credit risk relating to trade receivables is given in note 21.

Counterparty risk arises from the investment of surplus funds and from the use of derivative instruments. The Board has agreed a policy for managing such risk which is controlled through credit limits, counterparty approvals and rigorous monitoring procedures. The Group has no other significant concentration of credit risk. The Group's surplus funds are usually placed in short-term fixed interest deposits or the overnight money markets. All deposits are with counterparties which have a credit rating threshold approved by the Board.

3. FINANCIAL RISK MANAGEMENT *continued*

(b) Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to minimise the cost of capital.

In order to maintain or adjust the capital structure the Group seeks to maintain a balance of returns to shareholders through dividends and an appropriate capital structure of debt and equity for each business segment and the Group.

The Group monitors capital risk on the basis of the gearing ratio. This ratio is calculated as net borrowings divided by total capital. Net borrowings are analysed in note 36 and are calculated as total borrowings less cash and cash deposits. Total capital is calculated as total shareholders' equity plus net borrowings.

The gearing ratios at 31 March 2008 and 2007 were:

	2008 £m	2007 £m
Net borrowings (note 36)	**1,763.8**	1,557.3
Total shareholders' equity	**640.3**	627.2
Total capital	**2,404.1**	2,184.5
Gearing ratio	**73%**	71%

South West Water Limited is also monitored on the basis of the ratio of its net borrowings to Regulatory Capital Value.

	2008 £m	2007 £m
Regulatory Capital Value	**2,408.0**	2,265.0
Net borrowings	**1,450.0**	1,401.2
Net borrowings/Regulatory Capital Value	**60%**	62%

(c) Determination of fair values

The fair value of financial instruments traded in active markets (such as trading and available-for-sale securities) is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Group is the current bid price.

The fair value of financial instruments which are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. The Group uses a variety of methods and makes assumptions which are based on market conditions existing at each balance sheet date. Quoted market prices or dealer quotes for similar instruments are used for long-term debt. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments. The fair value of interest rate swaps is calculated as the present value of the estimated future net cash flows.

The carrying values less impairment provision of trade receivables and payables are assumed to approximate to their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate which is available to the Group for similar financial instruments.

4. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES

The Group's principal accounting policies are set out in note 2. Management is required to exercise significant judgement and make use of estimates and assumptions in the application of these policies.

Areas which management believes require the most critical accounting judgements are:

Underlying business performance
Underlying business performance is presented to provide more representative information on underlying trends. The term underlying is not a defined term under IFRS, and may not be comparable with similarly titled profit measurements reported by other companies. A reconciliation between underlying and reported measures is included in note 10 and in the Directors' report on page 28.

Exceptional items
The Directors consider that items of income or expense which are material and non-recurring by virtue of their nature and amount should be disclosed separately if the financial statements are to fairly present the financial position and financial performance of the Group. The Directors label these items collectively as "exceptional items".

Environmental and landfill restoration provisions
Restoration and aftercare provisions are recognised in the financial statements at the net present value of the estimated future expenditure required to settle the Group's restoration and aftercare obligations. A discount is applied to recognise the time value of money and is unwound over the life of the provision. This is included in the income statement as a financial item within interest payable. As at 31 March 2008 the Group's environmental and landfill restoration provisions were £97.7 million.

Where a provision gives access to future economic benefits, an asset is recognised and depreciated in accordance with the Group's depreciation policy.

Capitalisation of borrowing costs
The Group capitalises borrowing costs which are material and directly attributable to the construction of qualifying assets, which are assets that necessarily take a substantial period of time to be prepared for their intended use. Currently only the assets under construction in the Lakeside Energy from Waste joint venture meet the criteria for capitalisation.

Retirement benefit obligations
The Group operates defined benefit schemes for which actuarial valuations are carried out as determined by the trustees at intervals of not more than three years.

The pension cost under IAS 19 is assessed in accordance with Directors' best estimates using the advice of an independent qualified actuary and assumptions in the latest actuarial valuation. The assumptions are based on information supplied to the actuary by the Company, supplemented by discussions between the actuary and management. The principal assumptions used to measure schemes' liabilities, sensitivities to changes in assumptions and future funding obligations are disclosed in note 28 of the financial statements.

Cash-generating units
For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). The waste management segment is considered to be a single cash-generating unit as it is an integrated business.

4. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES *continued*

Areas which management believes require the most critical accounting estimations are:

Landfill costs
The estimation of landfill reserves is of particular importance in assessing landfill costs, since the cost of a landfill site is depreciated over its estimated operational life taking into account the usage of void space and gas production at the site post closure. The estimates of landfill reserves are regularly reviewed and updated during the financial year for usage and other events (for example site extensions). Estimates are also subject to physical review by external advisors.

A number of factors impact on the depreciation of landfill reserves including the available landfill space, future capital expenditure and operating costs. The assumptions are revised as these factors change.

Carrying value of long-life assets
The Group's accounting policy for property, plant and equipment assets is set out in note 2. The carrying value of property, plant and equipment as at 31 March 2008 was £2,663.0 million. In the year ended 31 March 2008 additions totalled £228.8 million and the depreciation charge was £129.2 million. Estimated useful economic lives of property, plant and equipment are based on management's judgement and experience. When management identifies that actual useful lives differ materially from the estimates used to calculate depreciation, that charge is adjusted prospectively. Due to the significance of capital investment to the Group, variations between actual and estimated useful lives could impact operating results both positively and negatively. Historically, only minor changes to estimated useful lives have been required.

Revenue recognition
The Group recognises revenue at the time of delivery of services. Payments received in advance of services delivered are recorded as a liability.

South West Water Limited raises bills and recognises revenue in accordance with its entitlement to receive revenue in line with the limits established by the Periodic Review price setting process. For water and waste water customers with water meters, revenue recognised is dependent upon the volume supplied including an estimate of the sales value of units supplied between the date of the last meter reading and the financial year end. Estimated usage is based on historic data, judgement and assumptions; actual results could differ from these estimates which would result in operating revenue being adjusted in the period in which the revision of the estimates is determined.

Provision for doubtful debts
At the balance sheet date each subsidiary evaluates the collectability of trade debtors and records provisions for doubtful debts based on experience including comparisons of the relative age of accounts and consideration of actual write-off history. The actual level of debt collected may differ from the estimated levels of recovery and could impact future operating results positively or negatively.
As at 31 March 2008 the Group's current trade receivables were £149.6 million, against which £36.2 million was provided for impairment.

Impairment of intangible assets
The Group records all assets and liabilities acquired in business acquisitions, including goodwill, at fair value. Intangible assets which have an indefinite useful life, principally goodwill, are assessed at least annually for impairment.

The initial goodwill recorded and subsequent impairment analysis require management to make estimations of future cash flows, terminal values and an assessment of the long-term pre-tax discount rate to be applied to those cash flows which reflects an assessment of the cost of capital of the cash-generating unit.

5. SEGMENTAL REPORTING

The water and sewerage business comprises the regulated water and sewerage services undertaken by South West Water Limited. The waste management business is the waste treatment, recycling and disposal services provided by Viridor Limited. Other includes parent company financing of business acquisitions made before 1999. Segment assets include goodwill and other intangible assets, property, plant and equipment, inventories, trade and other receivables and cash and cash equivalents. Segment liabilities comprise operating liabilities and exclude taxation. The other segment liabilities include the Company's financing of business acquisitions and Group taxation liabilities. Capital expenditure comprises additions to property, plant and equipment, including additions resulting from acquisitions through business combinations.

5. SEGMENTAL REPORTING *continued*

	2008 £m	2007 £m
Revenue		
Water and sewerage	**421.0**	381.5
Waste management	**455.1**	367.7
Other	**8.4**	7.6
Less intra-segment trading*	**(9.5)**	(8.5)
	875.0	748.3
Segment result		
Underlying operating profit before depreciation and amortisation (EBITDA)		
Water and sewerage	**270.0**	234.8
Waste management	**101.0**	82.8
Other	**(1.0)**	(1.8)
	370.0	315.8
Underlying operating profit		
Water and sewerage	**185.0**	157.1
Waste management	**58.1**	46.8
Other	**(1.0)**	(1.8)
	242.1	202.1
Operating profit		
Water and sewerage	**181.0**	156.8
Waste management	**56.8**	45.0
Other	**(1.0)**	(1.8)
	236.8	200.0
Underlying profit before tax		
Water and sewerage	**120.5**	99.2
Waste management	**35.5**	29.4
Other	**(1.1)**	4.6
	154.9	133.2
Profit before tax		
Water and sewerage	**116.5**	98.9
Waste management	**34.2**	27.6
Other	**(1.1)**	4.6
	149.6	131.1

All operating activities are continuing operations.

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

A reconciliation between underlying and reported measures is included in the Directors' report on page 28.

5. SEGMENTAL REPORTING *continued*

	Water and sewerage £m	Waste management (Restated note 37) £m	Other £m	Eliminations £m	Group £m
Balance sheet					
31 March 2008					
Assets (excluding investment in joint ventures)	2,632.6	775.8	794.5	(741.1)	3,461.8
Investment in joint ventures	–	1.4	–	–	1.4
Total assets	2,632.6	777.2	794.5	(741.1)	3,463.2
Liabilities	(1,829.8)	(647.0)	(1,087.2)	741.1	(2,822.9)
Net assets/(liabilities)	**802.8**	**130.2**	**(292.7)**	**–**	**640.3**
31 March 2007					
Assets (excluding investment in joint ventures)	2,429.2	593.5	553.1	(593.1)	2,982.7
Investment in joint ventures	–	1.4	–	–	1.4
Total assets	2,429.2	594.9	553.1	(593.1)	2,984.1
Liabilities	(1,659.9)	(480.1)	(810.0)	593.1	(2,356.9)
Net assets/(liabilities)	769.3	114.8	(256.9)	–	627.2

Segment liabilities of the water and sewerage and waste management segments comprise operating liabilities. The other segment liabilities include the Company's financing of business acquisitions and Group taxation liabilities.

	Water and sewerage £m	Waste management £m	Other £m	Group £m
Other information				
31 March 2008				
Amortisation of other intangible assets (note 15)	–	1.3	–	1.3
Capital expenditure (including acquisitions)	169.7	148.0	0.1	317.8
Depreciation	85.0	42.9	–	127.9
31 March 2007				
Amortisation of other intangible assets (note 15)	–	1.8	–	1.8
Capital expenditure (including acquisitions)	184.0	97.9	0.2	282.1
Depreciation	77.7	36.0	–	113.7

Geographical segments

Separate disclosure by geographical segment is not shown since the operations of the Group are all located in the United Kingdom.

6. OPERATING COSTS

	2008 £m	2007 £m
Manpower costs (note 12)	**100.4**	90.7
Raw materials and consumables	**54.8**	47.2
Other operating expenses include:		
Profit on disposal of property, plant and equipment	**–**	(2.6)
Operating lease rentals payable:		
– Plant and machinery	**5.9**	7.2
– Property	**5.2**	1.5
Research and development expenditure	**0.2**	0.1
Trade receivables impairment	**6.0**	5.6
Depreciation of property, plant and equipment:		
– Owned assets	**98.9**	90.7
– Under finance leases	**29.0**	23.0
Amortisation of other intangible assets (note 15)	**1.3**	1.8

Fees payable to the Group's auditors in the year were:

	2008 £000	2007 £000
Fees payable to the Company's auditors for the audit of the Company's accounts	**46**	37
Fees payable to the Company's auditors for other services to the Group:		
Audit of the Company's subsidiaries pursuant to legislation	**297**	243
Other services pursuant to legislation	**23**	17
Tax services	**197**	162
Services relating to corporate finance transactions	**359**	188
All other services	**5**	97
	927	744
Fees payable to the Company's auditors in respect of Pennon Group pension schemes:		
Audit	**22**	22

Expenses reimbursed to the auditors in relation to the audit of the Group were £30,000 (2007 £25,000).

