

SEVERN

TRENT

5 June 2008

Preliminary Results for the year to 31 March 2008

## FOCUS ON WATER

## Highlights

- Continued progress towards higher standards and greater efficiency
- Delivering tangible results:
  - Outperformed against Ofwat 2007/08 leakage target
  - Outperformed against Ofwat 2007/08 determination for operating costs
  - Group PBIT<sup>1</sup> up 15.8% at £469.5 million
- Delivering 3% real dividend growth
- Legacy issues nearing final resolution

## Financial highlights

	<b>31 March 2008</b>	31 March 2007	Increase/ (Decrease)
	<b>£m</b>	£m	%
Group turnover	<b>1,552.4</b>	1,480.2	4.9%
Group PBIT <sup>1</sup>	<b>469.5</b>	405.3	15.8%
Profit before tax <sup>2</sup>	<b>292.2</b>	252.0	16.0%
Profit before tax	<b>192.4</b>	325.5	(40.9)%
		pence/ share	
Adjusted basic EPS <sup>3</sup>	<b>97.8</b>	82.4	18.7%
Basic EPS	<b>89.7</b>	114.7	(21.8)%
Total ordinary dividends declared	<b>65.63</b>	61.45	6.8%

<sup>1</sup> before exceptional items (see note 3)

<sup>2</sup> before exceptional items and gains/losses on financial instruments

<sup>3</sup> from continuing operations, before exceptional items, gains/losses on financial instruments and deferred tax (see note 9)

**Sir John Egan, Chairman Severn Trent Plc, said:**

"I am pleased to report on a good set of results which clearly demonstrate progress towards delivering improvements through Severn Trent's business strategy of focusing on water. We are also nearing the end of resolving legacy issues from the previous regime. The increased momentum of our financial and operational performance underpins our ability to deliver dividends in line with our stated policy - an annual increase of 3% above the rate of inflation at least up to the end of the current regulatory period in 2010."

**Tony Wray, Chief Executive Severn Trent Plc, said:**

"These results demonstrate continuing improvements across the business. In particular, customer service standards are rising and we have outperformed against a tougher leakage reduction target. We have outperformed against Ofwat's determination for operating costs over the year and expect to outperform by 3% over the remaining 2 years of AMP4. We are investing heavily across our network and remain on track to meet our regulatory obligations with an overall capex efficiency of around 6% over the Ofwat determination.

Twelve months ago we took the unique step of publishing 20 Key Performance Indicators for Severn Trent Water to raise standards through continuous improvement. These measures demonstrate there is clear transparency in our performance. We have already made good progress, but still have further to go as we strive for upper quartile performance. We remain committed to raising standards still higher and to further invest in improving our operational efficiency because we believe that these will deliver improved customer service and enhanced shareholder value. We are now better placed to satisfy the expectations of our customers, regulators and shareholders."

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**Preliminary Results Presentation and Webcast**

There will be a preliminary results presentation at 9.30am on Thursday 5 June 2008. This presentation, together with the presentation slides, will be available as a simultaneous webcast on the Severn Trent web site ([www.severntrent.com](http://www.severntrent.com)) and will remain on the web site for subsequent viewing.

## **Operating Review**

### **Focus on Water**

Our commitment to fundamental and continuous improvement is now delivering tangible benefits to customers, shareholders and regulators. In line with our strategy to focus on water, we completed the reorganisation of our business in 2007/08 and we now have the right team to deliver. We have completed the integration of the head office and Severn Trent Water teams and now have one executive team focused on our core water activities. As a result of this integration, we have reduced our overhead costs by £14 million in 2007/08.

Severn Trent Water's outlook for the remainder of AMP4 (Asset Management Plan) is one of continued improvement, driven by the execution of our plans to invest in improving standards across the business. We aim to deliver around £30 million of cost efficiencies over the last two years of the AMP4 period. This is equivalent to around 3% annual outperformance against the Ofwat determination for operating costs in the last two years of AMP4 and will be achieved without affecting our ability to deliver the 6% efficiency on the capital programme.

We also aim to continue to develop our complementary business, Water Technologies and Services (branded as Severn Trent Services), enhancing its leadership position as a supplier of water and waste water solutions to key markets around the world. In 2007/08, we focused on continued investment in technology and organic growth, concentrating on building our international presence. We intend to continue this approach in the coming years.

### **Water and Sewerage**

In 2007/08, we turned a significant corner. The business is focused on continued investment to raise standards and improve efficiency and we have turned our operational performance around in some areas, while continuing to build on those areas which were already in good shape, recognising there are still further improvements to be made.

Last year, we highlighted the need to improve our performance in respect of leakage and customer service.

On leakage, we have introduced improvements in measurement and detection, speed of response, resource allocation and targeting the replacement of our network. We believe we have not just met, but outperformed against our Ofwat annual target.

With regard to customer service, we have achieved a 34% reduction in the number of written complaints in the last 12 months. This is against a background of being the poorest performer in the industry in 2006/07, and receiving criticism from Ofwat and the Consumer Council for Water. In 2007/08 we re-engineered the processes, improved our telephony infrastructure, further enhanced training for our staff and are now delivering levels of service that are significantly improved. Our customer service for 2007/08 is now back in line with other companies, but we continue to focus on further improving levels of service as we look forward.

In addition, we have outperformed against our target of meeting the Ofwat Determination for operating costs in 2007/08. For the first two years of AMP4 (2005/06 and 2006/07), we failed to

get down to the spending level assumed by Ofwat as we struggled with higher energy prices and inefficient processes. For 2007/08 we have delivered an operating cost outturn around 1% better than the level assumed by Ofwat in their Determination.

Last year, we reported that we had examined key aspects of Severn Trent Water's performance and carried out a benchmarking exercise against comparable companies in the water and sewerage sector, and where applicable against companies with similar characteristics in other sectors. This exercise was detailed and thorough. We used a range of publicly available and internally generated data to identify the population that we should compare ourselves to. This process involved a number of judgements being exercised to ensure that we used appropriately comparable data points for each measure.

The result of this process was represented by our publication of the 20 Key Performance Indicators (KPIs). Throughout 2007/08, we have been measuring ourselves against these KPIs and the benchmarks we established in 2006/07. In 2007/08 we improved year on year in 5 of our KPIs, maintained high standards in 7, remained static in 4 and deteriorated year on year in 3. At the end of 2007/08, we have 10 KPIs at upper quartile, 7 at median and 3 at lower quartile. As we expected, progress is being made but there is still more to do.

The table below sets out our actual performance for the period under review. Based on the benchmarking exercise carried out last year, our performance is shown in one of three categories of what we consider to be either lower quartile, upper quartile or median (representing 2<sup>nd</sup> and 3<sup>rd</sup> quartile) performance.

