

Annual Report and Financial Statements 2011



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South West Water Limited
Registered Office: Peninsula House, Rydon Lane, Exeter EX2 7HR
Registered In England No 2366665

Chief Executive's Review

At the end of the K4 (2005–2010) period South West Water reported that it had a solid platform in place for continued success during the new K5 period (2010–2015). 2010/11 has seen the Company already benefit from that robust position to deliver a strong start to K5 both financially and operationally with improved standards of customer service.

Through the Company's 'Pure Water, Pure Service and Pure Environment' vision, South West Water is focused on achieving increased levels of customer service and operational performance whilst at the same time delivering greater efficiency and adhering to high standards of corporate responsibility. We see innovation and continuous improvement as being essential ingredients to achieving our vision.

Highlights of the year

South West Water delivered another strong year of operational performance and customer service:

- no hosepipe restrictions or drought orders for the 14th consecutive summer; no water restrictions envisaged summer 2011
- industry leader in tackling leakage with the Ofwat leakage target being met again (it has been met or beaten every year since inception). Target achieved despite coldest December in England in the last 100 years
- near perfect water quality
- reliability resulting from our operating assets again achieving a consistent 'stable serviceability'* rating
- a reduction by over a quarter in the number of written complaints received.

These results were achieved in the face of some of the most extreme winter weather conditions experienced in the South West for many years.

* Serviceability is the capacity of a system of assets to deliver a reference level of service to customers and to the environment now and into the future. Serviceability is deemed to be stable when the assessment of trends in a defined set of service and asset performance indicators demonstrates that service is in line with the reference level of service and, by inference, is likely to remain so into the future.

Pure Water

This year, the Company once again successfully met both its annual and three year rolling leakage target, and has done so ever since leakage targets were originally set by Government and subsequently Ofwat. This was achieved in spite of the coldest December in 100 years which caused an exceptional number of burst pipes across the region.

A significant proportion of the Company's capital programme in 2010/11 was focused on maintaining drinking water quality, which remained near perfect with a 99.97% compliance rate during the 2010 calendar year. Investments made during the year included filtration improvements to a number of water treatment works, works security enhancements and refurbishment of the Lopwell raw water pumping station.

South West Water has put in place a comprehensive strategy to ensure a continued secure supply of water for the region. 2010 was the 14th consecutive summer with no water restrictions and it is envisaged that there will be no water restrictions in summer 2011 despite very dry conditions in the year so far. More cost effective than building new reservoirs, the two disused china clay pits acquired in 2006 and 2008, and now converted into Park and Stannon Lakes, represent a significant addition to water resources in Cornwall and further increase the robustness of the Company's water supply system. Park Lake became fully operational last year and Stannon Lake will follow this summer. The two lakes are the region's fourth and fifth largest reservoirs (behind Roadford, Wimbleball and Colliford).

Pure Service

South West Water's emphasis on excellent service is delivering tangible improvements for customers and is reflected in reducing levels of contacts (particularly repeat contacts). Customer satisfaction levels are rising. Service improvements undertaken in the past two years to reduce customer complaints are delivering results, with complaint levels falling for the third year running.

South West Water has welcomed the Government's response to the Walker Review of charging for household water and sewerage services. The proposal for Government to fund a cut in the average bill of all customers will be especially well received alongside proposals to target help at those in most need by funding the 'Water Sure' tariff, pegging it to the lower national average metered bill and allowing us to develop our own social tariff. South West Water will continue to work closely with Government and our regulators throughout the consultation phase to examine the practicality of all options to aid customers.

Regulations laid before Parliament, once they come into effect, will allow for the transfer of private sewers and lateral drains from 1 October 2011. South West Water has operational plans in place to manage the transfer and a procurement process with suppliers to deliver the service to customers is underway. Incremental costs efficiently incurred will need to be funded by future adjustments to price limits.

Heavy snow in December 2010



Blue Flag beach



Pure Environment

Of the 144 designated bathing waters in our region, 139 or 96.5% met good (mandatory), and 130 or 90.3% met the European excellent standard (guideline). This is an improvement on last year's results, when 121 or 84.0% met the excellent (guideline) standard. All the region's 18 Blue Flag beaches retained their European excellent status and 4 other local beaches could also reapply, having returned to excellent status. The exceptional results in Cornwall, with just one bathing water failing the good (mandatory) standard, are particularly pleasing, given the importance of the tourism industry to the county.

This summer South West Water will also be launching a new real time information service updating visitors on any potential risk to bathing water quality caused by storm overflows operating after a heavy rainfall at around 25 of the most popular beaches in our region. South West Water's website will be one of the first in Europe to offer this sort of service to beach users on a daily basis.

Our programmes to achieve energy efficiency and carbon reduction targets have made good progress this year. The energy awareness campaign, PowerDown, has been very successful working with the Energy Savings Trust. The PowerDown scheme has been recognised externally, being the Business Award winner of the Devon Environmental Business Initiative. Our combined energy volume reductions target of 3GWh has been met from these activities.

We have also made good progress in our development of renewable energy systems with major overhaul and control system replacements for our larger sewage gas combined heat and power plants (CHP); to give improved reliability and increased outputs. Our larger investment programme for new hydroelectric capacity has included a number of innovative cost effective solutions.

South West Water is working to integrate into all its business operations more sustainable way of working that support the company's climate change mitigation programme.

An important achievement for the Company during the year was the receipt of Emissions Measurement and Reduction certification. This can only be achieved by organisations that have not only made credible carbon reductions over the past three years, but also have robust plans in place to make more reductions in the future.

South West Water has embarked on an innovative programme of work called 'Upstream Thinking' to improve raw water quality in a sustainable way. This initiative, seen as best practice in the industry, seeks to improve the quality of water that feeds into treatment plants serving around 30% of our customers from the main moor sources of Dartmoor and Exmoor, by helping to re-establish the wetlands that naturally cleanse water by slowing the flows on their downhill journey to rivers and reservoirs. Receiving better quality water at the Company's plants reduces the work required to cleanse it for human consumption, lowers the quantities of chemicals the Company has to use and increases the cost-effectiveness of its operations. Work to re-wet uplands, restore grasslands and revise farming practices is under way and by working with farmers, environmental bodies and statutory bodies the Company aims to achieve multiple environmental benefits.

Financial Review

A strong start has been made towards achieving targeted operating cost reductions. The Company is seeking to front-end load delivery of efficiencies of 2.8% per annum targeted for K5. Some £8.4m, equal to 5.8% per annum, of operating cost efficiencies were delivered in 2010/11. This is being achieved through changing operational ways of working; right-sourcing and innovative contracting arrangements; energy procurement and reduced usage; and the rationalising of administration and support services.

Performance on the K5 capital programme, with its increased emphasis on maintenance of existing assets (66% of the total programme compared to 43% in K4), is being targeted to achieve 5%* outperformance of the Final Determination. South West Water continues to deliver capital projects in line with Ofwat, Drinking Water Inspectorate and Environment Agency expectations. Stable serviceability was maintained for all service areas.

Overall customer debt cash collections were stable despite the difficult economic environment, with the bad debt charge as a percentage of revenue raised broadly consistent with the prior year end.

Focus for K5

The focus for K5 is to continue to strike the right balance for investors, customers and other stakeholders. The Company has already delivered substantial efficiencies over the last two decades and will continue to focus on delivering further efficiency whilst satisfying its regulatory demands and improving services to its customers.

The South West Water strategy:

- targets outperformance of the regulatory contract
- continues to rigorously control costs
- delivers investment through increased capital maintenance that will secure operating cost savings and protect the service improvements made over the last 20 years whilst preparing for future increased investment requirements.

The commitment and professionalism of our employees have been essential ingredients in achieving this year's successes. We are confident that the continued outstanding performance of employees, with all the support we can give them, will ensure another good year of operations in 2011/12.



C Loughlin

Chief Executive

* Using 2009 Final Determination estimates of COPI

Directors, Registered Office and Auditors

Chairman	K G Harvey
Chief Executive	C Loughlin
Operations Director	S C Bird
Finance and Regulatory Director	S J Davy
Customer Relations and Business Development Director	M S Read
Non-Executive Directors	Lord Taylor of Goss Moor M J Hagen (Appointed 1 September 2010)
Secretary	K D Woodier
Registered Office	Peninsula House Rydon Lane Exeter EX2 7HR
Auditors	PricewaterhouseCoopers LLP Chartered Accountants and Statutory Auditors 31 Great George Street Bristol BS1 5QD

Roadford Reservoir, Okehampton



Notice of Meeting

The twenty-second Annual General Meeting of South West Water Limited will be held at Peninsula House, Rydon Lane, Exeter on 20 July 2011 at 10.30am for the transaction of the following business:

Resolution 1

To receive the Report of the Directors and the audited financial statements for the year ended 31 March 2011.

Resolution 2

To re-appoint PricewaterhouseCoopers LLP as auditors of the Company to hold office until the conclusion of the next general meeting at which accounts are laid before the Company and to authorise the Directors to fix their remuneration.

By Order of the Board

K D Woodier

Secretary
Peninsula House
Rydon Lane
Exeter EX2 7HR

24 June 2011

For the purposes of the appointment of auditors (Resolution 2 in this notice), Special notice in accordance with Sections 312 and 485(3), Companies Act 2006 of the intention to move Resolution 2 as an ordinary resolution has been received by the Company.

A member of the Company is entitled to attend and vote at the meeting or may appoint one or more proxies to attend and, on a poll, vote instead of her or him. A proxy need not be a member of the Company.

Report of the Directors

The Directors submit their annual report and the audited financial statements for the year ended 31 March 2011.

The Company's registered number is 2366665.

Principal Activities

The principal activities of the Company are the provision of water and sewerage services. The Company holds the water and sewerage appointments for Cornwall and Devon and small areas of Somerset and Dorset.

Business Review

Financial Results

South West Water's revenues rose 1.0% to £449.1m as a result of tariff increases, increased demand and new connections, offset by the effects of customers switching and lower other sales.

Approved tariff increases, including the 1.1% K factor, amounted to £8.0m. 5,500 new customer connections contributed £2.1m of additional turnover in main charges.

Measured demand was 1.3% higher than last year, following flat demand in the prior year. The effect of the higher demand was to increase turnover by £3.8m. The increased demand was largely driven by household consumption as a result of the good weather in the early part of the year rather than an increase in all customers' underlying demand.

The effect of meter option switchers was to reduce turnover by £6.9m, benefiting 14,198 customers (2010: 17,890 customers) by, on average, £423 each (2010: £380). 71% of South West Water's domestic customers are now metered (2010: 68%).

Reflecting the impact of the reduced rate of return allowed in the 2009 Ofwat price review, South West Water's operating profit decreased by £3.9m to £189.7m.

Operating costs, including depreciation and restructuring costs, increased from £250.9m to £259.4m.

The key increases have been:

- cost increases (including inflation) £8.3m
- additional costs from new capital schemes of £9.6m (including £3.4m of net depreciation and additional asset maintenance costs of £6.2m relating to the increased emphasis on maintenance in K5).

Offset by:

- operating cost efficiencies achieved of £8.4m
- increased property disposals and reduced cost of other sales of £1.0m.

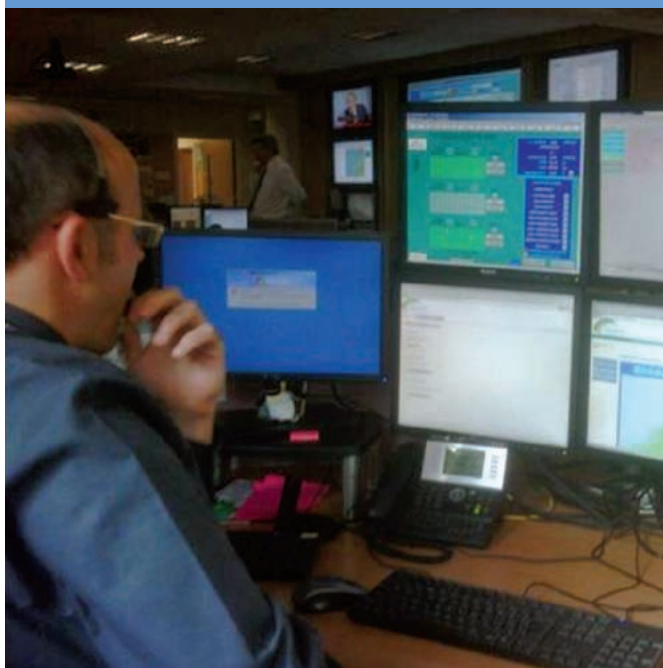
The depreciation charges increased by £3.4m from £93.6m to £97.0m reflecting the impact of the Company's capital expenditure programme.

The Company's restructuring programme continued in the year with £4.0m charged to the income statement (2009/10: £5.0m).

Despite the continuing difficulties in the property market, profit on property disposals in the year contributed £1.6m compared to £1.0m in 2009/10.

The charge for bad and doubtful debts increased in the year by £0.6m from £7.3m to £7.9m. During the year £7.2m (2009/10: £5.9m) of debts were written off against the provision, of which £1.0m (2009/10: £0.9m) related to the Company's Restart programme, a customer affordability initiative.

Centralised monitoring and control



A strong start has been made to achieving targeted operating cost reductions. £8.4m was delivered in 2010/11.

Wimbleball Reservoir, Dulverton



This has been our 14th consecutive year without water restrictions and no water restrictions are envisaged in summer 2011.

Investment

Capital additions in the year were £125.1m compared to £145.3m in 2009/10.

£59.4m was invested in water supply improvements including water mains renovation and water treatment works enhancement.

A significant proportion of the Company's capital programme in 2010/11 was focused on maintaining drinking water quality, which remained near perfect with a 99.97% sample compliance rate during the year.

Investments made during the year included filtration improvements to a number of water treatment works, works security enhancements, and refurbishment of the Lopwell raw water pumping station.

The flood resilience scheme at Pynes water treatment works has been delivered ahead of schedule and secures the supplies for c.32,000 properties from a major flood, including the impact of forecast climate change.

This has been our 14th consecutive year without water restrictions and no water restrictions are envisaged in summer 2011.

Capital investment in the year for the waste water business totalled £65.7m.

Three studies into Integrated Urban Drainage Management have commenced in Truro, Torrington and Plymouth. Our industry leading partnership with the Environment Agency and Torbay Council on identifying and resolving misconnections is also progressing well, where it improves bathing water compliance in a complex urban drainage environment.

Targeted investment in capital maintenance programmes ensured that serviceability was assessed as 'stable' for all the Company's areas of service.

Expenditure on PUROS (Phased Utilisation of Remote Operating Systems) was £4.0m. The PUROS programme is a key contributor to support the Company's strategy of delivering Pure Water, Pure Service and Pure Environment by aiming to contribute sustainable cost reductions and better service through the delivery of:

- [remotely managed networks and assets](#)
- [a flexible, mobile enabled, multi-skilled workforce](#)
- [central control of people, assets and information.](#)

South West Water office, Exeter



The Company has considerable financial resources and operates in a relatively stable, regulated business environment.

Taxation

The overall tax charge for the year decreased by £27.0m from £30.7m to £3.7m.