A description of the work of the Audit Committee is set out in its report on pages 54 and 55 which includes an explanation of how auditor objectivity and independence are safeguarded when non-audit services are provided by the auditors.

7. NET FINANCE COSTS

	2008 £m	2007 £m
Finance income		
Interest receivable	**21.0**	6.9
Expected return on pension schemes' assets (note 28)	**21.0**	22.1
	42.0	29.0
Finance costs		
Bank borrowings and overdrafts	**(47.6)**	(33.3)
Interest element of finance lease rentals	**(52.8)**	(41.9)
Other finance costs	**(1.4)**	(0.6)
Interest cost on retirement benefit obligations (note 28)	**(18.5)**	(18.4)
Unwinding of discounts in provisions (note 30)	**(4.3)**	(4.1)
	(124.6)	(98.3)
Net gains/(losses) on derivative instruments:		
Ineffectiveness on derivatives designated as cash flow hedges (note 22)	**0.3**	0.1
On derivatives deemed held for trading (note 22)	**(5.1)**	–
	(129.4)	(98.2)
Net finance costs	**(87.4)**	(69.2)

8. TAXATION

	2008 £m	2007 £m
Analysis of charge in year		
Current tax	**25.0**	23.9
Deferred tax	**12.0**	13.3
Deferred tax arising on change of rate	**(21.0)**	–
Total deferred tax (note 29)	**(9.0)**	13.3
	16.0	37.2

UK corporation tax is calculated at 30% (2007 30%) of the estimated assessable profit for the year. The deferred tax charge has been reduced by a non-recurring credit of £21.0 million reflecting the reduction in the rate of UK corporation tax from 30% to 28% effective 1 April 2008. The tax for the year differs from the theoretical amount that would arise using the standard rate of corporation tax in the UK (30%) from:

	2008 £m	2007 £m
Profit before tax	**149.6**	131.1
Profit before tax multiplied by the standard rate of UK corporation tax of 30% (2007 30%)	**44.9**	39.3
Effects of:		
Expenses not deductible for tax purposes	**2.7**	0.7
Sale of assets and finance leasing	**–**	(3.8)
Other	**(2.3)**	0.6
Capital gains reduced by capital losses	**(4.2)**	–
Effect of reduction in the rate of UK corporation tax on deferred tax	**(21.6)**	–
Adjustments to tax charge in respect of prior years	**(3.5)**	0.4
Tax charge for year	**16.0**	37.2

The average applicable tax rate for the year was 11% (2007 28%).

In addition to the amount credited to the income statement, a deferred tax charge relating to actuarial gains on defined benefit schemes of £1.4 million (2007 credit on actuarial losses £0.4 million) has been charged directly to equity. A deferred tax credit relating to share-based payment of £0.2 million (2007 nil) has been credited directly to equity.

8. TAXATION *continued*

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

9. PROFIT OF PARENT COMPANY

	2008 £m	2007 £m
Profit attributable to equity shareholders dealt with in the accounts of the parent company	**74.2**	93.8

As permitted by Section 230 of the Companies act 1985 no income statement is presented for the Company.

10. EARNINGS PER SHARE

Basic earnings per share are calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year, excluding those held in the employee share trust (note 34) which are treated as cancelled.

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to include all dilutive potential ordinary shares. The Group has two types of dilutive potential ordinary shares – those share options granted to employees where the exercise price is less than the average market price of the Company's ordinary shares during the year; and the contingently issuable shares under the Group's Restricted Share Plan, the Performance and Co-investment Plan and the deferred shares element of the Incentive Bonus Plan, to the extent that the performance criteria for vesting of the awards are expected to be met.

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

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

Underlying basic and diluted earnings per share

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

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

All operating activities are continuing operations.

11. DIVIDENDS

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

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

12. EMPLOYMENT COSTS

	2008 £m	2007 £m
Wages and salaries	**88.9**	77.9
Social security costs	**7.8**	6.7
Pension costs	**15.1**	14.2
Share-based payments	**1.9**	2.1
Total employment costs	**113.7**	100.9
Charged:		
Manpower costs	**100.4**	90.7
Capital schemes	**10.5**	9.9
Restructuring costs	**2.8**	0.3
Total employment costs	**113.7**	100.9

Details of Directors' emoluments are set out in note 13. There are no personnel, other than Directors, who as key management exercise authority and responsibility for planning, directing and controlling the activities of the Group.

	2008	2007
Employees (average number)		
The average monthly number of employees (including Executive Directors) was:		
Water and sewerage	**1,276**	1,301
Waste management	**2,059**	1,686
Other	**42**	38
Group totals	**3,377**	3,025

The total number of employees at 31 March 2008 was 3,388 (2007 3,204).

13. DIRECTORS' EMOLUMENTS

	2008 £000	2007 £000
Executive Directors:		
Salary	**875**	803
Performance related bonus payable	**390**	286
Share-based payments	**461**	501
Other emoluments	**63**	112
Payment in lieu of pension provision	**83**	48
Payments related to supplementary pension	**–**	100
Non-executive Directors	**358**	319
	2,230	2,169

The cost of share-based payments represents the amount charged to the income statement, as described in note 31.

The aggregate gains on vesting of Directors' share-based awards amounted to a total of £1,231,000 (2007 £512,000) of which the vesting of Restricted Share Plan awards was £1,006,000 (2007 nil) relating to the 2004 award, the details of which are shown on page 52.

Total gains made by Directors on the exercise of share options were £36,000 (2007 £15,000).

Total emoluments include £1,283,000 (2007 £1,074,000) payable to Directors for services as directors of subsidiary undertakings.

At 31 March 2008 retirement benefits were accruing to two Directors under defined benefit pension schemes (2007 two).
The accrued pension entitlement at 31 March 2008 under defined benefit schemes of the highest paid Director was £111,000 (2007 £90,000). No pension contributions were payable to defined contribution schemes but one Director has received payments in lieu of pension provision.

More detailed information concerning Directors' emoluments (including pensions and the highest paid Director) and share interests is shown in the Directors' remuneration report.

14. GOODWILL

	(Restated note 37) £m
Cost:	
At 1 April 2006	98.6
Recognised on acquisition of subsidiaries	38.9
At 31 March 2007	137.5
Recognised on acquisition of subsidiaries (note 37)	97.1
At 31 March 2008	234.6
Carrying amount:	
At 31 March 2007	137.5
At 31 March 2008	**234.6**

Goodwill acquired in a business combination is allocated at acquisition to the cash-generating unit (CGU) expected to benefit from that business combination. All of the carrying amount of goodwill is allocated to the waste management segment which is considered to be a single CGU, as it is an integrated business.

Goodwill is reviewed annually or when other events or changes in circumstance indicate that the carrying amount may not be fully recoverable.

The recoverable amount of the waste management segment is determined from value in use calculations. The key assumptions in those calculations relate to discount rates, cash flows, price increases and for landfill, the compaction rate. Cash flow projections are based on approved budgets and plans for the next five years and beyond this period on long-term growth rates for the waste sector based on GDP. The cash flows have been discounted using a pre-tax nominal discount rate of 13.2% which reflects the overall business risks associated with the waste management segment activities.

15. OTHER INTANGIBLE ASSETS

	Customer contracts (Restated note 37) £m	Patents £m	Total (Restated note 37) £m
Acquired intangible assets			
Cost:			
At 1 April 2006	8.5	0.2	8.7
Acquisitions	4.0	–	4.0
At 31 March 2007	12.5	0.2	12.7
Acquisitions	2.6	–	2.6
At 31 March 2008	15.1	0.2	15.3
Amortisation:			
At 1 April 2006	3.0	–	3.0
Charge for year	1.8	–	1.8
At 31 March 2007	4.8	–	4.8
Charge for year	1.3	–	1.3
At 31 March 2008	6.1	–	6.1
Carrying amount:			
At 31 March 2007	7.7	0.2	7.9
At 31 March 2008	**9.0**	**0.2**	**9.2**

15. OTHER INTANGIBLE ASSETS *continued*

Customer contracts are amortised over the useful economic life of each contract which at acquisition ranged between two and 15 years. The average remaining life is five years.

Patents are amortised over their estimated useful economic lives which at acquisition was 13 years. The average remaining life is nine years.

The carrying value of other intangible assets is reviewed annually or when events or changes in circumstance indicate that the carrying amount may not be fully recoverable.

16. PROPERTY, PLANT AND EQUIPMENT

	Land and buildings (Restated note 37) £m	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers £m	Landfill restoration £m	Construction in progress £m	Total (Restated note 37) £m
Group							
Cost:							
At 1 April 2006	265.3	1,108.0	557.3	970.1	35.4	99.9	3,036.0
Arising on acquisitions	6.9	–	–	5.3	1.4	–	13.6
Additions	31.5	60.7	2.1	72.9	–	77.9	245.1
Other	–	–	–	–	6.8	–	6.8
Grants and contributions	–	(3.6)	–	(1.3)	–	–	(4.9)
Disposals	(0.5)	(0.7)	–	(6.2)	–	–	(7.4)
Transfers/reclassifications	0.3	32.5	11.4	41.4	–	(85.6)	–
At 31 March 2007	303.5	1,196.9	570.8	1,082.2	43.6	92.2	3,289.2
Arising on acquisitions	0.9	–	–	6.4	–	–	7.3
Additions	33.1	50.0	1.6	62.6	–	81.5	228.8
Other (note 30)	–	–	–	–	1.1	–	1.1
Grants and contributions	–	(2.7)	–	(0.1)	–	–	(2.8)
Disposals	–	(0.7)	–	(8.7)	–	–	(9.4)
Transfers/reclassifications	1.2	17.3	13.1	34.7	–	(66.3)	–
At 31 March 2008	338.7	1,260.8	585.5	1,177.1	44.7	107.4	3,514.2
Depreciation:							
At 1 April 2006	97.1	24.8	121.4	374.1	2.7	–	620.1
Charge for year	18.3	15.1	10.6	68.1	3.1	–	115.2
Disposals	(0.2)	(0.7)	–	(4.1)	–	–	(5.0)
At 31 March 2007	115.2	39.2	132.0	438.1	5.8	–	730.3
Charge for year	22.1	16.9	10.3	76.1	3.8	–	129.2
Disposals	–	(0.7)	–	(7.6)	–	–	(8.3)
At 31 March 2008	137.3	55.4	142.3	506.6	9.6	–	851.2
Net book value:							
At 31 March 2007	188.3	1,157.7	438.8	644.1	37.8	92.2	2,558.9
At 31 March 2008	**201.4**	**1,205.4**	**443.2**	**670.5**	**35.1**	**107.4**	**2,663.0**

Of the total depreciation charge of £129.2 million (2007 £115.2 million), £1.3 million (2007 £1.5 million) has been charged to capital projects and £127.9 million (2007 £113.7 million) against profits.

Asset lives and residual values are reviewed annually.