Description		Basis	Note	Lower Quartile	Median	Upper Quartile
Lost time incidents per 100,000 hrs worked	2008 2007	MAT	2		0.61	0.59
Employee motivation	2008 2007	QR	3			77% 76%
Water quality (mean zonal compliance) %	2008 2007	MAA	1,4			99.96% 99.98%
Customer written complaints per 1,000 properties	2008 2007	MAT	1,5	10.90 16.58		
First time call resolution for billing %	2008 2007	MAT	6			85% 80%
Unplanned interruptions > 6 hrs per 1,000 properties	2008 2007	MAT	1,7	21.86 10.70		
Properties at risk of low pressure per 1,000 properties	2008 2007	NPR	8,9			0.06 0.09
First time job resolution	2008 2007		6		85% 84%	
Performance against Regulatory Obligations %	2008 2007	QR	6		15% 26%	
Capex (Gross) vs Final Determination %	2008 2007	ATD	10			1.7% 2.7%

Description		Basis	Note	Lower Quartile	Median	Upper Quartile
Capital process quality (no. of defects per £100k)	2008		6			0.03
	2007					N/A
Debtor days	2008		8,10		37.4	
	2007				37.5	
Opex vs Final Determination (UK GAAP) - £m	2008	MAT	10		480.9	
	2007			479.1		
Cost to serve per property - £	2008	MAT	11		236.82	
	2007				226.93	
Pollution incidents (cat 1, 2 & 3) per 1,000 properties	2008	MAT	4,12			0.11
	2007				0.14	
Sewer flooding incidents - other causes per 1,000 properties	2008	MAT	1,13	0.21		
	2007				0.17	
Sewage Treatment Works - breach of consents %	2008	PPS	1,8			0.00%
	2007					0.00%
Raw water storage %	2008	MAA	6			92%
	2007					90%
Net Energy Use – Kwh/MI	2008	MAT	6		608	
	2007				618	
Leakage MI/d	2008	MLE	1,14			491
	2007			524		

Notes:

All measures are for the period to 31 March 2008, except as stated.

MAT = Moving Annual Total

QR = Quarterly Review

MAA = Moving Annual Average

NPR = Number of properties on register

ATD = AMP4 to date

PPS = Percentage of population served

MLE = Maximum Likelihood Estimate

- As reported in June Return to Ofwat. Performance figures are provisional at this stage as the June Return will be submitted to Ofwat on 13 June 2008.
- Actual performance across all employees and agency staff. 2007 performance restated to include road traffic accidents.
- Performance based on quarterly survey of 10% of permanent employees.
- Measure for calendar year to 31 December 2007.
- Performance excludes properties billed by other water companies.
- Actual performance based on internal data.
- 2007 performance restated to include the impact of unplanned interruptions over 6, 12 and 24 hours. 2008 performance excludes impact of Summer 2007 flooding. 2008 performance is 184.5 if impact of Summer 2007 flooding included.
- Measure as at 31 March 2008.
- 2008 performance excludes impact of new pressure loggers installed in 2007/08. Including pressure loggers, 2008 performance is 0.455.
- Actual performance based on audited UK GAAP financial statements for the year ended 31 March 2008.
- Actual performance based on audited regulatory accounts for the year ended 31 March 2008.
- Restated to reflect all Environment Agency types of category 1, 2 & 3 pollution incidents.
- 2007 restated to reflect numbers of incidents as opposed to number of affected properties.
- 2007 restated to MLE leakage as opposed to DMA (District Metered Area) leakage.

For each indicator, we have set ourselves ambitious objectives for the coming years, and have action plans for achieving them. Our plans are long term, going beyond the current AMP4 period.

It would be unrealistic for any company to be at the top of every single league table, but nevertheless, we are aiming to achieve upper quartile performance over the next 3 to 5 years. Of course, the goal posts will move, as companies in our sector or elsewhere redefine what upper quartile means, so we expect our objectives to move with it. We intend to update our benchmarks during 2008/09 (and annually thereafter) to allow us to report against these benchmarks in future results announcements.

Last year, we identified £24 million of restructuring costs to be incurred in the remaining 3 years of AMP4 in order to raise standards and improve efficiency. We also highlighted that we expected staffing levels to reduce (permanent and agency) in Severn Trent Water by around 600 posts over a five year period.

In 2007/08 we expected to incur £8m of restructuring costs, to eliminate 130 posts and to meet the Ofwat determination for operating costs. During 2007/08 we have actually invested £13.9 million (classified as exceptional operating costs). This investment has delivered sustainable improvements in 2007/08, with operating costs around 1% lower than that assumed in the Final Determination and 150 posts being eliminated from the organisation. Notwithstanding the progress made to date, we continue to develop our plans to optimise the performance of the company and sustain the improvements in the longer term. These plans are now focused on three broad areas:

- Process improvements,
- The technology and systems that support these processes, and
- The location, training and development of our people to operate in this new environment.

These improvement plans are integrated into our business plan, are the basis of our future improvements in effective and efficient operation and will form a major part of the Company's Draft Business Plan to be submitted to Ofwat in August 2008. Over the next two years, we now expect to incur exceptional restructuring costs of around £24 million. These costs represent the continuing implementation of our improvement plans that extend beyond the end of the current AMP period as we continue to deliver against our objective of raising standards and improving efficiency. As we describe in our outlook statement, we remain on track to deliver around 3% annual out performance against the Ofwat determination for operating costs in 2008/09 and 2009/10.

## **Water Technologies and Services**

Water Technologies and Services is one of the world's leading suppliers of water and waste water treatment solutions. We operate at the forefront of new water technology, are known around the world for our quality, reliability and stability and enjoy a strong position in our chosen markets.

The business has three main divisions: Water Purification, Operating Services and Analytical Services. Water Purification is a leader in developing advanced technologies and products focused on disinfection, filtration, arsenic removal, ballast water treatment and metering. Operating Services is a leader in running and maintaining water and waste water treatment plants around the world and Analytical Services is a leader in UK environmental water testing services.

Throughout 2007/08 we remained focused on water and made good progress in all three divisions. Overall, we achieved top line and bottom line growth and maintained a good return on invested capital. We have focused on organic growth and have concentrated on building our international presence. Our strategy has been to expand our existing technologies into new geographical markets and take new technologies into existing markets. To support this strategy, we have been developing our international sales and distribution network beyond our primary markets of the US, UK and Italy to establish a growing footprint in the Middle East and Asia Pacific. In 2007 for example, we opened a new branch in Abu Dhabi. We continue to improve cost control and efficiency and to look for ways to maximise synergies throughout the business.

The global market for water and waste water is substantial and is growing at around 5% to 6% per annum. Within this diversified market, we focus on the higher growth and higher margin market segments and geographies where our particular products and services meet a particular need.

## **Group Financial Performance**

In this Preliminary Results announcement: PBIT is profit from continuing operations before interest and tax; PBIT<sup>1</sup> also excludes exceptional items as set out in note 3.

Group turnover from continuing operations was £1,552.4 million (£1,480.2 million), an increase of 4.9% over last year. The growth in turnover was mainly due to the price increases in Severn Trent Water.

Group PBIT<sup>1</sup> increased by 15.8% to £469.5 million (£405.3 million). Beyond the net increase in turnover, the main factors affecting PBIT<sup>1</sup> were an increase in infrastructure renewals expenditure in Water and Sewerage offset by reduced corporate overheads. There were net exceptional costs of £68.8 million (exceptional gain of £24.7 million). Group statutory PBIT was £400.7 million (£430.0 million).

## **Water and Sewerage**

Turnover in Water and Sewerage increased by 5.0% in 2007/08, to £1,279.2 million. Sales prices increased by 5.87% (including inflation) from 1 April 2007.

PBIT<sup>1</sup> was up by 11.9% on the previous year, to £462.3 million. Beyond the increase in turnover, a number of factors impacted PBIT<sup>1</sup>, principally; a reduction in energy costs of £19.4 million, other

increases in our cost base, net of efficiencies, of £21.2 million, an increase in infrastructure renewals expenditure of £13.1 million, and a decrease in depreciation charges of £3.1 million.