Within the tax charge the current corporation tax charge decreased by £7.1m, from £30.8m to £23.7m, the main reasons for the decrease being the release of corporation tax provisions no longer required.

Deferred tax for the year was a credit of £20.0m (2009/10: credit £0.1m), which included a credit of £24.0m from the impact of the reduction in the rate of corporation tax for future years.

Financing

Net interest payable decreased by £3.2m from £64.1m to £60.9m. The Company gained from favourable movements on LIBOR and swaps compared to the previous year, net of higher interest charges on the index-linked bond due to higher RPI and interest receivable on cash deposits was lower due to lower interest rates prevailing.

There was a marginal decrease in net debt from £1,547.2m to £1,542.8m. The inflow is largely attributable to lower capital expenditure and interest payable offset by additional tax payments and pension contributions in the period.

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. The 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.

Funding facilities are in place to cover both medium and long term requirements, including loans from the European Investment Bank. In addition, short term facilities exist with a range of financial institutions.

Short term committed facilities in place at 31 March 2011 and undrawn totalled £120.0m (2010: £110.0m). In addition the Company has short term uncommitted bank facilities of £60.0m (2010: £60.0m).

Derivatives, usually interest rate swaps, are used to manage the mix of fixed and floating rate debt, following the Pennon Group treasury policy that at least 50% of South West Water’s debt is fixed for a regulatory period. The notional principal amounts of the interest rate swaps are used to determine settlement under those swaps and do not, therefore, constitute an exposure for the Company.

The balance sheet value of net derivative liabilities moved from £17.7m to £17.4m at 31 March 2011. The movement is taken to reserves through the Statement of Comprehensive Income.



South West Water has approximately 24% of its debt index-linked.

South West Water has entered into covenants with lenders. Whilst terms vary, these typically provide for limits on gearing (primarily based on Regulatory Capital Value) 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 Company's debt facilities are monitored on a regular basis. The financial covenants accepted by the Company include a provision to re-test the covenants applying frozen GAAP accounting standards. This is to protect the Company from changes in accounting standards that may have a detrimental impact on the financial covenant testing methodology.

South West Water's net debt to Regulatory Capital Value (RCV) was 57.1% at 31 March 2011 (2009/10: 60.6%), within Ofwat's 'optimum range' of 55% – 65%.

The Board regularly monitors the Company's expected financial requirements for the next 12 months. These will be met from existing cash balances, loan facilities and cash flows for the coming year.

The Company has considerable financial resources and operates in a relatively stable, regulated business environment. Consequently the Directors believe that the Company is well positioned to manage its business risks successfully despite the current economic conditions.

Going concern

Having considered the Company's funding position and financial projections, the Directors have a reasonable expectation that the Company has 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.

Dividends and reserves

Dividends totalling £58.4m (2009/10: £54.4m) were paid to the parent undertaking, representing a base dividend for 2010/11. The dividend was calculated with reference to the projections in the Ofwat 2009 Final Determination.

The Company has established a dividend policy, which involves the following components:

- a sustainable level of base dividend growth, determined by a number of factors including the shareholder's investment and the cost of capital
- a further level of growth funded by efficiency out-performance
- consistency with the assumptions made by Ofwat in setting prices for the K5 period.

Dividend payments are designed to ensure that key financial ratios are not prejudiced and that the ability of the Company to finance its Appointed Business is not impaired.

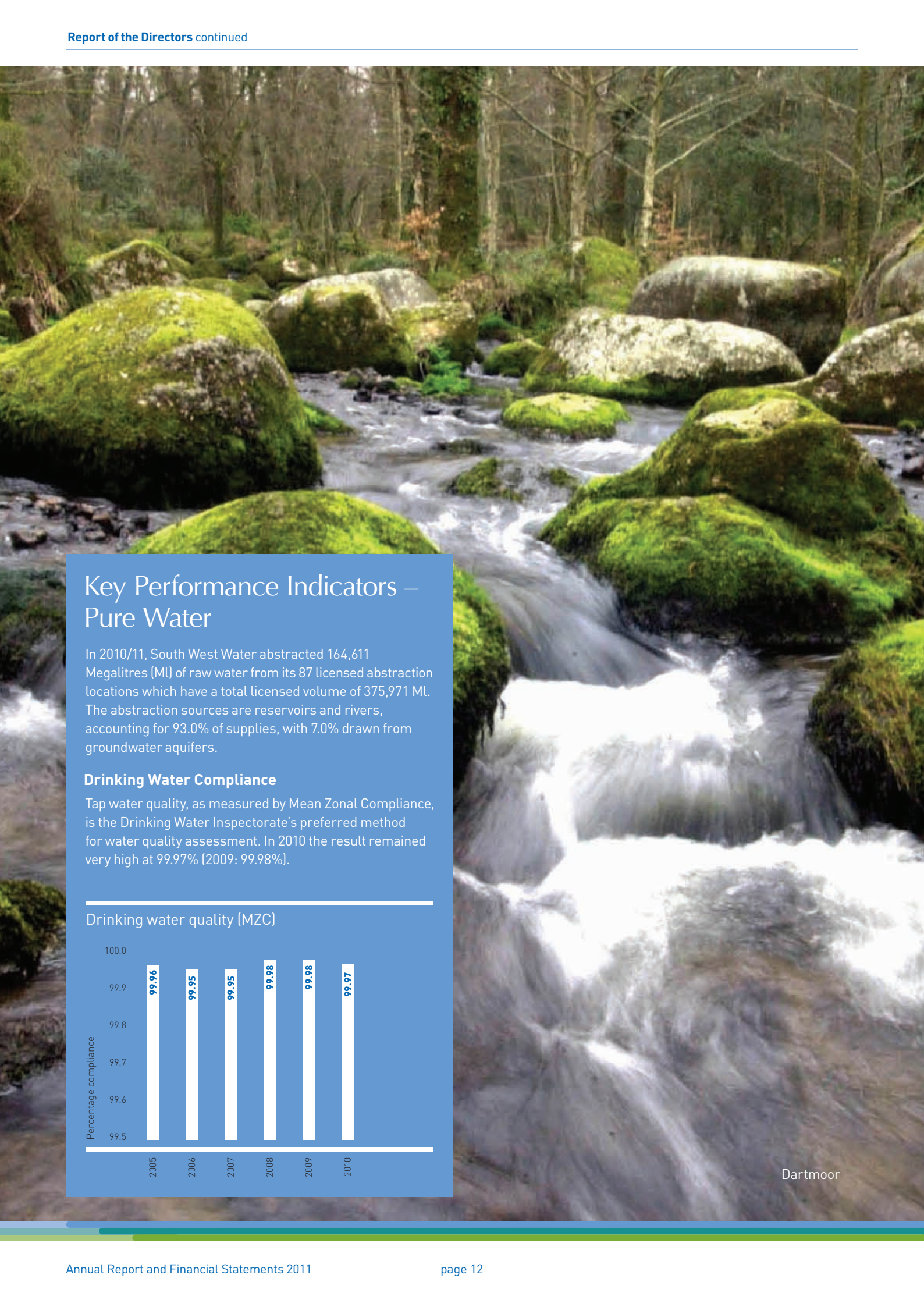
Principal risks and uncertainties

The following are identified as the principal risks and uncertainties facing the Company:

Risk	Mitigation
Regulatory	
Failure to deliver the capital investment programme	The Company has a track record of delivering its capital programme in accordance with regulatory requirements and progress is regularly monitored and reviewed.
Failure to deliver operating cost savings implicit in the regulatory review	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 to contribute towards the additional efficiencies required for the K5 period.
Regulatory compliance	As a regulated business we are subject to numerous and changing obligations with which we must comply. We pay particular attention to management of risks in these areas, particularly in relation to changing legal and regulatory requirements.
Uncertainty arising from market and other regulatory reforms	<p>The Company continues to consider and evaluate developments and proposals in relation to development of competition as part of its risk management and business strategic planning processes. Legislation will be required for any further extension of competition in the water and sewerage markets.</p> <p>The Company evaluates proposals for regulatory reform and contributes fully to consultations and other forms of dialogue with regulators and stakeholders in order to effectively convey its views.</p>
Economic downturn	
Non-recovery of customer debt and affordability	In addition to existing strategies, which are kept under review, South West Water continues to implement new initiatives to improve and secure cash collection, including the use of property charging orders. The accounts of major customers are kept under close review. Provision was made in the K5 Final Determination for companies to make an application for an Interim Determination in the event of household bad debts being significantly above the amount allowed by Ofwat due to worsening economic circumstances in the Company's operating area. We have worked with the Government on the findings of the Walker Report and have promoted fairness for South West Water bill payers and actively sought to introduce and promote practical measures to help customers struggling to pay their water bills.
Financial loss arising from the insolvency of a major supplier or contractor	<p>The Company does not have material exposure to payment before receipt of goods and services.</p> <p>The Company uses a third party credit monitoring service to identify changes in major suppliers' financial status and creditworthiness to supplement an annual risk review of key and strategic suppliers.</p>
Future environmental regulation / quality standards / change in legislation	
Environmental regulations and quality standards could increase the Company's costs	These issues are addressed through the five year regulatory price review mechanism.
Legislation for adoption of private sewers	Regulations laid before Parliament to allow for the transfer of private sewers and lateral drains will come into effect from 1 October 2011. South West Water has operational plans in place to manage the transfer. A procurement process with suppliers to deliver the service to customers is under way. Incremental operating and capital costs efficiently incurred will be funded by future adjustments to price limits.
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.

Risk	Mitigation
Financing	
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. Treasury policies and risk management are described in more detail on pages 33 to 35.
Pension costs may increase due to factors outside the Company's control	All defined benefit schemes have been closed to new entrants and replaced by defined contribution arrangements.
Poor investment performance may affect the defined benefit scheme assets and increase the pension scheme deficit	Employee and employer contributions are kept under review and have been increased. Further contributions of £16.6m were made in the year. Pension trustees keep investment policy under review and use professional investment advisers.
Government cut-backs	
Reduced revenue and demand associated with government and local authority cut-backs	The employment market in the South West is more reliant on the public sector than most other parts of the country so there is the potential for reduced revenue and demand from both public sector bodies and employees made redundant. However, the risk is mitigated by the regulatory Revenue Correction Mechanism, whereby shortfalls in revenue in one five year regulatory pricing period are adjusted for in the following period.
Operations	
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.
Contamination to water supplies	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.
Operational failures	Due to the nature of our business we continue to face risks arising during the normal course of our business, including risk of failure of our assets, processes or systems which could otherwise impact on the health, safety and security of our people or customers, or on our financial position and our reputation. 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.

The Directors have established a formal framework for the identification and monitoring of both operational and financial risks arising from the Company's activities.



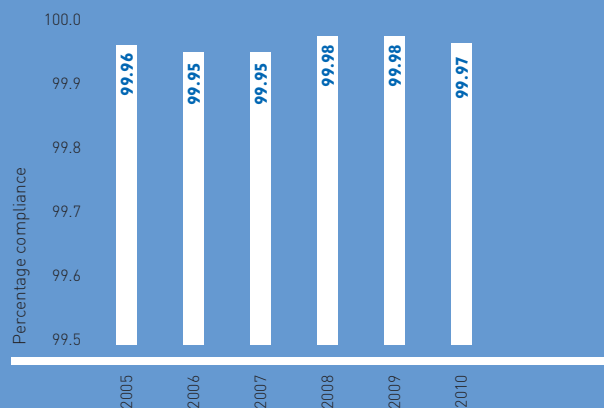
Key Performance Indicators – Pure Water

In 2010/11, South West Water abstracted 164,611 Megalitres (ML) of raw water from its 87 licensed abstraction locations which have a total licensed volume of 375,971 ML. The abstraction sources are reservoirs and rivers, accounting for 93.0% of supplies, with 7.0% drawn from groundwater aquifers.

Drinking Water Compliance

Tap water quality, as measured by Mean Zonal Compliance, is the Drinking Water Inspectorate’s preferred method for water quality assessment. In 2010 the result remained very high at 99.97% (2009: 99.98%).

Drinking water quality (MZC)



Dartmoor

Key Performance Indicators – Pure Service

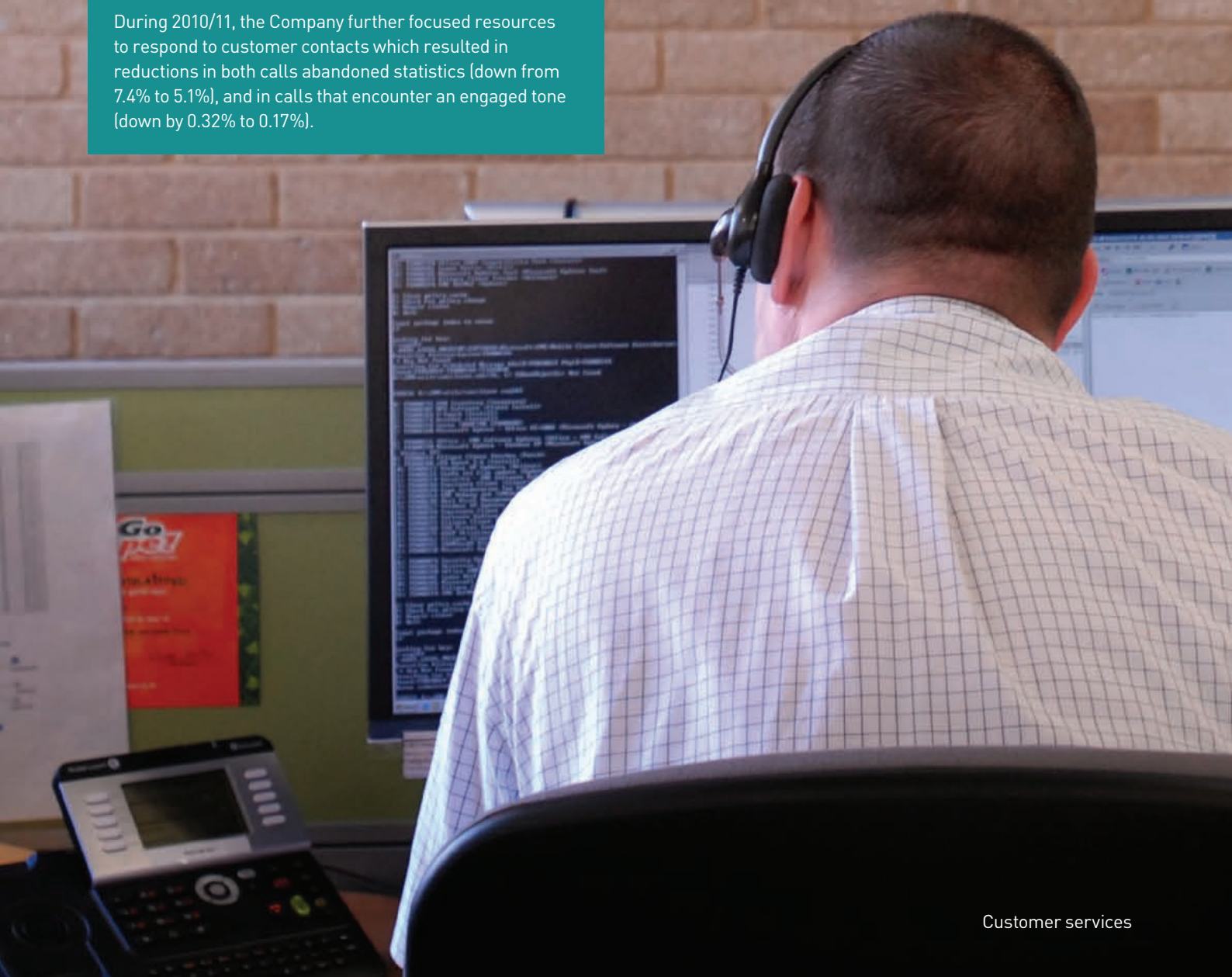
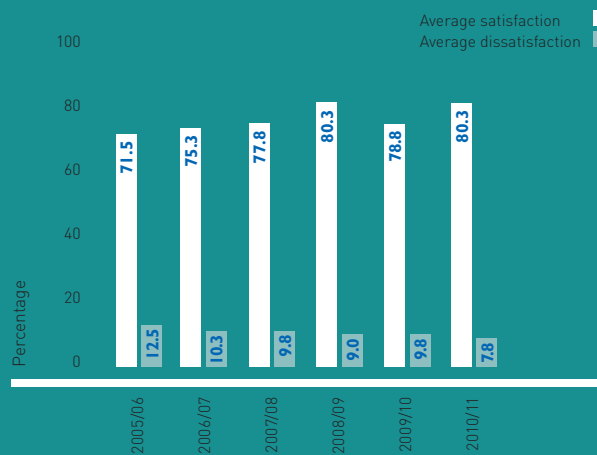
Service Incentive Mechanism (SIM)

SIM has been introduced for reporting purposes during 2010/11 as a replacement for the Overall Performance Assessment (OPA). Incentives associated with this measure will use results reported from 2011/12 onwards. The SIM evaluation is split between a quantitative and qualitative element.