16. PROPERTY, PLANT AND EQUIPMENT *continued*

Assets held under finance leases included above were:

	Land and buildings £m	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers £m	Landfill restoration £m	Construction in progress £m	Total £m
Cost:							
At 31 March 2007	–	271.3	387.3	277.1	–	52.3	988.0
At 31 March 2008	–	324.0	432.3	306.8	–	37.8	1,100.9
Depreciation:							
At 31 March 2007	–	6.5	59.9	137.9	–	–	204.3
At 31 March 2008	–	10.5	66.5	153.8	–	–	230.8
Net book amount:							
At 31 March 2007	–	264.8	327.4	139.2	–	52.3	783.7
At 31 March 2008	**–**	**313.5**	**365.8**	**153.0**	**–**	**37.8**	**870.1**

	Fixed and mobile plant, vehicles and computers £m
Company	
Cost:	
At 1 April 2006	0.2
Additions	0.2
Disposals	(0.1)
At 31 March 2007	0.3
Additions	0.1
Disposals	(0.1)
At 31 March 2008	0.3
Depreciation:	
At 1 April 2006	0.1
Charge for year	0.1
Disposals	(0.1)
At 31 March 2007	0.1
At 31 March 2008	0.1
Net book value:	
At 31 March 2007	0.2
At 31 March 2008	**0.2**

Asset lives and residual values are reviewed annually.

17. FINANCIAL INSTRUMENTS BY CATEGORY

The accounting policies for financial instruments have been applied to the line items as below:

	Note	Fair value Derivatives used for hedging £m	Fair value Derivatives deemed held for trading £m	Amortised cost Loans and receivables £m	Amortised cost Trade receivables and trade payables £m	Total £m
Group						
31 March 2008						
Financial assets						
Trade and other receivables	21	–	–	–	113.4	113.4
Derivative financial instruments	22	4.0	11.9	–	–	15.9
Cash and cash deposits	23	–	–	357.4	–	357.4
Total		4.0	11.9	357.4	113.4	486.7
Financial liabilities						
Borrowings	26	–	–	(2,121.2)	–	(2,121.2)
Derivative financial instruments	22	(0.5)	(17.0)	–	–	(17.5)
Trade and other payables	24	–	–	–	(89.8)	(89.8)
Total		(0.5)	(17.0)	(2,121.2)	(89.8)	(2,228.5)
31 March 2007						
Financial assets						
Trade and other receivables	21	–	–	–	85.0	85.0
Derivative financial instruments	22	16.0	–	–	–	16.0
Cash and cash deposits	23	–	–	127.9	–	127.9
Total		16.0	–	127.9	85.0	228.9
Financial liabilities						
Borrowings	26	–	–	(1,685.2)	–	(1,685.2)
Trade and other payables	24	–	–	–	(84.8)	(84.8)
Total		–	–	(1,685.2)	(84.8)	(1,770.0)
Company						
31 March 2008						
Financial assets						
Derivative financial instruments	22	0.5	–	–	–	0.5
Cash and cash deposits	23	–	–	49.7	–	49.7
Total		0.5	–	49.7	–	50.2
Financial liabilities						
Borrowings	26	–	–	(692.0)	–	(692.0)
Derivative financial instruments	22	–	(17.0)	–	–	(17.0)
Trade and other payables	24	–	–	–	(0.2)	(0.2)
Total		–	(17.0)	(692.0)	(0.2)	(709.2)
31 March 2007						
Financial assets						
Derivative financial instruments	22	1.7	–	–	–	1.7
Cash and cash deposits	23	–	–	24.1	–	24.1
Total		1.7	–	24.1	–	25.8
Financial liabilities						
Borrowings	26	–	–	(433.3)	–	(433.3)
Trade and other payables	24	–	–	–	(0.1)	(0.1)
Total		–	–	(433.3)	(0.1)	(433.4)

18. TRADE AND OTHER RECEIVABLES – NON-CURRENT

	Group 2008 £m	Group 2007 £m	Company 2008 £m	Company 2007 £m
Amounts owed by subsidiary undertakings	**–**	–	**258.5**	170.1
Amounts owed by joint ventures (note 42)	**9.3**	5.8	**–**	–
Other receivables	**1.1**	1.1	**1.1**	1.1
	10.4	6.9	**259.6**	171.2

Non-current receivables were due:

	Group 2008 £m	Group 2007 £m	Company 2008 £m	Company 2007 £m
Between 1 and 2 years	**1.4**	0.3	**66.4**	55.6
Between 2 and 5 years	**1.4**	1.8	**193.2**	115.6
Over 5 years	**7.6**	4.8	**–**	–
	10.4	6.9	**259.6**	171.2

The fair values of trade and other receivables were:

	Group 2008 £m	Group 2007 £m	Company 2008 £m	Company 2007 £m
Amounts owed by subsidiary undertakings	**–**	–	**258.1**	170.3
Amounts owed by joint ventures	**15.1**	9.2	**–**	–
Other receivables	**1.1**	1.1	**1.1**	1.1
	16.2	10.3	**259.2**	171.4

The fair value of amounts owed by joint ventures is based on cash flows using a rate based on the borrowings rate of 5.8% (2007 5.8%). The discount rate is equal to London Interbank Offered Rate plus an allowance to reflect an appropriate credit rating.

The effective interest rate on amounts owed by joint ventures was 13.4% (2007 13.4%).

19. INVESTMENTS

		Joint ventures	
	Shares £m	Loans £m	Total £m
Group			
At 1 April 2006	1.1	0.2	1.3
Share of profit	0.2	–	0.2
Part repayment of loans	–	(0.1)	(0.1)
At 31 March 2007	1.3	0.1	1.4
Share of profit	0.1	–	0.1
Repayment of loans	–	(0.1)	(0.1)
At 31 March 2008	1.4	–	1.4

	Subsidiary undertakings £m
Company	
At 1 April 2006	943.8
At 31 March 2007	943.8
Additions	101.0
At 31 March 2008	**1,044.8**

During the year the Company invested £100.0 million in the preference shares of a subsidiary undertaking to benefit from the efficient deposit of surplus funds to September 2008.

Details of the Group's principal subsidiary and joint venture undertakings are set out in note 38.

The Group's share of the results, assets and liabilities in its joint ventures are:

	Assets		Liabilities			
	Non-current £m	Current £m	Current £m	Non-current £m	Revenues £m	Profit £m
2008						
Echo South West Limited	–	1.0	(1.0)	–	5.6	0.1
Lakeside Energy from Waste Holdings Limited	69.4	4.3	(1.9)	(68.8)	0.3	0.1
	69.4	5.3	(2.9)	(68.8)	5.9	0.2
2007						
Echo South West Limited	0.1	0.6	(0.8)	–	5.2	0.1
Lakeside Energy from Waste Holdings Limited	38.3	2.8	(0.9)	(36.9)	0.3	0.2
	38.4	3.4	(1.7)	(36.9)	5.5	0.3

The joint venture in Echo South West Limited ceased operation on 31 March 2008.

20. INVENTORIES

	Group 2008 £m	Group 2007 £m	Company 2008 £m	Company 2007 £m
Raw materials and consumables	**5.2**	5.0	–	–
Work in progress	**0.1**	0.1	–	–
Finished goods and goods for resale	**1.3**	–	–	–
	6.6	5.1	–	–

21. TRADE AND OTHER RECEIVABLES – CURRENT

	Group 2008 £m	Group 2007 (Restated) £m	Company 2008 £m	Company 2007 £m
Trade receivables	**149.6**	118.8	**–**	–
Less: provision for impairment of receivables	**(36.2)**	(33.7)	**–**	–
Trade receivables	**113.4**	85.1	**–**	–
Amounts owed by subsidiary undertakings	**–**	–	**69.4**	55.6
Amounts owed by joint ventures (note 42)	**2.1**	0.9	**–**	–
Other receivables	**6.9**	3.2	**1.0**	0.3
Other prepayments and accrued income	**42.3**	33.3	**–**	0.1
	164.7	122.5	**70.4**	56.0

The Directors consider that the carrying amount of trade and other receivables approximates to their fair value. Group trade receivables, the provision for impairment and accrued income for 2007 have been restated to exclude amounts shown as a reduction to revenues and provided against accrued income in previous years.

There is no concentration of credit risk in trade receivables. The Group has a large number of customers who are dispersed and there is no significant loss on trade receivables expected which has not been provided for. The Group has created IAS39 portfolio provisions, but cannot practicably identify which receivables specifically are the ones impaired. It is Group policy to consider a receivable in a portfolio to which an impairment has been allocated on a collective basis as not being impaired for the purposes of IFRS 7 disclosures until the loss can be specifically identified with the receivable.

The ageing of trade receivables which are past due but not impaired was:

	2008 £m	2007 £m
Group		
Past due 0 – 30 days	**37.6**	24.0
Past due 31 – 120 days	**18.0**	8.3
More than 120 days	**52.6**	40.8

The Group's two operating businesses specifically review separate categories of debt to identify an appropriate provision for impairment. South West Water Limited has a duty under legislation to continue to provide domestic customers with services regardless of payment.

The movement in the allowance for impairment in respect of trade receivables which are past due but not impaired was:

	2008 £m	2007 £m
At 1 April	**33.7**	30.8
Provision for receivables impairment	**6.0**	5.6
Receivables written-off during the year as uncollectible	**(3.5)**	(2.7)
At 31 March	**36.2**	33.7

22. DERIVATIVE FINANCIAL INSTRUMENTS

	Group 2008 £m	Group 2007 £m	Company 2008 £m	Company 2007 £m
Interest rate swaps – cash flow hedges				
Non-current assets	**4.0**	16.0	**0.5**	1.7
Non-current liabilities	**(0.5)**	–	**–**	–
Derivatives deemed held for trading				
Current assets	**11.9**	–	**–**	–
Current liabilities	**(17.0)**	–	**(17.0)**	–

The full fair value of a hedging derivative is classified as a non-current asset or liability if the remaining maturity of the hedged item is more than 12 months and, as a current asset or liability, if the maturity of the hedged item is less than 12 months.

The ineffective portion recognised in the income statement which arises from cash flow hedges amounts to a gain of £0.3 million (2007 £0.1 million).

Interest rate swaps and fixed rate borrowings are used to manage the mix of fixed and floating rates to ensure at least 50% of Group net borrowings is at fixed rate. At 31 March 2008 58% of Group net borrowings was at a fixed rate (2007 66%).

At 31 March 2008 the Group had interest rate swaps to swap from floating to fixed rate and hedge financial liabilities with a notional value of £634.0 million and a weighted average maturity of 2.1 years (2007 £636.0 million, with 3.1 years). The weighted average interest rate of the swaps for their nominal amount was 4.8% (2007 4.8%).

At 31 March 2008 the Company had interest rate swaps to swap from floating to fixed rate and hedge financial liabilities with a notional value of £50.0 million and a weighted average maturity of 2.0 years (2007 £50.0 million, with 3.0 years). The weighted average interest rate of the swaps was 4.5% (2007 4.5%).

Derivatives deemed held for trading relate to the Company's investment of £100.0 million in the preference shares of a subsidiary undertaking to benefit from the efficient deposit of surplus funds up to September 2008.

The amounts above are the fair value of swaps based on the market value of equivalent instruments at the balance sheet date. All the interest rate swaps are designated and effective as cash flow hedges and the fair values have been deferred in equity.

23. CASH AND CASH DEPOSITS

	Group 2008 £m	Group 2007 £m	Company 2008 £m	Company 2007 £m
Cash at bank and in hand	**14.7**	8.9	**49.1**	24.1
Short-term bank deposits	**141.1**	114.3	**–**	–
Other deposits	**201.6**	4.7	**0.6**	–
	357.4	127.9	**49.7**	24.1

The effective interest rate on Group short-term deposits was 5.7% (2007 5.3%) and these deposits have a maturity of one day.