During the financial year, Severn Trent Water invested £567 million (gross, UK GAAP) in fixed assets and maintaining and improving its infrastructure network. Included in this total was net infrastructure renewals expenditure of £111 million.

Adjusting for minor timing differences and modifications to the AMP4 capital programme (notified to Ofwat through the change control process) we continue to be in line to achieve this programme with around 6% capex efficiencies compared to Ofwat's Final Determination for AMP4.

### Water Technologies and Services

Reported turnover in Water Technologies and Services was £297.3 million in 2007/08, up 2.9% on 2006/07. Reported Water Technologies and Services' PBIT<sup>1</sup> increased by 5.1% to £20.7 million. As set out in the table below, adjusting for the effect of the acquisitions and sales of small businesses and removing the impact of changing exchange rates, like for like turnover rose by 7.5% to £297.2 million and like for like PBIT<sup>1</sup> rose 14.3% to £21.6 million. Turnover grew in both Water Purification and Operating Services, with Analytical Services turnover broadly flat year on year.

	Turnover			PBIT <sup>1</sup>		
	31 March 2008 £m	31 March 2007 £m	Increase %	31 March 2008 £m	31 March 2007 £m	Increase %
"Like for like" constant currency	297.2	276.5	7.5%	21.6	18.9	14.3%
Acquisitions and sale of businesses	0.1	4.8		(0.9)	0.5	
	297.3	281.3		20.7	19.4	
Exchange rate impact	-	7.6		-	0.3	
As reported	297.3	288.9	2.9%	20.7	19.7	5.1%

### Corporate and Other

Corporate and Other Businesses' turnover was down 49.5% to £5.2 million (£10.3 million) and is now mostly internal charges from our captive insurance company. This turnover is eliminated on consolidation as the captive exists to insure Severn Trent group risks only and does not write any external business. Corporate and Other incurred a loss before interest, tax and exceptional items of £11.2 million (loss of £26.3 million), of which £10.9 million (£25.3 million) related to corporate overheads.

### **Exceptional items**

There was a net exceptional charge, on continuing operations, in the year to 31 March 2008 of £68.8 million (exceptional gain £24.7 million) comprising:

- Charge of £13.9 million in Severn Trent Water and £1.0 million in Corporate arising from the ongoing and developing programme to improve standards through process improvement; enhancements to supporting technology and systems; and the location, training and development of our people;
- Costs of £13.6 million, net of £16 million interim insurance recoveries, arising from the impact of the flooding in the summer of 2007;
- A charge of £35.8 million in respect of proposed fines issued by Ofwat; £34.7 million (2.9% of 2006/07 turnover) for deliberately misreporting some key customer service information; and £1.1 million (0.1% of 2005/06 turnover) for providing sub-standard services to customers in 2005-06 by failing to meet Guaranteed Standards of Service; and
- A charge of £4.5 million relating to third party legal costs incurred in the conclusion of a Water Technologies and Services arbitration to settle an interpretation on a long term operating service contract.

### **Profit from continuing operations**

After net interest charges of £177.4 million (£153.8 million) and share of results of associates and joint ventures of £0.1 million (£0.5 million), group profit from continuing operations before tax, exceptional items and gains/losses on financial instruments, increased by 16.0% to £292.2 million (£252.0 million). Group profit from continuing operations before tax was £192.4 million (£325.5 million).

### **Taxation**

The total tax credit for the full year was £18.2 million (charge of £76.9 million). A current tax charge of £56.2 million (£58.5 million) was offset by a deferred tax credit of £74.4 million (charge of £18.4 million), including an exceptional credit of £54.7 million arising from the change in the rate of corporation tax to 28% with effect from 1 April 2008.

The effective rate of current tax on continuing businesses, excluding prior year settlements and exceptional items, calculated on profit before tax, exceptional items and gains/losses on financial instruments was 25.6% (26.9%). The decrease in effective rate is as a result of higher year on year capital expenditure leading to a greater level of capital allowances.

Going forward, we expect the effective current tax rate for 2008/09 to be in the range of 25% to 27%. Regarding deferred tax, we anticipate that the abolition of industrial buildings allowances (IBAs) will result in an increased deferred tax charge of around £170m in 2008/09, with a cash tax cost of over £12m in the 3 years to abolition.

Profit for the period (after tax) from continuing operations was £210.6 million (£248.6 million).

## Earnings per share

Basic earnings per share from continuing and discontinued operations were 89.7 pence (114.7 pence). Adjusted basic earnings per share from continuing operations (before exceptional items, gains/losses on financial instruments and deferred tax) were 97.8 pence (82.4 pence) (see note 9).

## Cash flow

	<b>31 March 2008 £m</b>	31 March 2007 £m
Cash generated from operations	<b>645.9</b>	574.0
Net capital expenditure	<b>(439.6)</b>	(351.5)
Net interest paid	<b>(150.1)</b>	(156.4)
Tax paid	<b>(76.2)</b>	(36.0)
Other cash flows	<b>(1.2)</b>	1.2
Free cash flow	<b>(21.2)</b>	31.3
Dividends	<b>(147.3)</b>	(739.5)
Acquisitions and disposals	-	138.0
Issue of shares	<b>8.2</b>	10.0
Change in net debt from cash flows	<b>(160.3)</b>	(560.2)
Non cash movements	<b>(144.9)</b>	16.1
Debt demerged with Biffa Plc	-	377.6
Change in net debt	<b>(305.2)</b>	(166.5)
Net debt at 1 April	<b>(3,127.6)</b>	(2,961.1)
Net debt at 31 March	<b>(3,432.8)</b>	(3,127.6)
Net debt comprises:		
Cash and cash equivalents	<b>654.4</b>	143.2
Borrowings – current liabilities	<b>(459.5)</b>	(631.8)
Borrowings – non-current liabilities	<b>(3,627.7)</b>	(2,639.0)
	<b>(3,432.8)</b>	(3,127.6)

Cash generated from operations was £645.9 million (£574.0 million). The increase in cash generated from operations was principally as a result of lower cash pension contributions and an increase in working capital in the previous year. Capital expenditure net of grants and proceeds of sales of fixed assets was £439.6 million (£351.5 million). Net interest paid decreased to £150.1 million (£156.4 million).

Dividends paid in the year were as follows:

	<b>31 March 2008 £m</b>	31 March 2007 £m
Final ordinary dividend for the year ended 31 March 2007/2006	<b>90.4</b>	<b>111.4</b>
Interim ordinary dividend for the year ended 31 March 2008/2007	<b>56.9</b>	<b>52.9</b>
Special dividend for the year ended 31 March 2007	<b>-</b>	<b>575.2</b>
	<b>147.3</b>	<b>739.5</b>

Net debt at 31 March 2008 was £3,432.8 million (£3,127.6 million). Balance sheet gearing (net debt/net debt plus equity) at the year end is 74.0% (73.3%). Net debt, expressed as a percentage of 31 March 2008 Regulatory Capital Value (RCV) was 58.0% (56.4%), based on RCV at 31 March 2008 of £5,922 million (£5,546 million). The group's net interest charge, excluding gains/losses on financial instruments, was covered 3.7 times (3.9 times) by profit before interest, tax, depreciation and exceptional items, and 2.5 times (2.4 times) by PBIT<sup>1</sup>.