South West Water’s emphasis on excellent service is delivering tangible improvements for customers and is reflected in reducing levels of contacts (particularly repeat contacts). Customer satisfaction levels are rising. Service improvements undertaken in the past two years to reduce customer complaints are delivering results, with complaint levels falling for the second year running (written complaints down by over a quarter from 2009/10).

During 2010/11, the Company further focused resources to respond to customer contacts which resulted in reductions in both calls abandoned statistics (down from 7.4% to 5.1%), and in calls that encounter an engaged tone (down by 0.32% to 0.17%).

Customer satisfaction overall



Customer services

Key Performance Indicators – Pure Environment

The Company recognises the importance of its environmental responsibilities, monitors its impact on the environment, and designs and implements policies to reduce any damage that might be caused by its activities. The Company is subject to significant regulation and must comply with the high standards set by the Environment Agency. The Pennon Group has a long established environmental policy, as set out in its annual Corporate Responsibility Report, which is available at www.pennon-group.co.uk.

Waste Water Treatment Compliance

The percentage of population equivalent served by sanitary-compliant waste water treatment works in the calendar year 2010 was 99.55% (2009: 99.70%).

This consistently high performance is within the reference levels used to assess stable serviceability for this group of assets and contributes to South West Water’s region having the highest percentage length of high quality rivers in England.

Population equivalent sanitary compliance



Bathing Water Performance

Compliance with the mandatory EU bathing water standard was 96.5% in the 2010 calendar year, the same level it was in 2009. 90.3% met the EU guideline standard (excellent). This is an improvement on last year’s results when 84.0% met this standard. All the region’s 18 Blue Flag beaches retained their European excellent status and 4 other local beaches could also reapply, having returned to excellent status.

Incidents and Prosecutions

The Company always self-reports incidents it becomes aware of and co-operates fully with any investigation undertaken by 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.

There was one Category 1, and five Category 2 (serious pollution) incidents in 2010. This compares with two Category 2 incidents in 2009. The total number of waste water pollution incidents in 2010 was 132 (2009: 106). 34% of all incidents in 2010 were identified by the company and self-reported.

The increase in the total category 1, 2 and 3 incidents for 2010 is clearly disappointing. However, the Category 1 incident recorded in the year was very unusual for the Company and is the first one since reliable records began, and resulted from the failure of a number of storm pumps in a deep shaft, which we repaired as quickly as possible. Category 2 incidents rose slightly but remain in low numbers at levels similar to previous years and much better than those experienced in previous regulatory investment periods.

During the year the company was convicted on five occasions for environmental offences and fined a total of £29,000 (2009/10 four convictions and fines of £11,500).

Key Performance Indicators – Financial and Business

Growth in Regulatory Capital Value

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 2011 amounted to £2,703.5m, which represents an increase of 3.2% in the year.

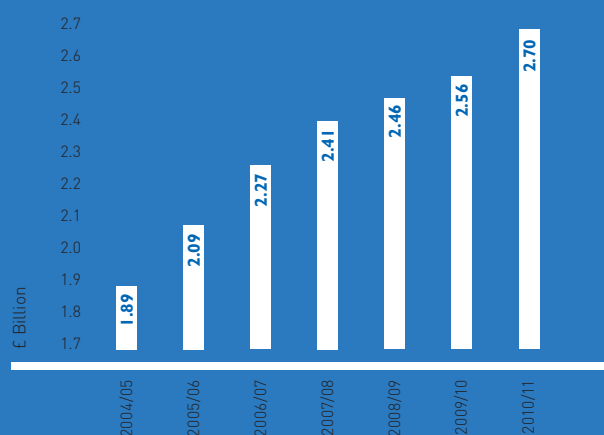
Net debt decreased by £4.4m to £1,542.8m, with the gearing ratio in relation to year-end RCV moving to 57.1% from 60.6%.

The growth in RCV adds directly to shareholder value as the allowed return is attributed to South West Water's asset base by Ofwat.

Operating Profit

South West Water achieved an operating profit of £189.7m in 2010/11, down £3.9m from 2009/10. Results for 2010/11 reflected the industry-wide reduction in the allowed rate of return for the K5 period.

Regulatory Capital Value



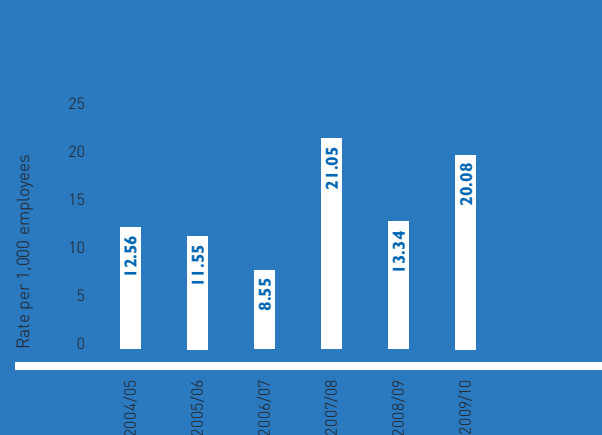
Key Performance Indicators – Health and Safety Performance

The health, safety and welfare of South West Water's employees remain paramount in all its activities. The Company has a health and safety strategy which focuses on providing strong leadership, engaging with employees, building competence and measuring performance. These principles are promoted by a health and safety steering group comprising a cross-section of directors, managers and employee representatives.

Occupational health and safety are key elements of South West Water's risk management and internal control processes. We continue to pursue initiatives to improve further the welfare of the Company's employees through the provision of training on and promotion of good health and practices.

RIDDOR incidents per 1,000 employees totalled 20 in 2010 (2009: 13). Analysis has shown that behavioural and cultural factors are often a significant contributory factor to RIDDOR incidents occurring: a major behavioural safety programme badged 'TAP' (Think, Act, Prevent) has been launched and targets a substantial reduction in the number of accidents and RIDDOR incidents.

RIDDOR rates per 1,000 employees



Environmental sustainability

We have robust systems in place, certified to ISO14001, to review our environmental impacts and then take action to minimise adverse impacts.

Because of our topography we use more assets per customer than any of the other water and sewerage companies in the UK. We have 636 treatment works and there are some 877 pumping stations and 1,001 combined sewer overflows in our 9,328 km waste water network. How we operate these assets is monitored by the Environment Agency against a range of measures of performance. We aim to deliver a service that represents high quality and reliability to customers and also complies with environmental standards.

Water abstraction and leakage

Water is a valuable resource and we abstract from our rivers no more than we need to maintain a reliable supply. We are also committed to keeping leakage to a minimum and our leakage rate remains among the lowest in the industry at 5.5 cubic metres per kilometre of mains per day.

Despite the coldest December in 100 years which caused a surge in burst pipes for both our customers and network, we still achieved our leakage target of 84 Ml/day.

We have now achieved or beaten our leakage targets every year since they were first introduced in 1999/2000.

Climate change

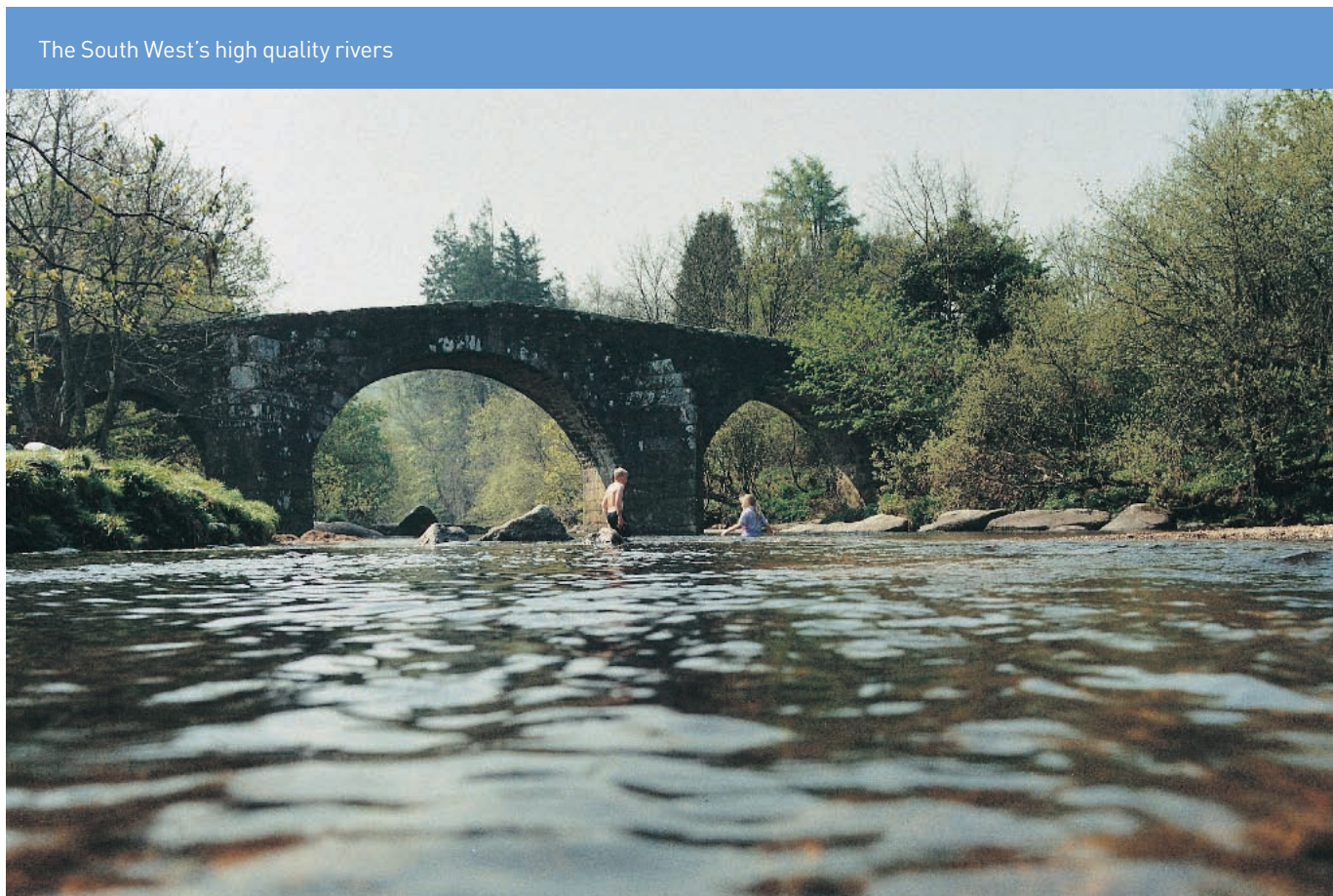
South West Water is working closely with many organisations to assess the implications of climate change for water supply and waste water services. Adaptation and mitigation plans are being developed which will involve innovative approaches and new methods of influencing catchment behaviour upstream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

The Company's final Water Resources Plan for the next 25 years was published in the summer of 2009 and was approved by Defra. It includes information relating to rainfall and temperature variations. The plan includes allowances for demand changes associated with climate change. Predictive models are in place to address uncertainty. Infrastructure developments have been identified, the timing of which can be adjusted if the expected rate of climate change alters. Increasingly efficient and careful use of water play a major part in adapting to the expected effects.

Climate change adaptation – Upstream Thinking

Our 'Upstream Thinking' strategy aims to improve water quality and control water treatment costs. This approach offers more sustainable management of climate change impacts by addressing risks and challenges at source, instead of incurring the additional capital and operating costs of more intensive water treatment. Benefits will also include lower carbon through reduced use of both energy and chemicals. We have named this industry best practice initiative 'Upstream Thinking'.

Within the price limits set for 2010 to 2015, Ofwat, our Economic Regulator, has supported this approach by enabling c.£9m to be spent – equivalent to 65p a year on customers' bills.



Climate change mitigation and carbon reduction

Carbon reduction targets are set for the short, medium and long term. The long term aim set out in our 25 year Strategic Direction Statement is to meet the carbon reduction targets that emerge from the developing national framework. This results in a reduction of 80% by 2050 (on a 2006/07 baseline).

Since 87% of our carbon emissions are associated with our consumption of energy, the largest opportunity to mitigate our carbon emissions comes from controlling our energy usage.

For the medium term the target for K5 is an 18% reduction in energy use by 2014/15 (on a 2009/10 baseline).

For 2010/11 the target set for the year was a reduction of 1.2% in energy use. Our actual performance was 0.7%, the shortfall being largely attributable to some clean water capital work taking longer than scheduled and requiring increased use of pumping facilities.

Energy efficiency

South West Water is one of the largest consumers of electricity in the South West, so an effective focus on energy efficiency is crucial, particularly as each year there is upward pressure on energy use arising from investment in new assets and in treatment processes required to meet higher drinking water and environmental standards.

Operational usage reduction is being targeted through the Company's PUROS project, one of the focuses for this project being more efficient remote operation of equipment. Work being carried out includes network optimisation programmes, the use of 'smart pumping' technology and the optimisation of treatment processes.

We launched our PowerDown energy efficiency campaign in March 2010 to focus on non-pumping energy efficiency. This campaign engages the entire staff-base in helping the energy team deliver innovative energy saving ideas across the whole Company. A series of energy awareness events has been run in conjunction with the Energy Savings Trust. We have launched a website and introduced an energy savings ideas register.