The effective interest rate on Group other deposits was 7.4% (2007 5.3%) and these deposits have an average maturity of 127 days.

Group other deposits include £10.1 million (2007 £4.1 million) of restricted funds to settle long-term lease liabilities (note 26) and £100.0 million of surplus funds deposited up to September 2008.

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

	Group 2008 £m	Group 2007 £m	Company 2008 £m	Company 2007 £m
Cash and cash deposits as above	**357.4**	127.9	**49.7**	24.1
Bank overdrafts (note 26)	**(18.6)**	(10.9)	**–**	–
	338.8	117.0	**49.7**	24.1
Less: deposits with a maturity of three months or more (restricted funds)	**(111.4)**	(4.7)	**(0.6)**	–
	227.4	112.3	**49.1**	24.1

24. TRADE AND OTHER PAYABLES – CURRENT

	Group 2008 £m	Group 2007 (Restated note 37) £m	Company 2008 £m	Company 2007 £m
Trade payables	**89.8**	84.8	**0.2**	0.1
Amounts owed to subsidiary undertakings	**–**	–	**11.0**	14.5
Amounts owed to joint venture (note 42)	**0.2**	0.3	**–**	–
Other tax and social security	**45.3**	42.7	**0.2**	0.3
Other creditors	**14.8**	10.6	**7.0**	3.1
Accruals	**54.1**	38.2	**0.5**	1.0
	204.2	176.6	**18.9**	19.0

The Directors consider that the carrying amount of trade and other payables approximates to their fair value.

25. CURRENT TAX LIABILITIES/(RECOVERABLE)

	Group 2008 £m	Group 2007 (Restated note 37) £m	Company 2008 £m	Company 2007 £m
Corporation tax	**43.1**	36.6	**(7.1)**	(1.2)

26. BORROWINGS

	Group 2008 £m	Group 2007 £m	Company 2008 £m	Company 2007 £m
Current				
Bank overdrafts	**18.6**	10.9	**–**	–
Short-term loans	**–**	7.6	**–**	7.5
European Investment Bank	**14.1**	16.3	**–**	–
Unsecured loan stock notes	**1.4**	2.1	**1.4**	2.1
Amounts owed to subsidiary undertakings	**–**	–	**295.9**	293.7
	34.1	36.9	**297.3**	303.3
Obligations under finance leases	**55.1**	48.9	**–**	–
Total current borrowings	**89.2**	85.8	**297.3**	303.3
Non-current				
Bank and other loans	**706.4**	350.1	**394.7**	130.0
European Investment Bank	**201.8**	215.9	**–**	–
	908.2	566.0	**394.7**	130.0
Obligations under finance leases	**1,123.8**	1,033.4	**–**	–
Total non-current borrowings (note 36)	**2,032.0**	1,599.4	**394.7**	130.0
Total borrowings	**2,121.2**	1,685.2	**692.0**	433.3

The Directors consider that the carrying amounts of current borrowings approximate to their fair value.

26. BORROWINGS *continued*

The fair values of non-current borrowings were:

	2008 Book value £m	2008 Fair value £m	2007 Book value £m	2007 Fair value £m
Group				
Bank and other loans	**706.4**	**673.1**	350.1	349.7
European Investment Bank	**201.8**	**197.3**	215.9	210.9
	908.2	**870.4**	566.0	560.6
Obligations under finance leases	**1,123.8**	**992.1**	1,033.4	921.8
	2,032.0	**1,862.5**	1,599.4	1,482.4
Company				
Bank and other loans	**394.7**	**392.4**	130.0	130.0

Where market values are not available, fair values of borrowings have been calculated by discounting expected future cash flows at prevailing interest rates.

The maturity of non-current borrowings was:

	Group 2008 £m	Group 2007 £m	Company 2008 £m	Company 2007 £m
Between 1 and 2 years	**263.4**	93.2	**205.0**	–
Between 2 and 5 years	**345.1**	442.0	**90.0**	130.0
Over 5 years	**1,423.5**	1,064.2	**99.7**	–
	2,032.0	1,599.4	**394.7**	130.0

The weighted average maturity of non-current borrowings was 24 years (2007 16 years).

Finance lease liabilities – minimum lease payments:

	Group 2008 £m	Group 2007 £m	Company 2008 £m	Company 2007 £m
Within one year	**76.8**	64.4	–	–
In the second to fifth years inclusive	**311.6**	270.0	–	–
After five years	**1,977.9**	1,866.7	–	–
	2,366.3	2,201.1	–	–
Less: future finance charges	**(1,187.4)**	(1,118.8)	–	–
	1,178.9	1,082.3	–	–

Included above are accrued finance charges arising on obligations under finance leases totalling £129.8 million (2007 £126.4 million), of which £39.5 million (2007 £36.5 million) is repayable within one year.

Within obligations under finance leases, South West Water Limited has utilised finance lease facilities of £180.0 million for certain water and sewerage business property, plant and equipment which are secured by bank letters of credit issued by United Kingdom financial institutions. These letters of credit, covering the full period of the finance leases, are renewable between the financial institutions and South West Water Limited at five-yearly intervals, the next being March 2011.

During 2007 the period for repayment of these liabilities was extended with an agreement to deposit with the lessor group amounts equal to the difference between the original and revised payments due. The accumulated deposits, £10.1 million at 31 March 2008 (2007 £4.1 million), are being held to settle the liability over the period from the end of the original lease term. The deposits are subject to a registered charge given as security to the lessor for the balance outstanding.

26. BORROWINGS *continued*

The effective interest rates at the balance sheet date and the exposure to interest rate changes and the repricing dates was:

	Effective rate %	6 months or less £m	6–12 months £m	1–5years £m	Total £m
Group					
31 March 2008					
Bank overdrafts	6.3	18.6	–	–	18.6
European Investment Bank	6.0	215.9	–	–	215.9
Unsecured loan stock notes	5.2	1.4	–	–	1.4
Bank and other loans	5.7	295.0	211.7	199.7	706.4
Finance leases	4.6	577.5	358.2	243.2	1,178.9
		1,108.4	569.9	442.9	2,121.2
Effect of swaps	4.8	(594.0)	–	594.0	–
		514.4	569.9	1,036.9	2,121.2
31 March 2007					
Bank overdrafts	6.2	10.9	–	–	10.9
Short-term loans	5.8	7.6	–	–	7.6
European Investment Bank	5.6	232.2	–	–	232.2
Unsecured loan stock notes	4.8	2.1	–	–	2.1
Bank and other loans	5.3	250.1	–	100.0	350.1
Finance leases	4.4	509.2	450.5	122.6	1,082.3
		1,012.1	450.5	222.6	1,685.2
Effect of swaps	4.8	(636.0)	–	636.0	–
		376.1	450.5	858.6	1,685.2
Company					
31 March 2008					
Unsecured loan stock notes	5.2	1.4	–	–	1.4
Bank and other loans	6.3	295.0	–	99.7	394.7
		296.4	–	99.7	396.1
Effect of swaps	4.5	(50.0)	–	50.0	–
		246.4	–	149.7	396.1
31 March 2007					
Short-term loans	5.7	7.5	–	–	7.5
Unsecured loan stock notes	4.8	2.1	–	–	2.1
Bank and other loans	5.8	130.0	–	–	130.0
		139.6	–	–	139.6
Effect of swaps	4.5	(50.0)	–	50.0	–
		89.6	–	50.0	139.6

Undrawn committed borrowing facilities:

	Group		Company	
	2008 £m	2007 £m	**2008 £m**	2007 £m
Floating rate:				
Expiring within one year	**50.0**	120.0	**25.0**	45.0
Expiring after one year	**135.0**	150.0	**55.0**	105.0
	185.0	270.0	**80.0**	150.0

In addition, the Group has short-term uncommitted bank facilities of £80.0 million available to the Company or South West Water Limited.

27. OTHER NON-CURRENT LIABILITIES

	Group 2008 £m	Group 2007 (Restated note 37) £m	Company 2008 £m	Company 2007 £m
Amounts owed to subsidiary undertakings	**–**	–	**8.7**	8.7
Other creditors	**4.0**	4.3	**–**	–
	4.0	4.3	**8.7**	8.7

28. RETIREMENT BENEFIT OBLIGATIONS

The Group operates a number of pension schemes including a defined contribution section within the main scheme.

The assets of the Group's pension schemes are held in separate trustee administered funds. The trustees of the funds are required to act in the best interest of the funds' beneficiaries. The appointment of schemes' trustees is determined by the schemes' trust documentation. The Group has a policy that one-half of all trustees, other than the Chairman, are nominated by members of the schemes, including current pensioners.

Defined contribution schemes
Pension costs for defined contribution schemes were £1.1 million (2007 £0.8 million).

Defined benefit schemes

Assumptions

The principal actuarial assumptions at 31 March were:

	2008 %	2007 %
Expected return on scheme assets	**7.0**	6.9
Rate of increase in pensionable pay	**4.4**	4.0
Rate of increase for present and future pensions	**3.4**	3.0
Rate used to discount schemes' liabilities	**6.9**	5.4
Inflation	**3.4**	3.0

Assumptions regarding future mortality experience are set based on actuarial advice in accordance with published statistics and experience. As at 31 March 2008 the mortality assumption uses a scheme-specific 'medium cohort' basis.

The average life expectancy in years of a pensioner retiring at age 62 on the balance sheet date is projected at:

	2008	2007
Male	**21.8**	23.8
Female	**25.3**	26.6

The average life expectancy in years of a pensioner retiring at age 62, 20 years after the balance sheet date, is projected at:

	2008	2007
Male	**23.3**	24.5
Female	**26.4**	27.3

28. RETIREMENT BENEFIT OBLIGATIONS *continued*

The sensitivities regarding the principal assumptions used to measure the schemes' liabilities are:

	Change in assumption	Impact on schemes' liabilities
Rate of increase in pensionable pay	+/– 0.5%	+/– 2.1%
Rate of increase in present and future pensions	+/– 0.5%	+/– 5.0%
Rate used to discount schemes' liabilities	+/– 0.5%	+/– 8.5%
Inflation	+/– 0.5%	+/– 8.0%
Life expectancy	+/– 1 year	+/– 2.5%

The amounts recognised in the income statement were:

	Group		Company	
	2008 £m	2007 £m	**2008 £m**	2007 £m
Current service cost	**(12.9)**	(12.6)	**(0.9)**	(0.8)
Past service cost	**(1.1)**	(0.8)	**–**	–
Total included in employment costs	**(14.0)**	(13.4)	**(0.9)**	(0.8)
Expected return on pension schemes' assets	**21.0**	22.1	**1.9**	1.7
Interest cost on retirement benefit obligations	**(18.5)**	(18.4)	**(1.6)**	(1.4)
Total included within net finance costs	**2.5**	3.7	**0.3**	0.3
Total charge	**(11.5)**	(9.7)	**(0.6)**	(0.5)

The actual return on schemes' assets was a loss of £23.7 million (2007 a gain of £23.6 million).