### Pensions

The group has four defined benefit pension schemes, of which the Severn Trent Pension Scheme (STPS) is by far the largest. Formal actuarial valuations were last undertaken for the STPS and another scheme, the Severn Trent Senior Staff Pension Scheme (SSPS), as at 31 March 2004. The valuation as at 31 March 2007 is nearing completion.

On an IAS 19 basis, the estimated net position (before deferred tax) of the group's defined benefit pension schemes was a deficit of £126.0 million as at 31 March 2008. This compares to a deficit of £135.1 million as at 31 March 2007. See note 10 for details of the year on year movement in this net position.

Total employer cash contributions to the schemes in the year were £55.6 million (£97.4 million).

The key actuarial assumptions were:

	<b>2008</b>	2007
Price inflation	<b>3.4%</b>	3.0%
Salary increases	<b>4.9%</b>	4.5%
Discount rate	<b>6.4%</b>	5.4%
Pension increases in payment and deferment	<b>3.4%</b>	3.0%
Expected return on equities	<b>8.00%</b>	8.25%
Longevity at age 65*		
Men	<b>20.1 years</b>	19.2 years
Women	<b>23.2 years</b>	22.1 years
Longevity at age 65**		
Men	<b>20.9 years</b>	19.9 years

Women

23.9 years 23.0 years

\* for pensioners retiring now

\*\* for pensioners retiring in 20 years

The following table summarises the estimated impact on scheme liabilities resulting from changes to key actuarial assumptions whilst holding all other assumptions constant.

<b>Assumption</b>	<b>Change in assumption</b>	<b>Impact on scheme liabilities</b>
Discount rate	Increase/decrease by 0.1%	Decrease/increase by £25 million
Price inflation	Increase/decrease by 0.1%	Increase/decrease by £25 million
Mortality	Increase life expectancy by 1 year	Increase by £36.5 million

On an IAS 19 basis, the funding level has remained unchanged at around 91% as at 31 March 2008.

As at 31 March 2008 the group's defined benefit pension schemes had total assets of approximately £1,332 million and total liabilities of approximately £1,458 million.

### **Treasury management and liquidity**

The group's policy for the management of interest rate risk requires that no less than 50% of the group's borrowings should be at fixed interest rates, or hedged through the use of interest rate swaps or forward rate agreements. At 31 March 2008, interest rates for some 70% of the group's net debt of £3,432.8 million were so fixed, with the remaining 30% index-linked to RPI. The weighted average interest rate for 2007/08 was 5.8%.

The group's principal operating activity, Severn Trent Water, is a long term business characterised by multi year investment programmes. The strategic funding objectives of the group must reflect this and the liquidity position and the availability of committed funding are essential to meeting its objectives and obligations. The group therefore seeks to attain a balance of long term funding or commitment of funds across a range of funding sources at the best possible economic cost.

In the context of a more general "liquidity crunch", the group is in a strong liquidity position today. It has in excess of £600 million in cash and liquid reserves and £580 million of undrawn five year committed bank facilities. During the year, and up to July 2007 when this market effectively closed down, the group issued a further £400 million of 50 to 60 year maturities bonds to the index linked bond markets. Index linked bonds total £1,021 million at the balance sheet date. The group also extended the range of markets from where it obtains funds through a March 2008 debut Euro 700 million 8 year Eurobond issue (entirely swapped into sterling at £536 million). The Eurobond market is of strategic importance to the future funding of the group and it was a successful first step into a new debt market for Severn Trent in what were challenging markets at the time. Average debt maturity is now in excess of 20 years (2007 14 years).

The group is well funded for the investment demands of this price review period and for those demands that will come with the next Ofwat price review from April 2010.

**Exchange rates**

The trading results of overseas subsidiaries are translated to sterling at the average rate of exchange ruling during the period and their net assets are translated at the closing rate on the balance sheet date. The impact of changing exchange rates was immaterial.

**Legacy issues**

Severn Trent Water has pleaded guilty to two offences relating to leakage data supplied to Ofwat in 2001 and 2002. A sentencing hearing to determine the amount of the fine began on 2 June 2008 and is due to resume on 1 July 2008.

When concluded, we will be able to commence discussions with Ofwat concerning the resolution of Ofwat's interim report of March 2006 which may result in further amends being made to customers.

No reliable estimate can currently be made of the amount that will become payable as a result of the SFO charges or Ofwat's final conclusion in respect of the allegations of false reporting. Consequently no provision has been included in these financial statements in respect of these matters.

On 8 April 2008 Ofwat published its proposals to fine Severn Trent Water a total of £35.8 million for deliberately providing false information to the Regulator and providing a poor service to customers. We have accepted the principle of a financial sanction and submitted our response to Ofwat's proposals. Ofwat will announce its decision in due course.

Severn Trent's new Board and management team has taken, and will continue to take, all actions appropriate to ensure the maintenance of both high ethical and professional standards and resilient and effective controls throughout our organisation. A comprehensive root and branch reorganisation of Severn Trent Water has been completed.

**Dividend**

In line with its policy for growing dividends by 3% above the rate of inflation to 31 March 2010, the Board is proposing a final ordinary dividend of 41.29p (2006/07 – 38.68p), an increase of 6.7% over the 2006/07 final ordinary dividend. This would give a total ordinary dividend for the year of 65.63p, an increase in real terms of 3% over the 2006/07 total ordinary dividend (61.45p). The final ordinary dividend is payable on 1 August 2008 to shareholders on the register at 20 June 2008.

## **Outlook**

The outlook for the coming year is one of continued improvement.

In Severn Trent Water, our improvement plans are progressing well. We expect to incur around £24 million of restructuring costs over the remaining two years of the AMP4 period. These restructuring costs will help drive increases in standards and deliver efficiency savings in the current AMP4 period and beyond. We expect that the achievement of our plans will enable us to deliver around £30 million of cost efficiencies over the last two years of the AMP4 period, which represents around 3% annual out performance against the Ofwat determination for operating costs in 2008/09 and 2009/10.

Risks to the achievement of these objectives include the potential impact of new, externally imposed requirements on the business, principally the Traffic Management Act, which became law in April 2008, and unforeseen variations in commodity prices or unhedged energy costs. Our energy costs are hedged to 93% of estimated volume in 2008/09 and to 86% in 2009/10.

We have a strong liquidity position and our capital programme is proceeding according to plan. We continue to expect to deliver on our regulatory commitments whilst achieving around 6% efficiency over the AMP4 period. Achieving this level of efficiency has allowed us to consider further options to enhance long term value, support our improvement plans and deliver greater efficiency. The three key areas we are focused on are:

- Accelerating our renewable energy programme to deliver greater operational efficiency, enhance our natural hedge to energy costs and reduce our carbon footprint,
- To engage with our supply chain to develop an “early start” contracting strategy and investment plan to deliver benefits in the AMP5 investment programme, and
- Investments in economically enhancing technology and locations, principally the construction of the new Severn Trent Centre.

Our decisions to invest in these areas to provide sustainable future improvements in efficiency will be equivalent to around the 6% capex efficiency.

In Water Technologies and Services, the market for all three areas of activity remains strong. We are working to an accelerated and focused growth strategy, building on our brand recognition and reputation, our strong market positions, our international scale and our advanced technologies.

At group level, we remain committed to achieving our stated target of around 60% group net debt to Regulatory Capital Value. At 31 March 2008, group net debt was 58.0% of RCV.