As part of the South West Water Business Plan for the next 5 years, a non-pumping energy reduction target of 6.6GWh and a cost saving of £600,000 has been set under PowerDown.

Renewable energy generation

Renewable energy generation plays an important role in our plans to mitigate carbon emissions and ultimately to combat climate change.

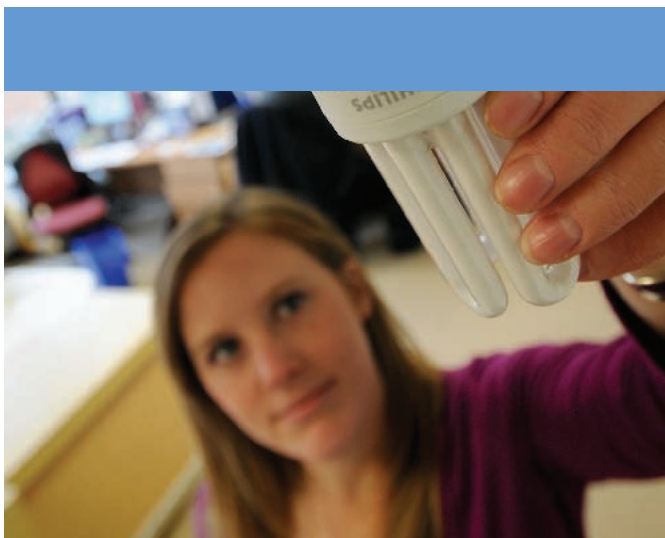
We generated 13.8GWh in 2010/11– enough to power around 3,000 homes. The electricity generated is used on site as a preference, with generation above site demand being exported to the national grid.

We generate renewable electricity by capturing methane gas from our anaerobic digestion plants at nine waste water treatment works. Work is underway to improve the efficiency of the current installed base of CHP engines to maximise the use of additional quantities of biogas resulting from process improvements.

We also generate electricity from seven hydro electric power plants at water treatment works and are investigating further potential at all of our sites which have sufficient volume and pressure. Three sites are currently being fitted with new hydro-electric turbines with a further 450kW of capacity planned for installation in 2011/12.

There is great potential in the South West Water region for the development of wind power which we could use on operational sites. This would reduce the amount of electricity that we import from the national grid. Our plans to harness wind power at our sites took a step forward with planning permission granted for a turbine at Crowdy water treatment works which when in place will supply half the site's energy needs.

Renewable energy generation plays an important role in our plans to mitigate carbon emissions and ultimately to combat climate change.



Morwellham hydro-electric powerstation

Helping customers



Customers

South West Water has consulted with customers about its priorities for K5 and this feedback has been central to the development of its customer service improvement plans to deliver its Pure Water, Pure Service and Pure Environment vision.

Providing help and support to customers in need is at the heart of the Company’s service strategy and accordingly the Company remains an industry leader in the provision of Priority Services to vulnerable customers. We provide Priority Services to customers who need extra help, for example the elderly, disabled, and those requiring large print / Braille bills or help in reading their meter.

Where customers have medical conditions necessitating a constant water supply, we arrange for water to be delivered in the event of interruptions to supply.

Our Priority Services Register is promoted in doctors’ and dentists’ surgeries and at Citizens Advice Bureaux and at 31 March 2011, we had 7,897 customers on the register.

Our aim, as set out in the Strategic Direction Statement, is to treat customers appropriately to their circumstances, especially with regard to affordability and debt.

During the year we have been enthusiastic to promote practical ways to help customers struggling to pay their water bills and have introduced several new initiatives to provide additional options and support for customers. The initiatives are:

- **WaterCare Scheme** which has helped over 8,000 with long term debt problems. This offers benefits entitlement and tariff checks, water audit and free water-saving devices
- **Restart Scheme** helping nearly 6,000 customers to reduce their debt by incentivising customers towards a pattern of making regular payments
- **Fresh Start Fund**, managed by an independent Board, for one-off hardship cases
- **targeted campaign** to promote and support low income customers who would benefit from metering
- **5,000 free leak alarms** fitted in the year for vulnerable customers wary of metering
- **training and administration resource** over five years for Citizens Advice Bureau staff
- **doorstep debt advisors** to provide advice and access to support schemes
- **Watersure tariff**: more than 9,800 households are on this tariff, one third of the national total.

Heritage open days



We work in a number of ways to promote water efficiency both to domestic and business customers.

Affordability and fairness

We have been working closely with Ofwat and Defra on providing the appropriate advice to the Government, supported by the extensive research and analysis we have undertaken, to address the issues on affordability and fairness for customers in the South West raised in the independent Walker Review.

In the consultation paper 'Affordable water: a consultation on the Government's proposals following the Walker Review of Charging' the Government indicated that public funding will be available to address the issue of fairness of charging for our customers that has arisen as a result of three per cent of the population funding the cleaning up of 30% of the nation's bathing waters since 1989. We are keen to continue to work closely with the Government to examine the practicality of options to help customers.

Water efficiency

We work in a number of ways to promote water efficiency both to domestic and business customers, which include:

- guidance to customers via our free phone water conservation helpline and Company website
- provision of water audits
- educational materials for and talks given to schools
- promotion of discounted water butts for the region's gardeners.

Working with customers to improve water efficiency



14,198 free meters were installed in 2010/11. At 31 March 2011 71% of domestic premises were metered.

The Company meets regularly with the Consumer Council for Water (CCWater), which champions the interests of water customers. It regularly consults with CCWater and other stakeholders such as pensioners' forums and Citizens Advice Bureaux, prior to introducing major changes or initiatives.

The Company continues to support business customers through water efficiency reviews, waste minimisation projects, providing advice for water management plans and by highlighting opportunities for reduction, re-use or alternative sources of supply. An education programme for schools has also been developed this year to extend the spread and reach of this work.

Business customers continue to have access to a secure online system which tracks and displays consumption on their sites. South West Water's 'Business Accounts Online' also offers a water efficiency calculator and a free water audit.

No single customer accounts for more than 1% of revenue.

Workforce and Community

Employees

South West Water’s people strategy continues to focus on recruiting and developing individuals who can support the delivery of the Company’s ‘Pure’ vision, enabling the provision of a high quality service to customers and the achievement of operational efficiencies.

Employee involvement and participation in all aspects of business and organisational change is encouraged and supported through the Company’s staff council, and craft and industrial consultative forums.

The safety of staff is paramount, and our Occupational Health and Safety strategy focuses on providing strong leadership, engagement with employees, building competence and measuring performance. These principles are promoted by a health and safety steering group comprising a cross-section of directors, managers and employee representatives. All members of the Executive Management Team and Senior Managers take part in two health and safety site audits per year. We provide training and promote a health and safety culture. During 2010/11 we have been addressing short term absence, musculo-skeletal problems and mental wellbeing in conjunction with our Occupational Health Advisor.

The Company holds the ‘Investor in People’ (IIP) Silver Status, which represents the achievement of a high standard in IIP evidence requirements.

Our employees are the foundation of our success. It is one of our core values that people matter, and we have programmes in place both to support their progress and to assure their safety at work. Examples of these include the formation of a ‘Management Academy’ to develop business, management and personal skills to help our managers become more effective leaders, a Post Graduate Certificate in Management developed with the University of Exeter’s Business School, and the ‘GROW’ staff development programme providing training in personal growth and business strategy.

As part of the Company’s GROW programme, an eight-strong team of South West Water staff raised over £12,000 for the Prince’s Trust Million Makers Challenge in six months. The money will help young, disadvantaged people get into work, education or training.

Staff and partners who deliver above and beyond what is required in their day-to-day jobs are eligible to be nominated for the Company’s Pure Award scheme in three categories – Pure Water, Pure Service and a Pure Environment. Around 50 staff and partners were recognised for their additional contributions in this way last year.

The Company conducts employee surveys, and one was completed in 2010/11. The survey asked general questions on how employees felt about their everyday role, their manager and the Company as a whole. A few more specific questions were asked, proposed by an employee focus group which was convened to help draw up the survey.

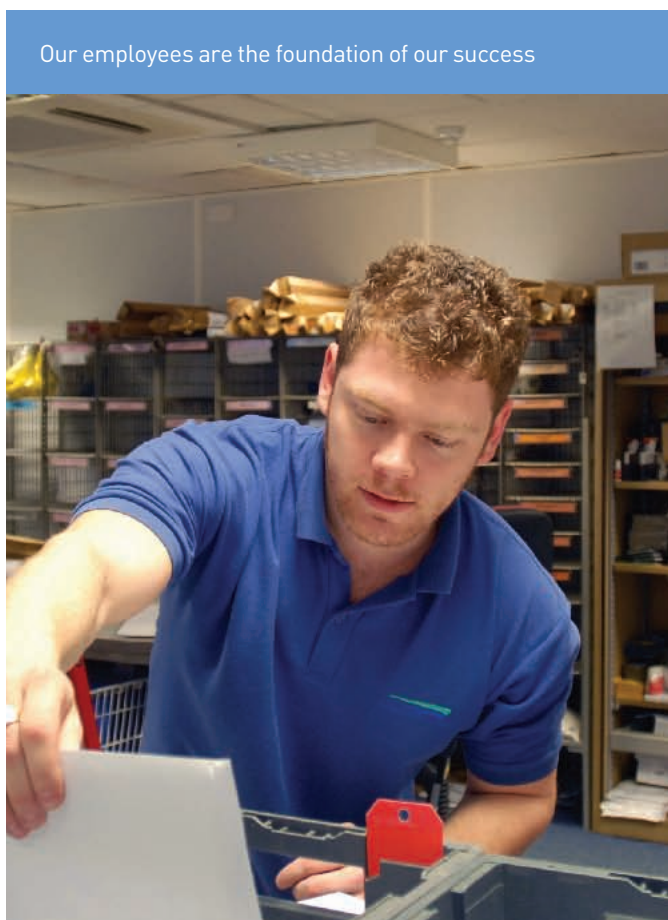
The survey identified a number of strong, positive themes:

- a strong passion and belief in the services we provide for each other and our customers
- a belief our work is important
- the confidence we have the skills to perform our jobs well
- a strong loyalty to South West Water.

Employee Survey Action Groups, with teams of employees representing all parts of the Company, were established to explore opportunities for improvement and drive implementation across all areas of the Company.

The Company as a ‘good employer’ has been introducing a number of ‘Family Friendly’ policies, which exceed statutory requirements. All employees are entitled to participate in a Pennon Group Sharesave Scheme and a Pennon Group Share Incentive Plan, both of which are all-employee plans where performance conditions do not apply.

The Company remains committed to a non-discriminatory employment policy, making every reasonable effort to ensure that no current or future employee is disadvantaged because of age, gender, religion, colour, ethnic origin, marital status, sexual orientation or disability. In particular, the Company welcomes applications for employment from disabled persons and makes special arrangements and adjustments as necessary 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 re-train people who become disabled during their employment in order to maintain their employment within the Company.



Community, Corporate Responsibility and Sponsorship

We are committed to being a good neighbour and a trusted partner in the communities we serve.

Our annual Community Sponsorship is targeted at community projects and organisations which are linked to water, benefit the environment or promote youth participation. During 2010/11, £79,761 was allocated to a wide range of projects across the region. Apart from this sponsorship, no charitable donations were made in the year (2009/10: £1,600).

We contributed £10,000 towards the management costs of the Keep Britain Tidy Beachcare Project. This pilot project is aimed at reducing beach litter on Cornwall’s beaches by involving communities. This secured almost 1,000 volunteer hours over the 2010 bathing season (engaging 70 volunteers).

In September 2010 we opened Mary Tavy hydro-electric power station and Brokenbury waste water treatment works, Torbay to the public under the Heritage Open Days initiative.

Our employees continue to fundraise for WaterAid, raising £39,200 during 2010/11.

We are developing a programme of employee volunteering to engage with local communities. This encompasses working with schools, whereby employees will educate children about the water cycle and WaterAid. Other employees will visit Exmoor to help maintain the dam structures which have been put in place as part of the Mires restoration project.

South West Lakes Trust manages the majority of inland waters in Devon, Cornwall and on Exmoor.

The Trust celebrated its tenth birthday in 2010, and received the Queen’s Award for Enterprise in the Sustainable Development category. The Trust has significantly improved the recreational facilities at many sites, whilst retaining opportunities for quiet relaxation at others.

We are committed to being a good neighbour and a trusted partner in the communities we serve.

Exmoor mires restoration



Employee volunteers involved in a conservation project



Involving communities to help reduce litter on beaches



Key relationships

Regulators and stakeholders

We involved a wide range of stakeholders in developing our Strategic Direction Statement and the business plans for the 2010-2015 (K5) period that evolved from it. Their involvement is essential as, against the background of a complex policy and regulatory context for the water industry, our stakeholders have diverse remits and differing requirements which we need to understand and balance in our strategy and plans. Engagement with stakeholders through a quadripartite process ensured structured discussions with the Environment Agency, Natural England, the Consumer Council for Water and the Drinking Water Inspectorate, allowing us to understand and discuss the sometimes competing requirements of our key stakeholders. We also ran workshop sessions with regulatory bodies, groups of business customers, environmental organisations and domestic customers. This has led to our confidence that our K5 Business Plan represents appropriate balances between customer service standards, environment impact, investment needs and the aim to keep the cost of customer bills as low as possible.

The Company has a wide range of contacts with our environmental and regulatory stakeholders involving many different functions within the Company. We also have central processes in place so that we can be confident that stakeholder contacts are dealing with the people most able to assist them, that consultations and information requests are handled in the most efficient manner and that information given to stakeholders is of high quality and consistent.

Ofwat, the economic regulator of the UK water industry, has been considering during the year a number of options in changing the way it regulates the industry, and the regulatory burden that arises from the approach taken to regulation, as well as alternative approaches to performance incentives, potential market reform and the price-setting process. A Defra review conducted under David Gray also considered the extent to which Ofwat is currently fit for purpose.

We have provided extensive input to the debates about how economic regulation for the sector should be developed and the role of market reform in those developments. Key themes for us have been:

- regulatory mechanisms should encourage and reward innovation and sustainability
- reduction in the regulatory burden at the same time as protecting customer interests
- market reform proposals must make sense in terms of customer service, prices and cost benefit analysis.

South West Water office, Exeter



Sustainable procurement and supply chain management

South West Water's procurement strategy is focused on partnering and strategic alliances with 60 key suppliers who account for the large 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 whilst improving performance and service levels.

We include all aspects of sustainability in our procurement processes and this is a central theme of our procurement strategy for our supply chains and support of the regional economy. With the start of the K5 period we introduced an innovative 'mixed economy' model to source our £705m* capital programme. This means using a significant number of smaller local contractors to provide specialised services as well as long term relationships with more major supply chain partners.

Our supplier assessment covers environmental, social and financial sustainability including suppliers' approaches to occupational health and safety, working conditions in the supply chain, corporate governance, sustainability of their products and services and attitudes to natural capital and the environment. We aim to work with the best companies whose forward thinking approach to sustainability gives reassurance that their environmental, social and ethical risks are minimised. This approach also supports our business continuity objectives and our key and strategic supplier risk review methodology.