The amounts recognised in the statement of recognised income and expense were:

	Group		Company	
	2008 £m	2007 £m	**2008 £m**	2007 £m
Actuarial gains/(losses) recognised in the year	**5.1**	(1.2)	**(1.3)**	(0.4)

The amounts recognised in the balance sheet were:

	Group		Company	
	2008 £m	2007 £m	**2008 £m**	2007 £m
Fair value of schemes' assets	**331.5**	347.6	**33.9**	27.0
Present value of defined benefit obligations	**(357.8)**	(388.8)	**(36.8)**	(30.4)
Net liability recognised in the balance sheet	**(26.3)**	(41.2)	**(2.9)**	(3.4)

28. RETIREMENT BENEFIT OBLIGATIONS *continued*

The schemes' assets and the expected long-term rates of return at the year end were:

	2008 Expected return %	**2008** Value £m	**2008** Fund %	2007 Expected return %	2007 Value £m	2007 Fund %
Equities	**8.5**	**195.0**	**59**	8.0	194.3	56
Property/currency	**7.8**	**14.7**	**4**	7.8	40.2	11
Bonds	**4.6**	**121.7**	**37**	4.7	112.5	33
Other	**5.0**	**0.1**	**–**	5.0	0.6	–
		331.5	**100**		347.6	100

The Company's share of the schemes' assets at the balance sheet date were:

	2008 £m	2007 £m
Equities	**20.2**	15.2
Property/currency	**1.5**	2.9
Bonds	**12.2**	8.9
	33.9	27.0

The expected return on plan assets is determined by considering the long-term returns and the balance between risk and reward on the various categories of investment assets held. Expected returns on equity and property investments reflect long-term rates of return experienced in the respective markets. Expected yields on fixed interest investments are based on gross redemption yields as at the balance sheet date.

In conjunction with the trustees and investment advisers, the Group restructured its portfolio of defined benefit pension investments during 2006/07 following a review of strategy. This led to a new asset allocation structure with the objective of increasing investment returns whilst reducing risk. The revised asset allocation has three main elements:

– an increased holding of bonds which are expected to be less volatile than most other asset classes and are a better match for the schemes' liabilities
– a reduction in the proportion of equities, but with fund managers having more freedom in making investment decisions to maximise returns
– investment of a relatively small proportion of the schemes' assets (circa 10%) in alternative asset classes which give the potential for gaining higher returns (property and currency).

Equities held by the scheme are spread between the UK (circa 60%) and international markets (circa 40%) excluding emerging markets.

The Group provides retirement benefits to some of its former and approximately 49% of current employees through defined benefit schemes. The level of retirement benefit is based principally on final annual salary earned in employment.

The liabilities of the defined benefit schemes are measured by using the projected unit credit method which is an accrued benefits valuation method in which the scheme liabilities make allowance for projected earnings.

An alternative method of valuation to the projected unit credit method is a solvency basis, which is estimated using the cost of buying out benefits with a suitable insurer. This amount represents the amount that would be required to settle the schemes liabilities at the balance sheet date rather than the Group continuing to fund the on-going liabilities. The Group estimates the amount required to settle the schemes' liabilities at the balance sheet date was approximately £630 million.

28. RETIREMENT BENEFIT OBLIGATIONS *continued*

Movements in the net liability were:

	Group		Company	
	2008 £m	2007 £m	**2008 £m**	2007 £m
At 1 April	**(41.2)**	(41.7)	**(3.4)**	(3.3)
Income statement	**(11.5)**	(9.7)	**(0.6)**	(0.5)
Statement of recognised income and expenditure	**5.1**	(1.2)	**(1.3)**	(0.4)
Regular contributions	**2.3**	2.8	**0.5**	0.5
Prepayment of regular contributions	**19.0**	8.6	**1.9**	0.3
At 31 March	**(26.3)**	(41.2)	**(2.9)**	(3.4)

Movements in the fair value of schemes' assets were:

	Group		Company	
	2008 £m	2007 £m	**2008 £m**	2007 £m
At 1 April	**347.6**	317.5	**27.0**	25.4
Expected return on schemes' assets	**21.0**	22.1	**1.9**	1.7
Actuarial (losses)/gains	**(44.7)**	1.5	**4.0**	0.1
Members' contributions	**0.3**	0.3	**–**	–
Benefits paid	**(14.0)**	(13.1)	**(1.4)**	(1.0)
Group regular contributions	**2.3**	2.8	**0.5**	0.5
Prepayment of Group regular contributions	**19.0**	8.6	**1.9**	0.3
Acquisition of subsidiary	**–**	7.9	**–**	–
At 31 March	**331.5**	347.6	**33.9**	27.0

Movements in the present value of defined benefit obligations were:

	Group		Company	
	2008 £m	2007 £m	**2008 £m**	2007 £m
At 1 April	**(388.8)**	(359.2)	**(30.4)**	(28.7)
Service cost	**(14.0)**	(13.4)	**(0.9)**	(0.8)
Interest cost	**(18.5)**	(18.4)	**(1.6)**	(1.4)
Actuarial gains/(losses)	**49.8**	(2.7)	**(5.3)**	(0.5)
Members' contributions	**(0.3)**	(0.3)	**–**	–
Benefits paid	**14.0**	13.1	**1.4**	1.0
Acquisition of subsidiary	**–**	(7.9)	**–**	–
At 31 March	**(357.8)**	(388.8)	**(36.8)**	(30.4)

The cash flows arising from the payment of the defined benefits are expected to be settled primarily in the period between 15 and 40 years from the balance sheet date.

28. RETIREMENT BENEFIT OBLIGATIONS *continued*

The Group's transition date to IFRS was 1 April 2004 and the following historical data is presented from that date. The historical data will provide a rolling five-year record from next year.

	2008 £m	2007 £m	2006 £m	2005 £m
Group				
Fair value of schemes' assets	**331.5**	347.6	317.5	223.8
Present value of defined benefit obligations	**(357.8)**	(388.8)	(359.2)	(303.6)
Net liability recognised	**(26.3)**	(41.2)	(41.7)	(79.8)
Experience (losses)/gains on schemes' assets				
Amount (£m)	**(44.7)**	1.5	34.2	9.8
Percentage of schemes' assets	**(13.5)%**	0.4%	10.8%	4.4%
Experience gains/(losses) on defined benefit obligations				
Amount (£m)	**49.8**	(2.7)	(37.0)	(7.9)
Percentage of defined benefit obligations	**13.9%**	(0.7)%	(10.3)%	(2.6)%

The cumulative actuarial gains recognised in the Group statement of recognised income and expense at 31 March 2008 were £3.0 million (2007 losses of £2.1 million).

	2008 £m	2007 £m	2006 £m	2005 £m
Company				
Fair value of schemes' assets	**33.9**	27.0	25.4	17.9
Present value of defined benefit obligations	**(36.8)**	(30.4)	(28.7)	(24.3)
Net liability recognised	**(2.9)**	(3.4)	(3.3)	(6.4)
Experience gains on schemes' assets				
Amount (£m)	**4.0**	0.1	3.9	0.9
Percentage of schemes' assets	**11.8%**	–	15.3%	5.0%
Experience losses on defined benefit obligations				
Amount (£m)	**(5.3)**	(0.4)	(0.3)	(1.1)
Percentage of defined benefit obligations	**(14.4)%**	(0.1)%	(0.1)%	(4.5)%

The cumulative actuarial gains recognised in the Company statement of recognised income and expense at 31 March 2008 were £1.8 million (2007 £3.1 million).

28. RETIREMENT BENEFIT OBLIGATIONS *continued*

The Group's current service cost during the year was 21.7% of pensionable earnings (2007 21.7%). The Group's existing defined benefit schemes have been closed to new entrants from 1 April 2008.

The Group has recently completed the triennial actuarial valuation of its defined benefit schemes as at 1 April 2007 which has resulted in higher future service and deficit recovery contributions. The Group has agreed with the trustees that it will aim to eliminate the actuarially calculated funding deficit of circa £38 million as at 31 March 2007 over a 10 year period. A contribution prepayment of £19.0 million was made during the year and a further £10.7 million contribution has been made in April 2008 (2007 £8.6 million). The Group monitors funding levels on an annual basis and as a result of these prepayments no further Group regular contributions are expected to be paid to the schemes during the year ending 31 March 2009.

29. DEFERRED TAX

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

Movements on the deferred tax account were:

	Group		Company	
	2008	2007 (Restated note 37)	**2008**	2007
	£m	£m	**£m**	£m
Liability/(asset) at 1 April	**313.5**	302.8	**(1.8)**	(1.8)
(Credited)/charged to the income statement	**(9.0)**	13.3	**0.7**	0.1
Charged/(credited) to equity	**1.2**	(0.4)	**(0.5)**	(0.1)
Arising on acquisitions	**1.5**	(2.2)	**–**	–
Liability/(asset) at 31 March	**307.2**	313.5	**(1.6)**	(1.8)

Deferred tax assets have been recognised in respect of all temporary differences giving rise to deferred tax assets because it is probable that these assets will be recovered.

All deferred tax assets and liabilities are within the same jurisdiction and may be offset as permitted by IAS 12. The movement in deferred tax assets and liabilities is shown below.

29. DEFERRED TAX *continued*

Group

Deferred tax liabilities

	Accelerated tax depreciation Owned assets £m	Accelerated tax depreciation Leased assets £m	Other £m	Total £m
At 1 April 2006	306.1	5.1	24.6	335.8
Charged/(credited) to the income statement	6.3	4.9	(2.1)	9.1
Arising on acquisitions	(2.4)	–	2.0	(0.4)
At 31 March 2007	310.0	10.0	24.5	344.5
(Credited)/charged to the income statement	(21.3)	5.5	(3.1)	(18.9)
Arising on acquisitions	0.7	–	0.8	1.5
At 31 March 2008	**289.4**	**15.5**	**22.2**	**327.1**

Deferred tax assets

	Provisions (Restated note 37) £m	Retirement benefit obligations £m	Other £m	Total (Restated note 37) £m
At 1 April 2006	(7.7)	(12.5)	(12.8)	(33.0)
Charged to the income statement	0.4	0.5	3.3	4.2
Credited to equity	–	(0.4)	–	(0.4)
Arising on acquisitions	(1.8)	–	–	(1.8)
At 31 March 2007	(9.1)	(12.4)	(9.5)	(31.0)
Charged to the income statement	2.5	3.6	3.8	9.9
Credited to equity	–	1.4	(0.2)	1.2
At 31 March 2008	**(6.6)**	**(7.4)**	**(5.9)**	**(19.9)**
Net deferred tax liability:				
At 31 March 2007				313.5
At 31 March 2008				**307.2**

Company

Deferred tax assets

	Retirement benefit obligations £m	Other £m	Total £m
At 1 April 2006	(1.0)	(0.8)	(1.8)
Charged to the income statement	0.1	–	0.1
Credited to equity	(0.1)	–	(0.1)
At 31 March 2007	(1.0)	(0.8)	(1.8)
Charged to the income statement	0.6	0.1	0.7
Credited to equity	(0.4)	(0.1)	(0.5)
At 31 March 2008	**(0.8)**	**(0.8)**	**(1.6)**

29. DEFERRED TAX *continued*

Deferred tax (charged)/credited to equity during the year was:

	Group 2008 £m	Group 2007 £m	Company 2008 £m	Company 2007 £m
Actuarial (losses)/gains on defined benefit schemes	**(1.4)**	0.4	**0.4**	0.1
Share-based payments (note 34)	**0.2**	–	**0.1**	–
	(1.2)	0.4	**0.5**	0.1

30. PROVISIONS FOR LIABILITIES AND CHARGES

	Environmental and landfill restoration £m	Restructuring £m	Other provisions £m	Total £m
Group				
At 1 April 2007	99.3	–	0.2	99.5
Charged to the income statement	5.5	4.0	–	9.5
Landfill restoration	1.1	–	–	1.1
Utilised during year	(8.2)	(2.5)	–	(10.7)
At 31 March 2008	97.7	1.5	0.2	99.4

The amount charged to the income statement includes £4.3 million charged to finance costs as the unwinding of discounts in provisions.