Severn Trent is a high quality business whose investment programme drives strong growth prospects. The management team has a clear and focused strategy and is engaged in the single minded pursuit of higher standards as the means to achieve both higher levels of customer satisfaction, and also sustained strong financial returns to shareholders.

## **Further information**

For further information, including the group's preliminary results presentation, see the Severn Trent website ([www.severntrent.com](http://www.severntrent.com)).

**Consolidated income statement**  
**For the year ended 31 March 2008**

	Note	2008 £m	2007 £m
<b>Turnover</b>	2	<b>1,552.4</b>	<b>1,480.2</b>
Operating costs before exceptional items		(1082.9)	(1,074.9)
Exceptional restructuring costs and termination of operations	3	(14.9)	(14.9)
Exceptional flood costs net of insurance recoveries	3	(13.6)	-
Exceptional provision for fines and penalties	3	(35.8)	-
Exceptional provision for third party legal costs	3	(4.5)	-
Exceptional demerger costs	3	-	(16.7)
Total operating costs		(1,151.7)	(1,106.5)
Exceptional profit on disposal of property and businesses	3	-	56.3
Profit before interest, tax and exceptional items	2	469.5	405.3
Exceptional items	3	(68.8)	24.7
<b>Profit before interest and tax</b>		<b>400.7</b>	<b>430.0</b>
Finance income	4	117.1	86.3
Finance costs	4	(294.5)	(240.1)
Net finance costs	4	(177.4)	(153.8)
(Losses)/gains on financial instruments	5	(31.0)	48.8
Share of results of associates and joint ventures		0.1	0.5
Profit before tax, (losses)/gains on financial instruments and exceptional items		292.2	252.0
Exceptional items	3	(68.8)	24.7
(Losses)/gains on financial instruments	5	(31.0)	48.8
<b>Profit on ordinary activities before taxation</b>		<b>192.4</b>	<b>325.5</b>
Taxation on profit on ordinary activities			
– current tax	6	(56.2)	(58.5)
– deferred tax	6	19.7	(18.4)
Exceptional deferred tax on change of rate	6	54.7	-
Total taxation	6	18.2	(76.9)
Profit for the period from continuing operations		210.6	248.6
<b>Discontinued operations</b>			
Profit for the period from discontinued operations	8	0.8	20.0
<b>Profit for the period</b>		<b>211.4</b>	<b>268.6</b>
<b>Attributable to:</b>			
Equity holders of the company		209.5	267.1
Equity minority interests		1.9	1.5
		211.4	268.6
<b>Earnings per share (pence)</b>			
From continuing operations			
Basic	9	89.3	106.1
Diluted	9	88.7	105.1
From continuing and discontinued operations			
Basic	9	89.7	114.7
Diluted	9	89.0	113.6

**Consolidated balance sheet  
At 31 March 2008**

	Notes	2008 £m	2007 £m
<b>Non current assets</b>			
Goodwill		50.2	49.1
Other intangible assets		107.2	101.2
Property, plant and equipment		5,731.2	5,521.1
Interests in joint ventures		0.1	0.5
Interests in associates		4.1	3.4
Derivative financial instruments		51.3	19.1
Available for sale financial assets		0.1	0.2
		5,944.2	5,694.6
<b>Current assets</b>			
Inventory		24.8	22.4
Trade and other receivables		434.1	387.1
Derivative financial instruments		5.3	1.6
Cash and cash equivalents		654.4	143.2
		1,118.6	554.3
<b>Total assets</b>		7,062.8	6,248.9
<b>Current liabilities</b>			
Borrowings		(459.5)	(631.8)
Derivative financial instruments		(8.9)	(9.6)
Trade and other payables		(423.4)	(405.1)
Current income tax liabilities		(32.4)	(59.0)
Provisions for other liabilities and charges		(50.4)	(6.7)
		(974.6)	(1,112.2)
<b>Non-current liabilities</b>			
Borrowings		(3,627.7)	(2,639.0)
Derivative financial instruments		(73.8)	(113.7)
Trade and other payables		(220.4)	(188.3)
Deferred tax liabilities		(808.3)	(891.1)
Retirement benefit obligations	10	(126.0)	(135.1)
Provisions for other liabilities and charges		(26.8)	(32.2)
		(4,883.0)	(3,999.4)
<b>Total liabilities</b>		(5,857.6)	(5,111.6)
<b>Net assets</b>		1,205.2	1,137.3
<b>Capital and reserves attributable to the company's equity shareholders</b>			
Called up share capital	11	229.7	228.3
Share premium account	11	64.3	57.5
Other reserves	11	427.7	419.0
Retained earnings	11	479.3	429.4
<b>Equity attributable to the company's equity shareholders</b>	11	1,201.0	1,134.2
Minority interests	11	4.2	3.1
<b>Total equity</b>	11	1,205.2	1,137.3

**Consolidated cash flow statement  
for the year ended 31 March 2008**

	Notes	2008 £m	2007 £m
Cash generated from operations	12	645.9	574.0
Interest paid	12	(153.5)	(148.6)
Interest element of finance lease rental payments	12	(20.6)	(20.2)
Tax paid	12	(76.2)	(36.0)
<b>Net cash generated from operating activities</b>	<b>12</b>	<b>395.6</b>	<b>369.2</b>
<b>Investing activities</b>			
Interest received		24.0	12.4
Dividends received from associates and joint ventures		0.3	1.5
Net loans advanced to associates and joint ventures		(0.7)	0.5
Net cash inflow from available for sale fixed asset investments		-	0.2
Cash demerged with Biffa Plc		-	(21.9)
Proceeds on disposal of subsidiaries net of cash disposed		-	130.6
Proceeds on disposal of associate		-	29.3
Proceeds on disposal of property, plant and equipment		3.4	62.2
Purchases of intangible assets and goodwill		(33.5)	(21.5)
Purchases of property, plant and equipment		(443.6)	(427.2)
Contributions and grants received		34.1	35.0
<b>Net cash used in investing activities</b>		<b>(416.0)</b>	<b>(198.9)</b>
<b>Financing activities</b>			
Dividends paid to shareholders of the parent		(147.3)	(739.5)
Dividends paid to minority interests		(0.8)	(1.0)
Repayments of borrowings		(634.6)	(789.9)
Repayment of obligations under finance leases		(23.1)	(34.6)
New loans raised		1,327.1	1,418.4
Issue of shares to shareholders of the parent		8.2	10.0
Issue of shares to minorities		1.0	-
<b>Net cash used in financing activities</b>		<b>530.5</b>	<b>(136.6)</b>
Increase in cash and cash equivalents		510.1	33.7
Net cash and cash equivalents at beginning of the period		143.1	110.4
Effect of foreign exchange rates		0.2	(1.0)
<b>Net cash and cash equivalents at the end of the period</b>		<b>653.4</b>	<b>143.1</b>
Net cash and cash equivalents comprise			
Cash and cash equivalents		654.4	143.2
Bank overdrafts		(1.0)	(0.1)
<b>Net cash and cash equivalents at the end of the period</b>		<b>653.4</b>	<b>143.1</b>