We have also established a framework for capturing and sharing innovative ideas, products and service opportunities through our supplier forum.

No supplier (revenue) accounts for more than 5% of turnover and South West Water sources all its purchases from competitive markets.

Payments to suppliers

It is the Company's payment policy for the year ending 31 March 2012 to follow the Code of The Better Payment Practice Group on supplier payments. The Company will agree payment terms with individual suppliers in advance and abide by such terms. Information about the Code may be obtained from The Better Payment Practice Group's website at www.payontime.co.uk. Trade creditors at 31 March 2011 represented 30 days of the amount invoiced by suppliers during the year (2010: 26).

* At 2007/08 prices

Future developments

A key factor affecting the Company's performance for K5 is the Periodic Review completed in November 2009 when Ofwat set water company charges for the years 2010-2015 giving 'K' price increases of 1.1%, 3.4%, 2.5%, 1.3%, and 1.1% for 2010-2015 (an average of 1.9% p.a. over the five years). It also determined the investment outputs to be delivered by the Company over this period.

Key points of the 2009 Final Determination are as follows:

- a cost of capital of 4.5% (real, post tax basis) applicable to the whole industry
- 'K' price increases (above RPI inflation) averaging 1.9% per annum over the five years
- a capital programme of around £705m at 2007/08 prices
- a Capital Incentive Scheme (CIS) score of 105 (water) and 110 (sewerage), in line with the industry average
- operating efficiency improvements of 2.8% per annum, comparable with K4 delivery
- over the period 2010-2015 average bills decreasing by 1% before inflation
- capital investment priorities, including protection and maintenance of the improvements made over the last 20 years, further improvements to meet EU Directives and their corresponding UK legislation, achievement of operating cost savings and delivery of projects to increase our levels of renewable energy generation and to improve sustainability of the Company's activities.

As demonstrated by the financial and operational results for 2010/11, the Company has embraced the challenges outlined above and is well placed to continue to do so in the future.

Political donations

No political donations were made in the current or prior year.

Research and development

The development and testing of innovative techniques and processes will continue to play a role in the further improvement of cost effective provision of services.

Directors

The current Directors of the Company are shown on page 4.

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.

Parent company

The Company is a wholly owned subsidiary of Pennon Group Plc.

Statement of Directors' responsibilities in respect of the Annual Report and the Financial Statements

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) 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 company and of the profit or loss of the company for that period.

In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently
- make judgements and estimates that are reasonable and prudent
- state that the financial statements comply with IFRSs as adopted by the European Union
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business, in which case there should be supporting assumptions or qualifications as necessary.

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 company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

Statement as to disclosure of information to Auditors

- a) so far as each director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- b) they have taken all the steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Auditors

A resolution to re-appoint PricewaterhouseCoopers LLP as auditors to the Company will be proposed at the Annual General Meeting. PricewaterhouseCoopers LLP have indicated their willingness to continue as auditors.

Annual General Meeting

The twenty second Annual General Meeting will be held at Peninsula House, Rydon Lane, Exeter on 20 July 2011 at 10.30 am.

By Order of the Board

K D Woodier
Secretary
Peninsula House
Rydon Lane
Exeter EX2 7HR

Independent Auditors' Report

Independent Auditors' Report to the members of South West Water Limited

We have audited the financial statements of South West Water Limited for the year ended 31 March 2011 which comprise the Income Statement, the Statement of Comprehensive Income, the Statement of Changes in Equity, the Balance Sheet, the Cash Flow Statement, and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Respective responsibilities of directors and auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 24, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, 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.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 March 2011 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

David Charles (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Bristol
24 June 2011

Income Statement

For the year ended 31 March 2011		2011	2010
	Notes	£m	Restated (Note 5) £m
Revenue	6	449.1	444.5
Operating costs	7		
Manpower costs (excluding restructuring costs)		(36.7)	(32.8)
Raw materials and consumables used		(14.2)	(14.2)
Other operating expenses		(107.5)	(105.3)
Depreciation		(97.0)	(93.6)
Restructuring costs	26	(4.0)	(5.0)
Operating profit		189.7	193.6
Finance costs	8	(83.5)	(83.9)
Finance income	8	22.6	19.8
Profit before tax		128.8	129.5
Taxation	9	(3.7)	(30.7)
Profit for the year		125.1	98.8
Profit attributable to equity shareholders		125.1	98.8

All operating activities are continuing activities.

Statement of Comprehensive Income

For the year ended 31 March 2011		2011	2010
	Notes	£m	Restated (Note 5) £m
Profit for the year		125.1	98.8
Actuarial gains/(losses) on defined benefit schemes	24	0.3	(32.8)
Cash flow hedges: net fair value gains/(losses)		0.2	(1.2)
Tax on items taken directly to equity	25	(2.2)	14.1
Total other comprehensive expense		(1.7)	(19.9)
Total comprehensive income for the year		123.4	78.9

The notes on pages 30 to 56 form part of these financial statements.

Statement of Changes in Equity

	Called up share capital £m	Retained earnings and other reserves Restated (Note 5) £m	Total Equity Restated (Note 5) £m
At 1 April 2009	150.9	249.7	400.6
Profit for the year	-	98.8	98.8
Other comprehensive expense for the year	-	(19.9)	(19.9)
Total comprehensive income for the year	-	78.9	78.9
Transactions with equity shareholders			
Dividends paid	-	(54.4)	(54.4)
Share based payments (net of tax)	-	0.7	0.7
Total transactions with equity shareholders	-	(53.7)	(53.7)
At 31 March 2010	150.9	274.9	425.8
Profit for the year	-	125.1	125.1
Other comprehensive expense for the year	-	(1.7)	(1.7)
Total comprehensive income for the year	-	123.4	123.4
Transactions with equity shareholders			
Dividends paid	-	(58.4)	(58.4)
Share based payments (net of tax)	-	1.5	1.5
Total transactions with equity shareholders	-	(56.9)	(56.9)
At 31 March 2011	150.9	341.4	492.3

The notes on pages 30 to 56 form part of these financial statements.

Balance Sheet

At 31 March 2011		2011	2010
	Notes	£m	Restated (Note 5) £m
Assets			
Non-current assets			
Property, plant and equipment	13	2,467.8	2,427.7
Investment in subsidiary undertakings	16	3.3	3.3
Investment in joint venture	16	0.1	0.1
Trade and other receivables	15	0.6	0.4
		2,471.8	2,431.5
Current assets			
Inventories	17	3.3	3.5
Trade and other receivables	18	89.8	70.6
Derivative financial instruments	19	0.3	-
Cash and cash deposits	20	301.6	264.9
		395.0	339.0
Liabilities			
Current liabilities			
Borrowings	22	(60.3)	(155.3)
Derivative financial instruments	19	(4.4)	(3.6)
Trade and other payables	21	(96.6)	(72.6)
Current tax liabilities		(45.0)	(51.9)
Provisions for liabilities and charges	26	(2.7)	(3.1)
		(209.0)	(286.5)
Net current assets		186.0	52.5
Non-current liabilities			
Borrowings	22	(1,784.1)	(1,656.8)
Other non-current liabilities	23	(15.6)	(1.4)
Derivative financial instruments	19	(13.3)	(14.1)
Retirement benefit obligations	24	(68.2)	(83.3)
Deferred tax liabilities	25	(284.3)	(302.6)
		(2,165.5)	(2,058.2)
Net assets		492.3	425.8
Shareholders' equity			
Called up share capital	27	150.9	150.9
Retained earnings and other reserves	29	341.4	274.9
Total shareholders' equity		492.3	425.8

The notes on pages 30 to 56 form part of these financial statements.

The financial statements on pages 26 to 56 were approved by the Board of Directors on 24 June 2011 and were signed on its behalf by:

C. Loughlin
Chief Executive

Cash Flow Statement

For the year ended 31 March 2011		2011	2010
	Notes	£m	Restated (Note 5) £m
Cash flows from operating activities			
Cash generated from operations	30	266.0	281.2
Interest paid		(55.7)	(60.1)
Tax paid		(30.6)	(1.3)
Net cash generated from operating activities		179.7	219.8
Cash flows from investing activities			
Interest received		2.8	3.7
Receipt of grants and contributions		2.0	0.4
Purchase of property, plant and equipment		(118.1)	(147.3)
Proceeds from sale of property, plant and equipment		1.8	1.3
Net cash used in investing activities		(111.5)	(141.9)
Cash flows from financing activities			
Deposit of restricted funds		(46.6)	(16.2)
Net proceeds from new borrowing		15.0	-
Repayment of borrowings		(14.1)	(14.1)
Proceeds from inter-company borrowings		31.9	-
Finance lease sale and leaseback		0.5	14.4
Finance lease principal repayments		(12.1)	(11.3)
Dividends paid		(58.4)	(54.4)
Net cash used in from financing activities		(83.8)	(81.6)
Net decrease in cash and cash equivalents			
Cash and cash equivalents at beginning of the year	20	214.4	218.1
Cash and cash equivalents at end of the year	20	198.8	214.4

The notes on pages 30 to 56 form part of these financial statements.

Notes to the Financial Statements

1. General information

South West Water Limited is a Company registered in the United Kingdom under the Companies Act 2006. The address of the registered office is given on page 4. The nature of the Company's operations and its principal activities are set out in the Directors' report on page 6.

These financial statements were approved by the Board of Directors on 24 June 2011.

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 unless otherwise stated.

a) Basis of preparation

These financial statements have been prepared under the historical cost accounting basis (except fair value items) and in accordance with International Financial Reporting Standards (IFRSs) and International Financial Reporting Interpretation Committee (IFRIC) interpretations, as adopted by the European Union, with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. 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 and interpretations in the year.

The going concern basis has been adopted for preparing the financial statements as stated by the Directors on page 9.

IFRIC 18 'Transfers of assets from customers'

From 1 July 2009, where an item of property, plant and equipment provided by a customer, or an equivalent payment to provide such property, plant and equipment, gives access to the supply of goods or services then the asset exchanged generates revenue. The effect of the restatement on the comparative figures is set out in note 5. In the year, assets with a value of £17.4m have been transferred to the Company, increasing deferred income by £14.7m and profit by £2.7m (2009/10: £2.0m).

The following revised standards, amended standards and interpretations, which are mandatory for the first time in the financial year beginning 1 April 2010, are relevant to the Company but have no material impact:

- IFRS 1 – 'First time adoption of IFRS' (revised)
- IFRS 1 – 'First time adoption of IFRS' (amendment)
- IFRS 2 – 'Share based payments' (amendment)
- IFRS 3 – 'Business combinations' (revised)
- Improvements to IFRS 2009
- IAS 27 – 'Consolidated and separate financial statements' (revised)
- IAS 32 – 'Financial instruments: presentation' (amendment)
- IAS 39 – 'Financial instruments: recognition and measurement' (amendment)
- IFRIC 15 – 'Agreement for the construction of real estate'
- IFRIC 16 – 'Hedges of a net investment in a foreign operation'
- IFRIC 17 – 'Distributions of non cash assets to owners'

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 1 – 'First time adoption of IFRS' (amendment) (hyperinflation exemptions and fixed date for IFRS transition)
- IFRS 1 – 'First time adoption of IFRS' (amendment) (limit exemption from IFRS 7 disclosures)
- IFRS 7 – 'Financial instruments: disclosure on derecognition' (amendment)*
- IFRS 9 – 'Financial instruments'*
- IFRS 10 – 'Consolidated financial statements'*
- IFRS 11 – 'Joint arrangements'*
- IFRS 12 – 'Disclosure of interests in other entities'*
- IFRS 13 – 'Fair value measurement'*
- Improvements to IFRS 2010
- IAS 12 – 'Income taxes' (amendment)*
- IAS 24 – 'Related party disclosures' (revised)
- IAS 27 – 'Separate financial statements' (revised)*
- IAS 28 – 'Investments in associates and joint ventures' (revised)*
- IFRIC 14 – 'Prepayments of a minimum funding requirement' (amendment)
- IFRIC 19 – 'Extinguishing financial liabilities with equity instruments'

* Not yet endorsed for use in the European Union

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 Company.

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that 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, events or actions, actual results ultimately may differ from those estimates. Details of critical accounting judgements and estimates are set out in note 4.

b) Basis of consolidation

The Company is exempt under the provisions of section 400 of the Companies Act 2006 from the requirement to produce group financial statements as it is a wholly-owned subsidiary of Pennon Group Plc which is registered within the European Economic Area and which itself produces consolidated financial statements. Accordingly consolidated financial statements have not been prepared and the financial information presented is for the Company as an individual undertaking. Group financial statements are included in the Annual Report of Pennon Group Plc which is available from Peninsula House, Rydon Lane, Exeter, EX2 7HR.

c) Revenue recognition

Revenue comprises charges to customers for water, sewerage and other services, excluding value added tax, and is derived only from the United Kingdom.

Revenue is recognised when the service has been provided to the customer.

Revenue relates to charges due in the year, excluding any amounts paid in advance. Revenue for measured charges includes amounts billed plus an estimation of the amounts unbilled at the year end. The accrual for unbilled charges is estimated using a defined methodology reflecting historical consumption, estimated demand trends and current tariffs. Revenue for unmeasured charges is recognised on a time apportioned basis.

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

d) Property, plant and equipment

Cost includes original purchase price of the asset and costs attributable to bringing the asset to its working condition for its intended use.

The cost of assets includes directly attributable labour and overhead costs which are incremental to the Company.

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 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 Company. 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 as follows:

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) 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 over their estimated economic lives to their residual value, which are principally as follows:

Freehold buildings	30 – 60 years
Operational properties	40 – 80 years
Fixed plant	20 – 40 years
Vehicles, mobile plant and computers	4 – 10 years

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

Asset lives and residual values are reviewed annually.

Gains or losses on disposals are determined by comparing the proceeds of sale with the carrying amount and are recognised within the income statement.

e) 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.

f) 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.

g) 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 circumstances indicate that the carrying value may not be fully recoverable.

h) Joint ventures

Joint ventures are entities over which the Company exercises joint control. Investments in joint ventures are accounted for using the equity method of accounting. Any excess of the cost of acquisition over the Company'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 Company's investment is adjusted for the Company's share of post-acquisition profits or losses recognised in the income statement and statement of comprehensive income. Losses of a joint venture in excess of the Company's interest are not recognised unless the Company has a legal or constructive obligation to fund those losses.

i) Inventories

Inventories are stated at the lower of cost and net realisable value.

j) Cash and cash deposits

Cash and cash deposits comprise cash in hand, short-term deposits held at banks and other short-term highly liquid deposits subject to insignificant risk of changes in value. Bank overdrafts are shown within current borrowings.

k) Derivatives and other financial instruments

The Company classifies its financial instruments in the following categories:

i) Loans and receivables

All loans and borrowings are initially recognised at cost, being the net fair value of the consideration received. Following initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost.