The addition to landfill restoration provision of £1.1 million recognised in the year has been matched with an addition to property, plant and equipment.

The analysis of provisions between current and non-current is:

	2008 £m	2007 £m
Current	**18.1**	13.2
Non-current	**81.3**	86.3
	99.4	99.5

Environmental and landfill restoration provisions are expected to be substantially utilised over the period from 2009 to beyond 2050. The provisions have been established assuming current waste management technology based upon estimated costs at future prices which have been discounted to present value. The restructuring provision related principally to severance costs and will be utilised within one year.

31. SHARE CAPITAL

	2008 £m	2007 £m
Authorised		
429,975,270 ordinary shares of 40.7p each	**175.0**	175.0

31. SHARE CAPITAL *continued*

Ordinary shares allotted during the year

	Number of shares			
	Deferred shares	Treasury shares	Ordinary shares	£m
At 1 April 2006 ordinary shares of £1.22 $^{1}/_{10}$ each	35,858,521		118,608,847	144.8
Deferred shares of £1.10 each				39.4
				184.2
Deferred shares of £1.10 each cancelled	(35,858,521)			(39.4)
For consideration of £3.3 million, shares purchased and subsequently cancelled			(245,000)	(0.3)
			118,363,847	
Sub-division into three new ordinary shares of 40.7p each			355,091,541	
For consideration of £0.2 million, shares purchased and subsequently cancelled			(50,000)	
For consideration of £1.9 million, shares issued under the Company's Sharesave Scheme			1,082,338	0.4
At 31 March 2007 ordinary shares of 40.7p each	–	–	356,123,879	144.9
For consideration of £5.9 million, shares purchased and subsequently cancelled			(960,000)	(0.4)
For consideration of £43.4 million, shares purchased and held as treasury shares		7,285,008	(7,285,008)	–
For consideration of £1.6 million, shares issued under the Company's Sharesave Scheme		(873,602)	873,997	–
At 31 March 2008 ordinary shares of 40.7p each	**–**	**6,411,406**	**348,752,868**	**144.5**

Shares held as treasury shares may be sold, re-issued for any of the Company's share schemes, or cancelled.

On 31 July 2006 each of the Company's issued and unissued existing ordinary shares of £1.22$^{1}/_{10}$ each were sub-divided into three new ordinary shares of 40.7p each.

During 2006 a capital return to shareholders was made by way of the B Share Scheme amounting to £143.5 million, of which £39.4 million was by way of the initial dividend payment and £104.1 million was through share redemption. The B Shares which received the initial dividend were subsequently converted into Deferred Shares, redeemed at the close of business on 6 April 2006 for a total aggregate consideration of one pence and were then cancelled. At 31 March 2007 £39.4 million of the capital return via the B Share Scheme was outstanding and held in Share Capital and £5.7 million of the B Shares not redeemed until 6 April 2007 were held within other payables.

Employee share schemes

The Group operates a number of equity-settled share plans for the benefit of employees. Details of each plan are:

i) Sharesave Scheme

An all-employee savings related plan is operated that enables employees, including executive directors, to invest up to a maximum of £250 per month for three or five years. These savings can then be used to buy ordinary shares at a price set at a 20% discount to the market value at the start of the savings period at the third, fifth or seventh year anniversary of the option being granted. Options expire six months following the exercise date and, except for certain specific circumstances such as redundancy, lapse if the employee leaves the Group before the option exercise period commences.

31. SHARE CAPITAL *continued*

Employee share schemes *continued*

i) Sharesave Scheme (continued)

Outstanding options to subscribe for ordinary shares of 40.7p each under the Company's share option schemes are:

Date granted and subscription price fully paid		Period when options normally exercisable	Thousands of shares in respect of which options outstanding at 31 March **2008**	2007
6 July 1999	275p	2002 – 2006	**–**	1
5 July 2000	154p	2003 – 2007	**–**	189
4 July 2001	163p	2004 – 2008	**31**	33
9 July 2002	189p	2005 – 2009	**40**	236
8 July 2003	177p	2006 – 2010	**339**	351
6 July 2004	200p	2007 – 2011	**314**	803
5 July 2005	270p	2008 – 2012	**633**	669
4 July 2006	358p	2009 – 2013	**612**	643
3 July 2007	522p	2010 – 2014	**550**	–
			2,519	2,925

At 31 March 2008 there were 1,281 participants in the Sharesave Scheme (2007 1,145).

The number and weighted average exercise price of Sharesave options are:

	2008		2007	
	Number of ordinary shares (thousands)	**Weighted average exercise price per share (p)**	Number of ordinary shares (thousands)	Weighted average exercise price per share (p)
At 1 April	**2,925**	**244**	3,465	201
Granted	**580**	**522**	665	358
Exercised	**(875)**	**189**	(1,082)	177
Expired	**(111)**	**337**	(123)	248
At 31 March	**2,519**	**322**	2,925	244

The weighted average price of the Company's shares at the date of exercise of Sharesave options during the year was 606p (2007 477p). The options outstanding at 31 March 2008 had a weighted average exercise price of 322p (2007 244p) and a weighted average remaining contractual life of 2.0 years (2007 2.0 years).

The aggregate fair value of Sharesave options granted during the year was £0.9 million (2007 £0.7 million), determined using the Black-Scholes valuation model. The significant inputs into the valuation model at the date of issue of the options were:

	2008	2007
Weighted average share price	**409p**	321p
Weighted average exercise price	**327p**	257p
Expected volatility	**21.0p**	22.3%
Expected life	**4.3 years**	4.2 years
Risk-free rate	**4.7%**	4.6%
Expected dividend yield	**4.2%**	4.6%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous two years.

31. SHARE CAPITAL *continued*

Employee share schemes *continued*

ii) Restricted Share Plan

Under this plan executive directors and senior management receive a conditional award of ordinary shares in the Company. The eventual number of shares, if any, which vest is dependent upon the achievement of the performance condition of the plan over the restricted period, being not less than three years.

The number and weighted average price shares in the Restricted Share Plan are:

	2008		2007	
	Number of ordinary shares (thousands)	Weighted average exercise price per share (p)	Number of ordinary shares (thousands)	Weighted average exercise price per share (p)
At 1 April	**1,498**	**346**	1,347	287
Granted	**–**	**–**	366	499
Vested	**(666)**	**270**	(95)	195
Lapsed	**(148)**	**304**	(120)	270
At 31 March	**684**	**449**	1,498	346

The plan was succeeded during the year by the Performance and Co-investment Plan.

The awards outstanding at 31 March 2008 had a weighted average price of 449p (2007 346p) and a weighted average remaining contractual life of 1.1 years (2007 1.2 years). The Company's share price at the date of the awards ranged from 357p to 499p.

The aggregate fair value of awards granted during the year was nil (2007 £1.0 million), determined using a Monte-Carlo simulation model. The significant inputs into the valuation model at the date of the share awards were:

	2008	2007
Weighted average share price	**449p**	346p
Expected volatility	**20.9%**	22.6%
Risk-free rate	**4.8%**	4.7%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous two years.

iii) Performance and Co-investment Plan

The plan was approved by shareholders at the Annual General Meeting in July 2007 and succeeded the Restricted Share Plan in September 2007.

Executive Directors and senior management receive a conditional award of ordinary shares in the Company and are also required to hold a substantial personal shareholding in the Company. The eventual number of shares, if any, which vest is dependant upon the achievement of conditions of the plan over the restricted period, being not less than three years.

The number and price of shares in the Performance and Co-investment Plan are:

	2008	
	Number of ordinary shares (thousands)	Exercise price per share (p)
At 1 April	**–**	**–**
Granted	**422**	**575**
At 31 March	**422**	**575**

The awards outstanding at 31 March 2008 had an exercise price of 575p and a remaining contractual life of 2.5 years.

31. SHARE CAPITAL *continued*

Employee share schemes *continued*

iii) Performance and Co-investment Plan (continued)

The aggregate fair value of awards granted during the year was £1.1 million, determined using a Monte-Carlo simulation model. The significant inputs into the valuation model at the date of the share awards were:

	2008
Share price	**575p**
Expected volatility	**18.7%**
Risk-free rate	**5.3%**

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous two years.

iv) Incentive Bonus Plan – Deferred Shares

Awards under the plan to Executive Directors and senior management involve the release of ordinary shares in the Company to participants. The number and weighted average price of shares in the Incentive Bonus Plan are:

	2008		2007	
	Number of ordinary shares (thousands)	Weighted average exercise price per share (p)	Number of ordinary shares (thousands)	Weighted average exercise price per share (p)
At 1 April	**406**	**350**	501	269
Granted	**124**	**600**	139	484
Vested	**(162)**	**320**	(234)	255
At 31 March	**368**	**465**	406	350

The awards outstanding at 31 March 2008 had a weighted average price of 465p (2007 350p) and a weighted average remaining contractual life of 1.3 years (2007 1.4 years). The Company's share price at the date of the awards ranged from 328p to 600p.

The aggregate fair value of awards granted during the year was £0.7 million (2007 £0.6 million), determined from market value. No option pricing methodology is applied since dividends declared on the shares are receivable by the participants in the scheme and there is no performance condition since vesting is usually conditional upon continuous service with the Group for a period of three years from the award.

Further details of the plans and options granted to Directors, included above, are shown in the Directors' remuneration report.

32. SHARE PREMIUM ACCOUNT

	£m
At 1 April 2006	10.2
Premium on shares issued for cash consideration	1.5
At 31 March 2007	11.7
At 31 March 2008	**11.7**

33. CAPITAL REDEMPTION RESERVE

	£m
At 1 April 2006	98.4
Transferred from retained earnings on redemption of 5,200,871 B Shares of £1.10 each	5.7
35,858,521 Deferred shares cancelled	39.4
Own shares purchased and subsequently cancelled	0.3
At 31 March 2007	143.8
Own shares purchased and subsequently cancelled	0.4
At 31 March 2008	**144.2**

34. RETAINED EARNINGS AND OTHER RESERVES

	Hedging reserve £m	Own shares £m	Retained earnings £m	Total £m
Group				
At 1 April 2006	0.1	(6.0)	294.3	288.4
Profit for year	–	–	93.9	93.9
Other recognised income and expense for the year	15.7	–	(0.8)	14.9
Dividends paid	–	–	(61.0)	(61.0)
Adjustment in respect of share-based payments	–	–	2.1	2.1
Adjustment in respect of share options vesting	–	1.1	(1.1)	–
Own shares purchased and subsequently cancelled	–	–	(3.5)	(3.5)
Own shares acquired by the Pennon Employee Share Trust	–	(2.3)	–	(2.3)
B Share payments	–	–	(5.7)	(5.7)
At 31 March 2007	15.8	(7.2)	318.2	326.8
Profit for year	–	–	133.6	133.6
Other recognised income and expense for the year	(12.7)	–	3.7	(9.0)
Dividends paid	–	–	(65.6)	(65.6)
Adjustment in respect of share-based payments	–	–	1.9	1.9
Adjustment in respect of share options vesting	–	3.0	(3.0)	–
Deferred tax in respect of share-based payments	–	–	0.2	0.2
Own shares purchased and subsequently cancelled	–	–	(5.9)	(5.9)
Own shares purchased and held as treasury shares	–	–	(43.4)	(43.4)
Proceeds from treasury shares re-issued	–	–	1.6	1.6
Own shares acquired by the Pennon Employee Share Trust	–	(0.3)	–	(0.3)
At 31 March 2008	**3.1**	**(4.5)**	**341.3**	**339.9**

The own shares reserve represents the cost of ordinary shares in Pennon Group Plc issued to or purchased in the market and held by the Pennon Employee Share Trust to satisfy awards under the Group's Restricted Share Plan and Incentive Bonus Plan.