**Consolidated statement of recognised income and expense  
for the year ended 31 March 2008**

	2008 £m	2007 £m
Exchange movement on translation of overseas results and net assets	2.9	(25.5)
Exchange differences on hedges of net investment	-	6.4
Tax on exchange differences on foreign currency hedging	4.1	(1.9)
(Losses)/gains on cash flow hedges taken to equity	(2.3)	6.2
Deferred tax on (losses)/gains on cash flow hedges taken to equity	0.7	(1.8)
Actuarial losses on defined benefit pension schemes	(28.1)	(14.3)
Deferred tax on actuarial losses	7.8	4.3
Change of tax rate on deferred tax previously recognised directly in equity	5.4	-
<b>Net income recognised directly in equity</b>	<b>(9.5)</b>	<b>(26.6)</b>
<b>Transfers</b>		
Amounts on cash flow hedges transferred to the income statement in the period	4.6	4.6
Deferred tax on transfers to income statement	(1.3)	(1.4)
	3.3	3.2
Profit for the period	211.4	268.6
<b>Total recognised income for the period</b>	<b>205.2</b>	<b>245.2</b>
Attributable to:		
Equity shareholders of the company	203.3	243.7
Minority interests	1.9	1.5
	205.2	245.2

## Notes

### 1 Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), International Accounting Standards (IAS) and IFRIC interpretations issued and effective and ratified by the European Union as at 31 March 2008 and those parts of the Companies Act 1985 applicable to companies reporting under IFRS as adopted by the European Union. While the financial information included in this preliminary announcement has been prepared in accordance with the recognition and measurement criteria of International Financial Reporting Standards (IFRSs), this announcement does not itself contain sufficient information to comply with IFRSs. The company published full financial statements that comply with IFRSs in June 2008.

The financial statements have been prepared under the historical cost convention as modified by the revaluation of certain financial assets and liabilities (including derivative instruments) at fair value through profit and loss.

The preparation of financial statements in conformity with IFRS 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 amount of revenues and expenses for the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results may ultimately differ from those estimates.

The financial information set out above does not constitute the company's statutory accounts, within the meaning of Section 240 of the Companies Act 1985, for the years ended 31 March 2008 and 2007, but is derived from those accounts. Statutory accounts for 2007 have been delivered to the Registrar of Companies and those for 2008 will be delivered following the company's annual general meeting. The auditors have reported on those accounts; their reports were unqualified and did not contain statements under s237(2) or (3) Companies Act 1985.

The comparative figures for the balance sheet as at 31 March 2007 have been restated to reclassify the analysis of derivative financial instruments between current and non-current amounts. This balance sheet was originally prepared on the basis of widely prevailing practice at that time which was to classify as current assets or liabilities all derivative instruments that were not designated as hedges. However, in May 2007 the International Financial Reporting Interpretations Committee reported that it had recommended to the IASB that IAS 1 be amended to remove the implication that such classification was required. In view of this decision the Group now classifies all derivative financial assets and liabilities according to their maturity. The impact on the comparative balance sheet as at 31 March 2007 is to decrease current assets and increase non current assets by £12.5 million and to decrease current liabilities and increase non current liabilities by £57.5 million.

### 2 Segmental analysis

The group is organised into two main business segments:

#### Water and Sewerage

Provides water and sewerage services to domestic and commercial customers in England and Wales.

#### Water Technologies and Services

Provides services and products associated with water, waste water and contaminated land principally in the US, UK and Europe.

2008	Water and Sewerage £m	Water Technologies and Services £m	Corporate and Other £m	Eliminations £m	Consolidated £m
External sales	1,278.0	274.4	-	-	1,552.4
Inter-segment sales	1.2	22.9	5.2	(29.3)	-
<b>Total Sales</b>	<b>1,279.2</b>	<b>297.3</b>	<b>5.2</b>	<b>(29.3)</b>	<b>1,552.4</b>
Profit before interest, tax and exceptional items	462.3	20.7	(11.2)	(2.3)	469.5
Exceptional items (note 3)	(63.3)	(4.5)	(1.0)	-	(68.8)
Profit before interest and tax	399.0	16.2	(12.2)	(2.3)	400.7
Share of results of associates and joint ventures	-	0.1	-	-	0.1
<b>Segment result</b>	<b>399.0</b>	<b>16.3</b>	<b>(12.2)</b>	<b>(2.3)</b>	<b>400.8</b>
Total net finance costs and losses on financial instruments					(208.4)
Profit before tax					192.4
Tax					18.2
Profit from continuing operations					210.6
Profit from discontinued operations					0.8
<b>Profit for the period</b>					<b>211.4</b>
2007	Water and Sewerage £m	Water Technologies and Services £m	Corporate and Other £m	Eliminations £m	Consolidated £m
External sales	1,216.3	262.6	1.3	-	1,480.2
Inter-segment sales	1.8	26.3	9.0	(37.1)	-
<b>Total Sales</b>	<b>1,218.1</b>	<b>288.9</b>	<b>10.3</b>	<b>(37.1)</b>	<b>1,480.2</b>
Profit before interest, tax and exceptional items	413.0	19.7	(26.3)	(1.1)	405.3
Exceptional items (note 3)	21.3	14.7	(11.3)	-	24.7
Profit before interest and tax	434.3	34.4	(37.6)	(1.1)	430.0
Share of results of associates and joint ventures	-	0.8	(0.3)	-	0.5
<b>Segment result</b>	<b>434.3</b>	<b>35.2</b>	<b>(37.9)</b>	<b>(1.1)</b>	<b>430.5</b>
Total net finance costs and gains on financial instruments					(105.0)
Profit before tax					325.5
Tax					(76.9)
Profit from continuing operations					248.6
Profit from discontinued operations					20.0
<b>Profit for the period</b>					<b>268.6</b>

### **3 Exceptional items**

#### **2008**

An exceptional charge of £68.8 million arose in the period. This comprised:

- a net cost of £13.6 million arising from the flooding incidents that affected the Water and Sewerage networks during the summer of 2007. This includes costs of £29.6 million which have been identified to date less insurance recoveries of £16 million which have been received. Costs still to be incurred are expected to relate mainly to the replacement of damaged assets which will be covered by insurance recoveries;
- a charge of £13.9 million in Water and Sewerage and £1 million in Corporate relating to the programme to improve, restructure and realign the Water and Sewerage business that commenced in the year ended 31 March 2007;
- A charge of £35.8 million relating to a provision arising from Ofwat's proposal to fine Severn Trent Water £35.8 million for misreporting customer service data and failure to meet Guaranteed Standards of Service in 2005/06. The provision has been recorded on the basis that the best available evidence for making an estimate of the fines that will be payable is Ofwat's proposals. However, Ofwat's consultation relating to the fines remains open, and there is a right of appeal at its conclusion so the amounts that finally become payable might not be the amounts proposed by Ofwat; and
- A charge of £4.5 million relating to third party legal costs incurred in the conclusion of a Water Technologies and Services arbitration to settle an interpretation on a long term operating service contract.

#### **2007**

A net exceptional credit of £24.7 million arose in respect of continuing operations and an exceptional charge of £24.4 million arose in respect of discontinued operations in the year ended 31 March 2007.

The exceptional credit in continuing operations comprised:

- A charge of £14.9 million in Water and Sewerage arising from a programme to restructure and realign the business including write off of decommissioned assets £11.9 million and restructuring costs of £3 million;
- A charge of £16.7 million in corporate costs, arising from the demerger of Biffa Plc, including £7.8 million relating to the settlement of pension obligations, and;
- A credit of £56.3 million of which £36.2 million arose from the disposal of properties in Severn Trent Water, £14.7 million arose in Water Technologies and Services from the disposal of Aquafin and £5.4 million in Corporate and other businesses from the disposal of Severn Trent Property and other property assets.