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

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

Trade receivables do not carry any interest and are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts and the impact of discounting. The allowance for estimated irrecoverable amounts is calculated by applying expected recovery rates to debts outstanding at the end of the accounting period. The expected recovery rate takes into account age of the debt and payment history.

ii) Derivative financial instruments

The Company uses derivative financial instruments, principally interest rate swaps, to hedge its risks associated with interest rate fluctuations. Such derivative instruments are initially recorded at cost and subsequently re-measured at fair value for the reported balance sheet.

The gain or loss on re-measurement 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 Company is required to document in advance the relationship between the item being hedged and the hedging instrument. The Company 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 ongoing basis. This effectiveness testing is reperformed at the end of each reporting period to ensure that the hedge remains highly effective.

The full value of a hedging derivative is classified as a non-current asset or liability when the remaining maturity of the 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 that 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 payables

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

l) Taxation including deferred tax

The tax charge for the year is calculated on the basis of tax laws enacted or substantively enacted at the balance sheet date.

Deferred tax 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.

m) Dividend distributions

Dividend distributions are recognised as a liability in the Company's 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 authorised by shareholders at general meetings.

n) Employee benefits**i) Pension obligations**

The Company operates defined benefit and defined contribution pension schemes through its parent company.

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 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 to 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, changes in actuarial assumptions and amendments to pension plans are charged or credited to equity and recorded in the statement of comprehensive income.

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 Company participates in a number of equity-settled share-based payment plans for employees operated by its parent company Pennon Group Plc. 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.

At each balance sheet date, the Company revises its estimates of the number of options that are expected to vest. It recognises the impact of the revision to original estimates, if any, in the income statement, with a corresponding adjustment to equity.

o) 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 Company for similar financial instruments.

p) Transfers of assets from customers

Where an item of property, plant and equipment that must be used to connect customers to the network is received from a customer, or where cash is received from a customer for the acquisition or construction of such an item, that asset is recorded and measured on initial recognition at its fair value. The credit created by the recognition of the asset is recognised in the income statement. The period over which the credit is recognised depends upon the nature of the service provided by the Company as determined by the agreement with the customer. Where the service provided is solely a connection to the network the credit is recognised at the time of connection. If the agreement does not specify a period, the revenue is recognised over a period no longer than the useful life of the transferred asset used to provide the ongoing service.

3. Financial risk management**a) Financial risk factors**

The Company's activities expose it to a variety of financial risks; market risk (interest rate risk), liquidity risk and credit risk. The Company receives treasury services from the treasury function of Pennon Group Plc, the parent company, which seeks to ensure that sufficient funding is available to meet foreseeable needs, maintains reasonable headroom for contingencies and manages interest rate risk.

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

i) Market risk

The Company has both interest bearing assets and interest bearing liabilities. The Company has a policy of maintaining, after the effect of interest rate swaps, at least 50% of interest bearing liabilities at fixed rates. At the year end 59% of net borrowings were at fixed rates and 24% index-linked. The Company 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. 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 Company. These instruments are analysed in more detail in note 19.

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.

At 31 March 2011, 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 decreased/increased by £0.2m (2010: £1.1m).

If RPI on index-linked borrowings had been on average 0.5% higher/lower with all other variables held constant, post tax profit for the year would have decreased/increased by £1.3m (2010: £1.2m)

ii) Liquidity risk

The Company actively maintains a mixture of long-term and short-term committed facilities that are designed to ensure the Company has sufficient available funds for operations and planned expansions equivalent to at least one year's forecast requirements at all times. Details of undrawn committed facilities and short-term uncommitted facilities are provided in note 22.

Contractual undiscounted cash flows were:

31 March 2011	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
Non-derivative financial liabilities					
Borrowings excluding finance lease liabilities	39.2	21.5	84.8	863.8	1,009.3
Interest payments on borrowing	16.2	17.7	54.7	557.3	645.9
Finance lease liabilities	38.7	50.3	199.3	2,234.1	2,522.4
Derivative financial liabilities					
Derivative contracts – net payments	(12.4)	(8.2)	(3.0)	-	(23.6)

31 March 2010	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
Non-derivative financial liabilities					
Borrowings excluding finance lease liabilities	114.1	21.1	73.3	849.8	1,058.3
Interest payments on borrowing	7.8	8.4	29.0	343.7	388.9
Finance lease liabilities	38.1	38.7	176.2	2,307.7	2,560.7
Derivative financial liabilities					
Derivative contracts – net receipts	14.3	8.3	12.9	-	35.5

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 customers, including outstanding receivables. Further information on the credit risk relating to trade receivables is given in note 18.

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

b) Capital risk management

The Company's objectives when managing capital are to safeguard the Company'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 reduce the cost of capital.

The Company monitors capital on the basis of a gearing ratio which is calculated as net debt divided by total capital. Net debt is calculated as total borrowings (including current and non-current borrowings as shown in the consolidated balance sheet) less cash and cash deposits. Total capital is calculated as equity as shown in the balance sheet plus net borrowings.

The gearing ratios at 31 March 2011 and 2010 were as follows:

	2011	2010
	£m	Restated (Note 5) £m
Net borrowings (note 31)	1,542.8	1,547.2
Total equity	492.3	425.8
Total capital	2,035.1	1,973.0
Gearing ratio	75.8%	78.4%

Consistent with the industry peer group, the Company is also monitored by the ratio of its debt to Regulated Capital Value (RCV) in line with guidance from the water industry regulator Ofwat.

	2011	2010
	£m	£m
Regulatory Capital Value	2,703.5	2,554.9
Net borrowings (note 31)	1,542.8	1,547.2
Net debt/Regulatory Capital Value	57.1%	60.6%

c) Determination of fair values

The Company uses the following hierarchy for determining the fair value of financial instruments by valuation technique:

- quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1)
- inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2)
- inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3)

The disclosures are set out in note 19.

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 Company is the current bid price.

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. The Company uses a variety of methods and makes assumptions that 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 cash flows.

The carrying value less impairment provision of trade receivables and payables are assumed to approximate 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 that is available to the Company for similar financial instruments.

4. Critical accounting judgements and estimates

The Company's principal accounting policies are set out in note 2 to these financial statements. 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:

Revenue recognition

Revenue is recognised by the Company when the service has been provided to the customer.

The Company 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, income 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 year end. Estimated usage is based on historical data, judgement and assumptions; actual results could differ from these estimates which would result in operating revenue being adjusted in the period that the revision to the estimates is determined. Revenue for unmeasured charges is recognised on a time apportioned basis.

Provision for doubtful debts

At each balance sheet date, the Company evaluates the collectability of trade receivables and records provisions for impairment of receivables based on experience including, for example, 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, which could impact operating results positively or negatively. As at 31 March 2011 current trade receivables were £85.0m, before provision for impairments.

Carrying value of long-life assets

The Company's accounting policy for property, plant and equipment is detailed in note 2 of the financial statements. The carrying value of property, plant and equipment as at 31 March 2011 was £2,467.8m (2010: £2,427.7m). In the year ended 31 March 2011 additions to property, plant and equipment totalled £125.1m and the depreciation charge was £98.3m. Estimated useful economic lives of tangible fixed assets 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 Company, 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.

Retirement benefit obligations

Some of the Company's employees are eligible to participate in funded defined benefit schemes, operated by the parent company. Actuarial valuations of the schemes 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 the advice of an independent qualified actuary based on the latest actuarial valuation and assumptions determined by the actuary. The assumptions are based on information supplied to the actuary by the Company, supplemented by discussions between the actuary and management. The assumptions are disclosed in note 24 of the financial statements.

Taxation

The corporation tax provision of £45.0m (2010: £51.9m) reflects management's estimation of the amount of tax payable for fiscal years with open tax computations where liabilities remain to be agreed by Her Majesty's Revenue and Customs.

5. Prior year adjustment

Accounting policy for transfers of assets from customers

The application of IFRIC 18 'Transfers of assets from customers' has required a restatement of amounts for the prior year. Where an item of property, plant equipments is received from a customer or where cash is received from a customers for the acquisition or construction of such an item the asset is recorded and measured on initial recognition at fair value.

As a result of the above change in accounting policy and restatements of prior year acquisitions, comparative figures have been restated:

31 March 2010	Note	Previously reported £m	Application of IFRIC 18 £m	Restated as now reported £m
Income Statement				
Other operating costs	7	(107.3)	2.0	(105.3)
Profit for the year		96.8	2.0	98.8
Balance Sheet				
Non-current assets				
Property, plant and equipment	13	2,425.7	2.0	2,427.7
Retained earnings				
Profit for the year	29	96.8	2.0	98.8
Carried forward		272.9	2.0	274.9
Cashflow				
Cash generated from operating activities				
Profit for the year	30	96.8	2.0	98.8
Purchase of property, plant and equipment		(145.3)	(2.0)	(147.3)

6. Segmental reporting

The Directors believe that the whole of the Company's activities constitute a single class of business. Operating segments are reported in the manner consistent with internal reporting to the Chief Operating Decision Maker, which has been identified as the Board of Directors.

The Company's revenue is wholly generated from within the United Kingdom.

7. Operating costs

	2011	2010
	£m	Restated (Note 5) £m
Manpower costs (note 11)	36.7	32.8
Raw materials and consumables	14.2	14.2
Other operating expenses include		
Profit on disposal of property, plant and equipment	(1.6)	(1.0)
Operating lease rentals payable:		
- plant and machinery	1.1	0.8
- property	1.5	1.4
Research and development expenditure	0.2	0.2
Trade receivables impairment (note 18)	7.9	7.3
Depreciation of property, plant and equipment:		
- owned assets	69.4	64.4
- under finance leases	27.6	29.2
	97.0	93.6

Fees payable to the Company's auditors in the year were as follows:

	2011	2010
	£000	£000
Audit of the Company's accounts	120	108
Audit-related regulatory reporting	28	28
Other services	120	79
	268	215

Expenses reimbursed to the auditors in relation to the audit of the Company were £14,000 (2010: £14,000).

8. Net finance costs

	2011	2010
	£m	£m
Finance Costs		
Intercompany interest payable to subsidiaries	(22.1)	(10.8)
Bank borrowings and overdrafts	(10.2)	(10.9)
Interest element of finance lease rentals	(29.4)	(44.7)
Other finance costs	(2.7)	-
Interest cost on retirement benefit obligations	(19.1)	(17.5)
	(83.5)	(83.9)
Finance Income		
Interest receivable	3.2	4.0
Intercompany interest receivable from subsidiaries	0.1	0.1
Expected return on pension scheme assets	19.3	15.0
Other finance income	-	0.7
	22.6	19.8
Net finance costs	(60.9)	(64.1)

9. Taxation

	2011 £m	2010 £m
Analysis of charge in year		
Current tax	23.7	30.8
Deferred tax – other (note 25)	4.0	(0.1)
Deferred tax – arising on change of rate of corporation tax (note 25)	(24.0)	-
	3.7	30.7

UK Corporation tax is calculated at 28% (2010: 28%) of the estimated assessable profit for the year. The tax for the year differs from the theoretical amount that would arise using the standard rate of corporation tax in the UK (28%). The differences are explained below:

	2011 £m	2010 Restated (Note 5) £m
Profit before tax	128.8	129.5
Profit before tax multiplied by standard rate of corporation tax in the UK of 28% (2010: 28%)	36.1	36.1
Effects of:		
Expenses not deductible for tax purposes	0.7	(0.1)
Adjustments to tax charge in respect of prior year	(8.5)	(2.7)
Change in rate of corporation tax	(24.0)	-
Other	(0.6)	(2.8)
Tax charge for year	3.7	30.7

The effective tax rate for the year was 3% (2010: 24%).

In addition to the amount credited to the income statement, a deferred tax charge relating to actuarial gains on defined benefit schemes of £0.1m (2010: credit on actuarial losses £9.2m) has been charged directly to equity. A deferred tax credit relating to share-based payments of £0.5m (2010: tax charge £0.1m) has been charged to equity.

10. Dividends

	2011 £m	2010 £m
Amounts recognised as distributions to equity holders in the year:		
Base dividend of 36.0p per ordinary share in respect of 2009/10 paid 13 November 2009	-	54.4
Base dividend of 38.7p per ordinary share in respect of 2010/11 paid 25 November 2010	58.4	-
	58.4	54.4

11. Employment costs

The average number of persons (including Directors) employed by the Company was 1,196 (2010: 1,191).

	2011 £m	2010 £m
Employment costs comprise:		
Wages and salaries	35.0	33.7
Social security costs	2.7	2.7
Pension costs	11.0	9.5
Share-based payments	1.2	1.3
Total employment costs	49.9	47.2
Charged as follows:		
Manpower costs	36.7	32.8
Capital schemes	9.5	10.0
Restructuring provision	3.7	4.4
Total employment costs	49.9	47.2

Details of Director's emoluments are set out in note 12. There are no personnel other than Directors, who as key management exercise authority and responsibility for planning, directing and controlling the activities of the Company.

12. Directors' emoluments

	2011 £000	2010 £000
Total emoluments of the Directors of the Company:		
Salary	658	611
Fees (non-executive Directors)	48	3
Performance related	252	240
Share-based payments	575	408
Other emoluments	141	132
Total emoluments	1,674	1,394

The cost of share-based payments represents the amount charged to the income statement, as described in note 28.

Performance related, share-based payments and other emoluments apply to Executive Directors only.

The performance related payment represents the cash element. In addition, Executive Directors receive a conditional award of shares in Pennon Group Plc for a matching amount which is subject to a future service criterion.

Other emoluments include car benefit and health care, and, in respect of the highest paid Director, a cash payment of 30% of his annual basic salary in lieu of any pension provision by the Company.

The emoluments of the highest paid Director were £506,000 (2010: £466,000).

At 31 March 2011 retirement benefits were accruing to 3 Directors (2010: 3 Directors) under defined benefit pension schemes operated by the parent company.

The highest paid Director did not participate in a company pension scheme.

The Chairman, K G Harvey, is a director of Pennon Group Plc and his remuneration is disclosed in the financial statements of that company.

13. Property, plant and equipment

	Land and buildings	Infrastructure assets Restated (Note 5)	Operational properties	Fixed and mobile plant, vehicles and computers	Construction in progress	Total Restated (Note 5)
	£m	£m	£m	£m	£m	£m
Cost:						
At 1 April 2009	18.9	1,334.2	605.8	1,042.0	89.8	3,090.7
Additions	0.6	38.0	0.8	33.1	72.8	145.3
Grants & contributions	-	(0.4)	-	-	-	(0.4)
Disposals	-	(0.7)	(0.2)	(13.6)	-	(14.5)
Transfers/reclassifications	0.9	36.3	8.1	35.5	(80.8)	-
At 31 March 2010	20.4	1,407.4	614.5	1,097.0	81.8	3,221.1
Additions	0.1	17.8	0.3	28.9	78.0	125.1
Assets adopted at fair value	-	12.4	0.6	1.7	-	14.7
Grants & contributions	-	(1.2)	-	-	-	(1.2)
Disposals	(0.1)	(1.8)	(4.4)	(52.2)	-	(58.5)
Transfers/reclassifications	0.9	21.7	11.3	30.1	(64.0)	-
At 31 March 2011	21.3	1,456.3	622.3	1,105.5	95.8	3,301.2
Accumulated Depreciation:						
At 1 April 2009	4.2	61.9	156.3	490.4	-	712.8
Charge for year	0.3	20.5	11.2	62.9	-	94.9
Disposals	-	(0.7)	(0.2)	(13.4)	-	(14.3)
At 31 March 2010	4.5	81.7	167.3	539.9	-	793.4
Charge for year	0.3	21.5	11.1	65.4	-	98.3
Disposals	(0.1)	(1.8)	(4.4)	(52.0)	-	(58.3)
At 31 March 2011	4.7	101.4	174.0	553.3	-	833.4
Net book value:						
At 31 March 2010	15.9	1,325.7	447.2	557.1	81.8	2,427.7
At 31 March 2011	16.6	1,354.9	448.3	552.2	95.8	2,467.8

Out of the total depreciation charge for the Company of £98.3m (2010: £94.9m), the sum of £1.3m (2010: £1.3m) has been charged to capital projects, and £97.0m (2010: £93.6m) against profits.