During 2008 the trustees of the Pennon Employee Share Trust acquired 57,967 of the Company's ordinary shares, financed through non interest bearing advances made by sponsoring group companies (2007 46,684 ordinary shares of £1.22 $^{1}/_{10}$ each and 319,334 ordinary shares of 40.7p each).

The market value of the 1,210,000 ordinary shares (2007 1,980,000 ordinary shares) held by the trust at 31 March 2008 was £7.8 million (2007 £11.6 million).

34. RETAINED EARNINGS AND OTHER RESERVES *continued*

	Hedging reserve £m	Retained earnings £m	Total £m
Company			
At 1 April 2006	0.6	410.1	410.7
Profit for the year	–	93.8	93.8
Other recognised income and expense for the year	1.1	(0.3)	0.8
Dividends paid	–	(61.0)	(61.0)
Adjustment in respect of share-based payments	–	0.5	0.5
Adjustment in respect of share options vesting	–	(0.4)	(0.4)
Own shares purchased and subsequently cancelled	–	(3.5)	(3.5)
B Share payments	–	(5.7)	(5.7)
At 31 March 2007	1.7	433.5	435.2
Profit for the year	–	74.2	74.2
Other recognised income and expense for the year	(1.2)	(0.9)	(2.1)
Dividends paid	–	(65.6)	(65.6)
Adjustment in respect of share-based payments	–	0.6	0.6
Adjustment in respect of share options vesting	–	(0.7)	(0.7)
Deferred tax in respect of share-based payments	–	0.1	0.1
Own shares purchased and subsequently cancelled	–	(5.9)	(5.9)
Own shares purchased and held as treasury shares	–	(43.4)	(43.4)
Proceeds from treasury shares re-issued	–	1.6	1.6
At 31 March 2008	**0.5**	**393.5**	**394.0**

35. CASH FLOW FROM OPERATING ACTIVITIES

Reconciliation of profit for the year to cash generated from operations:

Cash generated from operations

	Group		Company	
	2008 £m	2007 £m	**2008 £m**	2007 £m
Continuing operations				
Profit for the year	**133.6**	93.9	**74.2**	93.8
Adjustments for:				
Employee share schemes	**1.9**	2.1	**0.6**	0.5
Profit on disposal of property, plant and equipment	**–**	(2.6)	**–**	–
Profit on disposal of investment	**–**	(0.6)	**–**	–
Depreciation charge	**127.9**	113.7	**–**	0.1
Amortisation of intangible assets	**1.3**	1.8	**–**	–
Share of post-tax profit from joint venture	**(0.2)**	(0.3)	**–**	–
Finance income	**(42.0)**	(29.0)	**(22.0)**	(16.1)
Finance costs	**129.4**	98.2	**36.5**	9.9
Dividends receivable	**–**	–	**(85.7)**	(90.1)
Taxation	**16.0**	37.2	**(3.9)**	1.2
Changes in working capital (excluding the effect of acquisition of subsidiaries):				
Increase in inventories	**(0.6)**	(0.1)	**–**	–
Increase in trade and other receivables	**(29.9)**	(20.7)	**(103.0)**	(53.4)
Increase/(decrease) in trade and other payables	**12.5**	16.9	**(3.8)**	(0.4)
(Decrease)/increase in retirement benefit obligations	**(7.3)**	2.0	**(1.8)**	–
Decrease in provisions for liabilities and charges	**(5.5)**	(7.4)	**–**	–
Cash generated/(outflow) from operations	**337.1**	305.1	**(108.9)**	(54.5)

36. NET BORROWINGS

	Group		Company	
	2008 £m	2007 £m	**2008 £m**	2007 £m
Cash and cash deposits	**357.4**	127.9	**49.7**	24.1
Borrowings – current				
Bank overdrafts	**(18.6)**	(10.9)	**–**	–
Other current borrowings	**(15.5)**	(26.0)	**(1.4)**	(9.6)
Finance lease obligations	**(55.1)**	(48.9)	**–**	–
Amounts owed to subsidiary undertakings	**–**	–	**(295.9)**	(293.7)
Total current borrowings	**(89.2)**	(85.8)	**(297.3)**	(303.3)
Borrowings – non-current				
Bank and other loans	**(706.4)**	(350.1)	**(394.7)**	(130.0)
Other non-current borrowings	**(201.8)**	(215.9)	**–**	–
Finance lease obligations	**(1,123.8)**	(1,033.4)	**–**	–
Total non-current borrowings	**(2,032.0)**	(1,599.4)	**(394.7)**	(130.0)
Total net borrowings	**(1,763.8)**	(1,557.3)	**(642.3)**	(409.2)

37. ACQUISITIONS

On 5 December 2007 the entire issued share capital of Grosvenor Waste Management Limited, (now renamed Viridor Resource Management Limited), was purchased by Viridor Waste Management Limited for a cash consideration of £80.0 million, including costs of £0.5 million. The acquisition has been accounted for using the acquisition method.

Viridor Resource Management Limited contributed revenues of £17.3 million and net profit of £3.1 million for the period from 5 December 2007 to 31 March 2008. If the acquisition had occurred on 1 April 2007 Group revenues for the year would have been £908.9 million and profit for the year would have been £137.7 million. These amounts have been calculated after applying the Group's accounting policies, adjusting the results to reflect the provisional fair value adjustments as if they had applied from 1 April 2007 and include the costs of integrating the acquisition with the existing business.

All intangible assets have been recognised at their respective provisional fair values. The residual excess over the net assets acquired has been recognised as goodwill. The provisional goodwill is attributed to the profitability of the acquired business and the anticipated future operating synergies arising from the combination.

	Book value £m	Fair value adjustment £m	Fair value £m
Other intangible assets	–	2.6	2.6
Property, plant and equipment	5.9	–	5.9
Inventories	0.4	–	0.4
Receivables	11.0	–	11.0
Payables	(6.8)	(3.2)	(10.0)
Taxation – current	(1.9)	(0.1)	(2.0)
Taxation – deferred	(0.6)	(0.8)	(1.4)
Finance leases	(2.3)	–	(2.3)
Cash and cash deposits	0.6	–	0.6
Net assets acquired	6.3	(1.5)	4.8
Goodwill			75.2
Total consideration			80.0
Satisfied by:			
Cash			79.5
Directly attributable costs			0.5
			80.0
Net cash outflow arising on acquisition			
Cash consideration			80.0
Cash and cash deposits acquired			(0.6)
			79.4

The other intangible assets acquired as part of the acquisition relate to customer contracts.

37. ACQUISITIONS *continued*

On 25 March 2008 the entire issued share capital of Ledge 806 Limited (now renamed Viridor Electrical Recycling (Holdings) Limited), the holding company of Shore Recycling Limited, was purchased by Viridor Waste Management Limited for a cash consideration of £10.5 million, including costs of £0.3 million. The acquisition has been accounted for using the acquisition method.

Viridor Electrical Recycling (Holdings) Limited contributed revenues of £0.3 million and broke-even for the period from 25 March 2008 to 31 March 2008. If the acquisition had occurred on 1 April 2007 Group revenues for the year would have been £883.2 million and profit for the year would have been £134.8 million. These amounts have been calculated after applying the Group's accounting policies, adjusting the results to reflect the provisional fair value adjustments as if they had applied from 1 April 2007 and include the costs of integrating the acquisition with the existing business.

The excess over the net assets acquired has been recognised as goodwill. The provisional goodwill is attributed to the profitability of the acquired business and the anticipated future operating synergies arising from the combination.

	Provisional book value £m	Fair value adjustment £m	Provisional fair value £m
Goodwill	15.6	(15.6)	–
Property, plant and equipment	1.4	–	1.4
Inventories	0.5	–	0.5
Receivables	0.9	–	0.9
Payables	(0.9)	0.1	(0.8)
Taxation – current	(0.3)	(0.2)	(0.5)
Taxation – deferred	–	(0.1)	(0.1)
Other loans	(12.8)	–	(12.8)
Finance leases	(0.9)	–	(0.9)
Cash and cash deposits	0.9	–	0.9
Net liabilities acquired	4.4	(15.8)	(11.4)
Goodwill			21.9
Total consideration			10.5
Satisfied by:			
Cash			10.2
Directly attributable costs			0.3
			10.5
Net cash outflow arising on acquisition			
Cash consideration			10.5
Cash and cash deposits acquired			(0.9)
			9.6

Restatements at 31 March 2007

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

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

38. PRINCIPAL SUBSIDIARY AND JOINT VENTURE UNDERTAKINGS AT 31 MARCH 2008

Water and sewerage	Country of incorporation, registration and principal operations
South West Water Limited*	England
South West Water Finance Plc	England
Waste management	
Viridor Limited*	England
Viridor Waste Limited	England
Viridor Waste Exeter Limited	England
Viridor Waste Management Limited	England
Viridor Electrical Recycling (Holdings) Limited	England
Viridor EnviroScot Limited	Scotland
Viridor Glass Recycling Limited	England
Viridor Parkwood Holdings Limited	British Virgin Islands †
Parkwood Group Limited	England
Viridor Waste (Sheffield) Limited	England
Viridor Resource Management Limited	England
Viridor Waste (Bristol Holdings) Limited	England
Viridor Waste (Bristol) Limited	England
Viridor Waste Kent Limited	England
Viridor Waste (Landfill Restoration) Limited	England
Viridor Waste (Somerset) Limited	England
Viridor Waste (Thames) Limited	England
Viridor Waste (West Sussex) Limited	England
Other	
Peninsula Insurance Limited*	Guernsey
Peninsula Water Limited*	England

** Indicates the shares are held directly by Pennon Group Plc, the Company.*

† Operations are carried out in England.

The subsidiary undertakings are wholly-owned and all shares in issue are ordinary shares. All companies above are consolidated in the Group financial statements.

The consolidated Group financial statements also include Manilla Limited, a company incorporated in the Cayman Islands.
The Company has invested £100.0 million in the preference shares of Manilla Limited to benefit from the efficient deposit of surplus funds up to September 2008.

Joint ventures

All joint ventures and the subsidiary undertakings of Lakeside Energy from Waste Holdings Limited and Viridor Laing (Greater Manchester) Holdings Limited are incorporated and registered in England which is also their country of operation.

	Share capital in issue	Percentage held	Activity
Echo South West Limited	100,000 A ordinary shares	100%	Customer contact management
	100,000 B ordinary shares	–	

Shares in Echo South West Limited are held by South West Water Limited. The joint venture in Echo South West Limited ceased operation on 31 March 2008.

	Share capital in issue	Percentage held	Activity
Lakeside Energy from Waste Holdings Limited	1,000,000 A ordinary shares	–	
	1,000,000 B ordinary shares	100%	
Lakeside Energy from Waste Limited			Waste management
Lakeside Energy Limited			Waste management

Shares in Lakeside Energy from Waste Holdings Limited are held by Viridor Waste Management Limited.