The exceptional charge in discontinued operations comprised:

- A charge of £31.5 million arising from the impairment of goodwill relating to US Laboratories (see note 15);
- A loss of £2.4 million on the sale of US Laboratories; and
- A gain of £9.5 million on the sale of Biffa Belgium.

#### 4 Net finance costs

	2008 £m	2007 £m
<b>Investment income</b>		
Interest receivable on bank deposits	17.3	5.4
Other financial income	6.4	0.3
Total interest revenue	23.7	5.7
Expected return on defined benefit scheme assets	93.4	80.6
	117.1	86.3
<b>Finance costs</b>		
Interest on bank loans and overdrafts	(13.6)	(28.4)
Interest on other loans	(177.5)	(122.6)
Interest on finance leases	(20.6)	(20.2)
Total borrowing costs	(211.7)	(171.2)
Other financial expenses	(2.2)	-
Interest cost on defined benefit obligations	(80.6)	(67.5)
Unwinding of discounts on provisions	-	(1.4)
	(294.5)	(240.1)
Net finance costs	(177.4)	(153.8)

#### 5 (Losses)/gains on financial instruments

	2008 £m	2007 £m
Gain on derivatives in a designated fair value hedge accounting relationship	93.8	41.7
Loss arising on adjustment for the hedged item in a designated fair value hedging relationship	(95.9)	(41.0)
Fair value loss on cash flow hedges transferred from equity	(4.6)	(4.6)
(Loss)/gain arising on revaluation of derivatives not in a designated fair value hedge accounting relationship	(24.3)	52.7
	(31.0)	48.8

## 6 Taxation

	2008 £m	2007 £m
<b>Current tax</b>		
Continuing operations		
Current year at 30%	68.7	67.9
Prior year at 30%	(12.5)	(9.4)
Total current tax relating to continuing operations	56.2	58.5
Current tax relating to discontinued operations	-	9.2
<b>Total current tax</b>	<b>56.2</b>	<b>67.7</b>
<b>Deferred tax</b>		
Continuing operations		
Origination and reversal of temporary differences– current year	(2.4)	35.0
Origination and reversal of temporary differences– prior year	(17.3)	(16.6)
Exceptional deferred tax credit arising on change of rate	(54.7)	-
Total deferred tax relating to continuing operations	(74.4)	18.4
Deferred tax relating to discontinued operations	-	6.0
<b>Total deferred tax</b>	<b>(74.4)</b>	<b>24.4</b>
Total tax (credit)/charge relating to continuing operations	(18.2)	76.9
Total tax charge relating to discontinued operations	-	15.2
<b>Total tax (credit)/charge</b>	<b>(18.2)</b>	<b>92.1</b>

## 7 Dividends

Amounts recognised as distributions to equity holders in the period:

	2008		2007	
	Pence per share	£m	Pence per share	£m
Final dividend for the year ended 31 March 2007/2006	38.68	90.4	31.97	111.4
Interim dividend for the year ended 31 March 2008/2007	24.34	56.9	22.77	52.9
Special dividend for the year ended 31 March 2007	-	-	165.00	575.2
	63.02	147.3	219.74	739.5
Proposed final dividend for the year ended 31 March 2008	41.29	96.9		

The proposed final dividend is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements.

## 8 Discontinued operations

There were no transactions during the year that resulted in operations being classified as discontinued. In the previous year, Biffa Belgium, Biffa Plc and Severn Trent Laboratories were classified as discontinued operations.

### a) Profit from discontinued operations

	2008 £m	2007 £m
Turnover	-	495.4
Operating costs	-	(436.2)
Profit before interest and tax	-	59.2
Net finance costs	-	(0.1)
Share of joint ventures and associates	-	0.5
Profit before tax	-	59.6
Tax	-	(15.2)
<b>Profit after tax</b>	-	44.4
Exceptional impairment of goodwill	-	(31.5)
Exceptional gain on disposal of discontinued operations	0.8	7.1
Attributable tax expense	-	-
<b>Net profit attributable to discontinued operations</b>	0.8	20.0

### b) Cash flows from discontinued operations

	2008 £m	2007 £m
Net cash flows from operating activities	-	75.3
Net cash flows from investing activities	3.1	(26.2)
Net cash flows from financing activities	-	331.7
	3.1	380.8

## 9 Earnings per share

Basic earnings per share are calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the period, excluding those held in the Severn Trent Employee Share Ownership Trust which are treated as cancelled.

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all potentially dilutive ordinary shares. These represent share options granted to employees where the exercise price is less than the average market price of the Company's shares during the period and LTIP awards where the vesting conditions have been satisfied at the balance sheet date.

The calculation of basic and diluted earnings per share is based on the following data:

	2008 £m	2007 £m
Earnings for the purpose of basic and diluted earnings per share from continuing and discontinued operations being:		
Profit for the period attributable to the equity holders of the Company	209.5	267.1
Adjustment to exclude:		
Profit for the period from discontinued operations	(0.8)	(20.0)
Earnings for the purpose of basic and diluted earnings per share from continuing operations	208.7	247.1

### Number of shares

	2008 m	2007 m
Weighted average number of ordinary shares for the purpose of basic earnings per share	233.6	232.9
Effect of dilutive potential ordinary shares:		
Share options and LTIPs	1.7	2.2
Weighted average number of ordinary shares for the purpose of diluted earnings per share	235.3	235.1

Adjusted earnings per share figures are presented for continuing operations. These exclude the effects of deferred tax, gains/losses on financial instruments and exceptional items for both 2008 and 2007. The directors consider that the adjusted figures provide a useful additional indicator of performance. The denominators used for calculations of earnings per share from continuing and discontinued and from continuing operations are the same.

	2008 Pence	2007 Pence
Adjusted basic earnings per share	97.8	82.4
Adjusted diluted earnings per share	97.1	81.6

Adjusted earnings per share figures are presented for continuing operations. These exclude the effects of deferred tax, gains/losses on financial instruments and exceptional items and current tax on these in both 2008 and 2007. The directors consider that the adjusted figures provide a useful additional indicator of performance. The denominators used in the calculations of adjusted basic and diluted earnings per share are the same as those used in the unadjusted figures set out above.

The adjustments to earnings are as follows:

	2008 £m	2007 £m
Earnings for the purpose of basic and diluted earnings per share from continuing operations	208.7	247.1
Adjustments for:		
Exceptional fines	35.8	-
Exceptional flood costs	13.6	-
Exceptional restructuring costs	14.9	14.9
Exceptional provision for third party legal costs	4.5	-
Exceptional demerger and related costs	-	16.7
Exceptional profit on disposal of property and businesses	-	(56.3)
Current tax related to exceptional items at 30%	(5.6)	-
Losses/(gains) on financial instruments	31.0	(48.8)
Deferred tax	(74.4)	18.4
<b>Earnings for the purpose of adjusted basic and diluted earnings per share</b>	<b>228.5</b>	<b>192.0</b>

## 10 Retirement benefit schemes

Movements in the present value of the defined benefit obligation were as follows:

	2008 £m	2007 £m
At 1 April	(135.1)	(221.9)
Service cost	(31.5)	(41.5)
Exceptional loss on settlements	-	(7.8)
Expected return on scheme assets	93.4	87.0
Interest cost	(80.6)	(73.0)
Contributions from the sponsoring companies	55.6	97.4
Net liability transferred to Biffa on demerger	-	39.0
Actuarial gains and losses recognised in the statement of recognised income and expense	(27.8)	(14.3)
<b>At 31 March</b>	<b>(126.0)</b>	<b>(135.1)</b>