Assets held under finance leases included above:

	Land and buildings £m	Infrastructure assets £m	Operational properties £m	Fixed and mobile plant, vehicles and computers £m	Construction in progress £m	Total £m
Cost:						
At 31 March 2010	-	355.0	459.9	299.1	9.7	1,123.7
At 31 March 2011	-	357.0	465.0	301.2	0.5	1,123.7
Depreciation:						
At 31 March 2010	-	20.6	81.5	142.0	-	244.1
At 31 March 2011	-	26.0	89.2	154.5	-	269.7
Net book amount:						
At 31 March 2010	-	334.4	378.4	157.1	9.7	879.6
At 31 March 2011	-	331.0	375.8	146.7	0.5	854.0

14. Financial instruments by category

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

	Note	Fair value	Amortised cost		Total £m
		Derivatives £m	Loans and receivables £m	Trade receivables and trade payables £m	
31 March 2011					
Financial assets					
Derivative financial receivables	19	0.3	-	-	0.3
Trade and other receivables	15 & 18	-	19.2	30.5	49.7
Cash and cash deposits	20	-	301.6	-	301.6
Total		0.3	320.8	30.5	351.6
Financial liabilities					
Borrowings	22	-	(1,844.4)	-	(1,844.4)
Derivative financial instruments	19	(17.7)	-	-	(17.7)
Trade and other payables	21	-	(37.7)	(56.6)	(94.3)
Total		(17.7)	(1,882.1)	(56.6)	(1,956.4)
31 March 2010					
Financial assets					
Trade and other receivables	15 & 18	-	10.3	29.4	39.7
Cash and cash deposits	20	-	264.9	-	264.9
Total		-	275.2	29.4	304.6
Financial liabilities					
Borrowings	22	-	(1,812.1)	-	(1,812.1)
Derivative financial instruments	19	(17.7)	-	-	(17.7)
Trade and other payables	21	-	(24.0)	(48.6)	(72.6)
Total		(17.7)	(1,836.1)	(48.6)	(1,902.4)

£17.4m (2010: £17.6m) of the derivative value above is used for hedging with nil (2010: £0.1m) deemed as held for trading.

15. Trade and other receivables – non-current

	2011 £m	2010 £m
Amounts owed by subsidiary company	0.6	0.4

The effective interest rate on amounts owed by subsidiary is 2.0% (2010: 4.7%).

16. Investments

	2011 £m	2010 £m
Subsidiary undertakings	3.3	3.3
Joint venture	0.1	0.1

The Company has four wholly-owned subsidiaries, Peninsula Properties (Exeter) Limited, Peninsula Leasing Limited, South West Water Finance Plc and Source Collections Limited (formerly Haldon Collections Limited). All companies are incorporated, registered and operate in England.

The Company holds 99,999 (100%) A ordinary shares in Echo South West Limited, a joint venture previously engaged in customer contact management, established between the Company and Echo Managed Services Limited, a subsidiary of South Staffordshire Group Plc. The proportion of the nominal value of ordinary shares held by the Company is 50%. The joint venture in Echo South West Limited ceased operations on 31 March 2008.

Consolidated financial statements have not been prepared, as explained in note 2 (b).

The directors believe that the carrying value of the investments is supported by their underlying net assets.

17. Inventories

	2011 £m	2010 £m
Raw materials and consumables	3.3	3.5

18. Trade and other receivables – current

	2011 £m	2010 £m
Trade receivables	85.0	76.0
Less: provision for impairment of receivables	(54.5)	(46.6)
Net trade receivables	30.5	29.4
Amounts owed by subsidiary companies	1.9	0.9
Amounts owed by fellow subsidiary companies	1.3	1.5
Amounts owed by parent undertaking	0.6	1.0
Other receivables	14.8	6.5
Other prepayments and accrued income	40.7	31.3
	89.8	70.6

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

There is no concentration of credit risk in trade receivables. The Company has a large number of customers who are dispersed and there is no significant loss on trade receivables that has not been provided for.

The Company has created IAS 39 portfolio provisions, but it cannot identify which receivables specifically are the ones impaired. It is company 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 gross trade receivables was:

	2011 £m	2010 £m
Past due 0 – 30 days	10.9	9.0
Past due 31 – 120 days	10.5	9.7
Past due more than 120 days	83.0	69.0

The aged gross trade receivables above are taken directly from the Company's aged debt datamart before the deduction of credit balances and other adjustments. The figures are therefore higher than the trade receivables balance stated above in note 18.

The Company has a duty under legislation to continue to provide domestic customers with services regardless of payment. The Company specifically reviews separate categories of debt to identify an appropriate provision for impairment.

The movement in the allowance for impairment in respect of trade receivables was:

	2011 £m	2010 £m
At 1 April	46.6	38.8
Provision for receivables impairment	7.9	7.3
Amounts written off during the period	(7.2)	(5.9)
Cumulative amounts previously excluded from debt	7.2	6.4
At 31 March	54.5	46.6

19. Derivative financial instruments

	2011 £m	2010 £m
Interest rate swaps – cash flow hedges:		
Current assets	0.3	-
Non-current liabilities	(13.3)	(14.1)
Current liabilities	(4.4)	(3.5)
Derivatives deemed held for trading		
Current liabilities	-	(0.1)

The fair value of hedging derivatives is split between current and non-current assets or liabilities based on the maturity of the cashflows.

The ineffective portion recognised in the income statement arising from cash flow hedges amounts to a gain of £nil (2010: £nil).

Interest rate swaps and fixed rate borrowings are used to manage the mix of fixed and floating rates to ensure at least 50%, after the effect of interest rate swaps, of net borrowings is at fixed rate. At 31 March 2011 59% of net borrowings was at fixed rate (2010: 73%).

At 31 March 2011 interest rate swaps to hedge financial liabilities with a notional principal value of £605.0m existed, with a weighted average to maturity of 3.9 years (2010: £775.0m, with 4.4 years) to swap from floating to fixed rate. The weighted average interest rate of the swaps was 3.2% (2010: 4.0%).

The amounts above are the fair value of swaps based on the market value of equivalent instruments at the balance sheet date.

In 2010, derivatives held for trading relate to interest rate swaps which no longer qualify for hedge accounting.

Valuation hierarchy

The table below shows the financial instruments carried at fair value by valuation method:

	31 March 2011				31 March 2010			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets								
Derivatives for hedging	-	0.3	-	0.3	-	-	-	-
Total Assets	-	0.3	-	0.3	-	-	-	-
Liabilities								
Derivatives for hedging	-	17.7	-	17.7	-	17.6	-	17.6
Derivatives held for trading	-	-	-	-	-	0.1	-	0.1
Total Liabilities	-	17.7	-	17.7	-	17.7	-	17.7

Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 – inputs (other than quoted prices included within level 1) that are observable for the asset and liability, either directly (that is, as prices) or indirectly (that is, derived from prices).

Level 3 – inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

20. Cash and cash deposits

	2011 £m	2010 £m
Cash at bank and in hand	0.2	0.1
Overnight deposits	26.0	81.4
Other short-term deposits	195.2	150.2
Other deposits	80.2	33.2
	301.6	264.9

The effective interest rate on short-term deposits was 0.9% (2010: 0.8%).

Other deposits include £80.2m (2010: £33.2m) of restricted funds to settle long-term liabilities (note 22).

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

	2011 £m	2010 £m
Cash and cash deposits as above	301.6	264.9
Overdrafts (note 22)	(22.6)	(17.3)
	279.0	247.6
Less: deposits with a maturity of three months or more	(80.2)	(33.2)
Cash and cash deposits	198.8	214.4

21. Trade and other payables – current

	2011 £m	2010 £m
Trade payables	56.6	48.6
Amounts owed to subsidiary companies	17.7	2.9
Amounts owed to fellow subsidiaries	0.1	0.1
Other tax and social security	1.1	1.3
Other payables	3.8	0.8
Accruals	16.9	18.7
Deferred income	0.4	0.2
	96.6	72.6

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

22. Borrowings

	2011 £m	2010 £m
Current		
Bank overdrafts	22.6	17.3
Short-term Loans	0.4	-
Loan from subsidiary company	-	100.0
European Investment Bank	21.1	14.1
	44.1	131.4
Obligations under finance leases	16.2	23.9
	60.3	155.3
Non-current		
European Investment Bank	252.5	273.6
Loan from subsidiary company	360.8	218.7
	613.3	492.3
Obligations under finance leases	1,156.2	1,164.5
Other Bank loans	14.6	-
	1,784.1	1,656.8
Total borrowings	1,844.4	1,812.1

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

The fair value of the non-current borrowings were:

	2011		2010	
	Book value £m	Fair value £m	Book value £m	Fair value £m
European Investment Bank	252.5	219.5	273.6	235.5
Loan from subsidiary company	360.8	311.8	218.7	189.8
	613.3	531.3	492.3	425.3
Obligations under finance leases	1,156.2	929.2	1,164.5	967.7
	1,769.5	1,460.5	1,656.8	1,393.0

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

The exposure to interest rate changes (before the impact of swaps – note 19) and the repricing dates at the balance sheet date is:

	2011 £m	2010 £m
6 months or less	853.6	840.5
6 – 12 months	656.2	642.9
1 – 5 years	111.4	121.6
Over 5 years	223.2	207.1
	1,844.4	1,812.1

The maturity of non-current borrowings was:

	2011 £m	2010 £m
Between 1 and 2 years	41.5	37.1
Between 2 and 5 years	171.7	145.8
Over 5 years	1,570.9	1,473.9
	1,784.1	1,656.8

Finance lease liabilities – minimum lease payments:

	2011 £m	2010 £m
Within one year	38.8	38.5
In the second to fifth years inclusive	246.3	215.2
After five years	2,230.3	2,307.6
	2,515.4	2,561.3
Less: future finance charges	(1,343.0)	(1,372.9)
	1,172.4	1,188.4

Finance lease liabilities – present value of minimum lease payments:

	2011 £m	2010 £m
Within one year	38.8	38.5
In the second to fifth years inclusive	223.1	193.3
After five years	1,003.2	1,026.5
	1,265.1	1,258.3

Included above are accrued finance charges arising on obligations under finance leases totalling £130.8m (2010: £135.3m), of which £6.4m (2010: £11.9m) is repayable within one year.

Included above is £0.7m (2010: £7.7m) due to Peninsula Leasing Limited, a subsidiary company, under finance lease agreements of which £0.4m (2010: £7.4m) is repayable within one year.

Within obligations under finance leases, the Company has utilised finance lease facilities of £180.0m for certain water and sewerage business tangible fixed assets that 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 the Company at five-yearly intervals, the next being March 2016.

During 2007 the period for repayment of these leases 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 of £32.4m at 31 March 2011 (2010: £24.0m) are being held to settle the lease 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.

During 2010 the period for repayment of certain other existing leases was extended with an agreement to deposit with the lessor group amounts equal to the difference between the original and revised payments due. The deposit at 31 March 2011 of £47.8m (2010: £9.4m) is being held to settle the lease liability at the end of the lease term, subject to rights to release by negotiation with the lessor.

The Company has undrawn committed borrowing facilities:

	2011 £m	2010 £m
Floating rate:		
Expiring within one year	50.0	-
Expiring after one year	70.0	110.0
	120.0	110.0

In addition, the Company has short-term uncommitted bank facilities of £60.0m (2010: £60.0m).

23. Other non-current liabilities

	2011 £m	2010 £m
Other payables	15.6	1.4

24. Retirement benefit obligations

Some of the Company's employees are eligible to participate in funded defined benefit schemes, operated by the parent company. 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 the 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 active members of the fund and current pensioners.

The principal actuarial assumptions at the balance sheet date were:

	2011 %	2010 %
Expected return on scheme assets	7.3	7.4
Rate of increase in pensionable pay	3.9	4.1
Rate of increase for present and future pensions	3.4	3.6
Rate used to discount schemes' liabilities	5.5	5.5
Inflation	3.4	3.6

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

The average life expectancy in years of a member having retired at age 62 on the balance sheet date is projected at:

	2011	2010
Male	24.9	22.0
Female	26.9	25.4

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

	2011	2010
Male	25.7	23.4
Female	28.2	26.6

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%	+/- 1.3%
Rate of increase in current and future pensions	+/- 0.5%	+/- 6.1%
Rate used to discount schemes' liabilities	+/- 0.5%	+/- 8.6%
Inflation	+/- 0.5%	+/- 7.8%
Life expectancy	+/- 1 year	+/- 3.1%

The amounts recognised in the income statement were:

	2011 £m	2010 £m
Current service cost	(8.6)	(6.5)
Past service cost	(2.4)	(1.2)
Total included within operating costs	(11.0)	(7.7)
Expected return on pension schemes' assets	19.3	15.0
Interest cost on retirement benefit obligations	(19.1)	(17.5)
Total included within net finance costs	0.2	(2.5)
Total charge	(10.8)	(10.2)

The actual return on schemes' assets was an increase of £31.7m (2010: increase of £56.5m).

The amounts recognised in the statement of comprehensive income were:

	2011 £m	2010 £m
Actuarial gain / (loss) recognised in the year	0.3	(32.8)

The amounts recognised in the balance sheet were:

	2011 £m	2010 £m
Fair value of schemes' assets	307.0	264.3
Present value of defined benefit obligations	(375.2)	(347.6)
Net liability recognised in the balance sheet	(68.2)	(83.3)

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

	Expected Return %	2011 Value £m	Fund %	Expected Return %	2010 Value £m	Fund %
Equities	8.5	176.0	57	8.5	161.8	61
Property / currency	8.2	12.7	4	9.0	16.5	6
Bonds	4.8	91.0	30	5.0	83.9	32
Other	4.4	27.3	9	4.5	2.1	1
		307.0	100		264.3	100

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 its investment advisers, the trustees have structured the schemes' assets with the objectives of balancing investment returns and levels of risk. The asset allocation has three main elements:

- holding of bonds which is expected to be less volatile than most other asset classes and reflects the schemes' liabilities
- a proportion of equities, with fund managers having 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).

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.

Equities held by the scheme are spread between the UK and international markets circa 50% each.