	Share capital in issue	Percentage held	Activity
Viridor Laing (Greater Manchester) Holdings Limited	2 ordinary shares	50%	
Viridor Laing (Greater Manchester) Limited			Waste management

Shares in Viridor Laing (Greater Manchester) Holdings Limited are held by Viridor Waste Management Limited.

39. OPERATING LEASE COMMITMENTS

	Group		Company	
	2008 £m	2007 £m	**2008 £m**	2007 £m
The future aggregate minimum lease payments under non-cancellable operating leases are:				
Within one year	**7.2**	5.6	**–**	–
Later than one year and less than five years	**18.8**	16.0	**–**	–
After five years	**91.7**	79.8	**–**	–
	117.7	101.4	**–**	–

The Group leases various offices, depots and workshops under non-cancellable operating lease agreements. The leases have various terms, escalation clauses and renewal rights. Property leases are negotiated for an average term of 25 years and rentals are reviewed on average at five yearly intervals.

The Group also leases plant and machinery under non-cancellable operating lease agreements.

40. CONTINGENT LIABILITIES

	Group		Company	
	2008 £m	2007 £m	**2008 £m**	2007 £m
Guarantees:				
Borrowing facilities of subsidiary undertakings	**–**	–	**344.3**	322.0
Contractors' claims on capital schemes	**2.3**	–	–	–
Performance bonds	**87.4**	81.6	**87.4**	81.6
Letters of credit	**2.0**	5.1	**–**	–
Other	**6.9**	6.9	**6.9**	6.9
	98.6	93.6	**438.6**	410.5

Guarantees in respect of performance bonds are entered into in the normal course of business. No liability is expected to arise in respect of the guarantees.

The guarantee in respect of letters of credit has been given by Viridor Waste Limited in support of the borrowings of the joint venture of Viridor Waste Management Limited, Lakeside Energy from Waste Holdings Limited. In addition, Viridor Waste Management Limited has given a commitment to supply 200,000 tonnes of waste per annum (or pay market price based compensation) to the energy from waste plant of the joint venture. The Directors consider that the committed waste volume will be available in the ordinary course of business.

Other contingent liabilities relate to a possible obligation to pay further consideration in respect of a previously acquired business when the outcome of planning applications is known.

41. CAPITAL COMMITMENTS

	Group		Company	
	2008 £m	2007 £m	**2008 £m**	2007 £m
Contracted but not provided	**91.2**	71.7	–	–
Share of commitment contracted but not provided by joint ventures	**13.3**	41.7	–	–
	104.5	113.4	–	–

42. RELATED PARTY TRANSACTIONS

During the year, Group companies entered into the following transactions with related parties who are not members of the Group:

	2008 £m	2007 £m
Sales of goods and services		
Echo South West Limited	**2.7**	2.6
Purchase of goods and services		
Echo South West Limited	**10.3**	9.5

Year end balances

	2008 £m	2007 £m
Receivables due from related parties		
Echo South West Limited	**2.1**	0.9
Lakeside Energy from Waste Limited	**9.3**	5.8
	11.4	6.7
Payables due to related parties		
Echo South West Limited	**0.2**	0.3

All amounts relate to trading balances except £9.3 million of loans included within receivables due for repayment in instalments between 2009 and 2030. Interest is charged at 6% until 2009 then 15% thereafter.

Company

The following transactions with subsidiary undertakings occurred in the year.

	2008 £m	2007 £m
Sales of goods and services (management fees)	**6.8**	6.5
Purchase of goods and services (support services)	**0.5**	0.5
Interest receivable (loans)	**15.8**	12.3
Interest payable (short-term funding)	**0.8**	0.6
Dividends received	**85.7**	90.1

Sales of goods and services to subsidiary undertakings are at cost. Purchases of goods and services from subsidiary undertakings are under normal commercial terms and conditions that would also be available to unrelated third parties.

Year end balances

	2008 £m	2007 £m
Receivables due from subsidiary undertakings		
Loans	**326.9**	224.7
Trading balances	**0.8**	0.3

Interest on £104.8 million of the loans is charged at a fixed rate of 5.0% and on £66.2 million at a fixed rate of 6.0% (2007 £119.9 million, 6.0%). Interest on the balance of the loans is charged at Barclays Bank Plc base rate +1% (2007 Barclays Bank Plc base rate +1%). The loans are repayable in instalments over the period 2009 to 2013. During the year £0.6 million (2007 £0.2 million) was provided in respect of loans to subsidiaries not expected to be repaid.

42. RELATED PARTY TRANSACTIONS *continued*

	2008 £m	2007 £m
Payables due to subsidiary undertakings		
Loans	**295.9**	293.7
Trading balances	**19.7**	23.2

The loans from subsidiary undertakings are unsecured and interest free without any terms for repayment.

Five year financial summary

	IFRS 2008 £m	IFRS 2007 £m	IFRS 2006 £m	IFRS 2005 £m	UK GAAP 2004 £m
Income statement					
Revenue	**875.0**	748.3	645.7	551.4	471.3
Underlying operating profit	**242.1**	202.1	176.7	152.3	138.8
Net finance costs	**(87.4)**	(69.2)	(64.3)	(62.0)	(57.2)
Share of profit/(loss) in joint ventures	**0.2**	0.3	0.1	0.1	(0.3)
Underlying profit before tax and exceptional items	**154.9**	133.2	112.5	90.4	81.3
Non-underlying and exceptional items (before tax)	**(5.3)**	(2.1)	(58.4)	(1.3)	(9.0)
Taxation	**(16.0)**	(37.2)	(16.3)	(23.5)	(10.8)
Profit for the year	**133.6**	93.9	37.8	65.6	61.5
Dividends proposed	**69.1**	65.6	61.0	55.1	51.1
Underlying earnings per share (basic):					
From continuing operations					
Earnings per share	**38.2p**	26.5p	9.9p	16.0p	16.6p
Non-underlying and exceptional items (net of tax)	**1.3p**	0.6p	10.4p	1.7p	2.4p
Deferred tax	**(2.6p)**	3.8p	5.3p	4.1p	0.9p
Underlying earnings per share	**36.9p**	30.9p	25.6p	21.8p	19.9p
Declared dividend per share	**19.81p**	18.55p	17.2p	14.3p	13.8p

	IFRS 2008 £m	IFRS 2007 (Restated) £m	IFRS 2006 £m	IFRS 2005 £m	UK GAAP 2004 £m
Capital expenditure					
Acquisitions	**89.0**	37.0	45.8	30.8	19.8
Property, plant and equipment	**228.8**	245.1	249.7	181.0	170.0
Balance sheet					
Non-current assets	**2,922.6**	2,728.6	2,527.5	2,292.2	2,191.3
Net current assets/(liabilities)	**169.0**	(56.7)	(61.2)	193.1	75.9
Non-current liabilities	**(2,451.3)**	(2,044.7)	(1,885.1)	(1,776.4)	(1,367.6)
Net assets	**640.3**	627.2	581.2	708.9	899.6
Number of employees (average for year)					
Water and sewerage business	**1,276**	1,301	1,299	1,336	1,341
Waste management	**2,059**	1,686	1,388	1,169	895
Other businesses	**42**	38	35	39	39
	3,377	3,025	2,722	2,544	2,275

Information in 2004 was reported under UK GAAP which may differ materially from IFRS. The main differences relate to the treatment of infrastructure assets, retirement benefits, goodwill and intangibles, deferred tax, dividends payable and financial instruments.

FINANCIAL CALENDAR

Financial year end	31 March
Nineteenth Annual General Meeting	31 July 2008
2008 Final dividend payable	1 October 2008
2008 Half yearly financial report announcement	November 2008
2009 Interim dividend payable	April 2009
2009 Preliminary results announcement	May 2009
Twentieth Annual General Meeting	July 2009
2009 Final dividend payable	October 2009

SHAREHOLDERS' ANALYSIS AT 31 MARCH 2008

Range	Number of shareholders	Percentage of total shareholders	Percentage of ordinary shares
1 – 100	2,325	10.32	0.02
101 – 1,000	8,865	39.37	1.26
1,001 – 5,000	9,697	43.06	5.76
5,001 – 50,000	1,295	5.75	3.95
50,001 – 100,000	85	0.38	1.73
100,001 – HIGHEST	253	1.12	87.28
Total	22,520	100.00	100.00
Holder			
Individuals	20,090	89.21	8.38
Companies	170	0.75	3.67
Trust companies (pension funds, etc)	2	0.01	0.00
Banks and nominees	2,258	10.03	87.95
	22,520	100.00	100.00

SUBSTANTIAL SHAREHOLDINGS

At 16 June 2008 the following interests in the issued share capital had been notified pursuant to the Financial Service Authority's Disclosure and Transparency Rules:

Ameriprise Financial Inc	10.12%
Pictet Asset Management SA	7.34%
AXA SA and its Group companies	5.71%
Legal & General Group plc	5.06%
Standard Life Investments Ltd	5.00%

Further shareholder information may be found at: *www.pennon-group.co.uk*

SHAREHOLDER SERVICES

Share dealing service

The low-cost share dealing service offered by Stocktrade enables shareholders to buy and sell shares in the Company on a low-cost basis and to make regular investments in the Company. Telephone Stocktrade on **0845 601 0995** and quote: LOW C0107. Commission is 0.5% (subject to a minimum charge of £15) to £10,000, then 0.2% thereafter.

Share gift service

Through Sharegift, an independent charity share donation scheme, shareholders who only have a small number of shares with a value that makes it uneconomical to sell them, can donate such shares to charity. Donations can be made by completion of a simple share transfer form which is available from the Company's registrars, Equiniti.

Individual Savings Accounts

By holding their shares in the Company in an Individual Savings Account (ISA), shareholders may gain tax advantages.

Dividend Re-investment Plan

The Company operates a Dividend Re-investment Plan. The Plan provides shareholders with the opportunity to invest the whole of the cash dividend they receive on their Pennon Group shares to buy further shares in the Company at favourable commission rates. Full details of the Plan, including how to join, will be sent out to shareholders on 23 August 2008.

Online portfolio service

The online portfolio service provided by Equiniti gives shareholders access to more information on their investments. Details of the portfolio service are available from Equiniti online at *www.shareview.co.uk*

Electronic communications

At last year's Annual General Meeting, a resolution was passed which allows the Company to communicate with its shareholders by means of its website. As explained in the documentation sent out to shareholders in January, no action was required by shareholders unless they wished to continue to receive copies of the Annual Report and other shareholder communications by post.

Shareholders currently receiving a printed copy of the Annual Report who now wish to sign up to receive all future shareholder communications electronically, can do so via the Shareview service provided by Equiniti, by going to *www.shareview.co.uk* and selecting 'e-mail' as the preferred format for shareholder communications.

The Pennon Group website

The Pennon Group website at *www.pennon-group.co.uk* provides news and details of the Company's activities plus links to its business websites. The 'Investor information' section contains up-to-date information for shareholders including comprehensive share price information, financial results, dividend payment dates and amounts, and Stock Exchange announcements.

There is also a comprehensive share services section on the website which includes information on buying, selling and transferring shares, and the action to be undertaken by shareholders in the event of a change in personal circumstances, for example, a change of address.

Pennon Group Plc Registered office: Peninsula House, Rydon Lane, Exeter EX2 7HR
Registered in England No. 2366640

Pennon Group Plc

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