## 11 Movement in shareholders' equity

	Share capital £m	Share premium £m	Other reserves £m	Retained earnings £m	Equity attributable to the equity holders of Severn Trent Plc £m	Minority interests £m	Total £m
At 1 April 2006	227.2	48.6	432.4	1,188.2	1,896.4	2.6	1,899.0
Share options and LTIPs							
– proceeds from shares issued	1.1	8.9	-	-	10.0	-	10.0
– value of employees' services	-	-	-	3.6	3.6	-	3.6
Dividends	-	-	-	(739.5)	(739.5)	(1.0)	(740.5)
Deferred tax on items posted directly to equity	-	-	-	0.6	0.6	-	0.6
Demerger of Biffa Plc	-	-	-	(280.6)	(280.6)	-	(280.6)
Total recognised income for the period	-	-	(13.4)	257.1	243.7	1.5	245.2
At 1 April 2007	228.3	57.5	419.0	429.4	1,134.2	3.1	1,137.3
Share options and LTIPs							
– proceeds from shares issued	1.4	6.8	-	-	8.2	-	8.2
– value of employees' services	-	-	-	4.0	4.0	-	4.0
Dividends	-	-	-	(147.3)	(147.3)	(0.8)	(148.1)
Current tax on share based payments	-	-	-	2.7	2.7	-	2.7
Deferred tax on share based payments	-	-	-	(4.1)	(4.1)	-	(4.1)
Total recognised income for the period	-	-	8.7	194.6	203.3	1.9	205.2
At 31 March 2008	229.7	64.3	427.7	479.3	1,201.0	4.2	1,205.2

## 12 Reconciliation of operating profit to operating cash flows

	2008 £m	2007 £m
Profit before interest and tax from continuing operations	400.7	430.0
Profit before interest and tax from discontinued operations	0.8	34.9
	401.5	464.9
Depreciation of property, plant and equipment	204.5	254.5
Amortisation of intangible assets	27.3	29.4
Impairment of goodwill	-	31.5
Pension service cost	31.5	49.3
Pension contributions	(55.6)	(97.4)
Share based payments charge	4.0	3.6
Profit on sale of property, plant and equipment	(1.7)	(39.6)
Profit on sale of subsidiaries and associates	-	(24.5)
Deferred income released	(5.2)	(3.5)
Provisions for liabilities and charges	49.5	21.1
Utilisation of provisions for liabilities and charges	(11.4)	(21.8)
(Increase)/Decrease in stocks	(2.4)	(4.5)
Increase in debtors	(44.3)	(92.0)
Decrease in creditors	48.2	3.0
Cash generated from operations	645.9	574.0
Interest paid	(153.5)	(148.6)
Interest element of finance lease rental payments	(20.6)	(20.2)
Tax paid	(76.2)	(36.0)
Net cash inflow from operating activities	395.6	369.2

## 13 Contingent liabilities

### a) Bonds and guarantees

Group undertakings have entered into bonds in the normal course of business. No liability is expected to arise in respect of either bonds or guarantees.

### b) Regulatory matters

In May 2004 an employee of Severn Trent Water raised a number of allegations relating, in particular, to alleged accounting inaccuracies and regulatory returns.

On 7 March 2006 Ofwat published its interim report concerning the allegations of false reporting made against Severn Trent Water in 2004.

In responding to the report Severn Trent Plc agreed to credit customers' accounts and reduce future tariffs.

The Company also acknowledged that Ofwat may expect further amends to be made to customers.

Severn Trent Water has pleaded guilty to two offences relating to leakage data supplied to Ofwat in 2001 and 2002. A sentencing hearing to determine the amount of the fine began on 2 June 2008 and is due to resume on 1 July 2008. When concluded, Severn Trent Water will be able to commence discussions with Ofwat concerning further amends to be made to customers.

No reliable estimate can currently be made of the amount that will become payable as a result of the SFO charges or Ofwat's final conclusion in respect of the allegations of false reporting. Consequently no provision has been included in these financial statements in respect of these matters.

### **c) Disposal of subsidiaries**

The group has given certain guarantees and indemnities in relation to disposals of businesses.

In June 2005 The Flemish Waste Agency ("OVAM") instigated an investigation by the Antwerp Examining Magistrate into Biffa Belgium's waste recycling operations in connection with the payment of environmental taxes. Two of the Biffa Belgium companies were indicted by the Flemish prosecuting authorities on 13 December 2005. On 3 March 2008 the Company was informed by the purchaser of the Biffa Belgium companies that certain directors of those companies had been summoned to appear before the court in Antwerp. The Biffa Belgium companies were not summoned. However, under Flemish law the Biffa Belgium companies may be civilly liable for criminal penalties that may be levied upon the directors.

Separately, the Nivelles Public Prosecutor issued a claim on 22 November 2006 against Biffa Belgium that may relate to the same matters investigated in the Flanders region.

Pursuant to the sale agreement of 11 May 2006, the group has given an indemnity in relation to certain costs that may be suffered by the former Biffa Belgium businesses as a result of these proceedings. A provision of £1.5 million has been made in these financial statements for liabilities that may result from this indemnity.

On 5 March 2007 the group received notice of a claim for €23.4 million from Veolia Proprete S.A alleging breach of warranty in relation to the disposal of Biffa Belgium. The group has subsequently received notice from Veolia of a further claim for €5 million relating to the same matter. The group considers that there is no basis for this claim and hence no provision has been recorded in the financial statements in relation to this matter.

The group is not aware of any other liability that is likely to result from these guarantees and indemnities that has not been provided for in these financial statements.

## **14 Annual report**

The annual report will be made available to shareholders in June. Copies may be obtained from the Company Secretary, Severn Trent Plc, 2297 Coventry Road, Birmingham B26 3PU.

## **15 Annual General Meeting**

The Annual General Meeting will be held at The International Convention Centre, Birmingham B1 2EA, on 22 July 2008 at 11:00am.

## **16 Cautionary Statement regarding Forward Looking Statements**

This document contains certain 'forward looking statements' with respect to Severn Trent's financial condition, results of operations and business and certain of Severn Trent's plans and objectives with respect to these items. Forward looking statements are sometimes, but not always, identified by their use of a date in the future or such words as 'anticipates', 'aims', 'due', 'could', 'may', 'should', 'expects', 'believes', 'intends', 'plans', 'potential', 'reasonably possible', 'targets', 'goal' or 'estimates'. By their very nature forward-looking statements are inherently unpredictable, speculative and involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future.

There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements. These factors include, but are not limited to, changes in the economies and markets in which the group operates; changes in the regulatory and competition frameworks in which the group operates; the impact of legal or other proceedings against or which affect the group; and changes in interest and exchange rates.

All written or verbal forward looking statements, made in this document or made subsequently, which are attributable to Severn Trent or any other member of the group or persons acting on their behalf are expressly qualified in their entirety by the factors referred to above. Severn Trent does not intend to update these forward looking statements.

This document is not an offer to sell, exchange or transfer any securities of Severn Trent Plc or any of its subsidiaries and is not soliciting an offer to purchase, exchange or transfer such securities in any jurisdiction. Securities may not be offered, sold or transferred in the United States absent registration or an applicable exemption from the registration requirements of the US Securities Act of 1933 (as amended).