Movements in the net liability were:

	2011 £m	2010 £m
At 1 April	(83.3)	(51.4)
Income statement	(10.8)	(10.2)
Statement of comprehensive income	0.3	(32.8)
Regular contributions	9.0	1.2
Other employer contributions	16.6	9.9
At 31 March	(68.2)	(83.3)

Movements in the fair value of schemes' assets were:

	2011 £m	2010 £m
At 1 April	264.3	209.9
Expected return on schemes' assets	19.3	15.0
Actuarial gains	12.2	41.5
Members' contributions	0.3	0.2
Benefits paid	(14.7)	(13.3)
Company regular contributions	9.0	1.1
Other employer contributions	16.6	9.9
At 31 March	307.0	264.3

Movements in the present value of defined benefit obligations were:

	2011 £m	2010 £m
At 1 April	(347.6)	(261.3)
Service costs	(11.0)	(7.7)
Interest cost	(19.1)	(17.5)
Members' contributions	(0.3)	(0.2)
Benefits paid	14.7	13.3
Actuarial losses	(11.9)	(74.2)
At 31 March	(375.2)	(347.6)

The five-year history of experience adjustments is:

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Fair value of schemes' assets	307.0	264.3	209.9	255.4	285.5
Present value of defined benefit obligations	(375.2)	(347.6)	(261.3)	(277.1)	(320.0)
Net liability recognised	(68.2)	(83.3)	(51.4)	(21.7)	(34.5)
Experience gains/(losses) on schemes' assets					
Amount (£m)	12.4	41.7	(80.7)	(53.6)	3.2
Percentage of schemes' assets	4.0%	15.8%	(38.4)%	(21.0)%	1.1%
Experience gains/(losses) on defined benefit obligations					
Amount (£m)	(9.7)	2.8	18.3	(5.8)	(4.4)
Percentage of defined benefit obligations	(2.6%)	0.8%	7.0%	(2.1)%	(1.4)%

The Company's current service cost during the year was 26.9% of pensionable earnings (2010: 16.4%). The Company's existing defined benefit schemes were closed to new entrants from 1 April 2008.

In 2011 the Pennon Group completed the triennial actuarial valuation of its defined benefit schemes as at 1 April 2011 which resulted in higher future service and deficit recovery contributions. The Company has made deficit recovery contributions of £16.6m during the year (2010: £9.9m).

The Pennon Group monitors funding levels on an annual basis.

25. Deferred tax liabilities

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 26% (2010: 28%).

The movements on the deferred tax account were:

	2011 £m	2010 £m
At 1 April	302.6	316.9
Impact of change of corporation tax rate charged to income statement	(24.0)	-
Impact of change of corporation tax rate credited to equity	2.1	-
Other deferred tax charged/(credited) to the income statement	4.0	(0.1)
Credited to equity	(0.4)	(14.2)
At 31 March	284.3	302.6

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.

The deferred tax balance has been reduced by a net credit of £21.9m to recognise the changes in the rate of corporation tax enacted on 27 July 2010 and 29 March 2011 to reduce the rate from 1 April 2011 from 28% to 26%. If the published government proposals to reduce the rate of corporation tax by a further 1% for each financial year until 2014/15 were enacted at the balance sheet date the impact would be a further reduction of approximately £33m in total.

All deferred tax assets and liabilities are within the same jurisdiction and may be offset as permitted by IAS12. The movement in deferred tax assets and liabilities is shown below.

Deferred tax liabilities	Accelerated tax depreciation		Total £m
	Owned assets £m	Leased assets £m	
At 1 April 2009	315.8	16.3	332.1
Charged to the income statement	0.5	0.7	1.2
At 31 March 2010	316.3	17.0	333.3
Impact of change of rate	(22.9)	(1.3)	(24.2)
Charged to the income statement	4.6	0.7	5.3
At 31 March 2011	298.0	16.4	314.4

Deferred tax assets	Provisions £m	Retirement benefit obligations £m	Other £m	Total £m
At 1 April 2009	(0.4)	(14.3)	(0.5)	(15.2)
(Credited)/charged to the income statement	(2.0)	0.2	0.5	(1.3)
Credited to equity	-	(9.2)	(5.0)	(14.2)
At 31 March 2010	(2.4)	(23.3)	(5.0)	(30.7)
(Credited)/charged to the income statement	(1.8)	4.1	(3.6)	(1.3)
Credited to equity	-	0.1	(0.5)	(0.4)
Impact of change in rate	0.3	1.3	0.7	2.3
At 31 March 2011	(3.9)	(17.8)	(8.4)	(30.1)

Net deferred tax liability:

	£m
At 31 March 2010	302.6
At 31 March 2011	284.3

The deferred tax charged/(credited) to equity during the year was:

	2011 £m	2010 £m
Actuarial gains on defined benefit schemes	0.1	(9.2)
Share-based payments (note 28)	(0.5)	(0.1)
Hedging reserve (change in rate)	0.3	(4.9)
Other impacts of change in rate	1.8	-
	1.7	(14.2)

26. Provisions for liabilities and charges

Restructuring	2011 £m	2010 £m
At 1 April	3.1	0.3
Charged to the income statement	4.0	5.0
Utilised during year	(4.4)	(2.2)
At 31 March	2.7	3.1

The provisions are all current.

27. Called-up share capital

	2011 £m	2010 £m
Authorised		
500,000,000 Ordinary shares of £1 each	500.0	500.0
Allotted, called-up and fully paid		
150,950,000 (2010: 150,950,000) Ordinary shares of £1 each	150.9	150.9

28. Employee share schemes

The Company operates a number of equity settled share plans for the benefit of employees. Details of each plan are set out below.

i) Sharesave Scheme

An all-employee savings related plan is operated that enables employees to invest up to a maximum of £250 per month for three or five years. These savings can then be used to buy 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 Pennon Group before the option exercise period commences.

Outstanding options to subscribe for Pennon Group Plc shares of 40.7p each under the Sharesave scheme 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		
		2011	2010	
8 July 2003	177p	2006 - 2010	-	39
6 July 2004	200p	2007 - 2011	52	52
5 July 2005	270p	2008 - 2012	19	176
4 July 2006	358p	2009 - 2013	91	94
3 July 2007	522p	2010 - 2014	51	178
8 July 2008	517p	2011 - 2015	131	148
6 July 2009	386p	2012 - 2016	731	800
6 July 2010	431p	2013 - 2017	296	-
			1,371	1,487

The number and weighted average exercise price of Sharesave options are:

	2011		2010	
	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	1,487	388	1,365	379
Granted	299	431	854	386
Exercised	(315)	351	(460)	289
Expired	(100)	425	(272)	492
At 31 March	1,371	403	1,487	388

The weighted average price at the date of exercise of Sharesave options during the year was 478p (2010: 468p). The options outstanding at 31 March 2011 had a weighted average exercise price of 403p (2010: 388p) and a weighted average remaining contractual life of 2.7 years (2010: 2.3 years).

The aggregate fair value of options granted during the year was £0.5m (2010: £0.9m), determined using the Black-Scholes valuation model. The significant inputs into the valuation model were:

	2011	2010
Weighted average share price	539p	482p
Weighted average exercise price	431p	386p
Expected volatility	29.0%	29.0%
Expected life	4.1 years	3.8 years
Risk-free rate	1.4%	2.5%
Expected dividend yield	4.5%	4.7%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous two years.

ii) Performance and Co-investment Plan

Executive Directors and senior management receive a conditional award of ordinary shares in Pennon Group Plc and are also required to hold a substantial personal holding in Pennon Group Plc shares. The eventual number of shares, if any, which vest is dependent upon the achievement of conditions of the plan over the restricted period, being not less than three years.

The number and exercise price of shares in the Performance and Co-investment Plan are:

	2011		2010	
	Number of Ordinary shares (thousands)	Exercise price per share p	Number of Ordinary shares (thousands)	Exercise price per share p
At 1 April	393	553	233	598
Granted	130	546	160	487
Vested	(85)	557	-	-
Lapsed	(26)	557	-	-
At 31 March	412	549	393	553

The awards outstanding at 31 March 2011 had a weighted average exercise price of 549p (2010: 553p) and a remaining contractual life of 1.3 years (2010: 1.3 years). The aggregate fair value of awards granted during the year was £0.5m (2010: £0.5m), determined using a Monte-Carlo simulation model. The significant inputs into the valuation model at the date of the share awards were:

	2011	2010
Weighted average share price	546p	486p
Expected volatility	29.0%	29.0%
Risk-free rate	1.4%	2.5%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous two years.

iii) Annual Incentive Bonus Plan – deferred shares

Awards under the plan to Directors and senior management involve the release of ordinary shares in Pennon Group Plc to participants. There is no performance condition since vesting is usually conditional upon continuous service with the Pennon Group for a period of three years from the award.

The number and weighted average price of shares in the Incentive Bonus Plan are:

	2011		2010	
	Number of Ordinary shares (thousands)	Weighted average price per share p	Number of Ordinary shares (thousands)	Weighted average price per share p
At 1 April	146	551	118	578
Granted	61	573	69	476
Vested	(33)	579	(41)	502
At 31 March	174	550	146	551

The awards outstanding at 31 March 2011 had a weighted average price of 550p (2010: 551p) and a weighted average remaining contractual life of 1.5 years (2010: 1.6 years). The Company's share price at the date of the awards ranged from 473p to 620p.

The aggregate fair value of awards granted during the year was £0.3m (2010: £0.3m), determined from market value. No option pricing methodology is applied since dividends declared on the shares are receivable by the participants in the scheme.

29. Retained earnings and other reserves

	Hedging reserve	Retained earnings Restated] [Note 5]	Total Restated [Note 5]
	£m	£m	£m
At 1 April 2009	(16.4)	266.1	249.7
Profit for the year	-	98.8	98.8
Other comprehensive expense for the year	(1.2)	(18.7)	(19.9)
Dividends paid	-	(54.4)	(54.4)
Share-based payments (net of tax)	-	1.4	1.4
Share options vesting (net of tax)	-	(0.7)	(0.7)
At 31 March 2010	(17.6)	292.5	274.9
Profit for the year	-	125.1	125.1
Other comprehensive income/(expense) for the year	4.8	(6.5)	(1.7)
Dividends paid	-	(58.4)	(58.4)
Share-based payments (net of tax)	-	1.7	1.7
Share options vesting (net of tax)	-	(0.2)	(0.2)
At 31 March 2011	(12.8)	354.2	341.4

30. Cash flow from operating activities

Reconciliation of profit for the year to cash generated from operations:

Cash generated from operations	2011	2010 Restated [Note 5]
	£m	£m
Continuing operations		
Profit for the year	125.1	98.8
Adjustments for:		
Employee share schemes	1.2	0.6
Deferred income released to profits	(0.2)	(0.2)
Profit on disposal of property, plant and equipment	(1.6)	(1.0)
Depreciation charge	97.0	93.6
Interest payable and similar charges	83.5	82.3
Interest receivable	(22.6)	(18.2)
Taxation	3.7	30.7
Changes in working capital:		
Decrease in inventories	0.2	0.6
Increase in trade and other receivables	(18.4)	(6.2)
Increase in trade and other payables	13.1	0.8
Decrease in retirement benefit obligations	(14.6)	(3.4)
(Decrease)/increase in provisions for liabilities and charges	(0.4)	2.8
Cash generated from operations	266.0	281.2

31. Net borrowings

	2011 £m	2010 £m
Cash and cash equivalents	301.6	264.9
Borrowings – current		
Bank overdrafts	(22.6)	(17.3)
Other current borrowings	(21.5)	(114.1)
Finance lease obligations	(16.2)	(23.9)
Total current borrowings	(60.3)	(155.3)
Borrowings – non-current		
Other non-current borrowings	(627.9)	(492.3)
Finance lease obligations	(1,156.2)	(1,164.5)
Total non-current borrowings	(1,784.1)	(1,656.8)
Total net borrowings	(1,542.8)	(1,547.2)

32. Operating lease commitments – minimum lease payments

	2011 £m	2010 £m
Aggregate commitments under non-cancellable operating leases expiring:		
Within one year	1.4	1.4
Later than one year and less than five years	5.1	5.2
After five years	21.7	19.2
	28.2	25.8

The Company 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 27 years and rentals are reviewed on average at five yearly intervals.

The Company also leases plant and machinery under non-cancellable operating lease agreements.

33. Contingent liabilities

	2011 £m	2010 £m
Contractors' claims on capital schemes	0.2	3.1
Guarantee of borrowings of subsidiary undertaking	352.3	300.0
	352.5	303.1

34. Capital commitments

	2011 £m	2010 £m
Contracted but not provided	67.2	95.6

35. Related party transactions

During the year, the Company entered into the following transactions with related parties:

Parent company	2011 £m	2010 £m
Purchase of goods and services		
Group expenses	3.7	3.7
Sale of goods and services		
Administrative services	0.5	0.5
Dividends paid	58.4	54.4
Subsidiaries of the Company	2011 £m	2010 £m
Purchase of goods and services		
Property consultancy	0.3	0.3
Payment for provision of finance		
Loan interest	22.1	10.8
Finance lease charges: vehicles	-	0.1
Finance lease charges: plant & machinery	-	0.3
Sale of goods and services (administrative services)	0.3	0.3
Loan interest received	0.1	0.1
Fellow subsidiaries of the Pennon Group	2011 £m	2010 £m
Purchase of goods and services		
Waste disposal	0.6	0.7
Insurance premia	0.4	0.5
Sale of goods and services		
Tankered waste and trade effluent charges	0.8	0.9
Year end balances	2011 £m	2010 £m
Borrowings (note 22)		
Loan from subsidiary	360.8	318.7
Finance lease balances with subsidiary	0.7	7.7
Receivables (notes 15 and 18)		
Parent company	0.6	1.0
Subsidiaries	2.5	1.3
Fellow subsidiaries	1.3	1.5
Payables (note 21)		
Subsidiaries	17.7	2.9
Fellow subsidiaries	0.1	0.1

36. Parent company

The parent company, and ultimate controlling party, is Pennon Group Plc which is registered in England. Group financial statements are included in the Annual Report of Pennon Group Plc which is available from Peninsula House, Rydon Lane, Exeter, EX2 7HR.

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2	-	Heavy snow in December 2010
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6	-	Centralised monitoring and control
7	Jamie Bateman, AB Design	Wimbleball Reservoir, Dulverton
8	Claire Kendall	South West Water office, Exeter
8	Claire Kendall	South West Water office, Exeter
9	-	Customer service in action
12	Chris Saville	Dartmoor
13	-	Customer services
14	Claire Kendall	Exmoor mires restoration
15	Claire Kendall	South West Water office, Exeter
16	-	The South West's high quality rivers
17	Claire Kendall	Power Down energy efficiency campaign
17	-	Morewellham hydro-electric powerstation
18	-	Helping customers
19	Cathy McGarvey	Heritage open days
19	Claire Kendall	Working with customers to improve water efficiency
20	Claire Kendall	Our employees are the foundation of our success
21	Claire Kendall	Exmoor mires restoration
21	Mike Davies	Employee volunteers involved in a conservation project
21	Paul McNie	Involving communities to help reduce litter on beaches
22	Claire Kendall	South West Water office, Exeter

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